



IMF FINANCIAL SURVEILLANCE

Issues Paper for an Evaluation by The Independent Evaluation Office (IEO)

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I. INTRODUCTION

1. This Issues Paper discusses the proposed scope and design of an IEO evaluation of the relevance, quality and impact of IMF financial surveillance. Following the global financial crisis, the IMF invested heavily to strengthen its financial surveillance.¹ It analyzed risks to the financial sector and recommended actions to restore financial stability. It initiated mandatory financial stability assessments for jurisdictions deemed to have systemically important financial sectors.² It invigorated efforts to integrate financial and macroeconomic analysis into Fund bilateral and multilateral surveillance. And, together with, and as a member of, the Financial Stability Board, it contributed to monitoring and assessing vulnerabilities affecting the global financial system, including by co-leading the Early Warning Exercise.

2. The note is organized as follows. Section II provides an overview of the IMF's strategy, activities, and products in the areas of financial surveillance. Section III discusses the objectives and dimensions of the evaluation, and Section IV outlines its main building blocks. Annex 1 presents a list of countries that were deemed to have systemically important financial sectors for the purpose of mandatory Financial System Stability Assessments (FSSAs), and Annex 2 lists IMF documents relevant to the evaluation.

II. IMF FINANCIAL SECTOR STRATEGY AND ACTIVITY

3. IMF financial surveillance expanded in depth and breadth following the global financial crisis. This section describes the strategic and analytical underpinnings of this expansion, and the three major initiatives underlying it: promoting better integration of financial sector issues into the Fund's surveillance products, reforms to the FSAP, and activities to enhance the influence of IMF analysis and advice.

4. **Financial Surveillance Strategy.** The IMF's 2012 Financial Surveillance Strategy (and the 2013 Progress Report) proposed a series of steps "so that the Fund can fulfill its mandate to ensure the effective operation of the international monetary system and support global economic and financial stability." It listed the following three priorities:

- (i) *Strengthen the analytical underpinnings of macrofinancial risk assessments and policy advice.*

¹ Financial surveillance is defined, as in IMF (2012), as the intersection between the Fund's financial sector work and its surveillance activity, and includes macro-financial surveillance.

² Financial stability assessments are now mandatory at least every five years for the 29 countries whose financial sectors were deemed to be systemic (Annex 1 provides a list of these countries). For other countries, the Financial Sector Assessment Program (FSAP), initiated as technical assistance after the Asian crisis, remains voluntary and less frequent. The key findings and recommendation of the assessments are summarized in a Financial System Stability Assessment (FSSA).

- (ii) *Upgrade the instruments and products of financial surveillance to foster an integrated policy response to risks.*
- (iii) *Engage more actively with stakeholders in order to improve the traction and impact of financial surveillance.*

5. The strategy paper emphasized that the experience of the global financial crisis pointed to the need for greater efforts to explore interdependencies between real and financial sectors. An integrated macro-financial framework was needed to better identify risks to financial stability, highlighting the importance of strengthening macro-financial surveillance within the Fund. The IMF also opened the door to providing macro-prudential advice, integrating and complementing its traditionally separate advice on macroeconomic policy and the financial sector.

6. **Macro-Financial Surveillance.** Since the global financial crisis (GFC), the IMF has devoted significant effort to raising awareness of the importance of integrating financial sector issues into surveillance. While recognizing gaps in knowledge and data, the IMF has decided to adopt a practical approach in bilateral surveillance focused on developing a fuller understanding of macrofinancial linkages, but acknowledging that this goal remains a work in progress. The 2014 Triennial Surveillance Review (TSR) called for mainstreaming macro-financial surveillance into Article IV consultations, and was followed in 2015-16 by a pilot program in which country teams focused on one or more macro-critical financial sector issues in order to build experience and further develop the IMF's approach in this area. A Guidance Note for Surveillance (SM/15/71) underscored that macro-financial analysis should be an integral part of Article IV surveillance. A recent paper (IMF, 2017) reported that the Fund had made good progress over the past two years in integrating macro-financial analysis into Article IV surveillance, while calling for continuing efforts to deepen such analysis. The Board approved staff's proposal to mainstream this approach across the membership.³

