Evaluation of the Financial Sector Assessment Program (FSAP)

Issues Paper

Prepared by the Independent Evaluation Office

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This final issues paper is being posted on the IEO website. We invite your comments on any of the evaluation issues, which may be sent to ieo@imf.org.

I. Background Information

Origins and evolution of the initiative

The Financial Sector Assessment Program (FSAP) was designed to strengthen surveillance of member countries, facilitating early detection of financial sector vulnerabilities and identification of financial sector development needs. In this context, although a voluntary program, the FSAP has become a principal platform for financial sector diagnosis at the IMF. Over 80 country assessments have been completed or are underway (see Appendix I).

The FSAP was introduced in response to the financial crises of the late 1990s, which led to a call for the IMF and World Bank to jointly find an effective way to provide policy advice to strengthen the financial systems of member countries.[1] It was introduced to fill an identified gap in the international financial architecture in support of crisis prevention, based on a judgment that existing surveillance approaches at the IMF under Article IV consultations were not sufficient for effective financial sector surveillance.

At an early stage, the recognition of the close relationship between financial stability and financial development issues led to the decision to adopt a joint IMF-World Bank approach. Thus, in September 1998, the Financial Sector Liaison Committee (FSLC) was set up, comprising senior staff from the Bank and Fund, to enhance operational coordination between both institutions on financial sector issues. Subsequently, the FSLC took managerial responsibility over the FSAP, including country selection, assigning lead responsibility between the Fund and the Bank in each country, and resolving contentious issues in specific cases. The FSAP was launched formally in May 1999, first as a pilot of 12 country cases and later extended, initially with a goal of completing 24 cases per year.[2]

The objectives, scope and design of the initiative have evolved over time, first as lessons from the pilot stage were absorbed and then as various reviews were completed.[3] The most important of the latter was the 2003 review, which led to a number of important changes in design (see below).

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[1] For example, in the April 1998 communiqué of the then Interim Committee.

[2] See *IMF-World Bank Financial Sector Assessment Program (*SM/99/116, May 1999); and *Financial Sector Assessment Program—A Review—Lessons from the Pilot and Issues Going Forward* (SM/00/263, November 2000).

[3] See *Financial Sector Assessment Program—Progress* Report—*Lessons from the Pilot Exercise and Next Steps* (SM/00/54, March 2000); *Financial Sector Assessment Program—Update* (SM/00/205, September 2000); *Financial Sector Assessment Program—A Review—Lessons from the Pilot Exercise and Issues Going Forward,* SM/00/263, November 2000); *Financial Sector Assessment Program—Review, Lessons, and Issues Going Forward* (SM/03/77, February 2003).

The FSAP mission reports to country authorities on its findings and recommendations (in the form of an aide mémoire, previously referred to as the FSAP main report). Drawing on these findings, the IMF staff also prepare a Financial System Stability Assessment (FSSA), which summarizes the FSAP findings of relevance to Fund surveillance based on discussions with country authorities as part of the regular Article IV consultation.[4] The FSSA is provided to the IMF's Executive Board, usually as part of the Article IV consultation.

Objectives of the FSAP and links with Article IV surveillance

Any evaluation needs to assess performance against the final and intermediate objectives set for an initiative. While the design of the FSAP has evolved over time, the **final objectives** have remained broadly unchanged, albeit relatively general: "*to help countries enhance their resilience to crises and foster growth by promoting financial stability and financial sector diversity*."[5] While the precise language varied in different policy papers, the twin objectives—of (i) helping countries identify and resolve financial sector vulnerabilities and thereby contribute to crisis prevention; and (ii) fostering financial sector development and efficiency, thereby contributing to economic growth—were present throughout.

The concept of financial sector stability was not defined precisely in the various policy papers on the FSAP. Indeed, as Houben et al (2004) note, there is no general agreement on what the concept means precisely. Some define it in the negative—i.e., by the absence of financial crises that have a significant impact on GDP (see for example, Crockett (1996 and 1997)). But there are potential tradeoffs between measures to increase resilience to crises and economic and financial efficiency: minimizing a financial sector's vulnerability to crises can have direct implications for a country's growth potential. (For example, requiring all banks to hold 100 percent of their assets in low-risk securities would minimize the risk of crises but would not foster growth.) Consequently, the concept cannot be summarized in a single measure but would require consideration of country specific fundamentals, including incidence of macroeconomic volatility and broad institutional and legal infrastructure affecting economic incentives. In any event, the policy papers make clear that the aim of the

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[4] On the basis of the FSAP, the World Bank staff also prepares a Financial Sector Assessment (FSA) report for the Board of the World Bank that focuses on the financial sector development aspects. The Operations Evaluation Department (OED) is planning an evaluation of the Bank's role in the FSAP.

