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To: Members of the Executive Board

From: The Secretary

Subject: **Financial Stability Forum—An Update of Activities—
November 1999**

Attached for the information of Executive Directors is an update on the activities of the Financial Stability Forum (FSF) for the month of November 1999. This update is in line with the Executive Board's work program, which calls for periodic information notes on the activities of the FSF and its working groups.

Mr. Baliño (ext. 38551) and Mr. U. Das (ext. 36330) are available to answer questions relating to this paper.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

Financial Stability Forum: An Update of Activities—November 1999

Prepared by the Monetary and Exchange Affairs Department

(In consultation with the Policy Development and Review and Research Departments)

Approved by V. Sundararajan

December 9, 1999

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SUMMARY

November

- The FSF Working Group on Offshore Financial Centers (OFCs) met in Singapore on November 2–4, 1999. A full-day session was held with OFC representatives on November 3, 1999.
- The FSF Working Group on Highly Leveraged Institutions (HLIs) met in Hong Kong, November 8–9, 1999.
- The FSF Working Group on Capital Flows (CF) met in New York, November 15, 1999.
- Terms of reference and composition of the FSF Task Force on Implementation of Standards (IS) and Study Groups on Deposit Insurance (INS) and Insurance Industry (II) finalized.
- The FSF Task Force on IS met in Hong Kong SAR, November 22, 1999.

I. INTRODUCTION¹

1. As indicated in SM/99/277, a monthly note will be circulated to the Executive Board for information on the activities of the Financial Stability Forum (FSF). This note provides a brief update of the FSF's activities in November 1999.

II. FINANCIAL STABILITY FORUM GROUPS

A. Highly Leveraged Institutions (HLIs)

2. The HLI Working Group, chaired by Mr. Howard Davies, Chairman of the U.K. Financial Services Authority, met for the fourth time in Hong Kong SAR on November 8–9. The Group reviewed progress achieved by other groupings working on related issues (e.g., Multidisciplinary Group on Enhanced Disclosure, Committee on the Global Financial System, Basel Committee, IOSCO), and a draft paper outlining the different initiatives. The working group discussed the Patat initiative,² and the U.S. Hedge Fund Disclosure Bill (Baker Bill).³

3. The Study Group on Market Dynamics—headed by Mr. Charles Adams (Fund/RES)—which is assessing the impact of the activities of HLIs on small- and medium-sized economies, updated the working group on the progress made—the study group has assessed the experience of six economies (Australia, Hong Kong SAR, Malaysia, New Zealand, Singapore, and South Africa). A paper is being prepared that will review the issues and discuss possible policy options, for the Working Group's next meeting in Basel on January 23–24.

4. The working group also discussed the spectrum of regulatory responses to the systemic and other risks posed by HLIs, and agreed that the final report would need to show the respective trade-offs and costs and benefits, and make recommendations.

¹ See Attachments I–III for the terms of reference, membership and meetings held so far of the FSF Working Groups, task force and study groups.

² The Patat initiative proposed enhancing the transparency of aggregate foreign exchange positions. The G-10 recently decided not to pursue further work in this area, apparently on account of doubts about the value of aggregate foreign exchange data and concerns that the initiative could in some countries require legislature or regulatory actions to ensure participation.

³ The Bill, which is currently before Congress, would require greater public disclosure by hedge funds and call for public companies to provide more information on their significant exposure to hedge funds.

B. Capital Flows (CF)

5. The CF Working Group, chaired by Mr. Mario Draghi, Director General of the Italian Treasury, met for the fifth time in New York on November 15. Representatives from the Fund and World Bank provided an update on the work underway on debt management issues. The group acknowledged that the work underway for the respective Executive Boards would help the working group's deliberations and that the Group would provide a useful "sounding board" for the IMF/World Bank effort. The Group agreed on a work plan for the preparation of the final report. Mr. Draghi summed up his view of the overall framework for the WG's report. Recommendations for policy guidance to build a "prudential" framework for capital flows would recognize that the behavior of different sectors of the economy were bound by varied sets of constraints or guidelines. While all sectors were subject to a set of "rules" that could include capital controls, currency convertibility, exchange rate arrangements, taxation policy, etc., the government was also bound by debt management guidelines, and reserves policy; the banking sector by supervision and calls for transparency; and the corporate sector by transparency. Mr. Draghi saw the value added of the working group to be to give political momentum to the development and implementation of various policy guidelines, and in pointing to links between the various constraints. The final report will address risk management by the public sector, banks, and nonbank corporations, and will also include references to non-debt sources of vulnerability, capital controls, distortions, and data requirements.

