BUFF/03/82

June 9, 2003

Concluding Remarks by the Acting Chair
Financial Soundness Indicators
Executive Board Meeting 03/51
June 2, 2003

Executive Directors welcomed the Fund's on-going work on the development, compilation, and use of Financial Soundness Indicators (FSIs) and the broad support provided by member countries, international organizations, and other standard-setting bodies in this exercise. They considered FSIs a key tool for assessing financial sector soundness by national authorities, enhancing the overall effectiveness of Fund surveillance, increasing the transparency and stability of the international financial system, and strengthening market discipline. They commended the results achieved in three areas following the Executive Board's endorsement of a core and encouraged set of FSIs in June 2001: the draft *Compilation Guide on FSI*s (*Guide*), aimed at encouraging national authorities to compile and disseminate FSIs, has been completed; substantial progress has been made in analytic work to enhance the role of FSIs in macro-prudential analysis, and further work is planned; and the use of FSIs in Fund surveillance has been further developed. Notwithstanding this progress, Directors noted that use of FSIs needs to complement strong financial sector supervision.

Directors considered that the draft *Guide* represents a milestone in establishing a standard reference on the concepts and definitions, data sources, and techniques with respect to the compilation and dissemination of FSIs, and on the nature and type of information on a country's financial infrastructure that is relevant for analysis of FSIs. They broadly endorsed the *Guide*'s conceptual framework. They supported the dissemination of metadata that describe the attributes of the underlying data and facilitate interpretation of FSIs.

Directors noted that FSIs inevitably differ from country to country due to differences in accounting and bank supervision rules and varying levels of financial sector development. The development of FSIs consistent with established statistical conventions and evolving accounting and supervisory guidelines will be essential to limit reporting burdens. Meaningful comparability of FSIs over time and across countries, while desirable, remains a challenge. Many Directors suggested that fostering greater comparability remains an important medium term objective. Directors felt that convergence toward internationally accepted accounting standards should result in greater data comparability. In addition, Directors stressed the need for supplementing quantitative indicators with qualitative assessments.

Directors generally endorsed the ambitious work program for finalizing the *Guide*, welcoming in particular the planned regional outreach seminars on FSIs. They encouraged continued proactive consultations and outreach with experts from other international organizations, standard-setting bodies, and IMF members. For this purpose, a one-month extension of the period for public comment before finalization of the Guide was proposed, and will be announced shortly.

Directors observed that the experience to date in using FSIs in FSAPs has confirmed the relevance of the core and encouraged sets of FSIs, despite data limitations and difficulties in their compilation in many countries. They suggested that the two sets of FSIs be kept under review, to ensure that they reflect the evolving priorities of Fund surveillance, the rapidly changing financial environment, and the relative capacity of countries to compile FSIs. Many Directors encouraged members to increase public dissemination of data collected on the FSIs. Some Directors suggested that the FSIs on duration of assets and liabilities be moved from the core to the encouraged set.

Directors noted that FSIs for the corporate sector could serve as useful indicators of banking sector asset quality, and that FSIs for the insurance sector would be desirable given the growing linkages between the insurance and banking sectors. Several Directors therefore supported the development of these FSIs in order to strengthen financial sector surveillance. However, many Directors urged caution in expanding the number of FSIs, in view of the cost of compiling FSIs and the risk of compromising their quality. Directors welcomed the analytical work that continues to inform the selection of FSIs—with the core FSIs consisting of those that are sufficiently informative to merit widespread compilation, and the list of encouraged indicators being as focused and streamlined as possible and consistent with the overarching objective of strengthening surveillance modalities.

Directors encouraged work on combining the use of FSIs and stress testing in macro-prudential surveillance. They noted that stress tests may be particularly valuable in assessing market risk, but noted that they should serve as a complement to, and not as a substitute for, FSIs. They emphasized the importance of drawing on standards assessments and other sources of information on supervision and the financial infrastructure to strengthen the capacity to interpret FSIs and assess financial stability. They looked forward to the proposed conference on financial stability analysis in the second half of 2004.

Directors considered the proposed Framework for Financial Stability Analysis as a useful tool for integrating macro-prudential surveillance, analysis of macro-financial linkages, and surveillance of macroeconomic conditions. They observed that macro-financial linkages may vary across countries, and endorsed further analytic work to clarify these linkages, including the role of financial market functioning and cross-border linkages, and identify the data needed to assess them.

While recognizing resource constraints, Directors encouraged countries to compile at least a core set of FSIs on a continuing basis and called for more vigorous outreach and communication efforts to persuade countries of their usefulness. They endorsed proposals for assessing countries' capacity to compile FSIs and helping to develop this capacity, including through the FSAP, Article IV and UFR missions, as well as a coordinated compilation exercise, and other workshops and technical assistance. They generally endorsed the preparation of a guidance note on financial sector monitoring, including the use of FSIs, and the continued development of an operational database on FSIs, as steps that would enhance

Fund surveillance, help integrate FSIs into the broader framework of vulnerability assessments in the Fund, and facilitate the tailoring of indicators to country specific circumstances.

Directors considered the proposal that, to support country compilation efforts, the Fund should conduct, with the assistance of other international agencies, a coordinated compilation exercise for supervisors and statisticians after finalization of the *Guide*. Nearly all Directors supported the proposal. The exercise would involve the participation of around 60 countries representing a balance in country representation selected on transparent criteria. A variety of possible priorities for participation was suggested, including: countries with relatively good databases and the capacity to compile FSIs; systemically-important countries; developing countries with significant vulnerabilities; and SDDS subscribers. Nevertheless, a few Directors expressed concern about the potential resource costs of the exercise.

Views differed on the merits of including FSIs in the SDDS. The progress that has been made in clarifying and documenting the conceptual and compilation issues relating to FSIs, the early experience gained from using FSIs in FSAPs, and the availability of data in many countries on at least some core group FSIs, were seen by a number of Directors as arguments supporting the inclusion of FSIs in the SDDS. However, because of the high reporting burden and the ongoing development of FSIs, some of these Directors recommended that initially only a selective subset of the core FSIs—those likely to be most informative about financial system soundness—be included. Some of the other Directors were of the view that inclusion of FSIs in the SDDS should be voluntary. They felt that the first priority should be to address the significant gaps that still remain across countries in the compilation and dissemination of FSIs.

Directors discussed the merits and feasibility of establishing an indicative timeline for the inclusion of FSIs in the SDDS, including the proposal to include the core, or a subset of the core, FSIs as encouraged indicators by end-2006, and the core, or a subset of the core, FSIs as prescribed indicators in the SDDS by end-2008; and an alternative proposal involving more accelerated inclusion of—possibly selected—core indicators as early as end-2005. Most Directors were concerned about fixing target dates prematurely.

Most Directors endorsed expanded reporting and analysis of FSIs in Article IV reports, the *Global Financial Stability Report*, and in the quarterly vulnerability assessment report. Most Directors also supported the dissemination of FSIs on national websites, and consideration of the establishment of a Fund internet gateway in the medium term to provide a single entry point for accessing FSIs for all countries.

Directors welcomed the effort to continue to absorb the cost of work on FSIs within the existing budget for the current year. Some Directors noted their expectations that the Board will not need to return to consider the question of additional resources in the near future. A few Directors reiterated that technical assistance for this purpose should not come at the expense of other existing technical assistance. Directors looked forward to reviewing progress on the FSI work program in about two years.