Financial Stability Board

Tony Porter

I. Introduction

The Financial Stability Board (FSB) – known as the Financial Stability Forum (FSF) until April 2009 – was established in 1999 by the Group of Seven (G7) in response to the severe global financial instability that had been evident in the Mexican peso crisis of 1994 and the East Asian and Russian crises of 1997 and 1998. Its membership includes representatives from each G20 member, as well as Hong Kong, the Netherlands, Singapore, Spain, and Switzerland. It also includes representatives from the 11 international institutions most important to the regulation of global finance. It aims to identify and address systemic risks in global finance by facilitating information-sharing and coordination of regulatory responses across its member institutions and other public sector bodies. It has coordinated the presentation of information about international financial standards and codes produced by other international institutions, issued a series of reports on various systemic risks, and has sought to expand its influence beyond its original members by holding regional meetings and involving other states and international institutions in its projects. The secretariat of the FSB is located at the Bank for International Settlements (BIS) in Basel, Switzerland.

II. Origins and Development

Concerns about systemic financial instability have accompanied the current period of the globalization of finance since it began in the 1960s. A variety of international institutions have been created and used by governments in response to these concerns. These include formal organizations like the BIS, the International Monetary Fund, and the International Organization of Securities Commissions. In addition, the leading industrial countries have created a series of more informal and ad hoc technical groupings to work on various issues relevant to global financial regulation, mostly located at the BIS. When the G7 was created as an annual leaders’ summit in the mid-1970s, it included issues of financial instability in its work, and this role was
strengthened when the G7 finance ministers began meeting independently in 1986.

During the 1990s, concerns about global financial instability moved high on the agendas of policy makers, especially following the Mexican peso crisis of 1994 and the East Asian and Russian crises of 1997 and 1998. These crises had cross-border causes and effects associated especially with the large international financial flows that included bank loans, but also newer financial instruments such as derivatives and portfolio flows initiated by large institutional investors. At its first summit after the Mexican crisis, the Halifax summit of 1995, the G7 began to devote a great deal of high-level attention to what came to be labelled the international financial architecture. Following the crises of 1997 and 1998, on 3 October 1998, the G7 asked Dr Hans Tietmeyer, then head of the German central bank, to recommend reforms in this architecture. He recommended the creation of a Financial Stability Forum, and the new body was endorsed by the G7 Ministers and Governors at the meeting in Bonn on 20 February 1999. The G7 appointed Andrew Crockett, General Manager of the Bank for International Settlements, as first chair of the FSB. The Board’s first meeting took place on 14 April 1999 in Washington DC.

One of the FSB’s first projects was to help integrate work on financial standards and codes that was being carried out in a variety of uncoordinated locations such as the Organisation for Economic Cooperation and Development, the International Accounting Standards Board, and the International Monetary Fund. The FSB produced a Compendium of international financial standards and codes, made this available on its website, and began producing a series of reports addressing implementation issues. The FSB was especially interested in the way that standards might be used in financial choices made by market actors.

Over the years the Board has issued a series of reports on important international financial stability issues. For instance, in 2000 it issued a report on highly leveraged institutions (HLIs), also known as hedge funds. HLIs are generally restricted to very wealthy investors who are seen as not needing regulatory protection. HLIs often make money by speculating on financial fluctuations such as currency movements, magnifying these gains and losses by drawing on very large loans from banks. HLIs had been implicated by some observers in the East Asian crisis, and their lack of transparency and potential impact on other financial institutions such as banks had worried policy makers and regulators. The approach recommended by the FSB and generally adopted by regulators was to put pressure on banks to be more careful in their lending to HLIs rather than to develop more intrusive regulation for the HLIs themselves. As HLIs continued to grow rapidly and to draw in less wealthy investors renewed concerns led the G7 finance ministers