INTERNATIONAL MONETARY FUND

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2021 FINANCIAL SECTOR ASSESSMENT PROGRAM REVIEW—BACKGROUND PAPER ON TRACTION

May 2021

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2021 FINANCIAL SECTOR ASSESSMENT PROGRAM REVIEW—BACKGROUND PAPER ON TRACTION

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CONTENTS

Glossary

AML/CFT	Anti-Money Laundering/Combatting the Financing of Terrorism
BCBS	Basel Committee on Banking Supervision
CSR	Comprehensive Surveillance Review
DAR	Detailed Assessment Report
ED	Executive Director (of the International Monetary Fund)
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSSA	Financial System Stability Assessment
FSR	Financial Stability Report (published by a central bank)
GFSR	Global Financial Stability Report
GST	Global Bank Stress Test
IEO	Independent Evaluation Office of the International Monetary Fund
IMF	International Monetary Fund
MCM	Monetary and Capital Markets Department of the IMF
S29	The 29 jurisdictions with systemically important financial sectors in 2013
SCSI	FSB's Standing Committee on Standards Implementation
SIFS	Systemically Important Financial Sector
SPR	Strategy and Policy Review Department of the IMF
TA	Technical Assistance
TN	Technical Note

INTRODUCTION

1. **A key criterion for judging the success of the Financial Sector Assessment Program (FSAP) is the extent to which the program has enhanced the IMF's engagement with policymakers and influenced country policies**. This reflects the fact that achieving one of the program's key objectives—reducing the frequency and severity of financial crises—rests on its ability to encourage policy action by country authorities, either directly or through other bilateral and multilateral activities. The "traction" of FSAPs thus reflects the degree to which the program is seen as useful by the authorities and the effect it has in shaping the domestic policy agenda. And the impact that the FSAP may have on wider domestic and international audiences.

2. **The 2014 FSAP Review concluded that FSAP's traction was strong but saw room for improvement.** Based on survey data, it concluded that country authorities and IMF Executive Directors were highly satisfied with the FSAP, including with regard to the assessments' ability to promote policy dialogue on financial stability issues, both nationally and with the Fund. The Review also concluded that the FSAP was impactful, as evidenced by high implementation rates of FSAP recommendations, which was thought to possibly reflect improved streamlining of recommendations. However, FSAP recommendations were not seen as being well prioritized, the FSAP did not appear to have helped promote dialogue with some domestic audiences such as legislatures, and publication rates for FSAP reports were not uniformly high.

3. **Accordingly, a key objective in 2014 was to further enhance FSAP traction and impact.** The Review defined measures to increase the integration of the FSAP with the Article IV surveillance processes and to boost the profile, traction, and impact of the FSAP with its external audience. These included increasing the focus by FSAPs on macrofinancial relevance as a means of streamlining and prioritizing recommendations and structuring the Financial System Stability Assessments (FSSAs), so they could more easily feed into the surveillance priorities for Article IV teams.

4. **Traction needs to be assessed in multiple dimensions.** Ideally, it would be important to assess the FSAP against its ability to foster mitigating systemic risk, but measuring systemic risk is difficult. It is also difficult to disentangle how changes in systemic risk are linked to the implementation of FSAP recommendations (as opposed to changes in other drivers of risk). Instead, traction is often measured in terms of the extent to which Fund policy advice corresponded to subsequent policy action. However, even this metric has its difficulties. For example, it may overstate traction to the extent that the advice may have simply validated actions that the authorities were already planning to take. In the absence of policy action, this metric could understate traction if the advice had been highly valued by the authorities and stimulated policy debate.

5. **Mindful of these issues, this paper builds on earlier assessments and takes a broad perspective on FSAP traction**. The paper addresses the following questions: were FSAPs successful in spurring policy actions; did FSAPs improve the awareness of financial stability issues among country authorities; were FSAP assessments well integrated into Article IV surveillance; has the FSAP been impactful in the broader "financial stability" community and financial sector work more

broadly? In doing so, it leverages surveys of key stakeholders, a review of relevant papers including Article IV staff reports, including some of the novel textual analysis conducted as background for the Comprehensive Surveillance Review (CSR).

6. This paper links to the CSR work on systemic risk and macroprudential policy advice in Article IV consultations. A key objective shared between the CSR and the FSAP Review is to further strengthen financial surveillance in Article IV consultations. The CSR offers specific proposals on how to better integrate FSAP analysis, findings, and policy recommendations into Article IV consultations. The CSR also proposes recommendations to strengthen macrofinancial analysis in Article IV surveillance more broadly, including by developing new tools, increasing relevant macrofinancial expertise, and seeking to further reduce knowledge and data gaps.

TRACTION WITH COUNTRY AUTHORITIES

7. The survey of country officials for this review conducted in 2019 provides a positive assessment of the FSAP's impact as an instrument of Fund surveillance (Figure 1).[1]

- ***Value added***: The most valued aspects of the FSAP are the independent assessment that it provides, its in-depth analysis, the clarity of the analysis, the detailed assessments of supervisory standards, and the policy relevance of the findings. The FSAP was relatively less valued for benchmarking against other countries and transferring knowledge about new analytical techniques, and its value for defining the technical assistance (TA) agenda was greater in countries with greater TA needs.

- ***Engagement***: More than 80 percent of country authorities report being satisfied or largely satisfied with their interactions with FSAP teams both during the scoping phase and during the missions. The remainder were evenly split between those who thought their engagement was too little and that the engagement was too much.

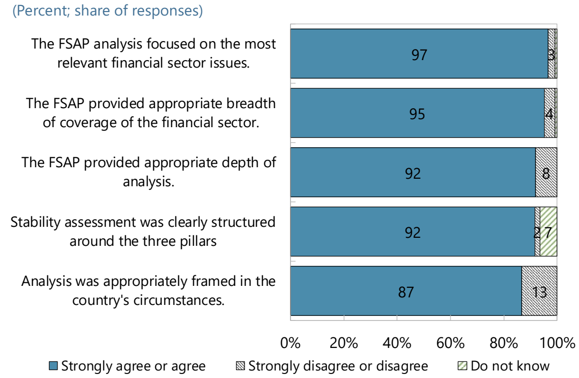
- ***Scope and focus***: The vast majority of respondents agreed or strongly agreed that FSAP assessment analyses were well structured, relevant, appropriate in both breadth and depth, and effectively took account of country circumstances. In the 2019 survey, a large majority viewed the resources devoted to the various components of FSAP assessments as appropriate, but 20–30 percent saw merit in increasing the resources on stress testing and assessments of financial sector policy frameworks and safety nets. The pandemic crisis has elevated authorities' interest in the FSAP across all three pillars. Over 60 percent of respondents to the 2020 follow-up survey suggested increasing the pillar 1 work, and 30–50 percent of respondents suggested increasing the work in pillars 2 and 3. 40 percent saw merit in increased resources for emerging issues (e.g., climate, fintech, and cyber) Some respondents, while finding the FSAP useful overall, expressed concerns about the burden for country officials (in terms of preparatory work and number of meetings) and encouraged efforts to streamline the work to the extent possible.

[1] For more detailed information, see the FSAP Review Background Paper on Survey Results.

Figure 1. The Value of the FSAP in IMF Country Surveillance

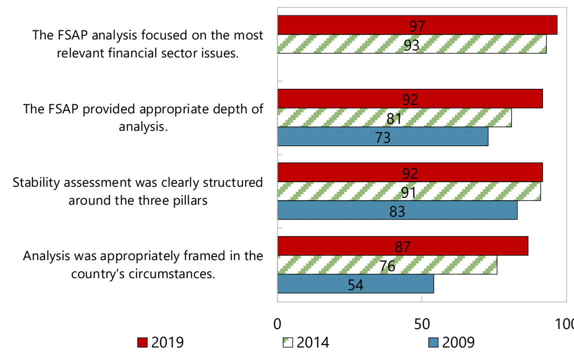
The FSAP provides valuable financial stability assessments…

Authorities' views on the scope of FSAP analysis
(Percent; share of responses)



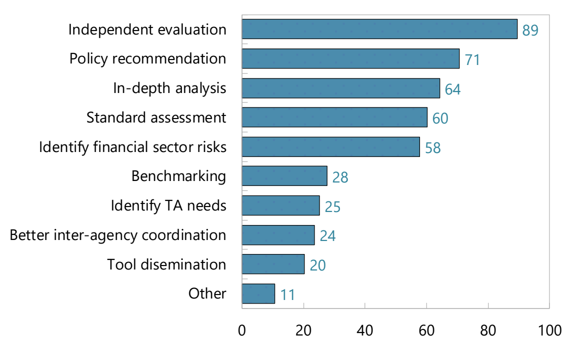
…and the authorities' approval of the FSAP has increased over time.

