



Executive Board Minutes 21/46-1

May 12, 2021–10:00 a.m.

2021 Financial Sector Assessment Program Review—Towards a More Stable and Sustainable Financial System

Documents: SM/21/52 and Cor.1 and Sup.1; SM/21/53; SM/21/54; SM/21/55 and Cor.1

Staff: Morsink, MCM; Kapan, MCM; Haksar, MCM; Oura, MCM

Length: 1 hour, 58 minutes

ISSUED: September 23, 2022
APPROVAL: September 30, 2022

CEDA OGADA
Secretary

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¹ Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary “gray” or “buff” statements by Executive Directors and staff’s responses to Directors’ technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair’s “sense of the meeting” or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF’s Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors welcomed the Financial Sector Assessment Program (FSAP) Review and its background papers. They noted that the FSAP has made an important contribution to Fund surveillance and capacity development. They also noted the potential strains facing financial systems across the Fund membership in the wake of the COVID-19 pandemic which have highlighted the significance of risks from the nonfinancial sector and vulnerabilities in nonbank financial institutions (NBFIs) and financial market infrastructures. In addition, the membership is facing important new opportunities and challenges, including from climate change and digitalization.

Directors emphasized that the three-pillar approach to conducting FSAPs—focusing on risk analysis, oversight, and safety nets—has worked well. The risk-focused approach to scoping Financial Stability Assessments (FSA) has provided flexibility to address relevant risks while helping to prioritize and contain the program's resource footprint in the face of increasingly complex financial stability challenges since the previous review. Going forward, greater use could be made of the flexibility within the framework when scoping issues for FSAPs, balancing current coverage with emerging risks and issues, with continued tailoring of FSAPs to country specifics, effective prioritization, and in close consultation with the country authorities. The risk-based approach would help decide whether to conduct a full standard assessment versus a focused review and leverage the findings of recent standards assessment to tailor the scope of FSAs. Directors endorsed the Key Attributes of Effective Resolution Regimes as the assessment benchmark for insurance resolution frameworks in FSAPs and stand-alone assessments.

Directors welcomed ongoing efforts to further enrich the FSAP's risk analysis toolkit. They stressed the importance of strengthening the development of tools to assess interactions between solvency, liquidity, and contagion risks, vulnerabilities among NBFIs, risks in nonfinancial sectors, interconnectedness, macrofinancial interactions, the macroprudential policy stance and new risks. Directors emphasized the importance of continued efforts to increase the efficiency, dissemination, and ease of use of the FSAP toolkit and to ease data constraints. They also stressed the need for continued efforts to strengthen the toolkit to enhance the assessment of financial vulnerabilities in low and lower-middle income countries.

Directors welcomed the proposals to improve the traction of FSAPs. While most FSAP recommendations were implemented, challenges arose when members faced political economy constraints or where there may have been differences in technical views. In this context, Directors welcomed the introduction of the authorities' views in FSSAs. Directors also welcomed efforts to leverage the FSAP to develop risk analysis tools for use in bilateral surveillance and looked forward to further progress in this direction. They emphasized the importance of closer integration of the Article IV consultation process with the FSAP.

Directors welcomed the update and expansion of the list of jurisdictions with Systemically Important Financial Sectors (SIFS) that are subject to periodic mandatory FSAs, and a few Directors recalled that Fund policy requires the periodic review of the list

and assessment frequency. They recognized that the cost of the FSAP had been broadly stable over time. Going forward, the slight cost increase from expanding the list of mandatory FSAs while maintaining space for voluntary FSAs could be accommodated within the current resource envelope.

Directors clarified the framework for expected periodic FSAs with supra-national authorities. A periodic FSA with a supra-national authority would be conducted if at least one member with a SIFS has delegated financial sector policies to the supra-national authority. The individual member country FSAs would be scoped to leverage the planned work on the supra-national FSA to avoid duplication.

EXECUTIVE BOARD DECISIONS

The Executive Board took the following decisions:

2021 Financial Sector Assessment Program Review—Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions

1. The Fund takes note of the Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions (the “Key Attributes”) and the Key Attributes Assessment Methodology for the Insurance Sector.
2. The Fund endorses the Key Attributes as they apply to insurance resolution regimes and the related assessment methodology for the purposes of undertaking assessments in the context of the Financial Sector Assessment Program (FSAP) and stand-alone assessments. (SM/21/52, 04/16/21)

Decision No. 17040-(21/46), adopted
May 12, 2021

2021 Financial Sector Assessment Program Review—Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance—Attachment ²

Decision Number 14736-(10/92), as amended by Decision No. 15495-(13/111), is hereby further amended to reflect the changes set forth in the Annex to this Decision. (SM/21/52, 04/16/21)

Decision No. 17041-(21/46), adopted
May 12, 2021

² The referenced attachment to the decision is included in an annex to these minutes.

EXECUTIVE BOARD ATTENDANCE³

T. Zhang, Acting Chair

Executive Directors

A. Andrianarivelo (AF)

C. Huh (AP)

A. Bevilaqua (BR)

Z. Jin (CC)

L. Levonian (CO)

D. Palotai (EC)

A. Buisse (FF)

S. Bhalla (IN)

T. Tanaka (JA)

H. Hosseini (MD)

P. Hilbers (NE)

M. Poso (NO)

A. Mozhin (RU)

A. Mahasandana (ST)

E. Shortino (US)

Alternate Executive Directors

W. Nakunyada (AE)

L. Herrera (AG)

A. Guerra (CE)

K. Merk (GR)

M. Massourakis (IT)

A. Alhosani (MI)

B. Alhomaly (SA)

M. Peter (SZ)

D. Ronicle (UK)

C. Ogada, Acting Secretary

S. Kalra, Summing Up Officer

R. Smith Yee / D. Alcantara, Board Operations Officers

L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Asia and Pacific Department: A. Gulde, E. Loukoianova, J. Turunen, J. Walsh.

Communications Department: E. Buckley. European Central Bank: K. Nikolaou, R. Rueffer.

European Department: V. Guzzo, M. Segoviano Basurto. Independent Evaluation Office:

³ For countries in each constituency, please see the Constituency Codes in the annex.

C. Collyns. Information Technology Department: H. Maddineni, C. Parent. Legal Department: J. Ams, F. Fernando, O. Kroytor, D. McDonnell, N. Rendak, B. Steinki. Middle East and Central Asia Department: A. Al-Eyd, J. Menkulasi, T. Mirzoev, A. Sadikov. Monetary and Capital Markets Department: T. Adrian, P. Ananthkrishnan, U. Das, V. Haksar, T. Kapan, I. Krznar, I. Lukonga, P. Lukyantsau, J. Morsink, J. Nelmes, P. Nowak, H. Oura. Office of Budget and Planning: A. Salerno, A. Schimmelpfennig, M. Shannon. Office of Executive Directors: A. Alaqla, C. Cruz. Office of Internal Audit and Inspection: B. Fosu. Office of Risk Management: B. Boulwood, M. Dal Corso. Strategy, Policy, and Review Department: F. Bornhorst, M. Cihak, S. Panth, F. Valencia Palau. Statistics Department: M. Kutlukaya, D. Marchettini, J. Matz, G. Quiros Romero, P. Tumbarello. World Bank Group: C. Mousset, J. Pesme. Executive Director: S. Chodos (AG), I. Mannathoko (AE), M. Mahmoud (MI), P. Moreno (CE), M. Mouminah (SA), S. Riach (UK), P. Trabinski (SZ), R. von Kleist (GR). Alternate Executive Director: H. Azal (EC), M. El Qorchi (MD), F. Fuentes (BR), S. Geadah (MI), A. Grant (AP), Y. Indraratna (IN), C. Just (EC), F. Mochtar (ST), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), J. Romero (CE), P. Rozan (FF), B. Saraiva (BR), J. Sigurgeirsson (NO), F. Sylla (AF), C. White (AP). Senior Advisors to Executive Directors: W. Abdelati (MI), S. Ahmed (MD), H. Andrianometiana (AF), E. Cartagena (CE), M. Choueiri (MI), J. Damgaard (NO), M. Gilliot (FF), R. Goyal (IN), P. Harvan (EC), O. Hendrick (AG), M. Ismail (AE), L. Johnson (AP), S. Keshava (SA), B. Lischinsky (AG), R. Mahabir (BR), L. Marek (EC), S. Naka (JA), T. Nguema-Affane (AF), D. Ong (ST), S. Potapov (RU), A. Sattler (GR), M. Scholer (NE), S. Senich (US), F. Spadafora (IT), N. Thiruvankadam (IN), G. Vasishtha (CO), R. Velloso (BR), L. Voinea (NE), C. Wehrle (SZ), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: F. Al-Kohlany (MI), P. Al-Riffai (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), Gonaya Basutli (AE), C. Becker (AP), S. Belhaj (MD), A. Biriukv (RU), B. Boostani (MD), I. Bustillo (AG), L. Cerami (IT), D. Cools (NE), J. Corvalan (AG), K. Dacharux (ST), F. Dogan (EC), D. Fadhel (MI), K. Florestal (BR), K. Kuretani (JA), M. Merhi (MI), R. Moral Betere (CE), A. Nainda (AE), B. Piasecki (SZ), A. Ribeiro Mateus (IT), D. Shestakov (RU), B. Singh (IN), D. Susiandri (ST), I. Valdes Fernandez (NO), C. Westphal (US), J. Yoo (AP), T. Abalala (SA), J. Barroso (BR), M. Law (CC), F. Lopez (CE).

DISCUSSION RECORD⁴

The Acting Chair (Mr. Zhang):

The purpose of today's session is to try to conclude the review of FSAP. As we know, the review started with scoping discussions back in March 2019. That was more than two years ago. Since then, we have had significant engagement with the Board, including the informal Board meetings, technical seminars and iLab sessions, so all of us have benefited from the close dialogue with the Board, and we are glad for the strong support for the review and for staff's proposals indicated in Directors' statements.

The FSAP has made important progress since the 2014 review. The FSAPs now pay more attention to nonbank financial institutions and interconnectedness, as well as macroprudential frameworks and policies. Standards and codes assessments have become more risk-based following the guidance set out in the 2017 Board papers.

Looking around the world, the financial stability landscape continues to evolve. The pandemic has elevated financial vulnerabilities, including from potential lasting scarring effects. Global regulatory reforms continue and also have become more complex. Emerging risks arise from climate change and potential risks from financial digitalization. We are glad to see the strong support in Directors' statement for the five objectives of this review. With many new challenges, as we mentioned earlier, in a constrained resource environment, ruthless prioritization within the FSAP scoping process will remain critical to balance the parameters of the risk assessment and available surveillance resources. We discussed that earlier this week.

The Deputy Director of the Monetary and Capital Markets Department (Mr. Morsink):

I would like to begin by thanking Directors for their high degree of engagement on the FSAP review over the past couple years. Directors have shared their ideas and suggestions in many fora, including informal Board meetings, iLab sessions, and bilateral meetings. We have incorporated many of these ideas and suggestions, and as a result, the review is much better than it otherwise would have been.

I would also like to acknowledge the excellent collaboration on the FSAP review of many colleagues in MCM, in other departments, and at the World Bank, and especially the work of the core team of Mr. Vikram Haksar, Ms. Hiroko Oura, and Mr. Tumer Kapan and former chief of MCM's Financial Sector Assessments and Policies Division, Mr. Martin Cihak.

⁴ Edited for clarity.

Turning to Directors' questions, there were several questions about resources. First, about the resource needs in emerging areas such as climate risk and digitalization. We are already doing some work in FSAPs in these areas. Specifically, we are currently doing about two pilot assessments per year in climate risk, fintech, and cyber risk. For example, in the area of climate risk, the recent Norway Financial System Stability Assessment (FSSA) contained an assessment of transition risks, and the recent Philippines FSSA contained an assessment of physical risk. Going forward, we aim to continue with about two pilot assessments per year in each area. Ideally, we would do in-depth assessments of climate risks and digitalization in every FSAP. Our ability to scale up work in climate risk and digitalization will depend on whether and, if so by how much, the Board approves a structural budget increase. My understanding is that the Board will have the opportunity to discuss a potential structural budget increase in the summer.

Relatedly, there was a question about how we expect FSAP costs to evolve over the coming years. If the Board does not approve a structural budget increase for climate and digitalization, then we would expect FSAP costs in terms of FTEs to remain broadly the same as they are now. If the Board does approve a structural budget increase, then we would expect that some of the additional resources would be used to strengthen the work on climate and digitalization in FSAPs.

Regarding the resource costs of expanding the coverage of mandatory financial stability assessments, staff estimates that this cost is small because most of the additional jurisdictions that will be covered already request voluntary FSAPs. To maintain the availability of voluntary FSAPs at their current level for other members, staff estimates that the net cost of the additional mandatory FSAPs would be about 1.5 FTEs per year, which is only about half a percent of MCM's budget. We believe that this small net cost can be addressed by small reprioritizations within MCM's budget.

Regarding the resource cost of having the area department mission chief attend the concluding meeting of the FSAP mission, staff estimates that the cost would be small. With remote missions, the cost is just the amount of time that the area department mission chief would spend to attend the concluding meeting. We will have to see whether this modality can continue once mission travel resumes. Even with travel, the cost would be relatively small.

On both the mandatory coverage and the area department mission chief participation, if the resource costs turn out to be larger than we currently expect, then staff would return to the Board with a request for additional resources as part of the annual budget cycle.

The staff representative from the Monetary and Capital Markets Department (Mr. Haksar):

Several Directors asked about approaches and challenges for considering climate risks in FSAPs, so we would like to offer a few remarks on the matter. On the climate risk diagnostic, the expectation is that this will help FSAP teams judge climate risks that are potentially material for the Financial Stability Assessment of the jurisdiction concerned, and we would consider this part of the scoping work of the FSAP to judge relevant risks. The risk assessment would also inform judgments about the extent FSAPs would focus on physical versus transitional risks or both, including potential spillover risks.

On the scenario design, including for carbon price paths, we are advising teams currently preparing FSAPs to consider using the standardized scenarios prepared by the NGFS with new more granular scenarios expected. Teams would also have the option to conduct sensitivity analysis and alternative carbon price scenarios and paths for carbon linked assess prices, and teams would make adjustments deemed relevant for country-specific circumstances in close consultation with the authorities as a normal part of the FSAP dialogue.

There were several questions about our engagement with other organizations, and so on broader consultation, we are participating actively in the various central bank Network for Greening the Financial System (NGFS) workstreams related to climate and the financial sector. The NGFS is advancing work rapidly on regulation and supervision of climate-related risks in the financial system, stress testing, including mapping, climate science and different temperature paths into country-specific macrofinancial scenarios, scaling up green finance, and bridging data gaps through better disclosure of climate-related financial risks.

We are working very closely with our colleagues at the World Bank on climate and other emerging risks topics as well on the climate side, particularly in physical risk diagnosis and risk analysis, leveraging their extensive experience with work on natural disasters among other areas. The collaboration is very rich. We have also engaged with colleagues from the Intergovernmental Panel on Climate Change (IPCC).

Lastly, data gaps are a clear challenge for the work on climate risk assessments in FSAPs, as they are in other emerging areas. The staff are coordinating work across departments to consider sources of data for climate change analysis, leveraging also the very important dashboard put together by the Statistics Department with an emphasis on the context of the FSAP on exploring even more granular data that is currently being used by central banks. Further progress is needed here, including in the context of the NGFS

workstream on disclosures, and FSAP teams will need to be agile to country-specific resources that may be available on climate risk data and risk assessments.

Mr. Ronicle:

Let me start by commending Mr. Morsink and his team for bringing this review to a very positive conclusion. It has not always been easy, and we very much appreciate their perseverance and tireless engagement with this chair. We issued a detailed and supportive gray statement. This morning I would like to underscore three points, not least in response to Directors' gray statements.

First, this chair firmly believes that the FSAP is a global public good. In assessing financial risks and adherence to standards, it helps foster the trust that is required to underpin an open and integrated global financial system. To do that credibly, the FSAP needs to be both rigorous and independent. That requires extensive engagement with the authorities and exercises such as stress tests that can appear duplicative. We recognize that that can feel burdensome, especially for countries like the UK that host the world's largest financial centers. We think the gain is worth it. After all, the global financial crisis found us all asleep at the wheel, to the great detriment of ourselves and the global economy. We cannot afford to become complacent again. The best way to avoid that is rigorous and independent peer review of the most systemic jurisdictions at the five-year frequency, a commitment all FSB members have made.

Second, the great challenge following the financial crisis was to strengthen our prudential frameworks and standards. The pandemic has revealed some issues in those frameworks, for example, in buffer usability and nonbank financial institutions. Those issues aside, the post-financial crisis reforms look to have been successful so far, and that reform effort is now largely complete in many countries. Instead, new challenges have come to the fore. Exiting the pandemic will require close scrutiny of risks in the traditional financial sector, as well as households, corporates, and market-based finance. This requires two shifts for IMF financial surveillance.

First, where standards are met, a shift to a greater focus on risks and emerging vulnerabilities. Second, consistent engagement across all our surveillance products. The proposals here and the joint proposals with the CSR will be crucial to the shift to identify monetary risks, track efforts to mitigate them, and provide advice on calibrating macroprudential policies. From our perspective, these proposals are ambitious and deliver on the IEO's recommendations, for which we are grateful, though naturally we will need to consider the resource implications alongside other demands through the budget process.

Third and finally, a specific set of risks, including cyber, fintech, and, most importantly, climate will need a deeper engagement from the Fund. I agree with other Directors that these are frontier topics where we are still feeling our way but disagree that the right approach would be for the Fund to sit back and wait for agreements on standards. Given the accelerating progress on actions to address climate change, transition risks arising across the membership and physical risks continue to pose a challenge. This chair expects that all FSAPs will need to consider climate risks, something the new climate financial risk diagnostic tool will help with. That does not mean it is the Fund's role to set standards in these areas, but it is the Fund's role to try to understand whether these risks are macrocritical and, if so, to think about how they ought to be managed. That should be part of a collaborative efforts with national authorities, standard setters, and networks like the NGFS; and FSAPs will be an important part of the learning process for all of us. Overall, I thought the staff answers to technical questions in this area were very encouraging.

Ms. Shortino:

I want to thank staff for the preparations and all the extensive engagement and completely agree that a lot of feedback was taken on board through this process and really do appreciate that. I will stick to just a few key points.

First, I wanted to say that we do agree that the existing three-pillar framework is relevant and flexible enough to accommodate coverage of issues such as climate, cyber, and fintech where these risks are macrocritical, but we do very much agree that in many, many cases these risks are macrocritical, and we strongly support efforts to integrate climate considerations into FSAPs, particularly physical and transition risks.

However, we note that climate risk analysis should remain voluntary, and there should be strong collaboration with other organizations, particularly with the financial sector standard-setting bodies and the World Bank. Similar to our comment during the CSR Board on Monday, we would welcome more information on whether management have considered establishing a framework to help ensure such collaboration.

In addition, unlike Mr. Ronicle, I just want to reiterate my authorities' concerns around the formal recommendations in the absence of international standards. In particular, we feel strongly that follow-up of FSAP recommendations in Article IVs should only apply to those recommendations that are based and grounded in international standards, and we should be very cautious about formal recommendations that may front run or conflict with

standards that are in the process of being developed. This is a sensitive issue, but I think we can find a way forward on it.

Third, on participation, we can go along with the new proposal, which we do find to be a reasonable compromise, but do want to agree with others that voluntary FSAPs should remain a priority. I am pleased to hear that many of the FSAPs that will be in the expanded list are ones that are already being done voluntarily, but there may be others that come up. As countries emerge from the pandemic, I could see more authorities seeking voluntary FSAPs to better understand their financial sector vulnerabilities.

I also want to echo Ms. Levonian's point that we welcome clarification around the participation of supra-national authorities and agree that a separate FSAP is warranted in cases where financial sector oversight has been allocated to supra-national authorities, such as in the euro area.

Finally, briefly on resources, I was a little troubled by the point made just now that if costs do end up being higher for some of these expanded participation lists, staff will seek additional resources in the budget process. We will no doubt see tradeoffs that will need to be faced in attempting to respond to all voluntary FSAP requests, cover all of the core risks, add coverage of new risks, but we are concerned about there being additional resource requests coming on top of the structural budget increase we are considering this summer. To that end, I would just urge staff to consider more ways to streamline existing FSAPs. I do think that there is scope to eliminate duplicative stress tests in jurisdictions with well-developed stress testing frameworks but also to agree to the initially agreed scope of FSAPs.

Mr. Bevilaqua:

This is a very important Board meeting. We arrive at the end of this Review with a substantial material for future reference and with a better understanding and vision about the FSAP for the forthcoming period. We issued a comprehensive and broadly supportive Gray statement, and I want to make a few comments for emphasis.

First, it is clear that the FSAP is a key part of our surveillance toolkit and that it complements well Article IV consultations, strengthening macrofinancial surveillance on both more structural and more conjunctural issues. FSAPs already provide a well-regarded service for the membership and this Review can improve but should not overhaul the Program.

Looking ahead, it is clear that macrofinancial surveillance should remain risk-based and focused on the substantial challenges associated with exiting the pandemic. With the pandemic and vaccination evolving in a diverse way across the globe, recovery will take place at different paces. This

will be the main factor shaping the macrofinancial landscape in the impending period, and the membership would certainly benefit from a well-tailored combination of FSAPs and Article IVs with appropriate emphasis on macrofinancial issues.

Other trends (like climate change and digitalization) should be monitored, but will most likely have a secondary role in shaping the landscape. Moreover, the combination of macro-criticality and Fund's expertise strongly advises towards focusing our macrofinancial surveillance on issues in which the IMF has the most value added and can effectively make a difference for our membership. Trying to bring a broad array of issues to our main surveillance dish risks diluting our capacity to contribute in an influential way in the policy dialogue.

Moreover, building in-house expertise is not a trivial task. The case of macrofinancial expertise cannot be easily transplanted. It took a substantial effort from the Fund to raise its knowledge and capacity on this field, but this was, to start with, an area at the very core of the IMF mandate, in which the Fund had always been involved and had a significant initial capacity. In any case, introducing one of the so-called emerging topics in a specific FSAP must first pass the macro-criticality criteria and should always derive from an open dialogue with the authorities.

I also want to highlight our full agreement with the proposal to have an "authorities views" section in the FSSA. It substantially enriches the document for the reader and the authorities will certainly appreciate the fact that their views are clearly and faithfully conveyed to the public at large. Given that there is an ample presumption of publication of other FSAP documents, it would be reasonable to have such an "authorities views" section in every FSAP document.

Finally, regarding mandatory FSAPs I'm still convinced that a risk-based approach yielding at least three different tiers of countries with mandatory FSAPs at different frequencies is the best framework. I'll go with consensus this time, but I sincerely hope we can address this issue in a more fundamental way in the next review. With these remarks, I want only to reiterate at this point our great appreciation for the tremendous job done by staff in this review.

Ms. Levonian:

I would like to join Mr. Bevilaqua and others in sincerely thanking staff for excellent papers and the close engagement with the Board over the course of the FSAP review. We were also very pleased with the close collaboration with the CSR. We agree that future FSAPs will need to pay close attention to pandemic-related challenges and that the current three-pillar

framework is flexible enough to adapt the assessments to each country's circumstances, new financial developments, and emerging risks. We have issued a detailed gray statement, so I will try to be brief.

First, better integration on Article IV and FSAPs and strengthening the analytical framework are key to enhancing financial surveillance. We welcome the careful consideration of this important issue in close coordination with the CSR and like Mr. Ronicle, believe that staff's proposal does justice to the IEO's recommendation on this topic.

Second, we stress that better integration of financial surveillance with CD is critical for strengthening traction of policy advice. As we noted in the CSR discussion, for countries with capacity constraints, policy advice needs to be well tailored, hands on, and accompanied by a clear roadmap for well-sequenced TA.

Third, like Ms. Shortino, we continue to place a priority on greater access to voluntary FSAPs and financial sector expertise for the broader membership, as the pandemic may create further challenges for financial sectors in EMDEs. We also support staff's proposal to sharpen the criteria for voluntary assessments.