[5] See *Financial Sector Assessment Program—Update*, September 11, 2002. This paper also acknowledged the objective of enhancing global financial stability: "Over time, as a greater number of governments address the vulnerabilities diagnosed under the FSAP, it is expected that the stability of the international financial system should improve as well" (Page 1). The priority being given to systematically important cases suggests a similar objective.

FSAP was to prevent *systemic* financial problems that can lead to substantial macroeconomic costs, rather than the prevention of failure by individual financial institutions.[6]

The rationale for placing financial sector development and crisis prevention objectives under the same program architecture (and having a joint Bank-Fund initiative) has been elaborated in policy papers over time. Some reasons were operational—to optimize the use of the limited pool of expert resources, to avoid duplication of efforts, to promote consistency of the two institutions' analysis and advice on financial sector issues. Other reasons reflected the recognition—reinforced by the early pilot experience—that most countries face both vulnerability and development issues that are inherently linked and require joint consideration.

IMF policy and review papers have also specified a number of **intermediate objectives** of the FSAP. The ultimate objectives of reducing financial sector vulnerability and fostering financial sector development have been linked to several intermediate goals:

- systematic assessment and monitoring of financial systems to identify strengths, vulnerabilities and risks (including through the observance of standards and codes);

- development of strategies for strengthening the financial sector and helping to prioritize policy responses;

- identification of development and technical assistance needs—with the recognition that the World Bank was expected to play a primary role in the former, and of shared responsibilities in the latter.

- In addition, policy papers have also stated the goal of achieving consistent assessments of financial systems across countries, for which a more systematic coverage and assessment was sought.[7]

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[6] In this context, Borio (2003) distinguishes between macroprudential regulation, whose ultimate objective is to avoid adverse output (GDP) costs by limiting financial system-wide distress and microprudential regulation, whose objective is consumer (investor/depositor) protection by limiting distress of individual institutions. Houben et al (2004) define financial stability as a situation in which the financial system is capable of (i) allocating resources efficiently between activities and across time; (ii) assessing and managing financial risks; and (iii) absorbing shocks.

[7] In practice this meant the development of a common template for FSAP assessment of both vulnerability and development issues. The generic template was to serve as starting point and initial guideline—not to be applied mechanically—and the FSAP team was to develop a country specific focus based on the structure of the country's financial system and evaluation

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Another potential output, not mentioned in the original policy papers but that has been noted subsequently, is the identification of issues or gaps in the various standards and codes that would require the attention of standard setting bodies. Experience gained in conducting FSAPs has informed the feedback that the IMF has provided to these groups.[8]

The FSAP was expected to play an important role in bringing considerations of financial system stability into the core of the Fund's Article IV surveillance of member countries, through the FSSA report. However, the boundaries between the FSAP and Article IV surveillance have not yet been fully delineated. This reflects the initiative's voluntary nature, which gives the IMF a different jurisdiction compared to surveillance. This ambiguity on the boundaries stemmed partly from a divided view among the IMF's membership on whether this initial arrangement for the FSAP was a transitional one—over time leading naturally to a full integration into the Fund's core activities, or whether the initiative's voluntary nature (providing country authorities limited, separate obligations from those under Article IV) was a permanent feature making the initiative more akin to technical assistance in nature and seeking to enhance the candidness of discussions between staff and the authorities (with expectations of a clear firewall beyond that domain, although in practice increasing links with program design have often been encouraged).

The FSAP was envisaged as a prime vehicle for financial sector assessment and a key input into surveillance of the financial sector, but such surveillance may not solely depend on the FSAP.[9] In principle, the coverage of financial sector issues belongs to the IMF's core mandate and falls under the Article IV umbrella. In this connection, some aspects of financial sector assessment done under the FSAP on a voluntary basis could be performed in the context of Article IV consultations. However, the effectiveness with which regular Article IV missions can do broad, in-depth assessments of financial sector issues—with increased assistance from the relevant functional departments—remains largely untested. The involvement and responsibilities of various departments under this modality of financial

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of priorities for both stability and sectoral development. (*IMF-World Bank Financial Sector Assessment Program (FSAP)*, SM/99/116).

[8] The feedback provided by the IMF to the standards setting bodies has taken several forms, including through dedicated conferences and seminars, participation of staff from those bodies in FSAP discussions, and specialized papers (*Financial Sector Regulation—Issues and Gaps* (SM/04/268)).