6. The Group anticipates holding two more meetings. The next meeting to be held in January 2000 will focus on the substance of the draft report. A final meeting will take place at the end of February or the beginning of March 2000 to finalize the report.

C. Offshore Financial Centers (OFCs)

7. The OFC Working Group, chaired by Mr. John Palmer, Superintendent of Financial Institutions, Canada, met for the fourth time. The meeting took place in Singapore on November 2-4, and covered the Group's work plan for the next few months as well as a full day session with representatives from 13 OFC jurisdictions. The purpose of the latter was to brief OFCs on the work of the FSF generally, the preliminary findings of the working group, its tentative areas for recommendations, and to solicit their feedback and suggestions. The session with the OFC representatives was constructive, had a positive tone and the Group received helpful input for its deliberations. Those attending the session were by self-selection, more in the mainstream, representing jurisdictions generally interested in improving their practices.

8. The working group is conducting a survey on OFCs. A questionnaire to onshore and offshore regulators and supervisors was issued in mid-November, for completion by December 21. The purpose of the survey is to help identify priority OFCs for assessing

compliance with relevant international standards. The results of the survey will be discussed by the Group at a meeting on February 3–4 in Vancouver.

9. A key focus of the Group is on enhancing OFCs compliance with relevant international standards (notably, cross-border cooperation and information exchange). The Group considers that standards related to cross-border cooperation would address many of the issues that arise with OFCs for the stability of the global financial system and is identifying the relevant elements within the various standards that should be the priority for implementation. Different approaches are being considered by which such standards could be assessed in OFCs as well as the incentives that could be applied to enhance compliance. The working group is also exploring issues related to OFCs and reinsurance, company formation and trusts, and funds management, as well as data requirements for OFCs.

D. Task Force on Implementation of Standards (IS)

10. Following the discussions by the Forum on its future work program at its September meeting, a Task Force on the Implementation of Standards has been established. The task force is chaired by Mr. Andrew Sheng, Chairman of Hong Kong Securities and Futures Commission, and includes representation by national authorities—Australia, China, India, Mexico, the Netherlands, and South Africa—as well as the IFIs (including the IMF) and other standard-setting bodies.⁴ The Fund nominee is Mr. John Hicklin (PDR).

11. The task force held its first meeting in Hong Kong SAR on November 22. An IMF Board paper, *Progress in Assessing Observance and Codes* (SM/99/274, November 14, 1999), was circulated by the Fund ahead of the meeting and was seen as providing useful background for an exchange of views by participants on key issues, including ownership of initiatives, priorities for assessing standards, and incentives to implement standards.

12. The task force has been asked to refine and elaborate issues related to implementation of standards for the FSF to consider what further work might be needed at the Forum's next meeting. A draft issues paper will be prepared and discussed by the task force at its next meeting on January 24 in Washington at the Fund. In addition, a note on possible criteria for setting priorities for standards will be circulated. It will include a draft proposal for revising the FSF Compendium of Standards (available on the FSF website—<http://www.fsforum.org>). The task force expects to meet again to finalize its report on February 28 in Basel.

⁴ The Czech Republic has also been approached to participate, but a nomination has not yet been put forward.

III. STUDY GROUPS OF THE FORUM

13. A study group has been formed to prepare an issues paper on **deposit insurance schemes**. It is chaired by Mr. Jean-Pierre Sabourin, President of the Canadian Deposit Insurance Corporation. The composition of the study group is still being finalized, but will include a wide range of participants, including from emerging markets. The Fund nominee will be Mr. Charles Enoch (MAE). The study group will hold its first meeting on December 16–17 in Ottawa.