Finally, the overall resource implications of the FSAP review and the CSR will need to be discussed as part of the medium-term budget process. According to the CSR, 24 additional FTEs will be needed to better integrate macrofinancial analysis in Article IVs. At the same time, the need to expand coverage of issues like we have discussed, climate change, fintech, and digitization, is placing additional demand on MCM, as well as the Fund's resources more generally. On these issues, the Fund should clearly establish the areas where in-house expertise needs to be developed and where external collaboration makes more sense.

We look forward to considering these budget implications, along with those from other major workstreams, in the budget discussions later this year.

Mr. Poso:

We have issued a comprehensive gray statement with Mr. Buisse, Mr. Fanizza, Mr. Hilbers, and Mr. Merk; I will only make a few points for emphasis.

We welcome the proposals for further strengthening the FSAP's role in the Fund's efforts towards building more resilient and sustainable financial systems. With its in-depth assessments of the members' financial sectors and increased focus on macrofinancial linkages, the FSAP is critically important analytical product that goes to the core of the Fund's mandate.

We strongly support the Fund's practice of conducting mandatory FSSAs for countries with systemically important financial sectors, while maintaining access to the FSAPs for all other members. We welcome the updates to the methodology of identifying systemic jurisdictions and support strengthening a risk-based approach by adding an extra level of risk tolerance to identify additional jurisdictions to be assessed at the lower frequency. We also support keeping the five-year minimum cycle for the S32 jurisdictions and adopting a 10-year cycle for the additional 15 jurisdictions.

Like Ms. Shortino, we consider supra-national FSAPs, focusing on region-wide risks and institutions such as the euro area, as crucial complements to national FSAPs. The national FSAPs should focus on country-specific issues, idiosyncratic risks, and national macroprudential policies. We welcome the clarification on expectations for supra-national authorities' participation in assessments. We also underline that regional risk analyses and stress tests should complement formal national FSAPs in strongly interlinked regions. Before COVID-19, we volunteered for a pilot regional risk assessment and stress testing exercise to complement the national FSAPs in the Nordic-Baltic region, which we hope will take place once the crisis passes.

In our view, financial surveillance, including FSAPs, is a vital part of the Fund's work, which warrants adequate resources. Nevertheless, we call for more cost efficient FSAPs via better planning and focus. The utilization of available data and relevant information from other competent institutions should be explored further to relieve the financial and administrative burden of FSAPs on both the Fund staff and national authorities. FSAP questionnaires and stress tests could also be streamlined further.

Finally, based on recent experiences, we think that virtual tools can complement on-site missions positively in a more hybrid model going forward.

Mr. Hilbers:

We signed a joint gray with other European Directors and would like to make some additional points based in particular on the experiences and feedback from the countries in my constituency.

First, let me start by emphasizing that my authorities are generally very supportive of this program and the proposals discussed today. FSAPs have a high value added, as they can provide early warnings and well-documented policy recommendations for financial sectors, which are key to macrofinancial stability. While the FSAP is a somewhat special and unique product, it is certainly not a stand-alone program, and we are a strong

supporter of both an effective integration of FSAPs in Article IVs and also of enhancing the link between FSAPs and multilateral surveillance, especially through the GFSR.

Second, we welcome the proposed risk-based approach and the flexibility to deliver the most relevant issues in an FSAP. That includes also ambitious steps to firmly integrate climate-related issues into the FSAP framework.

Third, we are pleased with the proposed country distribution for the mandatory FSAPs by adding additional jurisdictions, and in particular, we are happy with the inclusion of Romania in this group of countries with systemically important financial sectors. At the same time, voluntary FSAPs are very important to my constituency as well, as they contribute to developing and stabilizing financial sectors in emerging economies. Plus, risks in smaller countries can become systemically relevant as unfortunately we have seen in the past.

Fourth, we take note that the FSAPs' budget still only accounts for about 3 percent of Fund-wide direct spending, which is too low in our view. While this budget for now is envisaged to remain unchanged, we are open to reprioritization within the overall surveillance budget. As FSAPs will be better integrated with Article IVs, we look favorably to the proposal to allocate extra resources to financial sector surveillance. Plus, the FSAP is a product not only for national authorities, but for the common good of the stability of the international financial system. I have made this point before, and I just heard Mr. Ronicle reiterate the point again.

Let me finally also stress that, in my view, the FSAP program is a good example of effective Bank-Fund collaboration. It was developed jointly and is a clear division of labor between the Fund, which focuses on the global stability dimensions, and the Bank, which focuses more on the developmental aspects. As this chair has stated before, I see this as a model also for the desired and even necessary collaboration between the Fund and the Bank in the treatment of climate issues and risks. Is there nothing to improve upon them? The answer is no. Improvements are always possible and even necessary – markets, institutions, and products develop constantly. Innovation is good and welcome, but it can have negative consequences for financial stability, and that requires permanent attention.

Going forward, and in addition to climate risk, we see merit in focusing more also on the issue of central bank independence, which is under pressure in quite a few of our countries, including in my constituency, and I would not be surprised if that would only become more of an issue in the future.

Mr. Buisse:

Let me congratulate staff for finalizing this important work, which is central to ensure that our financial surveillance is up to date and up to the task following the IEO report. We agree with the main thrust of the staff proposal and FSAP review, including in the scope, quantitative analysis, traction, and country participation. We reiterate our strong support to the strengthening of the risk-based approach and the importance of traction. In this regard, and as mentioned in the background paper, the addition of a section to the FSSA discussing the authorities' views, as done in the Article IV staff report, would be helpful.

Much has been said on this review, and we have already raised our main points in the common statement cosigned with four European colleagues, so I will limit my comments to four issues which are in line with our previous comments on the FSAP review.

First, we welcome the continuous focus of the review on what the IMF does best, its core strengths; namely, spillover analysis and interconnectedness, not only across but also within countries, between banks and nonbanks, reflecting more deeply the risk associated to the new trends in technological changes. As underscored earlier, we continue to advocate for a greater consideration of big tech risks and challenges in competition and supervision, along with other key dimensions of the financial system related to cyber risks, climate change, and digitalization. We understand this big tech issue is a relatively new field, but this is one where we will need to step up of risk-based surveillance and gradually develop policy advice.

Second, duplicating well-established national and regional stress testing framework should be avoided. As reflected in the survey, I think our authorities are giving higher priority to the conduct of thorough and independent evaluation of existing frameworks. This is where the Fund's expertise and cross-country experience can add much value.

Third, related to the above and because resource constraints matter, we found the thematic approach for regional exercises quite interesting, although this would not remove the risk of duplicating what is done in the frame of national FSAPs by itself.

Finally, as discussed before, we would have favored a more risk-based approach regarding the list of mandatory FSAP for systematically important countries since its lengthening conveys the risk of blurring the notion of systematicity. That said, we can accept staff's compromise.

Mr. Tanaka:

The FSAP review this time is an extremely important opportunity and difficult task to strike the right balance between enhancing its effectiveness on traditional focus and adapting changing exceptional circumstances and the uncertainty. As we issued a gray statement broadly agreeing with staff views, I would like to offer the following comments for emphasis.

Firstly, on scoping, we are supportive of further strengthening the risk-based approach and greater flexibility within the three-pillar framework. It is useful to structure the financial stability assessments around one or two crosscutting themes like corporate solvency and liquidity test, which is surely relevant to FSAPs in the near future.

We support climate risk analysis in FSAPs from the perspective of financial system stability. We also welcome the helpful complementary with the coverage of climate issues in Article IV reports, rather than duplication. We should work closely with other bodies, including UN, World Bank, and FSB. Given the different situations among member countries, we should not fall into one-size-fits-all approach in FSAPs and try to conduct well-tailored analysis.

Secondly, as to quantitative analysis, we agree to improve modeling of interconnectedness, macrofinancial feedback effects, and the calibration of macroprudential policies with coverage of nonbanks. We also support to improve the modeling of financial stability analysis framework for risks related to climate change and financial innovations as well. In this sense, data accuracy is first and foremost important.

Thirdly, on traction, we commend the staff proposal to further deepen the integration of FSAP and Article IV consultations. Under the diversified situations among countries, it is welcoming that increasing cross-mission participation is already ongoing to monitor each member's financial sector developments and risks by country teams.

Fourthly, on country participation, we support the proposal on further strengthening the risk-based approach to monetary assessment given that we see the proposal as a good compromise or balance between the coverage and the resource through the Board discussion. The FSAP implementation should be more streamlined considering the labor-intensive characteristics for both staff and the authorities with this coverage of mandatory risk.

Lastly, on resource, we note the proposal for mandatory list needs additional 1.5 FTEs per year and that the augmentation could be addressed by reprioritization within MCM's budget. However, the additional cost to include emerging issues is still somewhat unclear. We expect staff to explain the

resource implications in the context of overall budget envelope. We really appreciate the staff and management effort for the FSAP review.

Mr. Palotai:

As we issued a detailed gray statement, I will only emphasize a few points.

The FSAPs three-pillar framework continues to be appropriate in setting the right scoping of financial sector assessments in this environment of rapidly evolving financial stability risks. In particular, interaction between the traditional financial sectors and shadow banking institutions, as well as the broader application of new technologies such as the distributive ledger technology, would pose financial stability challenges on a systemic scale. We welcome staff's emphasis on strengthening the quantitative analysis of risks in the nonbank financial sector, including through enhanced stress testing of asset managers and the greater focus of assessing cyber risks.

In our view, such risk analysis should have been also employed to produce a more scientific based methodology for identifying jurisdictions with systematically important financial sectors. Against this backdrop, we tend to share Mr. Mohieldin's view that expanding the mandatory FSAP list does not necessarily increase the coverage of systemic risks. We expect staff to appropriately maintain the Board's engagement regarding FSAPs' budgetary implications, which might require careful prioritization going forward. As Ms. Riach and several other Directors mentioned in their gray statements, staff should be mindful to maintain sufficient capacity to accommodate a likely increase in demand for voluntary FSAPs in the context of rising financial sector vulnerabilities in emerging and developing countries. Tailoring FSAPs to the systemic importance and risk in a given jurisdiction would also be instrumental in making the exercise less resource intensive for authorities, as Ms. Shortino explained in her gray statement.

We positively note the increased integration of FSAPs with Article IV staff reports. Country-specific issues could also more prominently feed into the semi-annual Global Financial Stability Report to detect emerging risks of global relevance and suggest broader responses for membership to enhance the FSAPs' traction. We also welcome the addition of authorities' views into FSSAs.

Last, as Mr. Buisse and other Directors noted in their gray statements, we agree that a separate assessment of supra-national policies is warranted when any of the members have transferred significant responsibility for financial sector oversight at a supra-national level.

Mr. Merk:

We would like to express our strong appreciation and support of the Fund's Financial Sector Assessment Program. We are part of a joint gray statement, as already mentioned, so I will highlight only a few points.

First, with respect to scope, we welcome the gradual integration of the analysis of emerging potential risk sources within the limits of the Fund's mandate. At the same time, this should not mean a tradeoff and neglect of more traditional assessment areas.

Second, regarding FSAP tools, we see further room for streamlining. Some countries, particularly those with highly developed financial sectors, conduct their own high-quality stress tests on a regular basis. In such case, it is our view, and also corresponds to a recommendation by the IEO, that FSAP assessment should be focused on reviewing the authorities' models, risk scenarios, and results of the tests to avoid overlaps and duplication of work. In addition, we would propose to limit questionnaires in future FSAPs as significantly as possible and to reduce overlaps between self-assessment and questions.

Third, on traction, as many colleagues, we continue to fully support efforts to integrate FSAP analysis and recommendations more strongly with Article IV consultations.

Fourth, with respect to country participation in FSAPs, we support and appreciate the proposal to increase the coverage of mandatory FSAPs and agree with the proposed differentiation of frequency of the coverage. We support conducting supra-national euro area FSAPs on a regular basis and at the same frequency as the systemically important jurisdictions. We deem it necessary that a holistic view on national financial sectors is maintained in the respective national euro area FSAPs. We, therefore, caution that euro area FSAPs should not mean a pushback of the scope of national euro area FSAPs, as this may run the risk of not identifying country-specific emerging vulnerabilities and financial stability risks in a timely manner.

As underlined in our joint gray, we believe that the IMF ECB staff level guidance agreement from July 2018 remains appropriate.

The Acting Chair (Mr. Zhang):

Certainly, in particular we have to accommodate the traditional issues under the FSAP and the new emerging issues without sacrificing either.

Mr. Herrera:

We issued a broadly supportive gray statement, so I will focus my remarks in three points.

First, we concur with the emphasis on corporate and household vulnerabilities and increased bank sovereign linkages in the aftermath of the pandemic crisis. However, we would also like to stress the vulnerabilities in the nonbank financial institutions. At the start of the pandemic crisis, important segments of capital markets became impaired by liquidity problems, and it took unprecedented emergency intervention by central banks to alleviate market stress. Some previous no-go zones were crossed, such as buying or accepting low-quality corporate bonds for commercial loans as collateral, and these interventions, although justified, could entail greater vulnerabilities in the future as nonbanks relied more and more on emergency interventions and less on self-insurance.

Second, we see merit in the proposals to strengthen the quantitative modeling of macrofinancial feedback effects, interconnectedness, macroprudential policies, and nonbank financial institutions. We place special emphasis on the analysis of international linkages and spillovers and the integration of these tools into national, regional, and global stress tests. These are interesting avenues where the Fund can add significant value relative to the current stress tests conducted by national or supra-national authorities and avoid overlaps or duplications, as highlighted by several other Directors.

Third, we strongly support strengthening the integration of FSAP and Article IV consultations. As highlighted by the IEO report, there are still gaps in the articulation and integration of macroprudential issues and policies into Article IV consultations. And we also support addressing climate change and cyber risks in FSAPs when macrocritical. However, we highlight that the main constraint to address this issue is the availability of macrofinancial experts at the Fund, as highlighted in the recent CSR, and also by Mr. Morsink's remarks this morning. These are important inputs to consider in the upcoming review of the medium-term budget strategy.

Mr. Hosseini:

We have issued a gray statement broadly agreeing with the 2021 review proposals. These are largely consistent with the Board discussion held in December 2020 and March 2021. I will limit my intervention to three points for emphasis.

First, we welcome the envisaged focus of FSAP in coming years and assessing financial stability risks from vulnerabilities in nonfinancial sectors, possibly long-lasting scarring effects due to the pandemic, digitalization, and

climate change. Tackling these issues in FSAPs would require enhanced collaboration with the World Bank, FSB, BIS, and other international organizations, as well as increased investment in human capital within the Fund.

Second, we are of the view that FSAP traction could be increased further by deepening integration with Article IV surveillance. In this regard, we encourage training of desk economists in developing and using analytical tools to leverage FSAPs to strengthen financial surveillance in Article IV consultations. Furthermore, Article IV may rely on authorities' stress testing capabilities and self-assessment.

Finally, we stress the importance of coordination between capacity building and surveillance, particularly of the financial sector, which is a key element of Fund's mission. We encourage acceleration of targeted technical assistance and financial stability issues and, where appropriate, use the World Bank's development modules to counterbalance the impact of the global systemic focus of the FSAP on low-income countries. And we call for a stronger engagement of Fund surveillance in capacity building, including training on macrofinancial issues in emerging and developing economies.

Mr. Peter:

We have issued a gray statement in which we broadly welcome the changes proposed in this review. These changes will be useful to preserve the high-quality and value added of FSAPs. Today, I would like to briefly highlight four points.

First, while we can go along with the proposed differentiation in frequencies for mandatory FSAPs, we note that our support hinges on making sure that FSAPs are closely integrated with Article IV consultations. We view this integration as key to ensure continuous financial surveillance. We also see a need to keep the assessment frequencies under close review to ensure that they allow us to detect financial sector vulnerabilities adequately and promptly.

Second, like many other Directors, we stress the importance of setting aside sufficient resources to carry out voluntary FSAPs given the high value added of such assessments for developing and emerging market countries.

Third, we strongly support including sections on the authorities' views in the FSSA. Better understanding the factors that may impede the implementation of recommendations, for instance, technical agreements, technical disagreements with staff, or political economy considerations, could help both staff and the Board to reflect on the usefulness of specific

recommendations to avoid one-size-fits-all recommendations and to enhance the traction of advice.

Fourth, we urge staff to keep a sharp eye on costs and to highlight ways to further streamline the exercise, also with a view to limiting the significant burden of the exercise on the authorities, as also noted by Ms. Shortino. For instance, we see merit in making virtual scoping missions the new standard. We also second Ms. Levonian and Mr. Merk in their calls for streamlined FSAP questionnaires, especially if they duplicate previous exercises.

With that, let me reiterate our authorities' great appreciation for this highly useful surveillance product that now belongs to the Fund's bread and butter.

Mr. Nakunyada:

We welcome the continued efforts to strengthen financial surveillance in the rapidly changing global landscape, including from the pandemic. We positively note the important progress made since the 2014 FSAP review, and the authorities' high-level satisfaction with the FSAP. We stress the need for this review to build on existing core elements of the FSAP. We issued a supportive statement and would like to emphasize a few points.

First, we see merit in retaining the three-pillar risk-based approach to FSAP scoping and the embedded flexibility that accommodates the key objectives of this review. We support the thematic approach to FSAPs but underscore the importance of aligning the teams with the risk assessment metrics and country priorities. We also emphasize the importance of prioritizing developing regions in the rolling out of work on digital and cyber in surveillance given the increased use of digital money.

Second, we welcome the improvements in FSAP traction over the years and agree that there is still room for improvement. We emphasize the need to seamlessly integrate FSAPs into surveillance to address fast-evolving risks to financial stability. We also support the proposal to enhance cross-mission participation and the inclusion of the authorities' views in the FSSA. Going forward, similar efforts are required to strengthen the FSSA toolkit to better identify financial vulnerabilities in low and lower middle-income countries.

Finally, we welcome the proposed refinements to the 2018 methodology and support the proposed five-year frequency for the monetary assessments considering the elevated global risks to financial stability amplified by the pandemic. We also support the expansion of FSAP coverage to include the additional 15 jurisdictions under the ten-year frequency.

Nevertheless, we stress the need for flexibility in FSAPs to maintain regional balance, including in voluntary assessments to meet the likely increase in demand.

Mr. Andrianarivelo:

We have issued a detailed gray statement in which we broadly agree and support the proposal. I would like to emphasize a few brief points.

First, on the scope of FSAP, more precisely regarding the emerging area of climate change. We note from staff responses that the supervisory bodies have not identified standards on climate-related risks. This reminds me that during the recent Article IV discussion on New Zealand, it was noted that this country has made it legal and mandatory for the financial sector to report on the climate impact on their activities. Can staff provide their views on whether what New Zealand is doing represents the kind of standards that the Fund should think about?

The second point is on quantitative tools. Staff has indicated that MCM is collaborating with STA to identify the relevant fintech-related statistics that need to be developed for regulatory purposes. We welcome this work underway, but since fintech is an emerging issue for all financial systems, it is important to ensure that the outcome of this collaboration will serve all the membership.

Third, like Mr. Hosseini and others, we welcome the increased support for members with mandatory assessments, notably through the FSSR. This report helps low-income and lower middle-income countries diagnose financial sector vulnerabilities and prioritize financial sector reforms. In this regard, coordination between capacity building activities and surveillance of financial sector is essential. The FSSR is a TA product and provides diagnostic. Staff indicates that FSSR and FSAs have similar evaluation. As we mentioned in our gray statement, we would have appreciated a concomitant review on the program of FSSRs to ensure that its focus also remains appropriate. We reiterate our request for an informal briefing on the FSSR program focusing on its scope and depth.

Mr. Bhalla:

I want to just highlight three brief points.

First, the COVID-19 crisis vividly illustrates the fact that significant risk to financial stability could emanate from areas outside of the financial system. The near-term priorities of FSAP should be to critically assess the risks posed by the pandemic, dissect the nature of the risk as transitory versus

durable, and further advise the membership on how to prudently respond to such risks.

Further, there should be a clear hierarchy of the near-term and the medium- to long-term priorities in FSAP missions. We could also think of separating the fast-moving risks from those which are slow moving and those which are difficult to assess or quantify. For instance, risks arising from cyber and fintech may have strong consequences on the financial landscape in the short to medium run. In contrast, the risks emanating from climate and demography are generally slow moving over a much longer horizon and therefore may need to be quantified or assessed separately.

Second, fintech results in unbundling of financial services, which increase the 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 systematic impact for disintermediation of incumbents and disaggregation of financial services. The role of big techs in financial and payment systems may also need to be quantitatively assessed given their market power and mass data collection practices.

My third point; the recommendations on climate change at best may be advisory in nature, and the UNFCCC should continue to be the overarching structure to deliberate and negotiate on climate change commitments of countries. Further, while it is evident that climate change results from insufficient mitigation action and that insufficient mitigation puts global, economic, and financial stability at risk, establishing which countries contribute significantly to this risk, as opposed to those that do not, is not straightforward and needs to account for objective assessment and development priorities of the EMDEs.

While we agree with developing a financial stability framework to account for modeling climate-related risk scenarios and developing understanding of implications to financial institutions and other finance entities, any requirement on mandatory disclosures related to climate risks may be decided after completing rigorous scientific and objective analysis.

Mr. Alhomaly:

We reiterate our strong appreciation of the FSAP, which, of course, provides valuable policy recommendations for financial surveillance. We have issued a detailed gray statement; I would like to make just a few specific points today.

First, in the context of COVID-19 pandemic, financial vulnerabilities have risen across the membership, which certainly require close attention in

the Financial Stability Assessments in the coming year. We also agree that eventual withdrawal of extensive policy support measures would need to be a major focus of FSAPs, keeping in view country-specific circumstances.

Second, assessing agreed international standards developed by financial sector standard-setting bodies is at the core of the FSAP exercise, and here we welcome staff's response to our questions that they are not developing new standards on climate-related financial risks but only providing feedback to standard-setting bodies. I believe this is essential to avoid offering conflicting recommendations to the authorities. We also echo the views expressed in the gray statement of Ms. Shortino, Mr. Senich, and Mr. Westphal that use of climate risk analysis in FSAP should remain voluntary for now given the early stage of development of data metrics and tools for assessing such risks.

My third point is that we welcome continued effort to increase traction, including the proposal to reflect the authorities' view in FSSAs. We also consider strengthening connection between the FSAP and follow-up technical assistance would go a long way in improving the implementation of recommendation and thereby further enhancing traction.

Finally, Mr. Chairman, we support the proposed strengthening of a risk-based approach to mandatory assessment, which is also important to accommodate all demands for voluntary FSAPs in the coming year as conducting financial surveillance is part of the core mandate of the Fund, and so necessary resources need to be provided. We also express our strong support for the FSSR targeted towards low and lower middle-income economies, which helped in identifying TA priorities.

Ms. Mahasandana:

We issued a detailed gray statement supporting staff proposal, so today I will limit my intervention to three points.

First, we support the proposal to strengthen the risk-based approach to scope FSAP assessments tailored to the challenge facing individual members. The scope of FSAPs should be customized considering the level of development in the financial system and institutional arrangement for individual jurisdictions. For EMDEs, sufficient resource must be dedicated for FSAP to perform detailed support assessments and institutional framework review. Meanwhile, review on jurisdictions with well-established supervisory and regulatory framework can focus more on risk-based thematic issues.

Second, it is important to strengthen the integration between FSAP and Article IV at this juncture given the impact of pandemic on the macrofinancial dynamics. COVID-19 outbreak has exacerbated financial vulnerabilities and

posed significant risks and lasting macroeconomic implications in many countries. The Fund must leverage Article IV, which is more frequent, to examine members' macrofinancial institutions in a timely manner. To this end, country teams need to be equipped with more comprehensive toolkits. Like Mr. Bevilaqua, we caution against excess reliance on simplified quantitative analytical tools. Article IV macrofinancial analysis should also be supplemented by qualitative instruments. For instance, getting authorities to perform self-assessment against important new supervisory standards in the area assessed to be macrocritical. This assessment could then be reviewed by macrofinancial experts off site before country teams discuss key findings on missions. Indeed, country teams need to have access to adequate macrofinancial expertise for more rigorous assessment that take into account country specificities. We would also like to urge staff to take data burden as well as jurisdiction capacity and readiness into account when rolling out new tools.

