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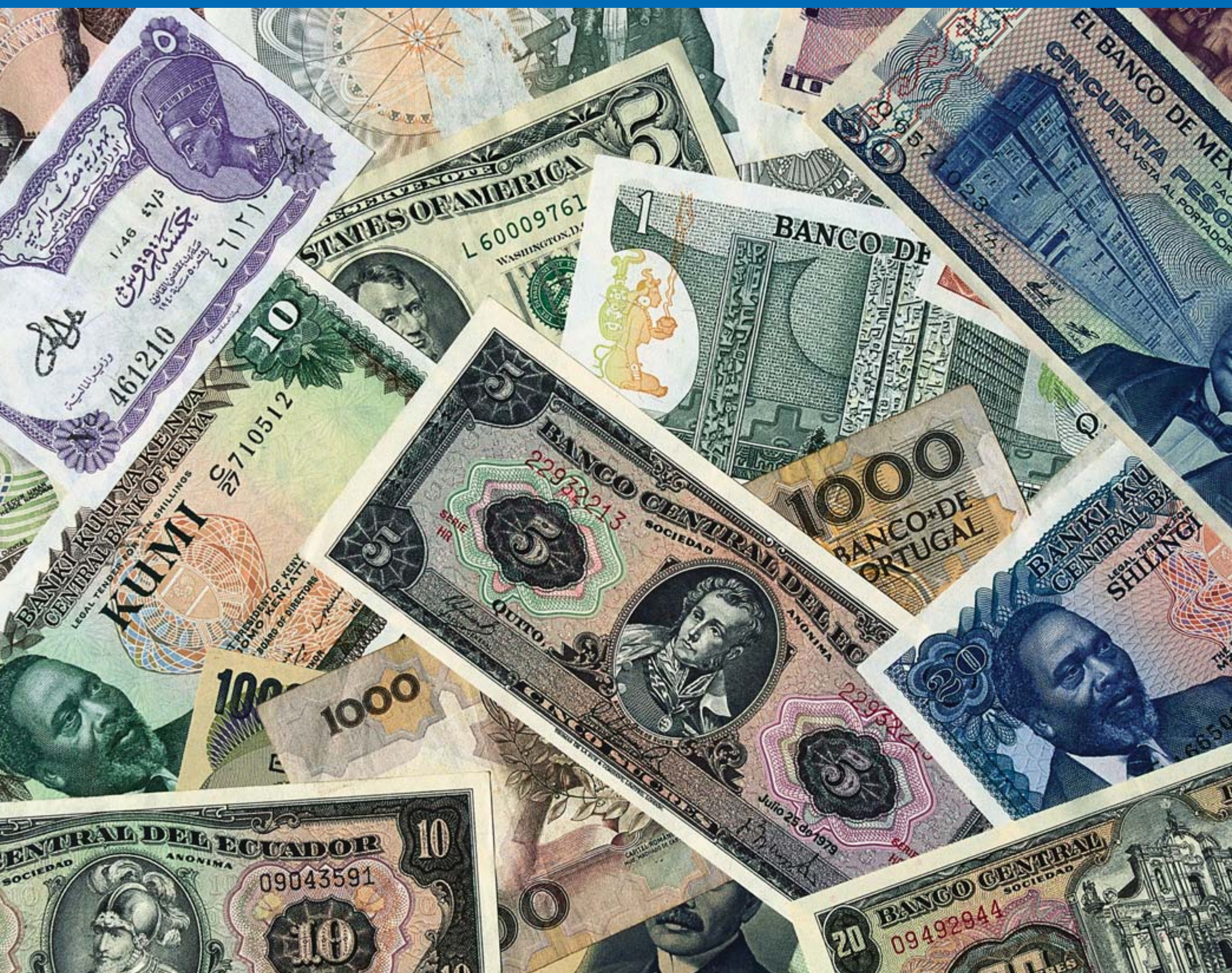
THE WORLD BANK

Financial Sector Assessment Program

IEG Review of the Joint World Bank and IMF Initiative



INDEPENDENT EVALUATION GROUP

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The World Bank
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Foreword

The Financial Sector Assessment Program (FSAP) is a major initiative, undertaken jointly by the World Bank and the IMF, in response to the financial crises of the late 1990s.

The ultimate objectives of the program are (i) to identify and resolve financial sector vulnerabilities and their macroeconomic stability implications; and (ii) to foster financial sector development and its contributions to economic growth. In addition, the FSAP is expected to help the Bank, IMF, and other institutions in the design of appropriate assistance to address issues identified by the FSAP.

This evaluation focuses on reviewing aspects of the FSAP that affect the attainment of the above objectives, specifically, the relevance of the program, quality, and effectiveness of inputs and outputs, and the impact of the assessments on different audiences. An evaluation of the ultimate impact of the program would be premature, given the limited time since the program was expanded.

The evaluation found that the FSAP is a good-quality diagnostic tool. Joint Bank and IMF cooperation has allowed an integrated approach toward identifying financial sector vulnerabilities and development needs, and has expanded the depth and quality of the skills base. The assessments, however, fall short in prioritizing recommendations and integrating the findings and recommendations of the assessments into overall country programs.

Country Selection. The FSAP has not covered all "systemically important" or vulnerable countries, or focused on countries where assessments can be most effectively used for development. The voluntary nature of the program limits the program's overall effectiveness in identifying systemic risks; however, there is a strong consensus among authorities and staff that the voluntary nature of the program should be maintained.

While the overall quality of diagnostics was generally good, the quality and appropriateness of coverage of specific sectors was uneven. Assessments of the nonbanking sectors were not as consistent as those of the banking sector. The Bank also needs to (i) develop better approaches toward analyzing missing market and access issues; (ii) devise creative solutions to improve those areas; and (iii) improve prioritization, sequencing, and analysis of implementation capacity.

Candor. The candor of the reports was generally satisfactory, although there have been some instances where the government or management has pressured staff to soften the written messages, or where the staff has chosen to convey key messages through presentations and discussions, rather than through written reports. Also, the current practice of informing the Executive Boards of the Bank and IMF is not effective. Financial Sector Assessments (FSAs) are delivered long after mission work is completed, so the Boards are not kept informed on a timely basis. In addition, because FSAs are summaries of the full assessments, sometimes the full context and nuances of the report have been inadequately conveyed.

Impact. While the program is still too new to have had measurable effects on ultimate outcomes (reduction of vulnerabilities and improved financial sector development), the assessments have been positively cited by country authorities for (i) providing an independent evaluation of the system; (ii) expanding their knowledge of the financial sector; (iii) improving technical abilities; and (iv) contributing to policy dialogue within the country. "Results on the ground" have been more difficult to assess; authorities have stated that most recommendations have been implemented, whereas Bank and IMF staff, as well as Independent Evaluation Group (IEG) reviews of country programs, have not yet seen as much evidence of implementation of critical reforms.

While the program has raised awareness among government authorities and within the Bank on the importance of the financial sector on stability and development, IEG finds that only 42 percent of the assessments have had a significant impact on the Bank's country programs or dialogue. In another 34 percent, the assessments had a minor influence, such as through reinforcing previous sector knowledge or contributing to the ongoing dialogue.

The FSAP does appear to have influenced economic and sector work (ESW) at the Bank; countries that have undertaken assessments appear to follow up with smaller, more targeted ESW, whereas countries with no assessments are more likely to carry out major pieces of ESW. This indicated that assessments are effectively leveraged.

The program has improved IMF surveillance, but has not had as strong an impact on other donors' and institutions' programs. While other donors support the initiative, and some have been able to use the FSAP to help shape their own programs, improved donor coordination would allow better leverage of donor resources to support reforms

Efficiency. The FSAP is a costly program, although the Bank's share of costs are commensurate with the costs of other major financial sector studies. Bank resources could be used more effectively if more time were spent on appropriate country selection and better tailoring of coverage. Efficiency and quality of the assessments would also improve if the Bank made full use of existing data and staff with country experience, and used the FSAP reports to internally leverage its knowledge base.

The relevance and efficiency of the program could be enhanced through improved country selection and better tailoring of assessments. Selection criteria would strengthen the program's mandates to decrease systemic risk and support financial sector development through focusing on systemically important countries, while realistically assessing the likelihood of impact (client commitment, preexisting conditions, etc.).

Better integration of the findings and recommendations of the FSAP into the overall country program is needed. This would include better coordination with donors. In the cases where a decision is made not to support FSAP recommendations through the Bank's program, the Country Assistance Strategy (CAS) needs to make the rationale clear (limited resources and other higher priority needs, availability of support through other sources, need to work on preconditions, etc.).

Improvements must be made in the process of keeping the Executive Board informed. The current process, on average, takes almost a year after the completion of mission work to deliver documents to the Board. In addition, there is not a clear venue for discussing critical issues and findings of the assessments.

Finally, the Bank must do a better job of knowledge sharing, both within the Bank and with partners. The assessments have resulted in a large amount of information that could assist programs within countries, across regions, and with partners. In addition, more effective partnering with other sectors would improve the knowledge base and insights of the assessments.

Vinod Thomas
Director-General
Evaluation

Preface

This evaluation presents an independent assessment of the joint World Bank-IMF Financial Sector Assessment Program (FSAP). This is the third in a series of reviews of financial sector work conducted by the Independent Evaluation Group (IEG).

The first evaluation was of *World Bank Lending for Lines of Credit*; the second was an *IEG Review of World Bank Assistance for Financial Sector Reform*, not including lines of credit or financial sector assessments.

The FSAP is conducted as a joint program between the Bank and the IMF, and the IMF's Independent Evaluation Office (IEO) carried out a parallel assessment of the program. The two teams worked in close collaboration, conducting joint interviews and surveys, and sharing data and interim work products.

This evaluation was circulated to the Bank Management involved in financial sector support, the Financial Sector Board of the Bank, the FSAP Unit (FSEFS), and the Financial Sector Operations and Policy Department (OPD). The Management response is attached as appendix E.

This evaluation was discussed by the Committee of Development Effectiveness (CODE) on February 6, 2006. The CODE Chairman's summary is included as appendix F.

Main Messages

- The quality of the diagnostics has been good, although quality and the appropriateness of specific sectors is uneven.
- Country authorities have found the assessment to be useful.
- FSAP recommendations need to be better integrated into Bank programs.
- Country selection needs to better reflect surveillance priorities and the likelihood of financial sector reform.
- The scope of assessments must be more tailored to the specific needs of the country.
- The program must do a better job of keeping the Executive Board informed in a timely manner.

Executive Summary

This evaluation is one of three IEG evaluations of the Bank's financial sector work. The first was a review of *World Bank Lending for Lines of Credit*; the second was an *IEG Review of World Bank Assistance for Financial Sector Reform*, which did not include lines of credit or financial sector assessments.

This evaluation focuses on the Financial Sector Assessment Program (FSAP). The IMF's Independent Evaluation Office (IEO) undertook a parallel evaluation of the FSAP. The IEO and IEG have collaborated closely on all aspects of their respective evaluations.

The Financial Sector Assessment Program (FSAP) is a major initiative, undertaken jointly by the World Bank and the IMF, in response to the financial crises of the late 1990s. The FSAP was set up in May 1999, initially as a 12-country pilot exercise consisting of diagnostic studies designed to facilitate early detection of financial sector vulnerabilities and identification of financial sector development needs, as well as support an improved and coordinated dialogue among the national authorities, the Bank, and the IMF. As of October 2005, over 109 country assessments and 18 updates have been completed or are ongoing, and the program has involved a significant deployment of resources at the Bank.

Various policy documents and review papers have indicated that the ultimate objectives of the FSAP comprise: (i) the identification and resolution of financial sector vulnerabilities and their macroeconomic stability implications, which would then lead to a reduction in the likelihood of crisis and improved global financial stability, and (ii) fostering financial sector development and its contribution to economic growth. In addition, the FSAP was expected to help the Bank, IMF, and other institutions design appropriate assistance to address issues identified by the assessments.

Ideally, this FSAP evaluation would measure whether the ultimate objectives have been achieved. But, given the limited time period since the program started and the voluntary nature of the program, such an analysis is premature. This evaluation instead focuses on reviewing aspects of the FSAP that affect the attainment of those objectives, specifically the relevance of the program, the quality and effectiveness of inputs and outputs, and the impact of the assessments on different audiences.

The FSAP is predicated on the assumption that the objectives of financial sector stability and development are essential and relevant to the Bank's and the IMF's missions. Reviews of economic data and literature have confirmed that financial sector crises often lead to sharply increased poverty and reduced growth, and that there is a link between financial sector development and poverty reduction and improved growth. Hence, this evaluation confirms that the program's objectives are relevant to the Bank's mission.

This evaluation has found that the FSAP is a good-quality diagnostic tool and the overall concept for the program is sound. Joint Bank and IMF cooperation has allowed an integrated approach toward financial sector vulnerabilities and development needs, while expanding the depth and quality of analytical expertise. However, the assessments are weak in prioritization and the Bank falls short in integrating the findings and recommendations of the assessments into its country programs, and could also take other steps (discussed below) to sharpen the program's relevance, quality, impact, and efficiency.

Quality. The overall diagnostics were generally good, but the quality and appropriateness of coverage of specific sectors was uneven. While banking sector coverage was satisfactory, the coverage in the nonbank financial sectors was not consistently of the same quality. The Bank also needs to develop better approaches toward analyzing missing markets and access issues, and devise creative solutions to improve those areas. This would include: (i) improving the use of indicators and datasets; (ii) deepening the analysis of political economy, culture, and other country-specific aspects that would allow the team to help authorities design tailored solutions; and (iii) focusing more on interlinkages between sectors, which would help authorities to develop better priorities and sequencing.

Prioritization of recommendations was weak, which adversely affected the impact of the overall program. There were often too many "priority" recommendations, or sequencing and implementation capacity were not well addressed. This may partly be due to the view of some Bank staff that the FSAP is only a diagnostic tool, although the mandate of the FSAP envisioned the use of the assessments as platforms for future work, policy dialogue, and as catalysts for financial sector reform. The assessment could be better oriented toward follow-up, with improved prioritization and sequencing.

Teams. The quality of teams was rated quite highly; 93 percent of country authorities responding to a survey on the FSAP expressed satisfaction with the FSAP team's skills. However, authorities have raised concerns about continuity of staff and the need for strong country experience. In addition, seniority of staff involved in the program has been dropping off; if the quality of the assessments is to be maintained, management will need to monitor staffing closely.

Candor. The candor of the reports was generally satisfactory, although there have been some instances where the governments or management have pressured the staff to soften the written reports, or where the staff have chosen to convey key messages through presentation and discussions, rather than through the written reports.

Informing the Executive Board. The current practice of informing the Board is not effective. Financial Sector Assessments (FSAs) are delivered a substantial time (both in absolute terms and compared with the IMF's delivery of the Financial Sector Stability Assessments (FSSAs) after the mission work is completed, so the Board is not informed on a timely basis. Also, given that the FSAs are summaries of the full assessments, sometimes the full context and nuances of the report have been inadequately conveyed.

Impact. While it is still too early to judge the full impact of the program, the assessments have been well received, and country authorities have cited the assessments for (i) providing an "independent evaluation" of the system, (ii) expanding their knowledge of financial sector vulnerabilities, (iii) improving technical abilities, and (iv) contributing to the policy dialogue within the country. "Results on the ground" have been difficult to assess; authorities have stated that most recommendations have been implemented, whereas Bank and IMF staff, as well as IEG reviews of the country programs, have not seen as much evidence of implementation of critical reforms. For example, authorities have noted post-FSAP changes, especially in legal, regulatory, and supervisory reforms, but the attribution is difficult, as many of these reforms have been part of previous Bank or IMF policy discussions. In addition, the more difficult reforms will take more time, and greater impact may be seen in the future.

Impact within the Bank. While the program has raised awareness with authorities and within the Bank on the importance of the financial sector on stability and development, IEG has found that only 42 percent of the assessments had a significant impact on the Bank's country programs or dialogue, as manifested by important changes or strengthening of the Bank's program or dialogue. In another 34 percent of countries, the assessments had a minor influence; for example, the assessment might have reinforced previous sector knowledge and contributed to the ongoing dialogue, and may have helped spur minor changes in the financial sector program, but there was no evidence that the direction or pace of the program had changed due to the assessment. The remaining 24 percent seemed to have had little influence on the Bank's program. Factors that could affect the degree of impact include the following: (i) country selection does not always factor in the usefulness of a development assessment (countries that are more advanced may not need Bank assistance; countries that lack the preconditions for a well-functioning financial sector, or have no interest in reform, might not be able use a development assessment effectively or in a timely fashion); (ii) there is no clear mechanism for Bank follow-up (such as the IMF's Article IV consultations (discussions with government authorities in the context of surveillance work); (iii) the country units are not always fully involved in planning the scope of, or participating in, the assessment, which may in turn affect both the efficiency of the assessment, and the effectiveness of follow-up activities.

The FSAP does appear to have influenced ESW at the Bank, as countries that have had assessments appear to have undertaken smaller, more targeted ESW in subsequent years. Countries without assessments are more likely to carry out major pieces of ESW. This indicates that assessments can be usefully and effectively leveraged.

Impact on the IMF. One impact of the program has been an improvement in IMF surveillance. IEO concluded in its evaluation that the program had significantly deepened the IMF's understanding of the financial sector in specific countries, improved the articulation of policy recommendations and discussions with authorities, and helped support policy and institutional changes in the countries.

Partners. However, the FSAP has not had as strong an impact on other donors' and institutions' programs. While other donors support the initiative, and some have been able to use the FSAP to help shape their own programs, the flow of information is less timely and complete than they would wish. Improvements in donor consultation would allow better leverage of donor resources to support reforms.

Country selection. The FSAP has not covered all "systemically important" or vulnerable countries, or selected countries where financial sector development assessments can be most effectively used. The voluntary nature of the program limits the program's overall effectiveness in identifying systemic risks; however, there is a strong consensus among authorities and staff surveyed for this review that the voluntary nature of the program should be maintained. Without the full cooperation of authorities, access to detailed information and key staff would be difficult, and would reduce the effectiveness of the exercise significantly.

Efficiency. The FSAP is an expensive program, although the Bank's share of costs is commensurate with the costs of other major financial sector studies. Bank resources could be more efficiently used if more time were spent on appropriate country selection and better tailoring of coverage. Efficiency and quality of the assessments would also improve if the Bank made full use of existing data and staff with country experience, and used the FSAP reports to internally leverage its knowledge base (and that of the IMF and other institutions).

Recommendations

Sharpening country selection and the scope of assessment have major impacts on the relevance of the program, both for the reduction of vulnerabilities, and the impact on the development agendas of the countries. Given limited budgets, there are difficult tradeoffs to be made, particularly when balancing the need to improve surveillance with development priorities. Management staff of the Bank and the IMF need to select countries for assessments and updates according to the priorities identified by the Boards, as well as the likely impact of the FSAP in a particular country, and adjust timing to suit the situation. In some cases, such as systemically important and vulnerable countries, this may mean that updates are carried out every two or three years. In other countries that are less systemically important or that are unlikely to treat financial sector development as a priority, initial assessments or updates could be delayed by several years. A priority list, as well as the rationale for selection, should be presented to the Board. In cases where countries have not volunteered, management needs to inform the Board of those gaps, and seek other ways to work with the country in addressing critical issues in the financial sector.

The scope of the initial assessments and updates must be more tailored to address the specific needs of the country. This may mean that a systemically important, vulnerable country may require a full set of Reports on Observance of Standards and Codes (ROSCs), and minimal discussion on missing markets or access issues, whereas another country may not require any formal ROSCs, but instead focus on access issues. Also, this process would be more efficient if more time was spent in advance, working with country units and authorities on developing prioritized terms of references (TORs).

Integrate the FSAP into a full reform program. The Bank, in consultation with the IMF and other technical assistance providers, must establish a clearer framework for coordinating follow-up programs, including technical assistance activities, based on the country's own action plans. While details will differ by country, building upon the FSAP by having follow-up discussions with country authorities on technical assistance and other development needs is essential; such discussions should include Bank technical and country staff, as well as the IMF's Monetary and Financial Systems Department and area staff. Once development and other assistance priorities are determined, this information should be quickly shared with the donor community. In addition, to improve donor effectiveness, the following recommendations might be considered: (i) inform donors in advance about the timing of the FSAP, so that donors can adjust their program timetables accordingly; (ii) improve consultations with donors who are active in the financial sector during the FSAP mission, including presentations of key findings; and (iii) provide donors with better and more timely access to reports.

Country units and the financial sector teams must work more closely to better integrate the FSAP findings and recommendations into the Bank's country strategies. This would include greater participation of the country units in the design of TORs, mission teams, and follow-up discussions. If a strategic decision is made that Bank follow-up to the FSAP will be limited, the CAS needs to briefly explain the reasons why (limited resources which need to be allocated to other priorities in the county, availability of other donor programs, need to sequence other reforms first, lack of interest or commitment of the client in those sectors, etc.).

Informing the Executive Board. The process of informing the Board is currently not working well. The FSAs take too long to produce. A deadline needs to be placed on the production time of the FSA. One option to speed up production is to leverage the work by the IMF more effectively. The IMF releases the FSSA an average of 16 days after the final report is sent to authorities. While cognizant that the different foci, timetables, and processes make it difficult to quickly produce a joint paper, the Bank could use the FSSA as a platform to summarize the main findings of the assessment, and then add chapters or appendixes on development or other issues, on which the IMF may not have focused.

Unlike the IMF, which discusses the FSSAs with its Board, there is no discussion of FSA documents at the Bank's Board, so the import, context, and nuances of the reports are often not clear. Critical information must be brought quickly to the Board or a subcommittee for discussion. In addition, discussions of key FSAP findings and recommendations, and their integration into the country program (or, as noted above, the decision not to include them into the country program), would ideally be part of the Country Assistance Strategy (CAS) report and discussions. Bank management could also consider periodic technical briefings summarizing major findings from recent assessments, as well as synthesizing the information to provide recommendations for future work (within countries, across regions, and for future assessments).