[9] See the *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision* (SM/04/212).

sector surveillance have yet to be specified, and there are some questions about whether the IMF's access to data under Article IV surveillance would be sufficient.[10]

Design and implementation of the FSAP

Fundamentally, the FSAP was initially conceived as a diagnostic and policy advice tool. In this connection, it was designed to work at two levels: (i) confidential advice to country authorities and (ii) peer review. The FSAP's role in linking policy recommendations to effecting policy and institutional changes so as to reduce vulnerabilities was limited to follow-up work intended to assess and inform on progress.[11]

A number of aspects of the FSAP have evolved over time, especially after the "pilot" stage and after the 2003 review.[12] However, the main design features are as follows:

i) *Voluntary participation*, with direct implications for the process of country selection and linkages to traditional surveillance and program activities. If some countries of systemic importance did not participate, the contribution of the FSAP to global financial stability could be diminished. Policy papers indicated that, over time, all countries were expected to participate, but the mechanisms to achieve that have not been made explicit. In this connection, acceptance to participate involves only a one-off assessment, not a permanent commitment to participate in follow-ups and reassessments. In practice, resource constraints have required some scaling back of the planned number of FSAP assessments—to about 17–19 a year—which would imply that a comprehensive assessment for the entire membership would take place over about a 10-year period. In principle, priority is being given to systemically important countries; other criteria guiding priorities include those countries with external sector weakness or financial vulnerability, likelihood of major reform

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[10] Provision of data under the FSAP has required in several instances agreements with country authorities on special confidentiality protocols that may not be automatically assumed under Article IV obligations for member countries. The legal basis of IMF surveillance and access to information thereunder is discussed in Appendix I of *Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision—Modalities of Surveillance* (SM/04/212, July 2004).

[11] Although under the voluntary nature of the initiative formal follow-ups are not automatic and can only be conducted with the consent of country authorities, in principle Article IV consultations can follow up on issues raised in the FSAP. Moreover, the IMF can also use FSAP results in the design of its program activities.

[12] This means that the evaluation will need to consider the evolving nature of the initiative's first few years of operation, and take into account that there might be different FSAP "vintages" (e.g., those in the 12-case pilot, those before and after the 2003 internal review) and that evidence on follow-ups and updates may still be limited.

programs, or where features of the exchange rate and monetary policy regime suggest potential vulnerabilities.

ii) *More systematic coverage and assessment* of financial sector issues and their impact on macroeconomic stability than hitherto under surveillance, including through the monitoring of a number of standards and codes. Policy papers have emphasized the need for comprehensive coverage of financial system areas, with tailoring of depth and intensity to country circumstances—including on which standards to assess. The 2003 review decided to increase selectivity on the number of issues and standards assessed for each country, in light of resource constraints, and the deployment of other instruments for ongoing financial surveillance (focused update, follow-up through Article IV consultations, etc.). Thus, over time FSAPs have moved towards more tailored, ongoing assessments.

iii) *Differential outputs for different purposes* including: (a) comprehensive and confidential FSAP reports and aide memoires to advise country authorities; and (b) separate summary reports—the Fund's FSSA and Bank's FSA—to inform the Boards for peer review. The initiative provides for voluntary publication of the FSSA, Reports on Observance of Standards and Codes (ROSCs), and selective background material to broaden dissemination and inform the private sector.[13] About two-thirds of recent FSSAs have been published.

iv) *Joint Bank-Fund initiative*, except in industrialized countries. In terms of division of responsibilities between the two institutions, the policy documents indicated that the IMF would have primary responsibility for financial sector stability issues and would also have a role in helping to improve financial sector efficiency. To the extent that development aspects may have stability implications in the short- and longer-term, the Fund would also be directly concerned with those aspects.[14] Joint staff documents indicate that about 60 percent of the resources involved in the FSAP initiative have been provided by the IMF and 40 percent by the World Bank.

v) *Connection with Article IV surveillance and IMF operations*. Procedurally, the FSAP team prepares an aide mémoire for the authorities at the conclusion of the evaluation process, which is subsequently refined and finalized. This serves as a basis for discussion of findings and recommendation with country officials at the time of the

[13] Publication policies have evolved in time; the pilot exercise explicitly barred publication, but later policy documents have permitted voluntary publication of the FSSA and some background material.

[14] The lead role in the conduct of the FSAP in specific country cases is assigned by the Financial Sector Liaison Committee, taking account of the types of issues expected to be of paramount importance in each case.

Article IV consultation. The FSSA report is part of the Article IV documentation distributed to the Board, and is intended to serve as a vehicle for linking FSAP findings with the Article IV consultation, serve as an input in the design of policy and structural benchmarks in IMF-supported programs, and be a basis for assessing needs and priorities for technical assistance.[15]

In this context, the instruments to achieve the initiative's objectives comprise (see Figure 1): (i) the identification of financial sector risks and vulnerabilities by a team of Fund and Bank staff and outside experts (mostly from central banks and supervisory authorities) through a series of field visits and using a variety of tools and methodologies; (ii) the articulation of findings and prioritized recommendations; and (iii) follow up activities to assess implementation of recommended measures. In addition, the initiative contemplates reassessments to identify new sources of vulnerabilities.