Lastly, we agree with the proposal on mandatory country participation. We urge staff to engage country authorities early to facilitate the process. For jurisdictions that are newly add to the ten-year mandatory list, an FSAP would only be due in 2031. If this jurisdiction were last access voluntary many years ago, this resulting interval between FSAPs could be much longer than ten years. In such case, the authorities might be keen to have an early review, also considering potential impact that pandemic has on financial stability. Early engagement with authorities plan out the FSAP review schedule could also prevent the bunching of the Fund's workload towards the end of the five and ten-year marks, and it will allow authorities to be able to prepare and mobilize resources more effectively. Well-planned mandatory FSAP would allow the Fund to manage and accommodate demand for voluntary FSAP in each year to meet its member needs.

Mr. Huh:

We are very happy to support this proposal and highly appreciate staff for the dedicated tremendous efforts with the following comments.

First, like many other Directors, we support coverage of supra-national entities and the consideration of regionally-focused FSAPs. In this vein, we welcome the discussion on financial surveillance with regional theme on Nordic countries. Likewise, we see merit in the Pacific recent exercise on the thematic topic to complement national surveillance. One such suggestion is the issue of rapidly declining CBR, where some countries have grave financial stability concerns. Also, like Ms. Mahasandana and Ms. Levonian, we would like to emphasize greater access to voluntary FSAPs and the FSSR for the EMDEs.

Second, in the case of delicate finance information with some secrecy, face-to-face engagement is very important to enhance the quality of the analysis. We insist, we like to suggest that the staff to consider such kind of special qualities in designing hybrid surveillance model of FSAPs.

Finally, careful consideration of resources implication from additional scope and the in-depth analysis in the FSAPs will be critical. In particular, more investment in financial expertise, financial and emerging expertise. At the same time, like other Directors, we see merit in further streamlining the FSAPs process and making less resource-intensive for national authorities. We expect the staff engagement with the Board on resources adequacy will become a more frequent feature with a periodical and participatory evaluation, including with the IEO.

Mr. Guerra:

I will react to some of my colleagues' interventions.

First, on scope, we agree with the shift towards a more in-depth risk analysis, but we highlight that an increased attention should be placed not only on nonbank financial institutions, as expressed by Mr. Herrera, but also on corporate households, and most importantly, on bank sovereign linkages in both advanced and, very importantly also, on emerging markets.

Second, on quantitative tools, while we agree that they should be strengthened, the availability of data could become a restriction given the new issues, and the capacity of some jurisdictions to produce that. Also adapting our new analytical tools, both stress tests and, other measures, should not be biased against sustained credit to other sectors that could be affected by climate events. In this regard, careful consideration should be taken on how we communicate our FSAPs on our climate-related risk assessment and also including in Article IVs.

Also, we agree with Ms. Shortino on her remarks related that stress testing should not be repeated for countries that already make them. Maybe the IMF could play a higher role in setting the standards for what the stress testing exercises should be. We also agree with Mr. Hilbers' comment on central bank independence. We finally agree on the participation proposals and as other chairs, we continue to see that access to voluntary FSAPs should be a priority.

Last but not least, on resources. We thank Mr. Morsink for the introductory remarks on resources, and we highlight that the necessary adaptation on human resource capacity in order to cover the emerging topics of digitalization and overall the fintech agenda will need an increase in the budget in order to comply with our aim to increase our expertise.

Mr. Massourakis:

Let me start by sincerely thanking staff for a job well done that reflects a successful attempt to incorporate lessons learned and to adjust the framework for financial sector assessments to a changing landscape. Let me express our deep appreciation for the staff outreach and discussions with our office. We have signed a joint statement with Mr. Buisse, Mr. Hilbers, Mr. Poso, and Mr. Merk, supporting the FSAP review, so I will be brief.

While the FSAP necessarily entails a structural perspective given its lower frequency, the relevance of the exercise depends on the capacity to properly identify and assess risks and to critically evaluate the institutional setting. This means that we support strengthening quantitative tools to identify and measure the relevant issues and sources of risk within or outside the banking and financial sectors, as put forward in the paper. We highlight a few areas that we find particularly important in this context: macrofinancial linkages, risks within nonbank financial institutions, and interconnectedness, climate risk, and cyber risk.

This work on risk assessment should be coupled with work on macroprudential policy, not just to support advice on the calibration of existing tools, but also to provide input to the choice and the development of new tools. We also fully support taking a forward-looking approach to the scoping and assessment exercises to maximize the usefulness of FSSA. This will not only help finding the right balance in covering the most relevant topics in each specific FSSA, but it will make the reports relevant into the future, especially when including the authorities' views in these reports, similarly to Article IV reports, and engaging early with the authorities for the scoping exercises.

Finally, we welcome the proposals to strengthen the risk-based approach to identifying systemically important financial sectors, including by having two different frequencies for mandatory FSAPs while leaving room for the very important voluntary assessments. We acknowledge that two countries in our constituency will become part of the list of countries with systemically important financial sectors (SIFS) subject to mandatory FSAPs with a five-year frequency. We understand that the rules dictate that the first mandatory assessment is expected after May 2026.

Mr. Alhosani:

We support the objectives and pillars of this review, as they address the medium-term needs of the membership as well as incorporate emerging areas going forward. For the medium-term, we believe that it is essential to support members in addressing economic vulnerabilities and mapping out

their exit from emergency policies. This could be achieved by strengthening systemic risk assessment, enhancing quantitative analysis of the nonbank financial sector, and conducting periodic review of macroprudential policies to ensure their effectiveness and ensure that they are up to date.

As for incorporating emerging areas, we do believe that a balanced and objective approach is necessary to address climate, fintech, and cyber risks. The process has to be organic in that regard. As Mr. Bevilaqua said in his intervention, these areas will likely take a secondary role in the reviews.

We are pleased to hear Mr. Morsink's comments regarding staff work on these areas. However, we are concerned and some of our capitals are particularly concerned over the lack of data as well as the lack of common international standards for these areas. Therefore, we urge staff to improve data availability and develop appropriate assessment tools, which we hope can be shared with central banks at some stage.

With that being said, and for these objectives to be achieved in a timely manner, we believe that a proper and adequate allocation of resources will be required. This is to preserve the quality of the Fund's core engagement while allowing flexibility to examine emerging areas at a level that is reflective and worthy of the Fund's status globally. An adequate budget, as we mentioned in our budget discussion a couple weeks ago, will be required to respond to members' request for capacity development for both core and emerging areas, particularly in EMDEs.

Finally, we are pleased to see the evolving partnership with the World Bank and hope to see a similar scale of cooperation and coordination with other partners, such as the UN system, BIS, and others to tackle some of these aforementioned areas.

Mr. Palei:

The review was long in the making, and we are happy that it came to successful conclusion. We have issued a comprehensive statement, and on many previous occasions we have expressed our views and preferences for possible changes to the FSAP format, coverage, and process. The end result is, of course, a joint product of many participants, and we endorse the proposals.

One of the troubling and well-known facts was the lack of resources for the FSAP throughout its history, the shortage and fact that the evolution of this product and limited access to it for many Fund members. Russia is, of course, among the subgroup of members with assured and preferential access to the FSAP, which is different for many others. My Russian authorities took full advantage of close collaboration with the Fund in several iterations of the

FSAP. Our desire to broaden access to Fund's expertise for other members was based on our own positive experience.

We all know that other Fund shareholders did not find the provision of additional resources to the FSAP a fruitful investment, and we have what we have today. Hopefully our colleagues and the authorities will eventually change their mind, and in any case, we believe that periodicity of 8, 10, 12 years, even 5 years, is not sufficient to monitor changes in the financial sector in most countries. Those are fast-paced and occur very quickly sometimes. Hence, we have always called for the integration of the financial sector work at the Fund with bilateral surveillance, and the Comprehensive Surveillance Review is already completed, so we did discuss all these issues already. Today, we discuss a rather limited set of remaining issues, basically some of the relatively limited changes to the FSAP exercise going forward.

Mr. Jin:

We have issued a comprehensive gray statement and broadly support the proposals, and I would like to just focus on a few points here.

First, we broadly agree with the proposals to better leverage the FSAP to strengthen financial surveillance in Article IV consultations, as also discussed at the CSR on Monday. As pointed out in the report, some authorities have expressed concerns about the burden of the authorities in terms of preparatory work at a number of meetings. We encourage staff to make more use of regular off-site surveillance measures to accumulate and update continuously the institutional evolution of member countries' financial sector to improve efficiency of FSAP work and reduce the administrative burden of the member countries.

On mandatory participation, while we can agree with the current proposal for the additional ten-year cycle, our preference remains that jurisdictions subject to mandatory FSAPs should follow the same cycle or at least shorten the ten-year cycle to seven or eight years. Furthermore, we should make the terminology clearer so that people can differentiate between the two groups that are subject to different cycles.

Second, we continue to emphasize that the scope of each FSAP should be risk-based and well-tailored to the jurisdiction's circumstances. The implementation of FSAPs should be forward-looking and pay close attention on new and emerging risks, particularly those from nonbanks, fintech, cyber, and climate.

Third, we strongly agree that the implications of the pandemic for financial stability, including from the eventual withdrawal of extensive policy support measures, should be a focus of FSAPs in the coming years. Given the

lower frequency of FSAPs compared to annual country surveillance, we encourage staff to focus more on the structural longer-term effects of the pandemic on financial stability.

Last but not least, the FSAP should pay special attention to those systematically important international payment systems. A fact-based risk assessment, stress tests, and the remedial advices are necessary for both the global economy and the member countries.

The Deputy Director of the Monetary and Capital Markets Department
(Mr. Morsink):

I am going to answer two sets of questions and then turn things over to my colleagues for some other questions.

There were some questions about the role of the Fund in the development of standards in these new areas like climate and fintech. I would just like to say, the Fund is not a standard-setter in financial regulation and supervision, so we are not developing new standards. What we do is we work with the standard-setting bodies to help them develop new standards, so we actively participate in many of the meetings of the standard-setting bodies. We provide feedback to the standard-setting bodies based on our experience in FSAPs on the implementation of standards and possibly the need for new standards, and we have done this for 20 years now.

A good recent example is how Fund staff contributed to the development of the new assessment methodology for the key attributes for effective resolution regimes for insurance companies, which, indeed, at this review we are asking for the Board's endorsement for us to be able to use that assessment methodology formally in FSAPs. We did not develop this methodology. This methodology was developed by the Financial Stability Board, but with our input and now with Board approval, we will now be able to use this methodology as a formal assessment methodology in FSAPs. This is very much how we would continue to work with the standard-setting bodies for them to be able to leverage our experience and for us to benefit very much from their experience and eventually any formal standards that could be set in these areas.

The second set of questions I wanted to talk about was resources. Here, I want to emphasize the importance of each FSAP being risk-based and tailored to the jurisdiction. So, it is very important that we avoid duplication obviously with other work, whether it is done by other organizations or by the authorities, that we minimize the number of meetings and the burden on the authorities. And to do this, we have a process of ruthless prioritization in the scoping of an FSAP, and we engage very deeply with authorities on scoping of each individual FSAP, and we feel that that process is very important to

make sure that we are not duplicating work or having any unnecessary meetings.

There was a specific question about hybrid engagement: we have had a certain degree of remote engagement over the past year. We do think that this has worked relatively well for our scoping missions, perhaps less well for the main missions. But, again, this is certainly something that we are going to bear in mind as travel resumes and we try to seek efficiency gains in the FSAP.

Finally, with regard to any specific budget implications, I think in the course of the next couple months I believe staff will be presenting to the Board specific proposals for climate strategy, for a digital money strategy, also for the further strengthening integration of FSAP findings and recommendations in Article IVs. So, there will be numbers put on these asks, on these requests, I think in the context of the budget discussions over the next couple months.

The staff representative from the Monetary and Capital Markets Department (Mr. Haksar):

I will pick up on two questions, one on formal mechanisms of coordination and the other on the climate disclosure topic.

On coordination, I think as Mr. Morsink laid out right now, we are not standard setters, but we do have formal coordination mechanisms. The Fund is an observer at the FSB. The Fund is an observer on the workstreams of the NGFS, the Network for Greening the Financial System of central banks. So, there are these mechanisms in place already, and we have significant dialogue around these mechanisms as well.

With regards to our colleagues at the World Bank, we have both formal and very extensive operational contact with our colleagues at the World Bank. We have meetings every month to coordinate on the FSAP. We attend each other's meetings on FSAPs' reviews and discussion of individual FSAPs. So, there is a lot of discussion. There is also the formal mechanism for larger policy issues for coordination with the Financial Sector Liaison Committee that has been established, and that does meet periodically to coordinate on some of the larger questions that the FSAP program needs to grapple with, so we feel that we have multiple modalities that have been established that have allowed for, as many Directors have noted, a very rich and productive collaboration with other bodies, including the World Bank.

On the topic of climate risk disclosure, which I think is a very interesting one, to be very clear, we are not standard setters out here, so we are not mandating any particular approach, but this is something where we have

worked very closely with different international groupings, with the IFRS, the NGFS, and the FSB has set up the TCFD. The TCFD is the Task Force on Climate Disclosure, and we are quite closely engaged with that. These are productive engagements for us to inform and share experiences from different members about what would be approaches that might work for them, what the constraints they face are.

In principal, we support the idea of having increased disclosure on climate risk for obvious reasons. We need to have data; we need to be able to know where the risks and exposures are to be able to make these assessments and judge what is material and where the risks lie and what would be a policy response. I think central banks are also very focused on this, so a lot of them are doing exploratory scenarios right now with climate risks assessments. I think this all reflects the fact that disclosure has to be feasible. We do need to have ability to get the data and to be able to build the analytical tools and to be able to assess them.

The staff representative from the Monetary and Capital Markets Department (Ms. Oura):

I will respond to the comments on the independent stress tests by the FSAP team. We have discussed these points quite extensively in the background paper on scope. We continue to think that independent stress testing exercise is a critical component of FSAP for several reasons. One is that to maintain the independent assessment aspect of the FSAP. FSAPs without own stress test is similar to the Article IV without the Fund own outlook, economic outlook projection and the risk analysis, so that is how we foresee the value, the importance of that stress test for the independent assessment.

Second, we also highlight the global public good aspects of our exercise. For the national authorities, there is receiving FSAP value added of the additional exercise may not come across as that much; however, that for the third-party countries, that independent exercise by the Fund along with the authorities' own exercise usually provides quite additional information, and that is received very positively.

The third aspect is evenhandedness. Our exercise tends to maintain some common elements across all the countries, including the stability of the scenario, so that in order to provide assessment based upon the somewhat Common Framework, we think it is critical for maintaining the evenhandedness of the assessment across countries.

Last point is a little bit technical point, but typically as a part of assessing certain models that learning the parallel exercise is considered as a critical component. For example, national authorities, regulatory or

supervisors, when they assess that risk models are maintained by individual banks they supervise, oftentimes they run their own exercise, their own top-town exercise, and compare the result with that of banks. So, in that sense, that even in order to assess the authorities' framework, the parlor exercise is, indeed, a critical element.

The Acting Chair (Mr. Zhang):

With that, staff proposes that the paper be published together with a press release. I did not hear any objections, so in that case, this proposal has been agreed.

To conclude the discussion, I would like to thank, together with the Directors, staff for their excellent work over the past two years. I would also want to thank Directors for their continuous and helpful engagement throughout the entire review process, as well as for the rich discussion today. I appreciate Directors' strong support for the recommendations and decisions proposed in the review, which I believe will help further improve the global public good value of FSAPs and the related toolkit.

With that, together with the entire management and staff, I am looking forward to hearing their further feedback as we implement these recommendations and decisions.

The Acting Chair (Mr. Zhang) adjourned the discussion.

ANNEX

- Gray Statements
- Staff's Responses to Executive Director's Technical Questions
- 2021 Financial Sector Assessment Program Review—Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance—Decision Attachment
- Constituency Codes

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GRAY/21/1180

May 6, 2021

**Statement by Mr. Bevilaqua, Mr. Saraiva, Mr. Velloso, and Mr. Barroso on FSAP
Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for a comprehensive, well-written and sensible set of papers as well as for the effective outreach, including to our authorities, throughout the process. We generally welcome the results of this review, which builds on the 2014 Review and tackles some new pressing issues, but want to make the following points.

The FSAP already makes an invaluable contribution to our policy dialogue, and improvements should be proportionate to its already effective role in surveillance. After the Global Financial Crisis (GFC), the FSAP evolved from largely technical assistance to become a very important part of the surveillance toolbox, with a list of mandatory assessments being established. In 2014, the FSAP Review strengthened a more focused and risk-based approach and the thrust of that review's recommendations remains adequate. Accordingly, we were not expecting an overhaul of the FSAP at this point. That notwithstanding, we welcome the opportunity to reflect on the program and the proposed refinements that would make it more attuned to current and forthcoming financial stability challenges, further sharpening the role of the Fund as a trusted advisor in such matters.

Looking ahead, the main FSAP priority should be to address the challenges associated with exiting the pandemic, which will shape the financial stability landscape in the next few years. The forceful policy and regulatory responses taken during the pandemic, while instrumental to avert further economic collapse, mitigate the impact on vulnerable households and sectors, and support the recovery going forward, fueled substantial balance sheet vulnerabilities. While the financial sector withstood well the shock –due to the enhanced resilience stemming from post-GFC regulatory reforms and the breadth and depth of the policy response – the withdrawal of policy support, even as the recovery takes hold, may pose significant challenges to financial stability. With the global recovery taking place at different timing and paces, challenges for policy makers will be substantial, especially in countries where exiting the crisis may take longer or entail surprises. In addition, where

vulnerabilities have been stretched, further shocks may lead to important episodes of financial instability.

More specifically, on scoping, the three-pillar approach remains valid and should provide the basis for more customized and focused assessments. The development towards less use of graded assessments of standards and codes and more focused, thematic reviews is welcome. Such decisions should continue to be made flexibly and in agreement with country authorities. We agree that proper prioritization of the analysis on the most critical risks is becoming even more important. Balancing resource constraints with emerging risks will be of the essence, as deep and thorough examination of the most critical risks tends to be more valuable than trying to be more encompassing but losing depth in the analysis. Hence, the use of standardized, simplified tools may yield some savings, but it should never disregard in-depth country-specific analysis. We agree that staff will likely face an increasing demand for support on issues related to the evolving methodology on resolution and early intervention frameworks.

Coverage of systemic liquidity issues as well as those related to nonperforming loans management should be strengthened. While the policy responses have so far dampened the impact of the crisis on those critical dimensions, support withdrawal may pose significant challenges going forward. Given that first best solutions may take longer than what would be required to address rising pressures within the current cycle, we encourage staff to think about pragmatic approaches that could feasibly improve resilience in a timely manner. Furthermore, some of those issues may require international cooperation to be effectively addressed. Risks related to climate change, cybersecurity and fintech should also be approached with practicality and a degree of humility, regarding what the Fund could offer. That notwithstanding, defining a clear focus and relying on collaboration with relevant institutions remain instrumental. Ultimately, country circumstances and open dialogue with the authorities should dictate the right balance between traditional and emerging topics, with effective prioritization. Scarce Fund resources must be used where they can have greater impact, and where the countries need most.

We agree that strengthening the macroprudential stress testing framework is a priority going forward. Such a task entails analytical developments to integrate complex interactions between different risks and diverse sectors. The combined use of different models to measure macrofinancial interactions seems to be a promising avenue and we look forward to reports on any early results in this area. That said, reliance on any such experimentation for policy advice should proceed with extreme caution and the appropriate disclaimers. Moreover, data requirements will need to be addressed, coping with data access constraints and without overburdening country institutions. Close interaction with national officials could lead to important results in developing such tools.

Despite the perception that FSAP traction is strong, steps should be taken to improve it further. Country authorities are generally satisfied with the policy dialogue and recommendations entailed by FSAPs. However, we have seen many instances in which the authorities perceived that their views (or their country's specificities) were not being properly

considered. The proposal of having a section of authorities' views, as successfully incorporated in Article IV reports, may go a long way to address such concerns. Having the authorities' views expressed clearly and faithfully would not only provide additional information to the readers but also improve the perception by the authorities that their views are being treated fairly. Therefore, we strongly support staff's proposal to add an authorities' views section in the FSSA. Also, we strongly suggest including a similar section in all other FSAP reports that are expected to be published. Moreover, the Fund must avoid weakening traction by expanding FSAP coverage to areas in which it does not have sufficient expertise and risk losing credibility.

Further and effective integration of FSAP recommendations into Article IV consultations should be a priority. However, this should not be a box-checking exercise of questionable efficacy. Indeed, FSAP and Article IVs can complement each other more fundamentally with many synergic gains, as the former considers more structural issues, while the latter provides higher-frequency assessment of financial risks. Moreover, the interaction of specialized expertise and country-specific knowledge is crucial for the quality of macrofinancial surveillance. Developing simplified analytical tools as suggested may be helpful, but we caution against putting too much emphasis on it. Simplified analytical tools cannot replace proper macrofinancial expertise and analytical capacity of financial sector specialists. We believe cross-mission participation is of the essence. However, we would suggest going beyond having the Article IV mission chief participating in the concluding FSAP mission. Having MCM experts in Article IV missions remains critical for advancing integration, which can be complemented by occasional participation of highly specialized MCM staff, including through remote means, on specific Article IV meetings. We welcome the proposal for early engagement of MCM and the FSAP team in the review of the Article IV policy note.

Mandatory FSAP participation should be defined by risk-based criteria. Both the list and frequency of mandatory FSAPs should reflect the systemic importance of a jurisdiction's financial sector and its interconnectedness. In addition, the Fund should be prepared to meet a potentially larger demand for voluntary FSAPs without undue delays. We have repeatedly expressed our opinion that higher-frequency mandatory FSAPs (every five years) should apply only to the core systemically important jurisdictions, with an intermediate category of systemically important jurisdictions having a mandatory FSAP every 7 years and a larger group of less systemic jurisdictions in a mandatory 10-year cycle. In this way, financial surveillance would be more adequately spread based on risk assessment and there would be more room for voluntary FSAPs, with benefits for the membership as whole. Having said that, we can go along with the staff proposal that garnered sufficient consensus at this point.

We should closely monitor the cost impact of this FSAP Review as changes are implemented. In addition to transitional costs that are difficult to estimate at this point, we are concerned about the potential impact of further enhancing the scope of FSAPs to areas in which the Fund has no expertise and, therefore, little value to add. We encourage staff to return to the Board with a better estimate of costs eighteen months into the implementation of the recommendations approved in this review.

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GRAY/21/1182

May 7, 2021

**Statement by Mr. Nakunyada, Mr. Ismail, Ms. Basutli, and Ms. Nainda on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive set of reports and appreciate the Fund's continued efforts to strengthen financial surveillance to ensure more stable, resilient, and sustainable financial systems. We welcome the substantial progress made since the 2014 review to improve FSAP analytics and risk-based scoping while responding to emerging challenges. Considering the authorities' high regard for the FSAP's scope and granular policy advice that is framed around country specifics, we stress the need to retain its key tenets, while leveraging the flexibility of the three-pillar strategy. We strongly support the five main aims of this review to enhance the effectiveness of future FSAPs, by adapting to evolving global challenges, including pandemic-related risks, digitalization, climate change, and cyber-risks.

The three-pillar framework has provided an effective anchor for scoping risk-based financial sector assessments (FSAs), reinforced by the Risk Assessment Matrix (RAM). In this regard, we see merit in the framing of FSAs around country specificities, that allows the scope of topics to be aligned with members' risk profiles and complexity of policy frameworks. Given the new financial stability risk factors, we underscore the need for more in-depth analysis of emerging risks, including the growing risks from nonbank financial institutions, climate, cybersecurity, interconnectedness, and fintech. An analysis of these emerging risks that were accelerated by the pandemic, would be important to help reverse the declining focus on these macro-critical risks by the authorities, as shown in figure 6. Greater focus should also be placed on the expected unwinding of regulatory response measures necessitated by the pandemic.

