

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

The Financial Stability Forum (FSF) held its fifteenth meeting on 17 March 2006 in Sydney. The issues discussed included: risks and vulnerabilities in the international financial system; preparedness for a possible avian flu pandemic; cross-border information exchange in crises; the robustness of international standard-setting processes; accounting and auditing issues; and offshore financial centers. This statement also covers recent regional FSF meetings in the Latin American and Asia-Pacific regions.

**Vulnerabilities in the international financial system**

FSF members remain optimistic about financial stability prospects. Balance sheets and capital levels of financial institutions are healthy, while continued structural improvements in markets appear to have strengthened systemic resilience. However, this positive environment has also given further stimulus to a variety of changes in national and sectoral balance sheets that have the potential to cause strains in financial systems. Members pointed in particular to further growth in external imbalances, high levels of household debt in some countries, and low risk premia reflecting a high degree of liquidity and the continuing search for yield in markets. These factors may have increased the sensitivity of some parts of the financial system to a deterioration in cyclical conditions or to unexpected events.

Although financial systems have proven resilient to quite significant market adjustments or cyclical developments in recent years, the possibility remains of more severe shocks accompanied by deterioration in market liquidity. Such a scenario could expose vulnerabilities in risk management, particularly with regard to complex instruments and strategies, and there are several areas in which financial institutions and authorities need to work further to strengthen resilience. Members welcomed progress by firms in addressing confirmation backlogs and issues related to the assignment of credit derivative contracts. However, further sustained progress is required across the financial sector, including hedge funds, on operational and back office issues, as well as on counterparty risk management and valuation practices for complex financial instruments. Firms also need to further develop and implement comprehensive stress testing and scenario analysis. It is reassuring to note that firms seem aware of the need to focus further on these issues, including through their follow-up to the recommendations of the private sector Counterparty Risk Management Policy Group II.

**The economic and financial stability implications of avian flu**

Members exchanged views on the potential implications for economies and financial systems of a flu pandemic. The uncertainties over the timing, severity and economic impact of a pandemic are substantial. Nevertheless, members agreed that it is important for financial authorities to consider well in advance the potential impacts of a pandemic. Financial

authorities need to make business continuity plans for their own institutions, to review business continuity plans elsewhere in the financial sector (with a particular focus on the maintenance of payments systems) and to improve channels for communication and coordination, both within and across borders. The FSF will continue to take a close interest in this subject.

### **Cross-border information exchange**

The FSF noted that, in addition to pandemic preparations, further investment in business continuity and contingency planning would be valuable more broadly. Members welcomed the publication of the Joint Forum's draft high-level principles for business continuity for financial authorities and financial industry participants, which responds to a request the FSF made in 2004. The UK authorities and the FSF will jointly organize a workshop for national authorities to share experiences in planning for business continuity incidents and financial crises, in particular focusing on issues and gaps in cross-border communication and in crisis management processes more generally.

### **International standard-setting processes**

Recently there has been increased focus on international financial standard setting arrangements. At their previous meeting in September 2005 the FSF had encouraged the bodies responsible for setting the 12 key international standards to maintain progress in strengthening the transparency, governance and robustness of their standard-setting processes. The FSF has now considered reports by the standard-setting bodies reviewing their current processes and ways in which they are working to strengthen them. Members found this a useful exercise and welcomed the efforts that SSBs are making to strengthen the robustness of their arrangements. They agreed that the FSF would revisit any relevant issues as necessary in the future.

### **Accounting and auditing**

The FSF continues to place importance on convergence and harmonization efforts for international accounting standards, including the goal of eliminating national requirements for reconciliation of IFRS-based financial statements to national accounting standards. Members welcomed the progress that continues to be made in these areas. The FSF agreed that it would be useful to continue its informal dialogue with the IASB on conceptual issues in standard-setting and the relationship with financial stability.

It is important that international accounting and auditing standards in a global, principles-based environment be consistently implemented and interpreted. FSF members welcomed initiatives, such as the roundtable held last month between audit oversight authorities, to enhance communication and coordination amongst international regulatory organizations, national audit oversight authorities and the Public Interest Oversight Board that could lead to further improvements in international auditing standards and practices.

### **Offshore financial centers (OFCs)**

The FSF received a report of its OFC Review Group, which was set up a year ago to review results of work underway by FSF member bodies to ensure that OFCs meet international standards and to address remaining problems in several OFCs, notably in the areas of effective cross-border cooperation, information exchange and adequacy of supervisory resources. The FSF welcomed the progress made, in particular in IOSCO's ongoing initiative, and urged its member bodies to continue their efforts. It called upon OFCs to continue to

cooperate with IOSCO and the IMF's ongoing assessment programme in a timely fashion. The FSF also encouraged OFCs to contribute more fully to the IMF Information Framework Initiative.

### **Other issues**

The FSF discussed work in a number of other areas, including by the IAIS and G30 on the global reinsurance market and by the Joint Forum on funding liquidity risk management practices. The FSF also considered the challenges, and potential implications for financial stability, of the recent bunching of international, regional and national regulatory initiatives. The FSF will continue to take a close interest in these subjects.

### **Regional meetings**

During the last six months the FSF held two further regional outreach meetings.

Last November, the FSF held its fourth Latin American regional meeting, at which participants had a fruitful and wide-ranging discussion. While authorities in the region were cautiously optimistic about growth prospects, they noted the importance of managing the consequences of these benign conditions, including by completing structural reforms and building buffers against a fallback in commodity export prices or a worsening of financing conditions. Participants also shared experiences on how best to encourage the growth of local securities markets and on issues raised by the increased importance of foreign-owned financial institutions in the region. They encouraged further work to enhance the prioritization of international standards assessments and asked to be more involved in the work of standard setters.

In conjunction with the FSF's recent Sydney meeting, it also held its fourth Asia-Pacific regional meeting. Here too there was a rich exchange of views. Countries in the region have reduced external vulnerabilities including through the build-up of official reserves and through continued actions to strengthen domestic financial systems. Participants strongly encouraged efforts by authorities in the region to increase domestic consumption and investment, as one element of the actions needed worldwide to reduce the risks from global imbalances. Better developed domestic corporate bond markets could play a role in that respect. Participants also discussed steps that could be taken to mitigate risks to the financial sector from an avian flu pandemic.