- The *assessment of vulnerabilities* comprise the review of prudential regulation and supervision, liquidity management (financial policies, instruments, and market arrangements), arrangements for crisis management (financial safety nets, frameworks for bank and corporate restructuring and bankruptcy), maturity and development of market infrastructure, systemic risk in payment systems, and vulnerabilities from macroeconomic shocks. The analytical tools include stress testing for macro-financial linkages stemming from macroeconomic shocks and the use of financial soundness indicators (FSI) for evaluation and monitoring.[16] It also comprises detailed assessment of observance of international standards and codes in three broad areas: financial sector regulation and supervision, institutional and market infrastructure, and policy transparency.[17]

[15] The liaison of the FSAP to surveillance would comprise in principle a two-way relationship: macroeconomic conditions and risks should feed into FSAP analyses and, in turn, FSAP findings should be an input into Fund surveillance.

[16] This include risks related to interest rates and the exchange rate, credit, liquidity, market, and real estate risks, and other macro risks such as to GDP growth and commodity prices.

[17] The standards typically assessed—although not necessarily all of them in every case—consist of the : (i) IMF Code of Good Practices on Transparency in Monetary and Financial Policies (MFP Code); (ii) Basel Core Principles for Effective Banking Supervision (BCP); (iii) Core Principles for Systematically Important Payment Systems (CPSIPS); (iv) International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation (IOSCO Principles); (v) International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP); and (vi) the Financial Action Task Force (FATF) Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). The latter standard is expected to be assessed in all cases. In addition, other standards, principles and guidelines may be used to facilitate the

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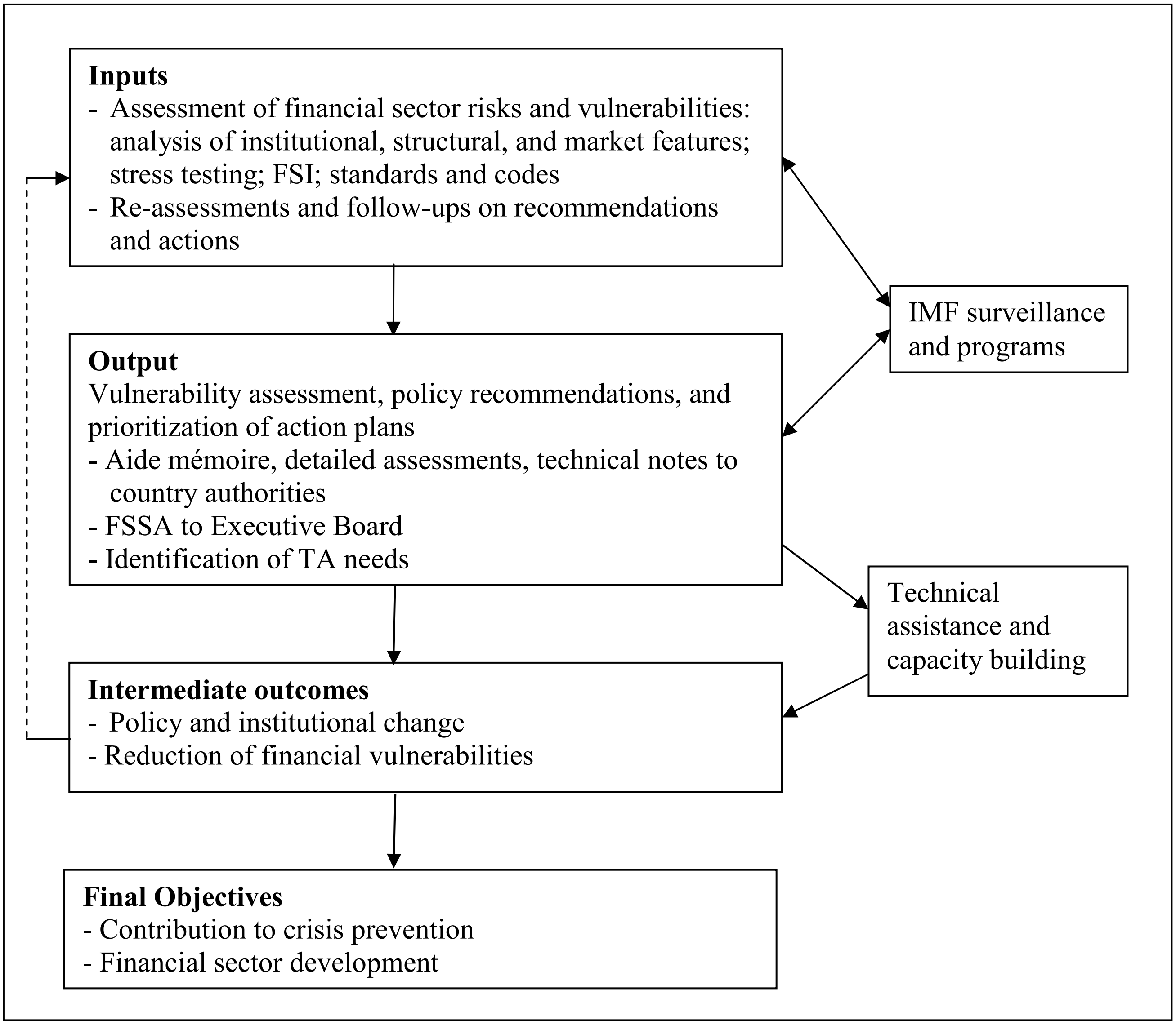
Figure 1. The FSAP's Framework