7. With respect to multilateral surveillance in 2011, the IMF launched an effort at formally integrating macroeconomic and financial assessments (i.e., WEO and GFSR) through a Consolidated Multilateral Surveillance Review (CMSR), that was produced only twice and was terminated in 2012. Although the CMSR was short-lived, macro-financial analysis has grown in scope and content, particularly in GFSRs, and the Managing Director's Global Policy Agenda has served to present high-level integrated policy messages. In addition, the IMF issued Spillover Reports during 2011–15, which included analyses of financial spillovers from developments and policies of the major economies.⁴

³ The goal of integrating macro-financial analysis and the macro-financial elements of the guidance note for surveillance under Article IVs apply to all country teams.

⁴ Spillover Reports were discontinued in 2016, but the analyses are reflected in the WEO, GFSR and Article IV consultation reports.

8. **Strengthening FSAPs.** Following the 2009 FSAP review, this program underwent major reforms, including the introduction in 2010 of mandatory FSSAs for jurisdictions deemed to have systemically important financial sectors. The 2014 FSAP review provided a largely favorable assessment of the program, focusing, inter alia, on the following refinements to the prevailing *modus operandi*:

- Continue to shift the focus of all components of the financial stability assessments towards systemic risk.
- Upgrade analytical underpinnings and assessment of vulnerabilities and resilience through deeper treatment of interconnectedness, better integration with stress tests, and more systematic analysis of cross-border exposure and spillovers.
- Explore a macrofinancial approach to supervisory standards.
- Ensure more systematic treatment of macro-prudential policy issues.
- Improve traction and maximize input to Article IV consultations by using macrofinancial relevance as the organizing principle for streamlining and prioritizing FSAP findings and recommendations.

9. **Partnering for greater traction.** Strengthening traction of surveillance has been a perennial IMF concern. Since the GFC, the IMF has intensified its efforts to collaborate with other organizations and standard setters to achieve greater visibility and leverage for its analysis and recommendations. These efforts include:

- Participation in the Financial Stability Board (FSB): The IMF became a member of the FSB when it was established in April 2009, as the successor to the Financial Stability Forum (FSF). The FSB mandate was to promote financial stability by coordinating and strengthening regulation and supervision and by exploring sources of financial risks. At the request of the G20, the IMF collaborates with the FSB in identifying macroeconomic and financial risks and the actions needed to address them.
- Early Warning Exercise: In 2009, at the request of the G20, the IMF in partnership with the FSB launched a semi-annual Early Warning Exercise (EWE) to explore tail risks to the global economy. The results of the EWE are presented to the IMFC as well as to the G20 Finance Ministers and Central Bank Governors.
- A clearer delineation of responsibilities with the World Bank in conducting joint FSAPs.
- Data Gaps Initiative (DGI). In 2009, the IMF and the FSB launched the G20 DGI to address gaps in economic and financial data revealed by the global financial crisis. The second phase of the DGI, launched in 2015, maintains the financial sector as central to the initiative

and places an increased emphasis on inter-linkages across the economic and financial system.

III. EVALUATION THEMES AND QUESTIONS

10. The evaluation will assess the efficacy of the IMF's post-crisis efforts to strengthen financial surveillance. It will ask whether financial surveillance addresses the weaknesses identified as having undermined the IMF's effectiveness in warning about financial vulnerabilities and risks ahead of the GFC, what role it has played in shaping post-crisis reforms, and in addressing new challenges to financial stability. The emphasis will be on the analysis and advice to jurisdictions with systemic financial sectors and other financial systems with the potential to undermine global stability. But the evaluation will also examine financial surveillance in non-systemic countries.