14. A group of supervisory authorities (coordinated by the International Association of Insurance Supervisors and the FSF Secretariat) is preparing a paper reviewing recent developments in the **insurance industry**, its evolving inter-relationships with other financial sectors, and the main sources of vulnerability in the industry. A first draft of the paper is expected by early 2000. In preparing the paper, comments are to be sought from finance ministries and central banks and incorporated before the paper is tabled for discussion by the Forum.

15. On issues raised by **Internet and electronic trading in financial markets**, the U.K. Financial Services Authority has been asked to set out in a brief paper the issues that need to be addressed by the international financial community. The paper is expected to be circulated early in the new year. Reactions from Forum members will be sought and an overview note prepared for discussion at the next meeting of the Forum in April 2000.

IV. OTHER ISSUES

16. A meeting of the technical subgroup of the FSF will be held in Basel on December 11.⁵ A background note on the procedural aspects for enhancing the Forum's discussions on vulnerabilities to the financial system is expected to be circulated shortly.

17. The next meeting of the Forum will take place on March 25–26, 2000 in Singapore.

⁵ The subgroup includes the Chairmen of the three working groups, and representatives from the Fund, the World Bank, the OECD, the BIS and the other standard-setting bodies of the Forum. A summary of the meetings of the subgroup is circulated to all the Forum members.

MEMBERS OF THE FINANCIAL STABILITY FORUM

Chairman

Mr. Andrew Crockett

National Authorities (25)

Australia

The Reserve Bank of Australia

Canada

Department of Finance

Bank of Canada

Office of the Superintendent of Financial Institutions

France

Ministry of the Economy

Commission Bancaire

Banque de France

Germany

Ministry of Finance

Bundesaufsichtsamt für das Kreditwesen

Deutsche Bundesbank

Hong Kong SAR

Hong Kong Monetary Authority

Italy

Ministry of the Treasury

Banca d'Italia

CONSOB

Japan

Ministry of Finance
Financial Supervisory Agency
The Bank of Japan

Netherlands

De Nederlandsche Bank

Singapore

Monetary Authority of Singapore

United Kingdom

Bank of England
Financial Services Authority
H M Treasury

United States

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

International Organizations (6)

International Monetary Fund (2)
The World Bank (2)
Bank for International Settlements
Organization for Economic Co-operation and Development

International Regulatory and Supervisory Groupings (6)

Basel Committee on Banking Supervision (2)
International Organisation of Securities Commissions (2)
International Association of Insurance Supervisors (2)

Committees of Central Bank Experts (2)

Committee on Payment and Settlement System
Committee on the Global Financial System

WORKING GROUPS

A. FSF Working Group On Highly Leveraged Institutions (HLIs)

Terms of reference

The working group on HLIs should help ensure a timely and coordinated response to the various concerns raised by institutions employing a high degree of leverage in financial markets. To this end, it should:

- Assess the challenges posed by HLIs to financial stability in both developed and developing countries;
- Take stock of work that has been completed or is underway in the groupings represented in the Forum or elsewhere on these issues;
- Establish what is being done to implement recommendations already made and consider the need for further impetus to enhance implementation;
- Make recommendations, where necessary, to improve coordination between existing organizations working in this area;
- Identify issues that have not been covered in existing work and propose suitable procedures for dealing with them;
- Foster a consensus on substantive supervisory or regulatory actions which would minimize the destabilizing potential of HLIs;
- Provide a status report to the Forum's next meeting.

Working group members

Financial Services Authority, U.K.
Reserve Bank of Australia
De Nederlandsche Bank
Ontario Securities Commission
Hong Kong Monetary Authority
Federal Reserve Bank of New York
Banque de France
International Monetary Fund
Bank of Japan
Ministry of Finance, Germany
U.S. Treasury
CONSOB

B. FSF Working Group on Capital Flows (CF)

Terms of reference

Drawing on work carried out by the institutions and groupings represented in the Forum and elsewhere, and on the experience and expertise of recipient countries and the private sector, the working group on capital flows should:

- Evaluate prudential policies, regulations and risk management (including debt management) practices in borrowing countries that may help reduce the risks to financial systems associated with the build-up of short-term external indebtedness;
- Identify any regulatory or other factors that may have introduced an unwarranted bias in favor of short-term flows, and recommend actions to reduce such bias;
- Review progress in improving the adequacy and timeliness of the data and reporting systems on which authorities and investors rely to monitor and assess risks associated with capital flows, and give impetus to improvements as needed;
- Evaluate other potential measures in debtor and creditor countries to reduce the volatility of capital flows and its adverse consequences for financial system stability;
- Provide a status report to the Forum's next meeting.