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analysis in the FSAP. These include: (i) the OECD Corporate Governance Principles; (ii) World Bank Principles for Effective Insolvency and Creditors Rights; (iii) CPSS-IOSCO Recommendations for Securities Settlement System (RSSS); and (iv) International Accounting and Auditing Standards. The 2003 review indicated that a typical FSAP would limit the number of standards assessed in detail to three, excluding AML/CFT, compared to a previous average of about five standards per FSAP.

- FSAP *findings and prioritized recommendations* are articulated in the report to the authorities (aide memoire) in detail, and summarized in the FSSA (covering those aspects relevant to Fund surveillance).

- *Follow-ups* serve to evaluate and inform the effectiveness of the authorities' actions to address identified weaknesses in the financial sector (policy, institutional and structural).[18] Moreover, the FSAP has been envisaged in principle as a dynamic process contributing to ongoing financial surveillance at the Fund; thus, *focused or full re-assessments* would seek to identify the emergence of new areas of potential concern. Re-assessments were initially conceived to take place every four to five years. Later staff documents put the frequency at seven to ten years because of resource constraints and their implications for the pace of the program. As of September 2004, only eight updates (more narrowly focused FSAPs) have been undertaken or are underway (see Appendix I).

Main findings of internal and external reviews of the FSAP to date

In February 2003, a comprehensive internal review of the FSAP was produced jointly by the staff of the Fund and the Bank.[19] The key recommendations, broadly endorsed by the IMF Board, were to tailor the scope of FSAPs to country circumstances (i.e., selectively narrow the number of issues and standards assessed); reduce the number of FSAP assessments and reassessments initiated each year; deploy other instruments for follow-ups and ongoing monitoring (e.g., focused FSAP updates, expert participation in Article IV consultations, and monitoring through FSIs); and streamline the production and review of documents.

Other evaluation efforts have included a review group chaired by Mr. Arminio Fraga that was set up by IMF management to assess the relevance and appropriate balance of the wide range of activities of the then Monetary and Exchange Affairs (MAE) department,[20] as well as the effectiveness and efficiency of its operations. The report of the group covered in part the FSAP.[21] Its main recommendations with respect to the FSAP included reducing the number of FSAPs targeted each year; greater priority on emerging markets and financial centers, and on perceived risks and systemic importance; more selective approach to issues and standards covered; and greater involvement of area departments in the FSAP process.

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[18] Follow-up can take place in the context of Article IV surveillance or technical assistance.

[19] See *Financial Sector Assessment Program—Review, Lessons, and Issues Going Forward* (SM/03/77, February 2003); and *IMF Reviews Experience with the Financial Sector Assessment Program and Reaches Conclusions on Issues Going Forward* (PIN/03/46, April 2003)

[20] Now the Monetary and Financial Systems Department (MFD).

[21] Review of the Monetary and Exchange Affairs Department, November 2002.

The FSAP has also been subject to external reviews, including the June 2003 report of the General Accounting Office (GAO) of the United States (GAO, 2003). The main findings were the need to improve the timeliness in the production and publication of reports, to expand the coverage and frequency of follow-ups, and to increase country participation, possibly by making the program mandatory. In the latter respects, the GAO evaluation contained a different message on comprehensiveness of coverage than the other reviews cited here.

II. Issues for the Evaluation

The IEO evaluation will focus mainly on those aspects of the FSAP for which the IMF has primary responsibility, especially financial sector stability. Development issues would be considered in as much as they have direct influence on these aspects. It is expected that a parallel evaluation by the World Bank's Operations Evaluation Department (OED) will assess the World Bank's role in the FSAP initiative.[22]

As noted earlier, there is no generally agreed measure of "financial stability," and the policy papers establishing the FSAP did not propose one. Helping countries reduce their financial sector vulnerabilities and thereby enhancing crisis prevention—with due consideration of financial sector efficiency implications—is perhaps the simplest way of summarizing the final objective of the initiative. Consequently, an overarching question for the evaluation is how effectively the FSAP has achieved these objectives, while recognizing that they are not easily defined or measured.