Comparison of the authorities' views overtime
(Approval rates: strongly agree and agree, percent)



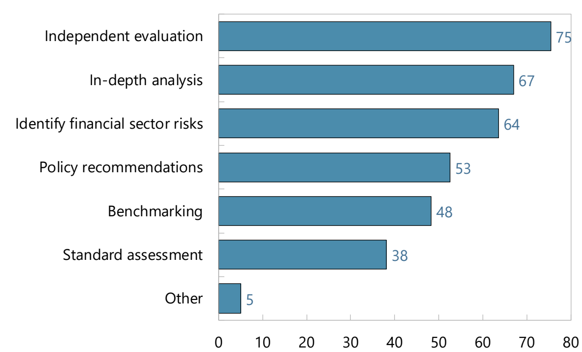
Authorities value FSAP highly for their own country…

Usefulness of the FSAP: own jurisdiction
(In percent of all responses, multiple answers, country authority)



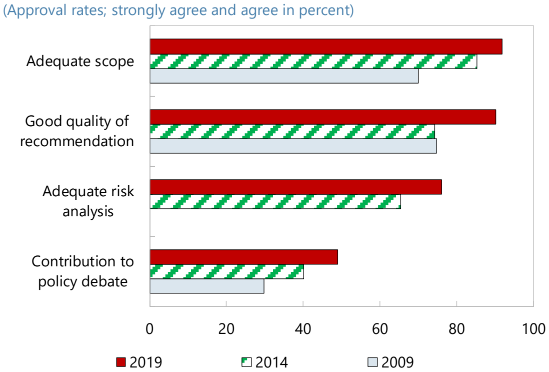
…as well as for other jurisdictions.

Usefulness of the FSAP: other jurisdictions
(In percent of all responses, multiple answers, country authority)



Country authorities value FSAP highly and increasingly more over time…

Country Authorities' Views on FSAP Over Time
(Approval rates; strongly agree and agree in percent)



…and more than other IMF products in the area of financial surveillance.

Authorities' views on the usefulness of the FSAP relative to other IMF surveillance activities

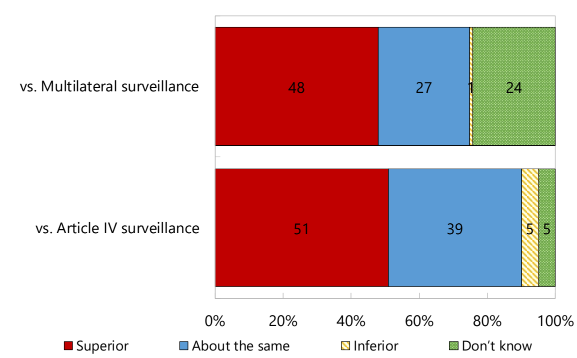


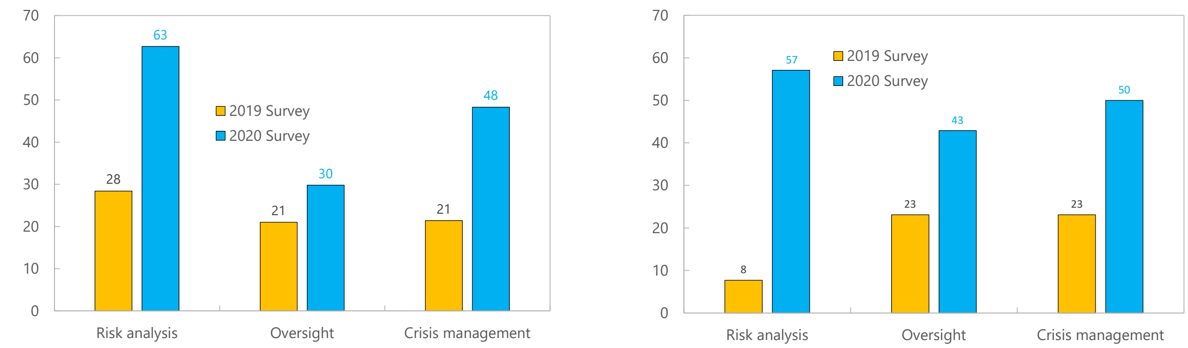
Figure 1. The Value of FSAP in IMF Country Surveillance (concluded)

In the context of the pandemic, authorities' support for FSAP work has increased across all pillars…

FSAP Prioritization: Country Authorities
(Share of "increase" resources in total respondents)

…with a similar trend for Executive Directors.

FSAP Prioritization: Executive Directors
(Share of "increase" resources in total respondents)



Sources: FSAP Review Surveys (2009, 2014, 2019, and 2020) and IMF staff calculation.

- ***Risk assessments***: The FSAP's stress testing of banks was also highly valued, although a minority of respondents cautioned that nonbank risk channels were less well covered. Issues related to interconnectedness, cyber risk, and fintech were frequently cited as examples where future assessments needed to devote more attention.

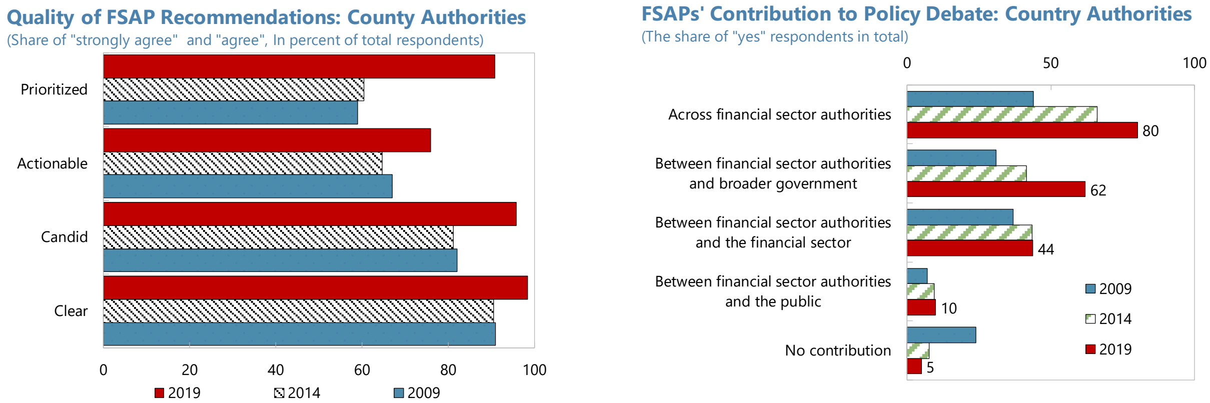
- ***Integration***: About 70 percent viewed the FSAP as adequately or well-integrated with the Article IV. However, some respondents questioned the depth of the analytical linkages between the FSAP's risk assessment and the Article IV's macroeconomic assessments and whether the Article IV team's expertise was sufficient to enable follow-up. Also, a large number of respondents agreed that there was a need to better ensure the macro-criticality of FSAP recommendations, deeper and longer participation of FSAP mission members in Article IV teams, and the development by FSAP teams of simplified analytical tools that could be used by Article IV teams.

8. The vast majority of respondents also viewed FSAP recommendations as clear, candid, well prioritized/sequenced, and actionable. Notably, country officials' views in each of these areas were significantly improved compared with the surveys conducted in 2009 and 2014 (Figure 2). Respondents also noted that the FSAP had played an important role in promoting a dialogue about financial sector risks and policies across agencies, with other parts of government, and with the private sector. Again, significant gains were seen regarding the FSAP's ability to promote dialogue among the regulatory agencies and with other parts of government, including legislators.

Figure 2. Quality of FSAP Recommendations and Policy Impact

The authorities' satisfaction with FSAP recommendations has improved over time…

… as well as the authorities' satisfaction with FSAP's contribution to policy debate.



Sources: FSAP Review survey and staff calculations.

