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**Statement by Ms. Mahasandana, Mr. Ong, and Ms. Susiandri on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive report and accompanying background papers as well as the useful outreach to our office. FSAP is an important element of the Fund's surveillance mandate, providing analysis of financial sectors and policy recommendations highly valued by the authorities. Thus, we welcome the fifth review of the FSAP which leverages the framework's in-built flexibility to meet with broader developments and evolving members' needs. **We support the main proposals of the 2021 FSAP Review and provide some comments for emphasis.**

General comments

We view that the three-pillar framework, which are risk analysis, oversight, and safety nets, continues to be fit-for-purpose. While new risks such as climate change, fintech, and cybersecurity, have emerged, these could be accommodated within the current framework.

We share staff's view that FSAPs in the next five years will face several common themes post-pandemic. That said, there will be a large divergence of the recovery both across and within countries. Hence, we call on FSAP teams to stand ready to tailor their assessments and policy advice for members at different recovery stages. Across the FSAP teams, there should be greater sharing of best practices and learning lessons of how different countries navigate the climb out of the pandemic.

Recommendation 1: Proposal to Strengthen Scoping

We agree with the proposal to strengthen the risk-focused approach to scope FSAP assessments, with the greater use of flexibility within the three-pillar framework in light of the evolving challenges facing member countries. Through this approach, we view that the IMF and member countries will be able to jointly identify more urgent and relevant risks which need to be prioritized in the FSAPs. Thus, scoping discussions and dialogue between the IMF and member authorities will be key in exercising this flexibility. This will, likewise, lead to a

more efficient use of the IMF's resources and to a more tailored recommendations based on country-specific needs. Taking into account different levels of development in financial system and institutional arrangements across jurisdictions, the scope of FSAP discussions should be customized accordingly, with those of EMDEs covering detailed supervisory standards assessments and institutional framework reviews, while those of AEs focusing more on risk-based thematic issues.

We agree with staff that the thematic approach could also be useful for conducting regional exercises in regions with strong financial linkages but without supra-national authorities. That said, staff should set clear guidelines for conducting the regional exercises on thematic topics and how staff identifies such regional groupings "with strong financial linkages but without supra-national authorities".

On the pillar of Risk Analysis, while we agree with the expanded scope of potential sources of financial stability risks, including new risk from digitalization, we view that greater consideration should also be given to Bigtechs and crypto-assets as they could also have significant implications to financial stability. Moreover, risks arising from interconnectedness between banks and financial market players that are outside of the regulatory perimeter merit attention. For jurisdictions with substantial Islamic financial system, it is proposed that the FSAP assessment also assesses the risk transmission channels, as it may differ based on the use of different contracts underlying the financial transactions.

On the resource implication, we compliment staff for being able to keep FSAP resource costs broadly flat, notwithstanding expanded coverage on a broader menu of topics due to new emerging risks and the growing list of risks to analyze, through the combination of pilots, rigorous prioritization efforts, leveraging the RAM, and increased thematic approach to help manage the scope of risk analysis

On the pillar of Oversight, the frameworks should respond to the risk priorities under the changing financial system landscape. FSAP should be adaptive and leverage relevant SSB initiatives in addressing the COVID-19 related risks and emerging risks. FSAP could also provide the reference of best practices from other international organizations such as the NGFS or other countries with more advanced development where standards and guidance are available. We also expect FSAP to contribute towards the closing the gaps of cyber resilience frameworks in AEs and EMDEs

On the pillar of Safety Nets, we have a few comments on the proposal to use the KA methodology as the assessment benchmark for insurance resolution frameworks in FSAPs and stand-alone standards assessment (paragraph 35). We agree with the proposed approach at this juncture. However,

- With the finalization of the Holistic Framework for Systemic Risk in the Insurance Sector ("Holistic Framework") by the IAIS in November 2019, the Insurance Core Principle (ICP) 12 on Exit from Market and Resolution has been enhanced to provide Standards and Guidance on the resolution of insurers. Hence, ICP 12 would be a relevant assessment benchmark to evaluate insurance resolution regimes as well.

- In light of the Holistic Framework, the FSB had suspended G-SII identification from the beginning of 2020. In 2021, FSB’s Cross-border Crisis Management Group for Insurers (“iCBCM”), in consultation with the IAIS, plans to compare the similarities and differences between the FSB KAs and the IAIS supervisory material. The analysis is meant to provide guidance for resolution authorities on the scope of application of the FSB KAs should G-SII identification be permanently discontinued in November 2022. The outcome of this work could subsequently affect the scope of application of the FSB KAs to insurers deemed to be systemically important. We suggest for staff to coordinate closely with the IAIS and FSB to evaluate the implications for FSAP assessment in this area.

