BUFF/00/190

December 14, 2000

**Summing Up by the Acting Chairman
Financial Sector Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward
Executive Board Meeting 00/123—December 13, 2000**

Overview

Executive Directors welcomed the opportunity to review the Financial Sector Assessment Program (FSAP) in light of the further experience that has been gained with the FSAP pilot since the review in the spring of this year. Directors agreed that based on the completion of the missions to all 12 pilot countries, the work to date with the second round of country cases, and the feedback and support received from participating countries and cooperating institutions, it is timely to establish guidelines for a continuation of the FSAP program for the period ahead.

Directors agreed that the FSAP process provides a coherent and comprehensive framework to identify financial system vulnerabilities and strengthen the analysis of domestic macroeconomic and financial stability issues, to identify development needs and priorities, and to help authorities develop appropriate policy responses. They welcomed the broad range of information and analysis that the FSAP process brings to financial sector assessments, and noted in particular that this process provides the overall macroprudential and institutional context necessary for a thorough assessment of observance of international standards, codes, and good practices in the financial sector.

Directors observed that the Financial System Stability Assessments (FSSAs) derived from FSAP findings and Article IV consultations have appropriately focused on the stability issues of relevance to Fund surveillance. The comprehensive coverage of FSSAs, drawing on a broad range of information, helps to deepen the quality and scope of coverage of Article IV consultations. Accordingly, Directors agreed that the FSSAs are the preferred tool for strengthening the monitoring of financial systems under the Fund's bilateral surveillance.

Directors underscored that an underlying objective of the FSAP is to encourage national authorities to implement measures to redress identified vulnerabilities and development needs. In that context, they believed that the Fund (as well as the Bank) should ensure that the strategic components of the assessment be reflected in other aspects of country programming, and that appropriate technical assistance and other support be provided to national authorities that request it.

Directors welcomed the steps taken in the Fund and the Bank to ensure consistency and quality in their joint FSAP work, as well as in the separate related work in the two institutions, including for the monitoring in the Fund of financial systems under Article IV surveillance. They encouraged the staff to press ahead with the work being undertaken in the context of the FSAP to develop analytical techniques, including macroprudential indicators, the use of stress tests and scenario analysis, and the assessment methodologies of financial sector standards in collaboration with standard-setting bodies.

Standards and Codes

Directors emphasized that assessments of observance of international standards, codes, and best practices have an important role to play in the FSAP. When considered with the other analysis undertaken in the FSAP, they help to identify vulnerabilities, gaps in regulatory structures and practices, and medium-term reform and development needs and priorities. They also help country authorities to evaluate their own systems against international benchmarks.

Directors noted that the summary standards assessments that flow from the detailed assessments are presented as an input into the overall stability assessment in the FSSA, and become financial sector modules of the Reports on Observance of Standards and Codes (ROSCs). While agreeing that the FSAP/FSSA process provides the proper context within which to assess standards, a number of Directors suggested that financial sector standards assessments carried out outside the FSAP also have a highly useful role to play, both to support implementation of standards by member countries, and as part of the preparatory work for a future FSAP assessment. Some Directors noted that, although central to the FSAP, the assessment of observance of standards and codes is resource-intensive and that the relevant standards to assess should be carefully selected in order to avoid stretching costs and procedures.

Bank-Fund Collaboration

Directors noted that the collaborative nature of the FSAP has ensured that the best expertise is mobilized to undertake the diagnostic work of joint Bank-Fund FSAP missions. At the same time, most Directors agreed that the division of responsibilities, once the joint work is completed, ensures that clear accountability for the Fund's and the Bank's separate work is maintained. While noting the interrelationship between financial system stability and financial sector development, Directors stressed that the Fund's primary responsibility is in the area of systemic stability issues, while that of the Bank is in the development aspects.

Coverage and Frequency of FSAP

Directors had an extensive discussion of prioritization in the FSAP process. They considered that a variety of criteria could appropriately be employed to establish priorities in selecting country cases in the face of limited resources, including a country's systemic importance; its external sector weakness or financial vulnerability; the nature of its exchange rate and monetary regime; and geographical balance among countries. All in all, Directors agreed that the country selection should be such as to help maximize the program's contribution to the strengthening of national and international financial stability. Most

Directors noted that within any one year, giving a higher priority in the FSAP country selection process, to systemically important countries would be warranted.[1] It was noted that prioritization in this sense means a difference in timing, not treatment. At the same time, Directors continued to stress the merit in maintaining a broad country coverage in the program. They felt that members should have the opportunity to participate in the FSAP to help them strengthen and develop their financial sectors, to prevent costly financial sector crises, and, where relevant, to prepare the ground for financial market liberalization and greater access to the international capital markets.