The evaluation will assess:

- The focus of the IMF's financial sector surveillance work and priority setting in allocation of resources across the membership in particular between systemic and non-systemic countries;
- The IMF's ex ante assessments of financial instability and crisis risks and the advice on strengthening financial resiliency and addressing systemic risks;
- How integration of financial and macroeconomic analysis has impacted IMF surveillance;
- The evolution of FSAPs and FSSAs in identifying and mitigating risks;
- The extent to which IMF policy advice has gained traction and affected policy actions by country authorities;
- Whether authorities find IMF financial surveillance helpful and effective at the country level; and
- Stakeholder perspectives of IMF financial surveillance following the GFC.

11. Following are some of the key evaluation questions that will be examined:

Strategic issues:

- (i) Are the main goals and activities in the Financial Surveillance Strategy well aligned with the lessons from the GFC, and is the Fund adept at incorporating new sources of risk?
- (ii) Has the IMF's strategy built appropriately on internal and external analyses and views?
- (iii) Are the IMF's attention and resources appropriately balanced between systemic and non-systemic countries, and between cross-border and individual country risks?
- (iv) Is the IMF's overall approach, as well as its advice in individual countries, evenhanded and appropriately tailored to country circumstances?

- (v) How much progress has been made in building up the IMF's human capital in financial stability issues, and is it deployed effectively? Is relevant internal learning adequate across the IMF? Is there appropriate interaction with the finance industry and other official groups?

Macro-financial surveillance:

- (i) To what extent has the analysis of financial risks and their macroeconomic impact been strengthened? Has the IMF made progress in developing a conceptual framework for understanding and monitoring macro-financial linkages? Has the IMF developed sound analytical underpinnings for its macro-prudential advice? What lessons have been drawn from the pilot program?
- (ii) What progress has been made in integrating financial sector trends and risks into the baseline macro-framework and the IMF policy advice in multilateral surveillance?
- (iii) How well are cross-border spillovers analyzed? Are these issues well integrated in the discussions with authorities during Article IV consultations? Has macro-financial analysis helped enhance staff's policy advice and traction with authorities?
- (iv) To what extent have surveillance activities and outputs discussed the systemic financial risks that could threaten macroeconomic stability? How effective has the IMF been in monitoring and assessing the evolving risks in non-bank financial institutions and markets? Are there remaining gaps or overlaps?
- (v) Are structures and incentives in the IMF well aligned to support the integration of macroeconomic and financial surveillance?

FSAPs/FSSAs:

- (i) Have FSAPs/FSSAs evolved appropriately to reflect the lessons learned from the crisis?
- (ii) Have the positive trends identified in the 2014 FSAP review, in terms of quality of analysis and presentation continued? Have the lessons from the 2014 FSAP review been addressed?
- (iii) Have FSAPs and FSSAs become a more effective instrument to identify systemic risks, including spillovers?

Partnership and traction:

- (i) How effectively has the IMF collaborated with the Financial Stability Board (FSB)? How is the IMF's analytical contribution to design and testing of the new multilateral regulatory framework viewed? Do member countries find the Early Warning Exercise (EWE) useful?
- (ii) How effective has been the collaboration with other relevant multilateral organizations and standard setters, e.g., BIS, World Bank, RFAs?

- (iii) Do authorities believe that IMF’s increased efforts to partner with other organizations have led to more effective surveillance and greater influence? Have these efforts weakened the IMF’s independence or its ability to “speak truth to power”?
- (iv) Is there appropriate interaction with academics, private sector experts, and former policymakers, including those whose work focuses on macro-financial linkages and those whose views may depart from those of IMF staff or the general international consensus?