Working group members

Ministero del Tesoro, Italy
Federal Reserve Board, U.S.A.
International Monetary Fund
Ministry of Finance, Canada
The World Bank
Banco Central do Brasil
Banco Central de Chile
Ministry of Finance, Japan
Commission Bancaire, France
Ministry of Finance, Pretoria
Deutsche Bundesbank
Bank of England
Bank Negara Malaysia
Bank for International Settlement

C. FSF Working Group on Offshore Centers (OFCs)

Terms of reference

Drawing on the work and experience of national authorities, the regulatory and supervisory groupings, and the Financial Action Task Force, the working group on offshore centers should:

- Take stock of the use made by participants in international financial markets of offshore centers and consider the impact of such use on global financial stability;
- Review progress made by offshore centers in enforcing international prudential and disclosure standards, and in complying with international agreements on the exchange of supervisory information or information relevant to combating financial fraud and money laundering;
- Taking account of the analysis under (1) and (2) above, identify and evaluate the threats to financial stability or to the credibility of regulatory efforts that arise from continued non-compliance, non-enforcement and non-cooperation by offshore centers;
- Evaluate the scope for improving compliance and cooperation through technical assistance to, and/or intensified regulatory or supervisory contacts with, offshore center authorities, and such other steps as may be appropriate, including supervisory reactions in the case of non-compliance and no-cooperation;
- Provide a status report to the Forum's next meeting.

Working group members

Office of the Superintendent of Financial Institutions, Canada

Bank of Thailand

Banca d'Italia

COB, France

Bundesaufsichtsamt, Berlin

Eidgenössische Bankenkommission, Bern

Ministère des Finances, France

Basel Committee on Banking Supervision

HM Treasury, U.K.

International Association of Insurance Supervisors, Basel

Securities and Exchange Commission, U.S.A

OECD

Monetary Authority of Singapore

Financial Supervision Agency, Japan

D. Task Force on Implementation of Standards (IS)

Terms of reference

The task force should explore issues related to promoting the implementation of international standards relevant to strengthening financial systems.

The task force should consider a strategy for implementation of standards that may include:

- countries announcing their commitment to implement standards and participate in credible assessments of compliance;
- technical assistance in support of implementation efforts being prioritized;
- relevant information on progress toward compliance of standards being made available; and
- compliance with sound practices being rewarded by market participants and others, thereby reinforcing further efforts at implementation.

In support of such a strategy, and taking account of country circumstances, the task force should:

- identify the set of international standards most relevant to strengthening financial systems and ways of disseminating these standards (e.g., through the Compendium of Standards);
- explore strategies for assisting countries in the practical implementation of standards;
- explore official and market *incentives* that could encourage the process of implementation;⁶
- outline options for generating credible *self-assessments and independent assessments* and for ensuring complementarity between the two;
- consider how, what kind of, and to whom, information on progress toward compliance with standards could be made available;
- consider how the *resources* required to support implementation and assessment of standards could best be mobilized.

The task force should consider how the various elements of the implementation strategy could best reinforce each other, and what the roles and responsibilities of various bodies in implementing it should be.

⁶ Such incentives might include, *inter alia*, making access to certain types of official sources of financing conditional on compliance (as in the case of the CCL), preferential risk weights in the capital adequacy framework, consideration in market access decisions by key financial centres, more generous offers of technical assistance to enhance the capacity of countries to implement sound practices.

In all of the above, the task force should draw upon the work already done by the IMF, World Bank, standard-setting bodies, and others with respect to encouraging implementation of sound practices.