We view the structuring of the FSAs around one or two cross-cutting themes as appropriate but emphasize the need to consider the comprehensive assessments under the latest standards. The application of the thematic approach should also be informed by the RAM and the systemic relevance of selected themes. Furthermore, we support the continued application of the risk-based approach to international standards that has allowed more in-depth and flexible coverage of specific issues in FSAPs, which country authorities also found to be useful. That said, we see merit in discontinuing the Report on Observance of Standards and Codes (ROSC) to avoid duplicative work, while unlocking resources by

streamlining the FSAP process. We also emphasize the need to strengthen bank resolution frameworks to resolve financial institutions in an orderly manner and prevent corporate insolvencies. *Could staff comment on sequencing of the remaining steps to improve bank resolution frameworks and any plans to accelerate bank resolution reforms in LIDCs?*

We welcome staff's plans to strengthen the macroprudential stress testing frameworks as well as improving the efficiency of quantitative tools through standardization and automation. These efforts are expected to enhance risk analysis and support better utilization of resources. We positively note the envisaged calibration of quantitative tools to focus more on risks stemming from non-financial corporates, NBFIs, interconnectedness, and macro-financial interlinkages. We also support plans to develop tools to assess fintech, cyber, and climate-related risks given their increased importance in recent years. Specifically, we welcome the pilot assessments that leverage external expertise in undertaking in-depth analysis of emerging risks. At the same time, we underscore the need to simplify model outputs, given the expected increase in the use of more sophisticated quantitative tools. In addition, we underscore the need for concerted efforts to enhance data quality and availability. *We would appreciate staff's comments on alternative funding sources considering the impending expiration of the G20 Data Gaps Initiative.*

We welcome the significant improvements in FSAP traction since the 2014 review. This notwithstanding, political economy challenges, technical disagreements, and capacity constraints appear to undermine traction in some jurisdictions. This highlights the need to work closely with country authorities, particularly jurisdictions with SIFS, to resolve potential technical disagreements and improve traction in implementing FSAP recommendations. In this context, we support the proposal to include the authorities' views in the FSSA in line with Article IV practice. The inclusion of the authorities' views and feedback would be important to clarify technical disagreements and improve Fund surveillance. In addition, we support the seamless integration of FSAPs into Article IV consultations to better identify fast-changing macro-financial risks and strengthen financial sector analysis. Additionally, we support the proposals to enhance cross-mission participation and enable early engagement in the preparation of Article IV consultations. *Could staff clarify the effectiveness of regional bodies and international groupings in monitoring the implementation of FSAP recommendations?*

We support the 2013 methodology as broadly appropriate to capture the direct and indirect linkages that transmit shocks and generate systemic risks across financial sectors. Moreover, we welcome the proposed refinements to smooth volatility in input data and remove the undesirable effects of derivative weights. In the same vein, we support the proposal to strengthen the risk-based approach to allow for identification of additional jurisdictions assessed at a lower frequency. Specifically, we view the proposed five-year assessment frequency for the refreshed list of 32 jurisdictions as justified given elevated global financial risks compounded by the COVID crisis. We, however, underscore the need for flexibility in FSAPs to maintain regional balance in the coverage of the additional 15 jurisdictions that fall within the 10-year horizon. We also stress the need for similar efforts to strengthen the FSSR to enhance its instrumental role in identifying financial sector vulnerabilities and addressing capacity gaps in low and lower middle-income countries. *Could staff clarify the impact of constrained fiscal space in several donor countries on the conducting of FSSRs, and any plans to expand its coverage going forward?*

Finally, we positively note that the proposed expansion in mandatory assessments can be managed by re-prioritization within the MCM resource envelope. That said, such re-prioritization should not compromise the coverage of voluntary assessments. We, however, note that the emerging demand for specialized technical support in stress testing and complex risk analysis in surveillance could exert additional pressure on resources. This underlines the importance of adequate funding including for assessment of new risks from household, corporate, and sovereign sectors, as well as those emerging from climate and technological change. That said, we view continued Fund/Bank collaboration as critical to ensure cost-effectiveness by exploiting synergies and eliminating duplications. We, therefore, commend the deepening of collaboration in financial surveillance between the two institutions with a clear delineation of responsibilities.

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GRAY/21/1184
Revised

May 7, 2021

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

We thank staff for the excellent papers, as well as the helpful prior engagement with our office. We broadly agree with the 2021 review proposals put forth in the papers. These are largely consistent with the Board discussions held in December 2020 and March 2021. We welcome additional progress made by staff to identify new risks and policy priorities in the context of evolving financial stability landscape and global challenges from the COVID-19 pandemic.

New regulatory and crisis management policy initiatives in response to the COVID-19 pandemic have heightened financial stability risks. We underscore that the FSAP remains a highly and progressively valuable exercise and a critical element of surveillance. Encouragingly, stakeholder surveys suggest that authorities value the FSAP for focusing on the most relevant issues and providing in-depth analysis framed in the country's circumstances and appreciate their contribution to policy debate.

Scope. We note the authorities' overwhelming endorsement of the three-pillar framework (risk analysis, oversight, and safety nets) and extend our support to greater flexibility within the framework to customize scope. We welcome the envisaged focus of FSAP in coming years on assessing financial stability risks emanating from vulnerabilities in the households, corporate, NBFIs, financial market infrastructure, and public sectors, including from possibly long-lasting scarring effects due to the pandemic. We emphasize the need for the FSAP to remain nimble to address emerging challenges in a fast-changing financial system, including potential stability risks posed by the rapid adoption of digitalization and climate change for many in the Fund's membership. Tackling these issues in FSAP would require enhanced collaboration with the World Bank, FSB, BIS and other international organizations, as well as increased investment in human capital within the Fund.

Modalities. We concur with MCM staff views that remote engagement could complement physical missions, but the former is less effective given the challenges of time zone variations, sharing of confidential information, and building relationships with authorities and engaging in sensitive conversations.

Analytical Tools. We support staff's work on improving the modelling of interconnectedness and macrofinancial feedback effects, the coverage of nonbanks, the calibration of macroprudential policies, and financial stability analysis frameworks for risks related to climate change and digitalization. We caution that addressing complexities in assessing climate-related financial risks, including data availability, and incorporating them into stress testing, and monitoring, will be challenging.

Traction. We note positively that FSAP traction is strong and has improved in recent years. However, we are of the view that traction could be increased further by deepening the integration with Article IV surveillance which is not seen as adequate by several Directors. Also, the low-frequency of FSAPs makes them less well-suited to identifying fast-changing risks creating an opportunity for Article IV consultations to look at higher-frequency risks. In this context, we encourage training of desk economists in developing/using analytical tools to leverage the FSAP to strengthen financial surveillance in Article IV consultations. Furthermore, Article IV may rely on authorities' stress testing capabilities and self-assessments.

We encourage acceleration of targeted technical assistance on financial stability issues and, where appropriate, use the World Bank's development modules to counterbalance the impact of the global systemic focus of the FSAP on LICs. We welcome the increased support for members without mandatory assessments through the FSSR to help low and lower-middle-income economies diagnose financial sector vulnerabilities and prioritize financial sector reforms, supported by targeted TA. The FSSR is not a substitute for FSAP, but it is a useful part of IMF's toolkit and it complements the World Bank's work on financial sector development in these economies. We stress the importance of coordination between capacity building and surveillance, particularly of the financial sector, is a key element of Fund's mission. Therefore, we call for a stronger engagement of Fund surveillance and capacity building, including training, on macro-financial issues in emerging and developing economies.

Country Participation. As discussed in the March Board meeting, we reiterate our support for staff proposal to update the current list of systemically important financial systems based on a *refresh-plus-risk-based approach*, by adding another level of risk tolerance to identify additional jurisdictions assessed at a lower frequency. We endorse staff proposal to assess the 32 jurisdictions at a 5-year frequency, identified on the basis of size and interconnectedness, and the additional 15 jurisdictions to be assessed on a 10-year cycle. We note positively staff calculations which confirm that no major gaps exist between FSAP demand and supply and

the two are largely balanced. We support staff proposal to conduct thematic assessments for regions without supra-national authorities subject to resource constraints.

Resources. We note that the budgetary implications from increasing mandatory FSAPs can be addressed by reprioritization within the MCM. We underscore the need to focus on macro-critical areas with clear financial stability implications to increase resource efficiency. We recall that, in the March Board meeting, several Directors called for continued focus on emerging issues including climate change, fintech, cyber security and digitalization, which would have resource implications. On the issue of human resources also, we note that additional staffing requirements are expected to be accommodated by reprioritization within MCM resources (§92). *Could staff provide more clarity on how the resources needed for emerging issues would be met over the medium term? We would appreciate elaboration on the incremental costs of including emerging issues like climate change and digitalization into FSAs?* Since these issues are now part of the Fund's strategic agenda, we are concerned at exclusive reliance on continued reprioritization and reallocations. This will prove detrimental to the quality of the Fund's work and to its engagement with the membership, alongside work pressure on staff. Augmentation of the structural budget in these areas will be critical. As recommended by the IEO, significant additional resources are needed to strengthen financial and macrofinancial surveillance in Article IV consultations and to respond to members' requests for voluntary FSAPs.

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GRAY/21/1185

May 7, 2021

**Joint Statement by Mr. Buissé, Mr. Fanizza, Mr. Hilbers, Mr. Pösö, and Mr. Merk on
FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We reiterate our strong appreciation and support of the Fund's Financial Sector Assessment Program (FSAP) as a highly useful element of global financial surveillance.

We welcome the thoroughness of the FSAP review, including the focus on preliminary lessons learnt from the Covid-19-induced crisis. Overall, we are of the view that staff drew appropriate conclusions from this crisis for the FSAP review.

We agree that the established three-pillar framework should remain the basis for all FSAPs. We consider this approach appropriate and useful across all the assessments. We agree with the staff's view that due to the Covid-19 pandemic, assessments under all three pillars have not only become more urgent, but might also have to be adjusted to properly cover new emerging risks. We consider that the three-pillar approach can ensure a sufficient degree of flexibility to adapt the assessments to each country's circumstances, to the global financial stability situation, as well as to increase focus on emerging risks.

We endorse the suggested additional emphasis on macroprudential stress testing in assessing financial sectors, as well as on analyzing macro-financial linkages and feedback effects.

We concur with the staff's view that, in the light of the current pandemic, new and emerging risks to the financial sectors have to be properly monitored and analyzed in line with the Fund's mandate. This includes, among others, risks stemming from the non-bank financial sector and FinTech, cyber risk, and climate-related risks. Prioritization will be key to strike the right balance between the analysis of traditional FSAP risks and new risks, while striving to improve data availability. As regards climate-related risks, we strongly welcome the

additional deployment of climate stress-testing and prudential frameworks' adequacy assessments.

We share the view that FSAP traction is strong and has improved further in recent years, and support staff's proposals for further strengthening. In particular, a closer integration of findings and recommendations of FSAPs in the corresponding Article IV reports is warranted, including better prioritizing FSAP recommendations based on macro-criticality, systematically following up on FSAP recommendations in Art. IV consultations, and greater cross-mission participation of the respective teams. In line with necessary adjustments to the FSAPs, Art. IV consultations should devote more attention to macro-financial stability risks, and in particular to crisis-related issues. Given their much lower frequency, the FSAPs pay greater attention to more structural and systemic risks. We are committed to co-operate with the Fund on its efforts to increase traction in our jurisdictions, including in terms of outreach to further disseminate FSAP findings and recommendations.

In our view, FSAPs should cover all jurisdictions with systemically relevant financial sectors. We agree with the suggested, broadly unchanged, methodology of identifying such jurisdictions, and take note of the two main adjustments to make the methodology and the selection more risk-sensitive and more robust. We understand that the application of this methodology leads to an expanded list of jurisdictions covered by mandatory FSAPs, reflecting the increasing size, dispersion and interconnectedness of financial sectors. At the same time, we underline that the methodology should not be used mechanically and should take into account country specificities. We agree that differentiating the periodicity of mandatory reviews is useful to address the increasing demand on resources. At the same time, the Fund could assess the frequency of mandatory reviews for the second subgroup of countries in light of fast-moving structural changes and the emergence of new sources of threats to financial stability. The demand for voluntary FSAPs should continue to be accommodated. We also consider that further assessment and discussion of the criteria for voluntary FSAPs might be warranted in the future.

We agree that, in accordance with established practice, when any of the members have transferred significant responsibility for financial-sector oversight to a supranational level, a complementary separate assessment of supranational policies is warranted. Such additional assessment is necessary to achieve a comprehensive evaluation. It should target policy recommendations to the appropriate supra-national and/or national authorities and minimize duplications of exercises.

We therefore agree that euro area FSAPs should take place at the same frequency as for the members subject to mandatory financial stability assessments with the highest frequency, and

should parallel the arrangements for surveillance of euro area monetary and exchange rate policies, which is an integral part of the Article IV process for each member. We recall the already existing commitment by FSB G20 members, including the European Union, to seek such regular assessments.

We take the view that the euro area FSAPs and FSAPs for individual Members of the euro area should be complementary, based on the IMF-ECB staff level guidance agreement from July 2018. By analogy, elements of this are also applicable as regards Member States that have entered into close cooperation with the ECB SSM. We expect that euro area Members' FSAPs will be scoped in such a way that they take a holistic view of the banking systems but avoid duplicating the assessment of euro area policies, which focuses on areas where euro area institutions have authority, implying also that national FSAPs abstain from assessments of the effectiveness of ECB/SSM banking supervisory work. We believe that, in light of the specificities of countries belonging to the euro area and of the broad scope of national FSAPs for euro area countries, the latter will remain important surveillance exercises in addition to euro area FSAPs.

FSAPs for euro area countries should continue to include an assessment of financial-stability risks that might, whenever possible, rely on stress tests already available or on a new stress test, run by the IMF, on the aggregate banking system. However, duplication of efforts should be minimized, by relying, as appropriate, on results of euro area-wide stress-tests, and by focusing on country-specific risks and macro-prudential policy considerations. We continue to support the principles we agreed on the aforementioned IMF-ECB staff level guidance to facilitate the articulation of future FSAPs for the euro area and euro area countries.

We are mindful of the impact of carrying out such FSAPs on the resources of the authorities and of the Fund. Yet, overall FSAP costs for the Fund remain limited and fully justified by the broadly recognized need to step up macro-financial surveillance. We consider that Fund resources made available for the conduct of FSAPs and other surveillance exercises, including surveillance carried out under Article IV, should always remain adequate and reflect the Fund's mandate and the adjusted role and scope of FSAPs due to the pandemic.

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GRAY/21/1186

May 7, 2021

**Statement by Mr. Huh, Mr. Becker, and Mr. Yoo on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We would like to thank staff for the presentation, papers, and helpful prior engagement with our office. We broadly agree with the proposals in the review and support the proposed decisions. Further progress made by staff to identify policy priorities and new risks from the COVID-19 pandemic is welcome.

Scope

IMF financial surveillance must be sufficiently flexible to capture and address new and emerging risks. The current three-pillar framework (risk analysis, oversight, safety net) has sufficient flexibility to be adaptable. We agree that the implications of the pandemic will be a defining feature in the next five years across the three pillars. These include debt vulnerabilities in the household and corporate sector, exit from exceptional financial sector interventions, corporate sector restructuring, and management of non-performing loans, to name a few. In this respect, we welcome staff's intention to deploy additional analytical tools to examine household, corporate, and non-bank financial sector risks.

Another defining feature in the next five years is likely to be a “low-for-long” interest rate environment. Exceptionally easy financial conditions support the recovery but might also contribute to rising financial vulnerabilities in the medium term. Therefore, FSAPs need to analyze risk-taking behavior related to exceptionally low interest rates and coordination between monetary and financial sector policies, including macroprudential policy. In this regard, the Integrated Policy Framework may provide useful guidance on the optimal use of multiple policy tools to contain cross-border systemic risks.

The pandemic has intensified vulnerabilities in non-bank financial institutions (NBFIs) and their linkages to the financial system that warrant further surveillance efforts.

Assessing vulnerabilities in NBFIs, as well as domestic and cross-border spillovers, should also continue to be one of the key areas of focus. The FSB is leading work on NBFIs and we encourage the Fund to remain engaged in their work program with application to FSAPs.

We agree that FSAPs need to address emerging issues such as climate change, cyber, and fintech comprehensively across the three pillars. However, it will be important for the Fund to focus on areas closely related to its mandate and where it has a comparative advantage (economic and macroprudential analysis). Some topics, such as modelling climate/natural disasters or resolution standards, should leverage the expertise of other international organizations and standard setting bodies. The impact of digital technology should be assessed in a holistic way - as it provides risks to incumbent financial institutions but also opportunities for efficiency gains and better resources allocation.

On modalities, while face-to-face engagement between the authorities and FSAP mission teams is very important, we see scope for ongoing use of virtual engagement. We believe that well-designed and targeted virtual meetings before and after physical missions can help efficient communication between FSAP teams and authorities. We encourage staff not only to draw lessons learned from remote engagement but also to consider how to efficiently use virtual meetings to supplement and improve other forms of communication.

Quantitative Tools

We support enhancing the macroprudential stress testing framework, which is fundamental to risk analysis. We welcome proposals to deepen the understanding of new and emerging risks to the banking, securities and insurance sectors, and we support staff's work on strengthening tools and methodologies for incorporating these risks into stress testing, interconnected analysis, macro-financial interactions, and macroprudential policy.

The pandemic has introduced challenges for the adverse scenario design in stress testing. The current baseline for the financial sector is weak and the outlook is unusually uncertain. We are of the view that the scenario design needs to be realistic but balance this against the potential impact on confidence in financial sector resilience. In addition, the influences on the economy and financial system are largely unprecedented and therefore also subject to a greater than usual degree of uncertainty that makes the calibration of probabilities more difficult or is sometimes hardly measurable. It is therefore important to acknowledge that the application of quantitative tools, interpretation of stress tests, and ensuing recommendations must also be properly guided by qualitative judgement about remaining "unknowns".

The Fund should closely collaborate with, and leverage off the expertise of, other international organizations in considering the need for new tools to assess emerging risks. We would hesitate to endorse the imposition of larger data reporting burdens on country authorities but support filling existing data gaps.

Traction

Closer integration of FSAPs into Article IVs is needed to boost relevance and traction.

Doing so will strengthen the analytical framework and increase the effectiveness of the Fund's financial surveillance, but care should be taken to maintain the distinction between the two surveillance mechanisms. Ensuring the Fund has the skills and expertise on financial surveillance is important. Article IV teams should have access to sufficient financial expertise to allow them to meaningfully pursue financial stability issues. With such expertise, Article IV missions could be used to scope upcoming FSAPs, follow up previously identified issues, and update existing FSAP recommendations. We see synergies between new and standardized tools that Article IV staff can more easily deploy to update FSAP analysis. This would also ensure more regular and effective financial surveillance across the entire membership in the context of Article IVs, even in the absence of an FSAP. This is also consistent with IEO recommendations and part of strengthening macro-financial surveillance in the CSR. We were disappointed that a proposal of the participation of FSAP mission chiefs in Article IV mission in intermittent years was dropped due to budget considerations. However, we think the proposal – for 2 to 3 years, rather than only one year after the FSAP – could better contribute to increased traction.

We support the inclusion of the authorities' views in the FSSA reports similar to the approach in Article IV staff reports. We expect this will make it possible to have deeper engaging communications between the authorities and the team, but also provides an opportunity to assess traction more precisely.

New simplified, user-friendly tools need to be sufficiently flexible and adaptable. This is to ensure that important country-specific circumstances and proper transmission channels are captured with advice targeted at direct application.

Country Participation

We support a more risk-based approach to determine mandatory FSAP participation.

But we note that not all financial sectors are equally systemic or interconnected. Therefore, a risk-based focus which differentiates the scope and coverage is important. We agree that a thematic focus on one or two issues can work well when there has been a positive comprehensive assessment under the latest standards.

We continue to place value on financial sector development in emerging and developing economies.

Access to voluntary FSAPs (and financial sector expertise more broadly) is important for countries on the voluntary list that greatly value the IMF and World Bank's help in strengthening their financial systems. We welcome the discussion on financial surveillance with a regional theme on Nordic countries and see merit in a Pacific region exercise on a thematic topic to complement national financial surveillance. Where there are specific issues of regional relevance to small and vulnerable countries with weak financial infrastructure, financial surveillance can play an important role. One such example is the issue of rapidly declining Correspondent Banking Relations where some countries have grave financial stability concerns. We therefore advocate coverage of supra-national entities

and consideration of regionally focused FSAPs, as well as broad spillover analysis for countries with important regional linkages.

Better integration of financial surveillance with capacity development (CD) is critical for small developing states, LICs and fragile states to ensure traction and delivery on policy advice. For members with capacity limitations, policy advice needs to be practical, tailored and accompanied by well-sequenced and well-coordinated technical assistance (TA) where needed. TA should be of sufficient quality that is leading to lasting capacity building. We therefore see synergies between spillover analysis in major country FSAPs that is supplemented by Financial Sector Stability Reviews (FSSR) for downstream lower-middle-income countries with associated TA follow-up.

Resources

Careful consideration of resource implications from additional scope in FSAPs is critical. FSAPs are resource intensive and the review highlights that additional scope that will become relevant going forward (e.g., post-pandemic stresses, digital technology, climate risks) will require more investment in human capital. Re-prioritization of resource deployment must ensure that new focus areas do not unintentionally crowd-out the core financial stability risk assessment undertaken in FSAPs. We note that some proposals could be absorbed within the existing medium-term budget envelope and we encourage the Fund to press on with implementation through appropriate reprioritization and reallocations to drive efficiencies. We would expect that staff engagement with the Board on resource adequacy will become a more frequent feature of meetings in the context of IEO recommendations.

Climate Risk and Mitigation

We broadly support the focus on climate change risk as a key emerging topic, and in particular the work on climate stress tests. We support work to deepen members' understanding of climate-related risks to the banking, securities and insurance sectors and to develop methodologies for incorporating these risks into stress testing. The IMF has played an important role in establishing stress tests, by sharing experiences and building the capacity of authorities to undertake these. We hope that by including climate scenarios in longer-run stress tests the Fund can play a similar role in addressing climate change risk.

We note that development of policy and regulatory frameworks in relation to managing climate risks is at an early stage. Accordingly, the Fund's work should be focused on taking stock of different country experiences and approaches, as we work towards a common understanding of climate-related risks to financial stability and how resilience to these risks can be improved. At this point we are cautious about Fund providing overly prescriptive policy advice or criteria against which a country's integration or assessment of climate-related risks will be assessed. That said, as experience is gained, best practices in this area can be identified and supplemented by recommendations by the relevant bodies for use in FSAPs. The Fund could collect information on different approaches and play a role in

contributing to the development of international consistency in the way climate-related risks are understood (e.g., in the NGFS).

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GRAY/21/1187

May 7, 2021

**Statement by Mr. Mouminah, Mr. Alhomaly, Mr. Keshava, Ms. Alaqla, and Mr. Rawah
on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the excellent set of papers and their continuous engagement on this important work. **We reiterate our strong appreciation of the FSAP, which provides valuable policy recommendations for financial surveillance and capacity development.** Indeed, stakeholders confirm a great degree of satisfaction with the FSAP (Figure 1), and the updated survey results following the pandemic show increased demand across all three pillars (Figure 2), reflecting a useful risk-based framework for scoping financial stability assessments keeping in view country's circumstances. Against this background, we would like to make the following preliminary comments.

The pandemic has upended the financial stability landscape and will have an important bearing on the conduct of FSAPs in the coming years. Notably, in the wake of a massive economic shock, financial vulnerabilities have risen across the membership, which deserve close attention in financial stability assessments. As rightly underlined in the paper, there has been a severe impact on the household, corporate, and public sectors, and so a deep dive into assessing granular risks stemming from those sectors maybe needed. In addition, the growth of nonbank financial institutions (NBFIs) and increasing cross-border and cross-sectoral interconnectedness, along with the acceleration of digitalization, represent new potential sources of financial stability risks that require close attention. Other emerging challenges also deserve attention, where macro-critical, and depending on country-specific circumstances. We also take note of risks arising from incomplete regulatory reforms, including for NBFIs. Furthermore, we concur that the eventual withdrawal of extensive policy support measures would need to be a major focus of FSAPs in the coming years.

