

INTERNATIONAL FINANCIAL CO-OPERATION

The RBA works with other areas of the Australian Government to further Australia's interests at the international level through participation in various multilateral forums such as the International Monetary Fund (IMF), the Group of 20 (G20), and the Finance Ministers' process of the Asia-Pacific Economic Cooperation forum (APEC). In several forums – the Bank for International Settlements (BIS) and its associated committees, the Financial Stability Forum (FSF) and the Executives' Meeting of East Asian and Pacific central banks (EMEAP) – the RBA is Australia's representative.

Australia's approach to international economic and financial relations is co-ordinated by the International Economic Policy Group, a Canberra-based committee chaired by a senior official from the Department of Prime Minister and Cabinet. Along with the Departments of Foreign Affairs and Trade and Treasury, AusAID and some other agencies, the RBA is an active participant in this Group.

Bank for International Settlements and Associated Committees

The RBA attended meetings held by the BIS during the year for governors or deputy governors of central banks from the major industrial and emerging market economies. These meetings provide an opportunity for central banks to discuss developments and major issues in the global economy and financial markets. These bi-monthly meetings, usually at the BIS head office in Basel in Switzerland, are supplemented by occasional Special Governors' Meetings held in the Asian region. The most recent of these, in February 2003, was hosted in Sydney by the RBA.

The BIS also hosts a number of committees which aim to promote international co-operation and the sharing of information among central banks. The RBA participated in some of these committees during the year. These included the Markets Committee, the Committee on the Global Financial System (CGFS) and the Committee on Payment and Settlement Systems (CPSS).

The Markets Committee brings together senior officials responsible for market operations to discuss developments in foreign exchange and capital markets. Its discussions during the year focussed largely on market conditions, but it also dealt with a number of special topics, including undisclosed principal trading and the involvement of central banks and the BIS in the continuous linked settlement system for foreign exchange. The CGFS also focuses on financial markets, but with a view to identifying potential sources of vulnerability. Much of the Committee's work in 2002/03 was focused on three working groups, all of which included RBA representation. The working groups on credit risk transfer and incentive structures in institutional asset management issued reports in January and March 2003, respectively. The other, on finance sector foreign direct investment in emerging market economies, is expected to complete its report by the end of 2003. Another working group, on the role of rating agencies in structured finance, is in the process of being established.

The CPSS monitors and analyses developments in domestic payment, settlement and clearing systems, as well as in cross-border and multi-currency settlement schemes. In 2002/03, the RBA

contributed to a CPSS report on the policy issues relating to retail payments for central banks and also continued its representation on the CPSS Sub-Group on Foreign Exchange Settlement Risk. The major task of the Sub-Group over the past year has been to co-ordinate approval processes for the inclusion of participating currencies in the continuous linked settlement system and ongoing oversight of participation in the system.

The BIS also undertakes, independently of these committees, programs aimed at improving information exchange between central banks on issues such as central bank governance and statistical collections. The RBA participates regularly in these programs.

Asian Consultative Council

A BIS initiative of particular relevance to members in our region was the establishment, in July 1998 in Hong Kong, of the BIS Representative Office for Asia and the Pacific. This has enabled the BIS progressively to expand its transactional services for central banks in the region, including the RBA. The Office has also organised a number of meetings and workshops on economic and financial issues of relevance to regional central banks. In 2001, the BIS created the Asian Consultative Council (ACC) as a means of guiding the work of the Office and more generally of the BIS in the region. The ACC consists of governors of the major central banks in the region. Ian Macfarlane was the inaugural chairman of the Council before passing the Chair in February 2003 to Joseph Yam, the Chief Executive of the Hong Kong Monetary Authority.

Financial Stability Forum

The FSF was established in 1999 to provide a forum for authorities responsible for financial supervision, surveillance and stability. It includes central banks, ministries of finance and supervisory agencies of the G7 countries (the largest industrial countries) and the governors of the central banks of four other economies with globally significant markets (Australia, Hong Kong, the Netherlands and Singapore).

