

## **Discussant comments on session IPM65: Statistical tools used in financial risk management**

Greg Haymes

Let me begin by thanking the IMF and ECB authors for their thorough and thought-provoking contributions on the topic of Financial Soundness Indicators, or FSIs. It is indeed an honour to act as a discussant for these papers. My remarks will begin with some broad observations, followed by key points raised in the papers, and end with some suggestions for the way forward.

The challenge of remaining current on developments in the financial world has never been greater – or more critical – for central banks. Indeed, over the past several years, financial crises have put pressure on central banks to obtain better sources of information on the financial system. For instance, the BIS recently expanded its International Banking Statistics to include exposures on an ultimate risk basis, and several central banks are improving available financial data, such as the ECB's Centralized Securities Data Base (CSDB).

The development of FSIs is another important step that provides a new direction for official statistics – one that can be compared with the development of the System of National Accounts (SNA) and, subsequently, of the GDP, some 50 years ago. The SNA enhanced our ability to measure how our economies were performing and transforming, while FSIs allow us to assess and monitor the strengths and vulnerabilities of financial systems. However, as was the case 50 years ago, prior to the development of GDP statistics, FSI data should be viewed as a work in progress. A cynic might argue that these heroic efforts to develop a comprehensive set of financial stability indicators have overtones of Don Quixote tilting at windmills – noble in intent, but ultimately futile in implementation. However, that view underestimates the various benefits of going through the exercise.

Indeed, the IMF's FSI initiative that began in the late 1990s created huge benefits for the central banking community because it encouraged countries to develop macroprudential indicators to monitor the state of financial systems. To ensure relevance and to cover all risks, these country-specific indicators have evolved over the years to reflect rapidly changing markets. As a result, macroprudential indicators for individual countries can be quite different from the FSIs. In the case of banks, for example, trading-book indicators have become more important for countries like Canada, where banking activity has moved from traditional intermediation to a more market-oriented approach. The implementation of Basel II will result in more detailed information on an institution's security holdings, and future FSI work should take this into consideration.

Both the ECB and IMF papers are broad ranging, yet concise and easy to read. The ECB paper compares the approach used for its macroprudential indicators (MPIs) with that of the IMF's FSIs. Key differences are frequency and timeliness – the MPIs of the ECB are annual and are available 5 to 7 months after the reference date, while the FSIs are expected to be quarterly, with a one-quarter lag. Other differences include: the preferred consolidation approach, accounting standard differences, and the geographical scope of the indicators. The IMF paper, meanwhile, provides background information on the FSI exercise, outlines key methodological challenges, and suggests items to be further addressed in a forthcoming report to the IMF's Executive Board. I concur with its conclusion that the FSI exercise has significantly advanced knowledge and experience in this new field of statistics and has set a good foundation for the regular compilation of FSIs.

Let me now step back and discuss various points raised in the papers.

Canada was among the original 40 countries that volunteered to participate in the FSI pilot, which was later expanded to 62 countries. The FSI Guide provides precise definitions for each indicator. In some cases, however, the lack of available data meant that exact IMF definitions could not be followed. In such cases, countries had to document how their measures differed from the Guide in terms of metadata. Compiling the detailed metadata was, by most accounts, the most difficult and time-consuming part of the project. Indeed, some suggest that the scope of the undertaking was not as clear at the beginning as it might have been. Besides the availability of data and resources, the complexity of the initiative may have been underestimated. With nearly 300 pages, the Guide itself is very comprehensive.

An important issue that FSI coordinators face is the need to collaborate with other government agencies, such as the supervisor of financial institutions and the national statistical office. In Canada, there were challenges in this regard, owing to the lack of available resources in these agencies. In the future, a more formal agreement among parties should be established at the outset.

Despite these challenges, results from the FSI exercise were quite positive, with almost 90 percent of participating countries reporting all core FSIs, 84 percent reporting encouraged FSIs for deposit takers, and about 50 percent reporting encouraged FSIs for other sectors. In addition, FSIs are being incorporated into the financial surveillance work of central banks. At the Bank of Canada, for example, every attempt is being made to harmonize the data sources used in our macroprudential analysis with those of the FSIs. FSIs also allow for a broader awareness of the situation in other countries.

Let me now turn to some of the key methodological challenges.