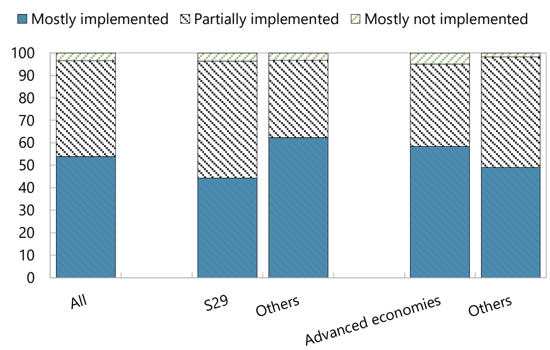
9. FSAP assessments appear to have made major contributions to the policy debate in the membership (Figures 2 and 3). Almost 95 percent of country respondents indicated that the FSAP recommendations had been partially or fully implemented. Assessments by subsequent FSAPs, however, indicate a somewhat lower implementation rate for non-S29 and non-advanced jurisdictions. With regard to the contribution of FSAPs to the policy debate, authorities' satisfaction has improved visibly over time, especially in the dimension of encouraging discussion among financial sector authorities, followed by a discussion between financial sector authorities and the broader government.

10. Respondents provided useful guidance on the factors that may have impeded a fuller implementation of FSAP recommendations. Besides the instances when the FSAP had been just recently completed, which limited the time available to implement changes, respondents also cited a lack of political support, technical disagreements with the recommendations, and capacity constraints. These latter factors suggest the possibility that traction could be enhanced by greater efforts by FSAP teams to explain the reasons why they make their recommendations—for example, by adding a section to the FSSA discussing the authorities' views, akin to the discussion in the Article IV Staff Report—and to actively engage in those cases where follow-up technical assistance may be helpful.

Figure 3. FSAP Recommendations

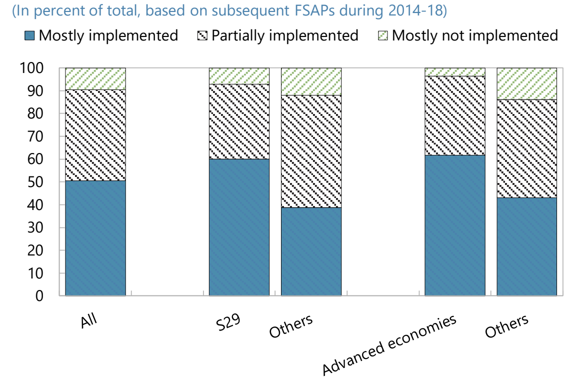
Country authorities consider almost all of the recommendations are mostly or partially implemented.

Status of Recommendations: Country Authorities
(In percent of total)



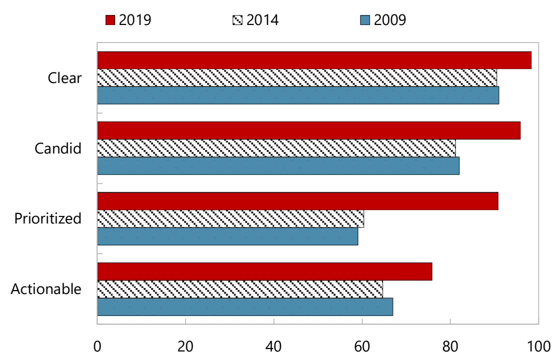
Subsequent FSAP teams reported slightly lower implementation rates among non-systemic jurisdictions…

Status of Recommendations: FSAP Teams
(In percent of total, based on subsequent FSAPs during 2014-18)



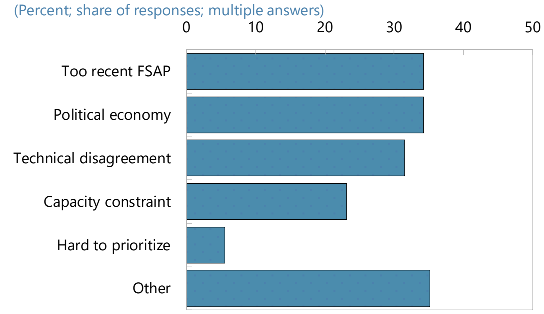
The authorities' satisfaction with FSAP recommendations has improved over time…

Country Authorities: Quality of Recommendations
(Approval rate: Strongly Agree + Agree)



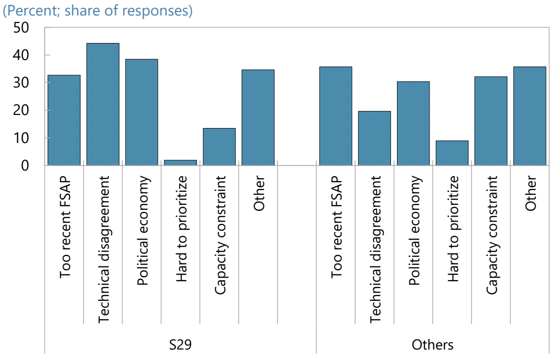
Political economy constraints and disagreements with Fund recommendations are main reasons for not implementing recommendations.

Reasons for Not Implementing Recommendations: All country authorities
(Percent; share of responses; multiple answers)



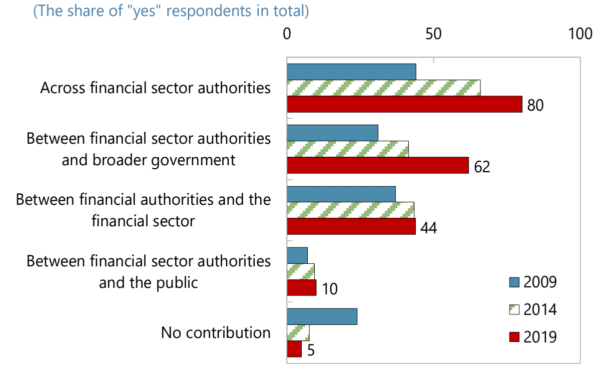
S29 jurisdictions considered technical disagreements to be the top reason, while others emphasized recent completion and capacity constraints.

Reasons for Not Implementing Recommendations: S29 vs Others
(Percent; share of responses)



The authorities' satisfaction with the contribution of FSAP's to the policy debate has improved over time, especially by encouraging discussion among financial sector authorities.

FSAPs' Contribution to Policy Debate: Country Authorities
(The share of "yes" respondents in total)



Sources: 2019 FSAP Review survey and staff calculations.
Note: The "status of recommendations" charts are based on the year of the previous FSAP, which is why they end in 2013.

11. The survey of the Fund's Executive Directors (EDs) also pointed to possible areas where the impact of FSAP's could be improved.

- ***Scope***: EDs generally agreed that the scope of FSAP assessments was appropriate in terms of its relevance and breadth, but some worried that scope was defined by the expertise available at the time of the mission and/or that there were no well-defined criteria for defining scope. EDs appeared to be interested in expanding coverage of issues related to interconnectedness, vulnerabilities in the nonbank sector (including market-based finance and the corporate and household sectors), fintech, and cyber risks. In the context of the pandemic, EDs' interest in bank stress tests, risk analysis of the household and corporate sectors, and macro-financial feedback effects have risen compared to the 2019 Survey, similar to the responses from national authorities.

- ***Traction***: Nearly 80 percent of respondents suggested that FSAPs warranted more attention at the IMF's Board, and suggestions for achieving this goal included separate Board discussions of assessments (e.g., stand-alone FSAP Board meeting slightly ahead of the Article IV Board discussion for the jurisdictions with systemically important financial sectors (SIFSs) or subgroup of SIFS),[2] or greater attention to the FSAP in Article IV staff reports (including by relaxing word limits) or by providing more time for discussion of the FSAP assessment during Board meetings.

- ***Integration***: About one-half of EDs felt that FSAP assessments are weakly integrated into the Article IV process. Reasons cited included lack of follow-ups in subsequent years—e.g., pro forma reference to past FSAP recommendations rather than a more current assessment of risks, and weak integration between FSAP and Article IV teams. Suggestions for improvement included better prioritization of recommendations, the use of simplified analytical tools for assessing financial risks that could be passed on to Article IV teams (consistent also with the need for further dissemination of FSAP tools identified in Figure 1 panel 3), better integration with the World Bank on developmental issues, and enabling the participation of FSAP mission members in Article IV missions in subsequent years.

- ***Resources***: Over 60 percent of EDs felt that the resources devoted to the FSAP were insufficient to enable a broader country coverage, with some EDs specifically suggesting that the overall envelope for assessments should be increased. Others however suggested that the program could be made more efficient, including by scaling back FSAP stress testing and coverage of development issues, and by better coordination ahead of missions to prioritize FSAP topic coverage.