Knowledge sharing. While remaining mindful of the needs of safeguarding sensitive and confidential information, the Bank must more actively leverage the knowledge gained from this extensive exercise. This would include actively disseminating "best practice" analysis, more discussion on concerns and issues that arise while conducting assessments, and improved sharing of data and insights gained through the program. The financial sector teams also need to partner more effectively with other sector teams to maximize collection and sharing of information.

In summary, the technical quality of the diagnostics has generally been good, although there are inconsistencies in the coverage and quality of some sectors. The assessments, however, often have weak prioritization of recommendations, and do not adequately consider sequencing or institutional capacity constraints. Furthermore, the Bank does not do enough to integrate the assessments' findings and recommendations into its country programs. While the IEO has found that the assessments have improved the IMF's surveillance work and significantly deepened the IMF's understanding of the financial sector in some countries, the parallel impact on the Bank and its financial sector development work has not yet occurred to the same degree. The full potential of the FSAP's usefulness to the Bank, therefore, has not yet been attained.

ACRONYMS AND ABBREVIATIONS

BCP	Basel Core Principles (for Effective Banking Supervision)
CAS	Country Assistance Strategy
CODE	Committee on Development Effectiveness
CPSS	Committee on Payment Systems and Settlements
DFID	Department for International Development
ESW	Economic and sector work
FIRST	Financial Sector Reform and Strengthening Initiative
FSA	Financial Sector Assessment
FSAP	Financial Sector Assessment Program
FSEFS	FSAP Unit
FSI	Financial Soundness Indicators
FSSA	Financial System Stability Assessment
FY	Fiscal year
IADB	Inter-American Development Bank
IAIS	International Organization of Insurance Supervisors
IEG	Independent Evaluation Group (formally OED)
IEO	Independent Evaluation Office (of the IMF)
IFI	International financial institution
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
OED	Operations Evaluation Department (changed to IEG)
PRSP	Poverty Reduction and Strategy Paper
ROSC	Report on Observance of Standards and Codes
SECO	Secretariat d'Etat a l'Economie
TMF	Code of Good Practices on Transparency in Monetary and Financial Policies
TOR	Terms of reference

Introduction

The Financial Sector Assessment Program (FSAP) is a major initiative, undertaken jointly by the World Bank and the IMF, in response to the financial crises of the late 1990s. The FSAP was set up in May 1999, initially as a 12-country pilot exercise to provide diagnoses to client countries to facilitate early detection of financial sector vulnerabilities and identification of financial sector development needs, as well as to support an improved and coordinated dialogue among the national authorities, World Bank, and IMF.

Each assessment would include written reports for government authorities and the Executive Boards of the Bank and the IMF.[1] As of October 2005, over 109 country assessments and 18 updates have been completed or are ongoing, and the program has involved a significant deployment of resources at the Bank. (See appendix A for a list of assessments and updates).

Main Objectives of FSAP

Various policy documents and review papers have indicated that the *ultimate objectives* of the FSAP comprise: (i) the identification and resolution of financial sector vulnerabilities and their macroeconomic stability implications, which would then lead to a reduction in the likelihood of crisis and improved global financial stability, and (ii) fostering financial sector development and its contribution to economic growth.[2] In addition, the FSAP was expected to help the Bank, IMF, and other institutions design appropriate assistance to address financial sector issues identified by the FSAPs.

The rationale for placing development and stability objectives under the same program (and thus for having a joint Bank-IMF initiative) has been elaborated 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' analyses 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, and considerable synergies might be achieved by addressing them jointly (e.g., institutional development aspects that may affect financial stability). These factors argued for an integrated approach to financial sector assessment. In terms of responsibilities, based on policy documents and their respective institutional expertise and mandates, the IMF would take the lead on stability issues, while the Bank would lead on development issues. However, because development aspects may have stability implications, and vice-versa, coordination between the two institutions is key.[3]

The FSAP was initially conceived of as a diagnostic and policy advice tool that would provide: (i) confidential advice to country authorities, (ii) information for the Bank and the IMF on development and stability issues, and (iii) in some cases, information to the international community.

Design and Implementation of the FSAP

In September 1998, the Financial Sector Liaison Committee was set up, comprising senior staff from the Bank and IMF, to enhance operational coordination between the two institutions on financial sector issues, including policy advice and support. Subsequently, the committee took managerial responsibility over the FSAP, including country selection, assigning lead responsibility between the IMF and the Bank in each country, and resolving contentious issues in specific cases.

In response to the financial crises of the late 1990s, the FSAP was created to facilitate early detection of vulnerabilities and financial sector development needs.

The FSAP provides findings and recommendations to country authorities both verbally—in a concluding session with senior national authorities—and in written documents. The documents include (i) an aide-mémoire, previously referred to as an FSAP report; (ii) detailed assessments of compliance with selected standards and codes (and associated Reports on the Observance of Standards and Codes (ROSCs)); and (iii) supporting technical notes. In addition, drawing on the FSAP findings for a country, Bank staff prepare a Financial Sector Assessment (FSA), summarizing major findings of the FSAP mission; the IMF staff prepare a Financial System Stability Assessment (FSSA), which summarizes the findings of relevance to IMF surveillance as part of its regular Article IV consultations. While the aide-mémoire is a confidential document, the FSA and FSSA are provided to the Board. Governments then have the option to publicly disclose these assessments or not.

Scope of the Evaluation

This evaluation is one of three IEG evaluations of the Bank's financial sector work. The first evaluation was of *World Bank Lending for Lines of Credit*; the second was an *IEG Review of World Bank Assistance for Financial Sector Reform*, not including lines of credit; and this evaluation, the third, is of the Financial Sector Assessment Program. The IMF's Independent Evaluation Office (IEO) has undertaken a parallel evaluation of the FSAP. The IEO and IEG have collaborated closely on all aspects of their respective evaluations.

Ideally, this FSAP evaluation would measure whether the ultimate objectives of increased financial stability and the reduction in the likelihood of crises, and fostering financial sector development and its contribution to economic growth have been achieved. But, given the limited time period since the program started and the voluntary nature of the program, such an analysis is premature.[4] This FSAP evaluation instead focuses on reviewing aspects of the FSAP that would affect the attainment of those objectives, specifically the relevance of the program, the quality and effectiveness of inputs and outputs (see appendix B for an illustrative framework), and impact of the assessments on different audiences.

To this end, IEG reviewed all FSAPs completed by fiscal year 2004, as well as related documents such as CASs and other Bank documents, and considered the articulation of recommendations and linkages to technical assistance (TA), policy and institutional change, and integration with other Bank work.[5] In addition, together with IEO, detailed country reviews were completed for 19 countries (IEO conducted an additional six detailed reviews of FSAPs in developed economies),[6] where the review of core documents were supplemented with detailed desk reviews of additional documents including project documents, relevant economic and sector work (ESW) (both financial sector and multisector, such as Poverty Reduction Strategy Papers and Country Economic Memorandums), and IMF documents. The detailed country reviews also included interviews with team leaders, mission chiefs, and country directors; and in all but two cases, interviews with authorities were conducted.[7] Following the detailed reviews, IEG and IEO carried out a survey to ascertain to what extent information gleaned from interviews and desk reviews were representative of the group of countries that had participated in the FSAP. (See appendix C for a detailed discussion of methodology; appendix D provides more details on the survey). IEG and IEO also conducted additional interviews with donors and other outside parties.

This paper is structured as follows: chapter 2 focuses on relevance, program design and inputs; chapter 3 discusses outputs; chapter 4 discusses the impact of the program outside the Bank; and chapter 5 summarizes key findings and recommendations.

Relevance, Program Design, and Inputs

Relevance

The FSAP is predicated on the assumption that the objectives of financial sector stability and development are essential and relevant to the Bank's and the IMF's missions. The initial documents setting out the rationale for the program note that crises in the financial sectors of emerging markets "highlighted the devastating effects of financial system failures on macroeconomic stability, growth, and welfare"[1] and "a well-functioning financial services sector is essential for sustained economic development and poverty reduction."[2]

The last decade provides ample evidence of the devastating impact that financial crises can have on countries. Most of the countries that have had such crises have seen their poverty rates jump dramatically and growth rates turn sharply negative (table 2.1), and some of the countries have taken years to recover their precrisis per capita income levels.

Research has also shown a causal link between financial sector development and growth,[3] and there is a new body of literature showing the link between financial sector development and poverty, including Beck, Demirguc-Kunt, and Levine (2004), which finds that financial sector development leads to less income inequality, and Honohan (2004), which shows that financial depth is correlated with the level of poverty. The objectives of the FSAP are thus highly relevant to the Bank's overall mission of fostering economic growth and reducing poverty.

Country Selection

The first key design element that will affect relevance is country selection. If the objectives of the FSAP are to be met, then the FSAP should focus on assessing countries that are systemically important or are considered more vulnerable, and ones where the FSAP can have an influence on financial sector development.

The Boards noted these priorities in their early discussions of country selection, which stated that the FSAP arose as a response to "episodes of financial crisis and cross-border contagion"[4] in the 1990s. Given the resource constraints of the FSAP program, "within any one year, giving a higher priority to systemically important countries would be warranted, while

Table 2.1. Select Countries with Financial Crises: Changes in Poverty Rates and GDP

Countries	Crisis year	Poverty rates: Precrisis	Poverty rates: Postcrisis	Real change in GDP (%, year following crisis)
Mexico	1995	23.32 (1994)	28.60 (1996)	–6.2
Indonesia	1998	25.7 (1996)	37.0 (1999)	–15.4
Korea, Rep of	1998	11.4 (1997)	23.2 (1998)	–10.6
Thailand	1998	12.5 (1996)	15.7 (1999)	–13.7
Malaysia	1998	.04 (1997)	0.11 (2000)	–12.7
Argentina	2002	37 (2001)	58 (2002)	–10.9

Source: Argentina data are from the World Bank 2003a. For other countries, "crisis year" is the peak crisis year, as determined in Caprio and Klingebiel 2003; Poverty rates are from World Bank 2000a, annex 1 and "Mexico: Country Assistance Strategy (late 1990s), and use the poverty levels as defined in those papers. GDP growth numbers are from Claessens, Kingebiel, and Laeven 2001. Different intervals are used for pre- and postcrisis poverty rates since data are not available for each year.

The objectives of the FSAP are highly relevant to the Bank's mission, as financial sector crises and depth have strong links with poverty and growth.

reiterating the importance of including countries at various levels of development in order to give a full range of countries access to benefits from the program's support for strengthening their financial policies and institutions in line with international practices."[5] Specific factors for country selection included: (i) interest of authorities in financial sector assessment and willingness, if necessary, to undertake reforms, address vulnerabilities and otherwise strengthen the financial sector; (ii) size, complexity, and relative efficiency of the financial system; (iii) size of the country and economy and economic and financial links with other countries in the region; and/or (iv) scope and timing of structurally related work under way in the country (i.e., existing Bank and IMF programs).[6] Although not explicitly listed, regional distribution and income levels of countries have also been factors in selection. The program relies on voluntary participation, but it was envisioned that over time, the full membership of the Bank and the IMF would be covered,[7] with reassessments being carried out as needed.

These factors, particularly the voluntary nature of the program, are not always consonant with each other, which has led to important omissions. A number of countries which are generally viewed as "systemically important" or vulnerable have not been assessed yet, nor have some countries with large financial sector development needs. Across a range of definitions, a large proportion of systemically important countries have had an FSAP, but about 20-30 percent have not (including China, Indonesia, Thailand, Turkey, the United States, and Venezuela) (see figure 2.1), and about one-third of countries with significant indications of vulnerability have also not yet undergone an FSAP.[8]

The Financial Sector Liaison Committee has attempted to balance the selection of countries by carrying out assessments of countries at all levels of development. To date, low-income countries are underrepresented (table 2.2), as are countries in the East Asia and Pacific Region and Sub-Saharan Africa Region (table 2.3). This reflects the tradeoff between emphasizing systemic importance versus depth of financial

Figure 2.1. Percentage of Countries with FSAPs

	Below median	Above median	
Systemically important[a]	66.7%	76.2%	73% of all systemically important xountries have FSAPs
Not systemtically important	53.8%	47.0%	54% of the not systemically important countries have FSAPs
	55% of countries with low M^2/GDP have FSAPs	54% of countries with high M^2/GDP have FSAPs	

M^2/GDP

Source: World Bank databases, IEO and IEG analyses.

a. Defined as the G-7 plus countries monitored by Bank for International Settlements.

sector development, as well as the voluntary nature of the program.

Voluntary nature of program. The voluntary nature of the program limits the program's overall effectiveness in identifying systemic risks. Nevertheless, interviews and surveys indicate that the majority of authorities and staff support the maintenance of the voluntary nature of the process.[9] The FSAP is a time- and labor-intensive exercise for staff and authorities alike.[10] Without the full cooperation of country authorities, access to detailed information and key staff would be difficult, and would reduce the effectiveness of the exercise significantly.

This tradeoff between effectiveness of the individual assessments and the effectiveness of the program's overall surveillance role has not been resolved. Although most systemically important countries acknowledge the importance and support participation in the program, these statements of support have not always been translated into action.[11] Given the practical realities of the situation, and the limited resources available for the program, resources should be directed at those countries that are willing to provide the data, access to key personnel and other support needed to make the assessments effective.

Table 2.2. Countries with FSAPs, by Income Level

	FSAPs completed	
Income Level	**Number**	**% of countries**
Low	21	36
Lower Middle	32	59
Upper Middle	22	55
High Income	31	56

Source: World Bank data.

Table 2.3. Percentage of Countries with FSAPs per Bank Region

Bank Regions	**Percentage of Countries with FSAPs per Region**
East Asia and Pacific	8.3
Europe and Central Asia	81.5
Latin America and the Caribbean	59.4
Middle East and North Africa	64.3
South Asia	50.0
Sub-Saharan Africa	35.4
BANK Regional Total	**47.7**
Advanced/High-income economies	77.4
BANK MEMBER TOTAL	**52.7**

Source: FSAP database, World Bank country group websites.

Scope of Assessments

The FSAP program sought to "develop an approach to financial system assessment that is broadly consistent across countries, while allowing for difference in emphasis to reflect different country circumstances." Staff would begin from a standard template, but would develop "a narrower country-specific focus depending on the structure of the country's financial system and an evaluation of priorities for both system stability and sector development."[12] The recent progress reports from Bank and IMF Management to the Boards on the FSAP stated that over time, there has been greater selectivity of assessments, with better streamlining and tailoring to country needs.

IEG found that since the 2003 Board update, which proposed more streamlining, the frequency of conducting the five most frequently used ROSCs has begun to drop off (table 2.4), and that there are fewer ROSCs in countries with less developed economies (table 2.5). Based on the review of individual FSAPs, decreasing the number of formal ROSCs has not impaired the quality of the FSAPs.[13]

Beyond the streamlining of ROSCs, IEG's review of FSAPs did not find consistent evidence of tailoring of topics to the country circumstances.[14] While many FSAPs are clearly tailored to reflect the circumstances of the country, others appear to be more heavily template driven. A review of the terms of

Table 2.4. Frequency of Assessment Done in Fiscal Years 2000–04

FY	BCP	TMF	CPSS	IOSCO	IAIS	Sum	Average per country
2000	13	11	3	8	7	42	3.2
2001	21	14	16	15	12	78	3.7
2002	20	18	19	17	14	88	4.2
2003	13	10	10	6	4	43	3.3
2004	17	11	9	10	5	52	3.1
Total	84	64	57	56	42	303	3.6

Source: IEG analysis based on reviews of FSAPs. Full assessments only; excludes updates. Reports reviewed were: Core Principles for Effective Banking Supervision (BCP), Code of Good Practices on Transparency in Monetary and Financial Policies (TMF), Committee on Payment Systems and Settlements (CPSS), International Organization of Securities Commissions (IOSCO), and International Association of Insurance Supervisors (IAIS).

Table 2.5. ROSCs per Category of Country

Category of country	Total number of countries	BCP	TMF	CPSS	IOSCO	IAIS	Total	Average number of ROSCs
Advanced in percent of countries	19	19	17	15	19	15	85	4.5
		100%	89%	79%	100%	79%		
Emerging in percent of countries	31	31	22	21	25	21	120	3.9
		100%	71%	68%	81%	68%		
Developing in percent of countries	34	34	25	21	12	6	98	2.9
		100%	74%	62%	35%	18%		
Total	84	84	64	57	56	42	303	3.6

Source: IEG analysis based on reviews of FSAPs.

reference (TORs) and the main reports of detailed country reviews found that 63 percent of the TORs and 47 percent of the main reports either did not prioritize sectors or did not adequately discuss the reasons for selecting particular sectors. Failing to tailor did not necessarily result in a poor FSAP; 75 percent of FSAPs reviewed were rated satisfactory overall, although with some weaknesses in specific areas (see table 2.6 in the section on output quality).

Updates

Questions of scope and priorities are more marked for updates. Whereas the original assessments were envisioned to be comprehensive, updates were to be more selective and focused, with flexibility on the scope. All updates were to include progress in implementing FSAP recommendations, a financial stability analysis, updates of standards and codes included in the initial assessment, and a reassessment of key development issues discussed in the first assessment.[15] Updates could also address issues not covered in the previous assessment, as well as carry out a deeper review of areas that were covered in the initial assessment.[16]

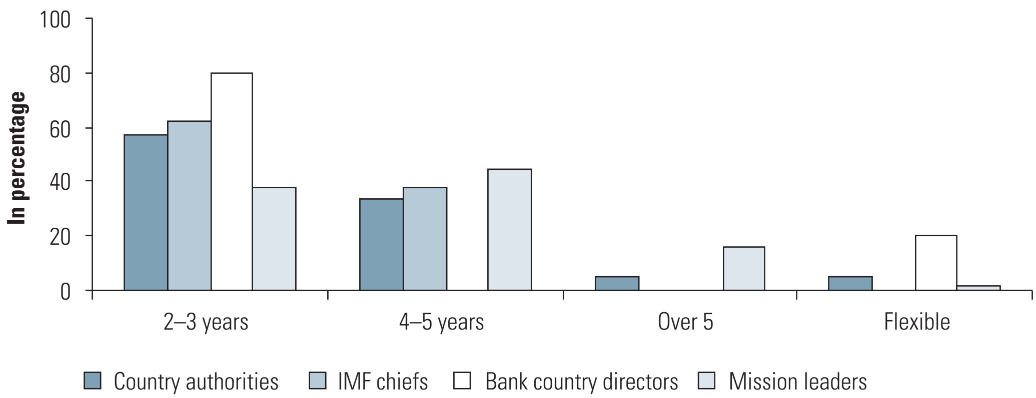
Ideally, the FSAP and the updates would be used to help support ongoing and timely surveillance of vulnerabilities, as well as provide input to development plans. To date, resource constraints have limited the number of assessments and updates to about 17–19 per year; at this rate, coverage of the full Bank/IMF membership would take approximately 10 years. Having an update every 10 years would not support either surveillance or development. Indeed, most survey respondents stated that two to three years is the appropriate time frame for updates (figure 2.2), with 90 percent supporting a time frame of four years or less.

Costs

IEG and IEO reviewed cost data for the FSAPs[17] of joint mission teams. Joint FSAPs averaged US$685,000, with an average Bank contribution of US$244,000. Bank and IMF management had expected that increased tailoring (especially in lower-income countries), as outlined in the fiscal year 2003 progress report on the FSAP, would result in lower costs. While fiscal year 2004 costs are lower (an average of US$652,000), there is not yet sufficient evidence to determine whether this is due to tailoring, selection of countries, or other factors[18] (figure 2.3). Data also show that the Bank's share of costs is higher in fiscal year 2004 than in previous years but the IMF still is

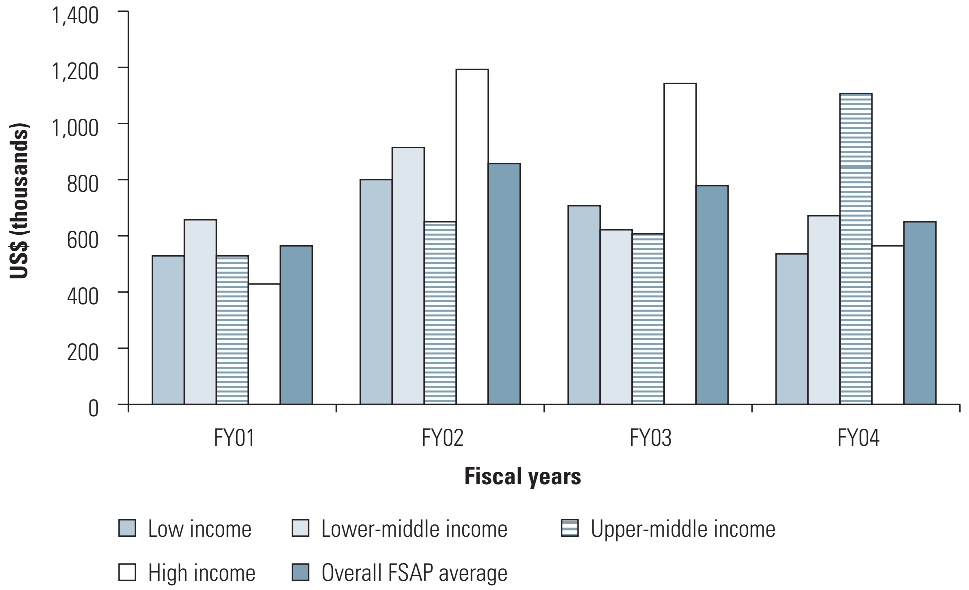
A significant number of systemically important countries have not yet had FSAPs.

