ANNEX

# 4 Additional Information on Priority-Setting Processes, Costs, and FSAP Organization

This annex supplements the discussion in Chapters 1 and 2 of the main report with additional information on arrangements for setting priorities; outcomes in terms of country and sectoral coverage; resource costs of the exercise; and some aspects of FSAP mission organization.

## Objectives and Procedural Arrangements for Setting Priorities

While the criteria for setting FSAP priorities across countries and for the selection of topics covered within countries have been modified over time—in the direction of greater selectivity—the core of the approach remains unchanged.

For *country participation,* the IMF and World Bank Executive Boards endorsed a variety of criteria for setting priorities at the time of the initial review of the pilot stage, including a country's (1) systemic importance; (2) external sector weakness and financial vulnerability; (3) features of its exchange rate and monetary policy regime that make its financial system more vulnerable—such as inconsistencies with other macroeconomic policies; (4) likelihood of upcoming major reform programs (as reflected for example in the Bank's Country Assistance Strategy);[1] and (5) geographical balance among countries. It was noted that country selection should seek to maximize the program's contribution to the strengthening of national and international financial stability, and thus within any one year should give priority to systemically important countries (SICs). The SICs were defined as (1) countries whose capital markets intermediate the bulk of global financial transactions; and (2) emerging market economies whose financial systems have the potential to cause, or be subject to, undue volatility in cross border flows and financial system contagion. However, no explicit list of such countries has ever been made public.[2]

The criteria were revised by the Executive Boards in March 2003 to take into account the need to accommodate countries' requests for FSAP reassessments and updates while balancing the expectation that all member countries would benefit from the program. While noting the need to give continued priority to industrial and emerging market economies of regional or international systemic importance, priority for reassessments and Updates would be given to countries where there have been major developments in the financial system, or a lengthy period had passed since the last assessment. These criteria were further refined in the 2005 FSAP review by noting that the interval between assessments should be shorter for SICs, and for countries where there have been significant macroeconomic shocks to the financial system, or major reforms have taken place. Furthermore, an earlier update may also be appropriate in cases where important financial sector issues were not covered in the initial FSAP but are deemed to warrant an in-depth analysis.

A few things are worth noting with regard to these criteria. First, even though they are multidimensional and with no specific weighting attached—hence leaving room for discretion in their implementation—they clearly signal the major importance attached by the Executive Boards to having systemically important countries' participation, both in the initial assessments and the Updates. Second, in any given year, there is an expectation that priority should be given to these countries. Third, these countries should also be reassessed more frequently. Finally, the notion of systemic importance encompasses both regional and global dimensions.

[1]This criterion was not explicitly identified in the Chairman's Summing Up, but it was fleshed out in subsequent reports and internal memoranda.

[2]In a table listing the FSAPs that have been initiated through FY2003, the staff identified the following economies (among those in the list) as being systemically important: Argentina, Brazil, Canada, Germany, Hong Kong SAR, India, Japan, Korea, Luxembourg, Mexico, Russia, Singapore, Switzerland, and the United Kingdom. There was no complementary list identifying the systemically important countries that had not participated up to that point.

**Box A4.1. Financial Sector Liaison Committee Guidelines for Country Selection**

The Financial Sector Liaison Committee (FSLC) developed guidelines covering all stages of the FSAP process, including country selection and scheduling, FSAP teams leader selection, terms of reference for FSAP missions, and preparation, discussion, and transmittal of FSAP reports.[1] For country selection, the FSLC envisioned an iterative consultative process involving the regions in the World Bank and the area departments in the IMF. Consultation would be undertaken every six months to prepare rolling FSAP work plans covering the year ahead. These procedures were endorsed by both Executive Boards.

Under these procedures, IMF area departments and Bank regions would each identify candidates for inclusion in the program with no requirement for agreement at the initial stage. Countries were to be ranked in three groups, highest (1), high (2), and medium (3) priority in accordance with the criteria established by the Boards, with a view to generate "first-best" lists. Country authorities' willingness to participate in the program was not supposed to be considered at this stage. MFD, and its counterpart in the Bank, the Financial Sector Vice-Presidency (FSE), would then compile separate "first-best" lists to be discussed by the FSLC. Discussions would seek to reconcile differences in ratings, preparing a modified "first-best" list of countries that would be sent to departments and regions for comments. MFD/FSE would then send a final "first-best" list to their respective managements for approval, noting remaining differences. On the basis of the consolidated list approved by the two managements, and now taking into account other considerations (i.e., resources availability, timing for Article IV consultations), MFD/FSE would follow up on country participation to prepare operational lists for the coming year, based on countries responses.