IV. TOOLS AND BUILDING BLOCKS OF THE EVALUATION

12. The evaluation team will review IMF publications and internal documents, and relevant work by academics, authorities, regulators, and other international organizations. It will conduct surveys of authorities, Board members, and Staff. Surveys will be complemented by structured and semi-structured interviews of relevant stakeholders. The evaluation will also build on the findings and conclusions of earlier IEO studies, and it will be informed by a series of background papers addressing, among others, the following topics:

(i) Macro-financial integration in multilateral surveillance

13. Focusing on the GFSR, WEO, and the risk analysis in the EWEs, this paper will assess the extent to which financial stability analysis has been integrated into macroeconomic analysis; and conversely, whether financial sector surveillance is sufficiently informed by the findings and conclusions of IMF macroeconomic surveillance. In particular, it will examine whether the discussion of risks in GFSRs adequately incorporates macroeconomic factors (e.g., the effects of quantitative easing on the profitability of banks and market risks), whether the WEO gives adequate weight to financial stability considerations and risks, and how financial spillover work has been covered since the Spillover Report was discontinued. It will assess whether multilateral and bilateral surveillance are well integrated, and examine how the EWE has integrated the macro and financial stability analysis, which are led by the IMF and the FSB respectively.

(ii) The IMF’s analytical toolkit

14. This paper will examine progress made in upgrading the IMF’s analytical toolkit to assess macro-financial linkages and financial markets risks (including to payments systems and market liquidity), both in banking and non-banking institutions. The paper will look at development of tools to assess how financial system factors—including regulatory changes, new macro-prudential policies, and balance sheet issues—interact with macro performance through banking and non-banking channels. It will consider the suitability of analytical tools to varying country circumstances and characteristics. The paper will also examine the analytical underpinnings of the Fund’s macroprudential framework and policy advice. In exploring these issues, the paper will consider the extent to which the IMF is engaging with and learning from outside academics and other experts. Finally, it will assess how well analytical tools are being disseminated and applied

across the IMF, and how they relate to the analytical frameworks used in other organizations, including central banks and other multilateral institutions.

(iii) FSAP/FSSA quality and effectiveness

15. Drawing on the IMF's post-crisis FSAP reviews and the country studies commissioned by this evaluation (below), this paper will assess the evolution of financial stability assessments following the crisis, focusing on those prepared after the conclusion of the 2014 FSAP review. It will revisit the findings and conclusions of the 2014 review, and assess the extent to which its concerns are being addressed. For example, the paper will assess whether FSSA recommendations are now prioritized according to their impact on financial stability rather than their compliance with international standards. It will also examine more broadly the quality and effectiveness of FSSAs, including the extent to which authorities find FSSAs useful in furthering needed reforms, the balance between internal and external expertise, and whether IMF advice is sufficiently candid. The paper will assess the extent to which FSSAs are consistent with the financial reform agenda articulated in multilateral surveillance, while being sufficiently attuned to the country's institutional features. The paper will also assess how data gaps are being addressed, and how much they compromise FSAP effectiveness. Finally, it will examine how FSAP resources are allocated across different countries.

(iv) IMF contribution and collaboration on the global financial reform agenda

16. This paper will take stock of the IMF's role in and influence on the post-crisis overhaul of the global regulatory system aimed at strengthening financial resiliency and reducing financial stability risks. It will look at the Fund's contribution to the broader debate on the financial reform agenda, in particular its role as a member of the FSB in its work to strengthen global regulatory oversight, and to bring a macroeconomic perspective to this work. The paper will take account of the views of stakeholders, including some policy makers and academics who are concerned that some of the structural factors behind the 2008 crisis have not been sufficiently addressed, as well as the views of many in the financial services industry concerned that regulatory overreach has had adverse and unintended consequences (see References).