Figure 2.2. Recommended Frequency of FSAP Updates



Source: IEG/IEO survey results; government authorities; IMF mission chiefs; team leaders; World Bank country directors.

Figure 2.3. Average FSAP Cost by Income Level



	FY01	FY02	FY03	FY04
Average FSAP Costs	$561,443	$859,059	$775,748	$652,019
World Bank Portion	37%	35%	31%	40%
IMF Portion	63%	65%	69%	60%

Source: World Bank budget data; IMF budget data.

responsible for about 60 percent of costs (figure 2.3).

Complete cost data were only available for four updates. These updates were substantially less costly than the full assessments, averaging US$266,000, of which the Bank paid approximately US$159,000, or 60 percent of the costs. This is consistent with the content of the updates, which were stability assessments, but often additional work on development topics was involved. Although initial costs submitted for other updates indicate that the average cost will be more expensive than the four completed thus far, data available at this time indicate that updates will still be substantially less costly than full assessments.

For timely surveillance and input into development plans, updates should be conducted every two to three years.

Compared with most pieces of ESW, the full FSAPs are very costly. However, the Bank's portion of the assessment is, on average, US$244,000 per assessment, which is slightly lower than the average cost for financial sector studies.[19] From fiscal year 2000 to fiscal year 2004, 45 major pieces of financial sector ESW were carried out, at an average cost of US$251,000.

The FSAP has not appreciably changed the amount of other financial sector ESW carried out by the Bank; 44 major pieces of financial sector ESW were carried out from fiscal year 1995 to fiscal year 1999. However, the composition of the ESW has changed. Of the major country-specific ESW pieces since fiscal year 2000, three-quarters were carried out in countries that had not yet carried out an FSAP. Smaller, targeted pieces of ESW are more common in counties that already have had FSAPs. The indications are that the Regions are using FSAPs as background pieces, and are subsequently carrying out smaller studies to supplement those assessments.

The FSAP does deliver more information than standard ESW, usually in the form of analyses such as the ROSCs and stress tests, which are more critical for surveillance than financial sector development. Much of the cost of that additional information and analysis is borne by the IMF. The IEO report indicates that the IMF has been satisfied with the improvements in surveillance.

Another aspect to be considered is the link between cost and country selection. The FSAP can be cost-effective for the Bank, when it is carried out in countries where a development assessment can be of use. However, in countries where financial sector development is still nascent, carrying out a full assessment does not appear to be a good use of Bank funds.

Cost-effectiveness can be expected to improve over time, as more updates are carried out in lieu of full assessments. In addition, increased streamlining should decrease overall costs. However, a more discriminating selection of countries to be assessed, and more up-front work to tailor the scope of the assessments, especially the inclusion of ROSCs, would further improve the cost effectiveness of the program.

Advance Preparation

One way of reducing costs is to maximize advance preparation. As noted above, 63 percent of TORs did not prioritize sectors or adequately discuss the reasons for inclusion of specific topics. In interviews, the authorities noted that the effectiveness of the program could be improved if there had been more consultation at the TOR stage, resulting in greater selectivity of topics. Others commented that, even in countries where extensive work had been previously carried out in the financial sector by the Bank and the IMF, the FSAP team often used a standard questionnaire rather than data previously obtained in the context of other missions. Other suggestions for improvement were to: (i) increase the lead time for data requests; and (ii) increase continuity of staff from previous financial work and for follow-up work.

Review Stage and Staffing

The review stage for the FSAPs may be too late in the process to provide input or add much quality control. While both the country and sector directors are generally involved to some extent, and a peer review process is carried out, major changes are rarely made at the review stage. Because the draft of the main document is left in the field, and the major points have already been discussed with authorities, it is difficult to alter core messages in the review stage. In interviews, the few examples of messages being changed were cases where the country authorities or management pushed for a softening of a critical report. The review stage does, however, seem to increase production time considerably (table 2.6).

One indicator of the efficacy of the review stage can be seen by the value placed by the team on resulting comments received. In the survey, team leaders and team members were asked about the usefulness of the comments received from the IMF and Bank (figures 2.4 and 2.5). A few things that can be noted from the survey: (i) most respondents were satisfied with the comments; (ii) IMF comments were viewed more favorably than Bank comments (by both Bank and IMF staff); (iii) 18 percent of team leaders and 15 percent of team members were actively dissatisfied with comments from the Bank departments; and (iv) more than one-third of mission members responded "don't know," when asked about Bank comments, as compared with 15 percent that responded the same to IMF comments.

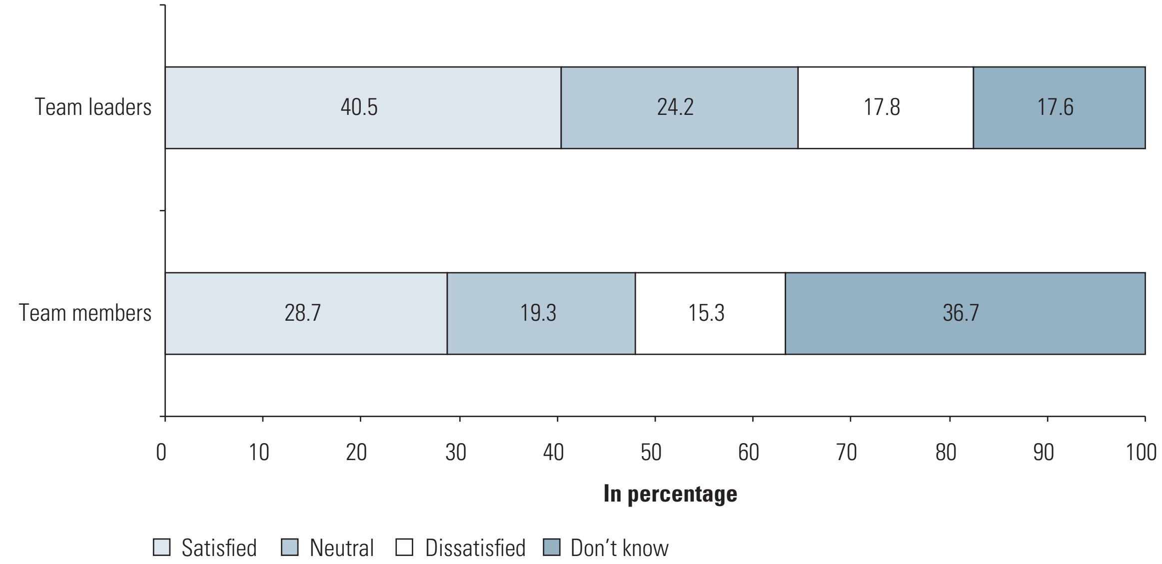
Economic and sector work is better targeted in countries that have received FSAP assessments.

Table 2.6. Completion Times of FSAP Documents

	Number of days since start of first mission	
	Joint Bank/ IMF FSAP	IMF-only FSAP
Draft aide-mémoire left in field	68	75
Delivery of final FSAP report to authorities	297	289
Completion of FSSA	311	293
Completion of FSA	394	N.A.

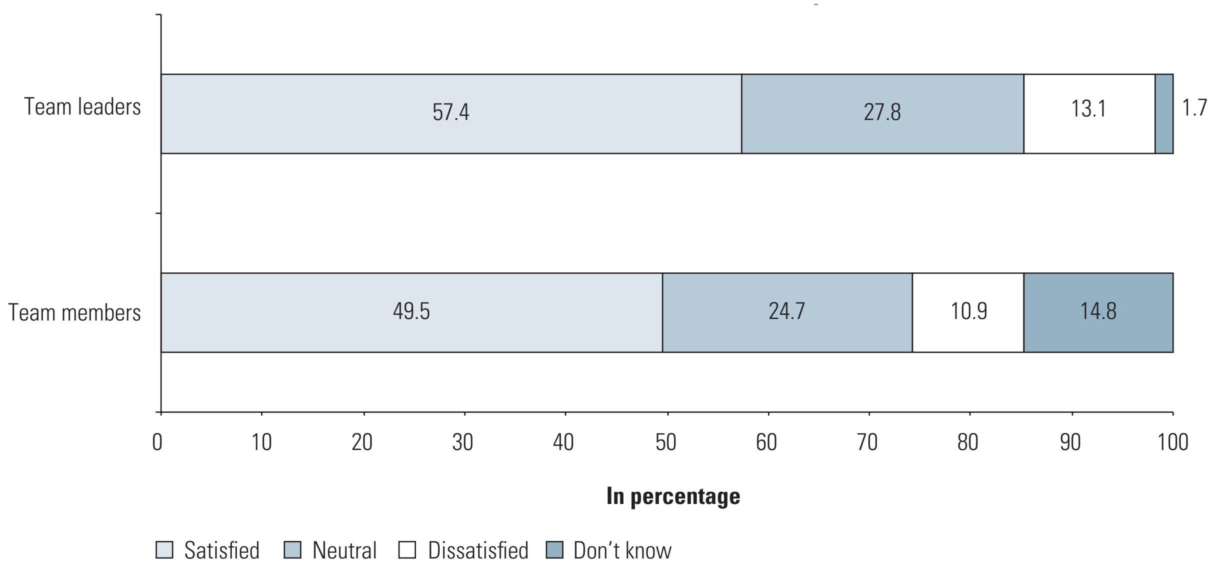
Source: Financial Sector Liaison Committee data, as of February 14, 2006.

Figure 2.4. Satisfaction with Comments from Bank Departments



Source: IEG/IEO survey; team leaders and team members.

Figure 2.5. Satisfaction with Comments from IMF Departments



Source: IEG/IEO survey, team leaders and team members.

Staff skills. There is high praise for the technical quality of the teams, especially those undertaking detailed standards assessments. Survey results indicate that the teams, as a whole, were well thought of, with 93 percent of authorities agreeing or strongly agreeing that team skills were "completely adequate." However, as noted above, *continuity of staff* was a problem raised in interviews by several authorities, who stated that not enough use was made of knowledge gained by previous teams and that key staff from the FSAP teams were not available for follow-up work.

There is a divergence of views on the *appropriate level of country experience* of staff. In some interviews, managers felt that team members should not have recent country experience, because those who had worked recently in the country or who had a current work program could be biased in their assessments, as they would be, in part, critiquing their own work. However, the majority of country authorities interviewed felt that some team members must have deep country experience, as that would allow for better tailoring of FSAPs, a better understanding of realities in the country, and better continuity of dialogue. While the issue of country knowledge might also be assuaged with more time spent in preparation or in the field, it would be more efficient to maximize the use of staff with country knowledge. As discussed in chapter 4, the inclusion in the FSAP process of more staff with country experience, including country unit staff, might also have the effect of improving the integration of the assessments into the Bank's country programs.

Given that most of the key messages are discussed in the field by the team, prior to the formal review, the quality of staff is critical. The team leader and deputy team leader have crucial roles in the selection of priorities of the assessment, integrating the results from many sector reports into an overall assessment, and developing, clear, prioritized recommendations. This task requires considerable technical expertise and policy judgment. Concern has been raised in interviews with both Bank and IMF management that as the FSAP has become more "routine," less experienced team leaders and mission members have been selected, with a potential adverse effect on quality. IEG's review of the composition of FSAP teams does show that the percentage of senior technical staff on the teams (H-level and above) has fallen from 33 percent in fiscal years 2001–02 to 13 percent in fiscal year 2005 and year-to-date in fiscal year 2006. Because these recent assessments are still being revised and completed, they were not included in this evaluation's detailed country reviews. As they are completed, however, it will be important for Management to monitor them to ascertain whether the decline in senior staff involvement has had any adverse effect on quality.

Joint Program between the IMF and World Bank

The joint nature of the FSAP program has both positive and negative features, but based on interviews and surveys of team leaders and team members, the consensus is that the advantages of the joint nature of the program outweigh the disadvantages. Among the positive aspects are: (i) a deeper pool of analytical expertise; (ii) pooled knowledge of the countries; (iii) more focused attention on the program by the authorities; and (iv) better coordination between the Bank and the IMF on recommendations and policy advice. Both Bank and IMF staff felt that, overall, the FSAP was improved by the participation of both institutions.

The review process lengthens processing time considerably, yet it is too late to provide much input into key messages.

Coordination between the two institutions may generate inefficiencies though, as evidenced by the longer production times for final documents when both institutions are involved (table 2.6).[20] Interviews also indicated that friction between the teams sometimes existed. Most staff, however, acknowledged that these inefficiencies might be even greater if the program did not exist, for example, disagreements on policy advice, if not discussed within the framework of the FSAP, could cause problems if authorities do not receive coordinated advice. On balance, both IEG and IEO agree that there are strong synergies from the joint program and it should be continued.

The inclusion of more staff with country knowledge would allow for better tailoring and continuity of dialogue.

A related question was raised at earlier Board discussions of the FSAP on whether the program should be formally expanded to include other institutions. The program has

The advantages of a joint Bank-IMF program outweigh the disadvantages.

successfully used experts from a number of other agencies and institutions, and some institutions have indicated an interest in being more actively involved with the program. Indeed, 91 percent of surveyed team leaders and 85 percent of surveyed mission members felt that outside experts worked well with the team. However, given the difficulties of coordination within the Bank/IMF arrangement, it seems impractical to expand the program to formally include more institutions on a regular basis. Chapter 5 discusses a number of recommendations on how to improve the role of donors.

Outputs

This chapter presents findings on the scope and quality of the assessments, as well as the usefulness and candor of the findings and recommendations. The primary sources were detailed reviews of all the FSAP reports for the 19 detailed countries' studies;[1] supplemented by survey results, and more limited reviews of other FSAP documents.

Quality of Analysis

The overall ratings for the FSAPs from the detailed country studies were generally satisfactory, although problems were identified, depending on the area rated, in 7 to 58 percent of the FSAPs reviewed (table 3.1). Interview and survey respondents also indicated that they were generally satisfied with the FSAPs, with almost 90 percent of country authorities responding that they were satisfied with the coverage and more than 70 percent were satisfied with the depth of analysis. IMF mission chiefs and Bank country directors had similarly high evaluations of the reports. Authorities were also positive, on balance, between stability and development, and the usefulness of the assessment in delivering new insights about the financial sector.

IEG's detailed country studies also found that most sectors were adequately covered, but there was variability in quality. The quality and thoroughness of the banking sector analyses were the most consistent, with 100 percent of the FSAPs covering the banking sector in detail, and only 7 percent of the banking sector analyses receiving a problem rating from reviewers. There was greater variability in the coverage and quality of the analysis of the other sectors, ranging from 19 to 58 percent of the analyses rated moderately unsatisfactory or unsatisfactory.

The emphasis on the banking sector was often appropriate, because in many countries, the banking sector dominated the financial sector;[2] hence, the other sectors might have a minimal effect on overall financial sector stability. In a number of cases, the FSAP clearly noted that the small size of those sectors led the authorities and team to limit assessment of specific areas. However, some of the omissions appeared inconsistent with country circumstances; for example, over one-third of assessments in low-income countries had little discussion on access issues

Overall ratings for the FSAPs were generally satisfactory.

For the nonbanking sectors, table 3.1 shows that while the average ratings were satisfactory, there were higher percentages of "problem" assessments. The weaker analyses reflect, in

Table 3.1. Summary of Results of Detailed Reviews

Criteria	Mean score (on scale of 1-4)	Percentage of ratings indicating some problems (i.e., ratings of 3 or 4)
Coverage of overall financial sector	2.38	26
Balance of development and stability issues	2.02	16
Banking	1.76	7
Insurance	1.73	29
Capital Markets	1.78	19
Asset Management/Pensions	2.29	58
Market Infrastructure	1.98	31
Clarity and candor of findings	2.16	16
Importance and consequence well explained	2.25	26
Clarity of recommendations	1.93	11
Usability of recommendations	2.08	21
Prioritization of recommendations	2.62	53

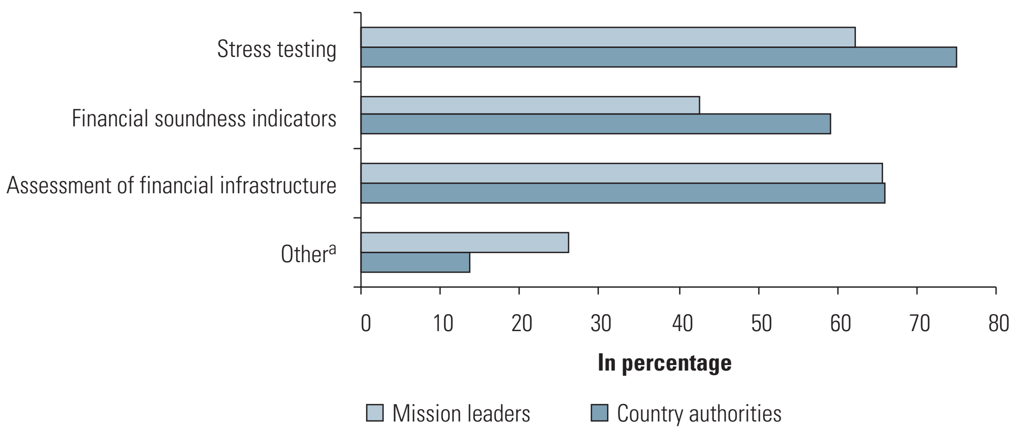
Source: IEG evaluations. "1" is the highest rating, "4" is the lowest rating. See endnote 1 for more detailed information on the ratings.

part, a weaker set of analytical tools and poorer data availability. In addition, few FSAPs fully analyze the linkages between sectors and discussed the effects on sequencing; for example, only about a third of detailed FSAP reviews had an integrated discussion of insurance issues with capital markets and investment issues.

Analytical tools. Analytical tools were well received; in interviews, country authorities frequently pointed to stress tests and the ROSCs as extremely useful tools, and asked for follow-up TA or training. Survey results were consistent with the interviews, with analytical tools being highly rated by country authorities (figure 3.1).

While these tools can be helpful in identifying areas of vulnerability, and thereby assist authorities in prioritizing supervision efforts and identifying needed reforms, each of these tools must be carefully interpreted as they also

Figure 3.1. Most Useful Analytical Components



Source: IEG/IEO survey, multiple responses allowed.
a. Includes analysis of vulnerabilities and development needs.

have a number of shortcomings. For example, the *quality of stress tests* varies greatly, owing to a number of factors including: (i) quality and availability of data; (ii) complexity of models; and (iii) selection of factors including interlinked factors, which might cause a shock to the system (box 3.1). The *type of shocks* considered by stress tests varied by country. In some cases, the variability seemed to be a considered choice (such as exposure to specific commodity risks); in other cases, the selection of issues did not seem to be as tailored to the countries. Finally, stress tests are not always an appropriate tool; they are best used to look at the ability of individual banks to withstand stress, not entire systems.

Bank and IMF staff are well aware of these risks and stressed in their documents the limitations of these tools, which should be interpreted only in the context of a comprehen-

Box 3.1. Stress Testing

Stress testing is a method of quantifying the impact of future extreme (but plausible) shocks on a financial system. The degree of sophistication of approaches used varies substantially across FSAPs, depending largely on the availability of data, sophistication of the financial system, cooperation from the authorities, available time for the analysis, and judgment of the FSAP team. The issues that will affect the quality and validity of stress tests are summarized here.

Data quality. The quality of data, and its implications, for any results should be described candidly; many FSAPs are weak in this respect. There are some cases where the FSAPs stress that the data are extremely poor; however, the results of the stress tests are reported with a great deal of precision, without an adequate discussion of the extremely limited value of a stress test done with poor data. Not conducting stress testing should always be an alternative in such cases (e.g., the *Costa Rica* and *Nigeria* FSAPs appropriately did not undertake any formal stress tests), because there is a high risk of producing spuriously concrete results that mask an unknown situation.

Calibration of shocks. The challenge is to develop a common understanding for what shocks could be considered as exceptional but plausible. Where feasible, calibration could use models to characterize the relationships among macroeconomic risk factors in the context of different scenarios and/or cases in which single variables are shocked (by using statistical or historical approaches). Some recent FSAPs (*Germany* and *Chile*) derived a consistent set of shocks to macroeconomic variables from a macro model. In one OECD country, however, the stress scenarios did not reflect exceptional shocks; they included growth rates of 0 percent and –1.7 percent, which were milder shocks than what the country had already experienced (in 1998 and 2002, actual growth rates were –0.9 percent and –2.4 percent, respectively).

Selection of shocks. The stress tests should select for plausible shocks for each country. For example, countries with heavy dependence on exports of a specific commodity would include price changes in their stress tests. However, some assessments omitted important possible shocks, particularly if they were politically sensitive. For example, the banking sector in one Latin American country holds one-quarter of its assets in government bonds, yet the stress test does not include a scenario for public debt default. One G-20 country's stress tests fail to test for the risks of its large net open position. There was also often inadequate consideration of regional or global effects. For example, the impact of a general lowering of international interest rates on bank profitability in an ECA country was not modeled, even though 40 percent of the banks' assets are invested abroad. In another example, contagion effects were omitted from a G-7 country's analysis. A positive example is *Kazakhstan,* which does consider the contagion effects from shocks in Russia.

Multifactor analysis. Most stress tests have included single-factor sensitivity analysis. The most recent vintages (e.g., *Jordan* and *New Zealand* and many European countries) have also included the use of scenarios that involve simultaneous movements in various macroeconomic risk factors. This is a positive trend as such scenarios could help better analyze the vulnerabilities of the financial system.

Interpretation of the results. More attention needs to be given to the interpretation of stress test results, not only in light of the methodological caveats but also in terms of the relative importance of different shocks (e.g., avoid overemphasizing market risks when credit risks are more relevant from a vulnerability perspective). This is an area where many FSAPs are weak, but *Korea* and *Cameroon* are examples of good practices.

Source: IEO 2006, box 1; IEG staff analysis.

