

**Statement by Roger W. Ferguson, Jr.**  
**Chairman of the Financial Stability Forum**  
**International Monetary and Financial Committee**  
**Meeting**

**24 September 2005**  
**Washington, D.C.**

The Financial Stability Forum (FSF) held its fourteenth meeting on 8-9 September 2005 in London. The issues discussed included: risks and vulnerabilities in the international financial system; the resilience of the financial system to shocks; lessons from past market liquidity crises; standards and codes, including the standard-setting process; accounting and auditing issues; and reinsurance.

**Vulnerabilities in the international financial system**

The FSF noted that economic and financial conditions in the last six months had remained generally benign, having weathered a number of challenges. However, members pointed to the potential impact of higher oil and gas prices on near term prospects for growth and inflation, a factor exacerbated by Hurricane Katrina. Members also pointed to a number of continuing developments that could over time lead to strains in financial markets. These included low levels of risk premia and long-term interest rates, the ongoing search for yield, increased exposures to complex and illiquid products, rising household sector indebtedness, and persistent and growing external and fiscal imbalances.

Considering the potential challenges these developments imply, many markets may perhaps be underpricing risks going forward. Events or policy mistakes that heighten perception of risks could significantly alter current conditions. In this regard, a resurgence in inflation could alter expectations about the path of short-term interest rates. Signs that higher oil prices are weakening growth, along with the maturing of the credit cycle, could alter perceptions about credit quality and widen credit spreads. Finally, rising oil prices may be troublesome for some emerging market economies.

In light of these developments, the FSF noted the importance of policymakers, financial supervisors and market participants taking an appropriately medium-term view of risks and paying particular attention to ensuring the adequacy of market discipline, credit and operational standards and levels of provisioning.

The FSF considered the resilience of the financial system to shocks, including the risk management capabilities and loss absorption capacity of financial institutions. Drawing on recent work undertaken by a number of national regulators, the FSF noted that there have been significant advances in risk management practices at financial institutions and strengthening of market infrastructure in recent years. Nevertheless, structural changes in markets, including growing product complexity and the entry of new participants, as well as the important role of large and complex institutions, highlighted the need for continuing improvements in both areas. In this context, members also welcomed the report by the private sector Counterparty Risk Management Policy Group II and strongly endorsed its call for all market participants to review and strengthen their practices in the light of the report's recommendations. Members will continue to assess the systemic implications of the rapid

growth of complex products and the hedge fund industry. The FSF will discuss these various issues again at its next meeting.

Members discussed lessons from past market liquidity crises, with an eye towards steps that could be taken to improve the prevention of future crises and preparedness to respond to them. As part of this discussion, they considered whether gaps existed in processes for timely international information-sharing among authorities at times of crisis. Events this year in the credit derivatives markets have emphasized the need for market participants to stress-test their risk management models effectively for disruptions to market liquidity, in particular with regard to complex products. In this regard, members welcomed the continuing work by the Joint Forum in reviewing the funding liquidity risk management practices in financial institutions.

### **Standards and codes relevant to strengthening financial systems**

The FSF discussed progress in the implementation of standards and codes. The discussion benefited from the recent reviews conducted by the IMF and World Bank Executive Boards as well as a roundtable discussion jointly organized by the FSF, IMF and World Bank earlier this year. The FSF noted that the 12 key international standards identified in 2000 remained the most important for strengthening financial systems. Members welcomed the large number of national assessments of observance of standards and codes that the IMF and World Bank had completed. Members pointed to steps toward implementation that the initiative had already encouraged, and emphasized the importance of fostering stronger commitment by domestic authorities, providing incentives for implementation, and mobilizing resources for assessments and technical assistance.

Going forward, the FSF noted the need to prioritize resources and to focus on effective on-the-ground implementation. The FSF encouraged relevant bodies to reflect on the issue of how to prioritize efforts in support of effective standards implementation, including the prioritization of principles within and across standards. The FSF also noted the need for further guidance for assessing the adequacy of enforcement and oversight of auditing and accounting practices at the national level, and welcomed the intention of the World Bank to convene a meeting of interested parties to consider how best to generate a consensus in this area.

The FSF noted that the greater emphasis now given to international standards has carried with it greater interest in, and closer scrutiny of, the arrangements for setting those standards. FSF members therefore encouraged standard setting bodies to maintain progress in strengthening the transparency, governance and robustness of their standard setting processes. Members also encouraged standard setting bodies to give priority to developing standards that address the most pressing risks and with an appropriate regard for the potential costs and benefits of implementing new standards. The FSF will discuss at its next meeting work by the standard setting bodies to establish and implement best practices in their processes.

### **Accounting and auditing**

The FSF welcomed the progress recently made by the International Accounting Standards Board (IASB) and financial regulators to resolve some of the issues that had stood in the way of agreement on an international standard for financial instruments. Progress continues to be made by the IASB and national accounting standard setting bodies towards internationally convergent accounting standards. New projects are underway revisiting conceptual frameworks for financial accounting and reporting and developing a new financial instruments standard. In this regard, the FSF noted the important role that financial

accounting and reporting standards play in safeguarding financial stability and the importance of dialogue on fundamental conceptual issues between accounting standard setters and stakeholders, especially financial supervisors. The FSF will continue to review the financial stability aspects of the development of accounting standards, while respecting the independence of the standard setters.

The Public Interest Oversight Board (PIOB), established in February 2005 to oversee the International Federation of Accountants' standard-setting activities relating to auditing and assurance practices and member body compliance programs, has met several times, and the European Commission's acceptance of observer status is welcome. The FSF will continue to support the activities of the PIOB and to encourage coordination between national auditor oversight bodies.

### **Other issues**

The FSF also discussed work in a number of other areas, including by the International Association of Insurance Supervisors to develop supervisory guidance on finite risk reinsurance; the Joint Forum's ongoing development of a set of high-level business continuity principles for financial authorities and financial industry participants; and ongoing work by the IMF, IOSCO and other bodies to promote improvements in offshore financial centers. The FSF will continue to take a close interest in these subjects.

In May 2005, the FSF further expanded its regional outreach by holding its first African regional meeting. Participants had a rich and frank exchange of views and regional participants valued the dialogue. Recognizing the imperatives of poverty alleviation and the pursuit of growth in the region, there was overwhelming agreement that the objectives of financial stability and economic development are inextricably interlinked. The FSF will hold a Latin American regional meeting in November 2005.