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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/122

10:00 a.m., December 12, 2000

Contents

Executive Board Attendance

H. Köhler, Chairman
E. Aninat, Deputy Managing Director

Executive Directors	Alternate Executive Directors
S.M. Al-Turki	A.S. Alosaimi
A. Barro Chambrier	D. Ondo Mañe
T.A. Bernes	P. Charleton
	K. Ongley, Temporary
	F. Zurbrügg, Temporary
B. Esdar	G. Schlitzer, Temporary
D.I. Djojosobroto	Low K.M.
V.L. Kelkar	R.A. Jayatissa
W. Kiekens	
O.-P. Lehmussaari	
	J.M. Abbott, Temporary
	B. Couillault, Temporary
A. Mirakhor	S. Vtyurina, Temporary
H. Oyarzábal	S.P. Collins
	H. Mori
	I. Usman
A.S. Shaalan	
Wei Benhua	
J. de Beaufort Wijnholds	H. Toyama
A.G. Zoccali	

S.J. Anjaria, Secretary
P. Cirillo, Assistant

Also Present
IBRD: M. Conthe, S. Marcus, L. Promisel, Financial Sector Offices; A. Bhattacharya, Poverty Reduction Office; Asia and Pacific Department: R.A. Elson, K.H. Kang. European I Department: M. Takeda, C.M. Watson. External Relations Department: R. Chote, P.N. Loungani. IMF Institute: N. Funke. Legal Department: W.E. Holder, Deputy General Counsel; R.C. Baban, P.M.-P. De Broek. Monetary and Exchange Affairs Department: S. Ingves, Director; V Sundararajan, Deputy Director; W. Blaschke, L. Errico, S. Geadah, P.L.C. Hilbers, C.S. Lee, A.M. Leone, M.B. O'Brien, A. Ouanes, R.D. Worrell. Policy Development and Review Department: J.T. Boorman, Director; N.R.F. Blancher, P. Gajdeczka, J. Hicklin, G.R. Kincaid, Y.A. Metzgen, M.L. Parkinson, M. Rossi, N. Tamirisa. Research Department: B. Drees, R.S. Craig. Secretary's Department: A.S. Linde, Deputy Secretary, A. Mountford, T. Turner-Huggins. Statistics Department: C.A. Enoch, R.C. Krueger. Western Hemisphere Department: A.M. Jul. Office of Budget and Planning: E.-A. Conrad, Director; S.B. Brown, N. Sachdev, T. Wolde-Semait; Office of Internal Audit and Inspection: S. Sheybani. Advisors to Executive Directors: M. Beauregard, J.A. Costa, S.S. Farid, P.R. Fenton, O. Himani, N. Jadhav, J. Jonáš, J.M. Jones, Liu F., C.-P. Schollmeier, P.H. Whitehall. Assistants to Executive Directors: J.G. Borpujari, I.- K. Cho, I.C. Ioannou, A. Kapteijn, K. Kpetigo, T.-M. Kudiwu, A. Maciá, R. Maino, T. May, G. Nadali-Ataabadi, J. Nelmes, E. Nyambal, J. Sigurgeirsson, T. Skurzewski, M. Walsh, D.B. Waluyo, A.Y.T. Wong.

1. FINANCIAL SECTOR ASSESSMENT PROGRAM—REVIEW—LESSONS FROM PILOT AND ISSUES GOING FORWARD

The Executive Directors considered a paper, prepared jointly by the staffs of the Fund and the World Bank, reviewing experience with the Financial Sector Assessment Program (SM/00/263, 11/27/00; and Cor. 1, 12/11/00). They also had before them a paper on financial system stability assessments and the monitoring of financial systems under Fund surveillance (FO/DIS/00/143, 11/27/00).

Mr. Callaghan submitted the following statement:

We continue to strongly support the objectives of the FSAP process and are encouraged by the evidence of progress under the pilot. FSAPs provide the opportunity for a comprehensive and strategic approach to identifying the strengths and weaknesses of various financial systems, and a sound framework for coordinated follow up work and technical assistance. However, the program is still in a developmental stage and further work needs to be done to streamline practices. In this regard, we welcome staff's focus on endeavoring to achieve greater efficiencies and synergies as the FSAP process evolves.

The true test for the success of the program will be its ability to assist in reducing the risks of financial instability over the longer—term. But, the issue for now should be to review the FSAP experience to date to determine whether it is achieving the intended objectives as efficiently and as effectively as possible—particularly given the resource costs involved—and how this might be improved for future FSAPs.

Country Coverage & Pace

One danger to avoid is for this to become a process—driven exercise. With this in mind, we have some reservations about the proposal to adopt an annual target for FSAPs. At this stage rather than having numerical targets, we should focus on the quality and effectiveness of FSAPs. The number undertaken should be a secondary consideration.

Faced with a resource intensive program but limited resources, the most important issue must be prioritization. Apart from the discussion of "systemically important" countries, we did not get a sufficiently strong sense of the importance of prioritization, or to express this differently that we are getting 'the most bang for our buck'. For example, for some countries, 6 years between financial sector reviews may be too long, while for others a full scope FSAP may not be the best use of Fund resources. It would be interesting for the some elaboration on the scope there might be to differentiate according to where the vulnerabilities are seen to be greatest, and what the relevant criteria might be.

Taking this thought a little further, it is now well recognized that the potential vulnerability of a country's financial system will be influenced by its macroeconomic situation and policies. An assessment of macroeconomic circumstances, exchange rate position, external vulnerability assessments, etc. should give a good indication of what priority should be given to undertaking a FSAP, as well as its likely focus. As such, rather than directing scarce resources to 'systemically important' countries, some weight should perhaps also be given to targeting those countries which prima facie would benefit most from an FSAP. This suggests that a decision about the need for and timing of an FSAP could be closely linked with the analysis in an Article IV report. We therefore see merit in Article IV reports making recommendations about prioritizing future FSAPs. However, there is an issue whether all Article IV teams will have the capacity to undertake such an assessment.

Again, from the perspective of getting the most value from scarce resources, it would seem important that the FSAP exercise remain voluntary. Where a member sees a FSAP as a useful exercise and agrees to one, there is more likely to be a sense of ownership and a willingness to act on the recommendations. The more effective voluntary FSAPs that are undertaken, the more likely that over time other countries will willingly undertake them.

Turning back to the issue of targets, in addition to the dangers of setting annual targets at this stage, we wonder how realistic the goal of 30 FSAPs per year might be. Of the 24 countries slated for FY2001, only 12 FSAP missions have been conducted and we wonder what prospect there might be completing another 12 before end April 2001. Subject to there being the demand and accepting that some target as to resource implications will be necessary for budgeting purposes, we can agree in principle to some expansion in the annual target for FY2002 (subject to our views on the budgetary implications discussed below).

Integration into Fund Surveillance and Follow-up

The FSAP has important interlinkages with the Fund's regular surveillance activities. As suggested above, judgements about prioritization can flow from the Article IV process, but it will also be a primary vehicle for follow up. We support the use of FSSAs as part of Article IV consultations, keeping in mind that FSAPs are voluntary and should be primarily demand driven (i.e., where comprehensive financial sector monitoring is warranted).

The common recommendations contained in FSAP assessments have largely focussed on the regulatory/supervisory framework in member countries. As noted in the paper, there is a need for ongoing surveillance to assess how recommendations are being addressed. With a number of recommendations outlined in FSAP assessments outside the mandate and expertise of the Fund, there appears to be a significant role for outside experts in the follow-up work. The provision of technical assistance is one area where outside experts will need to be heavily utilized and we are pleased this is recognized in the paper.

Scope of FSAPs

It is essential that FSAPs be tailored to meet the needs and circumstances of individual countries. It is also important for the FSAP process to be fully responsive to the rapidly changing nature of the financial system. In particular, it should not be bank centric, but give due recognition to the non-bank sector, securities markets, funds management sector, etc. This means that the resources of the Fund may be spread very thinly, hence the importance of prioritization. It is therefore reassuring that staff is taking care not to over-reach in terms of scope, and is endeavoring to build a degree of continuity in the personnel involved (and, to the extent possible, drawing on people with some existing familiarity with the financial system under review).

While stress tests and scenario analysis can give valuable insights into potential areas of vulnerability, we would urge staff to heed the advice of the October Outreach meeting to give more attention to identifying the vulnerabilities of maintaining the "status quo." We are also concerned by the evidence suggesting that a lack of quality data has raised doubts about the usefulness of stress tests.

We welcome developments that encourage countries to undertake self-assessments of their adherence to standards and codes. These can assist countries in their preparation for and reduce the costs associated with an FSAP, as well as being utilized as part of the follow-up work of a FSAP.

Regarding the coverage of development issues in FSAPs, we agree with the assessment of Fund staff. The stage of development of markets can have a bearing on how well a financial system can absorb shocks, and those issues should be addressed, but it would not seem necessary that FSAPs to go so far as to be concerned with, for example, whether "micro" enterprises have adequate access to finance. That may well be an issue in some countries, but generally will not be a source of systemic vulnerability.

Use of External Experts

We are encouraged by the wide-spread involvement and positive reaction of outside experts, in particular those from the relevant standard setting bodies. Moving forward, this will allow mutually reinforcing improvements in standards and effectiveness of FSAPs. One suggestion we would make for the further involvement of outside experts is in respect of how the Fund might use the work of those already actively involved in evaluating or managing financial risk (such as rating agencies and investment banks). We wonder to what extent the Fund can or does tap into intelligence from these sorts of sources? While we cannot vouch for the quality/accuracy of such assessments, our sense is they often have a reasonably good sense of what is going on in financial systems and of the key issues or vulnerabilities. We wonder whether more use could be made of this sort of intelligence in setting priorities and identifying approaches to individual FSAPs.

Publication

Given the high sensitivity of the information contained in FSAPs and FSSAs, the utmost care will be needed with our approach to publication. There are mixed views within this constituency, but, on balance:

we agree with staff's judgement that FSAP reports should not be published;

we support the publication of assessments of observance of standards and codes—although separate from, this would seem a logical extension of the publication of ROSCs; and

while we continue to have concerns about the potential damaging effects of the publication of FSSAs or the risk that FSSAs will be "watered-down" in an effort to make them 'suitable' for publication, we can go along with their publication should there be a majority in favor of it.

In respect of FSSA publication, we place considerable importance on voluntarism and the consistency with the Fund's broader publication guidelines (including the deletions policy) as proposed by staff. We would hope that any future review of the FSAP process should focus on, among other things, the reactions to and implications of publication. We also agree with staff's judgement not to retrospectively allow publication of the 12 pilot countries' FSSAs. While unfortunate for those countries that would prefer publication, we place greater weight on not changing the rules of the game ex post for those members not inclined to publish.

Resource Costs

It is clear that the resource costs of this exercise and the associated follow-up are significant. But, it may be a little unrealistic to simply assume that we can return to this as part of the regular budget discussion. If the Board is to agree to an annual target of 30 FSAPs per year, we are de facto taking a budget decision. However, we do that without the benefit of more fulsome information about costs and other priorities. For example, the extent and nature of offsets are as yet unidentified, and there is no information about the extent to which the associated technical assistance will be additional or just a redefinition of existing technical assistance. This concern adds to our reservations about agreeing to an annual target at this stage and we would suggest that we come back to the resource implications of the FSAP in the context of the budget discussions.

Review

Given the program is still in the developmental phase and given the resources involved, a review would provide the opportunity to refine the FSAP and further enhance its effectiveness. We therefore strongly support a review in 18 months or somewhat earlier.

Mr. Mozhin and Ms. Vtyurina submitted the following statement:

We would like to take this opportunity to thank the staff for the diligent work done during the Financial Sector Assessment Program pilot stage. We believe that so far the pilot program has been a valuable exercise in determining the ways by which to achieve the goals posed by the initiative on financial crises prevention. After the completion of a pilot stage this is the right time to assess the accomplishments and set the goals for future. We especially welcome the background paper provided for this review, which gives a closer look at the use of the pilot cases' FSSAs in the Fund surveillance. In our statement we will respond to the issues for discussion as well as add a few of our own observations.

FSAP as a coherent framework

We continue to see the FSAP as an indispensable tool in identifying financial sector vulnerabilities and working together with the authorities on subsequent strategies and solutions to improve the functioning of countries' financial systems.

We are in a broad agreement with the present FSAP's methodology which is based on the experience gained by the staff throughout the pilot stage as well as the suggestions made by the Directors at previous reviews. We particularly welcome the analysis and conclusions made regarding application of the standards assessments, and trust the staff to make a reasonable judgment on selectivity and prioritization of those in every single country case. As to the selectivity in the scope of the assessments in general, while it is important to maintain a fairy broad scope of the work, priority should be given to identifying and concentrating on the areas that are perceived to be most essential for financial sector stability in a particular country. This is important not only because of the resource constraints but also because of the need to ensure timely recognition of potentially harmful developments.

Ensuring consistency and quality of the assessments is rightly a primary objective of the FSAP. For that, not only selectivity and prioritization issues mentioned above are important, but also the capability of the staff, the external experts and the authorities to do the job effectively. As to the former, given the learning curve and a heavy workload, it would be inappropriate to reduce the number of mission members as was suggested by some authorities. This also should be taken in the context of a double increase in assessments as compared to the pilot stage. In regards to the external experts, we very much welcome their responsiveness in being a part of the FSAPs and the invaluable advice that they bring to the assessment process. However, as at the previous discussions, we remain concerned that the ability of cooperating institutions to release staff for missions is becoming limited. While the staff seem confident that additional experts can be brought from other institutions, this makes the case for more in-house development of expertise. Finally, full participation of the authorities in the assessment process is absolutely necessary. And we especially see a great value in conducting self assessments. The frank feedback from the authorities on how to improve the existing framework is also very important. In this regard, we welcome the continuing cooperation between the staff and the authorities in getting this feedback. We particularly welcome a more extensive feedback received from the authorities as well as from other participating parties during the outreach meeting. This helped to paint a clearer and a more comprehensive picture of the work done as well as identify the areas in need of enhancement. We encourage the staff to continue gather information from all parties during the next stage of the program since there is always room for improvement both in the coordination and the scope of the program.

Number and pace of assessments

When deliberating on the question of an appropriate number of the assessments to be undertaken each year, the first issue that comes to mind is unsurprisingly the one about resource constraints. And this relates not only to the dollar cost of the program, but also the workload for the staff. As before, we remain firm in our belief that more than 18-20 assessments per year would be strenuous for all parties involved. In this regard, we wonder if the staff can elaborate on the following: 1) are more staff being hired to conduct FSAPs, and especially in light of initiation of OFCs' assessments? 2) if there are already indication that external experts are limited in their ability to provide their services, would it be possible to attract an adequate number of experts when there is a more than a double increase in the assessments comparing to the pilot stage? 3) are the procedures under which the FSAPs are conducted streamlined and refined enough to preserve the quality and consistency of the assessments to expand the program to the proposed 30 assessments?

Besides the aforementioned concerns, we note that there are quite a few indications in the paper that undertaking even 24 assessments can result in some undesirable outcomes. The staff state that:

- comprehensive follow-up assessments would not be possible to undertake;
- regular technical assistance programs may experience further cuts so that to release resources for the FSAPs;

- the Fund will take on itself most of the developed countries' costs of assessments.

- there will be additional resource implications to the Fund resulting from its involvement in financial sector surveillance that is not part of FSAP;

- contrary to the expectations during the pilot stage there was no time saved from less costly assessments of some larger countries because greater resources were required for assessing developing country needs.

Another important point worth mentioning is the one also made by the staff about the Fund's work relating to the financial sector surveillance which is not a part of the FSAP. This involves work in countries where financial sector issues are emerging rapidly (Turkey would be a good recent example) but it is not possible to undertake a full FSAP in the short-term or where the country has not volunteered for the FSAP but there are concerns about its financial sector's health. Resources will be necessary in these cases and the Fund should be ready to provide ample amounts of them.

Therefore, although the staff indicate that increase above 24 assessment "seems justified", we do not see it appropriate at this point. Throughout the pilot program we were hesitant to support an increase to 24 assessments, mainly due to concerns recognized by the staff this time around. At this stage we are reluctant to support an increase in the number of assessments to 30. In addition, we believe that in the 18 month period proposed by the staff the Board should assess the experience of undertaking the 24 assessments a year before it can move ahead with increasing the number.

Selection of countries

We are glad to see that in this paper the staff made an emphasis on giving higher priority to systemically important countries. This Chair has always been of this opinion. This is not to say that other countries should not get an equal chance of going through an assessment. We think that all counties are entitled to the same opportunity, but given the resource constrains and potentially much more severe effects on the global financial system from problems in systemic countries, some prioritization should take place. And this goes not only for countries with less developed financial systems, but for industrial economies as well. As to the latter, the cost of the Canada's FSAP still haunts us, together with the fact that the Fund absorbs most of the cost of assessing developed economies.

But this issue may disappear if there are not enough volunteers from the systemically important members since the program is to remain of a voluntary nature. Nonetheless, if there are enough or more volunteers, we would prefer to see this kind of prioritization to take place.

FSAP/FSSA as a part of Fund surveillance

We are content that the FSAP/FSSA is taking its permanent place in the Fund's surveillance toolbox. The staff are doing a right thing by encouraging all members to participate in this program. It is also important that the experience gained from conducting FSAPs is applied to cases of non-FSAPs and that follow-ups on the conducted FSAPs become a part of the Article IV consultations. As to the cases of non-FSAPs, it is rightly noted by the staff that the fact that the country decided not to participate in the FSAP does not reprieve the Fund of the responsibility to conduct financial sector monitoring. The accumulated expertise gained from FSAPs can be very useful when conducting regular Article IV surveillance. Actually, this enhanced monitoring can be applied to cases of developed countries as well as to smaller economies when taking into account the prioritization matters discussed above.

In regards to those countries that have undergone the FSAPs, we agree with the staff that it is very important to develop a mechanism for regular updates of the assessments of financial sector risks following the initial round of assessments. And we concur with the proposal that these updates are to be presented to the Board as separate supplements to Article IV staff reports with key issues and conclusions summarized in the staff reports.

Publication issues

We continue to be of the opinion that publication of the FSSAs should be permitted on a voluntary basis. It should be consistent with the Article IV consultation publication and deletions policies. As to the latter, we would appreciate if the staff could elaborate on how the cases should be addressed where the authorities do not want to publish the FSAP paper but there are boxes containing FSAP summaries included in the Article IV report. Does the deletions policy allow for the whole box to be removed from the report? We recall dealing with this type of cases during the pilot stage and remember that this issue generated debate because there were no particular rules set at the time.

Mr. Kelkar submitted the following statement:

At the outset, we wish to commend the staff for providing a useful, detailed review of the Financial Sector Assessment Program (FSAP) in response to the Board's request in March 2000. The interrelationship between financial sector fragility and macroeconomic vulnerability has come into a sharp focus in the wake of financial crises of the late 1990s. Accordingly, greater emphasis is being placed on financial stability in international fora including IMFC and G-20. Against this backdrop, a review of FSAP—which was introduced with a view to monitoring of financial systems, assumes special significance. My own country, India was one of the 12 participants in the pilot exercise and my authorities' view is that our participation in the FSAP pilot project has been very valuable.

The review of lessons from the 12-country pilot presented in the staff papers is undoubtedly useful in terms of logistics of the initiative, especially in charting its future evolution. Arguably, however, such a review centered on logistics does not go far enough. A more substantive review would probably have asked questions regarding systemic issues in international financial stability thrown up by the FSAPs conducted so far. While discussing the March 2000 Progress Report our chair had highlighted the important issue of the design of the regulatory structure and the need to analyze the relative merits of alternative regulatory structures in financial sector—independent regulatory agencies a la USA, financial sector authority a la UK and a financial sector council a la Netherlands. We feel that usefulness of initiatives like FSAP lies precisely in such dissemination of cross-country experiences. Our chair would like to reiterate that the next review should address such broader systemic issues of financial sector.