The nonbanking sectors had a higher percentage of "problem" assessments.

sive and ongoing surveillance program.[3] Yet, these caveats are often absent in the FSAP discussions. In addition to the general caveats, IEG's and IEO's detailed country reviews show that individual stress tests sometimes have other flaws, including: (i) lack of a clear explanation for their choice of shocks and the appropriate magnitudes to be used; (ii) avoidance of modeling politically sensitive shocks; and (iii) inadequate consideration of regional or global effects. In some cases, such as when data are poor, the best approach may be to omit a formal stress test, as was done in several FSAPs.

Bank and IMF staff have also noted that freestanding ROSCs are not that useful in reducing vulnerabilities, and should also be carried out in the context of an overall surveillance program.[4] In interviews with Bank and IMF staff, as well as representatives of standard-setting bodies, the following concerns about ROSCs were raised:

- Authorities and other readers often focused only on ratings; team members noted that discussion with authorities often centered on whether there was agreement on the ratings rather than on the underlying substance that was being discussed. In some cases, the staff agreed on a "compliant" rating, relying on the text in the FSAP to spell out their ongoing concerns.[5]
- There is an uneven approach to assessments. Some assessors took the view that the same standards should be applied to all countries (an approach which many country authorities described as "failing to take into account country circumstances"), whereas other assessors stated that the ratings should reflect the country's stage of financial development.[6] One downside of lowering the assessment standards to reflect the level of development is that it can lead to complacency about system deficiencies.[7]

There is too much emphasis on ROSC ratings, instead of the content.

Feedback from assessors also indicated that there may be insufficient time to carry out assessments under the umbrella of the FSAP. For example, one assessor from an outside agency commented that he had two weeks to do one assessment (including field time), whereas he might normally do the same assessment over six months, with multiple trips and exchanges of information in between trips.

Financial Soundness Indicators (FSIs) are also used as a regular part of the analysis. Although most FSAPs presented data on core banking FSIs, there was often insufficient analysis to interpret the data, and insufficient explanation on the limitations of the data. In addition, using aggregate data often obscures vulnerabilities of individual institutions or subgroups of institutions. Financial sector indicators for the nonbanking sector were more sporadically presented, and had even less interpretive information or analysis. This reflects an analytical gap in the amount of development work done in the banking versus nonbanking sectors. One benefit of the FSAP program is that it has helped highlight the need for improved analytical tools, and has led to additional work in improving these tools (such as the recently released *Financial Sector Assessment: A Handbook*, World Bank and IMF 2005).[8] However, there have been neither consistent approaches in areas (such as use of similar tools or benchmarks in countries at similar stages of development), nor has there been a consistent progression in these areas (i.e., a deepening analytical approach over time in specific sectors); some of the latest FSAPs appear not to have drawn on lessons from previous FSAPs, perhaps owing to weaknesses in knowledge sharing in the program (see chapter 4).[9]

Data. While survey results show that teams rated access to data as adequate,[10] IEG's detailed country reviews found that 63 percent of the aide-mémoires either noted there were weaknesses in the data, or were missing important data that would normally be included in the analysis. All the FSAPs reviewed have basic banking sector data (nonperforming loans, provisioning ratios, capital adequacy, etc). In contrast, data for other sectors were more sporadic. Most FSAPs report statistics on size and structure of the nonbank financial institution markets, and liquidity and composition of securities markets, but do not consistently report on other areas which would reflect the sector's vulnerability, term transformation, or profitability, in part because of data availability problems. For example, many assessments exclude discussions of reinsurance, underwriting skills, an analysis of loss ratios, or a discussion of the matching of investment composition with projected liabilities. Data availability also hampers the analysis of access to financial services; usually only a handful of statistics is available (the percentage of deposits held by households, percentage of loans to small and medium enterprises, number of clients served by microcredit institutions, interest rates for microcredit, repayment rates, etc.). While the FSAPs do present the limited available data, they sometimes fail to fully analyze the information, factors such as culture and political economy, and benchmark data available from other FSAPs. To make this part of the FSAP more effective, better approaches are needed for analyzing development issues (see box 3.2 for examples of different approaches to analyzing nonbanking financial issues). The Financial Sector Assessment handbook lists a number of suggested indicators in each sector; however, these indicators are not consistently used.

Box 3.2. Different Approaches to Nonbanking Issues

FSAP coverage of nonbanking financial sectors have varied substantially. Countries face many different conditions, with varying amounts of data available, thus requiring FSAP teams to take different approaches and devise different solutions. Here are some examples of the different approaches:

Interlinkages and sequencing of sectoral development. A number of FSAPs discussed the need to expand the insurance and pension sectors, and to diversify asset holdings, but failed to discuss the lack of available investment instruments. In contrast, the *Tanzania* FSAP noted that investment funds were highly liquid, and in order to maximize returns, the investment funds should be able to invest more assets in equities. However, because equity markets are not well developed in Tanzania, the assessment advises that the funds be allowed to invest a portion of assets in equities of highly rated foreign corporations.

Insurance. Most FSAPs presented the basic industry structure, data on premiums and assets, and focus on the need to improve regulation, supervision, and depth. The *Nigeria* FSAP also discussed the link between insurance and development, and discussed vulnerabilities that could be inferred from the data, including the treatment of unearned premiums and the implications of uncharacteristically low claims ratios.

Capital markets. Many of the FSAPs focused on providing guidance on strengthening and deepening a vulnerable and shallow domestic market. The *Costa Rica* FSAP, instead, recommended that the country should integrate with a regional stock exchange rather than develop its own. The *Kyrgyz Republic* FSAP noted that the capital, insurance, and pension markets are all extremely small, not systemically important, and suffer from weak regulatory oversight. The FSAP then suggested that because these sectors will not be significant in the short term, work in these sectors should be limited.

Access to finance. In many middle- and higher-income countries, access to finance was not a priority, and justifiably was not discussed in depth. In many lower-income countries, where access is an issue, the discussion was surprisingly cursory. Some good examples of discussions do emerge, however. (i) In *Nigeria*, the discussion of access was placed in the context of the overall need for rural finance, given that the rural economy employs about 90 percent of the country's workforce and accounts for about 40 percent of GDP. (ii) In *Sri Lanka*, microfinance is relatively well developed, with an estimated 3 million loans outstanding in the formal sector, with a value of 22 billion rupees (approximately US$270 million) as of 2000. The FSAP report leveraged information taken from a poverty survey to provide data not only on formal microlending institutions, but also informal loans, and an analysis of borrowers, savings patterns, etc. Given the relatively extensive access, the focus of the FSAP is on improving the safety and efficiency of the microfinance system. (iii) In *Gabon,* microfinance is tiny, and little data are available; as of June 2000, there were only 13 microfinance institutions with only 2,781 clients. The Gabon FSAP thus focused more on analyzing the cultural reasons for the lack of microcredit, and avoided assuming that regulatory or legal strictures were constraining the sector.

Source: IEG analysis.

While FSAPs are generally candid, there have been cases where there was pressure to soften the written reports.

While data limitations are a major problem, several actions could be taken to strengthen the analyses. First, more coordination between the financial sector staff and other units in the Bank would help. For example, extensive data on household finance for Sri Lanka came from a household survey undertaken for work on poverty; the extensive work being done in the Private Sector Development Unit on "doing business" can be a useful source of data on small and medium enterprises and larger corporate borrowers. Second, even when there is limited data availability, an understanding of the country environment and culture can make up for data shortfalls (see discussion on Gabon in box 3.2). Finally, there should be wider dissemination of data within the financial sector.[11] Although some data are market sensitive and should remain confidential, industrywide data such as market structure and industrywide asset composition, can and should be shared across FSAP teams.

Quality of Updates. IEG also reviewed the updates; the quality was not substantially different from that of full assessments, although the foci of the updates were intentionally more narrow (box 3.3).

Articulation of Findings

IEG's detailed country reviews indicated that most of the FSAPs had clearly identified key issues (table 3.1), and most of the survey respondents felt that the FSAPs were generally candid. The most common reason given for lack of candor (in cases where it was an issue) was concern that negative findings could adversely affect the financial sector (figure 3.2). In

Box 3.3. Assessment of FSAP Updates

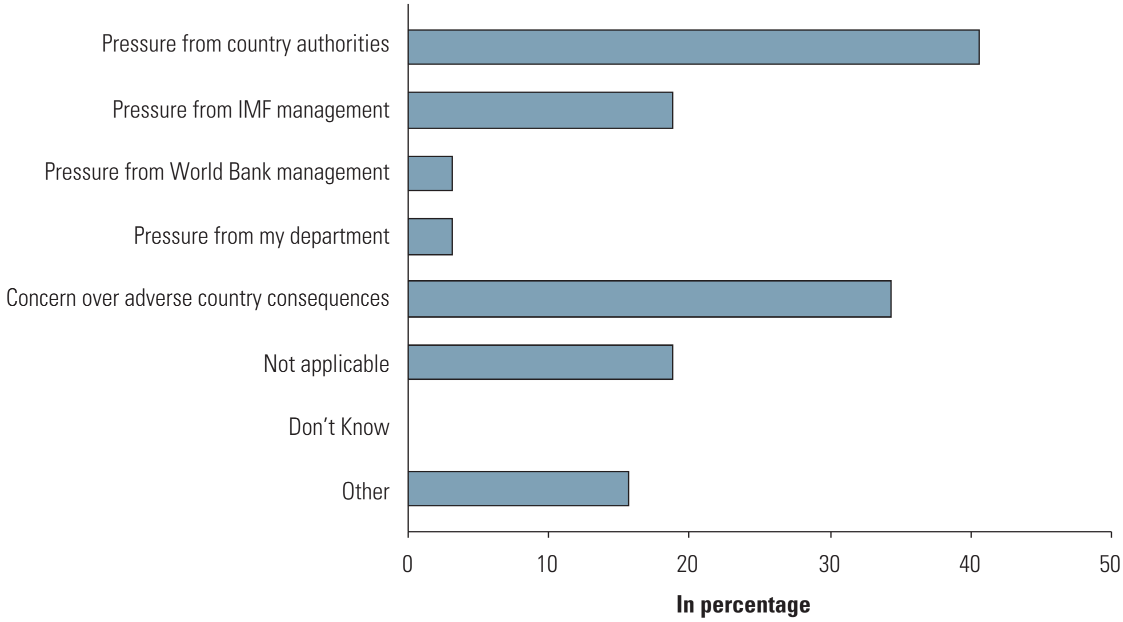
Each of the 10 FSAP updates completed in the post-pilot phase, as of June 2005, was reviewed by following a streamlined template, based on the one used for a detailed country review.[a] The key messages are the following:

- While the scope of the various updates has been implemented flexibly, in line with the Board's guidance, there was limited discussion of the rationale for the scope of updates. Thus, it is difficult to see how each of the FSAP activities fits into an overall strategy for the financial sector in each country.
- As intended, updates reviewed the status of implementation of recommendations.
- While most updates conducted a new round of stability assessments, including stress tests, in most cases there was little improvement in the methodological approach; thus, in a number of instances, data limitations still forced a highly simplistic approach. This raises questions about whether a greater ex-ante assessment of changes in data availability might have concluded that updating such tests was not a high priority use of resources.
- The limitations on what can realistically be expected from updates of different scope and depth (e.g., that narrowly focused updates cannot be expected to provide an in-depth assessment of progress in sectors that fall outside of its scope) are not adequately signaled to the reader. Stronger warnings of these limitations and the necessary qualifications to any conclusions are still needed.
- Inadequate prioritization of recommendations remains a problem in most cases. The updates do not provide an action plan or strategy for developments. Hence, if effective financial sector development is the priority and objective of the updates, they must either provide the additional guidance for strategy or actions, or they must be supplemented by other instruments.
- The degree of integration of findings into Bank programs appears to be broadly similar for updates as well as for full FSAPs.

Source: IEO 2006, box 4; IEG staff analysis.

a. The 10 updates completed in the post-pilot phase were: Armenia, Colombia, El Salvador, Ghana, Hungary, Kazakhstan, Peru, Senegal, Slovenia, and Uganda. IEO also reviewed Iceland, which IEG omitted from its sample because it was an IMF-only update.

Figure 3.2. Reasons for Noncandid FSAP Recommendations



Source: IEG/IEO survey, question 8, includes multiple responses from mission leaders.

interviews, staff explained that concerns about potential leaks led them to tone down the language in the text of aide-mémoires, while delivering tougher messages in wrap-up meetings; differences in wrap-up presentations and aide-mémoires support these statements. Of greater concern are the cases where pressure was put on the team to soften the written reports. Fifty-three percent of team leaders who responded to the survey, stated that there had been factors influencing the candor of results; of which, more than two out of five said they that they had felt pressure from country authorities to change the FSAP, and more than one in five stated that management had pressured the team to change the FSAP. Interviews with team leaders confirmed this perception. Disguising problems, even in a few cases, defeats the purpose of the FSAP program.[12]

Presentation of FSAP recommendations. While the FSAPs usually provide clear diagnoses and recommendations, prioritization is often lacking; indeed, more than half of the detailed country studies gave low ratings to the prioritization in the assessments (table 3.1). FSAPs often had too many "priority" recommendations; sequencing and implementation capacity also were often not adequately addressed. This may, in part, be because of the view of some Bank staff that the FSAP should be a diagnostic tool only, although the mandate of the FSAP envisioned the use of the assessments as platforms for future work as well. Without the development of a strategic vision, concrete action plan, or an analysis of the political realities, the FSAP risks becoming a sterile and irrelevant exercise.[13]

Informing the Executive Boards of the World Bank and IMF

The Bank's FSA and the IMF's FSSA documents are intended to keep the Executive Boards informed of vulnerability and stability issues, particularly those that might have spillover effects into other countries, as well as important development con-

Prioritization of recommendations is often lacking.

The FSA documents convey key messages to the Board, but its shorter format causes nuances to be lost.

cerns. The FSSAs and FSAs (usually 15–25 pages) are substantially shorter than the main FSAP reports, which can run into hundreds of pages. IEG's detailed review of FSAP documents indicated that although FSAs do provide a summary of the key issues and messages, nuances or caveats were often lost, which can sometimes present a misleading picture. A common flaw is for the main report to describe weaknesses and inconsistencies in data or findings, while the FSA presents the main findings without drawing the reader's attention to the limitations of the analysis.

The clarity of messages from the FSAP would be enhanced by greater discussion of FSAP findings by the Board. IEO's evaluation noted that the discussions of the FSAPs, which take place in conjunction with the IMF's Article IV consultations, do not always pick up on important messages. However, whatever their limitations, the IMF discussions are an improvement over the process in the Bank, where there is no formal mechanism for discussing the findings from the FSAPs.

The Bank takes too long to deliver FSAs to the Board.

Table 3.2. Completed and Disclosed FSAP Documents

	Developing country FSAPs	All FSAPs
Number of FSAPs	79	97
Number of FSAs	57	—
Number of FSSAs	62	79
Number of disclosed	30 (FSA)	—
	44 (FSSA)	62 (FSSA)
Completed FSA/FSSA as percent of FSAPs	72 (FSA)	—
	79 (FSSA)	81 (FSSA)
Percent disclosed	53 (FSA)	—
	71 (FSSA)	79 (FSSA)

Source: Financial Sector Liaison Committee data, as of February 14, 2006. These numbers exclude pilot assessments.

The usefulness of the FSAP as a means of keeping the Board informed is also diminished by the time it takes to complete the summary documents. As seen in table 2.6, on average, it takes *almost a year* to turn the draft aide-mémoire into an FSA delivered to the Board. From the pilot phase in May 1999 until October 2005, 97 additional assessments (including both full assessments and updates) were completed, including 18 developed-country assessments and updates. The completion rate for post-pilot FSAs is 72 percent, versus 81 percent for FSSAs (table 3.2). Moreover, as of February 14, 2006, the remaining uncompleted FSAs have been outstanding for a median of 646 days after the initial mission was launched. (See chapter 4 for related discussion on disclosure.)

The longest part of the delay in producing final documents is the review stage, which, on average, takes almost eight months. As discussed in chapter 2, because the draft aide-mémoire has already been delivered and discussed with authorities by the time of the review, the key messages have already been conveyed to authorities. Given this fact, the eight-month lag before finalization is too long. Similarly, while the IMF releases the FSSA an average of 16 days after the final report is sent to authorities, the Bank takes an average of more almost three months longer to release the FSA. Overall, the FSSA is completed before the FSA in over 80 percent of the joint FSAPs.

If the Board is to be kept informed in a timely manner, Bank Management should set deadlines for the delivery of the FSAs. One option for improving delivery times is to leverage the work of the IMF. Currently, the Bank and the IMF draft two separate documents; the rationale was because the Bank places a greater emphasis on development issues and the IMF places a greater emphasis on stability issues, the foci of the reports would be different. IEG has found that, while it is true that there is more discussion of financial sector development issues in the FSAs, and more discussion of stability in the FSSAs, there is not a substantial difference in content between the two papers. There is, however, strong resistance from staff to combining the two documents.

IMF staff are particularly concerned about delays caused by differences in process and timing, as they are expected to produce the FSSA to meet the Article IV consultation timetable, while Bank staff have no similar deadline. While keeping separate documents, if there are resource constraints, the Bank could speed delivery of the FSA by using the FSSA as a platform to summarize the main findings of the assessment, adding chapters or appendixes on development or other issues on which the IMF may not have focused.

Impact of the FSAP

Measuring the impact of the FSAP is difficult. As discussed in the first chapter, the program is still too new to have measurable effects on ultimate outcomes (such as the reduction of vulnerability and improved financial sector development). This section considers the extent to which the FSAP has: (i) had an impact on the reform process in the country; (ii) influenced the programs of other donors, agencies, and other IFIs; and (iii) informed markets.

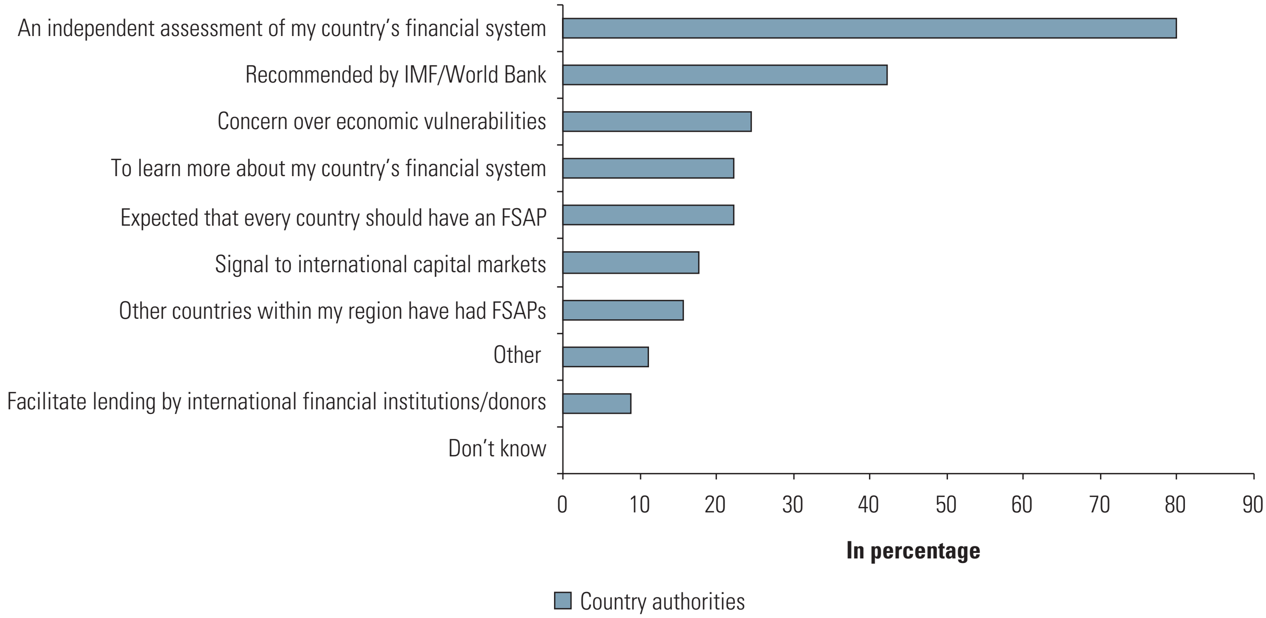
Authorities rated the impact of the FSAP as high—72 percent of surveyed authorities agreed the FSAP had contributed to positive changes in the financial sector and 83 percent were satisfied with the FSAP recommendations. Interviews and survey results indicated that the authorities agreed that the FSAP expanded their country's technical abilities, their understanding of issues, and their awareness of financial sector vulnerabilities.

One significant survey result shows that the primary reason most authorities requested an FSAP was to obtain "an independent evaluation" of the financial sector (figure 4.1). This is consistent with the authorities' responses that the most useful output from the FSAP process was an objective evaluation of the financial sector (table 4.1). The "evaluation" aspect of the program was rated much higher than use of the program for identifying development priorities or TA needs, which were rated as two of the least useful aspects of the program.

One side effect of this "independent evaluation" is some countries used the FSAP as incentive to improve their financial sectors prior to the formal assessment. Authorities from India, for example, noted that the assessment did not find anything new, but the process of preparing for the FSAP was useful. Interviews with authorities of the European Union/European Community, and countries that had been seeking to join, viewed the assessment as an important validation of progress made in the financial sectors of those countries. Bank staff working with some of the Asian countries that have not yet participated, have been told by authorities that the countries are working on improving their financial systems, and will subsequently participate. Hence, preparing for an assessment, even if that assessment does not add more to the countries' knowledge base, may serve as an instrument for countries to improve their financial sectors.

Country authorities rate the impact of the FSAP as high.

Figure 4.1. Reasons Why Authorities Requested an FSAP



Source: IEG/IEO survey.