We welcome the flexibility within the three-pillar framework, which helps customize assessments in light of the specific needs of member countries. The flexibility is important in the light of uncertainties in the wake of the pandemic as well as due to fast evolving financial landscape, especially due to financial innovations and increasing cyber risk. It is therefore logical to cover each of the three pillars in an FSAP while prioritizing among specific risk topics within each pillar given the resource constraints. In this context, we underline the importance of taking into consideration the authorities' risk assessment and priorities among many potential risks.

On modalities, we see remote engagement playing a complementary role to physical missions. We agree that remote engagements are particularly relevant for the scoping mission while in-person visits would be more effective for main missions especially given the difficulties in remote sharing of confidential data. At the scoping mission stage, remote engagements will also be helpful in expanding the reach to more financial institutions and stakeholders and making physical missions more focused. At the same time, remote missions are not a substitute for physical missions, which provide more opportunities for holding sensitive discussions, facilitating continuous dialogue, and building strong relationships, thereby improving traction and advancing the role of the Fund as a trusted advisor. It is therefore critical to strike a right balance between in-person visits and virtual meetings depending on country-specific circumstances.

We broadly support the proposals to strengthen scoping and have a few specific comments:

- Areas identified as important in the 2020 survey of stakeholders (Figure 6) provide important guidance for the prioritization of risk analysis for future FSAPs. Here, we note that country authorities have shown interest in vulnerability assessments of the household and corporate sectors, interconnectedness analysis, bank stress testing, followed by quantitative calibration of macroprudential measures, cyber risk, NBFi risk, and analysis of macrofinancial feedback. In this context, we note that risk related to climate was placed among the lowest priority. This shows that country authorities are prioritizing crisis-related risks as well as focusing on modalities for and implications of exits from extraordinary policies implemented during the pandemic.
- Against this background, we remain of the view that any coverage of emerging issues should depend on the characteristics of a particular country with macro-criticality and a strong link to financial stability risk, as well as close consultation with the authorities. Here, we emphasize that a phased approach to assessing climate risks would be important given expertise limitations in the Fund. Learning from integration

of climate change issues into surveillance first and building staff knowledge will facilitate gradual expansion of FSAP work in this area with good quality of policy recommendations. We would also encourage continued close cooperation with the World Bank in EMDE FSAPs, particularly given the link between financial stability and development and the Bank's deep involvement in climate finance.

- Assessing agreed international standards is at the core of the FSAP exercise. In this context, we take positive note of staff's view in ¶43 that Pillar 2 on Oversight "may need to develop a comprehensive approach to address emerging challenges from climate change, cyber risks, and fintech based on new standards and guidance for these risks under consideration by standard-setting bodies (SSBs) as they become available". *We would appreciate staff elaboration on the status of development of new standards in each of the emerging areas.* In this context, we are surprised that Fund staff is developing an approach to embed climate risk considerations in the review of supervision and regulation, which will be pilot tested in upcoming FSAPs (¶80 of the Background paper on Scope). *Here, we reiterate that the Fund should not duplicate the work underway in SSBs and would welcome staff elaboration on this work, including their collaboration with other relevant institutions particularly the FSB.* We also take note of important modeling challenges in assessing transition risks, as underlined in the paper. *In particular, we seek staff comments on how they would make carbon price path assumptions and whether they have consulted with the wider membership beyond the NGFS on modeling-related issues.*

On quantitative tools, we welcome the focus on further enhancing the macroprudential stress testing framework to help assess risks on a system-wide level. In particular, we take positive note of focus areas, including risks in nonbank financial sectors, links between the health of nonfinancial sectors and the soundness of banks' balance sheets, and greater analysis of interconnectedness. *We would be interested in staff's views on how they will make more effective use of improved quantitative tools in respect of G-SIBs in the light of continued data constraints.*

To help increase traction, we endorse proposals in Table 3. Survey results confirm already high levels of satisfaction of country authorities with FSAP recommendations, high implementation of recommendations, and improving publication rates of FSAP documents. All four proposals are well thought-out and will further increase traction. Explicitly reflecting the authorities' views in the FSSA, similar to the practice in Article IV staff reports, is a sensible move as it will help bring out the specifics of technical disagreement with staff. In this context, we take note that S29 jurisdictions considered technical disagreements to be the top reason for not implementing recommendations. We feel that strengthening connection

between the FSAP and follow-up technical assistance should have been one of the proposals, which would go a long way in addressing capacity constraints and improving implementation of recommendations, thereby further enhancing traction.

Finally, we support proposals in Table 5 on participation. In particular, we welcome the proposal to strengthen the risk-based approach to surveillance by identifying additional jurisdictions to be assessed at a lower frequency. It is also important to accommodate all demands for voluntary FSAPs as conducting financial surveillance is part of the core mandate of the Fund and necessary resources need to be provided for this crucial work.

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GRAY/21/1188

May 7, 2021

**Statement by Mr. Jin, Mr. Zhang, and Mr. Law on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

The Financial Sector Assessment Program (FSAP) is a critical element of the Fund's financial surveillance. Survey results show that the FSAP is highly and increasingly valued by authorities for its contributions to surveillance, and we are confident that staff would continue their good work. We welcome the final proposals and appreciate staff's work on the review exercise over the past two years. While we generally support the proposals of the 2021 FSAP Review, we would like to make the comments as follows.

The COVID-19 pandemic has resulted in an unprecedented shock to the global economy. We strongly agree that the implications of the pandemic for financial stability—including from the eventual withdrawal of extensive policy support measures—should be a focus of FSAPs in the coming years. The spillover effects from advanced economies to emerging markets and developing economies need to be a core focus of FSAPs. Given the lower frequency of FSAP compared to say, Article IV consultations, we encourage staff to focus more on the structural, longer-term effects of the pandemic on financial stability. At the same time, it is also important not to lose sight of factors that may be affecting financial stability prior to the pandemic.

We continue to emphasize that the scope of each FSAP should be risk-based and well-tailored to the jurisdiction's circumstances. While improvements in tool efficiency through standardization and automation could ensure cross-country comparability, it is important to ensure that the staff's advice would consider the political economy of the jurisdiction. We agree that the FSAP should make even greater use of flexibility within the three-pillar framework to prioritize scope around the most systemically important risks. The implementation of FSAP should be forward looking and pay close attention on new and emerging risks, particularly those from nonbanks, fintech, cyber, and climate.

We welcome staff’s proposal to improve the FSAP’s traction through engagement with the Executive Board. Besides the proposal that staff should stand ready to offer a technical seminar to Directors on the Financial System Stability Assessment (FSSA) ahead of the joint Article IV-FSSA Board discussion, *do staff have additional proposals in mind?*

We broadly agree with the proposals to better leverage the FSAP to strengthen financial surveillance in Article IV consultations. Article IV consultations and FSAPs should complement each other. As pointed out in the report, however, some authorities have expressed concerns about the burden for the authorities in terms of preparatory work and number of meetings. *What are the proposals to streamline the work for the authorities to the extent possible?* We also emphasize that staff should be mindful of the potential data requirements for conducting stress-testing exercises, particularly new requirements related to climate changes, and avoid overburdening authorities in the process.

On modalities, we agree that remote engagement could complement but not substitute for physical missions. While having physical visits for main missions make sense, we think the Fund should be more creative in exploring how remote engagement can be used not just in scoping missions. For example, a hybrid main mission may provide more flexibility in scheduling meetings and avoid the need to pack all meetings within the usual two-week timeframe.

There needs to be more clarity on whether only the 32 jurisdictions subject to mandatory FSAP every five years (S32) would be called “jurisdictions with systemically important financial sectors.. The Proposed Decision 2 currently proposes a “low threshold” to identify the “jurisdictions with financial sectors that are considered systemically important” subject to a ten-year cycle, and a “high threshold” to identifies the “subset” of those “jurisdictions with systemically important financial sectors” subject to a five-year cycle. The proposal seems to suggest that only the S32 would be called “jurisdictions with systemically important financial sectors”, which is also our preference as it provides logic continuity to the 2013 methodology, and we think calling the S47 “jurisdictions with financial sectors that are considered systemically important” is confusing. It is also unclear how we should call the 15 jurisdictions subject to the ten-year cycle. **One alternative is to call the S47 “jurisdictions with systemically important financial sectors” while the S32 “jurisdictions with global systemically important financial sectors (G-SIFs)”** (similar to the terms “global systemically important financial institutions” (G-SIFIs) and “global systemically important banks” (G-SIBs)). *Staff’s views are welcome.*

While we can agree with the current proposal for the additional ten-year cycle, our preference remain that jurisdictions subject to mandatory FSAPs should follow the same cycle. The current ten-year cycle is too long and does not provide sufficiently timely and frequent advices to new 15 jurisdictions. In the next FSAP Review, the Fund should

revisit the case to merge the two lists, or at least shorten the ten-year cycle to seven or eight years, subject to resources implications.

On resources, we would appreciate more details on how MCM would reprioritize its work, as requested by a few Directors in previous Board engagements. Given that there are a number of new areas (notably climate change, digitalization, and macrofinancial surveillance in Article IV consultations) that MCM would need to work on in the coming years, we would hope that the quality of FSAP would not be compromised by the reprioritization of resources.

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GRAY/21/1189

May 7, 2021

**Statement by Ms. Levonian, Mr. O'Brolchain, and Ms. Vasishtha on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the rich set of papers and the close engagement with the Board over the course of the FSAP review. We broadly support staff's proposals aimed at strengthening the FSAP's role in the Fund's efforts towards building a more stable global financial system, while ensuring that it is sufficiently nimble to address emerging challenges. We agree that FSAPs for the coming years will need to adapt to pandemic-related risk analysis and policy recommendations. The established three-pillar framework provides sufficient degree of flexibility to adapt the assessments to each country's circumstances as well as the evolving global financial landscape and emerging risks.

Scope and Quantitative Tools

The FSAP must continue to evolve with the financial systems it monitors to deliver ongoing value-added to the membership. In light of the new sources of financial stability risks from the pandemic, we welcome the proposals to develop better tools for analyzing household and corporate sector risks. Assessing systemic risks arising from interconnectedness, domestic and cross-border spillovers, and the vulnerabilities in NBFIs should also continue to be key priority areas of focus. In addition, growing cross-border linkages between banks and NBFIs can exacerbate vulnerabilities, which warrant ongoing close monitoring. Furthermore, we agree with staff that the pandemic will likely test the crisis management and resolution policies, safety nets, and corporate insolvency frameworks, making these issues more relevant for FSAPs in the coming years.

The evolving financial landscape calls for further strengthening of FSAP quantitative tools and assessment methodologies. We support the proposed additional emphasis on macroprudential stress testing in assessing financial sectors, as well as on analyzing macro-financial linkages and feedback effects.

New tools also need to be developed to assess emerging risks, including those arising from fintech, cyber, and climate change. On climate change risks, we welcome the progress on embedding physical and transition risks in FSAPs, including through climate stress-testing and adequacy assessments of prudential frameworks. Climate-related issues pertaining to the financial sector should be incorporated in FSAPs when macro critical. Given the degree of interconnectedness in the economy and the financial system, it is important to assess the direct impacts of physical and transition risks as well as the indirect and second-round effects – which is a particularly challenging task. To that end, we support staff proposed three-stage approach to assessing climate change risks.

Close collaboration with other international organizations, particularly on emerging risks, remains critical. We concur with staff that there are important synergies to be leveraged from close collaboration with the World Bank in the work on climate change and fintech where both developmental and financial stability issues are crucial. Given the global dimension of climate risks, we also encourage staff to collaborate closely with other international bodies, including the UN, the FSB, international standard setting bodies, and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS).

Traction

We endorse the proposal for the FSSA to include an explicit section on the authorities' views, consistent with the approach in Article IV reports. This will help improve the authorities' ownership of staff recommendations and clarify any potential factors impeding implementation. As indicated by the survey of country authorities, the FSAP's impact is sometimes weakened by a lack of political support for the recommendations, technical disagreements, and capacity constraints. In this context, we encourage staff to broaden the concept of tailoring of policy recommendations to include consideration of trade-offs and alternative policy options and recognizing capacity, political economy, and intertemporal constraints in designing policy recommendations.

Better integration between FSAPs and Article IVs and strengthening the analytical framework remain key to enhancing financial surveillance, consistent with the IEO's 2019 recommendations and proposals under the CSR. The varying degrees of satisfaction revealed by stakeholder surveys regarding the depth of FSAP-Article IV integration clearly points to the need for further improvement in this area. To this end, we support staff's proposals to better leverage the FSAP to enhance financial surveillance in Article IV consultations.

- We welcome the significant progress in developing and deploying new user-friendly tools for financial surveillance in Article IVs, including the Global Stress Test, the

Universal Stress Test, and other tools planned for stress testing of nonfinancial corporations.

- We see some scope for cross-mission participation of FSAP and Article IV teams in initial assessments and follow-ups, including the participation of Article IV mission chiefs in the FSAP concluding mission. More cost-effective and durable ways to strengthen integration, such as through improvements in the review process and better knowledge sharing between Article IV and FSAP teams should also be considered.

Country Participation

We support staff's proposed list of 47 jurisdictions for mandatory FSAs, which makes mandatory assessments – and hence Fund surveillance – even more risk-based and provides greater coverage of EMDEs. We reiterate that systemically important financial sectors (SIFS) should continue to be monitored regularly to preserve the FSAP's role as a global public good and capture emerging vulnerabilities that could result in a systemic crisis. This is even more important in a post-pandemic context.

At the same time, we continue to place emphasis on greater access to voluntary FSAPs, and financial sector expertise more broadly, in light of financial sector developments in EMDEs. Access to voluntary FSAPs is a priority for members who are not on the mandatory list and greatly value the Fund and World Bank's help in strengthening their financial systems or where there are specific issues of relevance to a broader region (e.g. withdrawal of CBRs). We note positively that over the 2014-19 period demand for and supply of voluntary assessments were roughly in balance. We encourage staff to continue to monitor this demand-supply balance for voluntary FSAPs, given the possible increase in demand for voluntary assessments in the near term.

We welcome the clarification on the participation of supra-national authorities in FSSAs. We agree that, following established practice, in cases where members have delegated significant responsibility for financial-sector oversight to supra-national authorities, a separate assessment of supranational policies is warranted. It should target policy recommendations to the appropriate supra-national and/or national authorities and minimize duplication of effort. For the euro area this means that euro area FSAPs should take place at the same frequency as for the members subject to mandatory financial stability assessments with the highest frequency, and should parallel the arrangements for surveillance of euro area monetary and exchange rate policies.

Modalities

While we agree that certain features of the FSAP process are better managed through physical missions, we see some scope for enhancing virtual engagement. Physical missions complemented with well-structured virtual meetings can help strengthen communication between FSAP teams and authorities. We encourage staff to continue to explore ways to enhance remote engagement, with a view to containing the costs of enhanced financial surveillance activities and stronger external collaboration on issues such as climate, cyber, and fintech. Greater remote engagement could also facilitate integration between Article IVs and FSAPs by facilitating cross-mission participation.

We also see room for reducing the burden of FSAPs by streamlining FSAP questionnaires, especially for jurisdictions that already participate extensively in peer review exercises or those with capacity constraints, to make better use of resources and enhance the value added and traction of FSAPs. We also welcome staff's proposal to hold a dedicated technical seminar on the FSSA ahead of the joint Article IV-FSSA Board discussion which would be particularly useful for SIFS.

Resource Implications

Resource implications of the FSAP review and the CSR should be considered in the context of the overall medium-term budget envelope to allow the Board to take informed decisions on resourcing and appropriate trade-offs. We note that the CSR's proposal to expand macrofinancial talent to deepen and better integrate systemic risk analysis and macroprudential policy advice in Article IV consultations will require as estimated additional 24 FTEs with macrofinancial expertise. While the resource costs of the proposed expansion of mandatory assessments are expected to be managed by reprioritization within MCM, the need to cover emerging issues like climate, fintech, digitalization is placing additional demand on MCM's resources. We encourage staff to proceed with implementation through appropriate reprioritization and resource reallocations to conduct surveillance in a more efficient and cost-effective manner.

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GRAY/21/1190

May 7, 2021

**Statement by Mr. Mozhin, Mr. Palei, Mr. Potapov, Mr. Biriukov, and Mr. Shestakov on
FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

1. **The FSAP review offers an important opportunity to enhance the IMF’s financial surveillance and adjust the role of FSAPs to the evolving global financial landscape.** We thank staff for their efforts in the recent years to prepare a set of important proposals for the Board’s consideration. We understand that since the beginning the review has been somewhat constrained by the need to remain budget neutral. Despite these limitations, staff have been able to identify scope for further improvements. At the same time, we continue to believe that additional efforts are required to substantially strengthen financial sector work in Article IV consultations.

Scope

2. **The Covid-19 crisis will have significant implications for FSAPs in the coming years. Traditional macrofinancial risks and assessment of existing standards and codes should remain the core to FSAPs.** Staff’s analysis has rightly highlighted rising financial stability risks, with the growing role of non-bank financial institutions (NBFIs), elevating bank-sovereign linkages, and increasing cross-border and cross-sectoral interconnectedness. The unwinding of extraordinary support measures can lead to further increase in corporate and household vulnerabilities and result in restructurings of non-viable firms, creating additional pressures for the financial sector. The potential scarring effects of the pandemic highlight the urgent need to strengthen the resolution and solvency frameworks, as well as nonperforming loan (NPL) management.

3. **The three-pillar framework for financial stability assessments remains broadly appropriate and provides sufficient flexibility to address the consequences of the pandemic crisis and gradually and pragmatically increase the focus on the emerging priorities, including climate change, fintech, and cyber.** The Fund needs to assess the risks from the household, corporate, and public sectors. The Fund should also focus more on

longstanding challenges, such as enhancing the analysis of NBFIs and interconnectedness to better grasp systemic risks and capture interactions between different forms of risks. The Fund should strengthen its analysis of macroprudential and microprudential policies, systemic liquidity, and AML/CFT issues. Assessing the effectiveness and adequacy of various financial sector policy measures taken in response to the pandemic crisis will also be an important task for FSAPs going forward. It will be critical to address data limitations at the global level and improve access to data in individual country FSAPs.

4. **The proposal to expand the practice of the thematic approach to scoping FSAPs on one or two issues requires careful and risk-weighted experimentation.** We understand that the thematic approach would require a recent positive comprehensive assessment of financial system health and oversight. This requirement could limit the exercise to the most systemically important jurisdictions, where the materialization of risks can adversely affect the global financial stability. We encourage staff to closely monitor potential tradeoffs and risks related to the implementation of the thematic approach. We also call for timely Board engagement in evaluating the effectiveness of any innovations, significant experiments, and pilots.

5. **Given the competing priorities and the resource constraints, incorporation of emerging risks from climate change, fintech, and cyber into FSAPs will be challenging.** The lack of common standards and guidance by SSBs can add additional complexities for the Fund to address these issues. In this context, we welcome staff's proposal to rely on a pragmatic pilot-based approach in those countries where the related risks are assessed to be macro-critical with a potential strong impact on financial stability. This approach should allow to take into account country-specific circumstances and support progress in the development of assessment techniques. Addressing these issues under FSAPs will require the development of the Fund's in-house expertise, including stress testing and quantitative tools, and better coordination with international organizations, relevant UN agencies, and SSBs. *Could staff elaborate on progress that has been made in developing international standards and guidance for emerging risks from climate change, fintech, and cyber?*

Quantitative tools

6. **We commend staff for advancing the analytical toolbox to account for evolving macrofinancial risks and vulnerabilities.** We welcome the expanded scope of systemic risk analysis that should properly cover not only the banking system, but also NBFIs and nonfinancial sectors. There are important efforts to analyze interconnectedness of different financial risks and broader macro-financial linkages and feedback loops with the real sector. We see a scope for better integration of many proposed modelling techniques into scenario analysis beyond stress-testing exercises.

7. **The Fund should not rely on a single modelling strategy and should command a wide variety of analytical tools, some of which might be more appropriate in one**

context and not in another. For example, DSGE models could also provide insight into the optimal policy mix, something that the Integrated Policy Framework is promising to deliver, and we believe that the IPF tools should be better utilized in FSAPs. However, while DSGE models could be used to extract interpretable shocks from the historical data and provide an empirically-based path for key variables in response to any simulated shock, they might be a poor guide when analyzing large shocks that trigger non-linear effects, which bring the economy far from its steady state. Therefore, in stress test scenarios DSGE models should be complemented by macroeconometric methods (e.g., SVARs). We also support the broadening of the Fund's toolbox with agent-based models to account for solvency-liquidity risks interaction, and hope that these models would provide more policy-relevant insights on the contagion risks.

8. **Going forward, the continued broadening and refinement of the Fund's quantitative toolbox would benefit from the collaboration with the external partners.** Transparency of the quantitative tools used by the Fund should be facilitated through publication of the detailed guidance notes and open software codes. Any costs that the preparation of such materials entails would be quickly offset by the improvement of the Fund's tools via discussion with the expert community. Given the sometimes large volumes of financial data, dynamic factor models, BVARs, and machine learning approaches might be used more frequently during FSAPs. Another challenge is to carefully map observed events to shock while conducting scenario analysis: for example, a catastrophic climate event could be represented in the model as simultaneous occurrence of productivity shock, uncertainty shock, and capital depreciation shock, and breakdown of an event between these shocks might matter for policy recommendations. In many cases, team judgement is an essential ingredient, which should enter the analysis in a clear and transparent manner.

Traction and integration between FSAPs and Article IV surveillance

9. **The key objective of the 2014 FSAP review to enhance traction and impact has been largely met.** FSAPs recommendations became clearer, better prioritized, and more actionable. These led to an impressively high rate of their implementation by the country authorities.

10. **Yet, there remains scope for further improvements.** First, we encourage staff to streamline work to the extent possible in those countries where the authorities expressed concerns about the excessive FSAP burden for country officials. Second, results of the survey point to the necessity to improve nonbank risk channels coverage in certain jurisdictions. Finally, we support the proposal to incorporate the authorities' views into the FSSA reports.

11. **The proposals to strengthen integration between FSAPs and Article IV surveillance could have been more ambitious and gone beyond the budget neutrality considerations.** We welcome the development of simplified analytical tools by the MCM

that could be used by Article IV teams. We also support participation of Article IV mission chiefs in FSAP concluding missions, as well as the MCM early engagement in the preparation of Article IV consultations. *Could staff elaborate on how these innovations can sustain the follow-up implementation of FSAP recommendations?* At the same time, we recall the idea of increasing the MCM participation in Article IV consultations to help deepen financial stability assessments and macroprudential policy advice. We are disappointed that this proposal was dropped due to the lack of resources. *We expect that the issue of strengthening macrofinancial analysis in Article IV surveillance will be addressed within the budget structural augmentation and the 2021 CSR and FSAP reviews' operationalization.*

Participation

12. **Staff's final proposal for determining the list of jurisdictions with systemically important financial sectors subject to mandatory financial stability assessments is a reasonable compromise.** We support the minor improvements in the methodology for SIFS identification. At the same time, we remain concerned that additional mandatory FSAPs can reduce the MCM's ability to provide support for financial surveillance in Article IV consultations, upgrade the analytical foundations of the Fund's policy advice, and respond to requests for voluntary FSAPs by other countries.