Specific Issues

(a)FSAP Process

We agree that the FSAP process provides a coherent framework to identify vulnerabilities and strengthen the analysis of domestic macroeconomic and financial stability issues by combining the results of macroprudential analysis, stress tests and scenario analysis, assessments of observance of standards and other relevant information. The FSAP process can facilitate identification and resolution of a range of issues relating to strengths, risks, vulnerabilities and weaknesses of the financial sector. It may be noted, however, that efficacy of the FSAP process is yet to be tested, and could be done only over time. In the meantime, FSSA process needs to be strengthened by improving its analytical content so as to make it an effective tool.

(b)FSSA and Fund Surveillance

Our chair has consistently opposed a premature and automatic integration of FSSA with Fund surveillance through Article IV consultations. Apart from the fact that one is voluntary while the other is mandatory, it involves different degrees of associated confidentialities. This is not to say that the two reports should not inform and interact with each other. They should, but only after taking due cognizance of differences in their nature and the underlying market sensitivities. The issues for discussion refer to a question whether FSSAs are a "preferred tool" for strengthening the monitoring of financial systems under Fund surveillance. The question is not clear as alternatives to FSSA have not been articulated. Presumably, the comparison is between FSSA and a series of stand-alone standards assessment. In that case, our preference is strongly in favor of FSSAs. In our view, stand-alone standards assessments are like comparative statistics whose value need not be exaggerated. On the other hand, FSSAs provide summary assessments in the broad context of institutional and macroprudential framework and therefore, are likely to provide a more meaningful assessment of stability issues.

(c)Country Coverage

Our chair is willing to go along with the staff proposal to undertake about 30 FSAP assessment each year, subject not only to the budget constraints, but also to a set of guiding principles.

The evolving composition of prospective FSAP countries appears to be somewhat ad hoc – based perhaps, on members that voluntarily come forward to participate in the program. A stage has now been reached where the process of selection is streamlined with agreed priorities so as to enhance the overall effectiveness and ensuring cost effectiveness. In this regard, our chair would like to accord high priority to include as many as possible "systemically important" countries from among both developed and developing economies. At least some countries with off-shore financial centers (OFCs) should also be included. We also feel that at the present stage, requests for comprehensive follow-up by countries that have already completed FSAP should be deferred unless there are compelling reasons to warrant it. Finally, keeping cost-effectiveness in view, self-assessment—aided by technical assistance if necessary, should be actively encouraged.

(d)Publication

We fully endorse the prevailing policy not to provide authorization for the publication of FSAP reports in their entirety. Publication of FSSAs and assessments of observance of standards and codes included in the FSAP reports should remain voluntary.

Further Review

(e)We agree with the staff proposal to have a further review of the FSAP in about 18 months.

Mr.Yoshimura and Toyama submitted the following statement:

The pilot completed thus far clearly shows the effectiveness of the Financial Sector Assessment Program (FSAP), a full-fledged assessment by third-party experts of the financial sector of a country where its risks and sources of vulnerabilities are identified and a guidepost for the necessary reform to remedy them is provided. On the other hand, the pilot illustrated that the FSAP was a labor-intensive work. To begin, I would like to commend both Fund and Bank staff, assisting national banks and other institutions, and the participating authorities. This heavy demand on Fund resources suggests the importance of deciding the scope of the FSAP and selecting countries to ensure efficient use of these limited resources. Once a track is established, this sort of initiative will gain the momentum to move ahead on its own until further review by the Board. In this regard, the direction established at today's Board meeting is crucial.

Views were divided at the Board meeting last March on such issues as selection of countries and publication, possibly reflecting the different emphasis on the ostensibly ambivalent facets of the FSAP. Some views tended toward emphasizing the facet that the FSAP is aimed at identifying possible causes for systemic repercussions on a regional or global basis and remedy these causes as much as possible to prevent a crisis or minimize the impact of a crisis when it occurs, and some on the facet that the FSAP is an initiative based on voluntary participation of member countries hoping to remedy the weakness of their financial sectors. Those two facets are, however, not necessarily contradictory. It is essential that the view be shared at large that strengthening a particular country's financial sector is not only good for the country in question, but beneficial to the region and the world. On one hand, it is agreed that countries with systematic importance should be given priority from the viewpoint that the FSAP is significant beyond the assessed country and maximizing the regional and global benefits should be essential. On the other hand, we should not forget the fact that the FSAP is aimed at helping member countries identify and remedy the weakness of their financial sectors. As such, the FSAP cannot become a reality without country ownership. Any modality that implies pass-fail-test must be precluded.

We regret that the staff paper does not refer to the question of how to cooperate with the Bank despite the fact that "a number of" Executive Directors, including this chair, raised this issue at the March Board meeting. This chair insisted that the responsibility of each institution should be clear and that the Fund should take the leading role. While it is important to have constructive and effective cooperation given the limited resources, that cooperation should not compromise the Fund's unique responsibility for the financial sector, which nobody doubts now is the core of Fund surveillance. In addition, to estimate the aggregate needs for Fund resources, we should know the scope of the Fund's responsibility. In this connection, we suspect that staff will consider the Financial Sector Review Group's recommendations—required by its terms of reference—on the scope of Fund activities in the area of the financial sector. If this becomes the case, the estimate for the needed resources made in this staff report might have to change in order to reflect the recommendation made by the group at that point.

In light of the Fund's limited resources and expertise, it is essential to strengthen coordination with, and ask for participation of experts from, the Basle Committee, IOSCO, and IAIS.

We now turn to specific issues along with the issues for discussion on page 35.

We agree that the FSAP process provides a coherent framework to identify vulnerabilities and strengthen the analysis of domestic macroeconomic and financial stability issues, to help authorities develop appropriate policy responses. However, being coherent should not mean being rigid. The flexibility seen in the pilot with regard to the scope and priority of assessments depending on the specific situation of any country is essential for enhancing the effectiveness of the FSAP. The most effective modality for achieving the purposes of the FSAP may vary among countries and efforts at discovering it for each program should be continued.

Long intervals between FSAPs are not desirable in light of the rapid change in environments surrounding the financial sector. On the other hand, it is understandable that ambitious pace setting would be difficult since the FSAP is a resource-intensive work. However, staff has not presented its view on the Fund's responsibility in the FSAP, making it difficult for the Board to estimate even roughly required resources per program. We hereby request staff to explicitly present its view on this point at the latest before the Board discusses the FY2002 budget.

We agree that higher priority should be given to assessing systemically important countries, including industrial ones. As described beforehand, one of the goals of the FSAP is to remove possible causes for systemic repercussions. On the other hand, from the viewpoint of responding to a country's need to strengthen its financial sector, it is also important to cover countries finding themselves in various circumstances and states of financial market development. While the decision to participate in the FSAP is voluntary, it is important to establish understanding among member countries that the program can be an effective method for strengthening restructuring efforts, and to encourage their participation.

We agree to management authorizing the publication of the detailed assessments of observance of standards and codes. While the publication of FSAP reports in their entirety may not be appropriate as some parts of the reports carry sensitive information, such as stress test results on individual financial institutions, publication of other parts that are not necessarily confidential—not limited to the above assessments—should be permitted with the consent of the country. We would like to reiterate our position taken in the March Board meeting that management's policy of not disclosing the FSAP to the Executive Board should be reconsidered. The Board has the responsibility for policy advice to member countries as well as for allocation of resources and budget. The Board cannot perform its responsibility without the ability to gain access to results of staff work when necessary. We strongly hope some measure that would balance this need for staff accountability to the Board against the confidentiality requirement will be implemented.

We basically agree that the Board will further review the FSAP in about 18 months with a request for management to issue a statement to the Board on the recommendations of the Financial Sector Review Group when ready in view of the possibility that those recommendations may affect the views of management and staff on the issues of the Fund's responsibility for the financial sector and its resource implications. Such a statement may include a description of the relationship of the Group's recommendations to the conclusion of today's Board meeting. It is possible that at the end of such a process, the Board may find the need to discuss the FSAP again. At least, the Board will take up the issue of resources in the discussion of the budget. On that occasion, I hope staff's estimate of resources will reflect a clear view on the Fund's responsibility for the financial sector.

We agree that the Financial System Stability Assessments (FSSAs) are the preferred tool for strengthening the monitoring of financial systems under Fund surveillance. The FSSA is a comprehensive work to assess the financial sector in the context of the country's particular macroeconomic situation, identify the sources of vulnerabilities, and help the authorities remedy the weakness of their financial sector and formulate appropriate policies. However, the FSSA is a work undertaken only once in several years, during which the financial sector and macroeconomic conditions can change dramatically. The country's vulnerability may be affected suddenly. Accordingly, it is important that the Article IV consultations and self-assessments by the authorities can measure the risks and vulnerabilities more frequently in accordance with such changes, although not as comprehensively as the FSSA.

I agree that the publication of FSSAs should be permitted on a voluntary basis at the conclusion of the FSAP process. There seems to be no legitimate reason to reject a country's request to have its FSSA published. As is the case for staff reports for Article IV consultations, markets will rightfully understand that the decision to publicize the FSSA paper or not is a country's judgment based on legitimate reasons. Alleged peer pressures that other country's decision to make their paper public might cast doubt on the financial sector's condition of a country that opts not to publicize the paper are unrealistic.

Mr. Oyarzabal submitted the following statement:

The introduction of financial sector assessment programs motivated by the financial crisis of the late 90s with the view to strengthening financial system surveillance, as well as promoting financial stability and growth, have been very successful. It is important to point out that, as more country cases are addressed within the context of this pilot project, the greater the experience and the benefit derived for those member countries that have willingly participated in their assessments. From further work that is done in this context, one would expect a greater strengthening of the analytical capacity within the Fund and other international financial organizations that are jointly working in this area. Moreover, national authorities can be better informed to address emerging problems in the financial system, to take advantage of technical assistance, and to implement reforms—if and when necessary—derived from the FSAP project.

In my view, the most important, if not one of the major elements contributing to the success of this initiative has been its voluntary nature. The sales effort promoted by staff should be given due recognition. This approach, I believe, is being instrumental in creating ownership at the domestic level in an area of activity that has significance for Fund surveillance as well as for economic performance of individual economies and the financial system, as a whole. The collaborative nature with other institutions which have also endorsed this approach certainly strengthens the possibility of greater openness in accepting recommendations, promoting a further development and liberalization of financial systems and services, and also identifying and focusing on vulnerabilities and risks that must be considered in the short and medium-term to support financial stability.

As the staff correctly points out, the program is in a developmental stage. This fact must be kept in mind before reaching conclusions too quickly with respect to its implementation. In any case, I believe that efforts should be made in trying to include 30 FSAP assessments at this stage on a yearly basis and, hopefully, that support will be found to allocate the necessary resources to carry on the efforts already started. In this context, it might be useful to envisage that, as experience develops, guidelines can be identified to facilitate a strengthening of the analysis of the financial sector through the FSAPs and FSSAs in Art. IV consultations and also help determine the frequency and the countries where full FSAPs would need to be carried out. This would lead eventually to a case-by-case approach.

The merit in prioritizing assessments to systemically important countries, including industrial countries, is not only based on the very significant role that their financial sectors play in the globalized financial markets, but also on the importance of identifying issues that could be of particular relevance and benefit to other countries whose financial sector is in need of being strengthened and are or would be playing an increasing role in this global market place.

As stated above, recognizing the link between the FSAPs and the Fund's regular surveillance activity, and as FSSAs are derived from the FSAPs, they should be the basic instrument of support of surveillance dealing with the financial sector within Art. IV consultations. In my view, it would be worthwhile to consider cost elements involved in strengthening Fund capacity to respond to these needs, taking into account, as I stated before, the need of prioritizing and determining the frequency that more in-depth analysis might be required in this respect.

Taking into account that the FSAP is a diagnostic tool, it might be too difficult to set standards or rules in implementing a follow-up process for these assessments. Authorities implementing reforms might face new risks and vulnerabilities that might require further changes. Also, some countries might be very quick in implementing staff recommendations from a FSAP, while others might need a greater time frame for the implementation of reforms. Therefore, I believe that at this stage authorities and staff working on a case-by-case basis should agree on the best time for conducting follow-up FSAPs. Article IV consultations would certainly give staff and domestic authorities an opportunity to evaluate how the work in progress is evolving and how to determine the best time to repeat this exercise.

The proposal by staff to amplify the scope of FSSAs to take into account cross-border effects and consideration of international repercussions, while maintaining a country's specific focus, should be supported. The integration of markets, as well as other significant issues such as the treatment of off-shore financial sectors, lend support to this proposal. The case for insisting in increasing the role of standards and codes, in my view, must be handled very carefully. The issue of ownership is essential. At the same time, if one takes into account the assessment by staff wherein the observance and application of these standards and codes can be very complex, particularly when they are excessively detailed, can represent an even greater burden for countries with limited domestic institutional capacity. The promotion of standards and codes would do well to go hand in hand with technical assistance and, as further experience with the pilot project is obtained, a better evaluation can be made of how their application can be further motivated and evaluated.

Confidentiality and market-sensitive information would appear to be an intrinsic and essential part of the content of FSAP reports and, given the success already achieved in the pilot project, that has been underpinned on the basis of mutual trust and cooperation, the suggestion by staff to keep FSAP reports confidential must be endorsed. A voluntary approach (FSSAs) in this sensitive area would certainly strengthen countries' ownership, links between Fund members and the institution, as well as the commitment in following through with initiatives towards financial stability and development.

I would appreciate staff's comments with respect to the statement presented on page 11, paragraph 19 of the report, where they stated that "assumed scenarios could sometimes be too extreme." Care must be taken that scenarios deal with realistic probabilities and not necessarily create a credibility gap that might hinder the efforts that are being made by staff in carrying out the FSAPs.

In closing, I would support to have a further review of the FSAP pilot in about 18 months.

Mr. Shaalan submitted the following statement:

The eruption of the recent financial crises and the intensity of cross-border contagion have underscored the increased role that financial sector weaknesses have come to play in the emergence of crises and in their transmission to the real sectors of national economies as well as across national boundaries. The importance of an early identification of risks and vulnerabilities in the financial sector in the prevention of crises and in enhancing countries' resilience to crises when they do occur, as they inevitably will, is self-evident.

Over the past few years, the Fund has introduced a number of initiatives aimed at assisting member countries reduce vulnerabilities to crises, and enhancing the functioning of the national and international financial markets. The FSAP clearly has the potential of playing a central part in the achievement of these objectives through the preparation and delivery to national authorities of comprehensive assessments of their financial systems. Ultimate success, however, will depend to a large extent on how we deploy the necessarily scarce resources available for this endeavor.

The paper before us reviews recent experience and makes a number of proposals on how to move forward. However, while I realize that the staff was constrained by the fact that the experience we have logged in this area remains limited, the paper could have been more focused and less conclusive. Thus, while I remain supportive of the exercise, I expected the paper to present deeper analyses to back the proposals it puts forward. I have a number of comments that I will group under two headings, namely (a) prioritization and resource costs, and (b) publication issues.

a) Prioritization and resource costs

If my memory serves me right, one objective of this review was to identify ways to reduce costs for the organizations and the national authorities without detriment to the quality of the work. Unfortunately, the paper makes no concrete proposals in this regard. Achieving this objective would require further analysis on how we can prioritize the work both in terms of country coverage as well as the scope of the assessments themselves. Instead, while acknowledging the high average dollar cost of each FSAP, at around US$ 500,000 (excluding the expected additional resource costs for the follow up work), the staff propose that the number of yearly assessments undertaken be raised from 24 to 30 to allow for a larger number of assessments of economies of systemic importance.

In my view, the case has not been made either for the expansion in the number of assessments from 24 to 30, or for the coverage of the entire membership in a five year cycle. While we would support focusing our efforts on economies of systemic importance, it is not clear that a full-fledged FSAP is needed for all countries for effective surveillance. Furthermore, when calculating the resource costs, we must include quantified follow-up costs of technical assistance, which should constitute an integral part of a country's FSAP. It makes no sense to identify vulnerabilities and then find that insufficient resources are assigned to addressing them.

The staff proposal for countries that have volunteered but cannot be accommodated in the program could well form the basis of a meaningful prioritization of country coverage. Undertaking targeted assessments of the most relevant issues in the context of Article IV consultations may be the optimum way to go for many countries, even though they have volunteered for an FSAP. This kind of prioritization needs to be given adequate consideration in the effort to optimize the use of scarce resources. What are staff views on the effectiveness of such an approach?

Still on prioritization, I feel that a strategic decision is required on the scope of assessments before we proceed to further commit large amounts of resources. The staff paper points to the assessments of observance of standards as an area where selectivity and prioritization is essential and alludes to questions surrounding the robustness of the relationship between observance of standards and financial system stability. Thus, while the importance of the observance of standards to the strength of financial systems over the medium term is acknowledged, there appears to be a case for assigning a lower priority to their assessment in the context of FSAPs, which should focus on the identification of immediate financial system vulnerabilities. The Fund could encourage countries to undertake self-assessments rather than do the work itself in the context of the FSAP. A clarification of staff views on this issue would be appreciated.

b) Publication issues

On the publication issue, generally, this chair has consistently held the view that the Fund needs to strike the right balance between assuring the candidness of discussions with member authorities, which constitute the core of effective surveillance, on the one hand and widening publication policy on the other. With regard to FSAP and FSSAs, we must exercise the utmost care not to allow wider circulation of these documents to the detriment of the basic objective of the exercise, namely to assist members in identifying vulnerabilities in their financial systems and in addressing them. Clearly here the issue of confidentiality is central and of paramount importance, not only to encourage members to volunteer for these assessments, but in order not to unduly risk precipitating the crises we are seeking to avoid.

Specifically, we find that the paper before us does not adequately address the implications of the publication of FSSAs. If I understand staff correctly, they are proposing not only the authorization of publication of the ROSCs included in FSSAs, but also the whole FSSA. It would seem to me that consideration of the authorization of publication is premature at this stage, particularly since the scope of both the FSAP, and hence the FSSA, remains a work in progress. While the authorization of publication for the ROSC part of the FSSA may not present a problem in itself, we cannot agree to similar treatment of FSSAs as a whole. Accordingly, we would like a clear separation of issues related to publication of FSSAs and the voluntary publication by members of Article IV reports.

Still on publication, I fully agree that any new policy for voluntary publication should not retroactively apply to the 12 pilot countries. To maintain the integrity of Fund pilot initiatives, we need to refrain from changing the rules that apply to them after they have begun or even after their completion. This is a matter of principle, about which I feel strongly.

I also cannot support the publication of the staff paper before us today. I do not find the analysis contained therein sufficiently rigorous to justify the paper's conclusions.

Before concluding I would like to express our lingering reservations with regard to the predictive value of so-called core macro prudential indicators. As I have noted on other occasions, over-reliance on such indicators should be avoided. While these indicators are no doubt valuable as an input among others in vulnerability analyses, they need to be carefully framed within an overall qualitative assessment of a country's financial system.

Finally, I can agree to the suggestion to hold a further review of the FSAP in about 18 months.

Mr. Bernes submitted the following statement:

I would like to express my appreciation to staff for their hard work in successfully completing the pilot exercise of the Financial Sector Assessment Program. I would also like to say at the outset that all of my authorities strongly support the program. Canada and Ireland participated in the pilot exercise and found the experience to be rewarding. The Eastern Caribbean Central Bank and its members are scheduled to receive an FSAP mission later this month. We look forward to the FSAP playing an integral role in the Fund's surveillance work and in its assistance to its members.