A related effect is some countries that have undergone FSAPs have used the assessment as a template for their own self-assessments. Pakistan, for example, developed a series of indicators and other tools, which it is using to monitor its financial sector.

Policy Debate

Fifty-six percent of surveyed authorities felt that the FSAP contributed to the policy debate in the country, with the greatest impact on debate within the government, and in supporting the authorities' discussions with the legislature[1] (figure 4.3). The FSAP was most useful in cases where the government already had a high commitment to financial sector reform; as mentioned above, the FSAP's status as an independent, external assessment sometimes aided in pushing reforms.

The FSAP contributed to policy debate, but primarily within government or with the legislature.

Implementation of Recommendations

Country authorities generally responded that the main FSAP recommendations had been mostly implemented; however, Bank and IMF managers rated the incidence of implementation much lower than did the authorities. Figure 4.3 shows the survey responses for degree of implementation; these responses are consistent with interview responses. The difference in impact may reflect differences in opinion on priority actions and on the depth of implementation. For example, in some cases, a new regulation may have been passed, but enforcement may be lax, resulting in no meaningful change. IEG's detailed country reviews were in line with staff perceptions; there were a number of cases where numerous technical improvements were made, but key recommendations were not implemented. This may also be a function of the limited amount of time since the program began; major reforms (such as restructuring of weak banks) will take much longer than administrative reforms (such as strengthening regulations), and may yet take place with ongoing support from the government and donors.

Attribution is also difficult to ascertain. In a number of cases where recommendations were

Table 4.1. Usefulness of FSAP Areas

Authorities	IMF Mission Chiefs	Country Directors	Team Leaders	Team Members
Three Most Useful:				
Objective evaluation of fin. sec. (58 percent)	Objective evaluation of fin. sec. (62 percent)	Objective evaluation of fin. sec. (40 percent)	Objective evaluation of fin. sec. (30 percent)	Objective evaluation of fin. sec. (38 percent)
Integrated view of fin. sec. (16 percent)	Identification of new fin. sec. risks and learning new analytical tech. (13 percent each)	Integrated view of fin. sec. (31 percent)	Integrated view of fin. sec., identification of new fin. sec. dev. needs and prioritization of fin. sec. ref. (13 percent each)	Integrated view of fin. sec. (15 percent)
Learning best international practices (11 percent)	Enabling reforms by contributing to public debate (8 percent).	Identification of new fin. sec. development needs, prioritization of fin. sec. reforms, learning new analytical techniques, learning best int. practices and identification of TA needs (8 percent each)	Identification of new fin. sec. risks (12 percent)	Identification of new fin. sec. risks (12 percent)
Three Least Useful:				
Identification of TA needs (58 percent)	Improved coordination among regulators (52 percent)	Enabling reforms by contributing to public debate (69 percent)	Enabling reforms by contributing to public debate (48 percent)	Enabling reforms by contributing to public debate (46 percent)
Enabling reforms by contributing to public debate (50 percent)	Enabling reforms by contributing to public debate (48 percent)	Improved coordination among regulators and prioritization of fin. sec. reforms (39 percent each)	Improved coordination among regulators (41 percent)	Improved coordination among regulators (40 percent)
Identification of new fin. sec. dev. needs (33 percent)	Learning new analytical tech. (35 percent)	Identification of new fin. sec. risks (31 percent)	Learning new analytical tech. (34 percent)	Learning new analytical tech. (28 percent)

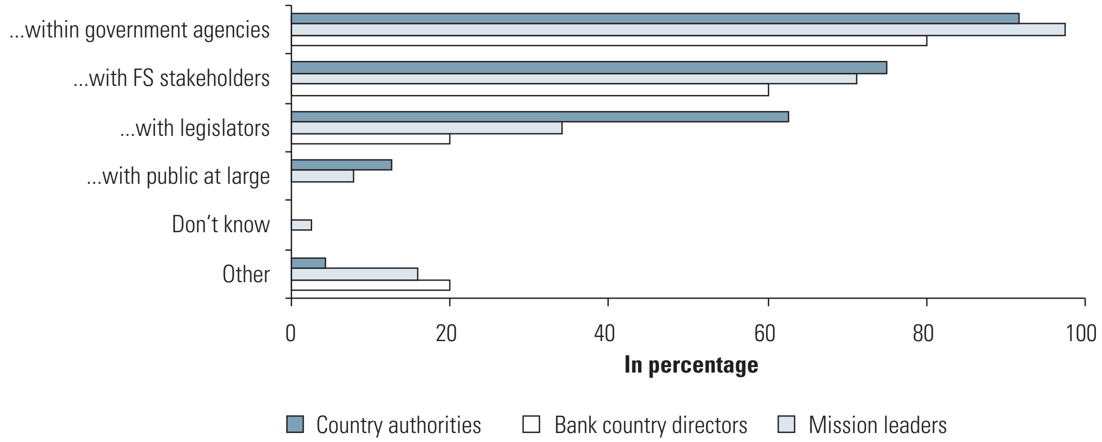
Source: IEG/IEO survey, government authorities; mission chiefs; country directors; team leaders; and team members. After initial interviews with authorities and staff members on the usefulness of FSAPs, the evaluation team compiled a full list of outputs named by the interviewees from the FSAPs. Surveys were sent to the full set of authorities and staff members, and respondents were then asked to select the three most important outputs, and then select the three least important outputs.

implemented, the recommendation was already part of a proposed program (supported through a loan, or through ongoing dialogue); hence, it is difficult to determine whether the reform would have been made in the absence of an FSAP. There were, however, cases where the authorities specifically pointed to the FSAP as a factor, or where the FSAP seemed to be the catalyst for a new or increased financial sector reform program (for more discussion and examples, see chapter 5). Overall, despite the difficulties of attribution, the FSAP appears to have contributed to reform in a number of countries.

Integration with Bank Country Programs

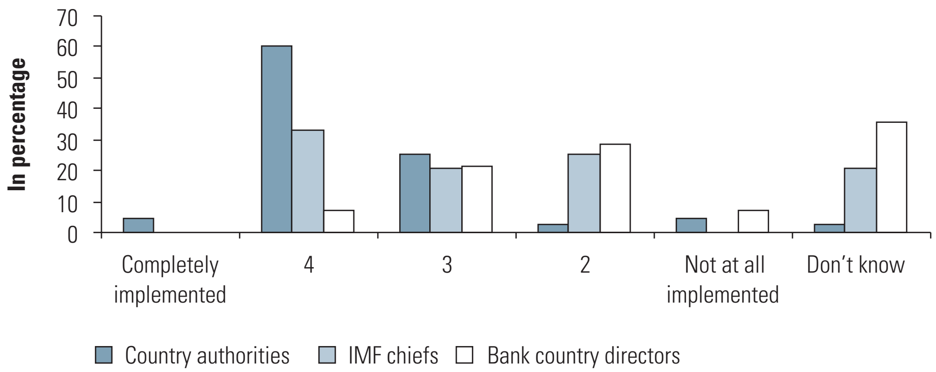
This section reviews the extent to which FSAP findings are integrated into country programs, as well as follow-up by the Bank. IEG supplemented survey and interview data with detailed document reviews. IEG reviewed 50 FSAPs,[2] and the associated CASs, proposed and actual lending and nonlending programs, and other relevant Bank documents. In addition, IEG also

Figure 4.2. Contributions to the Policy Debate



Source: IEG/IEO survey, government authorities; World Bank country directors; mission leaders. Multiple responses allowed. Percentages are based on a number of respondents who had previously agreed that the FSAP had contributed to policy debate.

Figure 4.3. Degree of Implementation of FSAP Recommendations



Source: IEG/IEO survey; IMF surveillance mission chiefs; World Bank country directors; government authorities.

reviewed information about other donor programs, as discussed in public documents such as IMF reports or donor databases.

The IEG review of Bank documents indicates that there is a highly divergent range of integration with, and follow-up through the country programs. The integration of the FSAPs with the CAS process is not consistent. Of the 34 cases where a CAS has been written after an FSAP, 68 percent had a discussion of the FSAP and its primary findings and recommendations. The remaining 32 percent had only a brief mention or the FSAP or its findings, ignored the FSAP, or inaccurately presented findings.

The CAS documents, however, are a much less significant indicator of the impact of FSAPs than the extent to which the FSAP recommendations were reflected in actual Bank programs and dialogue. Although attribution is difficult, in 42 percent of the cases, the FSAP appears to have influenced the Bank program in a significant way. In 34 percent of the cases, the FSAP seems to have had only a minor influence on dialogue or ongoing programs, and the remaining 24 percent appeared to have no influence on the program, or had components that were inconsistent with FSAP recommendations. (See box 4.1 for illustrations of levels of impact of the FSAP on Bank programs).

IEG's findings from country reviews are consistent with information received during interviews and from the survey. During interviews, when asked an open-ended question about follow-up, authorities almost always cited some form of IMF follow-up or assistance; Bank follow-up was often only mentioned when asked about in a direct question. In the survey, only 34 percent of the authorities recalled that the Bank had followed up in some way, whereas 80 percent recalled that the IMF had followed up (primarily through their Article IV consultations).

The factors that lead to follow-up, both within the country and within the Bank are complex. Most of the countries that have minor or negligible follow-up have small Bank programs overall. Some countries (Hungary, Estonia, Poland, etc.) indicated they wanted the FSAP primarily for its evaluative purposes, and did not want further assistance from the Bank or other donors and IFIs, except for targeted advice in specific areas. These countries generally are characterized by having good overall economic management, sound financial sector development, and a favorable business environment.

Although authorities generally stated that the main FSAP recommendations had been mostly implemented, Bank and IMF managers rated the incidence of implementation to be lower.

At the other end of the spectrum are countries that lack preconditions for developing an extensive financial sector (i.e., overall economic management and business environments are still weak). Given other priorities and the availability of financial sector TA from other

Box 4.1. Link between the FSAP and Bank Programs

Although attribution is difficult to measure, IEG reviewed FSAPs, CASs, and other Bank documents to assess the impact of the FSAP on the country program; three categories were used: (i) significant impact, (ii) minor impact; and (iii) negligible impact. Examples of these assessments are below:

Significant impact. In some countries, the FSAP contributed to an important change in the Bank's program, or strengthened an ongoing program. In *Guatemala*, prior to the FSAP, attempts by the Bank to support financial sector reform had been unsuccessful. An IEG country assistance evaluation noted, "Opponents of reforms in the financial sector succeeded in their goal of thwarting efforts of making financial institutions accountable and stronger," and that the sector should be a priority area for the Bank's assistance. The FSAP coincided with a period of instability in the banking sector, which helped break down resistance to reform. The FSAP laid out a series of urgent reforms, which the Bank used as one of the key components in its CAS progress report of fiscal year 2002. The Bank, IMF, and IADB used the FSAP as a basis for analytic work to help the government's reform program; the Bank also supported the program with two loans, the Financial Sector Adjustment Credit and a Financial Sector TA loan. Four key laws were passed, capital adequacy averages 15 percent, and the number of banks has been reduced.

Minor impact. This category includes cases where (i) the FSAP served to confirm findings and recommendations from previous work, so the impact of the FSAP was minor; (ii) minor recommendations were supported by the work programs; (iii) important recommendations have been supported in minor ways. In *Jordan*, policy dialogue on key issues, such as restructuring of insolvent banks and improving portfolios have not advanced much. The World Bank Group has continued to provide support in areas such as housing, finance, and business law.

Negligible impact. In *Costa Rica*, the CAS was much more positive about the financial sector than the FSAP had been. In the context of a highly selective lending program, support was limited to a few pieces of Analytic and Advisory Activities and donor-supported TA. In *Gabon,* the FSAP found the banking sector to be relatively sound, but shallow. The majority of the population lacks access to any type of financial services. In the context of a limited Bank program, limited follow-up is planned.

Source: IEG analysis.

sources, it may have been a considered decision not to focus on the financial sector. For cases such as these, it may have been appropriate for limited discussions in the CASs; however, the CASs should be explicit in explaining the reasons for not providing support to help implement FSAP recommendations.

Despite difficulties of attribution, the FSAP does appear to have contributed to reform in a number of countries.

For the remaining countries, there is a wide range of responses to the FSAP. There are some countries (Costa Rica) where the Bank previously identified the priority areas of vulnerability and development, but did not find a responsive counterpart; carrying out the assessment did not change the response. In other cases (India), the authorities were already working on a program of reform, and the FSAP did not alter that program markedly, but instead the FSAP used primarily to confirm and consolidate previous findings.

In some cases, even though there had been extensive pre-FSAP work and an ongoing program, the FSAP seemed to refocus the program (Tunisia), or generate more support for reform (Guatemala, Bangladesh).

All of these factors tie in with one of the initial questions of the evaluation: What should be the priority for selecting countries for full assessments and updates? For countries such as Hungary and Estonia, conducting assessments or updates for development purposes are of lower priority than for other countries; the inclusion of these countries in the program should be based on stability and vulnerability issues. If assessments are deemed necessary for surveillance purposes, the FSAP should be focused on ROSCs and identification of vulnerabilities, with a few focused topics, which the authorities have identified in premission discussions.

Two-thirds of CASs discussed the FSAP and its primary findings, but the FSAP appears to have influenced the Bank program significantly in onlt two-fifths of the programs.

In countries with few systemic risks from their financial sectors and a low level of financial sector development, carrying out formal ROSCs would not be the best use of resources. The assessments should focus on development, and depending on the scope for Bank assistance, should try to identify a few priority areas where development work could be focused. The Bank's follow-up role could also focus on donor coordination.

In countries such as Costa Rica and Algeria, where there is a fairly deep understanding of the major issues facing the financial sector, but with a poor reform record, and no apparent change in commitment, the costs of carrying out an FSAP may outweigh the benefits, as the knowledge base is not substantially increased, and the resultant reform dialogue does not change appreciably. Given limited resources, these FSAPs (and updates) could be deferred in favor of higher-priority countries. These countries might be better served with traditional Bank Analytic and Advisory Activities, targeted to specific topics.

For countries that have been engaged in financial sector reform, a full FSAP can be catalytic in helping to shape priorities and strengthen the hand of reformers within government. Countries that have not been engaged in reform can also benefit from an FSAP, but only if there are factors that indicate reform would be supported (such as a change in government, improved economic management, or a favorable business climate).

Process factors. While interest by the government and suitable economic preconditions are critical factors in follow-up, there are design elements of the program that also affect follow-up. From inception, the FSAP was conceived of as part of the Article IV surveillance program. The timing of the FSAP missions and outputs were coordinated with the timing of Article IV consultations, and discussions with authorities of the key FSAP findings are held in the context of the Article IV discussions. The Bank has no analogous follow-up process. In addition to the lack of an instrument to ensure that follow-up discussions are held with the authorities, there is no official instrument to discuss the findings with the Board (as there is with the IMF's Article

IV discussions). The FSA is usually sent to the Board for information only, and is not discussed.

A related issue is that whereas the program documents for the FSAP state "Fund area department staff will normally participate in the FSAP missions,"[3] no analogous statement exists for country department staff; therefore, there is often no one in the core country unit who has participated in the FSAP discussions and is fully cognizant of the findings.[4]

Another problem may be the lack of "ownership" by the country departments. Because the FSAP is an externally initiated "free good," with no mandatory follow-up, and the assessments and FSAs do not count as regional "outputs," [5] there is little incentive for Regions to support the FSAP. The country departments control the budgets for follow-up work but have little ownership in the program or incentive to follow-up. For these reasons, follow-up work is sometimes not supported with appropriate funding (fewer than one in four country directors indicated that the FSAP findings had led to a budget increase for financial sector work).[6] Given that there is always more demand for FSAPs in any given year than can be accommodated, one element to be considered in country selection might be the willingness of the country department to commit to funding to support follow-on work (in countries with small programs, this might simply be financing the costs of donor coordination and dialogue).

Knowledge Sharing at the Bank

Poor knowledge sharing affects both the quality of FSAPs and follow-up. The effect on donors is discussed below. The effect within the Bank is also significant. Confidentiality policies limiting dissemination of the FSAP aide-mémoire, while they are officially similar at the Bank and the IMF, they are, in practice, significantly more restrictive at the Bank than at the IMF, as well as more restrictive than for most other confidential Bank documents. While FSAP reports do contain sensitive information and should be handled carefully, in practice, the confidentiality policy has led to access being denied to: (i) managers from other sectors (but covering the same country); (ii) task managers of financial sector projects in those countries; and (iii) team leaders of other FSAPs, including those working on neighboring or similar countries. Furthermore, whereas other studies at the Bank are often widely disseminated and discussed, with "best practice" and "bad practice" examples circulated to help future teams, this is not done for the FSAP. As noted in chapter 3, the lack of knowledge sharing has meant that even nonconfidential data, such as benchmarking data collected for one assessment, is not passed on for use in other assessments.[7]

The Bank has started to draw lessons from the FSAP, as evidenced by the recent publication of the Financial Sector Assessment handbook, which is designed to help authorities conduct self-assessments. In addition, the Bank is working to develop a better set of financial sector indicators including those for stability, depth and vulnerability of nonbank financial institutions, and access issues. However, the limited access to the data and analyses gleaned from the assessments has meant that there has been little work on drawing regional and global lessons from groups of FSAPs.[8]

Only 34 percent of authorities recalled that the Bank had followed up on the FSAP, whereas 80 percent recalled that the IMF had followed up on it.

Influence on the IMF

This evaluation did not review the impact of the FSAP on the IMF because the IEO's parallel evaluation reviewed this in great detail. Key findings from IEO evaluation include:

> *The FSAP represents a distinct improvement in the Fund's ability to conduct financial sector surveillance and in understanding the important interlinkages between financial sector vulnerabilities and macroeconomic stability. While an overall judgment on the cost-benefit tradeoff will always be difficult for such activities because of the problems in quantifying the benefits, the evaluation*

Countries with a history of limited reform would have lower priority for FSAPs.

concludes that the FSAP has significantly deepened the IMF's understanding of the financial sector in specific countries, helped articulate policy recommendations, prompted better discussions with authorities, and helped support policy and institutional changes. The evaluation also suggests that the joint IMF-World Bank nature of the exercise has been beneficial.

However, the evaluation also notes,

Despite these achievements, the initiative is at an important crossroads and there is a danger that some of the gains already achieved could be eroded without some significant modifications. The evaluation indicates two interlinked sets of problems. First, financial stability assessments have not yet been fully "mainstreamed" as a regular part of IMF surveillance. Second, looking beyond the stage of initial FSAPs, there are doubts that current incentives for participation and priority-setting procedures will be sufficient to ensure continuing coverage of the bulk of countries where strong financial sector surveillance is most needed.[9]

More detail can be found in the IEO evaluation (2006).

Influence on other Donors, IFIs, and Agencies

Feedback from other donors and agencies was generally positive toward the overall program. Almost all of the donors noted that they, themselves, do not have the resources to carry out research and analysis on the scale of the FSAP. The donors, therefore, expressed great interest in being able to access the information from the FSAP, as it could help them to identify funding priorities. The use of the FSAP varied by donor, and sometimes varied within a donor agency, in part, because much of the access to FSAP findings was dependent on informal dialogue between individual staff members at a donor agency and the corresponding Bank/IMF staff, rather than any formal process of informing donors. Most interviewees cited the FSAPs as a useful source of background information; when formal documents could not be shared, donors received parts of reports, which allowed

Box 4.2. Donor Concerns About the FSAP

Access. The donors generally only have access to published FSSAs and FSAs. In some cases, donors were given access to a small part of the FSAP report, which was directly pertinent to the assistance requested of them, but because the donors cannot read the full report, it is hard for them to gain perspective on the overall strategy or the relative importance of that request. Even the Financial Sector Reform and Strengthening Initiative (FIRST), which was set up specifically to provide follow-up to the FSAP, has had a difficult time accessing information needed to design programs with significant impact in the country.

Timeliness. Given that FSSAs and FSAs only become available to donors when they are published, and these documents sometimes do not appear until more than two years after the start of the initial mission, the information is not available on a timely basis, particularly given the lead times that the donors need to plan their own programs.

Relevance. The sharpest comments were on the focus of the FSAPs. Although Bank staff stated that the FSAPs are tailored to the needs of the country, a number of donors stated that not enough emphasis was placed on development in developing countries, and that too much time was spent on ROSCs or other issues that were not as relevant. The donors also felt that the FSAPs did not always reflect the realities on the ground, including a failure to address political economy issues.

Lack of strategy. The donors stated frustration that the FSAPs rarely led to the development of an overall strategy for financial development, with a clear action plan that could be implemented by the authorities with donor assistance.

Source: IEG interviews with donor agencies.

them to help develop or improve their financial sector programs. Examples include SECO's (Secretariat d'Etat a l'Economie, Switzerland) work program in Azerbaijan, a financial sector program in Kenya cofinanced by DFID (Department for International Development, U.K.), Agence Francaise de Development, the World Bank and other donors, and IADB's financial sector program in Mexico. In addition, FIRST (Financial Sector Reform and Strengthening Initiative) was established to provide assistance to help convert recommendations from the FSAP and ROSCs into projects. As of September 30, 2005, FIRST had developed 48 FSAP-related projects.

Many donors, however, stated concerns about access, timeliness, relevance, and lack of strategy (box 4.2) of the FSAPs, and noted that they could be more active and effective in follow-up if these issues were resolved.

Feedback from country authorities confirmed the difficulty of donors in crafting appropriate follow-up; only 13 percent of authorities who responded to the survey agreed with the statement that they had "received support from other international financial institutions/donors to implement the FSAP recommendations."

Standard Setters

Interviews with representatives of standard-setting bodies[10] indicated that they found both formal and informal feedback from the FSAP to be useful. Most do not have the resources to conduct the assessments on the scale that the Bank and IMF have under the FSAP. Some interviewees also prefer not to do assessments, noting that they would like to be viewed as impartial setters of standards, not "judges" of what is good and what is not. Standard setters noted that they would, however, welcome: (i) franker language, especially when problems are detected; and (ii) greater use of the FSAP results to draw cross-country analysis.