Directors considered how to maintain adequate monitoring of financial systems under Fund surveillance in years between full assessments, given the voluntary nature of the program and the limited frequency with which full assessments of an individual member can be undertaken. This is particularly important for countries identified as vulnerable, or systemically important, and whose financial systems are evolving at a rapid pace. Directors agreed that, for surveillance purposes, focused updates of FSSA findings could be undertaken by Fund staff in the context of subsequent Article IV consultations.

Directors agreed that the country's choice of whether or not to participate in the FSAP does not alter the Fund's responsibility to conduct financial sector monitoring. If a country volunteered to participate in the FSAP, but could not be accommodated by the program immediately, or if a country chose not to participate in the FSAP, Directors noted that the Article IV mission team for that country could be reinforced with financial sector expertise, and some assessment in key areas of concerns could be undertaken. Nevertheless, Directors believed that the full exercise remains the preferred vehicle for conducting financial sector assessments as input to Fund surveillance, and they agreed that, when relevant, the staff should be prepared to recommend—for instance, in discussions with authorities or in the staff appraisal in the Article IV staff report—that the country participate in the FSAP.

Directors noted that the scope of FSSAs, particularly for countries with significant offshore financial centers, should be extended beyond domestic stability considerations to encompass possible cross-border effects and consideration of international repercussions, while maintaining its country-specific focus.

Offshore Financial Centers (OFCs)

Directors also noted that FSAP assessments covered both the cross-border activities of financial institutions, and the activities of financial institutions operating in an off-shore

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[1] Paragraph 71 of SM/00/263 defines systemically important countries as those countries whose capital markets intermediate the bulk of global financial transactions and emerging economies whose financial systems have the potential to cause, or be subject to, undue volatility in cross-border flows and financial system contagion.

center within the country. The FSAP assessment of such countries would generally be expected to result in "module three" assessments—which comprise financial risks, relevant financial sector standards and codes, and cross-border effects of the relevant OFC. Separate "module three" assessments could, however, still take place for OFCs that are not members of the Fund and the Bank, as well as, in some cases, for OFCs within a member country. In the latter case, these OFC assessments could provide input into a subsequent full FSAP assessment for the country.

Resource Implications

Directors considered the potential budgetary implications of the staff proposals on the FSAP for fiscal year 2002 and beyond. They noted that the pace of the FSAP will depend on a number of factors, including how the suggested prioritization of FSAP country cases is translated into practice. Directors broadly agreed that the Fund should keep the effective implementation of priorities in view in aiming for the suggested pace of up to 30 assessments per year. Both the pace of the FSAP and its new resource implications will be subjected to further assessments by the Fund and the Bank in the context of their respective upcoming budget discussions.

Publication and Circulation

On publication and circulation issues, Directors noted that, under the existing arrangements, FSAP reports are prepared as confidential documents for national authorities, since some information needed to carry out the diagnostic aspects of an FSAP mission's work, especially that related to individual financial institutions, is highly sensitive. Directors agreed that the current policy of the management of the Fund and Bank not to provide authorization for the publication of the main volume of FSAP reports and the associated confidential documents should be continued. They also endorsed the management's intended policy to provide authorization for the publication by the authorities of the detailed assessments of observance of standards and codes that are included in FSAP reports.

When discussing publication and circulation policies for FSSAs, most Directors agreed that the policy of voluntary publication was appropriate. They noted that several national authorities have requested that the Fund allow publication of FSSAs. Some Directors felt, however, that the current policy, whereby publication of FSSAs is not permitted, should be continued.

On balance, most Directors agreed to authorize Fund publication of FSSAs after the associated Article IV consultation has been concluded. Such publication will be subject to: (i) the consent of the respective member concerned; (ii) the same deletions policy regarding highly market-sensitive information that applies to Article IV staff reports; and (iii) the same rules on internal circulation and release to outside agencies that apply to Article IV staff reports. It was agreed that publication of an FSSA could proceed even if the member concerned did not consent to the publication of the relevant Article IV consultation report. While some Directors supported publication of the initial assessments for the 12 pilot countries, it was also agreed that the new publication policy for FSSAs should not apply to these cases. For a participant in the FSAP pilot project in the process of accession to the European Union, it was agreed that the member's FSSA could be circulated to the European Commission.

Confidentiality

The importance of adequate procedures to ensure the confidentiality of sensitive information provided to FSAP missions, especially on individual financial institutions, has been stressed in previous Board discussions. Directors noted that the confidentiality procedures that must be followed by staff, as well as experts from cooperating institutions, as laid out in the confidentiality protocol are working well.

Next Review

Directors agreed that the further review of the experience under the FSAP should take place in 18 months' time.