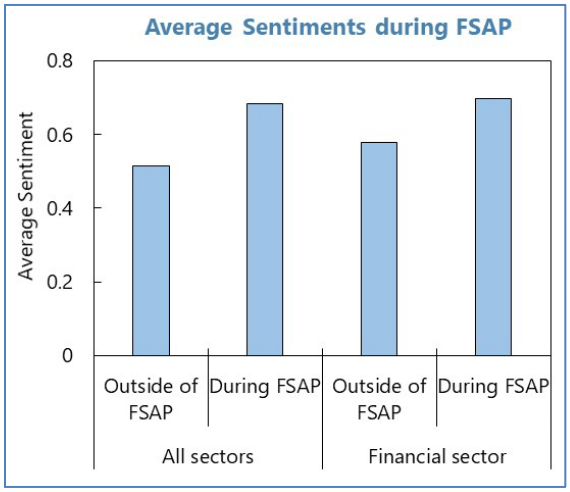
12. These results are consistent with those from the CSR survey (Figure 4). In particular, the CSR found that among country authorities, 80 percent reported that IMF financial sector recommendations influenced national policy formulation or debate "to a great extent or to some

[2] Under staff proposals to expand the list of jurisdictions with SIFS from current 29 to 47 with two differentiated frequencies, one could consider having stand-alone FSAP discussions for all 47 jurisdictions or the 32 jurisdictions that would participate in the FSAP at the 5-year frequency.

extent," which was more than for other policy categories (fiscal, structural, monetary, exchange rate, and capital flows). The CSR's sentiment analysis of authorities' views in Article IV staff reports using deep learning techniques also found that authorities' sentiment was higher when countries undergo FSAPs.

Figure 4. National Authorities' Views on Article IV Staff Reports

Authorities tend to have a positive view on Article IV analysis and policy recommendations on financial sector issues as well as broader policy areas in the year when an FSAP is concluded.



Source: CSR
Note: "Outside of FSAP" indicates Article IV staff report for the years without FSAP and "during FSAP" indicates staff report in the year concluding FSAP.

13. These results are also broadly in line with the evaluation of IMF financial surveillance by the Independent Evaluation Office (IEO). The background paper for the report by Caprio (2018) suggests that since financial stability analysis among the advanced economies was already at a high level, the value-added of the FSAP is mainly: "(i) the opportunity to exchange views with a trusted advisor and to explore lessons from the latest stress tests in other countries, and/or evidence of cross-border risks that the IMF believes; (ii) to warn against "regulatory backsliding" after the Global Financial Crisis; and (iii) to encourage needed communications and cooperation across regulatory and other agencies."[3] The IEO's case studies also suggested that while the value attached to the FSAP stability analysis by some EMs may also have diminished in recent years owing to their increased sophistication, the FSAP's impact had still been significant. For example, the China FSAPs of 2011 and 2017 appear to have provided "critical input into [the authorities'] deliberation and decision-making," and the Nigeria FSAP was also "influential in strengthening the regulatory environment."[4] Additionally, the IEO's survey of Executive Directors suggested that most of those

[3] Monasterski (2018) confirms this view based on a survey of IMF EDs, which showed that the majority of those representing advanced economies were less interested in FSAP analyses and valued more its role as a "sounding board for authorities, as a catalyst for measures to address domestic vulnerabilities, and as a mechanism for informing the international community of compliance with standards and codes." The staff surveyed by the IEO also viewed FSAPs as more influential among emerging markets and low-income countries.

[4] Caprio (2018), ⁋38.

representing emerging markets and low-income countries "believed that FSAPs helped authorities identify risks and vulnerabilities and served as a catalyst for reform."

14. A specific improvement to increase traction with country authorities would be for the FSSA to explicitly reflect the authorities' views. Including a staff-drafted summary of authorities' views in a special section in the FSSA as conveyed by the authorities, akin to the approach in Article IV Staff Reports, could improve the authorities' ownership of the FSAP recommendations and clarify the factors that may impede implementation.

INTEGRATION WITH ARTICLE IV SURVEILLANCE

15. The significance of the FSAP grew noticeably with the expansion of its role in Article IV surveillance for SIFS in 2010. Previously, assessments were entirely voluntary and were seldom conducted in advanced economies. However, in recognition that the Global Financial Crisis was triggered by major shortcomings in the oversight of the U.S. and European financial sectors, FSAP assessments were made a mandatory part of Fund surveillance for members with systemically important financial sectors (SIFS, IMF, 2010). As a result, assessments were required every five years for 25 jurisdictions deemed to meet this criterion, and in 2013 the list of jurisdictions with systemically important financial sectors was expanded to 29 (the so-called "S29").

16. The prominence of the FSAP was further enhanced by the 2010 commitment by the members of the Financial Stability Board (FSB) to undergo assessments periodically.[5] The FSB established a framework for "leading by example" in 2010 that includes a commitment that its members undergo FSAP assessments every five years and disclose the results of these assessments (FSB, 2010). Members' adherence to this commitment is monitored by the FSB's Standing Committee on Standards Implementation (SCSI).

17. These decisions contributed to efforts to mainstream macrofinancial surveillance in Article IV consultations, including by closer integration of FSAP assessments. The 2014 Triennial Surveillance Review (TSR) proposed to mainstream macrofinancial surveillance through better tools and new practices, as well as a shift in the skill profile of Fund economists. It also clarified the respective roles of the annual Article IV consultation and the lower frequency FSAP assessments in monitoring and assessing financial stability. And internal guidelines were established to ensure effective integration of the two workstreams. For example, Article IV and FSAP missions are required to be timed within two months of each other; area department staff (typically the desk economist) is expected to participate in the FSAP mission, and FSAP mission chiefs attend the concluding meetings for the Article IV mission. Coordination is also supported by the requirement that FSAP teams prepare an FSAP Approach and Staffing Note ahead of the scoping discussion with national authorities and Financial Stability Policy Note in advance of missions, in consultation with country teams and departments. In particular, the Policy Note is used to ensure agreement with area

[5] The 24 jurisdictions that are FSB members--Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, United Kingdom, United States—closely but not fully overlap with the S29 jurisdictions.

department counterparts (and other departments) on how financial stability and macroeconomic risks intersect and the FSAP mission's objectives. These notes and the FSSA are also required to review past Article IV recommendations on financial sector issues, ensuring that FSAPs incorporate analysis and policy recommendations of Article IV surveillance.

18. Article IV consultations generally incorporate FSAP recommendations. The results of the Board discussion of the FSAP assessments are usually incorporated into the press release for that year's Article IV, and—subject to the concurrence of the authorities—a press release is often issued at the conclusion of the FSAP mission. And typically, the concluding statement of the Article IV mission will contain substantive references to the FSAP mission's conclusions. For example, the June 2019 concluding statement for the Article IV consultation discussions with Romania made mention of the progress made in addressing the previous year's FSAP assessment, and the June 2019 concluding statement for the U.S. Article IV referred to the forthcoming FSAP. In those cases where Article IV consultations conclude with a press conference, staff will often also refer to the accompanying FSAP assessment (e.g., the May 2018 press conference that concluded the China Article IV).

19. However, the manner in which Article IV teams have followed up on FSAP recommendations has varied, falling along the following spectrum:

- ***Selective emphases***: At a minimum, Article IV reports will reference the previous FSAP assessment and anchor their advice on financial sector issues on the key FSAP recommendations. But typically, this will not involve a detailed, recommendation-by-recommendation review but a focus on a selected and smaller number of issues. For example, the 2018 Article IV report for India contained a general encouragement to follow up on the 2017 FSAP recommendations and focused specifically on the legal and regulatory framework covering public sector banks.

- ***Detailed review based on self-reporting***: Most Article IV teams request from the authorities detailed information on the status of FSAP recommendations and include this information and commentary in the Article IV report. For example, the 2017 Article IV report for Germany contained a detailed appendix on the authorities' response to the 2016 FSAP recommendations, which was also repeated in 2018, and this was also done in the 2019 Article IV report for Brazil. The current expected practice is for Article IV Staff Reports after FSAP to includes FSAP recommendations and their implementation status as self-reported by national authorities.

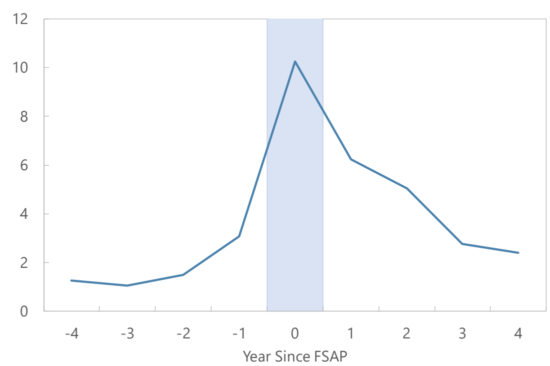
Figure 5. FSAP References in Article IV and Program Documents

References to FSAPs in country papers drop sharply the year after the FSAP but remain higher than pre-FSAP in the following couple of years.