Prioritization of Work

We welcome the approach to the prioritization of work set out in paragraph 27. We strongly support the notion that FSAP teams, in conjunction with national authorities, should focus the assessments on those issues and institutional features that are judged to be most important for financial sector stability and development in the particular country.

In making the inevitable trade-offs that will arise, we hope that staff will not underestimate the value of assessments of standards. In this regard, I was struck by the reference in paragraph 43 that some area departments question the value of standards assessments. Standards assessments may not be helpful in identifying short-term risks per se, but adherence to the appropriate standards is central to managing risks in the financial sector and to helping the financial system withstand adverse macroeconomic shocks. Adherence to standards will reduce the risk of a crisis and will reduce the severity and cross-border spillovers of a crisis should one occur. We agree, however, with being selective as to which standards are assessed in a particular FSAP. We feel strongly that observance of the Basil Core Principles (BCP) should be assessed early on. Assessment of the payment systems (SIPS) should also be a high priority.

While there are advantages to conducting assessments of standards within the context of a FSAP, we think that it is important to maintain the flexibility of carrying out ROSCs on a standalone basis.

Finally, we welcome the intention of staff to accord a high priority to cross-border issues in financial sector assessments of countries with significant offshore financial centers. In this regard, it is also worth noting that Directors underscored the importance of assessing consolidated supervision in relevant onshore centers vis-à-vis activities undertaken in offshore centers in the July discussion of the role of the Fund in OFCs (Buff/00/98).

Pace of the program, follow-up and linkages

Given the importance of the financial sector for the functioning of the domestic economy, its importance as a potential source of international spillovers, and the rapid and sustained pace of innovation in this sector, a comprehensive review is warranted periodically. We support the objective of undertaking 30 FSAP assessments each year, as it would enable all member countries of the Bank and the Fund to be covered on a six-year cycle. How quickly we move to a steady state of 30 or so countries per year should be decided within the context of the Fund's overall budgetary process. Consideration should also be given to availability of expertise both in the Fund and outside and the willingness of members to participate in the FSAP. We note the reference to the increased resources needed by the Fund to carry out reviews and the burden placed on national authorities. Both the Office of the Superintendent of Financial Institutions in Canada and the Bank of Canada have supplied experts to undertake peer reviews in other countries. We are reviewing our ability to supply these resources on an ongoing basis.

The follow-up to FSAP missions is crucial to deriving the full benefit of the program. FSAP recommendations should be reflected in country programs and in the allocation of technical assistance.

Between FSAP missions, it is essential that the financial sector is accorded due weight in Article IV consultations. Article IV reports should follow up on outstanding issues identified in the FSAP report as well as being alert to new issues. Indeed, it should be underscored that, in countries that do not participate in the FSAP, the Article IV mission should focus on the financial sector as appropriate. Significant developments that are picked during Article IV consultations could be reflected publicly through the Public Information Notice (PIN).

Country coverage

We support a balanced approached to selecting the countries to participate in the FSAP in any given year. While we support according higher priority in the near term to countries that are systemically important (including countries applying for a CCL), there should also be opportunities for countries that are committed to developing their financial sector and are at a stage that would benefit from an assessment, and for countries with an SBA. This latter group of countries should be encouraged to have a FSAP at the earliest feasible date.

Publication

The information produced by an FSAP is useful not only to the authorities and the Bretton Woods Institutions, but also to markets. The dissemination of this information can greatly facilitate decision-making and reduce uncertainty and volatility in financial markets. In addition, we have learned from the pilot exercise that it is possible to write FSSA reports that can be published without compromising their effectiveness as a surveillance instrument. Accordingly, we strongly support voluntary publication of FSSA reports, as well as the detailed standards assessments and any self-contained components of the FSAP that do not include highly market-sensitive information. Presumably countries with access to international capital markets would find it advantageous to publish these documents. I would note in passing that I do not think that voluntary publication will be a significant deterrent to participation in the program. At the time of the March review, staff was asked to inform the countries that had already volunteered for an FSAP in 2001 of the possibility of such a policy being adopted and to give them the option of withdrawing. To date, none of the countries has withdrawn.

Now that the pilot exercise is completed, we also support voluntary publication of the appropriate reports for the pilot countries. When the pilot exercise was being considered, it was unknown whether the possibility of publication would undermine the effectiveness of the reports. Since the first priority was to see what the best surveillance reports would look like, it was decided not to jeopardize or unnecessarily complicate the exercise, and the issue of publication was set aside. Indeed, there was no mention of publication in the first available summing up of a Board discussion of the pilot exercise (Buff 99/132). Consequently, allowing voluntary publication of pilot reports now is not changing the rules retroactively. The decision not to allow publication during the pilot exercise was respected. It is now time to decide on a publication policy for these reports. Several of the participants in the pilot have indicated their wish to publish their report. They should be permitted to do so.

Next FSAP Review

We support the staff proposal to have a further review of the FSAP in about 18 months.

Conclusion

Finally, I would like to commend staff for their ongoing emphasis on learning and on improving the FSAP as our knowledge evolves. The efforts of the FSLC to provide a forum for capturing the lessons of experience, the outreach meeting in October, and the feedback questionnaire are particularly notable in this regard. We also welcome the research program aimed at improving assessment methodologies, especially the work on macroprudential indicators.

Mr. Mori submitted the following statement:

Staff has provided us with a useful progress report on the financial sector assessment program (FSAP), which reviews the experience so far with the pilot country projects and presents the lessons learned.

We share the view that the FSAP has an important role in strengthening the financial system in member countries. However, with the pilot program still in the first year, it seems to be too early to conclude that (a) the current framework is the preferred one, and that (b) it provides the best framework within which to deepen the quality and coverage of the analysis of financial sector issues in the context of Fund surveillance. Each member country presents its own financial system's specificities and complexities, especially those more developed systems, and it requires a thorough understanding of the system to make an appropriate evaluation. As staff notes, there is still much to learn as experience with undertaking FSAP assessments accumulates.

In the FSAP process, a broad scope in the assessments is desirable to ensure that particular circumstances of individual countries are considered, and major financial system vulnerabilities and development needs are not overlooked. But it is also essential that on consideration of both cost effectiveness and relevance, the process be selective in the scope of the assessments covering those issues and institutional features which are judged by staff and authorities to be most important for financial sector stability and development in the particular country. Therefore, prioritization and selectiveness based on the experience gained in the operationalization of FSAP is fundamental. In addition, any further steps in the FSAP exercise need to take into consideration the ongoing evaluation work being done by the Financial Sector Review Group.

In this context, the suggestion to increase the number of assessments from 24 to 30 seems to be premature, and this issue needs to be addressed in the discussions of the Fund's budget as an additional resource cost of 25 percent is estimated by staff. Also, we do not go along with any suggestion of reprioritization of resources that entails cuts in technical assistance. In any event, technical assistance needs to be preserved in the annual budget allocations, and any additional resource needs resulting from the FSAP need to be undertaken in the context of the annual budget discussion. Our preference is to maintain the program in the current structure with 24 countries. Again, we believe it is premature to take a decision of extending its cover, particularly at this early stage of the program. We consider that it is essential that FSAPs continue to be a voluntary program.

Standards assessments are an important component of the FSAP in identifying medium-term development needs. But we share the staff's view that standards assessments play a more limited role in identifying immediate financial system vulnerabilities, as these are influenced by a host of macroeconomic and structural factors. Staff points out that the relationship between observance of standards and financial system stability is complex. In some countries, departures from standards were found to have limited connection with the financial risks and vulnerabilities and did not pose a threat to immediate stability. Standards assessments can contribute to a robust overall stability assessment only when they are combined with other analysis and information. One could also argue that the financial system is very dynamic, in a constant process of innovation so that the currently accepted set of standards, static by nature--or even more sophisticated ones--could not prevent a systemic crisis to occur in a changing environment. We therefore agree with staff that assessments of observance of standards is the area where selectivity and prioritization is essential to work more effectively and economize on resources.

The current policy of publication of FSAP reports needs to be maintained. The FSAP reports contain highly confidential information. It is appropriate for the management of the Fund and the World Bank to continue not to authorize the publication of the main volume of an FSAP report or associated confidential documents. We agree that these documents continue to be circulated only on a limited basis within the Fund and the Bank.

We could not go along with the proposal that FSSAs be treated as staff reports for Article IV for publication purposes. Staff suggests that FSSA reports be published subject to the same deletion policy regarding market sensitive information that pertains to staff reports. But in the case of Article IV reports, the policy is restricted to few specific items, while in the case of FSSAs, the report is of a different nature involving other confidential information and need therefore be subject to a different policy.

In general, we are of the view that, in terms of ensuring the stability of global financial markets a program restricted to bilateral surveillance seems not to be sufficient. The Fund's privileged position allows it to oversee macroeconomic and financial developments in a global perspective not restricted in a more narrow country-specific focus. Given the rapid integration of international financial markets, it is important to understand better the process of cross-border capital flows, especially those short-term, interbank and trade related, its incentives and determinants; the effect of monetary policy in major currency issuers and its global transmission and repercussion mechanisms; the movement of capital in events of financial shocks; the role of intermediaries such as major players in the international interbank market, major financial and offshore centers, and highly leveraged institutions in the creation and contraction of liquidity; the correlation among stock exchanges and the role of derivatives markets and OTC transactions; among other issues. Understanding these issues is essential to build safeguards and prudential rules in a global perspective to ensure a more stable global environment.

Mr. Milleron and Couillault submitted the following statement:

We welcome this review of the financial assessment program and would like to take this opportunity to state again our strong support to this initiative. We consider that the latest developments in Turkey have clearly illustrated the need to accentuate our efforts on crisis prevention and to strengthen the IMF involvement in the financial sector through notably the FSAP but also the ROSC.

The FSAP is now an integral part of our toolbox which buttresses our surveillance. The experience of the first sample of countries is wide enough to consider that this initiative has had very positive impact. Indeed, staff has been able to find a large number of countries to be candidates to this exercise while convincing more than 50 institutions to provide experts to conduct these assessments. Such a large support is ample evidence of the attraction of this initiative as well as an indicator of the size of the expectations it has created.

Staff has undertaken this daunting task while recognizing that this is a learning by doing process. So far, the difficulties have been overcome with a mix of skills and caution but before going ahead we believe we have to tackle boldly some difficult issues with regards to the scope of the initiative, the articulation with the other instruments of the Fund and the consistency within our transparency policy.

Scope of the initiative

Since we believe that the FSAP should be an integral part of our surveillance, we welcome the proposal to extend the scope of the initiative. We are ready to support the proposal to set an objective of 30 FSAP per year provided that sufficient resources can be devoted to the exercise and provided that we can be guaranteed that the increase in the number will in no case be at the expense of the quality of the assessment.

We would be uncomfortable with the idea to increase the number of FSAP at the expense of Technical Assistance or ROSC. Clearly, it would make little sense to identify vulnerabilities while not having enough resources to help fix them. And it would also sound odd to systemically focus on short term risks through the FSAP while neglecting medium term issues which could be identified through a ROSC.

Before taking decisions on this issue, we believe that more information should be provided to the Board on the resources implications. We note with satisfaction that budget estimates are broadly on track for the FY2001 but we would be interested in more precision on the impact of the proposed increase in the target on the budget but also on the amount of technical assistance provided to the members and on the number of ROSC which can be undertaken. We also believe that we should keep some room for maneuver to be in a position after our forthcoming discussion on money laundering to respond efficiently to the need to fight financial abuse.

Staff argues convincingly in favor of maintaining the participation to this initiative on a voluntary basis. We agree that, to be truly effective, an assessment of the financial sector should be undertaken in a constructive spirit on the basis of good collaboration between the authorities and the mission. But we also fully share staff's views that Fund surveillance would be significantly strengthened if all members were to participate in the FSAP. Therefore we consider that we have the duty to be more explicit on our intentions and clearly state that there should be an expectation or a presumption that countries would volunteer in a period of time which remains to be determined.

We consider that staff should progressively approach all the membership in order to examine with the authorities what could be envisaged in a medium-term framework in terms of financial sector surveillance. These discussions should aim at establishing a calendar in terms of ROSC, Technical assistance and FSAP and help to shed more light on the process of selecting candidates. Staff could thus focus in priority on countries where financial stability is more critical while being in a position to plan more efficiently the assessment of the entire membership.

Such a general planning would in our view help us deal with the issue of the follow-up and prepare our response to the question which will undoubtedly be raised on the occasion of a banking crisis : given the amount of attention and resources devoted to the financial sector surveillance, how could the IMF be in a situation where he was unable to prevent the crisis to happen? There is a reputational risk which needs to be dealt with.

The second issue we need to tackle is related to the nature of the links between Report on Standards and Codes and the FSAP exercise in the financial sector.

A great deal of attention has been devoted in this paper to this topic without in our view bringing the final note to the debate. When reading, I quote, "the FSAP process provides the proper context for assessment of codes and standards" and in the same document that "selectivity and prioritization are essential in this domain", one could have the impression that ROSC, mainly presented as an outcome of the FSAP, have a minor role in the new landscape of the IMF activity in the financial sector. It would be undoubtedly a wrong interpretation since we believe that these two exercises are of similar importance and should both play a key role in crisis prevention.

To be short, we believe that ROSC enables the authorities to assess, through a peer review, the quality of the legal and supervisory framework in the country. By helping to identify gaps, or improve the current practices, ROSC clearly participates to best practices diffusion and therefore to crisis prevention.

While participating also to best practices of dissemination, FSAP are more focused on identifying potential vulnerabilities.

Against this background, we strongly believe that both initiatives have a key role to play, provided that we do not build too rigid a system. In our view, the ROSC could either be seen as part of the preparatory work before engaging in an FSAP or an outcome of the exercise. Therefore, we believe that the Fund's action in the financial sector surveillance should be tailored to the country's needs in order to find the appropriate sequence of FSAP/ROSC or Technical Assistance.

With this caveat, we fully agree that when engaging in an FSAP, staff should be in a position to focus on areas where vulnerabilities have more probabilities to be identified.

Clearly, the issue of transparency is one of the most difficult we have to tackle. Given that this chair has expressed strong concerns in the past, it will be no surprise if we consider that this debate is critical for us.

Let's deal first with the simple questions:

First, we prefer to abstain commenting on Management policy with regards to the non publication of FSAP since we still have had no opportunity to read any FSAP;

Second, concerning the detailed assessments on standards and codes, they should be an integral part of the ROSC and the country should be allowed to publish either of them.

On the question of FSSA publication, we must say that we are a bit disappointed. Given the sensitivity of the topic, the divisions in the Board and the latest developments in the Turkish banking sector, we would have expected a long argumentation in favor of transparency. To be short, we expected to be provided enough material to convince those who still have some legitimate concerns on this issue. We are afraid that this review falls short of being decisively convincing but we consider that we are not in a position to dictate other countries their decisions and can go along with publication on a voluntary basis.

Ms. Lissakers and Mr. Abbott submitted the following statement:

The Financial Sector Assessment Program is a central component of the new international financial architecture. This chair strongly supports the ongoing and expanding FSAP work of the Fund and the Bank. International recognition and support for this effort is growing. In the past year, in addition to the IMFC, the G-7 and the FSF, the G-20, CHFI and APEC have all stressed the importance of codes and standards and the IFI assessment programs. Support for this effort radiates beyond the official statements noted in Box 1 and is stimulating further related assessments by private market analysts.

One of the primary objectives of the FSAP work is crisis prevention. The experience of Turkey in the past few weeks is a forceful, and expensive, reminder that financial sector weaknesses pose serious risks for macroeconomic stability. The fresh experience in Turkey should help sharpen our review of the FSAP work. It is relevant to ask: are there tools developed in the FSAP exercise that, if they had been applied, would have helped to have identified vulnerabilities and headed off the crisis in Turkey?

I think the staff could have gone farther than it did in synthesizing the experience to date. We now have useful case histories of vulnerability assessments. These are summarized in the companion paper on FSSAs and the Monitoring of Financial Systems under Fund Surveillance. The main paper stresses the importance of new analytical tools and methodologies, such as use of macroprudential indicators, stress tests and scenario analysis. We support use of these tools since they come from best practices in contemporary financial risk management. However, it would be helpful to have a fuller and more concrete discussion of how these tools are being applied in the FSAP cases. As noted in the staff paper, there are a number of outstanding issues in trying to apply these techniques. Data availability is a problem. Confidentiality limitations can be a problem. Time constraints are a problem. And we are still some way from having consistent standards regarding macro prudential indicators. On this last point, we are disappointed that the planned paper on macro prudential indicators has slipped and that we will only be getting a progress report by the time of the spring meetings. Macro prudential indicators are so central to our financial sector work that we believe this project should be accelerated.

Let me be a little more concrete. In Turkey, it has been understood for some time that there were weaknesses in banking practices with regard to exchange risk, interest rate risk, and credit risk arising from connected lending. Liquidity risk would certainly now have to be added to this list. Would the tools that have been developed for the FSAP, if they had been applied to the Turkish financial system, have allowed us to identify these vulnerabilities with greater precision and urgency than was the actual case under the Stand-By Arrangement?

One point that emerges from this review is that bilateral surveillance is an essential and indispensable component of the work undertaken within an FSAP. The mix of volunteerism and technical assistance that is part of the strategy we are following should not distract us from this point. We are satisfied that the protocols that have been developed for reporting to the Board are satisfactory for keeping these distinctions in proper balance. The FSSAs we have seen, with their emphasis on vulnerabilities and on compliance with codes and standards, are right on target for our surveillance work. We recognize that the full FSAP contains firm-specific information that must remain confidential and is probably unnecessary for the Board to carry out its surveillance responsibilities.

While we would stress the importance of the surveillance component of the FSAP work, this in no way detracts from the technical assistance that is a major benefit of participation in an FSAP assessment. The feedback from all participants is that the reviews have been a learning experience, bringing high level attention to issues that had either been unaddressed previously or had been only impressionistically understood. This is an extremely valuable feature of the program that should be sustained. Involvement of outside experts helps to foster the professionalism of the assessments. Equally important is the cooperative and collaborative way that the FSAP teams have gone about their work. This is helping to ensure that the maximum benefit is extracted from this expensive and time consuming process.

Much of the staff paper focuses on vulnerability assessments in FSAPs. For surveillance, this is probably where the emphasize should be. However, the emphasis on vulnerabilities should not overshadow the parallel work on adoption and observance of codes and standards. I think there is a risk this is happening. Paragraph 43 of the main paper notes that the link between observance of standards and financial stability is complex and that some area departments question the value of detailed standards assessments. In our view, observance of codes and standards is a basic and independent pillar of the new international financial architecture. Codes and standards are an essential component of our strategy for building an international financial structure that is less accident prone. The more fully codes and standards are observed, the more confidence we will have in the integrity of the financial system. This should not be downplayed simply because a direct link cannot be made between a gap in adherence to some specific principle and short-run systemic risk. The Fund, and the FSAP program, have an important role to play in pushing forward the codes and standards pillar of the new architecture.

We recognize that assessments of observance of Basel Core Principles and other standards are an integral part of FSAPs. These assessments are included in FSSAs and are being developed into ROSCs. We also recognize that some selectivity will always be required since not all standards are applicable to all countries, particularly those with less developed financial markets. Nevertheless, we believe the standards assessments component deserves greater prominence in the FSAP process and in the FSSAs presented to the board.