13. **A mandatory FSAP for the euro area is warranted.** It will be paramount to ensure that assessments of individual euro area member countries leverage on and do not duplicate the euro area assessment. We also broadly welcome the proposal to conduct regional exercises on thematic topics for regions with strong financial linkages. We would highlight the importance to address serious weaknesses in the implementation of the AML/CFT rules and call for urgent measures to strengthen governance frameworks and regional cooperation in the highly integrated financial sectors. We recall that the 2018 euro area FSAP highlighted the need for a common EU-wide AML/CFT supervision framework and enhanced exchange of information between the prudential supervisors and the AML/CFT supervisors. *Staff's comments would be appreciated.*

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GRAY/21/1191

May 7, 2021

**Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, and Ms. Arevalo Arroyo
on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive set of reports and for their continuous engagement throughout the process. The FSAP is a highly valued IMF product among the membership, given its high quality and in-depth analysis, as well as its contribution to macro financial surveillance. We take positive note of the progress made since the 2014 Review. Going forward, we agree with staff that the purpose of the Review is to maintain the key components that have proven successful in the past, while making the product more nimble and flexible to challenges and changes in a dynamic and evolving financial landscape. The COVID-19 pandemic has underscored the importance of keeping the FSAP effectively positioned to respond to unforeseen challenges, as well as new trends such as climate-related financial risks and digitalization. **We broadly agree with the Review's five aims and support the proposed decisions.** We will provide the following comments for emphasis.

On Scope. We support the proposals by staff to strengthen Scoping. Although a lot of progress has been made in customization and prioritization of FSAPs, we agree with staff that flexibility of the three-pillar approach can be applied in FSAPs over the next several years. This would allow them to adjust their goals and focus to address the effects of the pandemic and confront the challenges posed by digitalization. Going forward, strong and timely engagement with authorities should continue to be a priority. We take note of the challenges that remote work has on FSAPs and believe that, while scoping missions can take place remotely, the main mission would be better served by in-person missions when the context allows.

We support the shift towards more in-depth risks analysis. The prioritization of risk analysis will be critical for the next generation FSAPs. In this regard, we highlight that an increased attention should be placed not only on non-bank financial institutions (NBFIs), corporates,

and households, but also on bank-sovereign linkages in both advanced and emerging markets. We endorse the use of Key Attributes of Effective Resolution Regimes as the benchmark for our assessment for insurance resolution frameworks. In this regard, we should continue to use the risk-focused approach to international standards.

On Quantitative Tools. We support the aim to strengthen the analytical tools for macro financial feedbacks, the interconnections, and a more comprehensive analysis that included NBFIs. In this regard, the availability of data could become a restriction to an effective adaptation of risk analysis under the new digital landscape. *Can staff comment on their view regarding the challenges of the fintech and cyber risk analysis due to the lack of adequate data?*

On traction. We take positive note that traction has strengthened in the past years. However, we agree that further improvements could contribute to increase traction, and we consider that the proposals of Aim III will help in this regard. In particular, the **inclusion of the authorities' views in FSSA** is a welcome step that will advance traction and ownership. **We support further integration between FSAPs and Art. IV** as it would allow for a better assessment of systemic risk related to the financial system, in line with the CSR. We welcome the participation of Article IV mission chiefs in the FSAP concluding mission to enhance this integration, as well as early engagement in the preparation of Article IV consultations. Moreover, while collaboration on the initial stages of the Article IV could enhance integration, we continue to have the view that continuous participation of MCM experts in selected Article IV is crucial to deepen financial stability assessments. We agree that the FSAP comprehensive approach to financial sector recommendations plays a relevant role in guiding subsequent technical assistance engagements.

On Country Participation. We broadly agree with the proposals on participation as presented in Aim IV. We support the list of S47 jurisdictions with mandatory FSA assessments. We welcome that the framework allows flexibility for earlier or later mandatory assessments to accommodate country concerns and emerging risks, including commitments related to FSB processes. We continue to place importance on financial sector development in emerging and developing economies and thus see access to voluntary FSAPs as a priority. In this regard, we take note of the refinement of the criterion based on the importance of the financial sector rather than the jurisdiction, but would caution against this change hampering the supply of voluntary FSAPs, as demand for this product by jurisdictions that see value in it but might not have a systemic financial sector will continue.

Clarification of FSAPs at a supranational level is welcome. According to current practice, in cases of delegation of financial policy responsibilities by systemic jurisdictions to a supranational authority, it is warranted that the Fund carries out a separate assessment of

supranational policies, with a focus on the specific areas of responsibility, and with the same frequency as for systemic jurisdictions. This assessment should be complementary to national FSAPs to avoid duplications or overlaps and facilitate streamlining the burden on national authorities, while ensuring a comprehensive evaluation. Differences in supranational institutional settings should be considered in the design of individual FSAPs with members of different currency unions.

On resources. We take note that staff's analysis concludes that the expansion of the list of systemically important financial systems for which the financial stability assessment is mandatory, will have only minimal medium-term budgetary costs. Regarding this point, *we would like to ask staff if in their assessment, the cost of the proposal to have the country's mission chief attend the FSAPs concluding meetings is included. Also, can staff elaborate on the possible budgetary implications of addressing the proposal to broaden the FSAP scope to include fintech, cyber, and climate financial risks?* Although fully understanding that this is an analysis that will take place in our medium-term budgetary discussions, we missed any mention on the resources section of the budgetary implications of a broader scoping of FSAPs.

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GRAY/21/1192

May 7, 2021

**Statement by Mr. Chodos, Mr. Herrera, Mr. Hendrick, Mr. Lischinsky, Ms. Bustillo, and
Mr. Corvalan Mendoza on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive set of papers and for reaching out to our office and other stakeholders. We welcome the progress made since the 2014 review to improve FSAP analytics and risk-based scoping while responding to emerging challenges, including macroprudential frameworks and policies, nonbank financial institutions (NBFIs), and analysis of interconnectedness. We take positive note of the survey results reflecting the value and appreciation by country authorities for the FSAP and their overall usefulness of the exercise. This is also the case for several countries in our constituency that had been pilots at the beginning of the FSAP and continue to value successive follow up assessments, some of which have focused on more detailed topics required by country specific circumstances.

1. **We welcome this FSAP review which will enhance the Fund's efforts towards a more stable and sustainable financial system.** We agree that it is important to build on past progress and leverage the FSAP's flexibility to balance resources with priorities. In the process of adaptation to the evolving financial landscape, we have to be careful in identifying as macro-critical, new issues such as climate and technological change, before deciding the scope of individual assessment. Strengthening quantitative tools, including ad-hoc tools for area department economists, will further increase the traction and integration with surveillance. We agree with the inclusion of additional jurisdiction assessed at a lower frequency. We support the review proposals as shown in Table 6 of SM/21/52 and the accompanied proposed decisions.

2. **We agree that the flexibility of the three-pillars approach provides the foundations to further strengthen the risk-focused approach to scoping FSAs.** Physical missions would be needed for effectively assessing granular risk to financial stability, interconnectedness of financial systems, vulnerabilities in NBFIs, and sovereign-bank linkages. In addition, we also envisage considerations for corporate debt restructuring and associated frameworks, to deal with the post-pandemic scarring. It will be important to continue the open dialogue and reach an agreement with the country authorities, in deciding whether to conduct a graded assessment or a focused review. Again, this flexibility has been greatly appreciated by the membership. *We take note of the specific suggestion in the survey to discontinue a Report on the Observance of Standards and Codes (ROSC) when a Detailed Assessment Report (DAR) is being published. According to staff, this will reduce*

some duplicative work. We would like to ask staff if this proposal would have a broad support among countries, and if so, if staff will also support the proposal?

3. **We concur that increased economic and financial vulnerabilities in the aftermath of the pandemic crisis should be the key focus of Pillar 1 in the near term.** The COVID-19 crisis will leave a legacy of large public debt, increased sovereign-bank linkages, increased intervention of central banks in debt markets and bank funding, and weaker corporate and household balance sheets, which may morph into insolvency and credit risks once exceptional policy measures (i.e. credit guarantees, moratoria, regulatory forbearance) are lifted. We agree that monitoring and addressing these risks and legacies should be the main priority of financial surveillance in the near-term. Once the recovery is well underway, financial surveillance should focus on implementing exit policies and rebuilding prudential buffers. Looking ahead, "low-for-long" interest rates and other unconventional monetary actions, necessary to ensure a safe exit from the recovery, may increase future risks to financial stability. We welcome greater use of solvency and liquidity stress tests in assessing financial stability risks and calibration of macroprudential policy tools. We encourage staff to take advantage and coordinate as much as feasible with stress tests carried out by national, regional, or supranational authorities.

4. **We support the emphasis of Pillar 2 on the risks and opportunities of financial digitalization, including cyber risks, digital currencies, and the rising role of NBFIs.** There has been good progress on assessment of macroprudential policies, and we agree that future FSAPs will need to use more solvency and liquidity stress tests. The availability of microdata for more countries would be helpful in the future to inform the calibration of borrower-based tools, including loan-to-value and debt service-to-income ratios. Progress on microprudential policies remains a challenge. Progress in the implementation of international regulatory reform agenda has been uneven across countries, and those who have complied de jure, may face de facto application institutional limits.

5. **We concur with staff on the relevance of effective frameworks for crisis management, safety net and resolution of financial institutions.** Increased vulnerabilities in the wake of the COVID-19 crisis place an additional premium on implementing an effective safety net and resolution framework. We support continued assessment of international standards, especially in low- and middle-income countries that may lag behind, with due consideration of country-specific characteristics. We also endorse the Key Attributes of Effective Resolution for Insurance Companies, but we emphasize prioritizing their assessment according to the risks involved compared to other financial intermediaries.

6. **The global financial crisis highlighted the importance of the coverage of systemic liquidity issues and its impact on financial stability.** The Fund should make additional efforts in collaboration with other partners and country authorities to reduce data constraints and improve methodological challenges. The qualitative assessment that spans the three pillars of an FSA may not be enough, particularly for systemically important financial centers where risks could materialize as simultaneous dislocation of asset and funding markets. We agree that assessment of reserve adequacy on the Article IV consultations is critical for those countries, where systemic liquidity could also be the central macrofinancial topic, and international reserves are crucial to mitigate aggregate FX liquidity shocks.

7. **On borrower vulnerabilities and distressed asset restructuring, we agree that at the end of the day, country authorities have an important role to play in Pillar 2 and 3 areas.** The effectiveness of the response depends not only on a good legislative framework, but also and most

importantly on the institutional capacity. Indeed, in some countries, even in the absence of formal agreements, the facto resolution framework has been effective as long as there is good coordination and capacity to respond from regulators and key stakeholders.

8. **On coverage of risks from climate change, cyber, and Fintech, the Fund needs to invest in human capital and some creativity and reallocation of resources.** There is no doubt these topics are becoming increasingly important for financial stability, but the Fund cannot do it alone, even if it builds some in house expertise. External consultants, other partners, and training at the Fund would be needed to begin addressing these issues in an effective and timely fashion. In principle, we support the Fund's three-stage approach as described in Box 2, including the conventional medium-term (3-5 years) horizon. Yet, given resources' constraints, we cannot emphasize enough the staff's call for striking a right balance between traditional topics and new issues based on country circumstances. Pilot assessments, like at the beginning of the FSAPs, may provide valuable insight and a pragmatic approach for the future.

9. **We agree with the proposed quantitative tools enhancements for FSAPs reports** to better gauge a system-wide level of risks, as well as specific institutions, sectors, and when data permits, climate change, fintech and cyber risks. The range of approaches used by the Fund like growth-at-risk (GaR), SVAR, DSGE or ABM models, just to mention some of them, did receive a high degree of acceptance and satisfaction from central banks and supervisors according to a recent survey. The latter speaks well of the adaptability of quantitative tools to different situations and its usefulness to reinforce the three pillars of the FSAP framework, namely, risk assessment, oversight, and safety net. *We would like to hear from staff further clarification on additional resources involved to assess new issues such as climate change, fintech, and cyber risks.*

10. **Quantitative tools are central for the membership in its decision-making process**, which is data driven, buttressed by solid analysis and sound judgement of specific situations. We would like to emphasize that when increasing the coverage of the analysis to nonbanks, country specific consideration shall be considered, as well as when calibrating macroprudential measures. For the near-term future, we see the Fund's planning, to standardize core risk analysis, as a positive step forward. It would work on different data environments, supported by a detailed guidance note, files, and codes. This innovative step, in our view, would enhance the transparency in the use of specific methodologies, promote a deeper interaction between the Fund and the authorities, and disseminate the accumulated knowledge to the membership on the use of these tools. *On this topic, we would like to hear staff's view on the adequate balance between standardization versus customization of risks analysis.*

11. **We welcome the proposals on improving traction.** While we agree that FSAPs make a valuable contribution to the Fund's policy advice and engagement, there is room for improvement. Better integration of FSAP recommendations into Article IV consultations and increasing engagement should be a priority. We take note of past efforts in integrating FSAP findings into Article IV surveillance. However, as staff recognizes, progress has been uneven. We believe increased interaction of teams and cross FSAP-Article IV mission participation, including participation of macro financial experts in Article IV consultations, is essential. In addition, early engagement of the FSAP and MCM team in the review of Article IV policy note could further contribute to deepening integration and improving the quality of policy advice. As we have expressed, adequate resources are needed. We strongly support the inclusion of a section in the FSSA discussing the authorities' views. Incorporating authorities' views would add crucial information on country priorities and enhance engagement.

12. **On country participation, we recognize the extended FSAP coverage while focusing on countries that are systemic for global financial stability.** In this regard, 157 countries representing almost 100 percent of total global financial assets, were assessed at least one time. To strengthen the FSAP process, we broadly agree with the report's proposals on country participation in the FSAP derived from the survey, which would lead towards a more stable and sustainable financial system. In this regard, to improve the 2013 methodology to determine SIFS and mandatory FSAPs, we believe that using averages in a five-year period would be better than the latest available year to avoid the volatility involved.

13. **At the same time, the selection methodology should consider all types of risks that could be derived in potential cross-border spillovers.** If anyone is left out it could create the space to develop future vulnerabilities. We also support strengthening the risk-based approach to surveillance and we agree with the new 15 jurisdictions incorporated for a 10-year cycle assessment. Furthermore, we approve that flexibility be applied before the mandatory deadline is needed. Related to the criteria for voluntary assessments, we agree with those selected by authorities during the survey with the small change proposed by staff to the criterion that refers to the systemic importance of the *financial sector* (instead of the country). As proposed in the CSR, we agree with conducting regional exercises on thematic topics.

14. **With regards to additional resources, the FSAP review proposes a modest addition to total Fund-wide direct spending; however, we wonder to what extent it relies on the approval of additional resources for other related workstreams, such as the CSR, climate change, and digitalization.** If that is the case, those additional resources should be clearly specified. *Could staff provide comments on this issue?*

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GRAY/21/1193

May 7, 2021

**Statement by Mr. Tanaka, Mr. Chikada, Mr. Naka, and Mr. Kuretani on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive reports on 2021 FSAP review. We commend staff for their hard effort to make detailed report amidst the continuing exceptional and uncertain circumstances. The FSAP has provided valuable analysis and policy recommendations to member countries since its inception. We understand that the opportunity for this review is quite important for the FSAP to continue to play an important role as a financial surveillance exercise adapted to the evolving financial stability landscape. From this point of view, **we broadly concur with the thrust of the staff's assessment and support proposals in the reports**, and would like to offer the following comments for emphasis.

Scoping

We agree with the staff's proposals to further strengthen the risk-focused approach to scoping FSAs, making even greater use of flexibility within the three-pillar framework. While preserving assessments across all the three pillars, we acknowledge the usefulness to structure the financial stability assessments around one or two cross-cutting themes. For example, corporate sector vulnerabilities and non-performing loan management warrants vigilance as issues relevant across the pillars, considering the potential scarring effects of the pandemic.

Emerging/increasing issues should be captured and well assessed based on the risks to financial stability. As staff mentioned in the report, vulnerabilities in nonbank financial institutions (NBFIs), whose role has expanded in markets, could pose risks to financial stability. We also support conducting climate risk analysis in FSAPs from the perspective of financial system stability affected by physical climate shocks and the transition to a low-carbon economy. To avoid the duplication of works, it is crucial to work closely with other bodies with expertise, including the United Nations and the World Bank. The Financial Stability Board and the Network of Central Banks and Supervisors for Greening the Financial System have conducted climate change incorporated stress test, climate change

data collection, and integration of climate change risk with the regulation and oversight. **Furthermore, given the fact that circumstances surrounding member countries are different, the Fund should try to conduct well-tailored analysis to each country rather than a one-size-fits-all approach.** We endorse the Key Attributes of Effective Resolution Regimes as the assessment benchmark for insurance resolution frameworks in FSAPs and stand-alone assessments, and the Key Attributes Methodology for the Insurance Sector.

Quantitative Tools

We agree with the proposals to strengthen quantitative analysis in FSAPs. In particular, we support to improve the modeling of interconnectedness and macro-financial feedback effects, the coverage of nonbanks, development of financial stability analysis frameworks for emerging risks—such as climate change, cyber, and fintech—and the calibration of macroprudential policies.

We caution that one-size-fits-all approach should also be avoided in quantitative analysis. For instance, MMFs, typical products in the nonbank market, are not suitable for a uniformed analysis since the characteristics of the product differs from country to country and so do their risks.

Traction

We welcome further deepening the integration of FSAPs and Article IV consultations to increase traction. Given that the prolonged COVID-19 pandemic will affect the financial system to a greater or lesser extent, it is crucial for the Fund to monitor financial sector developments and risks more closely in Article IVs. In this context, we positively note that increasing cross-mission participation is already in progress.

Participation

We support the staff proposals on further strengthening the risk-based approach to mandatory assessments by adding an additional level of risk tolerance to identify additional jurisdictions assessed at a lower frequency. This proposal seems a good compromise of the Board discussion to date. That said, given that the FSAP is a labor-intensive exercise for both the Fund and the authorities, seamless efforts to streamline the FSAP and implement it in a more resource-efficient and effective manner are essential. We also agree with the proposal to clarify the expectations for supra-national authorities' participation in assessments.

Resources

We note that the average resource augmentation by the proposed expansion in the number of mandatory assessments would be 1.5 FTEs per year and can be managed by

reprioritization within MCM budget. However, it is still unclear how much additional cost will be required to include the emerging issues going forward. In this regard, we expect staff to appropriately maintain the Board's engagement and explain the budget implications and trade-offs if the emerging issues require more resource in FSAPs. We also underscore the importance of further streamlining efforts and efficient implementation of risk assessment for the emerging issues in the medium term.

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GRAY/21/1194

May 7, 2021

**Statement by Ms. Riach, Mr. Ronicle, and Ms. Andreicut on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the excellent set of papers, the hard work throughout the review process and the valuable engagement with the Board and our office.

The membership faces significant and evolving challenges. The FSAP review offers a key opportunity to adapt the FSAP to an evolving landscape of financial risks, including climate change, market-based finance and digitalization, while not relaxing attention to countries' adherence to global standards. When we started the review, we didn't know that we would be adding a global pandemic to the list of challenges. Staff have responded aptly and produced an excellent set of notes, which deliver an FSAP fit for the post-pandemic future.

As one of the countries currently undergoing an FSAP, we are very much aware of the balance that FSAPs need to strike in this challenging macro financial period. This includes examining the adequacy of the oversight of the UK financial system, host to an array of globally systemically important institutions and home to a large domestic financial sector. It also involves balancing this more traditional focus with due attention to the impact of the pandemic, the growing share of market-based finance, the adoption of new technologies, as well as the rapidly increasing importance of climate change and cyber risk. The FSAP review provides a valuable tool in helping staff and the membership strike the right balance between adherence to standards and adapting to a shifting set of challenges. We

broadly share staff's recommendations and would like to offer the following reflections on the reviews' five aims.

I. SCOPE

We support strengthening the risk-focused approach to scoping FSAPs, including the greater use of flexibility within the three-pillar framework.

We agree that in countries where compliance with relevant financial sector standards has been established in previous FSAPs, there is scope to conduct a more focused review in future FSAPs, including deep dives into selected topics. However, we reiterate the importance of staff articulating the case clearly, outlining developments since the previous FSAP and explaining their judgement that these are not material. That will allow more thematic FSAPs to nevertheless maintain continuity in the assessment of standards, a core element of their role as “global public goods”.

We strongly support plans to make assessments of climate-related financial risks more prominent and encourage staff to consider including such assessments in all FSAPs, to the extent possible. This reflects the fact that all member countries will be faced with transition risks, physical risks, or a combination of the two. We appreciate however that such a degree of ambition will have resource implications and are open to discussing them in the context of proposals for a structural budget augmentation later in the year. We also welcome the helpful complementarity with the coverage of climate issues in Article IV reports, as set out in the Comprehensive Surveillance Review (CSR). Like staff, we see scope to cover climate issues across Pillars 1 and 2 of the FSAP and we support the proposed approach of considering both medium and long-term horizons. We also see a role for the Fund in highlighting the importance of climate related financial disclosures, an aspect currently missing from the report. Disclosures are critical to identifying sources of climate risk. Finally, we encourage staff to continue monitoring international developments on climate standards and to maintain a close collaboration with partners, in particular the Network for Greening the Financial System and the World Bank.

We very much welcome the focus on pandemic related challenges and agree that individual country circumstances will vary depending on which phase of the recovery they are in. We consider that the FSAP's three-pillar approach is appropriate for addressing such challenges and see a case for deep dives into the non-bank financial sector, given the vulnerabilities exposed by the COVID-19 pandemic.

II. QUANTITATIVE TOOLS

We welcome progress made in recent years in expanding the FSAP's quantitative tools and support plans for further developing the framework to include enhanced macro-financial feedback analysis, better coverage of nonbanks, the calibration of macroprudential policies, development of financial stability analysis frameworks for risks related to climate change and financial innovation.

We appreciate that the success of these tools is contingent on data constraints, particularly when it comes to emerging risks. We encourage staff to set out a roadmap for countries to improve the quality of data, both for domestic purposes as well as for the FSAP, not least as part of the Review of Data Provision to the Fund. This would ensure that data gaps are filled proactively, rather than waiting for individual FSAPs to reveal the gaps. Turning specifically to data gaps on climate issues, the FSAP review documents do not refer to the Fund's Climate Change Indicators Dashboard. While we appreciate that the Dashboard focuses on aggregated data, we encourage staff to assess whether some of its financial sector indicators could be leveraged for FSAP work and consider areas where the Dashboard could be expanded.

We encourage staff to continue standardizing core quantitative tools and improving their efficiency. We welcome the projects already in train, such as the bank and corporate stress test tools which can also be deployed in Article IVs. These tools play a key role in enhancing the quality of macro-financial surveillance in Article IVs, as set out also in the CSR.

We welcome the detail provided in the Quantitative Analysis Background Paper, in particular on risk in the nonbank financial sectors, climate change, cyber and fintech. We called for such a level of detail in previous Board engagements and are pleased to see staff's responses.

III. TRACTION

We commend staff for their thoughtful consideration of traction across the FSAP and CSR reviews and welcome the joined-up set of proposals, which clearly deliver on the IEO recommendations in this area. In particular, we support the following concrete steps to enhance traction: deepening the integration of FSAPs and Article IV consultations, deploying new tools to help risk analysis by country teams, increased cross-mission participation, reflecting authorities' views in FSSAs and offering technical seminars to directors on FSSAs, ahead of joint Article IV- FSSA Board discussions.

As this chair noted in the context of the CSR, **the talent-building proposal to enhance the quality of macro-financial analysis in Article IVs reflects the right scale of ambition in response to the IEO's recommendations.** This proposal will need to be considered in the round as part of the request for a structural budget augmentation later in the year.

IV. COUNTRY PARTICIPATION

We strongly support staff's proposal to maintain the 5-year frequency of assessments for the 32 most systemic financial sectors. We completely agree that now is not the time to cut back on financial surveillance in the most systemic jurisdictions and are pleased that the "refreshed list" of the FSAP review delivers this. While we are still not convinced that there is a need to make FSAPs mandatory for the next 15 most systemic jurisdictions, we can accept staff's proposal in the spirit of compromise. At the same time however, we encourage staff to remain mindful of demands for voluntary FSAPs from the membership and to ensure that these are met, particularly as the pandemic may put further pressure on the financial sectors of emerging and developing economies. We also support staff proposals for increasing the precision of the criteria for voluntary assessments.