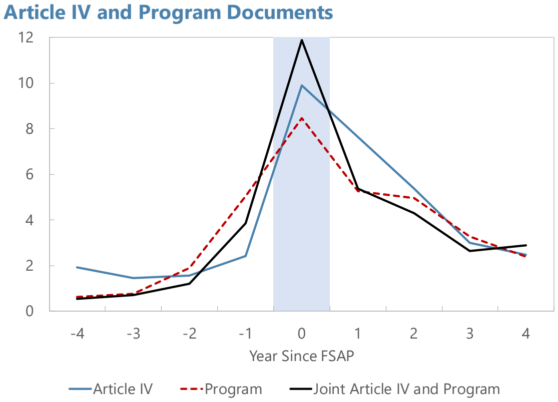
References to FSAPs are higher and more persistent in surveillance cases than in programs.

(Average number of references to FSAP by year since FSAP)

Article IV and Program Documents: Combined



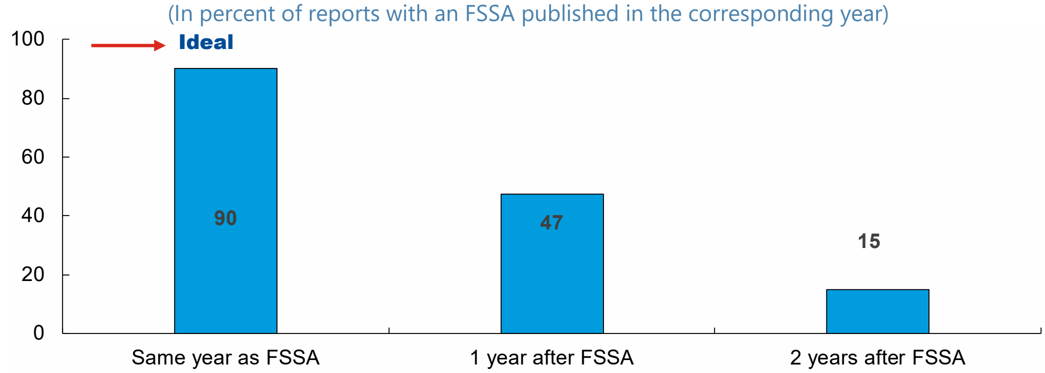
Article IV and Program Documents



Among Article IV staff reports, reference to FSAP stress tests in the context of systemic risk assessment also drops sharply by the second year since FSAPs, though staff reports refer to national authorities' test results as they may be more recent.

Staff Reports Discussing Conclusions from FSAP Stress Tests

(In percent of reports with an FSSA published in the corresponding year)



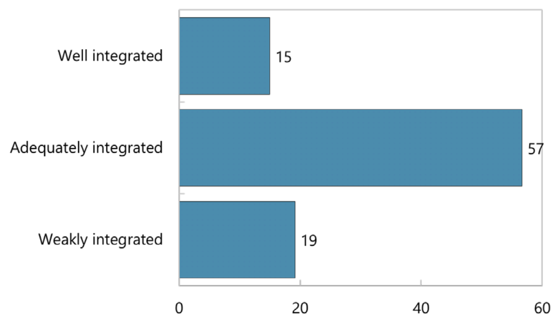
Source: IMF country reports and authors' calculation, and the CSR background work on "Systemic Risk and Macroprudential Policy Advice in Article IV Consultations."

20. **Also, the integration of FSAP findings into Article IV surveillance is high in the year of the FSAP but tails off gradually thereafter.** The top two panels in Figure 5 show the average number of references to the country-specific FSAPs per Article IV report during 1999–2018. They illustrate that the number of references to FSAPs in Article IV documents increases sizably in the year of the FSAP but then tails off sharply the next year many cases, albeit remaining higher than pre-FSAP for the next several years. It is also clear that FSAP integration on this measure is higher in pure surveillance cases than in programs. Moreover, as noted in the CSR, the frequency and clarity of systemic risk assessments in Article IV reports are also strongly temporally correlated with the FSAP. One possible contributing factor is the short shelf life of quantitative risk assessment, as balance sheet structures and macroeconomic conditions could change significantly in a year.

Figure 6. Integration with Article IV: Stakeholders' Views

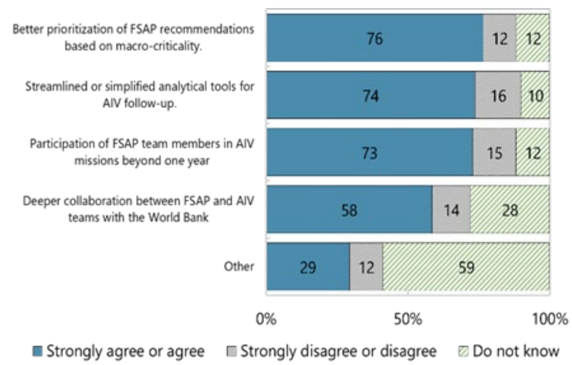
Country authorities mostly viewed FSAP to be adequately or well-integrated with Article IV…

Authorities' views on FSAP integration with Article IV
(Percent; share of responses)



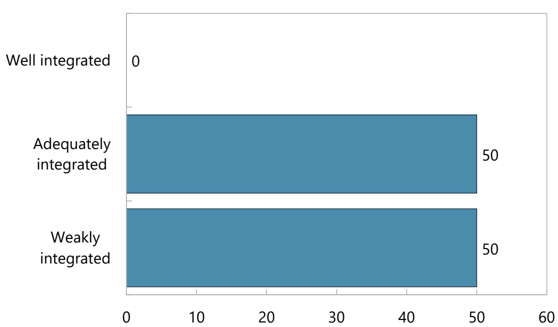
…but they generally saw scope for better integration in terms of recommendations, tools, and cross-participation

Authorities' views on improving FSAP-AIV integration
(Percent; share of responses)



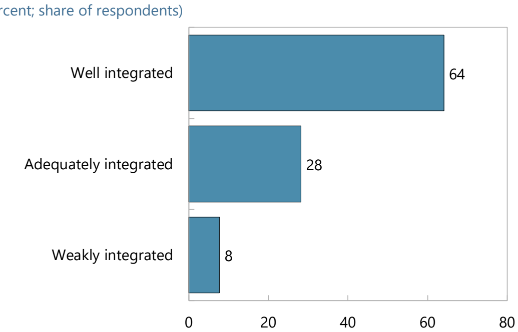
However, half of Executive Directors thought integration was weak…

Executive Directors' views on FSAP integration with Article IV (Percent; share of responses)



…in contrast with high levels of satisfaction among Article IV mission chiefs and reviewers.

Article IV mission chief and SPR reviewers' views on FSAP integration with Article IV
(Percent; share of respondents)



Sources: 2019 FSAP Review survey and staff calculations.

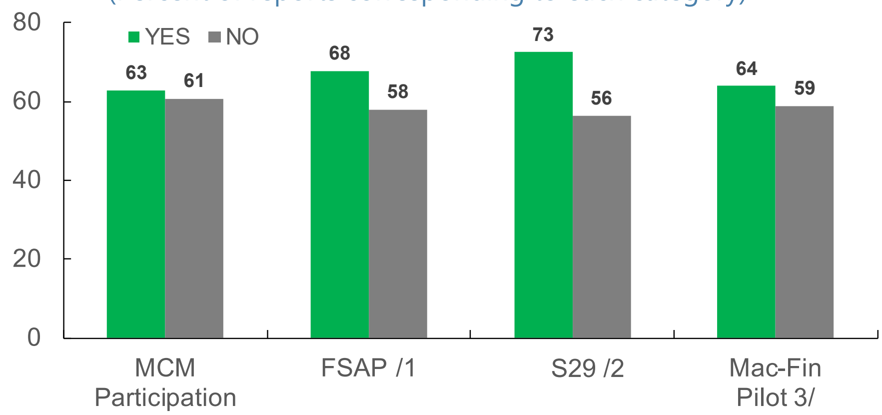
21. The survey conducted for this review suggested differing degrees of satisfaction among stakeholders regarding the depth of FSAP/Article IV integration (Figure 6). Two-thirds of the national authorities stated that the FSAP was "well" integrated. This reflected favorable views about the coordination between the Article IV and FSAP teams, including with regard to sharing of information and coordination of policy positions and the value and clarity of the FSAPs' in-depth assessment of financial sector policies and risks. Also, over 90 percent of Article IV mission chiefs and SPR respondents consider integration to be adequate. However, only one-half of ED respondents saw integration as adequate. While all responding Article IV mission chiefs and SPR reviewers rated their financial sector knowledge as "comfortable" or "strong," some national authorities expressed mixed views regarding whether Article IV teams had sufficient expertise to enable adequate follow-up. Linked to this, staff analysis in the CSR finds systemic risk analysis in Article IV is limited to the discussion of Financial Soundness Indicators (FSIs) in one-third of advanced economies and two-thirds of emerging market and developing economies Article IVs respectively.[6]

22. The IEO's evaluation also suggested that FSAP-Article IV integration was strong but needed to go further. In particular, a large majority of Executive Directors representing countries with recent FSAPs felt that the assessment had played an important role in the most recent Article IV consultation (Monasterski, 2018, para. 19). But Caprio (2018) notes that, while the quality of financial sector analysis of the FSAP was viewed as superior to that of the Article IV, their low frequency makes them less well-suited to identifying fast-changing risks. He suggested, therefore, that the FSAP's impact could be enhanced by continuous offsite analysis, greater selectivity of the topical focus of FSAPs, and improving the financial sector knowledge of Article IV teams.