We are still not entirely comfortable with the relation between the OFC assessments and the FSAP work. Modules two and three of the offshore assessments are variations of ROSC or FSAP reviews. We continue to think the vulnerability methodology that has been developed for other domestic financial sectors is probably not the relevant model for specialized offshore centers. The vulnerabilities posed by an OFC are primarily cross border risks affecting the integrity of international financial markets rather than financial vulnerabilities to the internal economy of the offshore center itself. It would be helpful if staff could comment on how its thinking has evolved regarding the proper focus of modules two and three of the OFC assessments. An FSAP has been scheduled for the East Caribbean Central Bank for this month. As the membership of the ECCB includes many offshore financial centers an explanation of how offshore issues will be integrated into this FSAP would be helpful.

We support the staff's recommendation that high priority should be given to assessing systemically important countries, including industrial countries. So far staff has achieved a reasonable balance of emerging market, industrial and developing economies. Once "volunteers" are lined up, staff should conduct a needs assessment as part of the scheduling process, and revisit on an on-going basis to ensure that priorities remain current.

We also agree that we should aim to achieve a target of 36 FSAP missions per year. This would enable a five-year cycle for all members. Less frequent reviews will, in many cases, result in too long an intervening period; a more frequent cycle is not realistic given resource constraints.

We agree that the full FSAP report is mainly for the benefit of the sponsoring authority and need not be published. The FSSAs originating from the FSAP, however, should be the preferred tool for strengthening the monitoring of financial systems under Fund surveillance. Thus, we agree with the staff recommendation that, for publication purposes, FSSAs should be treated the same as staff reports for Article IV consultations. This means that, going forward, FSSAs publication would be permitted. Once this policy is adopted, we see no reason to continue the ban on voluntary publication of assessments that were conducted under the pilot program. If some FSSAs are to be published, it hardly matters whether they were conducted under the pilot program or after the pilot program. In any case, all members will have the prerogative of declining to publish. Thus, we do not concur in the staff recommendation in paragraph 88.

Mr. Rustomjee submitted the following statement:

One of the salient features of the Financial Sector Assessment Program (FSAP) is the broad support that it enjoys, demonstrated by the collaboration among staffs of the World Bank, the Fund, member countries that are participating in the program and other financial and regulatory institutions. The experience thus far suggests that we are moving in the right direction in terms of laying a firm foundation for the new global economic architecture. By identifying strengths and vulnerabilities of financial systems, these assessments should make it easier for countries to establish blueprints for reform and institution building and mobilize technical assistance in a systematic manner.

The staff believe that Fund surveillance would be significantly strengthened if all member countries were to participate in the FSAP. We see merit in the principle. In this connection, the themes that have emerged from FSAP assessments seem to be relevant across countries: problems associated with the over-exposure of public banks, the importance of judicial reform for facilitating access to credit, the need to strengthen banking supervision to ensure financial system stability, the impact of external shocks on financial intermediaries, and the importance of sovereign debt management, among others. Having said that, it has to be noted that participation in the FSAP is, and, in our view, should remain entirely voluntary, whereas surveillance under Article IV consultation is not. This means that there should be flexibility, although FSSAs are likely to provide useful information on the stability of financial systems.

On the question of country coverage of FSAPs, we believe that it would be useful to include more countries. Whether it would be feasible to meet the target for the number of countries mentioned in the staff paper is another matter. An important concern has to do with the cost of doing these assessments, which, as the staff point out, can be expensive. Therefore, there is a need to ensure that any expansion would not lead to diminished resources for other forms of technical assistance, especially for the poorer countries. As a general principle, it would seem that projects like the FSAP need to be discussed against the background of their budgetary implications as a means of making rational decisions. The staff note that the precise amount of resources to be allocated to the FSAP and related work will be undertaken in each institution in the context of their separate annual budget discussions. This does not provide sufficient assurance regarding resource availability in the context of the overall technical assistance program of the two institutions. This is an area where a clearer degree of coordination of activities is very important.

Another issue that comes up in the context of expanded country coverage for the FSAP concerns selectivity and prioritization of work. The staff make the point that while assessments regarding standards are important in identifying medium-term development needs, their contribution to identifying immediate risks and vulnerabilities is limited. One gets the impression that their preference is for greater attention to be given to the latter issues. However, it is not apparent that this would necessarily be the focus of poorer countries, which might want to give priority to capacity building based on an assessment of medium-term development needs. Perhaps, the comprehensive model might not be suitable in all cases, and that a two-track approach---a comprehensive model covering the more advanced and systemic countries and a simplified version to be used for the others---could help to address both the issue of cost and that of relevance of the assessment to specific groups of country. The flexibility demonstrated in the work that has been done indicates that there is a basis for giving greater attention to specific circumstances of individual countries.

Regarding publication, we have always stressed the importance of maintaining confidentiality regarding sensitive information. We see no need to change the present policy regarding the voluntary publication of FSSAs and assessments of observance of standards and codes.

As the FSAP is an evolving process, we agree with the staff that a further review should be conducted in about 18 months.

Mr. Zoccali and Mr. Costa submitted the following statement:

We welcome the high quality set of papers prepared for today's discussion and, in particular, the encouraging evidence put forward with respect to the contribution of the FSAP pilot project to the strengthening of the soundness of financial systems in the 12-country sample. The individual country experiences surveyed in the background paper covering a broad spectrum, from cases where a rapid deterioration of the financial sector was taking place to cases where the financial sector was found to be strong, supports an optimistic view of the FSAP process.

As noted by staff, the FSAP initiative allowed even those countries with relatively stronger financial sectors to anticipate potential risks in the face of the structural changes that are taking place in the global financial system. In this connection, we would like to call attention to the importance, particularly when dealing with advanced economies, of broadening the analytic framework of FSAP's to include the international dimensions of banking and the modalities of international cooperation and coordination among different supervisory authorities. The international aspects of FSAPs are also worth highlighting in the case of emerging market economies where the participation of foreign banks continues to grow, carrying with it important considerations for the soundness of their financial systems.

One of the most significant benefits of the FSAP process is that it affords an opportunity to identify real and potential risks to financial sector stability in the context of a coherent framework covering both solvency and liquidity issues. The widespread use of stress tests on individual bank portfolios and the banking system as a whole suggests the usefulness of this methodological tool. The point should nonetheless be made that in an ideal scenario of full disclosure of information on the part of individual banking institutions, markets themselves would be in a position to assess the vulnerabilities. In this connection, it could be inferred that the lower the level of financial sector transparency in a given country, the higher the potential benefits of an FSAP. It goes without saying that although the effectiveness of the FSAP process should remain paramount, we should not lose sight of the importance of transparency. In reviewing the different country experiences, as reported in the background paper, it should be noted that weaknesses in transparency practices were found in only one case, and a consequent recommendation to increase transparency was issued. Staff might wish to clarify whether this should be understood as an implicit approval of transparency practices in the other cases or whether it simply reveals the fact that the issue of transparency has not been given uniform attention despite the comprehensive approach followed in preparing FSAPs.

The FSAP project, based on a broad array of instruments and procedures covering both macro- and micro-economic aspects as well as institutional, legal, regulatory and supervisory considerations, has proven its value to the members and to the institution at large. However, as other Chairs, we view the program as still at a developmental stage. Maximizing the FSAP potential contribution to the Fund's and Bank's capacity, to follow up work and focusing on the technical assistance needed to address identified vulnerabilities, is critical . With this important caveat, we support maintaining and expanding the FSAP project in a way that both budgetary constraints and the voluntary participation are fully taken on board. We are hesitant in this regard to commit ourselves to supporting a predetermined number of assessments each year as a target, even if subject to future budgetary decisions. In this regard, we fully concur with Mr. Callaghan on the need to focus on the quality and effectiveness of FSAPs rather than in their number. We also see merit in exploring the idea of sharing some of the costs of the FSAP undertaking keeping in mind in particular that the responsibility of dealing with advanced economies falls exclusively on the Fund. As mentioned earlier, however, by focusing on the international dimension of the banking and financial sector activities, in particular on the integrated institutional and regulatory infrastructure most appropriate for internationally active banks, important economies of scale could be realized clearly suggesting the secondary nature of any eventual push for cost recovery.

On the type of countries to be included in the list of assessments each year, the guiding principle should be to integrate FSAPs in the surveillance process to make it more effective. In this regard, we agree that the more systemic cases, including the advanced countries, should be given priority, assuming again a voluntary participation. Countries showing early signs of weaknesses in their financial sectors, irrespective of their systemic importance, however, should also be encouraged to participate in order to develop a comprehensive strategy that includes technical assistance, to deal with any emerging difficulty and better prepare their financial sectors to face the challenges of increasingly globalized financial markets.

On publication policies, we side with those that favor maintaining an element of confidentiality. Given the possibility that market sensitive information becomes part of the FSAP reports, and that the ultimate aim should be to address vulnerabilities in an orderly fashion, we agree with management's policy thus far of not authorizing the publication of FSAP reports in their entirety. We support the publication of assessments of observance of standards and codes in separate form. On the publication and deletion policies of FSSA's, we agree with the proposal to treat them in the same manner as Article IV Consultation reports, without any implication that publication of Article IV Consultation report should be pari-passu with the publication of an FSSA, or vice versa.

Finally, we concur with the need for a further review of the FSAP program and would find acceptable that it take place in 18 months as suggested by staff, and somewhat earlier if the development of the FSAP process should advance in a manner that is unambiguously beneficial for the effectiveness of Fund surveillance.

Mr. Wijnholds submitted the following statement:

I. Introduction

The FSAP process constitutes a significant strengthening of our surveillance. The level of scrutiny of financial sector issues is vastly enhanced by sending, on average, 12 person missions to look specifically at vulnerabilities and key short-term risks. This compares to an average of roughly 1-2 people looking at financial sector issues in a standard Article IV mission (i.e. usually one desk economist and, on occasion, one MAE economist). This constitutes a strengthening of our core business: FSAP's allow for an explicit analysis of the link between macro-economic developments and financial sector vulnerabilities (and vice versa). I agree with Ms. Lissakers and Mr. Abbott that the experience in Turkey in the last few weeks is a forceful and expensive reminder that financial sector weaknesses pose serious risks to macroeconomic stability.

II. Scope of FSAP/FSSA and Country Prioritization

I will focus my remarks on what I believe to be the controversial elements in this review.

First, the paper emphasizes somewhat of a trade-off between vulnerability assessments and the assessment of standards and codes. Of course, as the paper notes, compliance with standards will most often be a necessary condition for financial sector stability but it is certainly not a sufficient condition. There are obvious reasons for this. We have many countries come to the Board where supervisory regulation is largely in line with best practices but where the underlying system is putrid. Sometimes this is because prudential norms and regulation are not enforced, sometimes it is because underlying credit assessments/risks are bad, and sometimes it is because macroeconomic developments wreak havoc on the financial system. For instance, interest rates, exchange rates, asset prices and commodity prices have all played their role in damaging bank and corporate balance sheets, sometimes regardless of the quality of supervision. So there are limits to the value of standards and codes assessments within an FSAP.

Having said that there is merit in ensuring that the 'necessary but not sufficient condition' (i.e. codes and standards) are assessed. Determining precisely what amount of resources to devote to different areas within an FSAP mission is a judgment call and one which I do not think the Board is well suited to make. Nevertheless, I continue to think that the top priority in an FSAP/FSSA should be immediate short-term vulnerabilities and risks. Standards and Codes are, in my view, lower on the totem pole and this may require more selectivity than has been the case until now. I was frankly a little surprised that as much as half the staff members on a typical mission have been needed to assess various standards and codes. Table three shows that in many countries, regardless of the degree of sophistication or development of the financial sector, standards were assessed not just in the Fund's core areas (Basle Core Principles and the Monetary and Financial Code) but also in the area of insurance, payments systems and securities.

A second main issue under the heading 'prioritization' is which countries we conduct an FSAP for in the short-run, given scarce resources. Paragraph 70, in this regard, is rather vague. It notes that we should focus on all of the following: systemic countries, a balanced geographical mix, a balanced mix of developing/developed countries, a group undertaking liberalization and reforms, some with capital markets and, to top it all off, assessments of off-shore financial centers (OFC's). That is not prioritization. In my opinion, it should be clear that while all these groups are entitled to an FSAP they cannot all be first in line to get one. From the perspective of the international financial system it is clear that FSAP's should first be conducted for the most needy, the most vulnerable, and the most important (from a financial impact perspective). In my view, this rules out small industrial countries in the short-run which are perceived by the Article IV teams as being healthy. Rather, the immediate focus should be on the main financial centers (I note that the UK has volunteered already) and those emerging markets with significant vulnerabilities and potential for causing contagion effects. If FSAP's are indeed intended as a surveillance vehicle for a large part of the membership (which I think they should be), prioritization in this sense merely means a difference in timing not treatment.

III. Publication issues

I have long been a proponent of confidential 'vulnerability reports'. I have advocated that providing staff and authorities with an ex ante assurance that something will not be published, would increase candor towards the Board. Part of the underlying reasoning was that, to rely on an ex post deletion policy might not provide sufficient assurances. My thinking has been that FSSA's would precisely be the kind of reports that would contain market sensitive information prone to pre-editing. The recent transparency review concluded that our deletions policy has indeed been somewhat haphazardly applied.

However, given our recent transparency review where the Board adopted a general voluntary publication policy for all documents (and where there was no majority for 'vulnerability reports'), I am willing to go along with voluntary publication of all FSSA's (FSAP's remain confidential). I would stress that these reports will have to continue to be of the highest candor, and subject to our deletions policy. Should a financial sector crises occur in an ex-FSAP country, there would obviously be an expectation that all the relevant information was contained in the FSSA. Given the amount of resources involved and the level of scrutiny of the financial sector, it would be unacceptable if the Board were in any way to be 'surprised' about financial sector developments. In a way this poses a higher burden of vigilance on FSAP staff than they may be used to in their technical assistance activities.

Regarding the publication of the original 12 pilot cases, I have some sympathy for those who argue that we cannot change the rules of the game ex post. Although the Board, legally, has the authority to reverse its decisions, I would consider it an undesirable precedent, not least because publication was so explicitly discussed at the outset. Regarding the FSAP's conducted in the current fiscal year, staff needs to clarify what parameters were promised to these countries and what the participants' reaction was. If different publication parameters were communicated to different groups of countries, I would tend to allow those countries that want to do so publish.

IV. Budgetary issues

As I noted above, I find it difficult to assess whether FSAP missions until now have been adequately staffed or overstaffed. Is an average of 12 mission members the magic number? Could it be smaller? What about efficiency gains? Similarly difficult is the assessment as to whether the precise focus in each FSAP's has been correct and the correct standards have been assessed. This makes it difficult to comment on staff's proposed expansion of FSAP's from 24 to 30. Also, any increased number of FSAP's has an impact on the World Bank, so these decisions can not be taken in isolation.

More generally, however, I have a problem with the way we are presented with this de facto budget increase. First, we are not presented with the trade-offs that MAE will face if we do not expand the number of FSAP's. There are references to cutting technical assistance but this is not made explicit. Let me note, in this regard, that I would be very surprised if all FSAP related work and technical assistance follow up is entirely new. Second, to decide on this budget increase can imply one of two things: (i) we want FSAP's to increase and are willing to accept a general budget increase in April; (ii) we want FSAP's to increase in number and are willing to make cuts elsewhere in the organization so that the budget does not increase. Let me mention in this regard that I currently have a small UFR mission in one of my countries which was unable to get a PDR economist released because all the HIPC papers have to be brought to the Board. As a result, they are now understaffed, possibly to the detriment of their work, and this is in a situation where scarce Fund resources are actually at stake. I am thus uncomfortable to provide an increase for MAE without knowing what the impact on other countries will be. Also, if Area Departments are to do part of the 'update', should they not be the ones getting the budget increase? Separately, I wonder to what extent counting all experts from cooperating institutions as Fund or Bank employees (footnote 18), leads to over-budgeting given that their own institutions must carry part of the fixed employee costs. Finally, I wonder to what extent the 'Lipsky Group' recommendations will change the way in which we conduct FSAP's.

In conclusion, while I believe the FSAP is a surveillance vehicle here to stay, I believe there are a few uncertainties which rule against an outright budget increase for MAE at this time. Perhaps, we should stick to 24 countries for now (indeed, it seems we will have difficulty meeting this target by the end of the fiscal year), but I would be interested to hear what colleagues have to say.

V. Other

It would be interested to hear from staff to what extent information from private sector participants (e.g. rating agencies, foreign investors, international banks etc.) is incorporated into the FSAP analysis.

I look forward to progress in staff's work on macro-prudential indicators (MPI's). These will constitute an important analytical tool, beneficial to the analysis of vulnerabilities and the FSAP.

Mr. Lehmussaari submitted the following statement:

Financial sector weakness has been one of the underlying factors for large Fund programs in recent years. It is therefore increasingly important for the Fund to focus on the financial sector, and uncover linkages between financial markets' soundness and macroeconomic developments and develop early warning signals for problems associated with the financial sector .

The Financial Sector Assessment Program is, in my view, a good instrument for meeting this challenge. I believe that the FSAP is already an important tool for the Fund to ensure improved financial systems oversight and should become an integral part of Fund surveillance.

The FSAP is valuable in that it offers a uniquely integrated view of the whole financial system of a country. It complements the analysis performed by international rating agencies which generally tend to focus on more specific aspects of the financial system, and I believe that all countries, as well as all participating institutions and individuals, can benefit from the exercise.

Two countries in my constituency have undergone the FSAP and three more countries within the constituency have signed up for future participation in the program. Experience has been very positive. The authorities have gained much more than had initially been expected. They believe that the exercise has contributed to increased awareness of financial sector issues and assisted in pushing forward reforms in this area.

Before going into the details of today's topic, I would like to ask the staff about the status of the work that is being conducted by the Financial Sector Review Group which was established this past October. The group's findings could have important implications for the nature and organization of the Fund's work on financial sector and capital market issues, and also with respect to the FSAP.

Issues for the Fund and the Bank

I agree that the FSAP process offers a coherent framework for identifying potential vulnerabilities, weaknesses, and risks in financial systems. I believe that the analysis contained in the FSAPs is a welcome complement to the IMF's current tools of surveillance, i.e., Article IV consultations. It has become evident that the FSAPs are very resource intensive and it should, of course, be clear at the outset that FSAPs should not be carried out at the expense of regular Article IV consultations.

At this stage, I find the staff's proposal of conducting 30 FSAPs each year somewhat ambitious, given the resource requirements that such an undertaking would imply. During the related Board discussions earlier this year, this chair had agreed to a maximum of 24 country FSAPs per year. I do not see any reason to differ from that view now, and believe that an appropriate balance in resource allocation for FSAPs and other Fund tasks should be found in the forthcoming budget discussions.

FSAPs should continue to be undertaken on a voluntary basis and that all countries should be able to benefit from undergoing such an exercise. However, I would like to have FSAPs conducted selectively, starting, in general, with systemically important countries, and countries which are planning or implementing significant financial sector reforms. I believe that countries that have lately experienced financial crises, or appear vulnerable to financial sector shocks, would benefit the most from an FSAP. Furthermore, I also believe that countries requesting sizeable Fund programs should be strong contenders for FSAPs.

I agree with the Management's policy not to provide authorization for the publication of FSAP reports in their entirety. It is very important that the Fund avoids publishing information whereby individuals or individual institutions can be identified. This would be in conflict with many countries' regulations concerning professional secrecy and would therefore reduce the authorities' possibilities for providing information. I endorse the proposed policy to allow the publication of the sections with detailed assessments of observance of standards and codes. This decision should be left to individual countries.

I believe that a review of the FSAP process should take place in about 12 months. Periodical reviews are beneficial because the program is proceeding and involves a lot of learning-by-doing due to many country-specific factors and circumstances. In this connection, I especially look forward to the discussion which is scheduled this spring to address progress on the development of MPIs and stress testing techniques.

