

When Thailand sneezed in July 1997, the entire world caught a cold. The devaluation of the Thai currency triggered reactions in so many interconnected financial markets that the world has not been the same since. Thailand may be recovering, but the health of the international financial system is no longer taken for granted. Its doctors have greatly intensified their preventive measures.

At their meeting in Washington in October 1998, the Finance Ministers and Central Bank Governors of the G7 countries commissioned Hans Tietmeyer, then President of the Deutsche Bundesbank, to consult appropriate bodies and recommend new structures for enhancing cooperation among the various national and international supervisory bodies and international financial institutions to promote stability in the international financial system.

The Tietmeyer Report led to the formation of the **Financial Stability Forum**, which promotes international financial stability through information exchange and international cooperation in financial supervision and surveillance. The Forum coordinates the efforts of national authorities responsible for financial stability, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of

central bank experts.

The Financial Stability Forum's central message is that the development and implementation of internationally accepted economic, financial, and statistical standards promotes sound domestic financial systems and better economic performance. Successful implementation of international standards helps to strengthen domestic financial systems by encouraging sound regulation and supervision, greater transparency, and more efficient and robust institutions, markets, and infrastructure. It also helps to promote international financial stability by facilitating better-informed lending and investment decisions, improving market integrity, and reducing the risks of financial distress and contagion.

Standards define the widely accepted good principles, practices, or guidelines in a given area. The Forum's **Compendium of Standards** provides a common reference for the various internationally accepted economic and financial standards relevant to sound, stable, and well-functioning financial systems. The

Forum has designated 12 key standards for sound financial systems, as articulated by the relevant standard-setting bodies. They are broadly accepted as representing minimum requirements for good practice.

### Key Standards for Sound Financial Systems

#### Macroeconomic Policy and Data Transparency

- Code of Good Practices on Transparency in Monetary and Financial Policies (IMF)
- Code of Good Practices in Fiscal Transparency (IMF)
- Special Data Dissemination Standard/General Data Dissemination System (IMF)

#### Institutional and Market Infrastructure

- Principles and Guidelines for Effective Insolvency and Creditor Rights Systems (World Bank)
- Principles of Corporate Governance (OECD)
- International Accounting Standards (IASB)
- International Standards on Auditing (IFAC)
- Core Principles for Systemically Important Payment Systems (CPSS)
- The Forty Recommendations of the Financial Action Task Force (FATF)

#### Financial Regulation and Supervision

- Core Principles for Effective Banking Supervision (BCBS)
- Objectives and Principles of Securities Regulation (IOSCO)
- Insurance Core Principles (IAIS)

These key standards reflect the world's dependence on effective prudential supervision of banking, securities, and insurance. Their inclusion in the key standards gives the core principles articulated by the respective international bodies of supervisors the force of strong mandates from the finance ministers and the international financial institutions. Countries that want to be part of the global economy have little choice about observing these standards, but they often need substantial assistance to make it possible.

These standards provide benchmarks for the **Financial Sector Assessment Program**, a joint IMF and World Bank effort introduced in May 1999 to increase the effectiveness of efforts to promote the soundness of financial systems. Assessments seek to identify the strengths and vulnerabilities of a country's financial system; to determine how key sources of risk are being managed; to ascertain the sector's developmental and technical assistance needs; and to help prioritize policy responses. Following an initial one-year, 12 country pilot program, the IMF and the World Bank agreed to expand the pace of the program to around 24 countries per year.

While participation in the program is voluntary, there are strong incentives for countries to demonstrate their observance of international standards. Observance of standards can determine eligibility for IMF loans, for example. But more important than such official incentives are the market incentives. Capital will naturally flow to countries where investors perceive less risk, and observance of international standards signals a favorable investment climate. Some countries have chosen to make the complete FSAP report public, and they appear on the IMF website.

The FSAPs also contribute to Reports on Observance of Standards and Codes (ROSCs). These reports summarize the extent to which countries observe certain internationally recognized standards, focusing primarily on the areas of direct operational concern to the IMF. The World Bank has begun to prepare ROSCs in the areas of corporate governance and accounting and auditing, and it is developing a template to begin assessments of insolvency and creditor rights.

This emphasis on international standards helps to identify ailments that threaten financial stability. These benchmarks make it possible to measure the health of the global financial system on a country-by-country basis. Together with self-assessments and peer reviews, financial sector assessments by external experts are periodic check-ups that might reveal early signs of crisis prone systems.

A diagnosis that cites ills without prescribing remedies, however, offers little hope to the patient. The most important by-product of the FSAP is the identification of training needs. By highlighting the deficiencies according to accepted international norms, countries learn where to focus their priorities for improvement.

For the International Insurance Foundation, the FSAPs become inputs into planning our educational programs for insurance supervisors, facilitating a systematic process of continuous improvement. Specifically identified needs determine the content of each program, not the availability of a particular expert or source of funding. The IAIS Core Principles of Insurance Supervision represent the constant goal. Whether it deals with licensing, financial reporting, on-site inspections, or evaluation of assets, liabilities, or reinsurance, each program is designed to help supervisors implement some aspect of the Core Principles.

The need for such programs is enormous. Effective prudential supervision involves consistent application of financial analysis and related skills that are in short supply throughout the world. As the Chairman of the Financial Stability Forum recently noted, "Widespread international support is needed to provide expertise and funding for the provision of technical assistance and training to assist countries in implementing international standards."<sup>1</sup> The world has learned, however, that the massive educational effort directed toward preventing future financial crises is better medicine than the efforts required to cure the crisis once it has occurred.

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<sup>1</sup>Statement by Andrew Crockett, International Monetary and Financial Committee Meeting, Washington, DC, April 29, 2001.