



International Monetary and Financial Committee

Fourteenth Meeting
September 17, 2006

Statement by Mario Draghi
Chairman, Financial Stability Forum
On behalf of the Financial Stability Forum

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The Financial Stability Forum (FSF) held its sixteenth meeting on 6 September 2006 in Paris. The issues discussed included: global risks and vulnerabilities in the international financial system; the mitigation of risk in financial systems; effective and efficient regulation; international standard-setting practices; financial crisis and business continuity planning; offshore financial centres; and accounting and auditing issues.

Global risks and vulnerabilities

The FSF noted that the economic and market outlook remains broadly supportive of financial stability. Financial firms continue to report strong profitability and capital positions, and financial systems seem to be adapting well to the ongoing removal of accommodation in monetary policy in many countries and to shifts in the balance of demand among the major economies.

The FSF pointed to several areas of concern with the potential to cause strains in financial systems. These include the capacity of households to manage rising debt levels and possible adjustments in housing markets; the rapid pace of leveraged buyouts and debt-financed acquisitions; the growing complexity of financial instruments; and persistent global current account imbalances.

Mitigation of risk in financial systems

The FSF welcomed progress by financial firms in improving the trading and settlement infrastructure for over-the-counter (OTC) credit derivatives, particularly in reducing backlogs of outstanding confirmations, and in further strengthening counterparty risk management relating to complex products. The good cooperation between the private and public sectors provides a model for future work in other areas. The FSF noted that further work was needed to improve the infrastructure of these rapidly growing market segments, particularly in such areas as the automation of trade processing and settlement, and they encouraged the extension of these efforts to equity derivatives and other types of OTC derivatives. The FSF also underscored the importance of reliable valuation practices for illiquid products. Concerning hedge funds, the FSF stressed the importance of financial firms maintaining appropriate margining and collateral practices and guarding against any weakening of credit standards in prime brokerage and other counterparty relationships. Hedge funds themselves should also make further progress in strengthening risk management practices.

More generally, the FSF noted that financial market participants need to take into account in their risk analysis and pricing the full implications of a possible reversal of the current benign conditions, including less liquid markets. It encouraged financial firms to further strengthen risk management, in particular in running stress test scenarios involving low-probability, high-impact events or in which several vulnerabilities crystallise in combination.

Effective and efficient regulation

The FSF exchanged views with industry representatives on an Institute of International Finance (IIF) project on how financial regulation could be made more effective and efficient, and discussed ways to further enhance the dialogue between regulators and the financial industry. The FSF welcomed the IIF's efforts in this regard and noted that financial services firms and regulators share a common view of general principles that underlie good regulatory practice. Noting existing examples of effective interaction, the FSF encouraged the IIF and other private market participants to raise issues of market weakness and other important regulatory issues that could be addressed with collective action, and regulatory bodies to continue their dialogue with the IIF and other market participants on specific issues.

International standard setting practices

As a follow-up to the FSF's discussion in March of the robustness of international financial standard setting processes, the FSF further took stock of the arrangements employed by the key international standard setting bodies (SSBs). The FSF felt that this stocktaking exercise would be useful to SSBs over time as they review their arrangements. The FSF also welcomed the recent development of an Insolvency and Creditor Rights (ICR) Assessment Methodology by World Bank and UNCITRAL staff, which would lead to the completion of a concise, unified ICR standard to help facilitate assessments for Reports on the Observance of Standards and Codes.

In order to help inform regulators and other stakeholders of the international regulatory pipeline and any potential bunching of initiatives, the FSF placed on its website an overview by the FSF Secretariat of major international regulatory initiatives and the timing of their implementation.

Financial crisis and business continuity planning

The FSF noted that many financial authorities and private sector firms, particularly in developed financial centers, have advanced considerably in their contingency planning for a potential avian flu pandemic. Further action would be valuable not only in the event of a flu pandemic but also to prepare more generally for business continuity incidents. In this regard, the FSF encouraged financial industry participants and authorities to make use of the Joint Forum's high-level principles for business continuity published in August. The FSF welcomed the IMF's series of regional seminars which have enabled authorities to benefit from those whose planning is most advanced. As a further step to enhance international coordination, the FSF will jointly host with the UK authorities in November a workshop on planning and communication for financial crises and business continuity incidents.

Offshore financial centres (OFCs)

The FSF's OFC Review Group is continuing to monitor progress by FSF member bodies in working with OFCs to improve cross-border cooperation and exchange of information. The FSF noted the progress made in some OFCs and urged its member bodies to continue their efforts, including monitoring the progress achieved to improve international co-operation. The FSF encouraged OFCs to continue to cooperate with IOSCO and to participate in the IMF's ongoing assessment program in a timely fashion and to publish their IMF reports, including the detailed assessments. The FSF welcomed progress in implementing the IMF's information framework initiative, and urged the few remaining jurisdictions yet to participate to do so.

Accounting and auditing issues

The FSF reviewed recent international accounting and auditing developments, including the need to achieve more consistent interpretations of International Financial Reporting Standards (IFRS) and the IASB's "standard setting pause" under which no major changes to IFRS will become effective until 2009. Members welcomed work on convergence and harmonisation underway between the IASB, the US Financial Accounting Standards Board and other authorities. They reiterated the important role that financial accounting and reporting standards play in safeguarding financial stability.

Members expressed concern about recent incidents that raised questions about the quality controls in place within global accounting firms and the concentration of audit services for large companies at the four largest audit firms. They agreed to promote higher audit quality, given its importance for regulatory efforts. The FSF welcomed the proposal to create an International Forum of Independent Audit Regulators that could enhance and bring more global consistency to audit oversight and audit quality.