Issues for the Fund

I believe that FSSAs have the potential to become effective tools for strengthening the monitoring of financial systems under Fund surveillance, provided that resource demands can be curtailed.

FSSAs should be published on a voluntary basis at the conclusion of an FSAP, consistent with the publication and deletion policies for staff reports on the Article IV consultations. I also support Mr. Bernes' proposal that participants of the pilot project should be allowed voluntary publication of the FSSA reports.

In addition, the FSSA reports could assist countries on the EU accession track. I believe that the applicant countries should have the possibility to make the reports available to the European Commission. This is particularly relevant as a number of accession countries have already participated in the FSAP, and the possibility to use the FSSA reports in the accession process could entail significant resource savings for those authorities.

Issues for the Bank

I fully agree that recommendations from the FSAP assessments should be taken into account in the development of the Bank's country programs in order to fully utilize the likely benefits of a comprehensive diagnosis.

As for the publication of FSAs, the same practice should be followed as at the IMF.

Lessons from my constituency

Lessons from recent FSAPs in my constituency support many of the comments that came forward during the FSAP outreach meeting.

The FSAP is very resource intensive for the authorities undergoing the exercise. It should be stressed that it is necessary that all the institutions and participants which the FSAP mission will visit should prepare well in advance. Moreover, the mission team should also be properly briefed prior to the mission. A preliminary visit by, e.g., the head of the mission, to hold preparatory meeting(s) would be very useful to save time and help to ensure maximum efficiency of the FSAP process. Furthermore, a lot of work can be done before the FSAP missions. Financial legislation could be analyzed almost entirely 'off-site' and that exercise could also be outsourced.

The FSAP reports should look at the country in an international or regional context rather than in isolation. For instance, in the Estonian case, the analysis of the banking system would be incomplete without taking into account the presence of Swedish and Finnish institutions.

As experience has shown, there is certain room for interpretation in the practical applications of codes and standards. The assessment of compliance with international codes and standards is therefore especially useful as a review such as the FSAP gives the national authorities and the IMF an instrument for coordinating the application of codes and standards in practice.

Stress testing is an integral part for estimating the impact of macroeconomic developments on the financial sector. It should play a pivotal role in the whole exercise. While it is true that stress tests in the context of FSAP missions are subject to limitations and provide only a static analysis at one point in time, it should be underlined that they provide a centerpiece for the assessment that, naturally, should be complemented by qualitative analysis, and the results should be carefully evaluated and modified, if necessary.

The stress testing exercise should be properly designed either to look at the existing models (on both the official and commercial banking level) or to use models developed by the mission team. One should distinguish between countries with mature financial markets and emerging markets. In mature markets with long and reliable time-series and behavioral patterns, models tend to work well for predictions. In emerging markets, more intuition and related experience might be useful.

Mrs. Vittas and Mr. Schlitzer submitted the following statement:

The Staff Report confirms our perception that the experience gained so far with the FSAP is very positive, as indicated, inter alia, by the growing number of countries that are interested in participating. As this is a new tool of analysis, it is inevitable that continuous and substantial adaptations may be required in the initial years of operation. Moreover, frequent reviews by both Boards will be necessary to fully refine it. Yet, it is already quite clear that the FSAP can be a powerful instrument for the assessment of the strengths and vulnerabilities of financial systems, from the point of view of both macroeconomic stability and long–term economic development.

The staff elaborates a number of proposals aimed at defining some of the modalities of the FSAP, and our comments will be devoted to some of them. But overall we have no major point of disagreement with the conclusions and recommendations set out in the paper.

Coverage

Staff propose to increase the coverage at full regime of the FSAP from 24 to 30 countries annually (a 25 percent increase in resource costs). It is our understanding that the proposal hinges on the need to:1) increase the coverage of systemically important countries and 2) take into account our parallel mechanism for the assessment of OFCs. While we think that 1 and 2 are objectives worth pursuing, we have some questions concerning the staff proposal:

the budgetary implications for the Fund (and the Bank?) have not been assessed. These could be onerous, unless the scope for compensatory savings in other activities of the institution(s) is fully identified and exploited;

the proposal is based on the implicit assumption that the supply of outside experts is highly elastic; however, the paper does not provide any information to judge whether this assumption is valid. Perhaps staff could elaborate on this issue;

many program countries already receive considerable assistance to address vulnerabilities in their financial sector and/or restructure their banking sector in the context of the program. It is doubtful whether an FSAP on top of such assistance would be of any value. If such program countries are excluded, then one could cover the rest of the membership within a 5-6 year period, with a much smaller number of FSAPs per year.

By and large, provided that costs can be adequately contained, we can go along with the proposal. Financial sector assessments are part of the Fund's core business. Moreover, increasing the yearly target to 30 countries would allow more frequent updates, by reducing the "assessment cycle" from 8 to 6 years. As presumably there are some economies of scale, more frequent updates may in turn help reduce the cost of each mission.

Selectivity and prioritization of work

It was clear since the beginning, but it is becoming more and more evident as the new initiative develops, that the FSAP is a time- and resource-consuming exercise. Selectivity and prioritization of our work are thus essential from an efficiency point of view.

It is our impression that there is not much scope for streamlining the content of the FSAP. In fact, the analysis of macroprudential indicators and stress tests/scenarios, as well as standards assessments, are from the point of view of the Fund, three essential elements of the new mechanism. They are obviously complementary and may even overlap to some extent. Indeed, it would be quite exceptional if an FSAP were lacking one of the three. It follows that prioritization of work, if any, will have to be accomplished within each area, an operation that is to be dealt with on a case-by-case basis.

This said, we can agree with the staff that the scope for selectivity and prioritization is somewhat larger within the area of standards assessments. It is striking to note that performing the typical five standards assessments that are now envisaged requires up to half the average size of a mission team. Even in this case, though, the scope for selectivity may not be that large. Common sense suggests that the degrees of compliance to financial sector standards tend to be correlated across sectors.

With these caveats in mind, a number of alternative avenues can be pursued to cope with the resource problem, as for instance:

greater reliance on self-assessments of standards compliance. In this case, however, one should bear in mind that self-assessments are most effective (and objective) when there is a detailed methodology on how the self-assessment ought to be carried out (as in the case of the Basle Core Principles Assessment);

heavy reliance on external experts, the use of whom has been quite successful so far. Indeed, the confidentiality protocol adopted during FSAP missions to handle sensitive information has worked well so far and this should help address the concerns that some Chairs had raised;

in the case of OFCs, greater reliance on Module II (stand-alone Fund assessments) instead of a full FSAP, which may not always be necessary.

FSAP and Surveillance

We believe that the voluntary nature of the FSAP does not preclude its representing a valuable tool for Fund surveillance, one aimed at detecting (and thus helping correct) financial system vulnerabilities. The success of the initiative and its increasingly wide application should reduce the reluctance that some members may have to subject themselves to the assessment. Moreover, for those members that have received an FSAP, appropriate peer pressure can always be exerted on them so that they follow the Fund's recommendations.

It is also for these reasons that we continue to believe that the FSAP can be most effective if intertwined with the Art. IV consultation, which is the Fund's primary tool for bilateral surveillance. The recommendations emerging from the FSAP/FSSA should always be an integral part of Art. IV reports. Art. IV reports should take fully into account the analysis conducted in the FSAP/FSSA with the aim to fully develop the more general implications for macroeconomic analysis and policy. Finally, Art. IV consultations should provide occasions for FSAP follow-ups and updates, whether incorporated in the main report or in separate supplements.

Publication

We share the general sentiment that, since the FSAP may contain highly confidential and sensitive information, publication should be handled with some care. We think that the staff proposal strikes the right balance between the need to make the Fund's work as transparent as possible, on the one hand, and that of protecting confidential information, on the other. We note, in particular, that:

the procedure would remain voluntary, which makes it consistent with our publication policy for Art. IV reports;

publication would be limited to the FSSA and those parts of the FSAP not regarded as highly sensitive, namely the assessments of standards and codes;

it would remain highly flexible, allowing publication of the FSSA even if the national authorities did not wish to publish the Art. IV report.

Should this procedure be accepted, we would prefer not to allow it to be retroactive. During the pilot phase publication was not permitted and it would not be appropriate to change ex post the rules of the game.

Mr. Djojosubroto submitted the following statement:

First of all, we would like to join other Directors in supporting the FSAP process. We would also like to express our appreciation to the considerable efforts put in by staff of both the Fund and the Bank in ensuring the success of the FSAP program. We would like to focus our comments on three main issues.

Firstly, regarding the objective of the FSAP

As pointed out by staff, the main objective of the FSAP exercise is to help member countries identify and remedy the weaknesses in their own financial systems and thus contribute to the stability of the regional and global financial system. In this context, it is our view that the role of the Fund is to assist and guide individual national authorities to develop sound regulatory and monitoring systems, but it is the responsibility of individual countries to ensure that their own financial systems are sound and prudently managed. Supervisors should be undertaking regular monitoring and stress testing of their financial sectors on their own accord. We are of the view that the FSAP should remain voluntary to ensure greater ownership by member countries in the FSAP exercise. The Fund and the Bank could, however, work in partnership with individual national authorities, providing them guidance and technical assistance where necessary. By helping countries develop adequate supervisory and monitoring systems of their own, the role of the Fund could be subsequently reduced to helping to assess the adequacy of the systems that have been set up, the appropriateness of the assumptions made, etc in light of changes in the financial environment. In this way, valuable Fund resources could be devoted to countries which need assistance the most rather than conducting full fledged FSAP reviews for each and every country. Furthermore, the question of confidentiality of data would not be an issue as the assessments would be undertaken by the supervisory authorities themselves rather than by Fund staff. The Fund and the Bank could, in association with the BIS and other multilateral supervisory organizations, develop broad guidelines for financial supervision which could then be applied by individual countries in assessing the adequacy of their own supervisory systems.

In view of the foregoing, we would support Mr. Callaghan's comment that some weight should be given to targeting countries which would benefit most from an FSAP. This suggests that coordination between conducting FSAP reviews and Article IV consultations is important. At the same time, however, we believe all the large and developed financial markets, which would logically be considered "systemically important", should undertake self assessments under the FSAP as a sign of leadership to smaller and less developed markets. Furthermore, the experiences learnt by Fund staff through evaluating such self assessments would help upgrade their expertise in advising the less developed markets.

Secondly, regarding the scope of FSAP

Given the different levels of financial sector development among member countries, there should be sufficient flexibility in the scope of each FSAP review, taking into account the needs of individual countries. The FSAP exercise should be designed to meet the requirements and peculiarities of the financial system in each country rather based on fixed rules and guidelines that may impose unnecessary burden on the country concerned. In this regard, it would be useful for Fund staff and the authorities to work closely together. Staff should focus on potential vulnerabilities which required the most urgent attention.

Thirdly, regarding the publication of the FSAP/FSAA documents

We share Mr. Callaghan's views that FSAP reports should not be published. Like him, we are also concerned about the potential damaging effects of the publication of the FSSAs. While we note the proposal that the publication of the FSSA would be on a voluntary basis, we would like to caution that market participants could react negatively to a country which decides not to publish its FSSA report. As all of us are fully aware, more often than not, market participants react to rumors than facts. As the FSSA concerns the assessment of the stability of a country's financial system, non-publication of the report could signal to the market that there are indeed grave concerns which the authorities are not prepared to disclose. This could turn out to be a self-fulfilling prophecy. Therefore, we would urge that the Board considers this matter of publication seriously. Given that we are still in the developmental stages of the FSAP/FSSA process, we should perhaps allow the process to develop further before making a decision so that with more experience, we can make better a informed decision.

Mr. Bernes asked the staff representative from the World Bank to comment on the possible plans to reorganize or disband the Bank's financial sector unit—something that would have implications for Fund-Bank cooperation on financial sector matters.

The Director of the Monetary and Exchange Affairs Department, in response to questions and comments from Executive Directors, made the following statement:

I would like to give you a brief introduction to where we are in the FSAP process, and I will come back to answer some of the questions that are in the statements.

A year and a half ago we started the FSAP, and at that time it was—and still is—a major example of intense and effective collaboration of the Bank and the Fund in addressing financial sector work. At the same time, it provides a cooperative framework for international peer review. We started with a pilot of 12 countries. For nine of these countries, the Fund Board has reviewed the related Financial System Stability Assessment (FSSA), and the FSSAs for the remaining countries will be circulated to the Board shortly.

So far, two reviews of the FSAP have taken place; the first review of the main elements of the program in October 1999, and a second review of the experience with the pilot in April 2000. Both reviews took place almost simultaneously in the Boards of both the Bank and Fund. In addition, a brief progress report of the FSAP, including a procedures guide, was sent to the Boards in September 2000.

In the spring of this year, Directors in both the Bank and Fund agreed that the program should be continued with country coverage expanded to around 24 countries. Since then, 22 countries, including six industrial and systemically important countries, have agreed to participate in the FSAP for 2001.

For 12 of these countries, FSAP mission work has already begun, while missions for the remaining ten countries are being scheduled. Discussions are also under way with two other countries regarding their participation in FY 2001.

In addition, we have already received commitments from more than ten countries to participate in the program, beyond the current financial year. So that is where we are in the process of collecting countries.

Let me try to answer some of the questions in the statements. With 16 statements there are many questions, so, let me touch on a few of them.

Given that the program for Turkey will be considered soon by the Board, one of the questions was, what if an FSAP had been done in Turkey, would we have detected the problems? If an FSAP had been done in Turkey two years ago, we certainly would have detected both some difficulties on the supervisory side by analyzing the observance of standards and the data of the banking sector; those data also would have shown some substantial vulnerabilities. Turkey is perhaps not a perfect example, given that the Fund has had 14 programs with Turkey, we have more or less constantly been involved in working for a long time, so it is not as if the events in Turkey come as a total surprise.

Another question was what is the Financial Sector Review Group doing and how does its work fit into what we are discussing here today. My understanding is that the group will come up with their report sometime in January, and it simply is too early to tell what will come out of that work. One way or the other, it will certainly be factored into the work that we are trying to do.

There were questions about more staff being hired to conduct FSAP reviews. As you will recall, in last year's budget we were allocated 30 more staff years to deal with this work, and hiring is going on. How do we deal with this in the light of also doing the OFC assessments? For this budget year, the OFCs are being handled within the existing budget. For the next budget year, the whole OFC issue and the resource use and demands will have to be reconsidered.

Another question was, are there indications that there are too few experts available in the world to help us? So far, we have no indications of that, given that we are cooperating with the very large number of institutions, basically looking at the numbers we are asking for, two engagements a year from those institutions. And that works well as long as we start talking to them well ahead of time. We cannot call people up two weeks before it is time to go, so it is more up to us to deal with the planning, but so far the whole process has worked well.

Another issue was, are the procedures streamlined enough and how do we go about refining the work in such a way that this is efficiently carried out? The outreach that we conducted earlier this fall was very helpful when it comes to talking to experts in countries being involved in this process, and we are constantly working on such things as internal review procedures, in order to make sure that we keep this under tight control and try to make these products evolve in as efficient a way as possible.

Another issue was whether self-assessments are helpful or not. Self-assessments are certainly helpful, in the sense that when this process is going on over time, the more countries understand how we do the work, the more countries get involved in the early stages of the process, the easier it is for us to do the work, and in that sense, self-assessments of various kinds are very helpful. Self assessments actually become a tool in a gradual process which ultimately culminates in a full FSSA that is complementary to the Article IV staff report.

The number of country cases that we have discussed in the paper and the number 30 which is mentioned for next year and the resource use that we talked about is perhaps not all that dramatic, because if you move from 24 to 30, we are talking about roughly five to six more staff years, and all the calculations are based on the assumption that we assess a fair number of standards and that we do both the standards and the numbers in the same project.

Then, how many people are actually used in each mission is going to vary depending on the type of country and the issues we look into in some country cases. When there is more focus on developmental issues, more people would come from the World Bank, and when we do complex industrialized countries, we do them more on our own. In those cases, we end up assessing a fair number of standards, because in complex economies, so many activities exist.

Mr. Collins made the following statement:

I am grateful to the staff for the useful collection of papers which respond well to the Board's request a further review of the FSAP before the end of the year. The process thus far has been somewhat ungainly in that we reviewed the pilot program while it was still in its relatively early stages and made provision for it to continue even though we did not have a full picture of the outcomes. I hope now, however, that we can bring the review process to a close with a clear understanding within the Board on the modalities of the program, as it rolls forward into next year and beyond.

As the staff observe, Fund surveillance would be significantly strengthened if all members were to participate in the FSAP. But that is a goal which can only be achieved over a long period of time, even if all countries were to volunteer, because of the obvious fact that resources are constrained. It follows, therefore, that achieving appropriate focus and prioritization is all important. Staff propose that 30 countries a year should be subject to assessments. It is hard to come to a firm judgment on whether that is the right number without seeing what the overall budget for the Fund will be for next year. I think Mr. Wijnholds and one or two other Directors have made that point.

If I understand the figures in the paper correctly, and as amplified just now by Mr. Ingves, this would involve a resource cost of perhaps some 56 staff years of which 30 to 35 would involve Fund staff. All Fund financed external experts are to be, I would be grateful for confirmation that the figures are competitive to that extent and there are no additional involvement from outside the Fund or Bank being paid for elsewhere, as it were.

If so, this project, which involves essentially not more than one staff year per country, seems to me to be remarkably good value, when set against the potential payoff. In any event, although it will follow that undertaking 30 FSAP assessments per year would amount to covering the entire membership every six years, it does not follow necessarily that is the way the resources should be used. The fact is that the six-year cycle may be too long for some countries, particularly those which are systemically significant, but have weak or rapidly changing financial systems. This suggests that countries deemed to have strong systems the first time round and those which are very small, could be assessed less frequently. And, for some, even systemically important countries, which are unlikely, actually, to have fundamental weaknesses, they could perhaps be put off to later in the process. I will come on to the U.K.'s involvement in this later on.

An alternative approach would be to rely on the fact that once an FSAP assessment has been completed, any relevant findings become a legitimate subject for subsequent Article IV consultations. That would help to keep problem areas, in particular countries, under review, but would not be a complete substitute for a full FSAP assessment. So I suggest that a degree of flexibility about the frequency of FSAP assessments for individual countries be maintained.

That brings me to the question of prioritization. In my view, the FSAP exercise should initially focus on those countries where vulnerabilities are perceived to be the greatest, and where the crystallization of those vulnerabilities could have the greatest systemic impact. Now, I realize there is something of a chicken and an egg problem, how do you know when the vulnerabilities are greatest without an FSAP exercise first, however like an elephant, you know it when you see it, it should be clear in many cases that large users of the capital markets are likely to have the greatest systemic impact if things go wrong. So this, in turn, points to the industrial countries and emerging market economies as being priorities.

For the industrial countries in particular, the emphasis should be on identifying key vulnerabilities, rather than necessarily providing a fully comprehensive overview. An important, but certainly not exclusive aspect, will be where there are perceived to be gaps in regulatory oversight. For emerging market economies, priority cases should be those countries with relatively open capital markets, where contagion risk to international capital markets are greatest, and those countries where foreign institutions play a significant role in the private sector, and consequently carry exposure to local systemic risks. For most of these countries, the emphasis should be on the banking sector, although, of course, the World Bank will wish to assess weaknesses in other parts of the financial infrastructure as preparation for their technical assistance work. And it is worth emphasizing in this connection, the importance of FSAP process of identifying technical assistance needs which in turn should be ideally linked to a fully collaborative network for technical assistance involving the Fund, Bank, and donor countries.

At a more specific level in relation to the banking sectors of these emerging market countries, a key prerequisite of Basle core principles assessment, which I take to be an absolute sine qua non for these countries, is a proper analysis of so-called environmental and financial structural issues. And this will often identify key local systemic risks, full core principle assessments could follow later.