In addition, country authorities may independently request participation in the FSAP, but in such cases the relevant Bank region and IMF area department need also to agree that the country is a suitable priority candidate for participation.

If a country's participation in the FSAP is considered to be of high priority by IMF and World Bank staff, but the country is reluctant to commit to participating, the staff can seek the assistance of Bank and Fund management in encouraging the country's participation.

[1]See, for example, the Attachment in "Progress Report on the Bank-Fund Financial Sector Liaison Committee" (SM/01/295, September 2001).

For *topic coverage,* FSAP policy documents sought to establish from the inception of the initiative "an approach to financial system assessments that is broadly consistent across countries, while allowing for difference in emphasis to reflect different country circumstances."[3] To this end, the staff of the IMF and World Bank developed a common template covering all important sector and issues, from both stability and developmental perspectives, but with the understanding that FSAP teams would tailor its application to country circumstances. Comprehensiveness was viewed as key to ensure that major vulnerabilities and financial sector needs are not overlooked. However, judgments on cost effectiveness and relevance were to be used to set the scope of work in each case.

The approach of comprehensiveness in scope but selectivity in depth of coverage was developed further in the 2003 review. This called for FSAPs to be more sharply focused and tailored to individual country circumstances while maintaining a broad overall assessment. The varying depth of analysis across sectors would be achieved along various dimensions including (1) the selection and timing of standards and codes (S&Cs) to be formally assessed—in principle to be limited to no more than three plus AML/CFT; and (2) the extent of quantitative analysis. Furthermore, in low-income countries with small financial systems, the approach called for greater focus on medium-term and structural issues. It was envisioned that topics and S&Cs that warranted an assessment but were not covered under an initial FSAP could be included in FSAP Updates.

The Financial Sector Liaison Committee, a joint committee of senior IMF and World Bank staff, was responsible for coordinating many aspects of the FSAP, including the selection and sequencing of countries (Box A4.1).

One key objective of the FSLC guidelines was to generate a "first-best" list of countries, with a view to identify a pool of countries in accordance with the criteria set by the Boards. This "first-best" list was considered a key input into the preparation of a working plan. In particular, area departments and regions were instructed not to be constrained in their selection by their understanding of country authorities' willingness or unwillingness to participate. This was important because the signaling of how the IMF and World Bank viewed the importance and priority of a particular country's participation was expected to influence incentives to participate. The survey results provide some support for this view.

[3]"IMF–World Bank Financial Sector Assessment Program (FSAP)" (SM/99/116, May 1999).

**Table A4.1. "First-Best" Priority Lists for Initial FSAPs[1]**
*(In number of countries)*

| Ratings[2] | IMF area departments | FSLC-IMF | FSLC–World Bank | List to managements | Outcome[4] |
|---|---|---|---|---|---|
| | Source of Submission and Outcomes | | | | |
| | Submission date: spring 2001 for FY2002 | | | | |
| SICs priority ranking | | | | | |
| 1 | 10 | 10 | 4 | . . . | . . . |
| 2 | 4 | 7 | 2 | . . . | . . . |
| 3 | 5 | 3 | 3 | . . . | . . . |
| Total | 19 | 20 | 9 | 6 | 5 |
| Non-SICs rated priority "1" | 18 | 18 | 23 | 24 | 15 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 21 | 21 | 15 | . . . | . . . |
| | Submission date: spring 2002 for FY2003 | | | | |
| SICs priority ranking | | | | | |
| 1 | 4 | . . . | . . . | . . . | . . . |
| 2 | 8 | . . . | . . . | . . . | . . . |
| 3 | 3 | . . . | . . . | . . . | . . . |
| Total | 15 | . . . | . . . | 4 | 4 |
| Non-SICs rated priority "1" | 11 | . . . | . . . | 15 | 11 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 16 | 16 | 11 | . . . | . . . |
| | Submission date: spring 2003 for FY2004 | | | | |
| SICs priority ranking | | | | | |
| 1 | 5 | 0 | 2 | . . . | . . . |
| 2 | 3 | 2 | 1 | . . . | . . . |
| 3 | 1 | 1 | 0 | . . . | . . . |
| Total | 9 | 3 | 3 | 3 | 3 |
| Non-SICs rated priority "1" | 14 | 4 | 14 | 14 | 13 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 12 | 12 | 9 | . . . | . . . |
| | Submission date: spring 2004 for FY2005 | | | | |
| SICs priority ranking | | | | | |
| 1 | 3 | 3 | 2 | . . . | . . . |
| 2 | 3 | 3 | 1 | . . . | . . . |
| 3 | 0 | 0 | 1 | . . . | . . . |
| Total | 6 | 6 | 4 | 2 | 1 |
| Non-SICs rated priority "1" | 15 | 13 | 11 | 16 | 14 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 9 | 9 | 7 | . . . | . . . |