23. Moreover, staff analysis suggests better integration can indeed improve the financial surveillance in Article IV. One of the CSR background papers found that recent FSAP is associated with both stronger systemic risk analysis and a better link of this to macroprudential policy advice. Figure 7 illustrates factors supporting systemic risk assessments and their deeper integration into macroprudential policy formulation in Article IV reports. Among other factors, recent FSAPs help Article IV reports substantiating their macroprudential policy with well-articulated views about systemic risk.

Figure 7. Macroprudential Policy Advice Linked to a Well-Articulated View about Systemic Risk, 2014–19

(Percent of reports corresponding to each category)



Source: CSR Background paper "Systemic Risk and Macroprudential Policy Advice in Article IV."
1/ Whether a FSAP took place in the previous three years.
2/ Jurisdictions with systemically important financial systems, subject to mandatory financial stability assessments.
3/ 2015–16 Macrofinancial pilot.

[6] While FSIs are useful, they typically focus on the banking system with a few indicators for the corporate and household sector indebtedness (in some, but not all, jurisdictions). They do not capture vulnerabilities in the nonbank financial sector. Moreover, since the indicators are based on aggregated national-level data, they are not substitutes for stress testing and other risk analysis tools using more granular, firm-by-firm information with additional indicators.

24. The FSAP Review Survey also pointed to areas for possible improvements. All stakeholders pointed to the need for more effective follow-up on FSAP recommendations, better prioritizing FSAP recommendations, and the development of simplified FSAP analytical tools that could be passed on to Article IV teams. Article IV mission chiefs pointed to closer coordination with the World Bank on macro-critical developmental issues, and a quarter of respondents expressed concern about FSAP coverage of housing markets and household and corporate balance sheet risks. National authorities and Executive Directors additionally consider that deeper and longer participation of FSAP mission members in Article IV enhances the quality of financial surveillance in Article IV.

25. Overall, a number of options arise to better leverage the FSAP to strengthen financial surveillance in Article IVs. Some actions are already in progress (Box). While the availability of these tools should help integration, this also calls for increasing capacity in area department teams to implement these methodologies.

Box 1. Simplified Financial Risk Assessment Tools

Staff have recently developed simplified financial stability risk analysis tools using publicly available data that Article IV teams can use without needing access to confidential supervisory data. These include:

- ***Global Bank Stress Test (GST),*** first published in the October 2020 Global Financial Stability Report (GFSR), produces macro scenario-driven stress test results using publicly available financial statements of individual banks for about 30 jurisdictions. MCM has converted this into an excel-based tool for Article IV teams with a corresponding user manual and has carried out in-reach with area departments and MCM economists who support Article IV teams.

- ***Universal Bank Stress Test (UST):*** MCM is currently seeking to develop a simplified version of the GST, extended to a larger sample of emerging and developing economies using aggregate data at the country level from the IMF's FSI database for about 110 jurisdictions.

- ***Nonfinancial corporate stress testing tool***: Given the heightened risks from nonfinancial corporations (NFCs) as a result of COVID, a stress testing tool for NFCs that emphasize the link to bank stress tests is also underway.

- **Systemwide FX liquidity stress testing tool** examines spillovers of external FX liquidity shocks across domestic economic sectors and eventually on international reserves of the central bank, and that has also been published as a part of the COVID-19 note series.

- ***Develop simplified analytical tools***: Given that FSAPs take place only infrequently, it is essential for Article IV teams to strengthen their financial surveillance/systemic risk assessment skills to deepen annual risk assessments. MCM is making significant progress in developing and disseminating simplified analytical tools to support financial stability risk analysis by Article IV teams (Box 1). Until these tools are fully integrated as standard toolkits for Article IV surveillance, additional technical support from MCM may be needed in the context of the department's enhanced support for country teams.

- ***Increase cross-mission participation***: FSAP mission chiefs already join the Article IV mission in the year of the FSAP. Participation by Article IV mission chiefs in the FSAP and cross-participation in subsequent years could further support integration. But this would require additional resources.

- ***New process for early engagement in the review of Article IV***: The CSR proposes that the FSAP team be more closely involved in the early stages of the Article IV policy note review process.

LINKS WITH MULTILATERAL SURVEILLANCE

26. There are opportunities for cross-fertilization between the FSAP and the Fund's multilateral surveillance. The GFSR contains an extensive analysis of international financial markets, with an emphasis on the financial stability of the systemic financial sectors. FSAPs focus on financial stability of a specific jurisdiction, and the GFSR is the Fund's flagship communicating views on global financial stability. Both exercises focus on financial sector risks and vulnerabilities, and therefore, the tools used and the data compiled by the GFSR can be relevant for FSAPs and vice versa. Moreover, GFSR's views on key risks could be helpful to identify areas for deeper analysis and designing the scope of FSAPs, together with the Global Risk Assessment Matrix. At the same time, the FSAP's in-depth assessment of financial stability and institutional frameworks, including for jurisdictions with systemically important financial sectors, could provide relevant information for a multilateral view of financial stability.

27. This cross-fertilization has become more common since the 2014 FSAP Review, with the FSAP and the GFSR informing each other on key policy and analytical topics. On the surface, only 6 of the 12 GFSR publications since the 2014 FSAP review have made explicit references to the FSAP, with some of these references being relatively brief.[7] However, simply examining text references in the published reports would understate the deepening inter-relation between the FSAP and the GFSR. Some examples of this include:

- FSAPs use the GFSR as a starting point in their risk analysis, including in the context of the FSAP Risk Assessment Matrix. Examples include the 2015 United States FSAP, in which the technical note on stress testing explicitly used GFSR approaches to assessing mutual fund liquidity, and the FSSA for the 2018 euro area FSAP, which used the Growth-at-Risk framework and referred to estimates of the too-important-to-fail subsidy derived from the GFSR.

- The October 2018 GFSR contained a major chapter on regulatory reform after the Global Financial Crisis, which made extensive use of FSAP analysis.

- The 2019 France FSAP followed up on the issue of banks' U.S. dollar funding that the April 2019 GFSR highlighted.

[7] For example, at the press release of the April 2019 GFSR, staff noted that "the level of nonperforming loans in India remains high. And the level of the capitalization of some banks, particularly government-owned banks, should be bolstered. This is also one of the recommendations of the India FSAP."

- The corporate vulnerability analysis of the 2019 France FSAP was followed up in the 2019 October GFSR. The GFSR also included detailed discussion of U.S. dollar funding fragilities based on FSAP's findings. The April 2020 GFSR chapter on physical risks related to climate change includes a box drawing lessons from FSAP's climate stress tests

28. Another dimension of the strengthening integration of the GFSR and FSAP is analytical tools, including the Growth-at-Risk (GaR) framework and the GST. For example, the 2019 Canada FSAP employed GaR as a tool to frame the analysis of macrofinancial vulnerabilities and in the calibration of the severity of adverse scenarios for risk analysis. The granular, detailed analysis in the FSAP goes beyond the reduced-form framework of the GaR (see the background paper on quantitative tools). Still the GaR offers a useful common analytical ground, more explicitly connecting the GFSR and FSAP at the analytical level. The GST has been featured extensively in the Fall 2020 GFSR. While the GST's primary objective is to enrich FSAP risk analysis and financial surveillance in Article IVs, the stress testing teams worked with the GFSR team to deepen analysis and views on the potential impact of the COVID-19 on financial stability.