A further point to emphasize is the importance of those exercises covering banking sector liquidity and mismatches, which are not adequately covered in the core principles. But are an obvious source of risk in emerging markets. Turkey being a case in point.

Mention of the core principles brings me to the issue of the role of assessment of standards more generally. The report notes that their usefulness in identifying immediate financial system vulnerabilities is limited, and that a full FSAP assessment is much to be preferred. In an ideal world, of course, that is correct. But, given the resource constraints we face, we should not let the best be the enemy of the good. Stand-alone standards assessments or ROSC modules have a valuable role to play, and like full FSAP assessments, once completed, their findings become a legitimate area for follow-up in individual Article IV consultations.

More generally, the question arises of how to handle countries that do not volunteer for FSAP assessments. There is a notable absence of many major emerging markets from the sample to date, and in the plans for FY 2001 no Asian crisis countries are included, nor China, Russia, Brazil, Mexico, or Turkey. In this connection, I would echo the approach outlined in paragraph 67 of the paper: If a country chooses not to participate in the FSAP, it does not affect the Fund's responsibility to monitor the financial sector, and the important linkages between it and the macro economy. Article IV missions should be staffed appropriately with extra financial sector expertise in such cases. And I like the activist approach for dealing with such cases set out in that paragraph. In fact, I suggest going further and at least drawing attention to a country's FSAP status, as I might call it, in its Article IV report. That is to say whether it has, in fact, volunteered for an FSAP.

On the publication issue, it will come as no surprise that this chair is strongly in favor of voluntary publication of FSSAs. I cannot comment, however, on whether it is appropriate not to publish FSAP reports in their entirety, because I have never seen one. A point I think the French chair has made with Cartesian logic. I also fail to understand why those among the initial 12 pilot cases that wish to publish their FSSAs are not to be permitted to do so. Given that Canada and Ireland at least would certainly like to publish, why should they be prohibited. Mr. Bernes has explained cogently in his statement why no retroactive change in the rules will be involved, which I think serves as a response to those who want to root their opposition on narrow legal technicalities.

I would conclude with a few miscellaneous comments.

First, I hope that the paper on macro prudential indicators mentioned in paragraph 16 will come to the Board well this side of the spring meetings.

Second, it is important that the FSAP process is properly linked to the capital markets work going on elsewhere in the Fund. For example, as we called it in the international capital markets report, and as we Mr. Wijnholds points out, the outcome of the lips group will also be relevant in this regard, Mr. Ingves acknowledged this in his remarks.

If the capital market reports picks up on increased hedge fund activity in certain countries, then this should be followed you have in FSAP assessments being undertaken both in a target country and also in the home countries of those hedge funds. More generally, FSAP reports should deal to the extent necessary with foreign institutions located in a particular country, and any major foreign branches or subsidiaries of locally headquartered institutions. And this will, I believe, be constant with the intention, for example, to examine the extent of consolidated supervision in financial centers which contain institutions active in offshore financial centers.

In conclusion, I would just like to remind colleagues that the United Kingdom has recently volunteered to undergo an FSAP appraisal, which is expected to take place toward the end of next year. We do not regard ourselves as particularly at risk or posing undue risk to the international financial system, but we are obviously a systemically important economy, especially given London's status as one of the three major international financial centers. Moreover, we shall be implemented major changes in our system of financial regulation in the course of 2001, and we would welcome an expert outside view on the strengths and weaknesses of our regulatory arrangements, among other things, once a new arrangement has bedded down.

We urge all countries participating in the international capital markets to join us in the FSAP club, at least to the extent of volunteering, though as I say, I think we can spend some time working out the appropriate prioritization of how we deal with them. But, please do come forward.

Mr. Kiekens made the following statement:

The countries in my group who have participated in the FSAP all praise the professionalism of the staff in conducting in depth assessments of their financial sectors, which they find very useful. The FSAP is a major improvement in the Fund's surveillance of countries' macroeconomic and financial stability. This program not only benefits the countries involved but also enhances the stability of the international financial system as a whole. This is obviously a common good for the whole Fund membership.

We all agree that financial stability is an integral part of the Fund's surveillance mandate. Therefore, like Article IV consultations, FSAPs are mandatory, not voluntary.

The obligatory nature of the Fund's surveillance mandate does not mean that the Fund must conduct in depth financial sector assessments for every country on every occasion with the same intensity. This is not necessary for a proper exercise of the surveillance mandate, nor would it be feasible, given the limited resources of the Fund and of national authorities. The Fund must carefully and selectively apportion its time and attention to counties that are most likely to experience financial sector problems with systemic implications, and that lack the budgetary resources to cope with banking sector problems.

The Fund has ample experience in identifying situations that involve high risks for banks. These occur during periods of rapid disinflation, when banks must adjust to conditions changing from easy profits in an inflationary environment to the low interest margins that prevail when prices are stable. Monetary policies of the currency board type create another kind of stress for banks, which must be able to cope with greater interest volatility than usual.

A pegged exchange rate regime, as we all know, too often leads to excessive currency mismatches when banks try to profit from large interest rate differentials by borrowing in foreign currencies and investing in domestic currencies without due regard to exchange rate risk. Liberalization of international capital flows is another source of stress for banks that are not well equipped to intermediate international capital flows prudently. And weak fiscal positions, particularly those largely financed by banks; asset bubbles; and more or less severe cyclical downturns, all warn of potential banking sector problems.

Viewing an FSAP as voluntary blurs needed prioritization. Countries with weak banking sectors may prefer to hide problems, while countries with strong banking sectors may be tempted to use an FSAP to showcase their strength.

Engaging experts from national central banks and supervisory agencies, from international standard-setting bodies and from the World Bank to help the Fund properly fulfill its mandate is very welcome. It adds to the peer-review nature of the process, to which Mr. Ingves alluded at the beginning of the meeting. But these outside experts should be confined to an advisory role.

A large part of FSAP reports deals with issues that are at the center of the Fund's surveillance mandate. For these issues, the Fund cannot delegate, in part or whole, its Article IV responsibilities. In reaching its surveillance judgments, the Fund is not obliged to compromise with the opinions of any other body. I would therefore suggest that when formulating its policy recommendations on how to preserve, restore, or strengthen financial sector stability, the views of the Fund should prevail over those of the World Bank. This obviously applies to the assessments of the Fund Board, but should also be the rule for the assessments of the Fund's staff or Management. By the same token, the Fund should defer to the World Bank when it comes to the development aspects of a country's financial sector.

Assessing the strength of the financial sector is a sensitive matter, particularly if the situation of individual institutions is considered. I agree that data and recommendations concerning individual institutions should not be disclosed to Executive Directors, nor published. This is why FSAP reports containing such information are distinguished from FSSA reports. But as I have said on previous occasions, I believe that excessive numbers of redundant reports are produced under the program. I think a more straightforward approach would be to generate only two reports: a financial sector development report from the World Bank, and a financial sector stability report from the IMF, with confidential annexes that are neither circulated to Directors nor published.

FSAP reports that are not released to the Board contain detailed policy advice to countries concerning which areas most need reform and how the reforms should be sequenced. The legitimacy of the Fund's advice to countries is based on its consideration by the Executive Board. The advice given by the staff and Management to members must be transparent to the Board. I therefore invite the Managing Director to assure the Board that the policy advice in the secret FSAP reports will be fully reflected in the FSSA reports that the Board considers.

Moreover, the time that lapses between the conveyance of an FSAP report to the authorities and the Board's consideration of the FSSA report should be reasonable short, say not longer than three to four months.

For the two countries in my group that participated in the FSAP pilot the time elapsed was much too long. Hungary's FSAP mission took place early this year. But the Board will not consider the report before next spring, possible even after the Spring Meeting of the IMFC if the Secretary's schedule of Article IV discussions by the Board should remain unchanged.

I agree that FSSA reports can be published under rules similar to those for Article IV reports. This implies that the country must consent, and has the right to obtain the deletion of market sensitive information.

I disagree with the staff's proposal in Paragraph 88 of today's staff paper to bar publication of the FSSA reports for the 12 pilot countries even if they unanimously consent. If they agree to publication, there is no reason to stand in their way. In any case, I request that the FSSA report for any pilot country that is a candidate for EU accession should be released to the EU Commission at the request of the country concerned.

Information on individual financial institutions that is contained in FSSA reports should not be published without the consent of the institutions concerned. The FSSA report for Canada contains the Fund's calculation of the value at risk for Canada's major banks in case of interest and exchange rate changes. Although these calculation were based on data published by the banks, they were not submitted to those banks for comment. The results sometimes substantially differ from those published by the banks themselves. A possible reason is that the published data was not sufficiently detailed to enable the Fund to correctly assess hedging operations such as those involving derivatives. Publishing the Fund's less favorable outcomes could damage the credit standing of the concerned banks, and make the Fund responsible for the damage caused by its negligence in calculating and publishing such information. I invite the Board to consider this important issue.

Mr. Al-Turki made the following statement:

I welcome this opportunity to revisit the issues related to the FSAP. The staff report has confirmed both the desirability and the challenges of Fund engagement in financial sector assessment and related technical assistance. In this regard, I welcome the ongoing cooperation between the Bank and the Fund. I also welcome and thank the central banks and supervisory agencies that are contributing to this effort. It is important not to be too self congratulatory about the success of the FSAP program at this early stage. Let me turn now to the issues raised in the paper.

I agree that the FSAP provides a useful framework for identifying financial vulnerabilities and assisting the authorities in developing appropriate responses. That said, it is important to ensure that this program is custom-tailored to each country's circumstances while ensuring its cost effectiveness. In this connection, I am encouraged by staff's statement in paragraph 16 that "the range of MPIs reviewed under the FSAP has varied widely depending on the particular country case." I would like staff, however, to elaborate on their conclusion in paragraph 24 that "a high degree of observance of relevant standards is necessary for the stability of financial systems that are integrated into global financial markets and face a variety of financial innovations and shocks", given that footnote 12 states that research is still ongoing to assess and quantify links between non-observance of standards and financial vulnerability.

On the number and composition of countries to be covered, there are two important issues which need to be addressed. First, this is a voluntary program, so neither the number nor the composition of volunteers is under the Fund's control. Indeed, a glance at Table 2 shows fewer than 24 countries are lined up for the next fiscal year. Second, this is still a new program and the full budgetary implications of this exercise cannot be fully assessed at this stage. Therefore, it will be prudent to get a better handle on the demand, gain more experience in the conduct of FSAPs, and have a more complete view of the budgetary implications before we authorize an increase in the number of assessments.

Regarding publication, I have on past occasions stressed that success of the surveillance process depends in large part on maintenance of the Fund's role as a confidential advisor. In this regard, I fully agree with staff that the reports related to the FSAP should not be published. It is important to stress, however, that dissemination of the results of staff analysis is largely irrelevant for the FSAP's main goal of helping to identify and redress financial sector vulnerabilities. Many of the same concerns relate to the publication of the FSSA. However, if there is consensus for voluntary publication, the countries in the pilot program should be excluded as per the pilot exercise understanding. Here, I would like to hear from staff if countries that volunteered for this exercise following the pilot were under the impression that voluntary publication of FSSA's would not take place.

I agree that FSSAs can prove a very useful tool for strengthening the monitoring of financial systems under Fund surveillance. More experience in this area, however, is needed before a final judgment can be made. In this connection, I support having a further review of the FSAP in about 18 months.

Mr. Zurbrugg made the following statement:

I welcome today's review on the Financial Sector Assessment Program and thank the staffs of both the Bank and the Fund for providing us with comprehensive information on this important project. Financial sector issues are clearly a core area for Fund surveillance and we are encouraged by the overall positive experience with the FSAP pilot.

The FSAP has served well to identify vulnerabilities, to strengthen the analysis of financial market issues, to identify development needs and to help authorities develop appropriate policy responses. Therefore, it proves to be the appropriate vehicle for the Fund's financial sector surveillance. I particularly welcome the mobilization of a wide range of experts from cooperating institutions, including regional development banks, under the FSAP umbrella. This broad involvement is an important element for the demonstration effect and the learning process of financial sector monitoring. We expect the Bank and the Fund to spare no efforts toward ensuring the consistency of approaches, the confidentiality and the quality of work by all experts involved.

Given the broad range of issues that a financial sector assessment can cover, a prioritization of the work is necessary. I think it is reasonable that FSAP teams, together with the national authorities, make a judgment about the most important features for financial sector stability in each specific case. While I understand that a high degree of observance of relevant financial sector standards and codes is important for financially integrated markets, I recommend to carefully select which of the five standards and codes listed should be assessed under the FSAP. The assessments of standards are very costly. This clearly speaks against broadening the scope of these assessments to other international standards. Staff indicates that standards assessments play a more limited role in identifying immediate financial system vulnerabilities. While this is certainly true, like Mr. Milleron, Mr. Couillault, Ms. Lissakers, and Mr. Abbott, I think we should avoid unduly degrading stand-alone assessments. In my view, it makes sense to have different instruments in parallel to conduct financial sector surveillance, given the diversity of needs of the membership and the resource constraints.

With respect to the pace of the program, I agree with the proposition to aim for about 30 FSAP assessments each year. As we had already seen at our interim review, resource implications of the FSAP are substantial. We are willing to grant extra resources for this area, because we consider the FSAP to be a valuable tool for improving Fund surveillance, as well as the Bank's assistance in financial sector issues. However, I believe that some resource reallocation will also be necessary. The forthcoming discussion on the budget will provide an opportunity to discuss this in more detail. Given the still existing uncertainties surrounding the costs of this program, particularly those related to the follow-up, we should definitely not aim at a higher number of assessments.

Turning to the follow-up to FSAPs, it is essential to ensure the integration of results into the existing work of the Fund and the Bank. I agree with the staff that the FSSA should become the key instrument for the strengthened Fund's bilateral surveillance in financial sector issues. We have a strong preference for including the follow-up to recommendations as well as the monitoring of the progress since the completed FSAP assessment within subsequent Article-IV consultations. If this follow-up is not adequate or sufficient, national authorities could formally request technical assistance from the Fund or the Bank. Because of the limited experience to date, it is difficult to make projections about additional resource needs arising from the follow-up work. I suggest that this important issue be included in the discussion of the next review of the FSAP, once we have more experience that allows us to make some projections about these costs.

As regards country coverage of the FSAP, I agree that participation should remain voluntary. Based on the existing resource constraints, I share the view expressed by many Chairs that some form of prioritization should take place in the future. I support the view that systemically important countries should be given higher priority. As I mentioned before, we should not see non-participation in FSAP as not having a financial sector assessment. As the FSAP continues, staff will accumulate valuable specific know-how, which will be available to all members. This will allow, inter alia, to reinforce Article IV consultation staff teams with financial sector experts. In this context, I also support including a recommendation for FSAP participation in the appraisal of Article IV reports.

As regards the publication policy, I agree with the management's current policy not to provide authorization for the publication of FSAP reports, given the high content of sensitive and confidential information of the reports. I think we should permit authorization for the publication of detailed assessments of observance of standards and codes, if it is on a purely voluntary basis. As regards FSSAs, I find it important to adopt a publication policy that is consistent with the one applied to Article IV consultation reports. I clearly support the voluntary release of FSSAs.

On the question of a further review of the FSAP, I support the suggestion to have it in about 18 months.

Finally, as indicated in the staff report, Switzerland has accepted Mr. Collins's invitation for advanced economies to join the FSAP club. My authorities look forward to a comprehensive assessment of its multifaceted financial system.

Mr. Barro Chambrier made the following statement:

Given the important contribution provided today, I will try to be brief, and to limit myself to some general remarks, and to some issues raised for the discussion today.

Let me first thank the Fund and Bank staff for their concise and comprehensive set of papers prepared for today's Board discussion. And, I believe that the paper provides the basis for assessing progress in the FSAP process.

Some general remarks. I welcome the support that the FSAP has received from the international community and for its contribution to national reform efforts, as well as to the fostering of the surveillance work of the Fund, and the financial sector development work of the Bank. This has been instrumental in the context of strengthening Fund and Bank collaboration. And, this collaboration has helped, indeed, to provide a framework for in-depth assessment of the strength, weaknesses, risks, and vulnerabilities of member financial systems.

Beside the 12 FSAP pilot countries for which work is almost completed, I took note that numerous countries are also interested to join the program during fiscal year 2001. And, I note in light of the experience gained to date that standards and assessments represent an important component of FSAP and I also share the views of the previous speaker that the standard assessment are a necessary condition but not a sufficient one. However, further efforts are needed to enhance countries' ownership of assessment in order to improve the implementation of standards. In this regard, while countries are encouraged to undertake self-assessment, it goes without saying that support from the international community through technical assistance will remain critical.

I share on this point Mr. Wijnholds's view on the trade-off between vulnerability assessment and the assessment of standards and codes, and I agree with him that the top priority should be to the immediate short-term vulnerability and risk.

On the key points raised for discussion, first, on issues for both the Bank and the Fund, on the FSAP as a coherent framework, we agree it provides an important tool for assessing financial sector strengths and vulnerabilities, strengthening the analysis of domestic macroeconomic and financial stability issues. This framework helped also to identify development needs and priorities and allowed member countries to develop appropriate policy responses.

The frank collaboration between the Bank and Fund has been a key ingredient in the process. With regard to the broadening of country coverage, we see merit in it given that many countries have expressed strong interest to participate in the program. In order to gain more experience in this exercise, it is important to maintain a geographical balance coverage. While agreeing that priority should be given to systematically significant market economies, it is also necessary to be flexible, because all countries deserve help in the area of financial sector, particularly those who where vulnerabilities can constitute a threat to the whole international financial community.

In this regard, three countries in our constituency have accepted to be part of the program and we hope that many more will follow.

We believe that undertaking about 30 assessments per year is too ambitious, given the resource constraints, both for the Fund and the Bank, and for member countries. We, therefore, look forward to discussing soon the budget implication of this increase, and here I would like to state that I share Mr. Shaalan's views with regard to the calculation of the resource cost. It will be important to include quantified follow-up cost of technical assistance, which should constitute, as mentioned by Mr. Shaalan, an integral part of country FSAPs.

From paragraph 74 of the report, staff indicate that despite an increase in resource costs, they have anticipated realizing some efficiency gains. Could the staff provide further clarification on this point.

We also note possible cuts envisaged in the area of technical assistance. And we do hope that this would not be made at the expense of regular technical assistance provided to developing countries.

With regard to priorities, we understand that FSAPs should put greater emphasis on countries where it could have the most value added, in particular in systematically important countries to enhance the financial architecture. However, we think support should be provided to other countries that need help in the area of financial sector stability.

On publication issues, we support management's policy not to publish FSAP reports in their entirety for the moment given the highly confidential nature of information they contain and the need to be candid in the assessment.

With regard to the detailed assessment of the observance of standards and codes that are included in the FSAP report, we endorse management's intended policy to provide authorization for publication on a voluntary basis.

On issues for the Fund, given that the FSSA for particular emphasis on strength, risks, and vulnerabilities in the financial system in a broader macroeconomic and micro-prudential context, we agree that the FSAP, FSSAs provide an important framework for strengthening the monitoring of financial systems under the Fund surveillance. We, therefore, encourage the participation of more members to use the experience gained with the FSAP process in the Article IV consultation.

Regarding the publication of the FSSAs, we can agree to have the report published on a voluntary basis at the conclusion of the FSAP process.

In conclusion, we agree a further review of the FSAP take place in about 18 months, taking into account the next financial year's experience.