Sources: IMF internal memoranda, and IEO staff calculations.
[1]See main text for definition of systemic importance (SIC).
[2]Countries are classified by area departments in the IMF and regions in the World Bank into three groups: highest priority (1), high priority (2), and low priority (3) for participation in the FSAP, based on the criteria laid out by the Executive Boards.
[3]The number of SICs that have not had an FSAP up to that point.

## Outcomes for Country and Topic Coverage

The evaluation undertook a detailed examination of how this process worked in practice based on a review of internal documents and interviews with staff involved.[4] Tracking each stage of the process suggests the following (see Tables A4.1 and A4.2):

[4]The documentation is somewhat fragmentary, particularly for FY2003 and FY2004, and an attempt was made to reconstruct country ratings based on e-mail communications.

**Table A4.2. "First-Best" Priority Lists for FSAP Updates[1]**

| | Source of Submission and Outcomes | | | | |
|---|---|---|---|---|---|
| Ratings[2] | IMF area departments | FSLC-IMF | FSLC–World Bank | List to managements | Outcome[4] |
| | Submission date: spring 2003 for FY2004 | | | | |
| SICs | | | | | |
| 1 | 0 | . . . | . . . | . . . | . . . |
| 2 | 1 | . . . | . . . | . . . | . . . |
| 3 | 0 | . . . | . . . | . . . | . . . |
| Total | 1 | . . . | . . . | 2 | 0 |
| Non-SICs rated priority "1" | 3 | . . . | . . . | 7 | 4 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 5 | 5 | 4 | . . . | . . . |
| | Submission date: spring 2004 for FY2005 | | | | |
| 1 | 3 | 2 | 3 | . . . | . . . |
| 2 | 1 | 1 | 0 | . . . | . . . |
| 3 | 0 | 0 | 0 | . . . | . . . |
| Total | 4 | 3 | 3 | 4 | 3 |
| Non-SICs rated priority "1" | 3 | 2 | 3 | 4 | 3 |
| Memorandum item | | | | | |
| SICs remaining in pool[3] | 9 | 9 | 8 | . . . | . . . |

Sources: IMF internal memoranda and IEO staff calculations.

[1]See main text for definition of systemic importance (SIC).

[2]Countries are classified by area departments in the IMF and regions in the World Bank into three groups: highest priority (1), high priority (2), and low priority (3) for participation in the FSAP, based on the criteria laid out by the Executive Boards.

[3]The number of SICs that had an FSAP at least three fiscal years earlier than the one for which the submission is being prepared. Given time lag of completing Updates, this implies an overall lag of at least four years between an FSAP and an Update.

[4]Number of countries that had an FSAP during the corresponding financial year.

- The share of SICs that are given the highest rating by IMF area departments has fallen over the period FY2002–05.[5] The reasons are not fully clear, but in some cases area departments appear to be accepting countries' reluctance to volunteer.
- In effect, each institution has the ability to "block" countries appearing on the joint priority list that is signaled to the two managements. This has led to some cases of countries not been signaled as priorities for FSAPs because of concerns that to do so might disrupt the broader relationship with the country.[6] Thus, when a country was rated 1 by one institution and 3 (or not rated at all) by the other, typically that country was not included in the working plan of the FSLC. This was the case with Turkey and Malaysia, which were rated 1 in three successive submissions by IMF area departments, but were either rated 3, or not rated by the World Bank regions. For the FY2005 submission, these countries were dropped from the ratings.
- The share of SICs that are being flagged as high priorities for Updates is very small. One-third or less of the "pool" of SICs where the lag between initial FSAP and completion of Update would be at least four years are being signaled as "high priority."
- A very high proportion of nonsystemically important countries rated as the highest priority were included in that year's program.

In sum, while all SICs that volunteer for the program are implemented in a timely manner, the

[5]One reason why the IMF list submitted to the FSLC has many more "high-priority" ratings than does the similar list from the World Bank is because the former includes advanced economies (including the G-7).