29. There are, however, practical limits to the integration of the FSAP and the GFSR. One relates to the different timing: FSAPs for an individual country take place at most once in 5 years, while the GFSR is issued twice per year, and as such, tends to have a higher-frequency focus. Another relates to the nature of the assessments: FSAPs rely on insights from granular, country-specific, confidential, supervisory data, while the GFSR relies largely on publicly available data at the global level.

STANDARD SETTING BODIES

30. From its inception, the FSAP has featured strong linkages with the work of international standard-setting bodies (SSBs). This reflects the fact that the FSAP assessments of financial regulation, supervision, safety net, and resolution of financial institutions rely upon the framework set out by internationally accepted standards and codes that have been set by the SSBs.[8] The IMF and World Bank staff participate in many of these bodies and help ensure that SSB guidance reflects the needs of the broader membership and types of financial systems and that the standards and codes are assessable in the context of a typical FSAP mission wherever required.

31. The engagement with the SSBs is viewed as being constructive and collaborative. Supervisory standards have increased in number and have become much more complex, especially after the Global Financial Crisis, which has raised the burden (both for FSAP teams and the country

[8]The Basel Committee for Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO), the Committee on Payments and Market Infrastructures (CPMI), the Financial Stability Board (FSB), and the International Association of Deposit Insurers (IADI) each issue standards that express the international community's expectations for financial sector oversight and financial safety nets. The Financial Action Task Force (FATF) sets standards for financial integrity, i.e., Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT). In addition, both the World Bank and the IMF also participate in discussions on financial stability risks from climate change in the central bank Network of Greening Financial Systems (NGFS) and disclosure requirements on the exposures to climate change risks in the Task Force on Climate-Related Financial Disclosures (TCFD).

being assessed) of a full assessment covering all aspects. Partly in response, Fund staff reached understandings with the SSBs responsible for the banking, insurance, and securities markets standards on a flexible approach that allows for either a graded assessment of the full suite of principles or a more focused (and qualitative) examination of identified key areas that draw on a subset of the principles.[9]

32. Important linkages between the FSAP and the Financial Stability Board (FSB) were established as part of the G20 response to the Global Financial Crisis. In particular, FSB members have committed to adhere to international financial standards, as well as to undertake FSAP evaluations and publish their findings ('lead by example"). To help ensure implementation of international standards by FSB members, the FSB has established the SCSI, which "is responsible for monitoring the implementation of agreed FSB policy initiatives and international standards." Monitoring is performed in the context of the SCSI's peer review process, established partly to enable the FSB to assess its members' efforts to address FSAP recommendations on "financial regulation and supervision as well as on institutional and market infrastructure." The SCSI has also adopted an offsite self-reporting exercise—a 'Network'-to monitor implementation.

33. Coordination between the Fund and the FSB has become more effective since the last FSAP Review. Besides the linkage between the FSAP and the FSB's peer reviews, the Fund staff has worked closely with the FSB on policy issues, including inputs for the G20. The IMF is a formal member of the FSB and is represented by the IMF Financial Counsellor at the FSB plenary and steering committee, with representation by senior staff in other committees. For its country peer reviews, the FSB closely coordinates with Fund staff prior to its reviews on schedule and coverage. The IMF Article IVs and FSAPs have benefited from the findings of these reviews as well as the FSB thematic peer reviews.

34. The role of FSB peer reviews in monitoring the implementation of FSAP recommendations could be strengthened. This has diminished (e.g., after 2016, peer review reports made no mention of FSAP recommendations), even though the FSB's handbook for peer reviews still places a strong emphasis on FSAP follow-up. Indeed, a recent FSB "lessons" paper noted that synergies could be enhanced by deeper coordination between FSB peer review teams and Bank/Fund staff, possibly even by including FSAP team members on peer review teams (a recommendation that would need to be carefully considered given its implications for IMF resources). Moreover, greater efforts to ensure that peer reviews are scheduled mid-way between FSAP assessments could enhance their role in encouraging the adoption of FSAP recommendations.

THE FSAP AND TECHNICAL ASSISTANCE

35. The FSAP was originally intended to provide a platform for designing subsequent TAs. This linkage between the FSAP and TA reflected the fact that the vast majority of assessments in the first decade of the Program were of emerging market and developing economies, where capacity development needs were viewed as more significant. As a result, at the time of the Program's

[9] For more details of the understandings reached, see IMF (2017). Also, see the background paper on scope.

launch, the Fund and the Bank were charged explicitly with using FSAP assessments as a basis for establishing medium-term TA strategies that could be followed up not just by the two institutions but by other donors, multilaterals, or the countries themselves. And indeed, the 2005 Review of the FSAP illustrated this point by demonstrating that TA by both the Fund and the Bank rose significantly after assessments, especially in the context of World Bank Country Assistance Strategies (IMF and WB, 2005).

36. As a consequence, there have been important linkages between the FSAP and Fund TA. IMF TA is "demand-driven," so post-FSAP TA requires both interest on the part of the assessed country and capacity on the part of the Fund to deliver. Internal IMF prioritization processes give weight to addressing gaps identified by FSAP assessments. Recent examples of TA delivered as FSAP follow-up include the Democratic Republic of the Congo, Jamaica, Mauritania, and Moldova. In many cases, this follow-up is triggered by the needs of an IMF program since the FSAP provides a useful framework for defining the reforms needed to restore and maintain financial stability. Assessments of G20 countries have also sometimes triggered requests for follow-up training and technical collaborations, including and Russia, China, and Switzerland.

37. The FSAP's role in designing TA should be maintained. In some cases, the relationship between FSAP and TA has been dynamic. Some country authorities request TAs to improve the financial stability framework in anticipation of forthcoming FSAP. More broadly, the FSAP's key recommendations, prioritized according to their macro-critically, can help to prioritize multiple TA requests and the scope of each TA. In countries with Fund-supported programs, where TA is usually tied to structural benchmarks and FSAP recommendations, an FSAP provides a comprehensive approach to recommendations, including a roadmap for sequencing policy reforms. On a few occasions, MCM has received requests from advanced economies to provide more details of the innovative analyses conducted by the FSAP team. In those cases, MCM has been providing support in the form of small conferences or workshops rather than a TA.

OTHER FORMS OF TRACTION

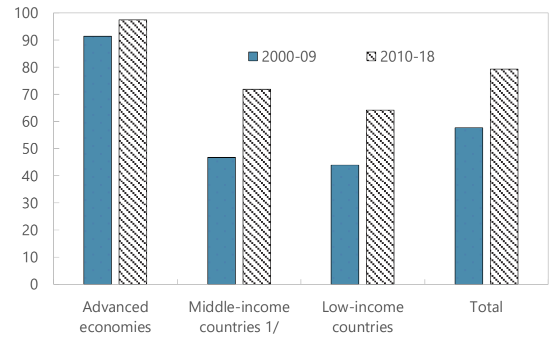
38. There are inherent and long-standing tensions with regard to promoting public recognition of the results of individual FSAP assessments. The critical importance of the confidentiality of supervisory data limits the extent to which results can be publicized. Moreover, any judgment regarding the financial stability of a country's financial system will be market sensitive, especially since assessments usually involve analysis of the soundness of individual, systemically important banks and other institutions. The fact that the details of these analyses are confidential also limits the traction that FSAP technical work may have in academic or public policy circles.

39. Despite these issues, FSAP assessments have a high publication rate. Just over 80 percent of the summary FSAP assessments—the FSSAs— were published since financial year 2010, and publication rates have climbed for advanced, emerging market, and low-income countries (Figure 8). This reflects the effects of a 2009 change in Fund policies that "presumed" publication of assessments, as is the case for Article IV staff reports, rather than leaving it wholly voluntary. Publication rates also rose with the 2009 establishment of the Financial Stability Board, which requires that its members undergo regular FSAP assessments and publish the results. Publication rates for technical documents—Technical Notes (TNs) and Detailed Assessment Reports (DARs)—are much lower than those for FSSA, partly because their publication is fully voluntary. But they, too, have risen in the second half of the 2010s.

Figure 8. FSAP Documents' Publication Rates

The publication rate for the summary report—FSSA—rose across all income groups since 2009.