First, and foremost, is the issue of consolidation. Few countries followed the approach recommended in the Guide, and various opinions have been expressed as to how best to proceed in this regard. It is important to note that increased flexibility in the Guide will lead to diminished cross-country comparability – one of the most desirable features of the FSIs. The analytical needs of countries, however, can vary, depending on the market and its participants. Might there be a case for suggesting two main types of consolidation approaches, depending upon the sophistication of a country's financial system? After all, smaller, less complex economies may need only national data. Such an approach would:

- provide users with a clear direction;
- reflect differences in practices between countries; and
- lead to higher-quality, more comparable data.

On the other hand, by limiting the number of allowable approaches, significant effort and adjustments may be required by certain countries.

The ECB paper puts forth a strong case for the domestically controlled cross-border, cross-sector consolidation basis (DCCBS), given that it corresponds to national supervisory standards and that the data are more readily available. It also suggests that the majority of EU countries support this recommendation. I tend to agree, and would feel more comfortable analysing data based on the standards that banks themselves use to judge their financial security or situation. Another contributing factor, discussed in the paper, is the growing importance of large and complex banking groups, and the impact that the failure of any one of these would have on the financial system, along with the importance of using a consolidation approach that captures all risks to the banking sector.

The ECB paper also suggests that the IMF should compile indicators for various regions – for example, on an EU and euro basis. Besides providing relevant benchmarks, regional data are required for the ECB to fulfil its mandate. The consolidation issues present the greatest challenge in this regard. But, as the paper states, the ECB already does this for bank supervisory data. Perhaps, therefore, if the FSI initiative proceeds, a pragmatic approach can be worked out between the ECB and the IMF on this issue.

A related point is the need for greater coordination among international agencies to harmonize and streamline requests. For instance, the BIS International Financial Statistics provide an important statistical standard for central banks. It would also be helpful if compilers of central bank data were more actively engaged and were consulted in the process of developing new requests.

As the IMF paper indicates, the FSI conceptual framework draws on statistical, supervisory, and business accounting frameworks. Unfortunately, the Basel framework and the use of International Financial Reporting Standards (IFRS) are in transition and, to a lesser extent, so too is the System of National Accounts. The timing of these developments is not optimal for the introduction of a compilation guide involving new financial statistics.

At a minimum, a discussion of the Basel framework should be included in the Guide, along with an acknowledgement of its use as a standard for certain series. In terms of accounting, Canada, like many other countries, will adopt the IFRS by 2011 for all publicly traded companies. Given this trend, and the need for consistency across standards, the Guide should accept the IFRS as the standard on most accounting issues. One exception is the IFRS recommendation to consolidate the parent and all of its subsidiaries regardless of whether they are financial or non-financial entities.

With respect to the issue of “income and expense recognition,” perhaps the case made in the IMF paper (and in the Guide) – that realized and unrealised gains and losses on available-for-sale financial instruments should be recognized as income rather than as equity – can be further elaborated and presented to the International Accounting Standards Board (IASB), with a view to promoting a possible change in their standard on this issue. There is, after all, some divergence in their treatment of financial instruments when it comes to foreign exchange: under IFRS, all foreign exchange gains and losses, including those on available-for-sale instruments, are immediately allocated to the income statement.

Through its FSI initiative, the IMF has created a new type of data governance, or framework, that formally establishes standards, processes and structures to ensure that data that are created and consumed are clean, relevant, and fit for use.

There are, however, some challenges.

In particular, as globalisation intensifies and capital markets converge, there is an appreciation among central bankers of the need for a high degree of international consensus on widely usable statistical definitions and norms. In order to achieve broad international comparability of data, it is sometimes necessary that otherwise justifiable national positions be modified. At the same time, experience indicates that in the process of developing international classifications, definitions and recommendations, one must accept the give and take required to establish international norms for statistical activities.

In closing, FSIs provide a greater sense of market and banking system conditions, and their continued use is highly recommended. I would like to conclude with some important lessons for relationship building, as related to the FSI experience, and with the thought that central banks need to work with other government agencies and banks to obtain FSI data. At the same time, international organizations must work with one another, with standard setters, and with the central banks. Key lessons include the need to:

1. establish relationships with senior reporting managers;
2. ensure that providers realize the value of their data;
3. target more in-depth relationships with the largest providers;
4. understand response burden;
5. seek early feedback on new requests;
6. conduct onsite visits, training, and information sessions; and
7. focus on the long-term benefits of such efforts.