The Country Departments have little ownership of the FSAP.

Influence on Financial Markets

A number of authorities identified the "signaling role" of the FSAPs as one of their motivations for participating in the exercise.[11] However, the impact of the FSAPs on financial markets appears to be minimal. There is some use of published FSSAs, FSAs, and ROSCs by institutions such as credit-rating agencies (which appear to be primarily interested in the ROSCs and vulnerability assessments).

Many donors expressed concern about access, timeliness, relevance, and lack of strategy.

Disclosure

During the pilot phase of the FSAP, it was agreed that the FSSAs and FSAs for the 12 pilot countries would not be disclosed. After the pilot phase, both Boards agreed that FSSAs and FSAs could be made public if the country agreed. The disclosure rate for post-pilot FSAs is 56 percent, versus 77 percent of FSSAs (table 3.2). It is not clear what the reasons are for the significant differences in the disclosure rates of the FSAs and FSSAs.

Key Findings and Recommendations

This evaluation has found that the FSAP is a good-quality diagnostic tool and the overall concept for the program is sound. Joint Bank and IMF cooperation has allowed an integrated approach toward financial sector vulnerabilities and development needs, while expanding the depth and quality of analytical expertise. However, the assessments are weak in prioritization, and the Bank falls short in integrating the findings and recommendations of the assessments into its country programs. In order to sharpen the program's relevance, quality, impact, and efficiency, a number of steps could be taken.

Country selection. The FSAP has not covered all "systemically important" or vulnerable countries, or selected countries where financial sector development assessments can be most effectively used. The *voluntary nature of the program* limits the program's overall effectiveness in identifying systemic risks; however, there is a strong consensus among authorities and staff surveyed for this review that the voluntary nature of the program should be maintained. Without the full cooperation of authorities, access to detailed information and key staff would be difficult, and would reduce the effectiveness of the exercise significantly.

Quality. The overall diagnostics were generally good, but the quality and the appropriateness of coverage of specific sectors were uneven. While banking sector coverage was satisfactory, the coverage in the nonbank financial sectors was not consistently of the same quality. In addition, while current analytical tools, such as stress tests and the reports on standards and codes, are highly valued by country authorities and other constituencies and can be very useful as a core framework for vulnerability assessments and development priorities, they can be improved by: (i) strengthening the methodology of stress tests to better tailor the tests to reflect country circumstances and risks; (ii) de-emphasizing ratings when reporting ROSCs, as the discussion of ROSCs is too focused on ratings, and not enough on the content of the assessments or the development of an action plan to address weaknesses; and (iii) ensuring that data limitations are clearly flagged. In some cases, it may be appropriate to drop formal stress tests, ROSCs, or other analyses, rather than lend a false sense of precision or security to the assessment.

The quality of teams was rated quite highly; 93 percent of country authorities responding to a survey on the FSAP expressed satisfaction with the FSAP team skills. However, authorities have raised concerns about the continuity of staff and the need for strong country experience. Moreover, the seniority of staff involved in the program has been dropping off; if the quality of the assessments is to be maintained, Management will need to monitor staffing closely.

The Bank also needs to develop better approaches toward analyzing missing markets and access issues, and devise creative solutions to improve those areas. This would include: (i) improving the use of indicators and data sets; (ii) deepening the analysis of political economy, culture, and other country-specific aspects that would allow the team to help authorities design tailored solutions; and (iii) focusing more on interlinkages between sectors, which would help authorities to develop better priorities and sequencing.

The *candor* of the reports was generally satisfactory, although there have been some instances where the governments or management have pressured the staff to soften the written reports, or where the staff have chosen to convey key messages through presentations and discussions, rather than through the written reports. Another weakness of the reports was that many of the caveats and nuances of the analyses that were raised with government officials were "lost in translation" as the documents were shortened for the Board or public review. Warnings on the limitations of the reports, as well as the limits on individual tools and data, should be strongly conveyed.

Prioritization of recommendations was weak, which adversely affected the impact of the overall program. There were often too many "priority" recommendations, or sequencing and implementation capacity were not well addressed. This may partly be because some Bank staff view the FSAP as only a diagnostic tool, even though the mandate of the FSAP envisioned the use of the assessments as platforms for future work, policy dialogue, and as catalysts for financial sector reform. The assessments should be better oriented toward follow-up.

Informing the Board. The current practice of informing the Board is not effective. FSAs are delivered a substantial time after the mission work is completed and the final report is sent to authorities, so the Board is not kept informed on a timely basis, whereas FSSAs are completed within 16 days of the report finalization. Also, given that the FSAs are summaries of the full assessments, sometimes the full context and nuances of the report have been inadequately conveyed.

Impact. While it is still too early to judge the full impact of the program, the assessments have been well received, and country authorities have cited the assessments for: (i) providing an "independent evaluation" of the system, (ii) expanding their knowledge of financial sector vulnerabilities; (iii) improving technical abilities; and (iv) contributing to the policy dialogue within the country. "Results on the ground" have been difficult to assess; authorities have stated that most recommendations have been implemented, whereas Bank and IMF staff, as well as IEG reviews of the country programs, have not seen as much evidence of implementation of critical reforms. For example, authorities have noted post-FSAP changes, especially in legal, regulatory and supervisory reforms, but the attribution is difficult, as many of these reforms have been part of previous Bank or IMF policy discussions. In addition, the more difficult reforms will take more time, and greater impact may be seen in the future.

While the program has raised awareness with authorities and within the Bank on the importance of the financial sector on stability and development, IEG has found that only 42 percent of the assessments have an *impact on the Bank's country programs*, as manifested by important changes or strengthening of the Bank's program and dialogue. In another 34 percent of countries, the assessment had a minor influence; for example, it might reinforce previous sector knowledge and contribute to the ongoing dialogue, and may help spur minor changes in the financial sector program, but there was no evidence that the direction or pace of the program had changed due to the assessment. The remaining 24 percent appears to have had little evidence on the Bank's program. This is consistent with survey results which show that only 34 percent of country authorities recall follow-up on the FSAP from the Bank (as opposed to 80 percent recalling follow-up from the IMF). Factors which could affect the degree of impact include: (i) country selection (countries that are more advanced may not need Bank assistance; countries that lack the preconditions for a well-functioning financial sector, or have no interest in reform, might not be able to use a development assessment effectively) does not always factor in the usefulness of a development; (ii) there is no clear mechanism for Bank follow-up (such as the IMF's Article IV discussions); and (iii) the country units are not always fully involved in planning the scope of, or participating in, the assessment, which in turn may affect both the efficiency of the assessment and the effectiveness of follow-up activities.

The FSAP does appear to have influenced ESW at the Bank, as countries that have had assessments appear to undertake smaller, more targeted ESW in subsequent years. Countries without assessments are more likely to carry out major pieces of ESW. This indicates that assessments can serve as useful background pieces which are effectively leveraged.

Integration. The FSAP alone cannot spark major reforms or development in the financial sector. As an assessment tool, it is most valuable in the context of a full program, as an instrument to assist in surveillance and to serve as input into a complete development strategy. Its comprehensive overview can also be an important tool for coordinating the Bank, IMF, and donor programs.

One impact of the program has been an *improvement in IMF surveillance*. The IEO's evaluation concluded that the FSAP had significantly deepened the IMF's understanding of the financial sector in specific countries, improved the articulation of policy recommendation and discussions with authorities, and helped support policy and institutional changes in the countries.

The FSAP has not had as strong an impact, however, on other institutions' programs. While other donors support the initiative, and some have been able to use the FSAP to help shape their own programs, the flow of information is less timely and complete than they would wish. Improvements in donor consultation would allow better leverage of donor resources to support reforms.

Efficiency. The FSAP is an expensive program, although the Bank's share of costs is commensurate with the costs of other major financial sector studies. Bank resources could be used more efficiently if more time is spent on appropriate country selection and better tailoring of coverage. The efficiency and quality of the assessments would also improve if the Bank made full use of the existing data and staff with country experience, and used the FSAP reports internally to leverage its knowledge base (as well as that of the IMF and other institutions). Best-practice examples should be shared, and data should be synthesized to draw lessons across countries. This would also feed into the development of better analytical tools and approaches. Cross-border and regional issues must be better factored into the assessments; regional and international solutions should also be more actively considered.

This evaluation and the IEO's evaluation have found that the joint participation of the Bank and the IMF in the program has been beneficial; it has contributed significantly to the depth of analytical expertise, credibility of findings, and coordination of recommendations and policy advice. Although there are some frictions and inefficiencies, on balance, the joint nature of the program is a positive feature and should be continued.

In summary, the technical quality of the diagnostics has generally been good, although there are weaknesses in the coverage and quality of some sectors. The assessments, however, often have poor prioritization, and do not adequately consider sequencing or institutional capacity constraints. Furthermore, the Bank does not do enough to integrate the assessments' findings and recommendations into its programs. While the IEO has found that the assessments have improved the IMF's surveillance and significantly deepened the IMF's understanding of the financial sector in some countries, the analogous impact on the Bank and its work on financial sector development has not yet occurred to the same degree. The full potential of the FSAP's usefulness to the Bank, therefore, has not yet been attained.

Recommendations

Country selection and the scope of assessment have major impacts on the relevance of the program, both for the reduction of vulnerabilities in countries' financial sectors as well as the impact on the development agendas of the countries. Given the limited budget envelope, there will be difficult tradeoffs to be made, particularly when balancing the desire to improve surveillance with development priorities. The Managements of the Bank and the IMF should select countries for assessments and updates according to the priorities identified by the Boards, as well as consider the likely impact of an FSAP in a particular country, and adjust the timing to suit the situation. In some cases, such as systemically important and vulnerable countries, this may mean that updates are carried out every two or three years, while in other countries that are not systemically important or that are not likely to treat financial sector development as a priority, initial assessments or updates may be delayed by several years. A priority list, as well as the rationale for selection, should be presented to the Boards. In cases where countries have not volunteered, Management needs to inform the Boards of those gaps, and should seek other ways to work with the country on addressing critical issues in the financial sector.

The scope of the initial assessments and updates should be more tailored to address the specific needs of the country. This may mean that a systemically important, vulnerable country may require a full set of ROSCs, and minimal discussion on missing markets or access issues, whereas another country may not require any formal ROSCs but may, instead, focus on access issues. Also, this process would be more efficient if more time were spent in advance, working with country units and authorities on developing prioritized TORs.

Integrate the FSAP into a full reform program. The Bank, in consultation with the IMF and other technical assistance providers, should establish a clearer framework for coordinating follow-up programs, including technical assistance activities, based on the country's own action plans. While details will differ by country, FSAP follow-up discussions with country authorities on technical assistance and other development needs are essential. Such discussions should include Bank technical and country staff, as well as the IMF's Monetary and Financial Systems Department and area staff. Once development and other assistance priorities are determined, this information should be quickly shared with the donor community. In addition, to improve donor effectiveness, the following recommendations should be considered: (i) inform donors in advance about the timing of the FSAP, so that donors can adjust their program timetables accordingly; (ii) improve consultation with donors who are active in the financial sector during the FSAP mission, including presentations of key findings; and (iii) provide donors with better and more timely access to reports.

Country units and the financial sector teams must work more closely to improve integration of the FSAP findings and recommendations into the Bank's country strategies. This would include greater participation of the country units in the design of TORs, mission teams, and follow-up discussions. If a strategic decision is made that Bank follow-up to the FSAP will be limited, the CAS should briefly explain the reasons why (limited resources which need to be allocated to other priorities in the country, the availability of other donor programs, the need to sequence other reforms first, lack of interest or commitment of the client in those sectors, etc.).

Informing the Board. The process of informing the Board is currently not working well. Financial Sector Assessments (FSAs) take too long to produce. A deadline should be placed on the production time of the FSA. One option to speed production is to leverage the work of the IMF. The IMF FSSAs are usually completed within 16 days of the delivery of the final report. For future assessments, knowing that the different foci, timetables, and processes of the two institutions make it difficult to quickly produce a joint paper, the Bank could use the FSSA for countries and regions as a platform to summarize the main findings of the assessment, and then add chapter or appendixes on development or other issues on which the IMF may not have focused.

Unlike the IMF, there is no discussion of the documents at the Bank's Board, so the import, context, and nuances of the reports are often not clear. Critical information should be brought quickly to the Board or a subcommittee for discussion. In addition, discussions of key FSAP findings and recommendations, and their integration into the country program (or the decision not to include them), should be part of the CAS report and discussions. Bank management should also consider periodic technical briefings summarizing major findings from recent assessments, as well as synthesize the information to provide recommendations for future work (within countries and across regions).

Knowledge sharing. While remaining mindful of the needs of safeguarding sensitive and confidential information, the Bank should leverage more actively the knowledge gained from this extensive exercise. This would include active dissemination of "best practice" analyses, more discussion of concerns and issues that arise while conducting assessments, and better sharing of data and insights gained through the program. The financial sector teams should also work to partner more effectively with other sector teams to maximize the collection and sharing of information.

APPENDIXES

APPENDIX A: ASSESSMENT AND UPDATES

FY00	FY01	FY02	FY03	FY04	FY05	FY06 (Planned)
Assessments						
Cameroon[a]	Armenia	Barbados	Algeria	Austria	Albania	Australia
Canada	Croatia	Brazil[a]	Bangladesh	Azerbaijan	Bahrain	Bosnia & Herzegovina
Colombia	Czech Republic	Bulgaria[a]	Bolivia	Chile[a]	Belarus	Brunei
El Salvador	Dominican Rep.[a]	Costa Rica[a]	Germany[b]	ECCU[c]	Italy	Denmark
Estonia	Finland	Côte d'Ivoire	Honduras	Ecuador	Madagascar	Fiji
Ghana[a]	Gabon	Egypt[a]	Hong Kong	France	Mauritania	Guyana
Hungary	Georgia	Japan[b]	Macedonia	Jamaica	Norway	Namibia
India[a]	Guatemala	Korea[b]	Malta	Jordan[a]	Paraguay	Portugal
Iran	Iceland	Kyrgyz Rep.	Mauritius	Kenya	Rwanda	Qatar
Ireland[b]	Israel	Lithuania	Mozambique	Kuwait	Serbia	San Marino
Kazakhstan[a]	Latvia	Luxembourg	Oman	Moldova	Sudan	Serbia-Montenegro
Lebanon	Mexico[a]	Morocco	Romania[a]	Netherlands	Trinidad and Tobago	Turkey
South Africa[a]	Peru	Nigeria	Tanzania	New Zealand[b]		Uruguay
	Poland	Philippines[a]		Nicaragua		
	Senegal	Russia[a]		Pakistan		
	Slovenia[a]	Slovak Rep.		Saudi Arabia		
	Switzerland	Sri Lanka[a]		Singapore		
	Tunisia[a]	Sweden				
	Uganda	Ukraine				
	United Arab Emirates	United Kingdom				
		Zambia				
Total: 13	Total: 21	Total: 21	Total: 13	Total: 17	Total: 12	Total: 13
Updates						
				El Salvador	Armenia	Georgia
				Ghana	Colombia	Guatemala
				Kazakhstan	Hungary	Ireland
				Slovenia	Peru	Kyrgyz Rep.
					Senegal	Mexico
					Uganda	Morocco
						Philippines
						Poland
						Tunisia
				Total: 4	Total: 6	Total: 9

Source: FSAP Database.
Note: The FSAP for Argentina (FY01) and Uruguay (FY02) were not completed.
a. Denotes joint desk study with IEO;.
b. Denotes desk study by IEO.
c. ECCU is the abbreviation for the Eastern Caribbean Currency Union.

APPENDIX B: FSAP FRAMEWORK

Inputs

Diagnosis

- Assessment of financial sector risks and vulnerabilities; analysis of institutional, structural, and market features; stress testing; FSI; standards and codes.
- Reassessments

Outputs

Findings, recommendations, and prioritization

- FSAP reports to country authorities
- FSA to Executive Board

Follow-up on recommendations

- Bank and other donor programs for lending / Analytic and Advisory Activities
- Government actions: policy, legal and institutional changes

Outcomes

- Reduction of financial vulnerabilities
- Improved financial sector depth and efficiency

Impact

- Crisis prevention
- Financial sector development leading to economic growth

APPENDIX C: METHODOLOGY FOR FSAP EVALUATION

IEG and IEO worked together to develop a common methodology for the evaluation of FSAPS. The core components of the evaluation were based on:

i. Detailed country studies;
ii. Survey of major stakeholders;
iii. Feedback from other important stakeholders;
iv. Review of country assistance strategies, Article IV surveillance documents, and other relevant Bank and IMF documents.

Detailed Country Studies

Nineteen detailed country studies were undertaken (the table below lists the countries).[1] All of these countries had completed FSAP processes and, as a group, represented one-third of the total number of completed FSAPs at the time.[2] Countries were selected with the aim of having a representative sample of the total universe of completed FSAPs, giving due weight to the following distinguishing factors:

a. Country income levels,
b. Regional distribution,
c. Fiscal year of FSAP (to cover pilot FSAPs as well as those done prior to and after the 2003 Board review of the program, which resulted in a major policy guidance for future FSAP), and
d. Type of FSAP (initial or update).

To maintain consistency of approach, a common methodology comprising standard sets of questionnaires and an evaluation matrix[3] was used for each detailed country study. Moreover, a two-person team, one each from IEO and IEG, was formed to work jointly on each case study.

The evaluators began with a detailed document review for each country, including: (i) the full set of FSAP documents, including the aide-memoire, all technical annexes, FSA, FSSA, TORs, and any other FSAP documents on file; (ii) CASs and CAS progress reports both prior to and following the FSAP; (iii) Article IV surveillance reports and other IMF documents; (iv) World Bank project documents for financial sector projects or multisector projects with financial sector components; (v) relevant ESW and other Analytic and Advisory Activities documents (both financial sector and multisector, such as PRSPs or CEMs); and (vi) information from other donors.

After the document review, the evaluators interviewed country authorities, using a structured interview template to ensure consistency in the questions. Eleven out of 19 cases involved a visit to the country to interview major stakeholders, including authorities (government and the central bank), regulators, selected major banks/financial institutions, and knowledgeable think-tanks. In an additional six cases, telephone interviews with authorities were carried out (see table below).

The evaluators then interviewed staff from the IMF and Bank who were involved with the FSAP. Typically, the group was comprised of the (i) team leader and co/deputy leader; (ii) country director; (iii) sector director/manager; and (iv) Article IV / area department mission chief. Sometimes the team was also referred to other staff (such as the country economist or a particular team member).

For each case study, a standard evaluation matrix model was used, which provided a rating system. After completion of all case studies, an

Countries in 19-Country In-Depth Sample

Country	Type of contact with country authorities[a]
Brazil	Conference call
Bulgaria	Country visit
Cameroon	Country visit
Chile	Conference call
Costa Rica	Country visit
Dominican Republic	None
Egypt	Country visit
Ghana	Country visit
India	Country visit
Jordan	Country visit
Kazakhstan	Conference call
Mexico	Interviews in Washington, DC
Philippines	Conference call
Romania	Country visit
Russia	Country visit
Slovenia	Country visit
South Africa	Country visit (IEO only)
Sri Lanka	Conference call
Tunisia	None

a. All country authorities were offered an opportunity to provide feedback to the evaluation on their experience with the FSAP process.

aggregate country evaluation matrix was prepared showing rating trends.

Survey of Major Stakeholders

The IEO and IEG also undertook jointly a survey of five major stakeholder groups: (i) authorities in the country (the primary FSAP counterpart in the country, usually the central bank governor); (ii) IMF Article IV mission chiefs and area department division chiefs for countries that had had an assessment; (iii) Bank country directors for countries that had had an assessment; (iv) all FSAP team leaders as well as deputies and coleaders; and (v) all FSAP team members from the Bank and IMF.[4] The services of an external company were used to ensure the confidentiality of the survey and its results. They conducted the survey in spring of 2005, largely online,[5] and provided aggregate results to the IEG and IEO (individual responses were not revealed). The overall response to the survey was quite high (53 percent of the net deliverable sample).[6] Different response rates were obtained from different groups, but the rate for the authorities was 59 percent. (See appendix D for more detail on the survey.)

Feedback from Other Important Stakeholders

Interviews were also held with other important stakeholders not covered by the survey, to assess the extent of FSAP's impact on their work program and their views on the program. These included:

a. bilateral donors, e.g., KfW (Kreditanstalt für Wiederaufbau), DFID, etc.;
b. regional or multilateral banks, e.g., African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Central Bank, European Investment Bank, Inter-American Development Bank, etc.;

c. standard setters, e.g., BIS, IOSCO, Financial Stability Institute, CPSS, IAIS, etc.; and
d. sources of technical assistance, e.g., SECO, GTZ (Gesellschaft für Technische Zusammenarbeit), US Agency for International Development, European Community, Directorate-General for Development Cooperation, FIRST, etc.

Reviews of Other FSAPs and Updates

FSAPs not covered in the detailed country studies, as well as the updates, were also reviewed, along with CAS documents and other Bank documents. These reviews were used to supplement, confirm, or clarify findings from the detailed country studies and the surveys.

Review of FSAP Background Information and Data

In order to build a solid knowledge base on FSAP, the IEG team collected all relevant background documents. In addition, it also collected and analyzed the relevant operational and budget data.