Addressing this central issue involves evaluating four broad questions related to the architecture of the initiative and different parts of the results chain—its inputs, outputs, outcomes, and integration with the Fund's core-mandate activities, especially surveillance:

i) *Inputs*: Has the assessment of financial vulnerabilities been effective and cost efficient in terms of identifying the principal sources of risks?

ii) *Outputs*: Have findings and recommendations been clearly articulated and prioritized?

iii) *Outcomes*: Has the FSAP process as well as supporting IMF instruments led to policy and institutional changes that significantly reduced financial vulnerabilities? Have follow-ups provided effective encouragement to this process?

iv) *Integration with surveillance*: Has the overall surveillance function of the Fund with regard to the financial sector been improved from the integration of the FSAP/FSSA

[22] In the conduct of the evaluations, the IEO and OED will collaborate closely in the collection of evidence as in past parallel evaluations. For accountability and internal governance reasons final evaluation reports will be separate.

into Article IV surveillance? Have the arrangements for follow-ups and reassessments resulted in effective support to ongoing financial sector surveillance?

Each of these questions, in turn, entails several subsidiary issues that the evaluation would need to assess. In this connection, the evaluation will have a selective focus on the key aspects of the initiative and would cover subsidiary or peripheral issues only to the extent that they may have an impact on design and implementation. Examples of the type of narrower questions that derive from the broader issues include:

Inputs: effectiveness and efficiency of assessment

The evaluation would seek to address issues of effectiveness and efficiency in the assessment of financial sector vulnerabilities at the country level and across countries.[23]

(a) Issues related to country coverage and prioritization

- What have been the selection and priority criteria envisaged? Has the actual coverage of FSAPs and updates, and resources devoted across countries followed these criteria? What have been the gaps in country coverage?

- What has been the coverage of assessment areas across countries? What has been the consistency of assessments across countries, and how has the internal review process influenced such consistency? Has voluntary participation of countries involved early dialogue with the authorities on assessment issues and coverage?

- Has the envisaged frequency of "full" FSAP assessments—and implications for reassessments—been commensurate with the design and objectives of the programs?

- What has been the division of labor and coordination with the World Bank, including on lead responsibility? Was collaboration on these issues effective? Has consideration of institutional priorities been balanced in the conduct of FSAPs? Has coordination on priorities extended to follow up and update work?

(b) Modalities and toolkit for the assessment of major sources of risks and vulnerabilities:

[23] A comprehensive cost-benefit assessment of the FSAP initiative would pose major methodological challenges. It would involve judging potential risks and benefits, including the reduction of the likelihood of a financial crisis and its cost. Rather, the evaluation will seek to assess a narrower set of issues including the *relative* cost efficiency—taking into account the impact on effectiveness—of different program modalities employed so far (e.g., the initial comprehensive pilot vis-à-vis the more focused and selective approach following the 2003 internal evaluation). The assessment of costs would comprise also the resource cost to national authorities relative to the various components of the FSAP.

- Has the coverage of risk assessments been tailored to specific country circumstances (taking account of the degree of financial depth and development, macroeconomic conditions, etc.)? Have assessments incorporated regional and global risks, including contagion from cross-border linkages where relevant (e.g., with inputs from multilateral surveillance exercise such as the *World Economic Outlook* and the *Global Financial Stability Report*)? Is the analysis cast broadly enough to capture less obvious vulnerabilities (e.g., transfer of risks between government and financial sector, perceptions of implicit government guarantees)? How have assessments balanced potential tradeoffs between financial development and stability issues?

- Have analytic tools and methodologies reflected state-of-the-art approaches (i.e., quality and modality of stress testing and FSI use, including assessment of off-balance sheet risks)?

- Has the access to information in practice been sufficient for effective financial sector surveillance?

- How are the standards and codes assessed and used in different country circumstances and is there sufficient allowance for diversity in circumstances? Do guidelines help to have consistent assessments across countries?

- How has the assessment process dealt with the distinction between *de jure* processes and *de facto* implementation, including issues such as regulatory capture, proper regulatory framework but pervasive governance problems, etc.?

(c) Operational organization of the FSAP

- How effective has Bank-Fund collaboration been in implementation and follow-up on the FSAP?

- Do different country experiences suggest particular "good practice" approaches to organizing the FSAP work, including the interaction between functional and area departments and the use of outside experts?

Outputs: articulation of findings and recommendations

- How well have FSAP outputs—detailed assessments, aide mémoires, FSSAs, Article IV coverage of FSAP findings—performed vis à vis the following tests:

    - Candor and clarity of diagnosis and consequence of findings?