Finally, we support the methodological improvements in the identification of systemically important financial sectors (using averages over a period of time and dropping derivatives weights) **and the proposal for assessments at the supra-national level**, where members subject to mandatory assessments delegate financial sector policies to a supra-national entity. We are also in favor of regional exercises on thematic topics subject to resource constraints.

V. RESOURCES

We note that most proposals in the FSAP review can be managed through reprioritization within MCM and that the expansion of the list of mandatory FSAPs to 47 would only entail a cost of 1½ FTEs. However, the papers also note that the FSAP would benefit from an augmentation of Fund resources for work on climate change and digitalization. The CSR in turn highlights that an extra 24 FTEs would be required to address the current gap in macro-financial analysis in Article IVs. We are very supportive of staff's degree of ambition, in particular on climate and macro-financial talent, but we will need to discuss the details as part of the budget discussions later in the year.

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GRAY/21/1195

May 7, 2021

**Statement by Mr. Palotai, Mr. Azal, Mr. Just, and Mr. Marek on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the detailed set of reports, as well as for their helpful outreach to our office. While we broadly share the thrust of staff's proposals to enhance the Financial Sector Assessment Program (FSAP) as one of the Fund's key surveillance products, we reiterate our concerns related to the employed methodology to determine the participation of jurisdictions in the list of systemically important financial sectors (SIFS) for mandatory FSAPs. We share the points in the joint gray by Mr. Buissé, Mr. Fanizza, Mr. Hilbers, Mr. Pösö, and Mr. Merk pertaining to the euro area.

The proposals to strengthen the risk-focused approach to **scoping** FSAPs are a step in the right direction to make the exercise more forward looking. It is critical to make even greater use of flexibility within the three-pillar strategy to customize scope in light of the evolving financial challenges facing member countries, including the impact of the Covid-19 crisis. The integration of new issues into FSAPs and surveillance in general, needs to be conditioned on their macro-criticality, which should be assessed on a case-by-case basis. *We would welcome staff's comments whether the proposed climate financial risk diagnostic will serve to assess macro-criticality of climate issues in a given jurisdiction. We note that staff have been intensifying cooperation with other international organizations on the emerging issues, including climate change, to leverage on their expertise. Can staff comment on the current climate-related work-streams in international organizations, in particular in the NGFS, where the Fund participates.*

The proposals to strengthen **quantitative analyses** in FSAPs are welcome, including to improve the modelling of interconnectedness and macro-financial feedback effects as well as to enhance the calibration of macroprudential policies. We underscore that future risks to financial stability might arise through interaction of traditional finance with increasingly complex sectors such as shadow banking and particularly hedge funds. Strengthening data coverage of NBFIs will therefore be instrumental to beef up the Fund's risk analysis of this sector. In addition, cyber risk monitoring is critical given that such risks have the potential to increase vulnerability across all financial markets and infrastructures. Given the market

sensitivity and low availability of data on cyber-attacks the Fund should focus on alternative analytical methods to mitigate the data gaps, including the cyber risk mapping exercise.

The operational proposals aimed at increasing **traction** through better integration of FSAPs with Article IV reports and increasing engagement with the authorities and the Board are welcome. The explicit reflection of the authorities' views in the FSSA would be particularly beneficial. In line with the adjustments to the FSAPs, Article IV consultations should focus more on macro-financial stability risks, and in particular to crisis-related issues. The inclusion of macrofinancial stability risks to Article IV consultations should proceed gradually in line with the Fund's capacities, be realistic and respect the relevance of macro financial issues for each country. Given their much lower frequency, FSAPs need to pay greater attention to structural, systemic and tail risks.

We note that the proposed methodology to determine the **participation** in the SIFS list for mandatory FSAPs is based on adverse spillover risks and transmission of macro-economic shocks across financial sectors. While we note that applying lower thresholds to indicators measuring the degree of interconnectedness reflect staff's ambition for a more risk-based approach and broader country coverage, they seem to be arbitrary, as any discretionary change would produce a different list of SIFS. Therefore, the methodology for identifying SIFS should not be applied mechanically and needs to reflect country-specific circumstances. *We would welcome staff's comments if they expect to use the same methodology in the next 5-year FSAP review and what the main determinants for setting the respective thresholds would be.* The authorities of the Czech Republic in our constituency remain unconvinced that the Czech financial sector should be identified as systemically important given the limited size of the non-bank financial sector and negligible spillover risks in the event of a domestic financial crisis.

We encourage staff to be mindful of the FSAP Review's **budgetary implications** in the context of the ongoing discussion on the FY22-FY24 medium-term budget. While we note positively that the costs related to conducting FSAPs in the newly proposed 15 SIFS could be accommodated through reprioritizing and savings in the MCM department, in our view these projections might be too optimistic. While some of the added 15 jurisdictions already participated in FSAPs on a voluntary basis and do not represent additional costs, the demand for voluntary FSAPs might increase from other members owing to potentially rising financial sector vulnerabilities as a result of the economic fallout of the COVID-19 pandemic. It is therefore critical to prioritize the use of budgetary resources in an efficient manner. To this end, a lighter version of FSAPs may be more appropriate for the 15 SIFS on the 10-year cycle list. *In addition, we would welcome staff's views on how the different FSAP costs will be reflected in the next FSAP review, against the backdrop of staff's assessment that average FSAP costs in large and complex financial sectors are nearly 3 times higher than in other jurisdictions.*

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GRAY/21/1196

May 7, 2021

**Statement by Mr. Andrianarivelo and Mrs. Raolisoa Andrianometiana on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the informative report and background papers, as well as for reaching out to our office.

We welcome this timely review of the Financial Sector Assessment Program (FSAP) which is taking place in parallel with the Comprehensive Surveillance Review. We note that the FSAP is increasingly appreciated by country authorities even though more is needed to further enhance traction and authorities' ownership of FSAP recommendations. The progress made in strengthening FSAP's focus, tools and implementation since the last review is commendable. We broadly concur with staff analysis and proposals and offer the following comments.

Regarding scope, we support the proposal to further strengthen the risk-focused approach to determining the scope of financial sector assessments (FSAs). We agree that the three-pillar framework remains useful for scoping the FSAs. We also agree that a greater flexibility within that framework would be appropriate to adapt FSAPs to the evolving global environment, including the effects of the pandemic. In this context, we encourage staff to further customize the FSAs to country specificity, building on the Risk Assessment Matrix (RAM). A greater emphasis on *oversight* would be warranted in future FSAs, especially as policy normalization strategies are being developed and implemented. As regards to *safety nets*, we support a Fund endorsement of the Key Attributes for reviewing insurance resolution schemes in the context of FSAPs. *Collaboration with the World Bank* remains an important part of the program—for emerging market and developing economies (EMDEs) but also, in some cases, advanced economies. This collaboration should be strengthened in the context of the Financial Sector Stability Reviews (FSSRs), especially with respect to the impact of the pandemic on digitalization and on financial inclusion.

On analytical foundations, we agree with the proposals to enhance the quantitative analysis in FSAPs. The quality of FSAP stress testing, as well as the other key areas of risk analysis remain appropriate. In addition, the FSAP clearly identified the most important contagion channels. The proposed increased focus on emerging issues—notably climate change, cyber security and fintech—and the calibration of macroprudential policy issues are warranted to adapt to the evolving landscape. We share the view that FSAP may need to further develop the analysis of granular financial risks stemming from vulnerabilities in households, corporate sectors, non-bank financial institutions (NBFIs), banking-sovereign nexus, and the interconnectedness of financial systems. Given the importance of country-specific circumstances, we would also like to see more attention to vulnerabilities stemming from the withdrawals of correspondent banking relationships in those members where this challenge remains. Additionally, modalities and implications of exits from policy support in response to the pandemic will be an important issue for many FSAs.

Regarding traction, we welcome its improvement among various stakeholders, and share the view on the necessity to further increase it, through greater integration of FSAP recommendations into Article IV surveillance, including for the most systemic jurisdictions. A closer integration of FSAP findings and recommendations into Article IV reports is warranted, notably through prioritization of FSAP recommendations based on macro-criticality. In this regard, providing streamlined or simplified analytical tools for Article IV follow-up is important and the participation of FSAP team members in Article IV missions is in our view logical. It is important to consider and incorporate the authorities' views in FSSA reports. As such Authorities can provide their views and insight, and FSAP team member may identify potential areas where further dialogue is needed to strengthen financial sector stability. We believe that publication of their views could also be considered. In addition, we believe that it is valuable to extend the scope of FSAP discussions to government agencies and parliamentarians to broaden political support and maximize the chances of implementation.

With respect to participation, a continued comprehensive coverage of jurisdictions with systemically important financial sectors (SIFS) is warranted while also paying attention to voluntary assessments and regional-level needs. We welcome the proposed refinements to the methodology for identifying SIFS to better reflect the key principles of relevance, transparency, and evenhandedness. With the significantly larger list, we must ensure that MCM gets the needed resources to accommodate these mandatory assessments. That said, requests for voluntary assessments from other central banks as well as requests for financial stability analyses from country teams should also be adequately met. On frequency, we are favorable to one assessment in five years per jurisdiction concerned. However, we underscore the importance of flexibility to conduct FSAP at a higher frequency as needed to account for major changes in regulatory systems and for emerging issues that warrant more immediate attention. Moreover, we support the proposal to conduct regional exercises on thematic topics where relevant and when resources permit.

Concerning resource implications, we take note that costs of FSAs have remained broadly stable over time but stress the importance of continuous vigilance on this front.

Although the scope of risk analysis has been expanding with new risks, the risk-based prioritization of topics has contributed to addressing the resource constraints. Likewise, with the reprioritization within the MCM budget, staff manage to address resource needs related to the expansion in the number of mandatory assessments as well as greater works on quantitative analysis. We encourage close monitoring of the adequacy of resources going forward.

Finally, we would have appreciated a concomitant review of the program of FSSRs to ensure that its focus also remains appropriate. The FSSRs introduced in 2017 have proven to be a useful complement to the FSAP in identifying financial sector vulnerabilities and guiding financial sector reforms in low-income and lower-middle-income countries. *While FSSAs and FSSRs are different exercises, we wonder whether the outcome of the current FSAP review will affect the FSSR program in any way? Moreover, we would welcome further elaboration on how FSSAs and FSSRs interact.* Going forward, greater Board engagement on FSSRs through informal briefings would be needed.

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GRAY/21/1197

May 7, 2021

**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.

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GRAY/21/1198

May 7, 2021

**Statement by Ms. Shortino, Ms. Senich, and Mr. Westphal on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the helpful reports and bilateral engagement on the Financial Sector Assessment Program (FSAP) review. The Fund's financial sector analysis has evolved to become a key pillar of its surveillance work, and the FSAP review recommendations appropriately aim to better and more seamlessly integrate financial sector surveillance with the rest of the Fund's surveillance and capacity development work. **We generally support the proposed changes regarding FSAPs' scope, quantitative tools, traction, and participation.** We are particularly supportive of plans to increase focus on the elevated vulnerabilities arising from the pandemic, deepen staff's financial sector analysis related to climate issues, and monitor delays in implementation of key regulatory standards. At the same time, it is important that analysis of new challenges does not come at the expense of surveillance of traditional ones, and striking the right balance will require that FSAPs be well-tailored to address specific circumstances within each jurisdiction.

We continue to emphasize the need to work with the financial sector standard-setting bodies (SSBs) and not preempt the development of international standards on emerging issues, including climate, cyber, and fintech. As there are few or no international standards on certain emerging issues such as climate, cyber, and fintech, the Fund will need to convey clearly where its assessments are based on international standards and where they are not. Staff should also avoid making recommendations, particularly in the Technical Note (TN) and Financial Sector Stability Assessment formal matrices of policy recommendations, when no international financial regulatory standards exist, and staff should not hold authorities accountable for implementing such recommendations in future years. Such recommendations, particularly if made across a range of jurisdictions, risk front-running international regulatory standard-setting processes and could lead to conflicting policy guidance. IMF surveillance should be a useful input into international regulatory standard-setting processes but not a substitute for them.

Scope

We strongly support international efforts to gain a more detailed understanding of climate-related financial risks. Toward that goal, we support the Fund's efforts to incorporate analysis of climate-related financial risks into FSAPs and to use standardized frameworks across countries to improve the efficiency and comparability of country results. Given that we are still in the early stages of developing data, metrics, and tools for assessing these risks and that many financial authorities are themselves developing and piloting such analysis, use of climate risk analysis in FSAPs should remain voluntary for now. Fund coordination with the Financial Stability Board and SSBs will be particularly important in efforts to develop and leverage common scenarios, analytical tools, and data sources, which will improve comparability and efficiencies in Fund surveillance across jurisdictions. It will also be important for the Fund to recognize and reflect the high levels of uncertainty involved in this analysis when presenting results, including those relating to bank resilience under its macro-financial scenarios, and to develop scenarios that consider reasonable expectations of the market and institutional adjustment to climate change on a plausible timeframe.

We support the continued use of the three-pillar framework with increased flexibility, as well as the assessment of compliance with international standards. Survey results find that the three pillars have helped staff to focus FSAPs on the most relevant financial sector issues, and these three pillars should also help to guide when to incorporate emerging issues into the reviews. We note that a majority of jurisdictions consider the principle-by-principle assessment of compliance with international standards to be among the most useful exercises in the FSAP, and we expect that staff will continue to prioritize these mappings as global public goods.

We agree with staff's proposal to allow for greater focus on specialized topics when international standards and country risk profiles have not changed since the previous FSAP, but we would appreciate additional information about how this will work in practice. For example, the Fund has written extensively about how financial sector vulnerabilities have risen in the wake of the pandemic, particularly in light of (1) elevated debt stocks; (2) feedback loops between corporates, banks, and sovereigns; and (3) the increased role of non-bank financial intermediation globally. Given these changes in most countries' financial sector risk profiles, we urge staff to prioritize the traditional mapping of standards and vulnerabilities during FSAPs in the near term. We agree that exit strategies from pandemic response policies will also be an important topic going forward, and we expect the Fund to collaborate closely with the SSBs on this issue.

As mentioned in our previous grays on the FSAP review, we would appreciate additional tangible recommendations from staff to streamline the FSAP process and make it less resource-intensive for national authorities. We note from our own experience that more focused FSAPs can still end up being incredibly resource-intensive for authorities, as our recent streamlined FSAP included 375 meetings – a 20 percent increase from the full FSAP five years earlier. We would once again recommend that staff place a ceiling on the number of meetings in an FSAP, tailored to the systemic importance and risks in a jurisdiction. This more focused FSAP also involved the maximum number of Full-Time Employees allowed by the Office of Budget and Personnel. It is also important for staff to adhere to the scope jointly agreed with authorities. In particular, when staff pursue TNs

instead of graded standard assessments, it will be important to select those TN topics early, prioritize meetings that will be relevant for those TNs, and stick with those TN topics throughout the FSAP process. Additionally, while we see value in the Fund performing stress tests for many jurisdictions, we would urge staff to make a clear assessment as to whether Fund stress tests will add sufficient value, particularly for those jurisdictions where it is widely recognized that they have already deployed comprehensive stress tests. It is important to weigh the high costs associated with staff and national authority time against the limited benefits of the additional stress tests.

Quantitative Tools

We support the proposals to develop new quantitative tools to measure financial stability risks, particularly to improve the modeling of interconnectedness and macro-financial feedback effects, as well as deepen the coverage of nonbanks. We consider this work to be core to the Fund's mandate. We expect that future work on macroprudential policies (MPPs) will treat MPPs as one set of tools among many in the financial regulatory toolkit, particularly given the lack of clear track record and limited deployment of some MPPs.

Traction

We support the proposed operational steps to increase the traction of FSAPs by integrating the FSAP and Article IV processes, deploying new tools to help risk analysis by country teams, increasing cross-mission participation, and improving follow-up on FSAP recommendations. We would appreciate more details on the potential timing for rolling out these recommendations, and we look forward to reviewing how the recommendations impact the traction of FSAPs over time. As stated previously, the proposals for additional resources seem ambitious, particularly the proposal for 50-75 additional FTEs to cover digital currency issues. We note that staff are not proposing to direct any additional resources to measures to increase traction. We will consider any such proposals as part of the broader request for a structural budget increase later this year.

Participation

We can support the hybrid approach that will add 15 countries to a 10-year mandatory FSAP rotation cycle. We appreciate that this increase in mandatory coverage will fit within the flat real budget envelope. We continue to expect that MCM will be able to perform voluntary FSAPs for other countries that request them, and these voluntary FSAPs align with the Comprehensive Surveillance Review's proposal to blend the Fund's surveillance and capacity development work for smaller countries, LICs, and fragile states. We also strongly support pursuing donor-funded Financial Sector Stability Reviews on a voluntary basis for low and lower-middle income countries.

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GRAY/21/1199

May 7, 2021

**Statement by Mr. Mohieldin, Mr. Alhosani, and Ms. Abdelati on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for the comprehensive and balanced set of papers and for their bilateral outreach to our office and outreach to member countries. The FSAP is an essential element of the Fund's work and it is encouraging that the Surveys confirm the valuable contribution of the FSAPs to policy formulation and risk mitigation.

We see this FSAP Review as having two distinct and complementary objectives, both of which we consider as necessary and strongly support. The first objective is to continue delivering on the earlier identified priorities to strengthen financial surveillance. The second is to incorporate the emerging issues that have become more critical for effective financial sector surveillance. This meeting builds on the recommendations of the 2010 and 2014 Reviews, and reflects the outcome of discussions in the informal meetings with the Board in March 2019, December 2020 and March 2021, as well as the financial sector proposals discussed as part of the recent Comprehensive Surveillance Review.

We fully support building on past progress and continuing to strengthen staff work on the earlier identified priorities. The immediate priority is to address the challenges of rising vulnerabilities during the pandemic and managing the exit from emergency policies, in spite of the resilience built since the global financial crisis. As also confirmed by surveys of members views, there is a need to build on past progress, and to continue to emphasize systemic risk, to deepen quantitative analysis of nonbank financial sector, to further explore interconnectedness, and to deepen the work on macroprudential policies. In the post pandemic period, coverage of the management of nonperforming loans will need to be strengthened, as well as challenges to systemic liquidity following the withdrawal of support measures.

We support flexibly balancing resources with priorities, including adding risks from climate and technological change, and new issues such as cyber risks, digital money, and fintech in the calibration of macroprudential policies. Staff should **continue to strengthen the risk-focused approach and to customize the scope of an FSA** in light of evolving challenges within the 3-pillar framework of risk analysis, oversight, and safety nets.

We place high priority on strengthening analytical tools as the Fund needs to remain a leader in order to ensure traction and value added. In this regard, we welcome the additional tools for calibration of macroprudential policies. We also look forward to the development of assessment methodologies and tools for fintech, cyber risk and climate risks, to the extent data permits. *While we welcome the combined use of different models to measure macrofinancial interactions, we call for caution in drawing policy advice on experimental models and tools.*

In this regard, we welcome proposals to further improve traction by better integrating FSAP work with Article IVs. We welcome the stability risk analysis tools being developed for the Article IV teams. We think it is important to include a summary of the authorities' view in the FSAP reports, as is done in the Article IV reports and the early engagement of MCM in the preparation of AIV consultations. We concur with the merit of ensuring participation of the AIV mission chief in the FSAP concluding meeting. We have also found it useful to include specialized MCM experts in Article IV missions. We also support the conduct of regional exercises on thematic topics and the assessments of financial policies at the supra-national levels, where appropriate. Re-prioritization and reallocation of resources within MCM should not compromise the country coverage of FSAPs and the departments' involvement in country team's work. Therefore, as stated in the budget discussions, it is important to ensure that MCM has adequate resources to carry out its mandate.

We place the utmost priority on ensuring adequate resources to respond to members' capacity development requests, to strengthen integration of financial surveillance in Article IVs with a stronger analytical underpinning, and to cover the new emerging areas. As such, regarding the staff proposal to adjust the list of mandatory FSAP assessments by having 32 FSAPs on a 5-year cycle and 15 FSAPs on a 10-Year cycle, our main priority is to ensure that this expansion and related resources does not detract from provision of CD or coverage of new areas of sector work that MCM needs to cover (fintech, digital money, and climate risks). It is not clear that we need to add to the number of jurisdictions under mandatory FSAPs, which do not necessarily add to the coverage of systemic risks, but we can go along with the proposal. As stated in the context of the CSR, we strongly support the provision of adequate resources to deliver on the surveillance priorities and to deliver on the provision of CD requests.

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GRAY/21/1200

May 7, 2021

**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 NBFIs space have done so for the insurance sector (most common), asset managers, and pension funds. However, the NBFIs 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.**

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GRAY/21/1201

May 7, 2021

**Statement by Mr. Trabinski, Mr. Peter, and Ms. Wehrle on FSAP Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We welcome staff's extensive work aimed at preserving the high quality, value added, and effectiveness of Financial Sector Assessment Programs (FSAPs). FSAPs are a core and highly valued element of Fund surveillance. We also welcome the close coordination with the Comprehensive Surveillance Review. We nonetheless agree that some refinements are desirable, including to better capture new issues and risks that have arisen in recent years.

We support further strengthening the risk-focused approach to scoping financial stability assessments (FSAs). Customizing scope within the three-pillar framework allows to adjust the focus to evolving country-specific circumstances, risks and needs, e.g., to address both the effects of the pandemic as well as emerging risks from climate and technological change, where relevant. Similarly, on standards assessments, FSAPs should continue to use a focused and risk-based approach. A country-specific approach and careful scoping are warranted, also to limit costs and resources to both the Fund and the authorities.

We strongly support strengthening FSAP traction through better integration with Article IV consultations. Integration helps ensure continued financial surveillance, which is particularly important for fast changing risks. Explicitly reflecting the authorities' views in Financial Systems Stability Assessments (FSSAs) will help to improve ownership and clarify factors that may impede implementation, for instance, technical disagreements with staff. The participation by area department mission chiefs in FSAP concluding missions would also facilitate follow-up on FSAPs. In parallel, early engagement of the FSAP mission chief and MCM in the Article IV consultation preparations is also important.

We welcome the Fund's efforts to refine its quantitative toolbox on financial surveillance. We support efforts to (i) improve the efficiency of core risk analysis tools, (ii) foster dissemination and application of new standardized tools, and (iii) strengthen the FSAP's quantitative tools, including for new risks, as feasible and as data permits. To

increase the traction of policy advice, staff needs to carefully explain the methodologies for assessing systemic risk in their dialogue with national authorities.

On modalities, the FSAP remains a complex exercise that requires rigorous planning and an understanding of the authorities' legal and/or institutional constraints. The Fund needs to remain mindful of confidentiality issues. Engaging with the authorities in a timely manner is important to find solutions that take data confidentiality issues into account, and appropriately balance transparency and market sensitivity. In addition, we reiterate the necessity of prioritizing data needs based on thorough cost-benefit analyses and in line with the Fund's core mandate. It is key to rely on existing data to the extent possible. We support remote engagements as a complement to physical missions, in particular for the scoping mission. At the same time, face-to-face exchanges between authorities and FSAP mission teams remain important, given the complexity and intensity of, and issues related to confidentiality in, an FSAP.

On mandatory assessments and country participation, we would have preferred an even more risk-based approach with more differentiated assessment frequencies. In our view, this would have allowed a more effective identification and prevention of systemic risk. For countries now on a ten-year cycle, we encourage staff to closely monitor whether such a long frequency is adequate from a systemic risk-management perspective or whether it would merit to be shortened, for instance, to seven or eight years. In addition, we stress the need to keep sufficient resources for FSAPs conducted before the mandatory deadline and for voluntary FSAPs. We continue to support the well-defined criteria to prioritize such FSAPs, including the proposed refinement to one of the criteria. We also take good note of the flexibility provided by the pandemic-related *de facto* extension of the deadline for mandatory FSAPs by one year. Finally, we agree to the clarifications made on the participation of supranational authorities in FSAs.

Financial surveillance is core to the Fund's mandate and should be adequately resourced. In general, additional resources in financial surveillance should predominantly be used to strengthen financial surveillance in Article IV consultations. We thus positively note that the expansion of mandatory FSAs to 47 jurisdictions will have limited cost implications, equivalent to an additional 1.5 FTEs per year.