Task force members

Securities and Futures Commission, Hong Kong SAR
The Treasury, Australia
Peoples Bank of China
Banque de France
Reserve Bank of India
CONSOB, Rome
Ministry of Finance, Japan
National Commission on Banking and Securities Supervision, Mexico
Netherlands Bank
Bank of England
U.S. Treasury
Reserve Bank of South Africa
Ministry of Finance, Czech Republic
Basel Committee on Banking Supervision
Committee on Payment and Settlement Systems
Committee on the Global Financial System
Financial Stability Institute, BIS, Basel
International Monetary Fund
International Organization of Securities Commissions (IOSCO)
International Association of Insurance Supervisors (IAIS)
OECD
The World Bank

E. Study Group on Deposit Insurance (DI)

Terms of reference

Study recent experience with deposit insurance schemes—by examining systems that worked well, those that did not work well, and the reasons why—and synthesising the key lessons learned.

- Sketch the policy trade-offs presented by different types of deposit insurance schemes, taking account of different institutional settings.
- Examine the issues involved in transitions from implicit or explicit blanket guarantees to limited coverage deposit insurance schemes.

- Assess the desirability and feasibility of setting out international guidance on deposit insurance, recognising that different country circumstances may imply different policy prescriptions.
- Evaluate what form such guidance could take (ranging from formulation of general principles for deposit insurance schemes to setting out pitfalls to be avoided in their design and operation) and who would be best able to take forward this work.

Members of the study group (to be finalized)

Canada Deposit Insurance Corporation

Jamaica Deposit Insurance Corporation

Ministry of Finance, Germany

Ministry of Finance, Japan

Commission Bancaire, Paris

Federal Deposit Insurance Corporation, Washington, D.C.

Argentina

Chile

Hungary

Korea

Mexico

Philippines

Romania

Basel Committee on Banking Supervision

International Monetary Fund

The World Bank

10 November 1999

Revised

PAPER ON THE INSURANCE INDUSTRY

Aim of Paper

- To provide an overview of the insurance industry and recent developments.
- To describe potential gaps in the supervisory system.
- To analyze potential sources of vulnerability in the insurance industry.
- To identify areas for improvement and further work.

Outline of Paper*

1. An Overview of the Insurance Industry
(*United Kingdom, Germany, United States*)

Special character of the insurance industry

- Law of large numbers
- Providing security to society
- Differences between life, non-life and reinsurance
- Character of risks surrounding the insurance industry

Recent trends and developments in the insurance industry

- Market developments
- Integration with other financial industries
- Competition
- Globalization
- Liberalization
- Securitisation
- Financial innovation and new products

Role of insurance sector in the financial industry

- Differences between the insurance and banking sectors
- Inter-relationship between the insurance industry and other financial industries

* National supervisory authorities responsible for the respective chapters are in parenthesis.

2. Supervision of the Insurance Industry

(Canada, Australia, Germany, Hungary, United States)

An overview of insurance supervision

- General principles and guidelines (licensing control, ongoing supervision, remedial measures and sanction, control of fit and proper management)
- Structure and framework for insurance supervision

Potential gaps in the supervisory system

- Lack of professionalism in insurance supervision
- Lack of funding and training systems
- Weak international co-ordination (cf. difficulties in coordinating supervision of globalized insurance companies, shortage of resources devoted to international coordination)
- Lack of an internationally harmonized accounting system
- Impact of weak regulatory regimes on other jurisdictions
- Lack of transparency in insurance business
- Lack of market discipline
- Lack of safety net in some jurisdictions
- Lack of total risk evaluation in financial conglomerates
- Possible regulatory arbitrage between banking and insurance

3. Reinsurance

(Germany, the Netherlands, Switzerland, United Kingdom, United States)

Character of reinsurance

Market developments

- Alternative risk transfer
- Consolidation of small reinsurance companies

Potential gaps in the supervisory system

- Weak reinsurance companies and less supervised jurisdictions
- Lack of information requirements
- Lack of capital requirements
- Lack of fit and proper control

4. Life Insurance

(France, Japan, Mexico, United Kingdom)