On the insolvency framework, it is important to strengthen this framework, particularly in EMDEs, in anticipation of a rise in insolvencies and to reduce financial stability implications. However, the works might face some political challenges which require legislation changes. We encourage the Fund to closely collaborate with other partner, in particular the World Bank, to address this challenge.

Recommendation 2: Proposal to Strengthen Quantitative Toolkits

We welcome staff’s proposals to strengthen quantitative analysis in FSAPs, including efforts to enhance the macroprudential stress testing framework. We note that when identifying risks in non-bank financial sectors, specifically insurance, staff plan to focus more on cross-sectoral interactions and impacts on market which is broadly in-line with the IAIS Holistic Framework. In this light, staff should pay close attention to the developments in the IAIS holistic framework review to ensure that the Fund’s quantitative tools are aligned with international standards.

We also take note that quantitative methods in FSAPs have been adapted to support analysis of emerging risks. The quantitative tools should be tailored for each jurisdiction, taking into consideration country-specific factors and circumstance. Moreover, quantitative analysis, in particular for fintech, climate and cyber risks, has been limited partly due to data constraints. Thus, we support staff’s intention to continue to develop such tools while also considering jurisdiction’s readiness to incorporate such factor into the model and working to address some data gaps including by assisting the authorities to develop new data. On this approach, we underscore the importance of the Fund to help members in building such new data sets taking into account country’s capacity without overburdening authorities.

We see that analytical tools developed by the Fund would be highly valuable inputs to support member countries in building their capacity. In this regard, we suggest the Fund to share methodological tools to the membership to strengthen their own surveillance system coupled with TA missions.

Recommendation 3: Proposals to Increase Traction

We support the various proposed works to increase traction of FSAPs. While authorities already report high levels of satisfaction with the FSAP, there is room to gain further traction, particularly by implementing the improvement for the FSSA to explicitly reflect the authorities’ views. Given the rapid development in many of the new issues that FSAPs would address, it

would be useful to take into account, and explicitly document, alternative perspectives from the authorities, including clarifying the factors that may impede implementation of the recommendations, technical disagreements or divergent views.

We also welcome the efforts to further integrate FSAP and Article IV surveillance. The pandemic has introduced various financial vulnerabilities, including rising corporate distress and intensified bank-sovereign nexus, that will also have macroeconomic implications and need to be examined more timely and thoroughly during Article IV consultations. Country teams will therefore need to be equipped with a more comprehensive toolkit, comprising both quantitative and qualitative instruments, to perform such analyses meaningfully.

Specifically, given the heightened risks from nonfinancial sectors (NFCs) as a result of pandemic, we fully support staff's ongoing work to develop stress testing tools for NFCs as well as further analyze the link with the banking sector. To this end, staff should take into consideration the granularities and availability of data of each jurisdiction before conducting the analysis. Having said that, we encourage staff to also complement the quantitative analysis of NFCs with a qualitative analysis which could capture their specific characteristics to get a broad picture when assessing their vulnerabilities.

Recommendation 4: Proposal on Country Participation

We welcome staff's proposal on participation in the FSAP, including by strengthening the risk-based approach to surveillance. We view that staff's proposal would (a) prudently maintain the assessment frequency for the most systemic SIFS in light of current elevated financial stability risks (32 jurisdictions in the refreshed list), while (b) also cautiously expanding the list of jurisdictions to enhance coverage of the global financial system (the newly added 15 jurisdictions). This approach reflects an appropriate balance, at this *current* juncture, between the need for the mandatory FSAP to be more risk-based and minimizing the budget implication.

However, we view that the criteria in determining the jurisdictions with mandatory assessments should be periodically reviewed and refined considering that financial sectors and markets constantly evolve, and new risks and vulnerabilities are likely to emerge. Moreover, we continue to see the scope for the Fund to further refine its risk-based approach to mandatory FSAPs in the medium to long-term, for instance through additional tiering of the assessment frequency for even the most systemic SIFS.

Resource Implication

We welcome staff's sharing that the proposed expansion in the number of FSAP mandatory participations can be managed without reducing opportunities for voluntary assessments by reprioritization within MCM's budget. Staff highlighted that FSSR has helped in achieving the supply-demand balance of FSAPs during 2014 - 2019. We encourage staff to continue to explore ways to better leverage this product to help our less-developed members, through the balanced mix of surveillance and TA.