[6]The FSLC uses the ratings given by the regions and area departments in the preparation of the working program. For example, whenever a country is rated 1 by both a region and area department, it is highly likely that it makes into the list, followed by those rate 1 by one of them and 2 by the other. For countries for which the IMF is solely responsible, for example the G-7, generally it suffices to have a rating of 1 to make it into the working program. The evidence shows that there are some exceptions to these working rules, reflecting at times the fact that country authorities have indicated their preference not to participate or to do so at a later date. There are also cases where a country is rated low by an area department or region, but it is nevertheless included in the working plan reflecting the drive to achieve geographical and developmental diversity, or because of a substantial lag since it volunteered.

**Table A4.3. Formal Assessments of Standards and Codes by Country Type[1]**
*(In average number of standards and codes)*

| Standards and Codes FSAP Vintage | Country Type[2] | | | |
|---|---|---|---|---|
| | Advanced | Emerging | PRFG-eligible | Total |
| Basel Core principles | | | | |
| Pilot | 1.00 | 1.00 | 1.00 | 1.00 |
| Pre-2003 | 1.00 | 1.00 | 1.00 | 1.00 |
| Post-2003 | 1.00 | 1.00 | 0.89 | 0.97 |
| CPSIPS | | | | |
| Pilot | 1.00 | 0.63 | 1.00 | 0.75 |
| Pre-2003 | 1.00 | 0.90 | 0.81 | 0.90 |
| Post-2003 | 0.50 | 0.73 | 0.33 | 0.52 |
| IAIS | | | | |
| Pilot | 1.00 | 0.50 | 0.50 | 0.58 |
| Pre-2003 | 1.00 | 0.70 | 0.31 | 0.66 |
| Post-2003 | 0.88 | 0.18 | 0.00 | 0.31 |
| IOSCO | | | | |
| Pilot | 1.00 | 0.50 | 0.50 | 0.58 |
| Pre-2003 | 1.00 | 0.67 | 0.38 | 0.66 |
| Post-2003 | 0.88 | 0.36 | 0.22 | 0.48 |
| MFP | | | | |
| Pilot | 1.00 | 1.00 | 1.00 | 1.00 |
| Pre-2003 | 1.00 | 0.97 | 0.88 | 0.95 |
| Post-2003 | 0.38 | 0.55 | 0.56 | 0.48 |
| Memorandum item | | | | |
| Total average number per country, excluding AML/CFT | | | | |
| Pilot | 5.00 | 3.75 | 4.00 | 4.00 |
| Pre-2003 | 5.50 | 4.37 | 3.50 | 4.36 |
| Post-2003 | 4.00 | 2.75 | 2.00 | 2.86 |
| **Total** | 4.91 | 3.88 | 3.04 | 3.88 |

Sources: MFD database and IEO estimates.
[1]Includes all completed FSAPs and those in which at least a first mission has taken place through June 2005.
[2]Advanced as per World Economic Outlook classification, PRGF-eligible as per PDR classification, and emerging all other countries.

number of such "volunteers" is declining markedly, especially for Updates, and the current system is no longer providing an effective signaling of priorities independent of such countries' willingness to volunteer.

Finally, data on the number of detailed standards and codes assessed per FSAP indicate that the greater selectivity called for by the Boards has been implemented as planned (Table A4.3):

- The average number of standards assessed (excluding the AML/CFT) has declined to under 3 since the 2003 review.
- Fewer standards are being assessed in emerging market economies and even fewer (an average of only 2) in low-income countries.
- The banking standards (Basel Core principles) are assessed in almost all cases.

## Resource Costs of the FSAP

To track costs of the FSAP for the two institutions, we combined data from the IMF (MFD) and World Bank on the expenses incurred on each FSAP (staff and experts' time plus travel costs, but excluding overhead). While there are some differences in the way the cost data are compiled in the two institutions, we do not think the differences are sufficiently great to affect the overall conclusions.[7]

[7]IMF data on staff resource costs are calculated from the amount of staff and expert time spent on each FSAP (obtained from the Budget Reporting System) and applying standard labor cost factors (salaries plus benefits) provided by MFD (at an average of about $200,000 per person-year). World Bank data are actual dollar budgetary expenses reported under the FSAP accounts. The IMF data do not include expenses associated with AML/CFT assessments, whereas the World Bank data include such costs. For

