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Financial Stability Forum meets in Paris

6 September 2006

The Financial Stability Forum (FSF) met today in Paris, the first meeting chaired by Mario Draghi, Governor of the Bank of Italy. Members of the FSF discussed risks and vulnerabilities in the international financial system and reviewed ongoing work to strengthen financial system stability and resilience.

Global risks and vulnerabilities

The FSF noted that the economic outlook remains broadly supportive of financial stability. Financial firms have strong balance sheets, 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.

Members pointed to several areas of concern with the potential to cause strains in financial systems. These include the capacity of households in some countries 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. Financial market participants need to take account in their risk analysis and pricing of the full implications of a possible reversal of the current benign conditions, including less liquid markets.

Mitigation of risk in financial systems

The FSF encouraged financial firms to further strengthen their risk management practices, in particular in running stress test scenarios involving low probability, high impact events or in which several vulnerabilities crystallise in combination.

Members also reviewed the infrastructure for over-the-counter (OTC) derivatives, the growing role of hedge funds and counterparty risk management. They welcomed progress by financial firms in improving the trading and settlement infrastructure for 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. Members 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 other types of OTC derivatives. More generally, members stressed the importance of reliable valuation practices for illiquid products. Concerning hedge funds, the Forum stressed the importance of financial firms maintaining appropriate margining practices and guarding against any weakening of credit standards in prime brokerage and other counterparty relationships. Hedge funds themselves should make further progress in strengthening risk management practices.

Enhancing the effectiveness of regulation and standard-setting

Effective and efficient regulation. As part of their ongoing dialogue with market participants, members exchanged views with representatives of the Institute of International Finance (IIF) on how regulation could be made more effective and efficient, and discussed ways to further enhance the dialogue between regulators and the financial industry. The 2/3 Forum welcomed the IIF's efforts in this regard and noted that financial services firms and regulators share a common view of 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 warrant attention, and regulatory bodies to continue their

dialogue with the IIF and other market participants on specific issues.

International standard setting practices. Members took stock of the standard setting arrangements employed by the key standard setting bodies (SSBs). Members felt that this stocktaking exercise would be useful to SSBs over time as they review their arrangements.

The FSF welcomed the development of an Insolvency and Creditor Rights (ICR) Assessment Methodology by World Bank and UNCITRAL staff. Members look forward to the completion of a concise, unified ICR standard to help facilitate participation in the ROSC process.

Members agreed that the FSF should place on its website an overview by the FSF Secretariat of major international regulatory initiatives and the timing of their implementation, in order to inform regulators and other stakeholders of the international regulatory pipeline and any potential bunching of initiatives.

Follow-up of other ongoing concerns

Avian flu pandemic and business continuity. The FSF discussed preparedness for an avian flu pandemic in financial authorities and the wider financial sector, including efforts to foster international communication and cooperation. Further action would be valuable not only in the event of a flu pandemic but also in other sorts of business continuity incidents. In this context, members encouraged financial industry participants and authorities to make use of the Joint Forum's high-level principles for business continuity, which were published in final form in August. A workshop on planning and communication for financial crises and business continuity incidents will be hosted by the FSF and the UK authorities in November.

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.

International accounting and auditing issues. Members 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. They welcomed work on convergence and harmonisation underway between the IASB, the US FASB and other authorities. Members 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. Members 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.

The next meeting of the Financial Stability Forum will be held in Frankfurt on 29 March 2007.

Institutions and Groups Attending the Meeting of the FSF

6 September 2006

Chairman, Mr Mario Draghi

National Authorities***Australia***

Reserve Bank of Australia

Canada

Department of Finance
Bank of Canada
Office of the Superintendent of Financial Institutions

France

Ministry of the Economy
Banque de France
Autorité des Marchés Financiers

Germany

Ministry of Finance
Deutsche Bundesbank
BaFin

Italy

Ministry of the Economy and Finance
Banca d'Italia
CONSOB

Japan

Ministry of Finance
Bank of Japan
Financial Services Agency

Netherlands

De Nederlandsche Bank

Singapore

Monetary Authority of Singapore

United Kingdom

H M Treasury
Bank of England
Financial Services Authority

United States

Department of the Treasury
Board of Governors of the Federal Reserve System
Securities and Exchange Commission

International Financial Institutions

International Monetary Fund
World Bank
Bank for International Settlements
Organisation for Economic Co-operation and Development

International Regulatory and Supervisory Groupings

Basel Committee on Banking Supervision
Financial Action Task Force
International Accounting Standards Board
International Association of Insurance Supervisors
International Organization of Securities Commissions
The Joint Forum

Committee of Central Bank Experts

Committee on Payment and Settlement Systems

European Central Bank**Institute of International Finance**

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