(v) IMF internal governance and organization to strengthen financial surveillance

17. This paper will assess progress in building the Fund's human capital in macro-financial issues and how the organization of work and collaboration across departments has evolved to support the expansion in the scope of financial sector work following the crisis and the integration of macro-financial analysis. For example, to what extent have the staff's financial skills been enhanced through recruitment, external assignments, and training? Given the emphasis on mainstreaming of macro-financial Article IVs, how effective have been the efforts to integrate staff with financial expertise into Area departments, and to mitigate silo behavior and foster cross-departmental cooperation? Are there systems to ensure that SPR, the RMU and other relevant units get the necessary information to "connect the dots" and are their responsibilities

sufficiently clear? Are area departments incorporating new tools and frameworks developed by RES and other functional departments in their macro-financial analysis? Finally, the paper will examine how resources for financial sector work are allocated across countries.

(vi) Country case studies

18. The evaluation will be informed by country case studies that examine the quality of IMF bilateral surveillance from a number of perspectives, including how well surveillance focuses on and highlights key risks and macro-financial linkages, whether macroprudential policy advice is grounded in analytical work, how Article IV consultations and FSAPs reinforce each other to address the country's financial policy challenges, whether such advice is consistent with IMF multilateral surveillance where applicable, the quality of surveillance risk assessments and advice. The case studies will also consider the adequacy of data and challenges that any data gaps or data confidentiality issues pose for surveillance. The country cases will serve to assess the usefulness of macro-financial analysis in improving staff's policy advice and the traction of this advice with authorities. These studies will present the views and perspectives of country authorities on the value of bilateral financial surveillance and how it may be improved.

19. The IEO will prepare case studies on different types of countries. It will examine a sample of economies with systemically important financial sectors, emerging market economies and low-income countries. For the latter group, the evaluation will also examine the extent to which IMF surveillance covered issues such as financial inclusion and the constraints to financial deepening. These country case studies will feed into an overall assessment of the quality, evenhandedness, and effectiveness of IMF analysis and advice.

ANNEX 1. JURISDICTIONS WITH SYSTEMICALLY IMPORTANT FINANCIAL SECTORS

Australia	Hong Kong SAR	<i>Poland</i>
Austria	India	Russian Federation
Belgium	Ireland	Singapore
Brazil	Italy	Spain
Canada	Japan	Sweden
China	Korea	Switzerland
<i>Denmark</i>	Luxembourg	Turkey
<i>Finland</i>	Mexico	United Kingdom
France	Netherlands	United States
Germany	<i>Norway</i>	

Countries in italics were added in 2013.

ANNEX 2. SELECTED RELEVANT IMF DOCUMENTS¹

Crisis Lessons

- 2009 Initial Lessons of the Crisis
- 2009 Initial Lessons of the Crisis for the Global Architecture and the IMF
- 2009 Lessons of the Global Crisis for Macroeconomic Policy
- 2011 Analytics of Systemic Crises and the Role of Global Financial Safety Nets
- 2016 The Financial Crisis and Information Gaps—Second Phase of the G-20 Data Gaps Initiative (DGI-2)—First Progress Report (EBS/16/80)

Financial Sector Surveillance

- 2009 Financial Sector Surveillance Guidance Note
- 2010 Financial Sector Surveillance and the Mandate of the Fund
- 2010 A Fair and Substantial Contribution by the Financial Sector, Final Report for the G-20
- 2010 The Fund's Mandate—The Legal Framework
- 2010 Understanding Financial Interconnectedness
- 2012 The IMF's Financial Surveillance Strategy
- 2012 Enhancing Financial Sector Surveillance in Low-Income Countries: Financial Deepening and Macro-stability
- 2012 Strategic Plan for Financial Sector Surveillance
- 2012 Guidance Note for Article IV Consultations
- 2013 Modifications to the Current List of Financial Soundness Indicators
- 2015 Guidance Note for Surveillance Under Article IV Consultations
- 2016 IMF Staff Collaboration with the Financial Stability Board on Information on Global Systemically Important Banks (SM/16/287)
- 2017 Ensuring Financial Stability in Countries with Islamic Banking (SM/17/3)

