

1. 2021 Financial Sector Assessment Program Review - Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance

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

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 ~~first~~ deadline for completion of ~~an-the first~~ Article IV consultation with the member that follows the ~~fifth-relevant~~ anniversary of such determination or, in the case of the financial sector of a territory of a member, the ~~first deadline for date of~~ completion of ~~an-the first~~ Article IV consultation discussion with respect to that territory by the Executive Board that follows the ~~fifth-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 ~~first~~ deadline for completion of ~~an-the first~~ Article IV consultation with that member that follows the ~~fifth-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 ~~first deadline for date of~~ completion of ~~an-the first~~ Article IV consultation discussion with respect to that territory by the Executive Board that follows the ~~relevant fifth~~ 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

9.10. 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.