### Table A4.4. Direct Cost of Initial FSAP Assessments for the World Bank and IMF[1]

*(In thousands of U.S. dollars)*

| | IMF Average[2] | | World Bank Average[3] | | Total | | |
|---|---|---|---|---|---|---|---|
| Country Type | Total | Of which: labor | Total | Of which: labor | Average[4] | Maximum | Minimum |
| Advanced | | | | | | | |
| Pre-2003 | 822 | 571 | 110 | 67 | 887 | 1824 | 321 |
| Post-2003 | 591 | 371 | 36 | 25 | 600 | 939 | 438 |
| Emerging | | | | | | | |
| Pre-2003 | 410 | 295 | 271 | 167 | 681 | 1469 | 267 |
| Post-2003 | 367 | 280 | 321 | 223 | 689 | 1108 | 559 |
| PRGF-eligible | | | | | | | |
| Pre-2003 | 396 | 287 | 259 | 155 | 656 | 1070 | 323 |
| Post-2003[5] | 408 | 294 | 285 | 146 | 693 | 824 | 459 |
| All countries | | | | | | | |
| Pre-2003 | 488 | 349 | 244 | 151 | 710 | 1824 | 267 |
| Post-2003 | 438 | 308 | 283 | 172 | 668 | 1108 | 438 |

Sources: MFD, World Bank Secretariat to the FSLC, and IEO estimates.

[1]Excludes overhead, but includes cost of experts and travel costs. Data for the FY2001–04 period (IMF financial year). The costs of noncompleted FSAPs (Argentina, Côte d'Ivoire, and Uruguay) are excluded from the calculations. The unit of observation is the completed FSAP, irrespective of the fiscal year in which the expense is incurred.

[2]Estimates based on the amount of time allocated to FSAPs, converted into U.S. dollars using a factor provided by MFD. Excludes the cost of AML/CFT assessments.

[3]The estimated average is based only on the FSAPs in which the World Bank actually participated.

[4]The reported values are not the sum of the corresponding values for the IMF and World Bank, as the latter does not always participate in FSAPs for advanced economies. Rather the estimates reported are total direct cost divided by total number of FSAPs.

[5]Includes costs for an FSAP undertaken in the Eastern Caribbean Currency Union, which covers six small countries. Excluding this FSAP from the calculations, the estimates for the first five columns would be $379,000, $275,000, $303,000, $129,000, and $681,000.

The main findings (see Table A4.4) are as follows:

- The average direct cost has declined by about 6 percent between the pre- and post-2003 review periods, with a 10 percent decline for the IMF partially offset by a rise in average cost for the World Bank.[8]
- The realized savings are driven by a sharp decline in the average direct cost of FSAPs in advanced countries, while the average direct cost of FSAPs in both emerging and PRGF-eligible countries have not changed much.[9]
- Resource savings generated by the reduction in the number of formal assessments of standards and codes in emerging and PRGF-eligible countries have been reallocated to other activities in the FSAPs for these countries.
- Post-2003, the average direct cost of FSAPs in emerging and PRGF-eligible countries is broadly the same (around $690,000), which is surprising.
- The IMF still incurred the larger share of FSAP costs for assessments in PRGF-eligible countries after the 2003 review (about 60 percent).
- FSAP Updates for which direct cost data are available suggest the potential for some savings

earlier cost estimates by the staff, see "FSAP—Indicative Fund Resource Costs" (SM/03/77, Supplement 4, February 2003), and "Financial Sector Assessment Program—Indicative Fund Resource Costs" (SM/05/67, Supplement 2, February 2005).

[8]The post-2003 review period corresponds to the latter part of FY2003 and FY2004.

[9]These statements and the data reported in Table A4.5 treat the FSAP for the Eastern Caribbean Currency Union (ECCU) as a single assessment. However, excluding this case does not alter the broad conclusions.

### Table A4.5. FSAP Team and Deputy Leaders and Country Type[1]

*(In number of FSAP led)*

| | World Bank | | IMF | |
|---|---|---|---|---|
| | Leader | Deputy | Leader | Deputy |
| Advanced | . . . | 1 | 21 | 20 |
| Emerging | 33 | 22 | 22 | 33 |
| PRGF-eligible[2] | 21 | 11 | 11 | 21 |
| Total | 54 | 34 | 54 | 74 |

Sources: World Bank FSAP website and IEO estimates.

[1]All completed or ongoing FSAPs and Updates through June 2005.