2021 Financial Sector Assessment Program Review

Responses to Technical Questions Posed by Executive Directors in Advance of
EBM/21/46—May 12, 2021

Staff's responses to technical questions are below. Broader policy questions in the areas of resources and emerging issues, particularly climate change, will be addressed in staff's intervention at the Board meeting.

Aim I: Scope

1. Could staff comment on sequencing of the remaining steps to improve bank resolution frameworks and any plans to accelerate bank resolution reforms in LIDCs?

Detailed recommendations on bank resolution frameworks are provided as part of TA and are tailored to the country given its existing framework and institutions (e.g., legal system and protection of creditor rights). More generally, there are several factors that make it difficult for LIDCs to strengthen their resolution frameworks: 1) capacity constraints, for both legal drafting purposes and the operationalization of a resolution toolkit; 2) differences in prioritization, with many LIDCs starting only recently with reforms to bank resolution frameworks in view of other pressing needs; and 3) weaknesses in the broader institutional framework that can hamper effectiveness (e.g., insufficient legal protection, lack of operational independence, and inadequate data).

2. We would appreciate staff elaboration on the status of development of new standards in each of the emerging areas.

3. Could staff elaborate on progress that has been made in developing international standards and guidance for emerging risks from climate change, fintech, and cyber?

[Climate] SSBs have so far not identified new standards on climate-related risks but are developing guidance as to how to address climate-related risks within existing standards frameworks. Climate-related risks are likely to amplify traditional financial and operational risks. Therefore, a whole new set of standards may not be needed, but some enhancements are likely to be identified in the medium term. The NGFS has developed a Guide for Supervisors, which sets out high-level recommendations.

[Fintech] There has been limited progress with developing new standards, given fintech's relatively recent emergence. Nevertheless, selected principles of some of the existing standards are applicable for managing risks from emerging innovations and there are also ongoing initiatives to develop new guidelines and standards, including in the area of digital payments. In 2018, the Bank and the Fund developed the Bali Fintech Agenda (BFA), including 12 policy elements to harness the benefits while managing the risks. The FSB has published a set of 10 high-level recommendations for the regulatory approach to global stablecoins, while the IOSCO has published an approach to global stablecoins that might be considered securities. Similarly, the FATF has developed guidance on the AML/CTF

approach to crypto assets. The BCBS is reviewing the Basel requirements for banks that may hold crypto assets on their balance sheets. There are on-going initiatives to develop frameworks for managing risks posed by third party providers (e.g. cloud providers), the role of AI in finance, distributed ledger technology in payment, clearing and settlement, and decentralized financial technologies.

[Cyber risk] The supplemental guidance to the CPMI-IOSCO Principles on cyber resilience provides an effective framework for managing cyber risks that firms in financial services may face. The BCBS has focused on operational resilience and published guidance. The FSB has produced a Cyber Lexicon to establish a common taxonomy for regulators and the market, developed guidance on cyber incident response and recovery, and is currently developing guidance on cyber incident reporting. In addition to the SSBs, the G7 Cyber Expert Group has published a suite of Fundamental Elements (e.g. third-party risk, threat-led penetration testing, effective cyber assessments and cybersecurity risk management), which are increasingly used in different workstreams. Standards are also being developed by a range of bodies outside of the financial sector (e.g. NIST, ISO and ISACA), which are leveraged by financial authorities and market participants.

4. We take note of the specific suggestion in the survey to discontinue a Report on the Observance of Standards and Codes (ROSC) when a Detailed Assessment Report (DAR) is being published. According to staff, this will reduce some duplicative work. We would like to ask staff if this proposal would have a broad support among countries, and if so, if staff will also support the proposal?

MCM has piloted this approach. For example, the recent Philippines FSSA did not include a ROSC for the Basel Core Principle assessment, since the DAR (which include much more detailed information than ROSC) had already been published. This approach reduces duplication and saves resources without compromising the quality of the FSAP.

5. We would highlight the importance to address serious weaknesses in the implementation of the AML/CFT rules and call for urgent measures to strengthen governance frameworks and regional cooperation in the highly integrated financial sectors. We recall that the 2018 euro area FSAP highlighted the need for a common EU-wide AML/CFT supervision framework and enhanced exchange of information between the prudential supervisors and the AML/CFT supervisors. Staff's comments would be appreciated.

The European authorities are taking steps to address money laundering risks more systemically, following money laundering breaches by financial institutions in the region. Following the 2018 Euro Area FSAP, ECB Banking Supervision set up an AML coordination function that acts as a central point of contact and information exchange for significant institutions, provides for a consistent SSM-wide approach for integrating AML/CFT concerns into prudential supervision, and develops training for supervisors (2019 AIV Euro Area Policies). Consistent with the Fund's recommendations in the 2018 Euro Area FSAP, the European Commission has laid out plans to establish a single AML/CFT rule book and expressed support for a single AML/CFT supervisor, to ensure harmonized and consistent

AML/CFT oversight in the region (2020 AIV Euro Area Policies). IMF staff continue to monitor these developments in the context of the Fund's surveillance.

6. In this context, we are surprised that Fund staff is developing an approach to embed climate risk considerations in the review of supervision and regulation, which will be pilot tested in upcoming FSAPs (¶180 of the Background paper on Scope). Here, we reiterate that the Fund should not duplicate the work underway in SSBs and would welcome staff elaboration on this work, including their collaboration with other relevant institutions particularly the FSB.

We would like to clarify that the Fund staff are not developing new standards. MCM staff participates in SSB meetings actively to keep abreast of latest developments and discussions in SSBs. At the same time, MCM staff provides feedback to SSBs based on specific pilot exercises in FSAP—as we have been doing in the past for various regulatory reforms. For example, the Fund contributed to develop the assessment methodology for KA on insurers, which this Review is asking Directors to endorse, by conducting preliminary assessment using the earlier version of methodology in a pilot assessment in 2019 France FSAP. We will continue to take this approach to leverage approaches being developed in SSM discussions for consideration in the context of FSAPs.

Aim II: Quantitative tools

7. Can staff comment on their view regarding the challenges of the fintech and cyber risk analysis due to the lack of adequate data?

Data gaps constitute an important challenge for assessing risks that may be posed by new fintech innovations and cyber risks. These data gaps exist due to many factors (i) the rapid evolution of the sector, (ii) the growing cyber risk threat landscape and related market sensitivity of financial institutions acknowledging such incidents, (iii) the growing use of decentralized technologies where transactions occur outside the traditional financial systems and (iv) the interconnectedness that introduce new channels for risk propagation, including through third party providers. Though regulatory sandboxes and innovation hubs are useful to test innovative regulation mechanisms, so regulators can learn about fintech services and adapt their future reporting processes, the data they provide are still limited. Central banks and supervisors are starting to collect and understand the data generated by fintech companies, and at the Fund, MCM is collaborating with STA to identify the relevant statistics that need to be developed. However, the agenda for further action remains complex and large.

At the same time, in line with the FSB's view, staff consider financial stability risks from Fintech are not likely to be systemic in most jurisdictions given their limited presence so far. We have conducted pilot risk analysis where Fintech is considered as systemic (such as Korea and Singapore, as detailed in the background paper on Quantitative tools).

8. We would be interested in staff's views on how they will make more effective use of improved quantitative tools in respect of G-SIBs in the light of continued data constraints.

National supervisory authorities generally collect adequate data on banks, including G-SIBs, and typically share data with FSAP teams. Data constraints are more binding for NBFIs, market financing, financial market infrastructures (such as clearing and settlement), and emerging risks. Improved data in these areas are critical for any analytical tool to produce reliable results.

9. 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 NBFIs space have done so for the insurance sector (most common), asset managers, and pension funds. However, the NBFIs 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 NBFIs segment is diverse across jurisdictions. In particular "shadow banks" could take different forms and names across countries, including credit unions, finance companies, factoring companies, and institutions that provide credit without taking deposits (i.e., financing in markets). However, to the extent that these institutions are engaged in credit intermediation, we can apply bank stress testing methodologies to assess their credit risks. Implications for capital and the overall assessment could follow regulatory capital requirements specifically set for these firms as applicable. The companies may have different types of assets than banks (e.g., long-term infrastructure projects, account payables/receivables, distressed assets, etc.), but, as long as the company specific data are available, it should be possible to establish empirical models to assess risks from company specific investments. However, NBFIs could face different types of liquidity risks from banks depending on how they finance themselves and the extent of their maturity mismatch.

Aim III: Traction

10. Could staff clarify the effectiveness of regional bodies and international groupings in monitoring the implementation of FSAP recommendations?

FSB Peer Reviews monitor the implementation of post GFC reforms and the follow up on FSB's own standards and guidance. FSB Peer Reviews do not explicitly evaluate the implementation of FSAP recommendations.

11. Besides the proposal that staff should stand ready to offer a technical seminar to Directors on the Financial System Stability Assessment (FSSA) ahead of the joint Article IV-FSSA Board discussion, do staff have additional proposals in mind?

Staff will stand ready to offer a technical briefing on the findings of the FSSA ahead of the joint Board meeting. Earlier staff proposals to have separate a Board meeting on the FSSA

or an informal Board meeting on the FSSA ahead of the joint meeting did not garner sufficient support among Executive Directors.

12. Article IV consultations and FSAPs should complement each other. As pointed out in the report, however, some authorities have expressed concerns about the burden for the authorities in terms of preparatory work and number of meetings. What are the proposals to streamline the work for the authorities to the extent possible?

We agree that Article IV consultations and FSAPs should complement each other. For this reason, the FSAP team works closely with the Article IV team in the early phase of FSAP work to ensure that the FSAP builds on and does not duplicate earlier work by the Article IV team. The number of meetings between the FSAP team and the authorities depends largely on the size and complexity of the financial system and number of financial regulatory agencies. We will continue to make every effort to seek efficiencies on in the organization of FSAP work and the number of meeting requests.

13. We welcome the development of simplified analytical tools by the MCM that could be used by Article IV teams. We also support participation of Article IV mission chiefs in FSAP concluding missions, as well as the MCM early engagement in the preparation of Article IV consultations. Could staff elaborate on how these innovations can sustain the follow-up implementation of FSAP recommendations?

The development of simplified analytical tools will help Article IV teams conduct analysis of financial system risks in the years after an FSAP. The participation of the Article IV mission chief in the FSAP concluding meeting will strengthen the mission chief's engagement with the FSAP findings and recommendations, as well as with the authorities' views and potential implementation challenges. Early engagement by the FSAP team in the preparation of subsequent Article IV consultations will help ensure that the Article IV team is fully aware of FSAP findings and recommendations.

Aim IV: Country participation

14. There needs to be more clarity on whether only the 32 jurisdictions subject to mandatory FSAP every five years (S32) would be called "jurisdictions with systemically important financial sectors... One alternative is to call the S47 "jurisdictions with systemically important financial sectors" while the S32 "jurisdictions with global systemically important financial sectors (G-SIFs)" (similar to the terms "global systemically important financial institutions" (G-SIFIs) and "global systemically important banks" (G-SIBs)). Staff's views are welcome.

The current framework considers all jurisdictions for which the Fund makes FSAs mandatory to have "SIFS." As such, for purposes of the Fund's framework on mandatory FSAs, staff would consider all the 47 jurisdictions to have "systemically important financial sectors", and not introduce new labels, while using the two tolerance thresholds to differentiate frequency of assessments based on relative importance within that group.

15. While we note that applying lower thresholds to indicators measuring the degree of interconnectedness reflect staff's ambition for a more risk-based approach

and broader country coverage, they seem to be arbitrary, as any discretionary change would produce a different list of SIFS. Therefore, the methodology for identifying SIFS should not be applied mechanically and needs to reflect country-specific circumstances. We would welcome staff's comments if they expect to use the same methodology in the next 5-year FSAP review and what the main determinants for setting the respective thresholds would be.

The staff implement a common methodology to ensure evenhandedness and transparency so that the identification of systemically important financial sectors does not rely on opaque, subjective judgments. In the current update, when determining the thresholds and the size of the list, staff took a two-step approach. The first group of jurisdictions (S32) is obtained by updating the input data and setting thresholds to capture roughly the strongest 5 percent of global financial connections. To determine the larger group (S47), staff lowered the thresholds so as to capture roughly the strongest 10 percent of global financial connections. This approach of having two frequencies was the result of balancing the desire to avoid a reduction in the frequency of assessments for the most systemically important financial sectors at a time of unprecedented global risk and uncertainty with the desire to expand the coverage of the mandatory assessments to a broader share of the members.

It is expected that the Fund will review the methodology and the list of jurisdictions with SIFS within five years of the conclusion of the 2021 FSAP Review. Given that "systemic importance" is a dynamic concept, the staff will examine and propose revisions, as necessary, to the criteria and methodology for determining members with systemically important financial sectors.

Aim V: Resources

16. We would appreciate staff's comments on alternative funding sources considering the impending expiration of the G20 Data Gaps Initiative.

As per the latest [progress report](#) of the initiative issued in October last year, the group is discussing the continuation of similar international statistical cooperation beyond the DGI conclusion in 2021. STA will continue to assist authorities, including with capacity development, to enhance the data quality of their Monetary and Financial Statistics database (MFS) and the Financial Soundness Indicators (FSIs) -- key data to assess macro financial exposures. Select series from these datasets are included in the IMF's Data Standards Initiatives (Special Data Dissemination Standards (SDDS), enhanced General Data Dissemination Standard (e- GDDS) etc.) which set the standards for voluntary dissemination of economic and financial data. TAs for low income and lower middle income countries are funded by Financial Sector Stability Fund ([FSSF](#)), the same funding source used for FSSR), which is almost fully funded up to FY24.

FSSR

17. While FSSAs and FSSRs are different exercises, we wonder whether the outcome of the current FSAP review will affect the FSSR program in any way? Moreover, we would welcome further elaboration on how FSSAs and FSSRs interact.

The FSSR is a TA product, designed to look at financial sector stability risks and reforms and identifying TA priorities to help fill the gaps. Therefore, a requirement for an FSSR is that the member country is interested in a follow-up TA plan. While the FSSR provides a diagnostic and the FSAP provides an assessment, these evaluations have similarities, so developments in evaluation approaches will benefit both the FSSR and the FSAP.

18. Could staff clarify the impact of constrained fiscal space in several donor countries on the conducting of FSSRs, and any plans to expand its coverage going forward?

We are not aware that there are any constraints impacting current funding. The FSSF is almost fully funded in its first phase (lasting up to 2024). We plan to continue with a second phase and are hopeful that donors will continue to support the FSSF. The FSSF is focused on low and lower middle-income countries and we do not expect to expand coverage in terms of country eligibility. So far, we have been able to offer diagnostics in 22 countries (18, excluding ongoing exercises) but many more countries are eligible.

Annex. Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance

This Decision sets out the scope and modalities of bilateral surveillance over the financial sector policies of members with systemically important financial sectors and of multilateral surveillance over the spillovers arising from such policies in accordance with Article IV, Sections 3(a) and (b) of the Fund's Articles and the Fund's Decision on Bilateral and Multilateral Surveillance – 2012 Integrated Surveillance Decision (Decision No. 15203-(12/72), adopted July 18, 2012 (the "ISD").

Introduction

1. The obligations of the Fund and its members with regard to bilateral and multilateral surveillance are set forth in Article IV of the Fund's Articles and further elaborated in the ISD.

- a. With respect to bilateral surveillance, Article IV, Section 1 requires each member to "collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates" ("systemic stability"). Recognizing the important impact that a member's domestic economic and financial policies can have on systemic stability, Article IV, Sections 1(i) and (ii) establish obligations for members respecting the conduct of these policies, including their financial sector policies. In accordance with the framework set out in Article IV, the ISD provides that systemic stability is most effectively achieved by each member adopting policies that promote its own balance of payments stability and domestic stability—that is, policies that are consistent with members' obligations under Article IV, Section 1 and, in particular, the specific obligations set forth in Article IV, Section 1, (i) through (iv). "Balance of payments stability" refers to a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements. In the conduct of their domestic economic and financial policies, members are considered to be promoting balance of payments stability when they are promoting their own domestic stability that is, when they comply with the obligations of Article IV, Sections 1 (i) and (ii) of the Fund's Articles. For this purpose, the ISD requires the Fund's bilateral surveillance to assess, in particular, whether a member's domestic policies are directed towards domestic stability. It provides that "financial sector policies (both their macroeconomic aspects and macroeconomically relevant structural aspects)" will always be the subject of the Fund's bilateral surveillance with respect to each member. The ISD also provides that, where relevant, each member is accountable for those policies that are conducted by union-level institutions on its behalf.

- b. With respect to multilateral surveillance, Article IV, Section 3 (a) requires the Fund to oversee the international monetary system in order to ensure its effective operation, and requires members to consult with the Fund on any issue that the Fund considers necessary for this purpose. The ISD recognizes that the international monetary system may only operate effectively in an environment of global economic and financial stability, and provides that the Fund in its multilateral surveillance will focus on issues that may affect global economic and financial stability, including the spillovers arising from policies of individual members that may significantly influence the effective operation of the international monetary system. The policies of members that may be relevant for this purpose include, among others, members' financial sector policies.

2. While an examination of members' financial sector policies is important in all cases of bilateral surveillance, the Fund decides that, taking into account the framework described above and the overall purpose of surveillance, heightened scrutiny should be given in bilateral surveillance to the financial sector policies of those members whose financial sectors are systemically important, given the risk that domestic and balance of payments instability in such countries will lead to particularly disruptive exchange rate movements and undermine systemic stability. Heightened scrutiny should also be given in multilateral surveillance to the spillover effects of the financial sector policies of those members, given the risk that they may undermine global economic and financial stability. As financial stability assessments are a key tool for assessing members' financial vulnerabilities and financial sector policies, it is appropriate that financial stability assessments be conducted with such members as provided for in this Decision.

3. This Decision does not impose new obligations on members or, in particular, modify the scope of their obligations under Article IV. The Fund, in its bilateral surveillance, will continue to assess whether a member's domestic economic and financial policies are directed toward the promotion of domestic stability. In its multilateral surveillance, the Fund may discuss the impact of members' policies on the effective operation of the international monetary system and may suggest alternative policies that, while promoting the member's own stability, better promote the effective operation of the international monetary system.

Scope and modalities of financial stability assessments

4. *Determination of systemic importance.* The Managing Director, in consultation with the Executive Board, will identify those members that have systemically important financial sectors. This

determination will be made in the context of each review that is conducted under paragraph 9 below, and will be based on an assessment taking into account the size and interconnectedness of members' financial sectors as contemplated in paragraphs 23 to 27 in SM/13/304 and further modified in Appendix V of SM/21/52. Pursuant to paragraph 7 of Appendix V of SM/21/52, two sets of thresholds are relevant for the methodology. Using the lower set of thresholds, the methodology identifies jurisdictions with financial sectors that are considered systemically important. Using the higher set of thresholds, the methodology identifies the subset of those jurisdictions with systemically important financial sectors that are subject to more frequent financial stability assessments.

5. *Financial stability assessments.* Where the financial sector of a member is determined to be systemically important pursuant to paragraph 4 of this Decision, the member shall engage in a financial stability assessment in the context of bilateral and multilateral surveillance under Article IV of the Fund's Articles in accordance with the terms of this Decision. For this purpose, the member shall consult with the Fund and the authorities of the member shall make themselves available for discussions with Fund staff of the issues that fall within paragraph 6 of this Decision.

6. *Scope of financial stability assessments.* The financial stability assessments undertaken under this Decision will consist of the following elements:

- a. An evaluation of the source, probability, and potential impact of the main risks to macro-financial stability in the near-term for the relevant financial sector. Such an evaluation will involve: an analysis of the structure and soundness of the financial system; trends in both the financial and nonfinancial sectors; risk transmission channels; and features of the overall policy framework that may attenuate or amplify financial stability risks (such as the exchange rate regime). Both quantitative analysis (such as balance sheet indicators and stress tests) and qualitative assessments will be used to evaluate the risks to macro-financial stability.
- b. An assessment of the authorities' financial stability policy framework. Such an assessment will involve: an evaluation of the effectiveness of financial sector supervision; the quality of financial stability analysis and reports; the role of and coordination between the various institutions involved in financial stability policy; and the effectiveness of monetary policy.
- c. An assessment of the authorities' capacity to manage and resolve a financial crisis should the risks materialize. Such an assessment will involve an overview of the country's liquidity management framework; financial safety nets (such as deposit insurance and lender-of-last-

resort arrangements); crisis preparedness and crisis resolution frameworks; and the possible spillovers from the financial sector onto the sovereign balance sheet.

- d. Where relevant, the assessments will also cover the spillovers arising from a member's financial sector policies that may significantly influence global economic and financial stability.

7. *Modalities of assessments.* The key findings and recommendations of a financial stability assessment under this Decision will be summarized in a Financial System Stability Assessment Report (FSSA) that will normally be discussed by the Executive Board at the same time as the relevant Article IV consultation report.

8. *Frequency.* Where the financial sector of a member is determined to be systemically important pursuant to this Decision, it will be expected that a financial stability assessment will be conducted and the FSSA resulting from such an assessment will be discussed by the Executive Board by no later than the deadline for completion of the first Article IV consultation with the member that follows the relevant anniversary of such determination or, in the case of the financial sector of a territory of a member, the for date of completion of the first Article IV consultation discussion with respect to that territory by the Executive Board that follows the relevant anniversary of such determination. It is expected that subsequent FSSAs for a member with a systemically important financial sector will be discussed by the Executive Board by no later than the deadline for completion of the first Article IV consultation with that member that follows the relevant anniversary of the date of completion of the previous Executive Board discussion of the FSSA respecting that member or, in the case of the financial sector of a territory of a member, the deadline for date of completion of the first Article IV consultation discussion with respect to that territory by the Executive Board that follows the anniversary of the date of completion of the previous Executive Board discussion of the FSSA respecting the financial sector of that territory. For purposes of this paragraph, the relevant anniversary shall be the tenth, except that for members with systemically important financial sectors that are identified by the methodology using the higher set of thresholds referenced in paragraph 4, above, the relevant anniversary shall be the fifth.

9. *Supranational institutions.* This Decision applies to members that have delegated any of the financial sector policies within the scope of paragraph 6 to supranational institutions, subject to the following considerations.

- a. *Financial stability assessment.* Where a member has been identified as having a systemically important financial sector in accordance with paragraph 4 of this decision and the member has delegated any of the financial sector policies within the scope of paragraph 6 to supranational institutions, staff will conduct a financial stability assessment with the relevant supranational institutions.
- b. *Scope and modalities.* The scope of financial stability assessments undertaken under this Decision with supranational institutions will be broadly as outlined in paragraph 6 of this Decision to the extent applicable. The key findings and recommendations of a financial stability assessment will be summarized in a FSSA that will normally be discussed by the Executive Board at the same time as the relevant report on common policies in the context of Article IV consultations with member countries.
- c. *Frequency.* The financial stability assessment with supranational institutions will occur at the frequency applicable to the relevant member subject to mandatory financial stability assessments with the highest frequency. The FSSA will constitute an integral part of the FSSA for each individual member and of the Article IV consultation with each individual member.

Miscellaneous

10. *Review.* It is expected that the Fund will review this Decision no later than five years following the date of its adoption and subsequently at intervals of no longer than five years. In particular, as “systemic importance” is a dynamic concept, the Fund will, in the context of each such review, examine and revise, as necessary, the criteria and methodology for determining members with systemically important financial sectors. Moreover, the Fund may review this Decision at any time to take into account major advances in the availability of data and in the development of methodologies for assessing the systemic importance of financial sectors.

CONSTITUENCY CODES

OEDAE

Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF

Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG

Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP

Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR

Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC

China

OEDCE

Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO

Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC

Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF

France

OEDGR

Germany

OEDIN

Bangladesh, Bhutan, India, and Sri Lanka

OEDIT

Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA

Japan

OEDMD

Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI

Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE

Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO

Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU

Russian Federation and Syrian Arab Republic

OEDSA

Saudi Arabia

OEDST

Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ

Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK

United Kingdom

OEDUS

United States