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**Statement by Mr. Bhalla and Mr. Singh on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank the Staff for their comprehensive set of papers and their perseverance and hard work spread over several months. We believe that the near-term priorities of the FSAP should be focussed on critically assessing the risks posed by the pandemic, dissect the nature of the risk as transitory versus durable, and advise the membership on how to prudently respond to such risks. Also, there should be a clear hierarchy of the near-term and the medium-to-long-term priorities in the FSAP missions. We could also think of separating the fast-moving risks from those which are slow-moving and are difficult to assess/quantify over a short-to-medium horizon. For instance, risks arising from cyber and fintech may have strong consequences on the financial landscape and markets in the short to medium run. In contrast, the risks emanating from climate change and an aging population are slow-moving over a long horizon, and therefore, need to be quantified appropriately. One will have to also think through how to integrate them into the FSAP horizon. The design of the FSAP surveillance for individual jurisdictions should also recognize the inherent diversities in the financial structures viz., bank-based versus market-based financial systems, public versus private ownership, and the dominance of banks versus non-bank financial entities.

Issues of discussion

1. Do Directors agree with the proposals to further strengthen the risk-focused approach to scoping FSAs, making even greater use of flexibility within the three-pillar framework to customize scope in light of the evolving financial challenges facing member countries, including the impact of the Covid-19 crisis?

We generally agree with the proposals to further strengthen the risk-focused approach to scoping FSAs. The specific assessment of financial safety nets (the third pillar) becomes particularly relevant in the post-COVID world, as the financial system looks to assess the impact of the pandemic on the obligor and looks for orderly resolution. **A significant**

part of risk assessment (pillar 1) may be related to the capacity of the regulatory regime to implement an orderly resolution regime for all classes of obligors, both retail and wholesale. The Overview paper observes that “Staff will leverage the findings of recent detailed standards assessments to tailor the scope of the FSAP and increase its thematic focus.” (Pg. 25) However, formal, graded standard assessments are conducted during FSAPs. Thus, such formal, graded standard assessments may not be available during the scoping mission, which takes place at the beginning of the FSAP exercise.

2. Do Directors agree with the proposals to strengthen quantitative analysis in FSAPs, in particular, to improve the modelling of interconnectedness, nonbanks, and macro-financial feedback effects, the analysis of new issues – such as climate risk, cyber, and fintech– and the calibration of macroprudential policies?

- It is important to note that the robustness of advanced quantitative models also depends on data availability and its quality. In EMDEs, this could raise some concerns, including the issues of data confidentiality. **It is proposed that the scoping exercise while deciding on models and areas in focus, may incorporate these factors.**
- The review attempts to expand its arsenal of quantitative tools to better capture vulnerabilities in non-bank financial intermediaries (NBFIs) and their interconnectedness with markets and banks. The country-specific FSAPs, which undertake stress tests in the NBFI space have done so for the insurance sector (most common), asset managers, and pension funds. However, the NBFI sector in EMDEs like India comprises Non-banking financial companies (NBFC) which largely perform credit intermediation functions, similar to banks. *How could such a group be included in the risk analysis for NBFIs?*
- The FSAP Analytical Focus survey notes that participants did not identify climate and Fintech as strong enough areas of focus in 2019, and the focus on these aspects further decreased in 2020. Further focus on new areas - climate change, cyber risks, and fintech - may involve **data challenges** for several EMDEs. While the data relating to climate risks may be a challenge in EMDEs, transaction data related to fintech may raise confidentiality concerns as well. Such concerns may get further aggravated, given the access issues, while working remotely.
- Fintech results in unbundling of financial services, which increase nodes of operational points of failure. Lack of adequate regulatory oversight in this space raises concerns of online privacy, transparency, and accountability standards. More broadly, Fintech is likely to have a systemic impact through disintermediation of incumbents and disaggregation of financial services. **The role of BigTechs in financial and payment systems may also need to be quantitatively assessed, given their market power and mass data collection practices.**
- It is understood that extensive quantitative analysis will be undertaken to guide the macroprudential policy prescriptions. In EMDEs, although a well-laid macroprudential framework may not be evident, the macroprudential tools are used regularly to achieve similar objectives. In this context, **while the use of models to arrive at prescriptions may be acceptable, due care would need to be taken while making macroprudential policy recommendations to avoid overlaps.**

- The Overview paper states “Enhanced quantitative tools will be complemented by improvements in tool efficiency through standardization and automation. These efforts also help to ensure cross-country comparability.”(pg. 27). However, this standardization may ignore country-specific factors and could lead to spurious conclusions and there is a need to guard against this risk.

3. Do Directors agree with the operational proposals to increase traction by better integration with Article IV reports and increasing Board engagement?

It is felt that post-FSAP, the recommendations, their follow-up, and compliance with the recommendations in the FSAP should be diligently discussed with by the Article IV mission. All the proposals regarding greater consultation between Article IV and FSAP teams are necessary.

On early engagement in the preparation of Article IV consultations, the paper says, “The details are discussed in the CSR paper.” The CSR Report observes that “Analysis would be supported by early engagement with authorities on spillover issues and greater use of the Fund’s convening role for constructive dialogue between spillover producing and receiving countries.” While spillovers do pose risks to a country, there could be additional sources of risk, which need to be considered.

4. Do Directors agree with the proposal to strengthen the risk-based approach to mandatory assessments by adding an additional level of risk tolerance to identify additional jurisdictions assessed at a lower frequency?

Prioritizing assessment of risk elements would be the key to better utilize the Fund's resources. The COVID-19 crisis also shows that significant risk to financial stability could emanate from areas outside of the financial system and such possibilities need to be included in FSAP assessments.

5. Do Directors agree with the proposal to clarify expectations for supra-national authorities’ participation in assessments?

We agree with the staff proposals that clarify the position on the participation of supra-national authorities in the assessment. When a systematically important financial sector delegates policies in certain areas to the supra-national entity, such as in currency unions, the origination of risk elements could shift outside the country in focus. Without meaningful assessment at the supra-national level, the assessment of the country involved would be partial.

Other comments

- The proposals for a review of FSAP are broadly aligned with new emerging challenges like the rise of new technology and climate risks, among others. However, the suggested improvements are to be seen mostly from a macro-stability perspective, particularly in the context of the emerging linkages/interconnectedness of various

elements of risks with the broader economy. It is felt that the review must **focus on the effective use of new tools to alleviate data constraints and technical capabilities that can be used for ongoing monitoring of risks and vulnerabilities.**

- Given the increased importance of the Fintech sector in providing financial services, the related risks need to be assessed by the FSAP. **As many fintech entities do not fall under the direct purview of central banks and operate outside the compliance/ reporting framework, gathering sector-wise data may be a challenge.**