    - Clarity, usability, and prioritization of the recommendations, taking due account of sequencing and implementation capacity?

- Has the exercise led to a better understanding of the needs, and appropriate provision of technical assistance (TA) in the context of strengthening the financial sector and addressing capacity building issues? How has the prioritization of the IMF's own TA in this area been affected?

- Is the current degree of transparency appropriate? How have the tensions between candidness and transparency been addressed and with what results?

Outcomes: policy and institutional changes and reduction of financial vulnerabilities[24]

The impact of the FSAP will be judged according to two measuring rods:

i) Perception of relevance/usefulness by different audiences, i.e., country authorities, markets, etc. For example:

   - How do country authorities assess the FSAP exercise? Has it deepened the quality and coverage of discussions with authorities on financial sector issues? Have authorities perceived an effective contribution to understanding vulnerabilities? Has it affected the domestic policy debate on these issues?

   - How has the private sector reacted to the new information published in FSSAs and how has it impacted their activities and risk perceptions? What are the views of market participants on the value added of FSSAs?

ii) Actual changes in policies and institutions. For example,

   - Have recommended actions/reforms been effectively carried out by country authorities?

   - Has follow-up resulted in effective support to policy and institutional changes?[25] What has been the role of follow-up in evaluating implementation of recommendations?

   - In countries with IMF-supported programs, how have major FSAP recommendations affected program design?

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[24] Methodologically, the evaluation of outcome questions is especially subject to problems of attribution, since many factors may have contributed to a particular result and a precise identification of each factor's contribution may not be possible.

[25] As mentioned above, follow-up activities can take different forms, including during Article IV consultations. Updates (focused FSAPs) and re-assessments would not only follow up on past recommendations, but also evaluate the potential emergence of new vulnerabilities and recommend corrective actions.

- What are the limits of what can be expected from FSAPs in terms of identifying vulnerabilities, e.g., with regard to identifying and forestalling fraudulent operations or in the context of widespread legal and institutional weaknesses?

Integration with IMF surveillance

- How have Article IV consultations in effect incorporated financial sector surveillance (on- and off-site)? Have Article IV consultation discussions and reports reflected key FSAP findings clearly and candidly, drawing particular attention to the findings of most importance to macro stability? Has the Fund's differential "jurisdiction" for the FSAP and Article IV affected the integration with surveillance?

- How has the assessment of financial sector risks been integrated with the overall assessment of macroeconomic vulnerabilities under IMF surveillance? Has the assessment process effectively identified the potential for macro stability implications? What has been the FSAP's value-added on the coverage of financial sector issues under Article IV consultations (e.g., in countries that have undertaken an FSAP vis-à-vis those that have not; or for a particular country before and after the FSAP)?

- What has been the role of FSAP assessments and updates in ongoing financial surveillance under Article IV consultations—including taking account of actions to address identified weaknesses and of changing risks and vulnerabilities as country circumstances change?

Issues outside the scope of the evaluation

A number of issues will not be investigated, in order to keep the scope of the evaluation manageable or because evidence to perform an assessment may not yet be available:

- Specifics of the assessment of the AML/CFT standard or the Offshore Financial Center assessment program—except to the extent that these activities affect the broader FSAP objectives and implementation.

- Other crisis prevention activities of the IMF (e.g., the efficacy of multilateral surveillance activities in predicting crises; early warning system models, etc.), except to the extent that they directly interact with the FSAP.

- We do not intend to evaluate all aspects of IMF surveillance of the financial sector beyond the FSAP, except to investigate how such activities have been integrated with the FSAP or where it may provide evidence on the cost effectiveness of different approaches to assessing potential financial sector vulnerabilities.

- We do not intend to evaluate the technical merits of particular codes and standards, but the evaluation will look into how the IMF experience in assessing these standards has informed its feedback to the standard setting bodies.

III. Methodology of the Evaluation

The evaluation will use a variety of types of evidence to address the questions posed in Section II. The primary "level" at which an issue is addressed (e.g., cross-section analysis and desk reviews of a wide range of FSAP cases or more detailed case study evidence) will depend on the nature of the question:

Cross-country analysis of full sample of FSAP countries. Using a broad database of FSAP indicators, this will address issues such as how FSAP priorities were implemented in practice, regional composition and systemic relevance of FSAPs undertaken yearly since the inception of the program, coverage of ROSCs, characteristics of stress testing performed and usage of FSIs. Other cross-country analyses would include the market response to FSSA reports and ROSCs results (on sovereign risk, market valuation of debt and securities of domestic financial institutions, etc.).