Mr. Mirakhor made the following statement:

I join Mr. Toyoma and Mr. Yoshimura in commending both the Fund and Bank staff for assisting national banks and other institutions, and the participating authorities for rendering the FSAP experience a success so far. Like Mr. Kiekens and Mr. Kelkar and other colleagues, the authorities in my constituency, who have gone through the experience, have been very pleased and consider the FSAP a valuable exercise and a useful service to membership. As Mr. Collins suggested this morning, FSAP is a remarkably good value for investment.

Directors' statements so far have been very comprehensive, which allows me to shorten my comments and to state my position on only two issues; I join the consensus on the others.

First, given the broad range of information and technical expertise brought to the exercise, the FSSA—which is derived from the FSAP findings and the Article IV consultation discussions—is the preferred tool to strengthen financial sector assessment in Fund surveillance. This implies that all countries would choose to participate in the FSAP over time. In any one year, however, a higher priority could be given to systemic cases, including industrial countries, while maintaining a balanced coverage that would allow adequate scope for other countries to participate. I am pleased to know of the number of industrial countries that have volunteered to participate in the

FSAP, and I join Mr. Collins in encouraging the rest of the major industrial countries to join the FSAP's full exercise.

Second, I agree with the staff's position as outlined in paragraphs 20, 25, 41, and 43 of their report SM/00/265, that relationship between observance of financial system standards and financial system stability is a complex one and not so straightforward. This suggests that information on the observance of standards should be used in surveillance only as part of a broader analysis of financial system stability that takes into account a wider range of information bearing on vulnerability.

Finally, just a quick remark to confirm collaboration between Fund and Bank staff. I have been on an FSAP mission and have observed that the cooperation of the two institutions is very seamless and very effective in the exercise, which has been very much appreciated by the authorities.

Mr. Wei made the following statement:

I welcome today's discussion and thank staff for the well-prepared papers. While I agree that the FSAP has made a contribution in providing a framework to identify vulnerabilities and strengthen the analysis of macroeconomic and financial stability issues, given the complexities of a specific-country's financial system and staff resource constraints, I would rather suggest that member countries are encouraged to conduct self assessment with their financial sectors in parallel with the FSAPs. As recognized by Mr. Ingves in his opening remarks, staff assessment of financial sectors is helpful progress which could lead gradually to a full-fledged FSAP.

On the issue of coverage of the program, as recognized by Directors and staff, recent experience shows that the FSAP and FFSA are indeed resource intensive. These programs also put a great strain on the resources of member countries which should be considered as we determine whether we should further expand the program. Like Mr. Shaalan, Mr. Mori and others, I have reservations about the enlargement of the program from 24 to 30 from FY2002 and beyond. I also emphasize that participation in the program should be on a voluntary basis.

On the publication of FSAP and FSSAs reports, this chair's position is clear-cut. Given the confidential and sensitive nature of these reports, it is not appropriate to publish them, even on a voluntary basis. As I explained before, by publishing these reports, the participating countries would exert pressure on those countries which are unable to do so. In addition, a country which is able to publish the report might not be able to do so in the next round. Such cases might create unnecessary speculation and volatility in the markets. We agree with others that, in any context, we should not regard FSAP reports as part of Article IV reports. As a policy approved by the Board, Article IV reports are published only with the authorities' permission.

On the issue of a further review of the FSAP, although some progress has been made since the FSAP pilot started, based on the experience to date, I agree with others that the analytical techniques, tools, and methodologies concerning FSAP need to be further improved. In this regard, I agree that it would be appropriate to have a further review of the FSAP in about 18 months.

Lastly, I agree with Mr. Mori and others, that the issue of additional cost in conducting FSAPs should be fully discussed in the next budget. The process of conducting FSAPs should not be at the expense of Fund technical assistance.

Mr. Esdar made the following statement:

I do not have much to add. Let me briefly stress the main points which my authorities have on this issue.

We share the view of all those speakers who mentioned that the FSAP process is a full success, and we also praise management of Bank and Fund for their contributions, and particularly the staff who was in the country and the country work.

There can be no question that this very successful process has to be continued for the time being on a voluntary basis, to make it as operational as possible, it is crucial to integrate the outcome of the FSAP and FSSA process into the Article IV consultation process in our technical assistance work, and also in our program work.

I think the objective, the target for the next years of 30 cases per year is a reasonable one. I think as Mr. Collins put it, I think the resources we invest in this issue is very well invested money and I think we have to be prepared, and we have to be ready to provide the necessary resources to make this process, to continue that this process will be a success. I think some shifting of resources within this institution, some additional resources, but also the use of external expertise might help to keep the costs under control, the resource requirements under control.

Thirty countries per year would mean that every country would be, in a kind of six-year cycle. I think this is a very formidable approach. Like Mr. Collins, I think here we have to be a little bit more selective and more flexible and concentrate on those countries where we have particular vulnerabilities.

> With regard to the selection of the countries, I think the staff is right in concentrating on those countries which have a particular impact on the financial system, and emerging market, but also, I am also interested that some countries in Africa have already FSAPs. I think this is a very encouraging process that should be continued.
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> Also, further, on selection of countries, Mr. Kiekens gave some very good advice in this regard to concentrate in particular on those countries which have particular vulnerabilities with regard to the exchange rate system and he mentioned some other indicators, which should be considered.
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> With regard for the invitation of Mr. Collins and Mr. Mirakhor, I hope that, in the case of Germany, I can be a little bit more concrete in some weeks on this issue.
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> On the publication issue, I fully support the staff's approach on the retroactivity. I have no strong feelings, but in general, I am always a little bit reluctant to change the rules of the game retroactively, but again, I have no strong feelings. I think also it is crucial to review the experience with this process within the next 18 months

Mr. Kiekens pointed out that the FSAP exercise conveyed detailed policy advice to countries concerning which areas most urgently need reforms and how these reforms should be sequenced. However, FSAP reports were not disclosed to the Board, which was one reason why he had not considered these papers as absolutely necessary. Nevertheless, there was a long-standing understanding in the Fund that the legitimacy of the Fund's advice to countries was based on its consideration by the Executive Directors, and that the advice given by the staff and management to members must be transparent to the Board. In order to comply with these long-standing principles, he sought two assurances from management. First, that the policy advice contained in FSAP reports was fully and faithfully also identified in the FSSA reports, which were disclosed to the Board, in order to have Board involvement. Second, that the time span between the policy advice given to the countries on a preliminary basis by the staff and management, in the FSAP paper, and the time that the Board considers the FSSA would be limited to what was reasonably possible. In that regard, the experience to date had not been reassuring. For example, Hungary had received its FSAP report at the beginning of 2000, but Board consideration of that advice would only occur in the context of the Article IV consultation scheduled for after the spring meetings—about 15 months later. In Kazakhstan, too, the time span between the delivery of the FSAP paper to the authorities and the opportunity for the Board to consider the advice was a very lengthy period. Therefore, it was important that every effort be made to limit that time span to, say, about three months.

The Chairman asked the Director of the Monetary and Exchange Affairs Department to respond to Mr. Kiekens' first point, and for the Deputy Managing Director, Mr. Aninat, to respond to the second point.

The Director of the Monetary and Exchange Affairs Department responded that the policy advice contained in FSAP reports was contained in the FSSA report presented to the Board. On Mr. Kiekens' second point, efforts would be made to reduce the time between the delivery of the FSAP report to the authorities and the consideration of the FSSA report by the Board. In the early stages of the pilot project, extra time had been required to deal with the establishment of the required procedures.

The Deputy Managing Director pointed out that Mr. Kiekens' s concern about having FSAP findings and recommendations feed into the Article IV process in a timely manner had been an ongoing concern. It would be important to ensure the utmost efficiency in conducting an assessment and having the lessons carry into the policy deliberations of the Board. However, it was necessary to recognize that this would take some time, as experience would need to be gained on how to improve the functioning of the program. Moreover, there were budgetary constraints, which would be somewhat eased if the Board were to agree to the proposed increase in resources to be allocated to an expanded FSAP. In addition, it was important to recall that the program was a joint Fund-Bank program, and sufficient time was required to ensure effective collaboration. That collaboration had been progressing well, and should improve the effectiveness of the program. Continued efforts would be made to improve the efficiency of the program and to have the findings of the program incorporated into the Fund's surveillance function.

Mr. Mirakhor agreed that the collaboration with the Bank had been useful and effective and that it was important to strengthen it further. He had participated in one FSAP mission, which had been undertaken in a smooth and effective manner.

Mr. Kiekens wondered how any differences between the Fund and Bank staffs were resolved. An FSAP paper must be cleared in all its respects by the staff of the Fund and the World Bank, by the department head in the Fund, Mr. Ingves, by the vice-president in the World Bank, by the Managing Director, and by the President of the Bank. Although management had recently informed the Boards of the Fund and the Bank that cooperation had been very smooth, it also had said that perhaps all the differences of opinion had not been communicated to the managements of the Fund and the Bank. Against that background, he asked how any differences had been resolved. In the event of a difference in a particular area, perhaps the institution that had principal responsibility for that area should take the lead.

The Chairman considered that it was to expected that, from time to time, the two institutions would have different perspectives on issues, which underlined the importance of good cooperation and communication. In the context of the current Board discussion, it was important for Directors to concentrate on the issue of how best to prioritization the FSAP in order for it to better contribute to the stability of the international financial system. In particular were questions such as whether the program is sufficiently focused on weaknesses and vulnerabilities, particularly in the short term, in financial sectors—especially banking sectors. In that context, it was reassuring to hear that several advanced economies, such as Switzerland, the United Kingdom, and perhaps Germany, had agreed to participate in the FSAP. More advanced economies should be encouraged to participate, and it was important to concentrate, in the first few years of the program, the country selection process on those countries that would have the greatest impact on the stability of the international financial system.

The Director of the Monetary and Exchange Affairs Department reiterated that in each case, the staff considered carefully the data in order to draw the appropriate lessons. To that end, a number of tools were used, such as stress testing and scenario analysis, to make recommendations. However, it was also true that a considerable amount of time is spent in each country trying to understand fully the data, because it was often necessary to deal with bank-by-bank data. In addition to dealing with the numerical data, standards assessments were required to provide a medium-term perspective on what needs to be done—such as how to operate supervisory agencies effectively and whether medium-term legal changes were necessary. Although mistakes could be made, serious efforts were made to come up with the best possible judgements to determine shorter- and longer-term vulnerabilities.

The staff representative from the Monetary and Exchange Affairs Department explained that, at present, the country selection process focused on having a balanced approach in terms of number of countries per region and in different stages of development, while giving some priority to the systemically important countries, including industrial countries. At the launch of the program, those criteria had been interpreted to mean including about three industrial countries, one offshore financial center, and some major emerging market economies where both the Bank and Fund could focus on both the developmental issues and stability issues. However, as the program remains voluntary, some countries that had initially been approached about possible participation had not been prepared to do so. Going forward, a more systematic approach to country selection was being developed in the joint Financial Sector Liaison Committee. That approach would be more proactive, in which more systematically significant economies would be approached as early as possible—perhaps even in the context of Article IV staff missions. Mention could also be made in the staff appraisal section of the staff report.

The Chairman underlined the need to clarify further the criteria by which economies could be included in the FSAP. While systematically important economies could be the source of instability for the international financial system, other economies might also be vulnerable, as modern financial markets had become quite complex.

The Deputy Managing Director considered that the economies that had participated in the program to date had benefited considerably from the assessment of weaknesses and vulnerabilities. In that context, it would be interesting to consider three examples that provided support for the efficacy of the program and the staff's approach, although it would be challenging to determine, ex ante, some kind of automatic rule by which the most appropriate candidates were included in the program. One example was the case of El Salvador, for which an FSAP review had been conducted and had proved invaluable for the subsequent decision on dollarization. The staff had worked closely with the authorities on the vulnerabilities and regulatory implications of dollarization. A second example was the case of South Africa, in which he had personally been involved. There had been good discussions with the authorities on a number of important issues on potential vulnerabilities, including the possible timing of opening up the capital account, the cross vulnerabilities with the insurance sector, the strength of the regulatory bodies, and central bank independence. The third example was the case of Peru, which was facing considerable difficulties. The FSAP review provided a good basis on which the staff had discussed with the authorities the vulnerabilities of the banking sector.

Mr. Esdar considered that the issues relating to prioritization was somewhat more complicated than had been suggested. One aspect was the voluntary nature of the program, which could limit the scope of the countries involved and could exclude countries with substantial vulnerabilities—even those countries identified, in the context of Article IV consultations, as having vulnerabilities. Thus, the voluntary nature of the program could limit the efficacy of the program to substantially contribute to the stability of the international financial system. A second issue was what would happen if more than 30 countries volunteered per year (the proposed annual number of FSAP reviews). Decisions would have to be made regarding where the limited resources—including the limited number of experts—would be deployed.

The Chairman reiterated the importance of advanced economies participating in the program.

Mr. Kiekens agreed that the issue of prioritization was key, as he had outlined in his statement, and the level of prioritization to date. It was regrettable that Turkey had not had an FSAP review, as that could have averted the current crisis—as the staff had indicated. It was also a matter of concern that the staff had considered that it would be necessary to review the numerical data before determining whether a country was a high-risk case. In fact, he had already indicated several circumstances under which a high-risk scenario was likely; in such cases, an FSAP review should be conducted—even without analyzing carefully the numerical data. Such cases included monetary policy under a currency-board type, pegged exchange rate regime in emerging markets, rapid disinflation processes, capital account liberalization, and large fiscal deficits financed through the banking system. If one were to consider those scenarios, then Turkey would have fit the profile of a good FSAP candidate. However, Turkey has not been encouraged to participate in the program.

In response to the matter of the voluntary nature of the program complicating prioritization, Mr. Kiekens considered that no country should have the right to interfere in the needed prioritization. Moreover, the FSAP should not be abused to showcase how well a country's financial sector was doing. The appropriate solution would be to make FSAP reviews mandatory, and to permit the Fund to decide which countries underwent a review. In his opinion, this would be consistent with the Fund's mandate under Article IV, which provides the Fund the duty to exercise firm surveillance over a country's policies to promote stability—financial stability being an integral part of that, as the previous decade had shown.

The Chairman recalled that the majority of the Board had expressed a preference to maintain the voluntary nature of the FSAP. On Mr. Kiekens's point regarding Turkey, it was regrettable that the authorities had not approached the Fund sooner to ask for assistance with the emerging problems—especially to ask for a review of the country's financial sector.

Mr. Kiekens pointed out that the staff had not suggested that Turkey participate in the FSAP. Indeed, the staff had focused its attention on the problems relating to the possible currency mismatch, rather than maturity mismatch, in the financial sector. In addition to his own exhortations to the staff on the possible banking sector problems, there had been several technical assistance missions on the banking sector. However, the staff had concluded that the problems of the banking sector—which were being addressed in the context of the Fund-supported program—did not constitute a particular risk. Clearly, the responsibility for the problems in the Turkish banking sector could be shared between the staff and the authorities.

Mr. Collins remarked that, while he did not wish to comment on the matter of responsibility of the current crisis in Turkey, the FSAP was a voluntary program and relied primarily on the national authorities coming forward. The case of Turkey pointed to the need for the Fund to more proactive in the selection of countries participating in the program. There appeared to be a certain degree of adverse selection in the current voluntary approach, as countries with problems might not wish to volunteer, thereby publicizing those problems.

Ideally, the FSAP reviews should be subsumed under Article IV, but there did not yet appear to be sufficient support among the membership. Mr. Collins continued. A useful way to progress was to continue to build peer pressure for countries to participate, thereafter following up on issues in the context of Article IV consultations. In such a way, a kind of case law could be built up.

It was interesting to point out that the members of the G-20 had, in principle, volunteered to participate in the FSAP, Mr. Collins remarked. Therefore, the systematically-important economies could be assessed by an early date, although not all those economies posed risks to the international financial system and need not be given priority.

Mr. Lehmussaari considered that, on the selection of countries, there should be a strong presumption that a country that requests a large program from the Fund should also involve itself in the FSAP. Second, when there was a clear sign that a country appeared to be vulnerable to financial shocks or risks—such as in the recent case of Turkey—there should be a presumption that at least the Fund staff would then propose that the country participate in the program. Third, countries implementing major financial sector reforms should be strong candidates for the program.

As regards the mission work, in his experience in his constituency, the most valued component had been the stress testing exercise, for two reasons, Mr. Lehmussaari continued. First, there was an obvious opportunity to look at the models that the authorities or the banks were using, so it was a kind of check-up situation. Also, it provided a good opportunity to work as a catalyst to try to develop those models further and stimulate further analysis. In that context, he would agree with Mr. Kiekens on his questioning of the balance of allocating resources between standards and codes, and other parts of the assessment. Clearly, further close consideration of that aspect was needed. Despite the widely-accepted limitations of stress-testing—such as in data and complexity—they should be the core part of individual FSAP reviews.

Mr. Abbott commented that the current discussion was reminiscent of a comment made by a former U.S. Executive Director, who said that the two important principles of the Fund were equality of treatment and case-by-case treatment. The tensions between these two core principles of the Fund were quite evident in the current discussion. On prioritization, he would agree with many of the comments made—especially those by the Chairman that is was important to be able to identify real problems, address them in the next few of years, and not wait six years. He would also agree with the consensus of the Board that the FSAP is a voluntary program, although Mr. Kiekens's formulation could provide much clarity, if not agreement. As it appeared that there were a number of countries in the process of volunteering to participate, the Fund would need to decide on the order of assessments. Several Directors, including Mr. Kiekens, Mr. Lehmussaari, and Mr. Collins, had outlined a number of useful criteria that could be used in determining that prioritization. Clearly, the Fund would need to be more proactive in encouraging—and perhaps coaxing—particular countries to participate, which would facilitate the Fund's task in ensuring the stability of the international financial system.

Another dimension of priorities that needed to be addressed was for those dealing with the methodological approach that the Fund would take to different countries, Mr. Abbott continued. It was unclear from the staff presentation whether the program would rely entirely on a case-by-case method, or whether the program would focus on the vulnerabilities particularly on the methodology with respect to stress testing and scenario analysis. It would seem difficult to expect that such stress testing and scenario analysis could be reasonably conducted in a very large financial center with several thousand financial institutions. Such detailed analysis could be possible in a small- or medium-sized emerging economy, but not in a country like Germany. As he had outlined in his preliminary statement, it was also difficult to envisage how a vulnerability assessment could be applied to an offshore financial center, where business was essentially done in some other markets and there was no local financial risk. Therefore, there would need to be some shading of the methodology and tiering of priorities across countries.

Mr. Zurbrugg reiterated that his authorities were committed that, at present, the program remain voluntary. However, it was to be expected that such a voluntary approach might not be optimal to address short-term vulnerabilities identified by the staff. As long as the voluntary approach were followed, such disadvantages would need to be accepted.

In response to Mr. Kiekens's view that national authorities should not use the FSAP as a way to showcase the strength of their financial systems, Mr. Zurbrugg commented that his authorities held a different view. Having sound economies undergo an FSAP review was a way to remove the possible stigma that could come from participating in the program, because if participation were limited to economies that had a high probability of short-term vulnerability, then that would automatically mark those economies as potentially unsound, which could lead to negative market consequences. Thus, it would be important to maintain diversity, and the Deputy Managing Director' examples showed that there were a variety of benefits that could stem from an FSAP review.

Mr. Couillault pointed out that prioritization was necessary only if there were to be too many candidates. In such a case, it would be important to ensure that the systemically important were candidates. Nevertheless, it would be useful for most—if not all—members to undergo an FSAP review, because, as had been pointed out by Mr. Kiekens, an FSAP review could be useful in many different situations. One good example would be in the event of countries in the process of undergoing capital account liberalization. During previous discussions on the subject—which should be pursued further—the Fund concluded that countries engaging in capital account liberalization must have a strong financial sector. In that context, an FSAP review would be perfectly suited.