APPENDIX D: SURVEY OF STAKEHOLDERS

As part of the evaluation, IEO and IEG undertook jointly a survey of the key stakeholders involved in the FSAP. This appendix presents the methodology used for surveying the views of participants. The main findings from the surveys have been incorporated in the report. To ensure the confidentiality of survey responses, an external company was hired to administer the implementation and collection of results.[1] The surveys were conducted in the spring of 2005, to a large degree through an online modality.[2]

Population Surveyed

Survey questionnaires were sent to five groups of stakeholders, consisting of different users and producers of the FSAP:[3]

1. **Authorities.** A single survey was sent to the authorities of all countries that had completed an FSAP by the first quarter of 2005. Every effort was made to send the survey directly to the authorities in the country most directly involved with the FSAP.
2. **IMF Article IV mission chiefs and area department division chiefs.** The survey was sent to the relevant staff that worked on countries that had an FSAP.
3. **World Bank country directors.** The survey was sent to the relevant directors that worked on countries with an FSAP.
4. **FSAP team leaders as well as deputies and coleaders.** Team leaders and co/deputy leaders are typically drawn one each from the IMF and World Bank.[4] FSAP updates were treated as a separate assessment from the original FSAP.
5. **FSAP team members.** The survey was sent to all team members from the IMF and World Bank staffs. External experts were not included.

Main Features of the Questionnaires[5]

- The outline of each questionnaire followed broadly the outline of the evaluation questions in the IEO and IEG issues/approach papers. The main components of each questionnaire related to inputs, outputs, outcomes, and process issues.
- There were about 30 questions for each group of stakeholders. Where applicable, the same questions were posed to different groups; a number of questions applied only to specific groups.
- Survey questions were mostly of the closed-end type. Many consisted of specific statements where respondents were asked to identify their views on a 5-point scale (ranging from "strongly agree" to "strongly disagree"). Some questions had multiple choices, and others sought "yes/no" answers. Where applicable, the respondents were given the opportunity to chose a "don't know" option and to write in their response ("other, please specify"). At the end of the survey, all respondents were given the opportunity to provide comments on the FSAP.

Survey Response

The overall stakeholder response to the survey was quite high (53 percent of the net deliverable sample).[6] Significantly different response rates were obtained across groups; those from the authorities and FSAP leaders and members were the highest at around 60 percent (see table below).

Survey Samples and Response Rates

Survey	Original unique sample	Total nonqualifying sample	Net deliverable sample	Responses received	Response rate[a] (in percent)
Authorities	81	5	76	45	59
IMF Article IV mission chiefs	83	9	74	27	36
World Bank directors	57	3	54	14	26
FSAP team leaders	79	8	71	45	63
FSAP team members	289	41	248	148	60
Total	589	66	523	279	53

Source: IEO report, January 2006.

a. The response rate is the number of responses received as a percentage of the net deliverable sample.

APPENDIX E: MANAGEMENT RESPONSE

Introduction

Management welcomes IEG's Review of the Financial Sector Assessment Program (FSAP), which centers on (a) the relevance of the program in assessing the stability and development needs of national financial systems, (b) cooperation between the IMF and the Bank as well as with other partners, and (c) coordination within the Bank. Management notes the Review's clear acknowledgment that "[t]he objectives of the FSAP are thus highly relevant to the Bank's overall mission of fostering economic growth and reducing poverty."

General Alignment of Views. Management concurs with most of the Review's analyses and recommendations. They are generally in line with staff views and ongoing endeavors to adapt the program to the evolving needs of our clients and to make it more effective and relevant. In this context, Management believes that the need for more systematic follow-up is the key concern. Management, however, believes the issues raised by the Review in respect of country selection need to be understood in the context of the Bank's development mandate and the needs of its clients, including low-income countries.

Overview. This response summarizes the main findings and conclusions of IEG's Review and sets forth Management's comments. The Management Action Record is attached.

Summary of IEG's Findings and Recommendations

The IEG Review's main messages in the Executive Summary are quoted below with its summary of associated findings:

- "The quality of the diagnostics has been good." Joint Bank-IMF cooperation has allowed an integrated approach toward financial sector vulnerabilities and development needs, while expanding the depth and quality of analytic expertise. Within this positive assessment, coverage of specific sectors of the financial systems has been of uneven quality, particularly where nonbank financial institutions are concerned. Also, "the scope of assessments should be more tailored to the specific needs of the country."
- "Country authorities have found the assessment to be useful" and have cited them for (a) providing an "independent evaluation" of the system, (b) expanding their knowledge of financial sector vulnerabilities; (c) improving technical abilities; and (d) contributing to the policy dialogue within the country.
- "FSAP recommendations need to be better integrated into Bank programs." IEG has found that 42 percent of the FSAPs have a significant impact on the Bank's country programs or dialogue. In another 34 percent of cases, the FSAP had a minor influence, while in the remaining 24 percent it seemed to have had little influence on the Bank's program. FSAPs can serve as useful background pieces which are effectively leveraged.
- "Country selection needs to better reflect surveillance priorities and the likelihood of financial sector reform." It involves difficult tradeoffs, notably in balancing the need to improve surveillance with development priorities. The voluntary nature of the program limits the program's overall effectiveness in identifying systemic risks; however, there is a strong consensus among authorities and staff surveyed for the IEG Review that the voluntary na-

ture of the program and associated country "ownership" should be maintained.
- "The program must do a better job of keeping the Board informed in a timely manner," and Financial Sector Assessments (FSAs) should have a quicker turnaround.

The recommendations for Management are in the attached Management Action Record under the following headings:

- Sharpen country selection and scope of assessment,
- Integrate the FSAP into a full reform program,
- Informing the Board, and
- Knowledge sharing.

Management Comments

Coverage and Quality

Management welcomes the Review's finding on the relevance of the FSAP to the Bank's mission and the generally good quality of the assessments. It is gratified with the appreciation expressed by country authorities on the usefulness of the program.

Coverage. Management notes the recommendation to tailor the scope of the FSAP assessments to the specific needs of the country. Given the objectives of development, stability, and efficient use of resources, Management agrees that there is an inherent need for judgment in resolving the trade-off between tailoring and comprehensiveness. Early consultations across the Bank, with the authorities and the IMF, as well as awareness of other partners' programs should help guide the judgment. The current practice of involving country management in reviewing the scoping note should be helpful, although it is unlikely to eliminate conflicting views.

Quality. Management notes the Review's observation that assessments of the nonbanking sector were not as consistent as those of the banking sector. This is inherent to the nature of nonbank financial intermediation, which is generally at a much earlier development stage than that of banking. The latter is broadly established and supervised with a longer tradition of information collection and with longer-tested analytical tools. Nonbank financial intermediation is of more recent derivation when it exists, is generally less systematically monitored, and is subjected to fewer analyses. Moreover, banking systems may exercise different functions across countries, reflecting different legal and regulatory structures. This can blur the distinction between banking and nonbanking activities and requires addressing issues of financial intermediaries in a functional rather than strictly institutional context. Notwithstanding the foregoing, additional efforts are required to develop relevant indicators and analytical tools for assessing development needs outside the banking system. The FSA Handbook[1] provides a benchmark on approaches and methodologies. An ongoing project to develop financial development indicators will improve monitoring capacity. A review of methodologies aimed at nonbank financial institutions (NBFIs) to guide FSAP assessments will be pursued with due attention to resource trade-offs.

Reports on the Observance of Standards and Codes. While the IEG Review does not emphasize the Bank Reports on the Observance of Standards and Codes (B-ROSCs), they can and should contribute additional information to FSAP assessments.[2] B-ROSC and FSAP staffs are working to improve the coordination of assessments and follow-up work. The initiative is consistent with the call for more effective partnership with other sector teams.

Staffing. Finally, the Review's observation on quality and coverage clearly suggests the need to ensure the consistent availability of staff with sufficient experience and financial and political economy skills. Management will continue to work to ensure that it has the right staff and that it assigns them effectively. The Financial Sector Network plays a key role in this process.

Integration of FSAP Recommendations in Country Programs

Management concurs with the message that FSAP recommendations should be better integrated in country programs. The nature of Poverty Reduction Strategy Papers (PRSPs) and CASs and their multiyear cycle, as well as the joint World Bank/IMF nature of the FSAP, may compound the coordination challenge. Notwithstanding, program adjustments are being made to involve country units more closely at the initiation of the process and to keep them involved throughout the assessments. For example, the practice of early involvement of country management should provide an opportunity to organize the handover from FSAP diagnosis to follow-up. Participation of country unit staff in FSAP policy discussions may facilitate more prompt dialogue on follow-up.

Bank Program versus Country Program. The Bank need not be the sole source of financing and technical assistance in implementing the recommendations of the FSAP. Often, reform needs identified by the FSAP can be implemented by the country without external TA, for example as follow-up to country-owned Poverty Reduction Strategies (PRSs) in low-income countries. The full drawing down of Financial Sector Reform and Strengthening Initiative (FIRST) resources allocated to middle-income countries is a good reflection of follow-up that is not part of Bank country programs. The real test is not the Bank country program, but the country's reform program.

Further Integration into Country Programs. Management wants, however, to increase the integration of FSAP recommendations within country programs in order to further enhance FSAP's value to member countries. The recent practice of early involvement of country management is expected to provide an opportunity to organize the handover from FSAP diagnosis to follow-up.

Donor Coordination. Management concurs that greater donor cooperation can increase effectiveness of FSAP follow-up. The involvement of donors raises the issue of confidentiality and the scope of information to be shared. Arrangements will continue to be explored in consultation with country authorities and the IMF to involve interested donors.

Country Selection

The Review acknowledges the difficult tradeoffs the Bank must make in allocating limited FSAP resources, but highlights that "Country Selection needs to better reflect surveillance priorities and the likelihood of financial sector reform."[3] Covering systemically important or vulnerable countries is a priority inasmuch as financial instability of such a country can have serious economic and social costs, nationally and internationally. The Bank will maintain its readiness to respond promptly to a request for an assessment from a systemically important country. However, as the report notes, the Bank must factor in its focus on development and poverty reduction, including in smaller countries that may not be systemically important from the perspective of global financial stability.

Systemically Important Countries. Management has encouraged systemically important countries to participate in the program, with overall good success. Consequently, among countries still due for initial assessments, there are only a limited number of systemically important countries (with signs of growing interest), and a group of smaller and low-income countries, including in Africa.

Process of Country Selection. Currently, the process of country selection involves Regional and central units, both in the Bank and the IMF, while the Financial Sector Liaison Committee acts as a forum to reach consensus on a feasible program. Both Boards have confirmed that the program should be voluntary and have already stated their criteria for selection in the context of keeping the program voluntary. That said, Management would ask the Bank Board to encourage participation as a form of good citizenship in the international community.

Informing the Board

Management concurs that the Board should receive FSAs in a timelier manner and it will take action to ensure this. However, what is more important is informing the Board on the follow-up to these findings in country programs. Whenever the main objective is related to a specific country assistance program, discussions with the Board should take place in the context of discussions of the CAS, programming documents, and related lending operations. In addition, Management will organize periodic technical briefings to highlight the cross-country financial sector issues that have an impact in shaping the Bank's financial sector work. Management has submitted a request for scheduling a first technical briefing this spring.

Use of Financial System Stability Assessments. Management does not share IEG's view on the effectiveness of using Financial System Stability Assessments (FSSAs) to expedite the preparation of FSA. Both the FSA and FSSA are based on the FSAP main report, with the former emphasizing developmental issues and the latter emphasizing stability. Enforcing current deadline policy should improve the FSA timeliness. IEG's suggestion to leverage the FSSA downplays the relevance of the Bank's focus on development and poverty reduction. In addition, it is unlikely to accelerate the process as it still requires substantive additions to the document.

Management Action Record	
Major Monitorable IEG Recommendations Requiring a Response	**Management Response**
Sharpen country selection and scope of assessment. Management of the Bank and the IMF should select countries for assessments and updates according to the priorities identified by the Board and adjust timing to suit the situation. In some cases, such as systemically important and vulnerable countries, this may mean that updates are carried out every two or three years, while in other countries, that are not systemically important or that are not likely to treat financial sector development as a priority, initial assessments or updates may be delayed by several years. This priority list, as well as the rationale for selection, should be presented to the Board. In cases where countries have not volunteered, management needs to inform the Board of those gaps, and should seek other ways to work with the country on addressing critical issues in the financial sector. The scope of the initial assessments and updates should be more tailored to address the specific needs of the country. This may mean that a systemically important, vulnerable country may require a full set of ROSCs, and minimal discussion on missing markets, whereas another country may not require any formal ROSCs, but instead focus on access issues. Also, this process would be more efficient if more time was spent in advance, working with country units and authorities on developing prioritized TORs.	Management will continue to respond promptly to requests from systemically important and vulnerable countries for initial assessments and updates. A different phasing for less systemically important countries would be considered with due consideration to regard for the Bank's objectives of development and poverty reduction and the lagging coverage of certain countries, notably in Africa. Management will inform the Board on the confirmed list of countries due for an assessment through the current vehicles of the periodic reporting to the Boards of the IMF and the Bank on the program, country programming documents and discussions, and semiannual technical briefings. Management will continue to encourage countries to volunteer and will use alternative vehicles for financial sector work when needed. Management will continue to seek mechanisms to improve the tailoring of the scope of initial assessments and updates to the specific needs of the country, with due consideration for the efficient use of resources. Early scoping notes, benefiting from consultation with authorities, will permit a better understanding of country needs. They will permit more informed cross-unit discussions within the Bank and with the IMF and an improved decision-making process on scope and focus. Periodic Board updates on the FSAP program will review experience with increased tailoring, notably scoping notes.
Integrate the FSAP into a full reform program. The Bank, in consultation with the IMF and other technical assistance providers, should seek to establish a clearer framework for coordinating follow-up programs, including technical assistance activities, based on the country's own action plans. While details will differ by country, management should consider building upon the FSAP by having follow-up discussions with country authorities on technical assistance and other development needs; such discussions should include Bank technical and country staff, as well as the IMF's Monetary and Financial Systems Department and area staff. Once development and other assistance priorities are determined, this information should be quickly shared with the donor community. In addition, in order to improve donor effectiveness, the following recommendations should be considered: (i) inform donors in advance about the timing of the FSAP, so that donors can adjust their program timetables accordingly; (ii) provide donors with better and more timely access to reports; (iii) improve consultation with donors who are active in the financial sector during the FSAP mission, including presentations of key findings.	Management concurs with the need for a clearer framework for coordinating follow-up programs based on country ownership and the country's own action plan. Early consultation at the initiation of the FSAP and subsequently among the FSAP team, the IMF, country management, and country authorities will be organized to facilitate the process and ensure a smooth handover from the FSAP team to the Bank's country operations and dialogue. The actual process will vary according to country circumstances and partners. Cognizant of country ownership, the Bank will encourage and support the sharing of information with the donor community by the country authorities, consistent with confidentiality policies. While FSAP teams can hold consultations with interested donors, within the framework of confidentiality commitments, it would be premature to share key findings before their confirmation through internal reviews within the IMF and the Bank, and the information's formal conveyance to the authorities. Country-led consultations with interested donors to organize support for follow-up will be encouraged.

Major Monitorable IEG Recommendations Requiring a Response	Management Response
The financial sector teams must also work to improve coordination with the country units to ensure integration of the FSAP findings and recommendations into the Bank's country strategies. This would include greater participation of the country units in the design of TORs, mission teams, and follow-up discussions.	Coordination between country and sector teams will benefit from consultation meetings at the time of country selection and again at the time of the initial review of issues to be addressed in the assessment. Meetings chaired by the country director will provide guidance to the team leader and helps set the stage for later follow-up discussions. Management will report on the implementation of the above actions in its proposed periodic Board updates.
Informing the Board. A deadline should be placed on the production time of the FSA. One possibility to speed production is to leverage off the work done by the IMF. The IMF FSSAs are usually completed within 16 days of the delivery of the final report. While cognizant that the different foci, timetables, and processes make it difficult to quickly produce a joint paper, the Bank should consider using the FSSA as a platform to summarize the main findings of the assessment, and then add chapters and annexes to address issues upon which the IMF may not have focuses.	Currently, both the FSA and FSSA are based on the FSAP main report ,with the former emphasizing developmental issues and the latter emphasizing stability, with due attention to their inherent linkage. The IEG's suggestion to leverage the FSSA downplays the relevance of the Bank's focus on development and poverty reduction. Moreover, it is unlikely to accelerate the process as it would require additions of substance to the FSSA. Pursuing timely delivery of an FSA, responding to well-identified information needs, directly based on the FSAP main report is deemed more appropriate.
Critical information should be brought quickly to the Board or subcommittee for discussion. In addition, discussions of key FSAP findings and recommendations, and their integration into the country program (or the decision not to include them in the country program) should be part of the *CAS report and discussions*. Bank management should also consider periodic technical briefings summarizing major findings from recent FSAPs, as well as synthesizing the information to provide recommendations for future work (within countries, regions, and for future FSAPs).	A timely FSA, incorporating essential messages, will be a vehicle for bringing critical information to the Board. CAS discussions will provide an opportunity to discuss integration of FSAP in country programs and follow-up. A request was submitted to schedule a first semiannual technical briefing in the spring. The briefings will include information on progress in improving the timeliness of FSAs.
Knowledge sharing. While remaining mindful of the needs of safeguarding sensitive and confidential information, the Bank should more actively leverage the knowledge gained from this extensive exercise. This would include actively disseminating "best practice" analysis, more discussion on concerns and issues that arise while conducting FSAPs, and improved sharing of data and insights gained through the program. The financial sector teams should also work to partner more effectively with other sector teams to maximize collection and sharing of information.	Management concurs with the objective of a more active leveraging of knowledge gained from the assessments. Initiatives in this direction have been taken. They include the completed FSA handbook, reviews of treatment of specific topics across FSAPs (including International Organization of Securities Commissions issues and microfinance), the development of templates to share accepted practices, periodic team leaders meetings as well as gatherings of assessors of standards to exchange experience. A more systematic effort will be pursued with an annual program of knowledge sharing, within the overall objective of efficient resource use. Progress will be reported in the planned periodic briefings for Executive Directors.

APPENDIX F: CHAIRMAN'S SUMMARY, COMMITTEE ON DEVELOPMENT EFFECTIVENESS (CODE)

The Informal Subcommittee (SC) of the Committee on Development Effectiveness (CODE) met on February 6, 2006 to discuss the IEG Review of the Financial Sector Assessment Program (FSAP), prepared by the Independent Evaluation Group-Bank (IEG) and the Draft Management Response to the IEG review. Written statements were issued by Messrs/Mmes Dorn, Hermann, and Ketsela.

Background. The Financial Sector Assessment Program (FSAP) is a joint World Bank-IMF initiative, undertaken in response to the financial crises of the late 1990s. The ultimate objectives of the program are: (i) the identification and mitigation of financial sector vulnerabilities and their macroeconomic stability implications; and (ii) fostering development of the financial sector and its contribution to economic growth. The IEG evaluation focused on reviewing the relevance of the program, quality and effectiveness of inputs and outputs, and impact of the assessments on different audiences. The IMF's Independent Evaluation Office (IEO) has undertaken a parallel evaluation of the FSAP. IEO and IEG have collaborated closely on all aspects of their respective evaluations.

The IEG evaluation concluded that the FSAP is a good-quality analytical tool with overall sound program framework, where joint Bank-IMF cooperation allowed for an integrated approach toward financial sector vulnerabilities and developmental needs. Among specific lessons and findings identified by the evaluation are: (i) country selection – not all "systemically important" or vulnerable countries were covered, nor were developing countries selected to reflect the potential impact the FSAP could have on financial sector development; (ii) uneven quality and appropriateness of coverage of specific sectors; (iii) candor of the reports was generally satisfactory, but there were also instances of pressure to soften the written messages; (iv) the assessments often had weak prioritization of recommendations, and did not adequately consider sequencing or institutional capacity constraints; (v) the Bank needs to better integrate the assessments' findings and recommendations into its programs; and (vi) the impact of the FSAP on the Bank and its work on financial sector development has not been consistent, indicating that the full potential of the FSAP usefulness to the Bank has not yet been attained.

The report's recommendations focused on: (a) the need to select the countries and scope for assessments based on the institutional priorities, systemic importance of countries, likely country impact, country needs, and timing; (b) integrating the FSAP into a country reform program and establishing a clearer framework for coordinating follow-up programs, based on the countries' own action plans and the Bank's country strategies; (c) improving the process of informing the Board about the main findings; and (d) more actively leveraging the knowledge gained from the FSAP through dissemination, information sharing, and partnerships.

In its written response to the review, management welcomed the IEG evaluation of the FSAP and concurred with most of its analyses and recommendations. Management noted, however, that the issue of country selection needs to be viewed in the context of: the Bank's development mandate; clients' needs—especially the small and low-income countries, and the voluntary nature of the program.

Management agreed with the need to inform the Board in a more timely manner and noted that measures are being undertaken in this regard (e.g., technical briefings). At the same time, management disagreed with IEG's suggestion that the FSSA could be used as a platform to summarize the main findings of the assessment in the preparation of the Bank's FSA, and emphasized that the FSAP aide-mémoire is the platform for both FSSA and the FSA and that these reports have different foci (for the FSSA, stability, and for the FSA, development).

Main Conclusions and Next Steps. The Subcommittee commended the high quality of the IEG review of FSAP and the Management Response and broadly agreed with the review's analysis and recommendations. Members concurred that the FSAP is highly relevant to the Bank's mission and, therefore, warrants additional Board involvement through timelier reports to the Board. Members were strongly in favor of maintaining the voluntary nature of the program, which is equally relevant for systemically important countries and those interested in implementing the reforms. Members welcomed the joint Bank-IMF approach to conducting FSAPs, and the efficient division of labor based on expertise, mandates, and comparative advantages of two institutions. Issues raised included: the need to keep the scope of FSAPs manageable; employing country-specific approach; importance of nonbanking sectors, including access to finance; more extensive use of the FSAP in terms of donor coordination and identification of best practices; centrality of the authorities as the primary audience of the reports and the importance of country ownership. It was suggested to proceed with disclosure of the evaluation following the CODE Subcommittee discussion and to brief the Board on the IEG FSAP review at the time of Management's semiannual Board briefing on FSAP. The following points were raised.