Character of life insurance

- Provisions for old age and dependants
- Long-term business

Market developments

- Fast growth in private pension and life insurance due to aging population
- Important role of life insurance in particular in emerging markets

Potential gaps in the supervisory system

- Difficulties in risk management of long-term business
- High vulnerability to the interest rate risk

5. Non-life Insurance
(Mexico, France, South Africa)

Character of non-life insurance

- Mainly short-term (one year) contracts
- Need for appropriate reinsurance programs

Market developments

Potential gaps in the supervisory system

6. Potential Sources of Vulnerability
(Canada, Australia, Germany, Hungary, United Kingdom, United States)

Industry-specific risks

- Liquidity risks arising from short-term funding of illiquid assets in life insurance business
- Potential for systemic risks within the re-insurance business

Inter-relationship risk

- Transfer of risks from insurance to securities industry through securitisation
- Systemic risk between insurance and banking
- Risks associated with insurance companies' asset management activities
- Risks associated with activities of financial conglomerates where the lines between insurance, banking, and securities activities are blurred

7. Areas for Improvement and Further Work

(Australia, Canada, Germany, Hungary, South Africa, United Kingdom)

Reinforcement of insurance regulatory framework

Enhancing transparency and market mechanism

Reinforcement of international co-ordination

- Further harmonization of regulatory regimes across financial industries
- Better co-ordination in supervision of insurance companies in different jurisdictions
- Minimum harmonization of the insurance accounting system
- Minimum harmonization of the regulatory framework for insurance
- Providing assistance in the implementation of the IAIS Core Principles

FINANCIAL STABILITY FORUM GROUPS—MEETING SCHEDULE

CHAIRMAN	SECRETARY	IMF REPRESENTATION	1 ST MEETING	2 ND MEETING	3 RD MEETING	4 TH MEETING	5 TH MEETING
HIGHLY LEVERAGED INSTITUTIONS							
Mr. Howard Davies Financial Supervisory Authority, United Kingdom	Mr. Svein Andresen BIS, FSF Secretariat	Mr. Charles Adams (RES)	June 4, 1999 London	June 30-July 1 New York (included private sector participation)	September 1 London	November 8–9 Hong Kong	
CAPITAL FLOWS							
Mr. Mario Draghi Ministry of Finance, Italy	Mr. Larry Promisel World Bank, FSF Secretariat	Mr. Mark Allen, Mr. John Hicklin (PDR)	May 28, 1999 New York	July 20–21, 1999 London (two-day session, including private sector participation)	August 26, 1999 Paris	September 28 Washington	November 15 New York
OFFSHORE FINANCIAL CENTERS							
Mr. John Palmer Office of the Superintendent of Financial Institutions, Canada	Ms. Kate Langdon MAE, FSF Secretariat		June 7, 1999 Toronto	July 22–23, 1999 Basel (Chairmen of the Offshore Groups of Banking Supervisors and Insurance Supervisors, and a financial services supervisor from an OFC (Jersey) participated in part of the session. Private sector participants and a key financial supervisor and OFC expert (U.K. FSA)	September 3, 1999 New York	November 2–4, 1999 Singapore. Broad range of OFCs to be invited to attend session on November 3.	

FINANCIAL STABILITY FORUM—TASK FORCE AND STUDY GROUP

CHAIRMAN	SECRETARY	IMF REPRESENTATION	1 ST MEETING	2 ND MEETING	3 RD MEETING
IMPLEMENTATION OF STANDARDS					
Mr. Andrew Sheng Securities and Future Commissions, Hong Kong SAR	Mr. Svein Andresen Ms. Kate Langdon Mr. Ravi Menon FSF Secretariat	Mr. Jack Boorman/Mr. John Hicklin (PDR)	November 22, 1999 Hong Kong SAR	January 24, 2000 Washington, IMF	February 28, 2000 Basel, BIS
DEPOSIT INSURANCE					
Mr. Jean Pierre Sabourin Canadian Deposit Insurance Corporation Canada	Mr. Pierre Cailleteau FSF Secretariat	Mr. Charles Enoch (MAE)	December 16–17, 1999 Ottawa		