Integration of Macro-Financial analysis

- 2010 The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit
- 2010 The Fund's Role Regarding Cross-Border Capital Flows
- 2011 The Multilateral Aspects of Policies Affecting Capital Flows
- 2012 Macrofinancial Stress Testing—Principles and Practices
- 2012 Macrofinancial Stress Testing—Principles and Practices Background Material
- 2013 2013 Spillover Report
- 2014 A Macrofinancial Approach to supervisory Standards Assessments
- 2014 Strengthening surveillance of financial sector issues in Article IV consultations
- 2015 FDMD on Strategy for Mainstreaming Macro-Financial Surveillance (blog)
- 2015 2015 Risk Report—Adapting to New Challenges
- 2015 Departmental Plans to Mainstream Macrofinancial Surveillance
- 2015 Balance Sheet Analysis in Fund Surveillance
- 2015 How to Integrate Macrofinancial Assessments in the Pilot Article IV Staff Reports—MCM-SPR note

¹ Excludes GFSRs, WEOs, individual FSAPs/FSSAs and Article IV Consultations, Triennial Surveillance Reviews, Staff Discussion Notes, and Research Publications.

- 2015 Making Macrofinancial Surveillance Work
- 2016 Macroeconomic Developments and Prospects in Low-Income Developing Countries—2016 (SM/16/325)
- 2017 Approaches to Macrofinancial Surveillance in Article IV Reports

Macro-prudential analysis and advice

- 2010 Central Banking Lessons from the Crisis
- 2011 Macroprudential Policy—What Instruments and How to Use Them? Lessons from Country Experiences
- 2011 Towards Effective Macroprudential Policy Frameworks—An Assessment of Stylized Institutional Models
- 2011 Staff Note on Macroprudential Policies—Institutions and Instruments
- 2011 Macroprudential Policy—An Organizing Framework
- 2011 Macroprudential Policy—An Organizing Framework—Background Paper
- 2012 The Liberalization and Management of Capital Flows—An Institutional View
- 2013 Key Aspects of Macroprudential Policy
- 2013 Key Aspects of Macroprudential Policy—Background Paper
- 2013 The Interaction of Monetary and Macroprudential Policies
- 2013 The Interaction of Monetary and Macroprudential Policies—Background Paper
- 2013 Implementing Macroprudential Policies—Selected Legal Issues
- 2014 Staff Guidance Note on Macroprudential Policy—Detailed Guidance Note on Instruments
- 2014 Staff Guidance Note on Macroprudential Policy
- 2014 Staff Guidance Note on Macroprudential Policy—Considerations for Low-Income Countries
- 2015 Group of Twenty—Measures Which are Both Macroprudential and Capital Flow Management Measures: IMF Approach
- 2015 Group of Twenty – Measures Which are Both Macroprudential and Capital Flow Management Measures: IMF Approach (EBS/15/33 Strictly Confidential)
- 2015 Cooperation on Approaches to Macro-Prudential and Capital Flow Management Measures—Update by the IMF and the OECD to the G-20 (EBS/15/92)
- 2015 Monetary Policy and Financial Stability (FO/DIS/15/138)
- 2016 Elements of Effective Macroprudential Policies—Lessons from International Experience (EBS/16/82 joint IMF, FSB and BIS)
- 2016 Staff Notes for the G-20 Presidency—Enhancing Resilience (EBS/16/133)

FSAP

- 2009 Financial Sector Assessment Program After Ten Years—Experience and Reforms for the Next Decade
- 2009 Integrating Financial Sector Issues and FSAP Assessments into Surveillance—Progress Report
- 2010 Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance—Background Material
- 2010 Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance
- 2013 Mandatory Financial Stability Assessments Under the Financial Sector Assessment Program—Update

- 2013 Financial Surveillance Strategy—Progress Report
- 2014 Review of the Financial Sector Assessment Program—Further Adaptation to the Post-Crisis Era
- 2014 Review of the Financial Sector Assessment Program—Further Adaptation to the Post-Crisis Era—Background Studies

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