On the matter of the Turkish program, it was incorrect to try to lay blame—especially on the staff—as the vulnerabilities had been well identified, and the program had been designed to address those problems, Mr. Couillault remarked. Once the banking crisis arose, questions were raised about the ability of the Fund to prevent such crises—especially in the case of program country. Clearly, the Fund's reputation was at stake, and the whole institution and its membership had to face the difficult questions that had been raised in the Board—as well as outside the institution. In the coming years, the issue of prioritization would recede in importance, but the issue of how careful the Fund followed-up to FSAP reviews would emerge as important.

On the question of priorities, Mr. Couillault agreed with the many speakers that underlined the importance of having good collaboration with the World Bank. However, it was also important to recognize that the Bank might have a set of priorities that differed from the Fund.

The Chairman stressed that the cooperation with the Bank had been most fruitful. While it was true that the Bank focused on longer-term development objectives in developing countries, it was also important to recognize that short-term vulnerabilities in advanced and systematically important countries could greatly complicate the Bank's overall objectives. This fact would support encouraging systematically important countries to participate in the FSAP as soon as possible.

The staff representative from the World Bank, in response to questions and comments by Executive Directors, made the following statement:

> After your reassuring words, let me first reply briefly to Mr. Bernes's initial remark about the Bank's work in the financial sector being dismantled with a famous Mark Twain quote—the reports about my death are somewhat exaggerated. As far as I know, we are budgeting for not only the financial sector work this year, but also in the next fiscal year. Just recently, the Bank's Board of Directors approved the financial sector strategy paper, as you know, in the context of the work on the international financial architecture. We in the Bank, jointly with the IMF, are working not only on financial sector issues, but also in areas such as corporate governance, legal and judicial reform, auditing and accounting, and public debt management.

Coming now to the second question, I fully share the view that there are strong synergies in the Fund and Bank working together. As was explained the other day during the informal technical briefing, the team work created by this joint exercise is worth bearing in mind because, besides institutional links, there are also personal links, and team work is key.

We in the Bank definitely recognize the primacy of the IMF when it comes to dealing with short-term banking crises and dealing with vulnerabilities. That is part of the Concordat that we signed, and definitely, as qualified a person as Mr. Ingves here, I will always defer to him on how to deal with a banking crisis. At the same time, you should recognize, as the Chairman has emphasized, we in the Bank have an interest in banking crises and financial crises because they are related to poverty. In Turkey, we are interested both in physical earthquakes and in financial earthquakes, because the two of them have implications for development. It would be naive on our part to say that there is vulnerability, but it is not our business. I think it is our business, of course deferring to the Fund's leadership in how to address those issues.

It is true that sometimes there are different views among the institutions, not so much in the case of the FSAP, but in other work. From what I have seen, one typical case of some nuances in views is precisely about the role of safety nets, because sometimes the short term and long term are in conflict. This is a typical case of dynamic inconsistencies, because if you are too generous in giving, for instance, a blanket guarantee, that can be expensive in the future, and that in the future might crowd out social expenditure in countries not very far away from the United States You have had that debate--why was this banking crisis so expensive--and so sometimes it is difficult to disentangle how to deal with the banking crisis in the short term with how to develop the country in the medium term. If you saddle the country with huge liabilities which, to a great extent, benefit wealthy creditors, then the political debate may make it somewhat complicated. Of course, as you know, the Bank-Fund liaison committee is coordinating not only the FSAP, but many other things, including policy views, and we have had already a number of seminars on policy views, particularly on deposit insurance, to mention one. So, in some cases, there are different views within institutions, say within the Bank or within the IMF, and we try to sort any differences among ourselves.

On a different topic that you mentioned, Mr. Chairman, do FSAP reviews focus on vulnerabilities, I will say definitely so, that is, existing FSAP cases definitely concentrate primarily on vulnerability issues which, of course, are of interest not only to the IMF but also to the Bank. Sometimes we have very little time and resources to pay attention to developmental issues other than those that relate to reducing vulnaribliities. So, the argument we have made many times in the Bank that FSAP reviews are not only about crises but also about development is only partially true, because in fact they have so far concentrated mostly on vulnerabilities.

This brings me to a question which you raised, even though I think it belongs only here in the IMF and not in the World Bank, because in the World Bank any involvement in the FSAP is always voluntary, so the question of whether FSAPs should be mandatory or voluntary is something to be decided by the IMF. We will take any decision that member countries in this institution will take. That is my personal feeling.

As is apparent from interventions, you are here in the midst of a conundrum, because any alternative is not first best, because if you take the voluntary approach that we are taking now, you have the problem of adverse selection that Mr. Collins said. Actually, I have seen that personally, because let us consider one East Asian country which went through a crisis a few years ago, and we in the Bank were going to wind up special programs that we organized for them. My natural instinct would be to say, before we phase out the special assistance programs, let us do a check-up to see. Of course, that assumes that the country is willing to have that check-up. If the country does not take it, that is it, and it is too bad, and we have to wind down the program without that FSAP.

But, at the same time, if you take the other tack and maybe the FSAP is mandatory, you run into the opposite problem, which is the signaling effect mentioned by many, because then if you exercise judgment in deciding which countries are vulnerable, then the FSAP teams would be like vultures, circling countries which are vulnerable. The signal sent to financial markets would be negative. So, the only way to have a mandatory approach which could be acceptable by countries which see and may surmise that they are vulnerable would be to take an approach which is not judgmental. Probably it is too unusual to suggest here, but you could take a sampling of some 30 countries for the FSAP and you say, I will take a batch of 10 systemically important countries, and I will draw lots. The important thing is that the selection process does not convey any information whatsoever to financial markets, because, to the extent that you do, you enter into the problem of unfair treatment.

The other approach would be, as suggested by others, to use a fixed objective rule which does not entail any judgment. For instance, as I mentioned, if the World Bank is going to phase out a financial sector special program, then it might make sense to have an FSAP review, or if access by that country to resources is X amount or if a contingent credit line is requested. So, some objective rule which does not convey any information whatsoever to financial markets. There are some around this table who lived through the discussions in September 1992 about the ERM, and they know something about the signaling effect of public statements, and we need to be particularly careful in sending the wrong signals to the markets.

This is also related to the question of the publication of FSAP documents. If you make participation in the FSAP mandatory on the basis of judgment via IMF staff, and on top of that you make FSAP documentation susceptible to publication, even on a voluntary basis, you will be adding insult to injury to those countries which consider themselves to be vulnerable and which do not want their FSAP documents to be made public. Making the FSAP subject to publication, either voluntary or mandatory, is irrelevant, because the effect would be the same. That is the famous unraveling information theory that, when you make something voluntary, everybody will do it; it will be the process of selection. So, those who do not publish will be under such huge pressure that markets will say, they have a problem and that is why they are not releasing the FSAP documentation. So, I would tend to think that the approach which has been enshrined in this FSAP paper by the IMF and by the Bank of an approach, as Mr. Collins said, with the main FSAP report remaining confidential and not being public, even on a voluntary basis, is a very good compromise.

Probably one alternative would be to raise the level at which the process of discussion and selection of FSAP countries is currently conducted. I do not know about the Fund, but my impression at least in the Bank is that, as of today, it is done at a technical level, so that if a country does not want the FSAP, that is the end of it; there is not a long process of moral suasion. Probably bringing in the heavy political weights from institutions in that process, while preserving the principle of a voluntary FSAP, might make the selection closer to your objectives, which we in the Bank fully share, to have the FSAP concentrate de facto on the most vulnerable countries.

The Director of the Monetary and Exchange Affairs Department remarked that, in preparing an eventual list of possible future participants in the FSAP, the staff would consider carefully the comments made by Directors during the current meeting. At that point, those countries would be approached about their possible participation, which might take a few rounds of discussion. Given the voluntary nature of the program, there could be changes to the list of possible participants. If those changes were not considered advisable by the institution, then those countries would need to be approached again; it was hoped that, by following such a course, convergence would be achieved in the process. Inevitably, some flexibility would need to be accepted with regard to the precise participation.

On the issue of what methodological approach was appropriate in conducting a review, it would be necessary for the staff to be aware of what tools were available, and then apply the proper tools in individual country cases, the Director continued. In some country cases, it would be unclear whether the quantity and quality of the necessary data would be sufficiently clear. In such cases, the tools that could be used would be fairly limited. In other cases, the staff would be provided with the necessary data, and consideration could be made about using one of the models that has been used in the process. In some countries with very advanced financial sectors, it would not be advisable for the staff to use its own models, as that would require very much time and resources; rather, in such cases it would be more appropriate to discuss with the authorities and the financial institutions the kinds of models that they used, and to conduct an assessment on that basis. Therefore, judgment would need to be exercised on a case-by-case basis to determine which tools were appropriate in particular countries.

On the matter of how to assess OFCs, it was true that, in an OFC a major part of the activity is not technically taking place within the country itself, the Director commented. In that case, the focus of the assessment would have to change totally. When considering vulnerabilities in the international financial system, it would be important to look carefully into the interlinkages between the particular OFC and major financial centers. It would probably not be very meaningful to concentrate fully on the domestic financial sector, because doing so would be to use up resources concentrating on an issue which is of minor importance. So, the OFC assessments would have to be tailor-made for those particular countries or jurisdictions, because using a one-size-fits-all approach would not produce good results.

Mr. Kiekens thanked the staff representative from the World Bank for his candid comments, and he took note of his statement that, in the case of unavoidable differences of views between the two institutions, prevalence would be given to the views of the institution to whose core mandate belonged the issue under consideration. In that regard, reference had usefully been made to the Concordat between the Fund and the Bank, and also to long-term development issues and more short-term stability issues. Those points should be reflected in the summing up of the current meeting.

Mr. Bernes pointed out that, during the Asian crisis, there had been a series of problems with cooperation between the institutions, and the new structure that had been put in place had worked well to resolve many of those problems. Therefore, it was reassuring to hear from the Bank representative that, in essence, the Bank's current structure would remain in place with adequate resources. On publication, he wondered, like Mr. Al-Turki, about the understanding on publication of pilot project cases.

The Director of the Monetary and Exchange Affairs Department replied that the letter sent to those countries who were in between the pilot project and the formal launch of the program had said that the practice had been that the Financial Sector Assessments and Financial Systems Stability Assessments would not be published. The letter continued by saying that, in recent Board reviews, Directors had confirmed that that practice would continue for the time being, and it would apply to those countries that were about to participate in the FSAP (including Canada). The letter had noted that the two Boards had wished to review the issue of publication of these reports toward the end of 2000, and that, in particular, the Boards would review whether to allow publication of these Board documents on a voluntary basis. In that regard, the letter had requested the authorities' reactions if such a decision, if taken, were to apply also to those countries about to participate in the FSAP. The staff had received responses, which could be explained, if the Board wished.

Mr. Bernes remarked that it had been his understanding that a decision was to be taken at the current meeting. His chair had sought an earlier decision with respect to both Canada and Ireland, but the decision of the Board had been not to take a decision in the context of the pilot project, which could have prejudged the overall result, but to come back to the matter at the end of the pilot. In that context, his chair would support the staff proposal. It was important to recognize that there should be uniformity of treatment applying to the countries in the pilot project, as well as to the countries going forward. Those countries that would like to publish should be allowed to do so, and those countries who participated in the pilot project should have the same rights.

Mr. Wijnholds said that, on prioritization, many good suggestions had been made. Clearly, it would be difficult to determine precise criteria, but it would be important to include systematically-important countries. One lesson to be derived from the recent crises—as Mr. Lehmussaari has said—was that whenever the Fund supports a program with a country where there might be financial sector problems, an FSAP review should be conducted. While the FSAP was not mandatory, the Fund's conditionality should indicate what the Fund considered necessary.

Mr. Abbott remarked that, on the issue of codes and standards, he had said in his statement that the assessment of standards and codes was an important, separate pillar in the whole strengthening of the international financial architecture. It was therefore of some concern that the staff paper gave the impression that this was secondary or done as kind of completing the project rather than a core element. It would be unfortunate if, on the basis of economizing, stand-alone assessments were reduced. Moreover, it appeared that the Fund had reached collaborative understandings with the standard setting bodies to have such assessments as part of the FSAP.

The Deputy Managing Director remarked that Mr. Abbott was correct that there had been understandings with standard setting bodies. The Board would consider experience with ROSCs in January 2001, and the staff paper would propose concentrating those standards and codes in order to make those assessments more effective.

The Secretary pointed out that only about half of the Directors had expressed an opinion on the matter of the publication of FSSA reports. Perhaps those Directors that had not yet expressed an opinion on the matter could do so.

Mr. Esdar asked about the responses received from the letter the staff had sent to participating national authorities.

The Deputy Director of the Monetary and Exchange Affairs Department noted that, at the time of the previous Board meeting, seven countries had expressed interest in participating in the program. Of those, two countries had agreed to voluntary publication; one country had not agreed to retroactive publication, but did not express a view on publication more generally; the remaining countries wished to have some experience with the FSAP before commenting. Since that time, those countries had agreed to voluntary publication. On the 12 pilot cases, in order to encourage volunteers at the beginning of the pilot, it had been the practice to promise very limited distribution of the FSSA report, and not to publish it. The staff was now proposing to quickly update those reports, and to permit voluntary publication, while maintaining the no-publication rule of the original reports.

Mr. Jayatissa stated that his chair wished to preserve the voluntary nature of the publication of papers. On another point on the link between the Article IV consultations and the FSAP, it was important to ensure that, as stated in paragraph 67 of the paper, Article IV missions would be reinforced in cases where the countries had not volunteered to participate in the FSAP.

Mr. Barro Chambrier stated that his chair supported the voluntary publication of the information. On the matter of the Fund's publication policy and crisis management, he wondered in the event that information was not published in a case such as Turkey, what kind of signals would be sent to markets?

The Director from the Monetary and Exchange Affairs Department replied that, in those cases, very careful consideration would be required about what would be said to the markets.

Mr. Bernes pointed out that it would not be useful to update the pilot reports, as they were all recent. Moreover, it would be an unwise use of scarce resources. He reiterated his request that pilot cases be permitted to publish their reports on a voluntary basis—which was the same policy that would be applied for future participants.

Messrs. Abbott and Collins said that they agreed with Mr. Bernes's views. It appeared pointless to agree to voluntary publication of future participants, while not applying the same principle to past participants.

The Deputy Director of the Monetary and Exchange Affairs Department remarked that the quick updates suggested by the staff would not require any significant resources.

The Deputy Managing Director pointed out that the staff had been reluctant to propose a change in the rules of the game with regard to publication of the pilot cases. The original rules under the pilot had not permitted publication, and some pilot countries might feel pressured into publishing if one or more of the pilot cases were to be permitted to publish their FSSA report. On a related point, there did not appear to be much support for the staff proposal of quickly updating the reports of the pilot cases, and then to permit voluntary publication—something that would maintain the integrity of the original rules.

Mr. Bernes remarked that he was not aware that there had been rules of the game regarding publication under the pilot. Indeed, during a mission to Canada, the First Deputy Managing Director had noted that the publication policy under the pilot was not yet clear and that it would require further Board consideration. At that subsequent Board meeting, Directors had said that they were not prepared to take a decision that could prejudice their final outcome, and concluded that it was prudent to wait until the current meeting.

Mr. Kiekens remarked that if all 12 pilot countries were to agree to voluntary publication, then the matter could be resolved. He invited those Directors representing those countries to express their positions.

Mr. Shaalan said that he represented one of those countries, and he did not agree to voluntary publication of the pilot cases.

Mr. Rouai commented that he also represented one of the pilot cases, and he did not agree to publication of the pilot cases. He would agree to permitting the voluntary publication of future cases.

Mr. Kiekens said that he represented two countries in the pilot; one country was in favor of publication, but the other was not. However, he would be willing to seek its agreement regarding the voluntary publications by the others.

Mr. Shaalan considered that the credibility of the Fund was, in part, at stake. The Fund had stated to the pilot countries that there would not be publication of the 12 pilot cases. The Fund should maintain its word on that matter.

The Chairman believed that Mr. Shaalan raised a fair point.

Mr. Collins wondered what the original letter inviting participation in the pilot project had stated.

The Deputy Director of the Monetary and Exchange Affairs Department reiterated that, in communications to the original pilot cases, it had been expressed that the understanding at that time was that there would not be publication of the FSSA reports. However, that remained, in the final analysis, a matter for the Board to decide.

After some further brief discussion, the Chairman suggested that the Board agree that there should be no publication of the pilot cases. Also, the FSSA reports of those countries seeking accession to the European Union would be shared, on a confidential basis, with the European Commission.

Mr. Abbott asked whether Mr. Shaalan might be prepared to withdraw his objection to the publication of the staff paper for the current meeting. It would be useful to give the paper a wider circulation.

Mr. Shaalan considered that the paper was a work in progress, and it would be premature to publish the paper at the current stage. He would have to review the paper more closely, as one of the countries in his constituency was mentioned as having had an FSAP review. He would also consult with that country's authorities before passing judgment on that.

The Chairman, in concluding the meeting, remarked that there had been broad support for the continuation of this important program. There had also been the understanding that further consideration was needed to sharpen the program's priorities, recognizing that there would be a mix of criteria to be taken into account. The summing up of the discussion would be considered the following day.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/121 (12/11/00) and EBM/00/122 (12/12/00).

2. REPUBLIC OF ESTONIA—STAND-BY ARRANGEMENT—REVIEW

1. The Government of the Republic of Estonia has consulted with the Fund in accordance with paragraph 3(d) of the Stand-By Arrangement for the Republic of Estonia (EBS/00/18, Sup. 2, 6/2/00) and the second paragraph of the letter dated February 11, 2000 from the Prime Minister and the Governor of the Bank of Estonia.

2. The letter dated November 24, 2000 from the Prime Minister and the Acting Governor of the Bank of Estonia shall be attached to the Stand-By Arrangement for the Republic of Estonia, and the letter dated February 11, 2000, as supplemented, from the Prime Minister and the Governor of the Bank of Estonia shall be read as supplemented by the letter dated November 24, 2000 from the Prime Minister and the Acting Governor of the Bank of Estonia.

3. Accordingly, the performance criteria for March 31, 2001 and June 30, 2001 as set forth in paragraph 3(a) of the Stand-By Arrangement for the Republic of Estonia shall be provided in Table 1 to the letter dated November 24, 2000.

4. The Fund decides that the second review contemplated in paragraph 3(d) of the Stand-By Arrangement for the Republic of Estonia is completed, effective on Monday, December 11, 2000. (EBS/00/237, 11/27/00)

Decision No. 12355-(00/122), adopted
December 11, 2000
effective December 13, 2000

3. ZAMBIA—ENHANCED HEAVILY INDEBTED POOR COUNTRIES INITIATIVE—DECISION POINT DOCUMENT; AND SMOOTHING DEBT-SERVICE PAYMENTS

Pursuant to Paragraph 2 of the Decision Point Decision on Zambia adopted at EBM/00/118, December 1, 2000, the Fund decides that the World Bank has concluded that Zambia has reached its Decision Point under the enhanced HIPC Initiative. Accordingly, Paragraph 1 of the Decision Point Decision on Zambia set forth in Attachment II of this document, shall become effective on December 11, 2000. (EBS/00/248, Sup. 1, 12/08/00)

Decision No. 12356-(00/122), adopted
December 11, 2000

4. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 00/31 are approved.

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director, by an Advisor to Executive Director, and by an Assistant to Executive Director as set forth in EBAM/00/168 (12/8/00) is approved.

APPROVAL: April 16, 2001

SHAILENDRA J. ANJARIA
Secretary