FOR AGENDA

SM/03/175
Supplement 1

May 29, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Financial Soundness Indicators—Comments on Draft Compilation Guide**

The attached supplement to the staff paper on financial soundness indicators (SM/03/175, 5/14/03) provides a brief note summarizing the main themes arising from outside comments to date on the draft Compilation Guide on Financial Soundness Indicators (SM/03/92, 3/13/03), which was posted on the IMF website on March 21, 2003, for comment. This item is tentatively scheduled for discussion on **Monday, June 2, 2003**. The staff does not propose the publication of the attached note. The deadline for receiving outside comments is June 20, and the staff intends to disseminate a paper to the Board on the comments after that date.

Questions may be referred to Ms. San Jose, STA (ext. 36327) and Mr. Swinburne, MAE (ext. 34777).

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INTERNATIONAL MONETARY FUND

Financial Soundness Indicators—Comments on Draft Compilation Guide

Prepared by the Staff of the Monetary and Financial Systems and Statistics Departments

Approved by Carol S. Carson and Stefan Ingves

May 29, 2003

Contents **Page**

I. INTRODUCTION

1. On March 21, 2003 the draft *Compilation Guide on Financial Soundness Indicators* (*Compilation Guide*) was posted on the Fund's external website for a comment period ending on June 20, 2003. A comprehensive publicity campaign, including a Fund press release, a short article in the IMF Survey, and individual letters to those with an interest in this field of work, including in national agencies, has been undertaken. Also, representatives of 43 countries attended the first outreach seminars in Europe.[1]

2. This short note summarizes the main themes arising from the comments received to date. Participants provided comments at the regional outreach seminars and there has been comments received in letters and e-mails sent to the Fund.[2]

A. General Comments

3. The reaction to the production of the draft *Compilation Guide* has been **positive.** With the attention of policy makers and private sectors analysts increasingly focusing on the financial sector issues, the development of international guidance that could provide ***objective benchmarks*** and support ***cross-country comparability*** of data over time has been welcomed. One private sector bank stated that they strongly appreciate the ***initiative*** to produce the *Compilation Guide*. Also appreciated by compiling agencies has been the wide ***consultative effort***, the ***cooperation among international agencies***, and the ***link to existing international measurement systems*** that is evident in the draft. Such efforts are seen as helping to keep down the burden on countries. Looking ahead, there has been a call for ***procedures to be established for revisions or updates of the Compilation Guide*** and for a "road map" for the development of FSIs.

B. Specific Comments

Concepts and definitions

4. Discussion on the concepts and definitions outlined in the *Compilation Guide* has generally been **supportive.**

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[1] Seminars were conducted in Vienna and in Frankfurt in the latter part of April. The seminar in Vienna involved essentially the Baltic countries, Russia, and some other countries of the former Soviet Union, and countries in Eastern Europe. The seminar in Frankfurt involved essentially countries from Western Europe and other countries in the European region not represented in Vienna that subscribe to the Fund's data dissemination standards.

[2] To date, 7 letters and e-mails commenting on the draft *Compilation Guide* have been received, with respondents from both the public and private sectors.

5. Most significant has been the issue of the **institutional coverage for deposit-takers** and, in particular, the coverage of ***foreign controlled deposit-takers*** in the local economy. Given that the main recommendation of the *Compilation Guide* is to compile data on a domestically controlled cross-border basis for deposit-takers, participants in both seminars in Europe, but particularly in Vienna, noted the sometimes central role of ***foreign controlled banks*** in their financial systems. Further one central bank expert has written that "they are less convinced that it makes sense to apply the "domestic control" concept to the full gamut of FSIs as, in particular, it is unlikely to be the type of distinction that national supervisors will themselves choose to make whenever foreign banks have a sizeable presence in the local market." [3] On the other hand, support for present approach in the draft *Guide* has also been provided.

6. There has been some discussion of the need to identify the ***systematically important deposit-takers in the economy,*** of covering the ***large conglomerates*** to include entire lines of business, and more generally of including nonbank lines of business owned by deposit-takers, particularly ***security dealing subsidiaries,*** in the information for deposit-takers. At the other end of the spectrum, some have questioned the need to cover ***small-scale deposit-takers*** such as savings associations, although a speaker from the ECB at the Vienna seminar emphasized, from experience, the importance of covering such institutions, if possible.