[2]Advanced as per *World Economic Outlook* classification, PRGF-eligible as per PDR classification, and emerging all other countries.

of resources, although this would depend on the type of reassessment. Estimates range between $45,000 for a very narrow Update (Iceland) to $342,000 for a significantly more comprehensive Update (Kazakhstan), which is half the average cost of initial assessment for a PRGF-eligible country.

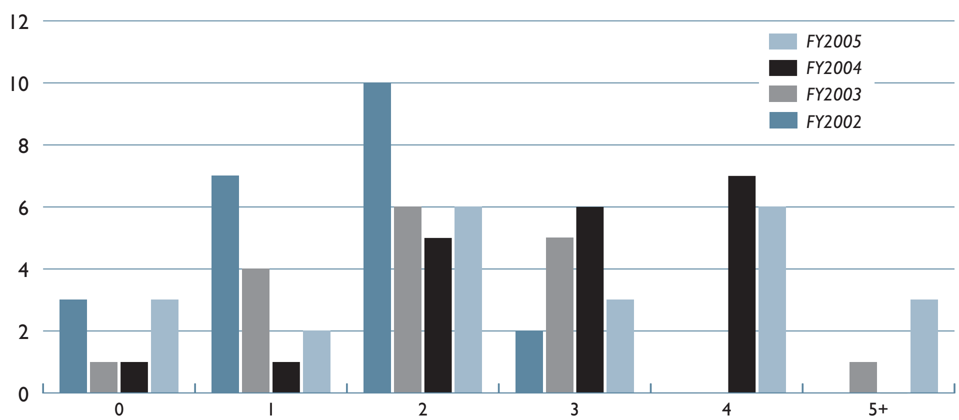
## FSAP Mission Organization

The FSLC allocates FSAP team leadership responsibility between Bank and Fund staff. In practice, overall team leadership has been divided equally (Table A4.5). The IMF staff have led all FSAP teams to advanced countries, about 40 percent of teams to emerging market economies, and one-third of teams to low-income countries.

During interviews with the evaluation team, some senior Bank and IMF staff expressed concern over what they perceived to be the increasing appointment of team leaders with little experience. In their view, this runs the risk of lowering the quality of FSAPs as the task of mission leader requires the judicious combination of technical skills and balanced macrofinancial policy judgment necessary to form sound overall assessments.

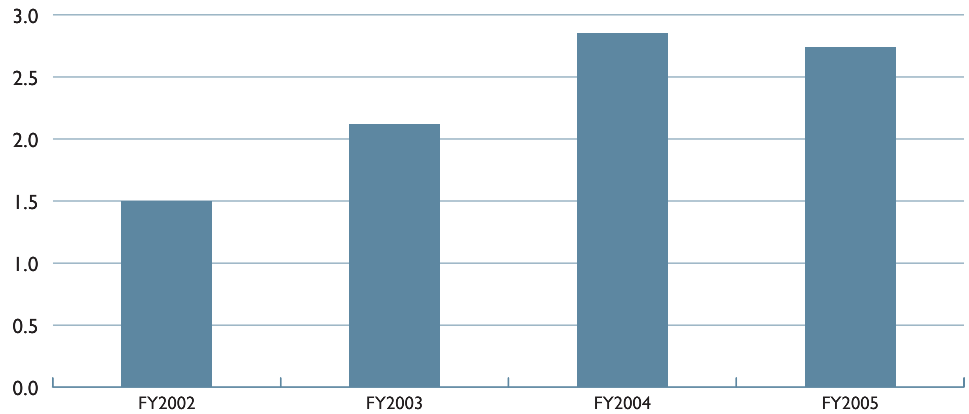
An examination of trends in the experience of FSAP team leaders (defined in terms of their participation in previous FSAP missions) suggests that there may be some basis for this concern. After rising steadily as the FSAP exercise matured, the "average" previous experience of FSAP team leaders began to decline again in FY2005 and the share of team leaders with no or very limited previous FSAP experience began to rise (Figures A4.1 and A4.2).

**Figure A4.1. FSAP Mission Leaders and Experience[1]**
*(Number of prior FSAPs)*




Sources: Travel Information Management System and IEO estimates.
[1]A "unit" of experience is participation in an FSAP either as a team member or in a leadership capacity.

**Figure A4.2. Median "Units" of Experience[1]**
*(Prior FSAPs)*




Sources: Travel Information Management System and IEO estimates.
[1]A "unit" of experience is participation in an FSAP either as a team member or in a leadership capacity.