Desk reviews. These will seek to systematically collect evidence contained in FSAP documents and assess the main evaluation issues across a broad group of countries. Moreover, desk reviews will investigate a number of more specific, qualitative issues including the role of FSAPs under special country circumstances such as cases where there was a banking crisis following the FSAP, or cases with high share of foreign ownership in the financial sector and special approach to regulation. *Desk reviews will serve to gather evidence on specific aspects of assessment effectiveness (e.g., stress testing, FSI), articulation of recommendations and overall surveillance integration under diverse country circumstances*.[26]

Country case studies. Case studies will seek to gain a more in-depth understanding of how FSAPs have been undertaken and of their policy impact. The choice of cases will need to reflect various stages of financial development and depth, systemic importance, regional diversity, the stage of progress in the process (e.g., whether an update has taken place), balance between program and surveillance cases, and specific macroeconomic circumstances and starting conditions in the financial sector. *Case studies will provide evidence on a broad spectrum of qualitative issues: on effectiveness of assessments; articulation of recommendations and linkage to TA; policy and institutional change; follow-ups and updates; and on integration with surveillance*.

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[26] This will include the design of various assessment criteria to ensure uniformity of cross-country assessments.

Examination of internal IMF guidelines. This would help identify and present evidence on the specific evaluation questions, including the nature of risk assessment performed in the context of the FSAP, the consistency of assessment procedures across countries, and the integration with surveillance functions.

Reviews of other evaluations and studies. This would include, for example, areas such as stress testing, financial soundness indicators, and early warning systems.

Interviews and Surveys. The interviews would seek to gather the views of diverse groups of stakeholders, including Fund and Bank staff, financial market participants, regulators, and country authorities. They would be complemented by surveys to obtain systematic evidence on the views of various stakeholders on a more specific range of issues. *Interviews and surveys would be used to obtain evidence on assessment effectiveness and scope of coverage, articulation and prioritization, contribution to policy and institutional change, consideration of vulnerability assessment in a dynamic framework, and relevance to overall surveillance.*

IV. TIMETABLE AND RELATION TO OED'S EVALUATION

Timetable. The final report is expected to be presented to the Board in Fall 2005.

Collaboration with the OED. The modalities for coordination with OED's evaluation are being discussed, but the aim will be to cooperate on various "joint" inputs—including special thematic notes, case studies, and survey exercises.

FSAP: Completed and Ongoing/planned (*in italics*) per Fiscal Year [1]
(As of September 2004)

2000	2001	2002	2003	2004	2005
Colombia	Ghana	Gabon	Kyrgyz Republic	Macedonia	*Belarus*
Lebanon	Guatemala	Switzerland	Japan	*Kenya*	*Sudan*
Canada	Poland	Lithuania	Bangladesh	Jordan	*Norway*
South Africa	Armenia	Luxembourg	Hong Kong	*ECCU* [2]	*Italy*
El Salvador	Israel	Sweden	Honduras	Kuwait	*Belgium*
Hungary	Peru	Philippines	Malta	*Ecuador*	*Mauritania*
Iran	Yemen	Korea	Mauritius	*Azerbaijan*	*Rwanda*
Kazakhstan	Senegal	Costa Rica	Singapore	*Austria*	*Albania*
Ireland	Slovenia	Bulgaria	*Bolivia*	New Zealand	*Serbia*
Cameroon	Iceland	Sri Lanka	Oman	Netherlands	*Jamaica*
Estonia	Czech Republic	Morocco	Germany	*Nicaragua*	*Trinidad and Tobago*
India	Uganda	Nigeria	Mozambique	*Chile*	*Bahrain*
	Dominican Republic	United Kingdom	Tanzania	*Saudi Arabia*	*Paraguay*
	United Arab Emirates	Slovak Republic	Romania	*France*	*Spain*
	Latvia	Barbados	Algeria	*Pakistan*	
	Tunisia	Brazil		*Moldova*	
	Finland	Ukraine			
	Mexico	Russia			
	Croatia	Egypt			
	Georgia	Zambia			
Total: 12 (Pilot countries)	**Total: 20**	**Total: 20**	**Total: 15**	**Total: 16**	**Total: 14 (preliminary)**
FSAP Updates					
	Lebanon	Hungary	Iceland	Ghana	*Senegal*
	South Africa			Slovenia	*Colombia*
				Kazakhstan	*Uganda*
				El Salvador	*Nigeria*
					Peru
					Hungary
					Armenia
Total: 0	**Total: 2**	**Total: 1**	**Total: 1**	**Total: 4**	**Total: 7 (preliminary)**

Note: The FSAP for Argentina (FY 2001) and Uruguay (FY 2002) were not completed. The FSAP for Cote d'Ivoire (FY 2002) has not yet been completed due to security reasons.
1/The fiscal year runs from May to the end of April. Within the column of each fiscal year the order of countries is determined by the order of first missions.
2/ ECCU stands for the Eastern Caribbean Currency Union.

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