7. On **nonperforming loans**, no comments received have disagreed with the draft *Compilation Guide*'s proposed idea to classify as nonperforming those loans (or other assets) that are 90 days past due in terms of payment of interest or principal. However, there has been comment on the need to close potential loopholes in the definition, such as could arise if deposit-takers restructure nonperforming loans. Most significantly, there has been disagreement over whether there should be any degree of national discretion for determining a loan as nonperforming even before being 90 days in payment arrears. One seminar participant from a country with a stricter than "90 day rule" considered that giving national discretion would make their position look worse than that of other countries. On the other hand, another participant at the same seminar provided examples whereby a strict application of the "90 day rule" would not cover certain loans known to be nonperforming to the authorities. One private sector commentator has stressed the need for ***publicly available information*** on nonperforming loans.

8. Regarding **valuation**, the *Compilation Guide*'s proposal that valuation be based on the most realistic assessment at any moment in time of the value of the instrument has found support. There continues to be an aversion, notably among those from supervisory agencies, for fair valuation of loans because of the potential degree of subjectivity involved in any estimates.

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[3] This comment suggests there is more to be done to explain the rationale for the priority afforded to cross-border consolidation, and the different uses to which different types of data are best suited.

9. The need for the list of FSIs to include a measure that provides some indication of the impact of changing interest rates on the value of a deposit-takers' portfolio (**interest rate sensitivity** measure) is recognized, but a number of comments received note the difficulty of calculating, on an aggregate basis, the proposed ***duration*** measures for deposit-takers. The use of ***gap analysis***, an alternative approach outlined in the draft *Compilation Guide* whereby expected payments are placed in time buckets, has been considered a possible approach by some but not all commentators. Notably, in this regard, there has been interest in learning more about how to conduct ***stress tests***.

10. One central bank commentator has raised the need to distinguish between lending by foreign subsidiaries in **local currency** to local residents and lending in other currencies to nonresidents from the host country's viewpoint. One private sector commentator has noted the relationship between the maturity of deposits and foreign exchange reserves. In their view, an increasing concentration of deposits towards the short-term maturity makes it easier for the depositors to convert deposits into **foreign currencies**, potentially triggering financial difficulties including a weaker exchange rate.

11. Further, there has been a general call for more in the *Compilation Guide* on the **analysis of FSIs**, in particular on the relationship with external vulnerability, on the use of FSIs as early warning indicators, and on the correlation between indicators. One seminar participant noted that without explaining the linkage between indicators, FSIs remain only a set of indicators rather than an instrument of analysis. A number of participants saw the need to improve their own analytical capability.[4]

12. Finally, the lack of, but need for, data on **real estate prices** was emphasized by many participants to the seminars. One participant considered that **equity price indices** should be included in the list of FSIs.

Compilation issues

13. While there has been general approval of the *Compilation Guide*'s approach in linking the conceptual approach to compiling FSIs with that of other international measurement standards, the challenges facing national compilers has been noted at the seminars. There has been a general recognition that in the short-term **available information might be utilized**, with harmonization toward international best practice a medium term objective. Some participants noted the difficulty in harmonizing different sources of data even within a country let alone across countries. For other financial corporations, more work was considered needed because of the general lack of data provision. For market indicators, stock exchanges are a common source of data.

[4] The Financial Soundness Indicators Paper provided to the Executive Board for discussion, and the associated Background Paper, once published, should contribute significantly to meeting this need.

14. The wide range of indicators covered by FSIs has bought to the fore in many compilers minds the need for **inter-agency cooperation**. While in many countries, the central bank seems to be the agency that is most likely to take the lead in FSI work, the need for cooperation with the supervisory agency, the national statistics institute, and even the ministry of finance in compiling data has been noted. For instance, a number of participants considered that data on the corporate and households sectors are highly relevant to the soundness of the financial sector, but noted that this information is typically compiled, if at all, by the national statistics agency. The data may only be available with a long lag, if at all, and definitions and concepts used may differ from those used to compile data for deposit-takers. This all implies a major challenge in inter-agency coordination.

Data dissemination

15. Seminar participants expressed considerable interest in the possible timetable for the inclusion of FSIs in the Fund's **data dissemination standards**, not least because they felt it would spur development of FSI data at the national level. The medium-term likelihood of FSIs being included in the SDDS was publicly raised by ECB staff at the Frankfurt seminar, and considered this possibility as one important reason for conducting the seminar. However, there has been a view that any quarterly dissemination of data should focus on a subset of FSIs for the most important institutions and not the full list for all institutions. The availability of metadata describing the disseminated data has been stressed particularly in the short-term when countries might deviate from the recommendations in the *Compilation Guide*.