An important element of the FSF's role is its ongoing monitoring of potential vulnerabilities in the international financial system. In the past year, it has looked at the impact of increased risk aversion in emerging economy bond markets, the transitory impact of war in Iraq, and the pressure placed on financial systems by weak world growth. The Forum has taken a particular interest in developments in household and corporate balance sheets and their sensitivity to changes in interest rates and exchange rates. A discussion of these risks in the Australian context can be found in the Financial System Stability chapter of this Annual Report.

Beyond these conjunctural issues, the Forum has promoted and co-ordinated reform efforts by national authorities and international organisations in areas such as corporate governance, auditor independence and oversight, audit practice standards and accounting standards. Initiatives supported by the FSF in the past year have included an OECD review of its Principles of Corporate Governance, the release of principles on auditor independence and oversight by the International Organisation of Securities Commissions, and progress on convergence between International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) standards. The Forum will continue to assess reforms in these areas with a particular focus on the promotion of coherence and convergence.

Last year the Forum requested decisive action by key reinsurance regulators to improve transparency and disclosure in the reinsurance industry – an area of some interest to Australia following the HIH collapse. This request has been taken up by the International Association of Insurance Supervisors (IAIS). The IAIS Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector is developing a proposal for a global reinsurance market database that would allow analysis of the nature and scope of the industry's risk-taking, its resilience and soundness, and knock-on effects if a major reinsurer should fail.

One of the ongoing goals for the Forum has been to improve the supervisory, regulatory, information-sharing and co-operation practices of offshore financial centres (OFCs). The IMF has been undertaking assessments of these jurisdictions since late 2000. By the end of 2003, it will have assessed all of the significant OFCs identified by the Forum in May 2000 as priorities for assessment. In the IMF's view, OFCs have been able to focus resources on the areas of offshore business that are important for their jurisdiction. While weaknesses remain, observance of supervisory and regulatory standards among the OFCs assessed to date is similar to that of other countries. The Forum will consider at its meeting in September 2003 how progress can be maintained.

Executives' Meeting of East Asian and Pacific central banks

The mainstay of regional central bank co-operation for the RBA continues to be the EMEAP group of eleven central banks from the region (Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand). The group meets at the governor, deputy governor and working group levels and has also introduced a new forum for information technology (IT) directors.

In addition to being active at all levels of EMEAP, the RBA has in the past year hosted meetings of IT directors, the Working Group on Financial Markets and the Working Group on Payment and Settlement Systems.

One of EMEAP's major achievements over the past year has been the establishment of the Asian Bond Fund (ABF), in conjunction with the BIS. EMEAP member central banks have invested a total of US\$1 billion of foreign exchange reserves in the Fund, which will in turn invest in a basket of US-dollar denominated bonds issued by sovereign and quasi-sovereign issuers in EMEAP economies (other than Japan, Australia and New Zealand). At the same time as establishing the US-dollar denominated ABF, EMEAP announced that it will study the feasibility of extending the investment to include bonds

denominated in regional currencies. Australia's investment in the ABF is discussed in the chapter on Operations in Financial Markets.

While only a small step when judged against either the size of aggregate foreign reserves in the EMEAP group or even against the size of regional bond market issuance, the establishment of the ABF is significant for EMEAP. It represents a firm commitment by the member central banks to regional bond market development and, while most of the potential benefits from this would come from the local-currency fund which is yet to be established, the initial US-dollar based step represents EMEAP's first collaborative financial commitment.

International Monetary Fund

Although Australia's relationship with the IMF is conducted mainly through the Treasury, there are several areas where the RBA has a role. In the past year, these have been primarily in the debate on sovereign debt restructuring and in the provision of resources for technical assistance co-ordinated by the IMF.

Sovereign Debt Restructuring

The possible benefits from, and design for, a well-defined and predictable mechanism for working-out sovereign debt crises were placed on the international agenda in late 2001 in a speech by IMF First Deputy Managing Director, Anne Krueger. She proposed a statutory international system – a Sovereign Debt Restructuring Mechanism (SDRM) – that would be established by amending the IMF's Articles. In its initial form, the proposal entailed a significant role for the IMF in co-ordinating and approving restructurings, though later refinement of the proposal reduced the Fund's direct role to providing an independent judicial body to verify claims and settle disputes.