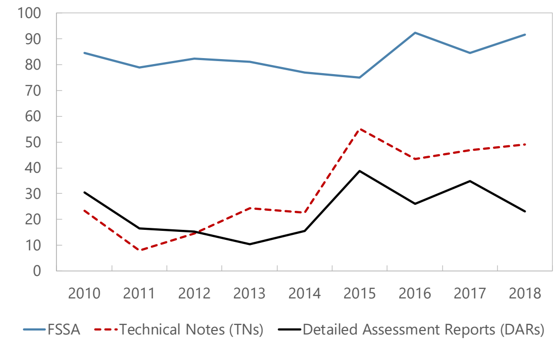
FSSA Publication Rate by Income Group
(In percent, period total)



1/ Including high-income countries that are not advanced economy.

Publication rate has risen in the second half of the 2010s, especially for technical notes.

FSAP Technical Documents Publication Trends
(Percent; share in total)



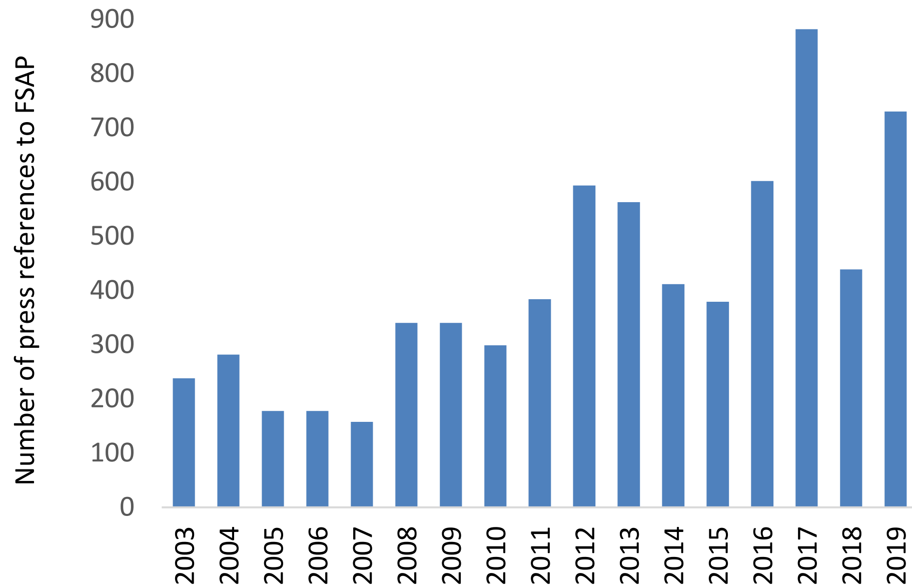
Sources: IMF Tracking System Database; and authors' calculations.
A Detailed Assessment Report (DAR) is drafted when an FSAP conducts a formal, rated assessment of the compliance with international standards (such as Basel Core Principles for bank regulations). Since the 2014 FSAP Review, in countries where compliance with updated financial sector standards has been established in previous FSAPs, assessments under the FSAP have shifted away from comprehensive DARs to more focused Technical Notes (TNs). As a result, the number of DARs per FSAP has declined while the number of TNs has increased (see the Main Report).

40. The FSAP is having a visible effect on central banks' financial stability work, both published and confidential. A survey of financial stability reports (FSRs) published by central banks suggests that 75 percent of central bank FSRs published within the year of the FSAP contained specific references to findings or recommendations of the FSAP. This is only the public representation of the FSAP's impact, with even more traction indicated in confidential feedback from central banks. Indeed, the results of the stakeholder survey carried out for this FSAP review indicate that even among those central banks that did not publish an FSR and those that published it without references to FSAP, 90 percent worked to implement FSAP recommendations.

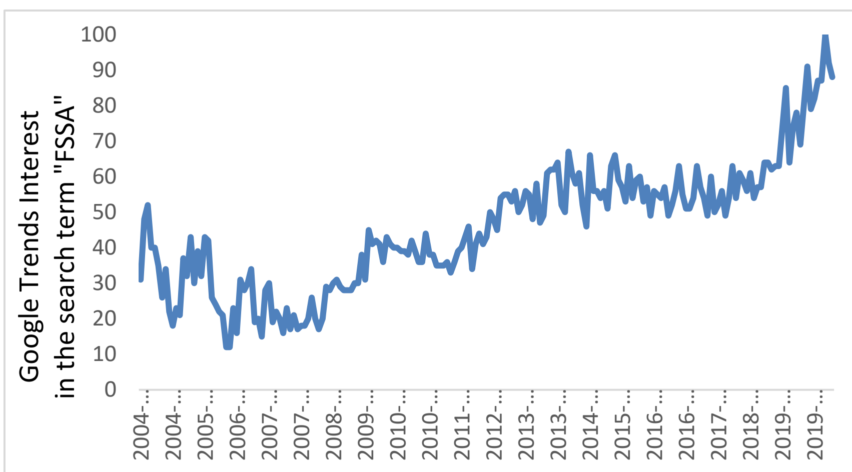
41. Experience with the audience for FSAPs beyond the official sector has so far been more mixed. For example, Caprio (2018) concludes that there is limited awareness of FSAP documents for the advanced S29 countries among market participants. However, for the emerging market economies, FSAPs are more "highly regarded as a source of information," citing the examples of the China FSAP as having provided "critical for data and useful for analysis," and the Malaysia FSAP as having been well regarded by market participants. Nonetheless, in neither group of countries did there appear to be much interest by the academic community (as noted above, this may reflect the confidentiality of the technical analysis, given their focus on institution-specific data and risk).

Figure 9. Public Attention to FSAP

Even though not the FSAP's objective, press references have been increasing over the years …



… as have been the degree of public interest in internet searches



Sources: Wall Street Journal-Factiva, Google Trends, IMF, and authors' calculations.

42. **Nonetheless, public attention to FSAP assessments has been on an increasing trend (Figure 9).** The number of press references to FSAPs has steadily grown, as has the frequency of internet searches for FSAP-related terms. There is considerable year-to-year variation, which largely reflects the rhythm of the FSAP assessments for G20 members. For example, the spike in press references in 2017 was largely owing to the publication of the assessments for China and Spain. The number of press references and Google searches is closely mirrored by other metrics, such as the number of downloads of FSAP documents from the IMF's website.

43. The impact of FSAP on policy debate could increase by seeking outreach opportunities to broader government, non-government institutions, academics, and market participants. As shown in Figure 3, the FSAP has helped to spur policy debate over the years, especially among financial regulators who are the direct counterpart of missions. The impact on the policy dialogue among broader government agencies has also risen over time, but still less than the level seen among financial regulators. A number of FSAP mission chiefs noted that the impact of their FSAPs was enhanced as a result of the attention paid to the assessment by the press and, in some cases, cited effective liaison with the IMF's Communications Department to help improve press coverage. More conscious outreach efforts to a wider audience could further increase the impact of FSAP. Moreover, greater effort could be made to leverage the IMF's website and social media as portals for FSAP assessments and stability issues more generally.

CONCLUSIONS

44. FSAP traction is strong and has improved further in recent years. Country authorities find that FSAPs provide value-added through independent assessment, in-depth analysis, clear findings, and relevant policy recommendations. Country authorities judge that most FSAP recommendations are implemented, and the implementation rate has significantly improved in the last five years. This gain appears to have been concurrent with improved perceptions of the clarity, candor, prioritization of recommendations, and the FSAP's contribution to the policy debate across agencies and legislators. In addition, country officials highly rated the quality of their interaction with FSAP teams and the appropriateness of the scope and focus of FSAP assessments. Moreover, the publication rate of FSSAs has improved, and public attention to FSAPs has increased.

45. In addition, there are encouraging signs that the FSAP is increasingly integrated with the Fund's Article IV surveillance. A large share of country officials surveyed rated the level of integration with the Article IV as adequate or higher. Integration is also evinced by the increasing extent to which FSAP recommendations feature as a substantive part of the Article IV, both in terms of the depth of coverage and the extent to which follow-up extends beyond the initial year of the FSAP.

46. Nonetheless, there is scope for further improvement. In the survey, IMF Executive Directors called for increased attention to FSAP assessments in their deliberations. Article IV mission chiefs indicated a preference for FSAP teams to provide analytical tools that could be used for ongoing monitoring of financial sector risks and vulnerabilities. Country officials surveyed also suggested that FSAP impact at times was diluted by a lack of political support for, or technical disagreements with, the recommendations, as well as by capacity constraints. A practical option for increasing traction with country authorities and other stakeholders is to start including a special section in the FSSA summarizing the views conveyed by the authorities. This could support the authorities' ownership of the FSAP recommendations and clarifying the factors that may impede implementation. Outreach efforts to broader government agencies, experts, and legislators could help to gain the essential political support to fully implement FSAP recommendations.

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