Relevance and Impact of the FSAP. Members broadly agreed with the relevance of the FSAP for poverty reduction and growth, which benefits both developed and underdeveloped financial systems. Members acknowledged that it would be premature to measure the actual impact of the program started in late 1990s, but also expressed interest in seeing some empirical evidence of implementation of reforms in countries that have been assessed in the early years, and the impact of adopting the FSAP recommendations on: country financial stability, occurrence of crises (or absence thereof), credit availability, investment and growth rates, etc. IEG noted that it had looked at the mentioned issues and found it difficult to construct a statistically valid dataset and make attributions owing to multiple lags between reforms, impact and data, and sample selection bias (due to the voluntary nature of the program). IEG added that doing an FSAP does not guarantee avoiding crisis, and it is not possible to prove that a crisis has been averted in any particular case. A member was interested in more information on the viability of the stress test, and reliability of the underlying data. IEG noted that the stress test is just one of the tools to evaluate the financial system and its limitations should be properly communicated to and acknowledged by the authorities. Management added that although stress testing is a useful tool, it has its limitations when applied to detecting systemic vulnerabilities of the entire system and is probably more valuable when applied to individual institutions.

Integration into Country Programs. Some members noted with concern the IEG observation that less than half (42 percent) of the assessments had a significant impact on the Bank's country programs, and only 34 percent of country authorities recalled the Bank engaging in follow-up to the FSAP (as opposed to an 80 percent follow-up rate at the IMF), and asked for more detailed explanation in this regard. They supported the IEG recommendation to establish a follow-up mechanism, and make the best use of the expertise of the FSAP team even in the absence of a relevant follow-up Bank program or lending operation. Management noted that the differences in the rate and time of follow-up actions are stipulated by the different business models, organizational structures, and priorities of the two institutions. Unlike in the IMF, financial sector work in the Bank is highly decentralized, with over 20 units involved in providing policy-based TA and advice on financial sector-related matters to the clients. Management recognized the importance of working within the existing institutional constraints and will make additional efforts to involve country units in the FSAP process. Several members agreed with the Management view that financial sector reform needs identified by the FSAP may not necessarily be supported by the Bank only, but include other donors who may choose to support some recommendations. They urged Management to implement specific measures to increase communication and collaboration within the Bank Group, other donor partners and the clients to assist countries interested in incorporating FSAP findings into their PRSPs and to facilitate inclusion of FSAP findings in CASs. In response to some members' request to honor the confidentiality of country assessments and close dialogue with country authorities, IEG concurred that no confidential information can be disclosed and shared with other donors without the consent of the client, but added that, usually, there is plenty of publicly available information that can be brought to the attention of the donor partners. Some members highlighted the importance of the FSAPs both to inform and draw on other pieces of the Bank's analytical work, but cautioned not to duplicate the work done in the context of other sectoral ESW.

Bank-IMF Cooperation. Members broadly welcomed the joint Bank-IMF execution of the FSAPs. They stressed the importance of balancing the objectives of the two institutions through the Financial Sector Liaison Committee (FSLC) and making the best use of their respective comparative advantages: the IMF is well-equipped to deal with macroeconomic and financial stability issues, and the Bank has an advantage in handling other sectoral issues. IEG noted that its review of the FSLC indicated a good level of cooperation between the two institutions—a point that was also confirmed by management. A view was expressed regarding the need to examine the relation of the FSAP with the Review of Standards and Codes program and how they can be better coordinated to increase efficiency of the process.

Country Selection. Members noted that the main criteria for country selection and allocation of necessary resources should be their demonstrated interest in reforms, existing preconditions for financial sector development, and systemic importance or vulnerability. It was broadly agreed that participation in the program should remain voluntary. Several members emphasized that giving priority to systemically important countries within the allocated resource envelope should not exclude the poor or smaller countries, whose financial systems do not play significant role in the international financial system.

Coverage. Some members and participants felt that expanding FSAP coverage beyond its present scope (including topics such as access to financial services, missing markets, political economy, etc.) would undermine the consistency of the exercise and would require additional skills and resources. Others noted that nonbanking sectors often carry equal importance and were interested in why analyzing them might be problematic. A member suggested that future FSAPs include the issues of cross-border linkages of financial systems more systematically. Some members felt that the issue of access to finance should have been given more prominence in the FSAPs, and especially those done in poorer countries. Management agreed with the importance of the FSAPs looking at access to finance, but also underscored that they should not be viewed in a dichotomy vis-à-vis stability.

Audience and Country Approach. Several members stressed that the main audience of the FSAP is, and should remain the country authorities, which should benefit from an independent evaluation of the financial sector vulnerabilities. In this context, they also underlined the crucial role of country ownership for achieving the maximum positive impact of the program. Some members urged taking opportunities to standardize the assessment framework, especially for the banking sector and its linkages to the other segments of the financial sector. A member noted that a "handbook" coming out of the FSAP experience could be a useful and cost-saving tool. Others were in favor of tailoring FSAPs to the country needs, commensurate with their levels of development. IEG replied that although a certain degree of standardization is possible in selected sectors, the differences in the levels of development of financial systems in the countries under review do not allow applying a common-template approach.

Informing the Board. Some members supported the IEG recommendation to have a deadline on the FSA production and indicated that there was a need to have a Board discussion of the main findings of the FSAP. Others noted that, given the technical nature of the FSAP, a summary of the main findings should be a sufficient vehicle for informing the Board and should normally be discussed in the context of a respective CAS. Some members and participants expressed disappointment that it takes the Bank much longer to issue its summary of the FSAP (FSA), as compared with the IMF's FSSA and asked for explanations in this regard. Management agreed with the need to keep the Board better informed and added that it is planning to provide the Board periodic reports on the FSAPs and ROSCs, together with a semiannual technical briefing to the Board on the FSAP this spring. Management also agreed that delays in the circulation of the FSAs should be kept to the minimum and will undertake necessary measures in this regard.

Discussion at the Board and the Report's Dissemination. Some participants noted that the IEG evaluation of the FSAP should have been discussed by the full Board, taking into account that the parallel IMF IEO review was discussed at the IMF's Board. IEG noted that it is normal practice for its evaluations (with few exceptions) to be discussed at either CODE or CODE Subcommittee. A suggestion was made to brief the Board about the IEG review of the FSAP in tandem with the upcoming semiannual Management briefing on the FSAP implementation. In the absence of objections, the report will be disclosed following the CODE Subcommittee discussion.

Pietro Veglio, Chairman

ENDNOTES

Chapter 1

1. A typical report would include reviews of all the major financial sectors, including banking, insurance, capital markets, pensions, and asset management, and would cover legal, supervisory, and regulatory systems, the infrastructure supporting the sectors, and a discussion of market structure, competition, and vulnerabilities. The reviews usually include several formal Reports on the Observance of Standards and Codes (ROSCs), which assess the degree to which a system is compliant with recommended standards set by different standard-setting bodies. Technical notes usually include more detailed reviews and discussions on specific financial sector topics, such as stress tests, rural finance, access to credit, etc. Normally, the draft aide-memoire is provided to the authorities at the end of the mission, and after review and revision at Bank and IMF headquarters, the report is finalized and sent to the authorities.

2. "The objective of the FSAP is to benefit countries by alerting them to likely vulnerabilities within their financial sectors and to assist the Bank and the IMF and the international community more broadly, in designing appropriate assistance. The FSAP will ensure that financial sector analysis is brought further into the core of economic policy discussions. It is expected that the program will better help countries reduce financial sector vulnerabilities, and therefore the likelihood of crisis. It will also provide national authorities with a strategic framework within which to undertake the strengthening of the financial systems." (Internal Bank document.)

3. In the case of most industrialized countries, the exercise was led by the IMF. The Bank contributed staff with specific development expertise.

4. While intermediate actions (such as passage of a new banking law, or improved regulations) may occur reasonably quickly, the strengthening and deepening of the financial sector cannot be measured over a short timeframe. With only 12 FSAPs completed in 2000, and 20 in 2001, and given the differing characteristics of the countries, it is not possible to find a statistically significant connection between the FSAP and changes in indicators. The problem is compounded by the fact that the countries volunteering for the program are not necessarily representative of the overall population.

5. FSAPs conducted since fiscal year 2004 were also reviewed; however, because the most recent FSAPs often have not yet completed their outputs (FSAs and FSSAs), and are too recent to have had an impact on with Bank programs or country programs, they were not included in the surveys or detailed reviews.

6. While IEG participated in interviews on the advanced economies, it did not assess those FSAPs as part of this evaluation. See appendix C for a list of FSAP countries and detailed review countries.

7. Authorities from those two countries were also contacted for their views on the FSAP, but discussions were not held. (See appendix C).

Chapter 2

1. Internal Bank document.

2. Internal Bank document.

3. See Caprio 2001: Rajan and Zingales 1998; Levine, Loayza, and Beck 2000.

4. Internal Bank document.

5. Internal Bank document.

6. Internal Bank document.

7. World Bank and IMF 2000.

8. This section relies heavily on an analysis by IEO(see IEO 2006, pp. 19–22, and annex 4) for additional detail. Note that the FSAP documents do not provide definitions of "systemically important" or "vulnerable" countries. This analysis used a number of different definitions for systemic importance, including G-20, G-7 plus markets covered by the Emerg-

ing Markets Bond Index, G-7 plus countries covered by the IMF's International Capital Markets department, or countries monitored by the Bank for International Settlements. For measures of "vulnerability," internal IMF Monetary and Financial Systems Department reports and Standard and Poor's global financial ratings were used. The findings did not vary significantly under the different definitions.

9. Eighty percent of authorities, 69 percent of country directors, 52 percent of IMF mission chiefs, and 59 percent of team leaders surveyed supported a voluntary program.

10. Fifty-eight percent of authorities surveyed thought too much data was required, and 41 percent thought the exercise was too time consuming.

11. From the *Communique of the Meeting of G-20 Finance Ministers and Central Bank Governors,* 1999: "G-20 Finance Ministers and Central Bank Governors welcomed the important work that has been done by the Bretton Woods institutions and other bodies toward the establishment of international codes and standards in key areas, including transparency, data dissemination, and financial sector policy. They agreed that the more widespread implementation of such codes and standards would contribute to more prosperous domestic economies and a more stable financial system. To demonstrate leadership in this area, Ministers and Governors agreed to undertake the completion of Reports on Observance of Standards and Codes ("Transparency Reports") and Financial Sector Assessments, within the context of continuing efforts by the IMF and the World Bank to improve these mechanisms."

12. Internal Bank document.

13. Management has commented that FSAPs would benefit from the inclusion of ROSCs on corporate governance, insolvency and creditor rights, and accounting and auditing. IEG does not disagree with the importance of those ROSCs. However, IEG's review of FSAPs does not provide evidence supporting or disputing the hypothesis that conducting formal ROSCs in those areas in the framework of the FSAP has been more or less effective than carrying out tailored reviews outside the ROSC or FSAP framework, nor is there sufficient evidence to determine whether these ROSCs are more critical than other ROSCs.

14. IEG reviewed all the FSAPs carried out for Bank client countries. The number of major topics reviewed (i.e., significant discussion or analysis in the paper) increased through 2003, and then decreased in 2004, but had no overall pattern (i.e., consistent increase or decrease over time). More significant than the number of topics was the matching of topics to the individual countries' priorities.

15. World Bank and IMF 2005a, p. 33.

16. Management believes the scope of tailoring initial assessments depends on available background work on the country's financial sector and country conditions. The scope for tailoring is likely to be greater for updates, given the availability of initial assessments and subsequent work. IEG believes that even given the varying level of current knowledge, there is a wide scope for tailoring in the initial assessments (for example, in a low-income country under stress, the initial assessment might focus mainly on stability and access issues, and then, as the country's economic environment improves, the update might actually be broader, as it reviews additional subsectors).

17. Data from all completed FSAPs from fiscal years 2001–04 were used; the first set of pilot FSAPs were omitted, as inspection of figures indicated that budget codes had not been consistently used in the first year. Fiscal year 2005 FSAPs and some fiscal year 2004 FSAPs were also omitted because not all final documents had been delivered; therefore costs to date were only partial. Costs include direct labor costs and travel, but exclude overhead calculations. "Fiscal year" refers to that of the first mission. This evaluation only includes costs from FSAPs with joint participation; FSAPs carried out by IMF staff-only were omitted from the data set. Note that because the IMF and World Bank use different budget systems, the two sets of costs may not be directly comparable; however, based on discussions with budgets officers in both institutions, the figures used are generally comparable; the remaining differences are not sufficiently great to affect the overall conclusions.

18. Initial indications are that the mix of countries affects costs, with FSAPs for systemically important countries being more expensive. However, because there is a weighting toward the early years for those countries, there is not yet enough data to distinguish the country effects versus time effects.

19. The definitions of major and minor sector work are not firm. "Major" work or "formal" sector work are usually pieces of sector work which were "delivered" to the Board, in addition to the government, such as Financial Sector Reviews, Financial

Sector Strategies, etc. In addition, regions often produced "informal" sector work, which were usually shorter policy pieces sent to the government, but not formally published. IEG has attempted to categorize the ESW by scope and depth. IEG has omitted from its count ESW that is funded under special programs (such as Anti-Money Laundering), and also has not counted general research on financial sector topics, but instead has focused on ESW written for client countries (such as policy notes or FSRs), or groups of client countries (such as "Central American Capital Markets" or "Bank Consolidation in the Europe and Central Asia Region" (ECA).

20. It has been suggested that the shorter processing times for "IMF-only" FSAPs reflect that those FSAPs are less complex. There is no clear evidence to support this hypothesis; review of the complexity of the FSAPs (scope, depth of coverage, time in field) indicate that the IMF-only assessments are as complex, and in some cases, even more complex than many of the joint assessments.

Chapter 3

1. In addition to the FSAP documents, the reviewers read CASs, Article IV reports, relevant ESW, and projects reports to evaluate whether the FSAP had fully reviewed, prioritized, and analyzed the issues. Reviewers rated the FSAPs along a number of dimensions, including coverage, depth of analysis, clarity and candor of findings, clarity, and prioritization of recommendations. IEO assessors carried out ratings in parallel. Both sets of reviewers used the same set of guidelines, in order to ensure consistency of ratings. For example, a question on coverage of a sector might have the following rating definitions:

1: Comprehensive, including (where appropriate) market structure, compliance with standards and codes stress testing, governance issues, legal and institutional aspects, etc.
2: Some aspects not adequately covered (without a clear explanation of why) or only partially discussed.
3: Several aspects not covered, partially discussed.
4: Focus only on a few aspects (without proper explanation), cursory discussion across the board.

The ratings for questions generally correspond to Satisfactory (1); Moderately Satisfactory (2); Moderately Unsatisfactory (3); and Unsatisfactory (4). Note that the figures in table 3.1 are not the same as the figures in the IEO's evaluation, reflecting differences in the sample (IEO's evaluation includes six advanced economies), as well as IEG's greater emphasis on the development aspects of the assessments.

2. In the low-income countries where FSAPs have been completed, banking sector assets represented approximately 85 percent of total financial sector assets.

3. An internal Bank document states:

> *The experience to date suggests that there is a role in the FSAP for stress tests, in part because they highlight the link to macroeconomic developments and can be a useful tool to help missions form an overall view of a financial system's robustness. However, it is also clear that stress tests are subject to limitations and their value erodes over time. They can provide only a static analysis at one point in time of financial system health based on specific (and often crude) assumptions on the evolution of key variables as well as on the reliability of balance sheets. Further, sufficiently detailed data on individual institutions may not exist or may not be provided to FSAP teams . . .*
>
> *. . . Stress test analysis is likely to be more useful in cases where there are few banks, so that the stress tests can contribute to a picture of the health of the banking system as a whole. In any event, stress testing should be viewed as one of the tools available to help form views on potential risks and vulnerabilities, but the outcome of the tests should be carefully evaluated, taking into account the quality of input data as well as the underlying models and their assumptions.*

4. An internal Bank document states:

> *While standards assessment may be a useful first step, they have not been found by FSAP missions to be particularly helpful in isolation in identifying short-term risks, vulnerabilities, or key development weaknesses. Moreover, an analysis of the Basel Core Principles (BCP) assessments done by Bank and IMF staff both in FSAP mission and as free-standing exercises in*

the context of technical assistance, confirms that for effective surveillance, BCP assessments should be conducted in a broader institutional and macroeconomic context, rather than on a stand-alone basis.

5. For example, the Basel Core Principles ratings for one ECA country showed that it was compliant with 17 principles, largely compliant with seven, and materially noncompliant with only one, even though the FSAP text stated "remaining gaps are mainly in the regulation and supervision of country, market, and operational risk, formalizing information sharing arrangements, and strengthening corporate governance in banks." Information on ownership is considered largely compliant and connected lending limits are rated "in compliance," although the text notes that "lack of knowledge of the ultimate shareholders also makes effective monitoring of prudential standards impossible."

6. The authorities for a low-income African country pressed management to raise the ratings to take into account their level of development; the ratings were lowered back to the original ratings when the team leader pointed out that increased ratings were higher than those of Canada.

7. For example, authorities and donors working in one Middle East and North Africa Region country stated that the positive ratings of the FSAP made it harder to push reforms through, as those opposed to reform pointed to the ratings as evidence that reform was not needed. In another case, an ECA country used the FSAP ratings as justification for not moving forward with reform.

8. World Bank and International Monetary Fund 2005b.

9. Management has noted that the analytical tools have been improved during the FSAP program, pointing in particular to the treatment of annuities in pension reform. IEG review of FSAPs indicates that individual analytical tools have not been systematically applied (or increasingly applied over time), including the treatment of annuities.

10. On a scale from 1 to 5 (with 5 being "strongly agree") 91 percent of team members gave a rating of 4 or 5 on the question of whether authorities cooperated with the process, and 88 percent felt that the access to data was sufficient.

11. Benchmarking of data does not appear regularly. For example, the Tunisia, Jordan, and Morocco FSAPs have benchmark data on insurance, but Lebanon and Yemen do not.

12. The Dominican Republic is an interesting case study of the limitations of FSAPs. The FSAPs did diagnose severe and widespread vulnerabilities in the banking system, including an undercapitalized banking system, inadequate provisioning, overall weak compliance with BCP standards, and weak institutional capacity and judicial enforcement. Despite pressures from the government and IMF area department, the key messages were conveyed in the FSSA and FSA (although the language was toned down from the aide mémoire and a presentation to the authorities). The FSAP did not detect the immediate cause of a subsequent crisis, which involved fraudulent accounting. The FSAPs cannot substitute for effective accounting and supervision. (See IEO 2006, box 3 for a more detailed discussion of the Dominican Republic case).

13. In some cases, authorities indicated they were only interested in the assessment, and did not seek assistance for follow-up work.

Chapter 4

1. IMF mission chiefs and Bank country directors were less sanguine about the impact on debate. Only about one-third of Bank country directors and IMF mission chiefs thought that the FSAP had contributed to a policy debate.

2. IEG omitted FSAPs for countries that do not have an active Bank program, or for which the FSAP was only recently completed and would therefore not have been factored into country programs yet.

3. Internal Bank document.

4. This is not only owing to lack of interest from the country units. Some team leaders did not want to take country unit staff on mission, preferring to take only technical staff.

5. There were numerous examples of countries where a CAS was prepared shortly before an FSAP was launched, or was already under way, but the CAS made no mention of the FSAP. This is another illustration of how little ownership the country departments have in the FSAP.

6. Reasons for not increasing funding included, *inter alia*: (i) competing priorities for funds, (ii) lack of commitment or political support for reforms; (iii) current funding levels that were deemed adequate; and (iv) support that was available from other sources.

7. One example is the Bank's work in pensions. IEG's evaluation, *Pension Reform and the Development of Pension Systems* (2006), found that in many countries, access of Bank staff working on pension reform to FSAP documents was limited owing to confidentiality issues.

8. Management is broadly in agreement with these goals, and has noted that it is already working on assessing and designing policies, costs, and modalities for improving knowledge sharing, including the expansion of current initiatives.

9. IEO 2006, p.59.

10. The majority of these interviews were conducted by IEO staff.

11. The downside of this perception of "signaling" is that several countries that have delayed FSAPs have cited the desire to do their own review and cleanup prior to the FSAP, rather than risk having the FSAP review problems or make negative assessments.

Appendix C

1. IEO carried out 25 detailed country studies; in addition to the 19 reviewed by IEG, IEO also reviewed FSAPs for six advanced economies.

2. At the initiation of the FSAP evaluation, 70 FSAPs had been completed, of which 57 were of developing countries.

3. The questionnaires and evaluation matrix models were developed jointly by IEO and IEG.

4. A sample of external team members were interviewed directly.

5. Only a handful of authorities replied by fax.

6. Net deliverable sample means total target population minus those who could not be contacted for various reasons.

Appendix D

1. The external company was Fusion Analytics LLC, Washington, DC.

2. Participants were also given an opportunity to send their responses directly to Fusion Analytics by facsimile. Only a handful of authorities replied by fax.

3. Stakeholders other than the authorities that had been involved with more than one FSAP were invited to submit a survey response for each country (up to a maximum of three).

4. In advanced economies, the IMF has responsibility for the FSAP.

5. For those readers who are interested in seeing details of the specific questions and responses, a full version of each questionnaire (and a summary of the responses) will be made available on the IEO website at www.imf.org/ieo.

6. Net deliverable sample is defined as the total target population minus those who could not be contacted for various reasons.

Appendix E

1. World Bank and IMF 2005b.

2. The three B-ROSCs are corporate governance, insolvency and creditor rights, and accounting and auditing. Accounting and auditing involve separate standards, but they are typically assessed as a single ROSC.

3. See main messages box, Executive Summary.

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