At the same time that the IMF was refining its proposal, there was a parallel push for a system where, rather than overriding the contractual terms of debt contracts, the contracts themselves would be

amended to include mechanisms to make it easier to restructure sovereign debt – referred to as collective action clauses (CACs). New bond contracts could, among other things, include terms which allowed decisions of a large majority of bondholders to bind the minority, reducing the incentives for minority bondholders to hold out for a better deal. A third approach, based on a code of conduct among lenders and borrowers, also gathered some momentum during the year.

The debate on these proposals was conducted in a number of forums in 2002/03, most importantly in the IMF itself and in the G20 (see below). In April 2003, the IMF's International Monetary and Financial Committee concluded that there was not enough support among members to move forward with the SDRM at this time. On the other hand, much progress was made on the more widespread acceptance of CACs in sovereign bond contracts. Beginning with Mexico in February 2003, several sovereigns have issued bonds containing CACs into the US market, including Brazil, Korea, South Africa and Uruguay (as part of a debt exchange).

The RBA was an active participant in the debate. An RBA research project supported the conclusion that collective action clauses do not increase borrowing costs for sovereign bond issuers, negating the concerns of many emerging market investors, as well as a number of sovereigns, that the CAC approach to restructuring would lead to higher borrowing costs for emerging markets. The RBA presented these and related findings in a number of international forums, including the G20 and the Reinventing Bretton Woods Committee.

IMF-Sponsored Technical and Financial Assistance

The Australian Government, under the *International Financial Agreements Act*, provides financial assistance from time to time to individual countries in conjunction with assistance programs from the IMF and other bodies. Sometimes this assistance is

provided by the RBA, as agent of the Government. The one outstanding example of such financial assistance in 2002/03 was the foreign exchange swap facility established with the Bank of Thailand in 1997, as part of a regional financing package in support of the program put in place by the IMF to assist Thailand in dealing with what became the Asian financial crisis. Drawings of US\$862 million were made under this facility up to mid 1999, and repayments began in early 2001. By the end of June 2003 only US\$43.8 million remained outstanding, with this amount repaid by mid July 2003.

During 2002/03, the RBA provided assistance in a training course in Singapore sponsored by the IMF, and in the reviews of Hong Kong SAR and Macedonia that were undertaken by the IMF under its Financial Sector Assessment Program.

Group of Twenty

The G20 was established in 1999 to bring together a cross-section of systemically significant economies to broaden dialogue on major economic and financial policy issues and to promote sustainable and equitable economic growth through international co-operation. The main meetings of the G20 are an annual meeting of finance ministers and central bank governors, at which Australia is represented by the Treasurer and the Governor, and bi-annual meetings of senior officials from participating countries, at which Australia is represented by Treasury and RBA staff. The G20 also sponsors occasional conferences on major issues, such as the conference on Globalisation, Living Standards and Inequality which was jointly hosted by the RBA and Treasury in Sydney in May 2002.

The focus of the G20 over the past year has been on members' experiences with globalisation and market reform. Group members finalised in 2002 case studies outlining their own – predominantly positive – experiences with globalisation. The present G20 agenda aims to build upon this work, with member countries undertaking further case studies on the role of financial sector institution-building in

promoting economic growth. These studies are due to be finalised later in 2003. An Australian study is being prepared jointly by the RBA and Treasury.

Other issues discussed by the G20 over the past year have included combating terrorist financing and money-laundering, improving the effectiveness of official development assistance, promoting international trade and investment flows and, as discussed above, new proposals on sovereign debt crisis prevention and resolution.

APEC

The RBA participates in the Finance Ministers' process within the APEC forum, together with Treasury. In the past year, the main contribution has been to act as Convenor of the Expert Panel for

Thailand in the APEC initiative on Securitisation and Credit Guarantee Markets in Asia.

Bilateral Relations and Technical Assistance

A large number of bilateral and informal relationships with regional central banks have been maintained. An important element of these bilateral linkages is the provision of technical assistance. Assistance in the past year was given to a number of central banks in the Asia-Pacific area, mainly in areas of liquidity management and securities markets. The RBA also provided technical experts to lecture at training courses run at the SEACEN (South East Asian Central Banks) Centre.