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The Five Ws of the Financial Sector Assessment Program (FSAP)

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FSAP in a Nutshell

What	• A comprehensive framework through which assessors and authorities in participating countries identify financial system vulnerabilities and develop appropriate policy responses
Why	• To help countries to reduce the likelihood and severity of financial sector crises
Who	• A joint program of the International Monetary Fund (IMF) and the World Bank (WB)
When	• Launched in 1999 in the wake of the Asian financial crisis • Countries with systemically important financial sectors are subject to a 5-year assessment cycle
How	• Basis of assessment: Banking Core Principles (BCP), Insurance Core Principles (ICP), and IOSCO Principles

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International Standard Setting Agencies

BCBS	• Basel Committee on Banking Supervision: sets standards for prudential regulation for banks (1974)
IAIS	• International Association of Insurance Supervisors: sets standards for supervision of the insurance sector (1994)
IOSCO	• International Organization of Securities Commissions: sets standards for securities markets regulation (1983)
FSB	• Financial Stability Board: Monitors and makes recommendations about the global financial system (2009). [Predecessor: Financial Stability Forum (1999)]
JF	• Joint Forum: contributes to the international regulatory agenda in particular where risks exist across or in gaps between the three financial sectors, under the aegis of BCBS, IAIS and IOSCO (1996)

Bank of International Settlement (BIS)

- Promotes global monetary and financial stability through international cooperation
- Hosts 9 organizations that set international standards and pursue financial stability (including all of the above organizations except IOSCO)

Twin Goals of FSAPs

To assess stability

- Assess of the resilience of the financial sectors;
- Conduct stress tests and analyze systemic risks, including linkages among banks and nonbanks and domestic and cross-border spillovers;
- examine microprudential and macroprudential frameworks;
- review the quality of bank and nonbank supervision and financial market infrastructure oversight; and
- evaluate the ability of central banks, regulators and supervisors, policymakers, backstops and financial safety nets to respond effectively in case of systemic stress.

To assess development

THE WORLD BANK

- Examine institutions, markets, infrastructure, and inclusiveness;
- the quality of the legal framework and of payments and settlements systems;
- obstacles to competitiveness and efficiency;
- progress in financial inclusion and access to retail payment digital technology;
- examine the financial sector's contribution to economic growth and development.

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Components of Financial Supervision

	Macro- Prudential Oversight	Micro-Prudential Supervision	Market Conduct Supervision
Objective:	To reduce the risk and costs of financial instability.	To protect consumers from insolvency of individual financial institutions.	To protect consumers from unfair practices of financial institutions, and to facilitate fair and efficient markets.
Focus:	Primarily on systemically important institutions and the consequences of their behavior on the overall stability of the financial systems.	The solvency of individual institutions.	How financial institutions and their sales representatives conduct business with their customers.
Responsible Agency:	Typically carried out by central banks who are more concerned about systemic risks.	Increasingly by independent financial supervisory agency.	Financial supervisory agency.

Evolution of the FSAP

- In response to ***the*** Global Financial Crisis, the FSAP underwent significant changes in 2009. These changes included:
  - a clear definition of the components of stability assessments (vulnerabilities and resilience of the financial system, regulatory and supervisory framework, and financial safety nets);
  - emphasis on identifying risks in the financial systems; and
  - the possibility of modular FSAPs conducted separately by the IMF or the WB, focusing on each institution's chief responsibility.
- A review in 2014 found that FSAPs conducted since 2009 improved in all dimensions and featured stress tests that covered a broader set of risks, and, increasingly:
  - analyzed spillovers and macroprudential frameworks;
  - facilitated a more coherent discussion of risks and their likely impact; and
  - integrated FSAP into IMF surveillance program, known as Article IV Consultations.
- Countries have implemented a large share of the recommendations.

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FSAP is voluntary…except for G20+

Obtain agreement with country to conduct FSAP: date and scope

Assemble assessment team:

Mission Chief, Deputy Mission Chief, mission members (staff and external experts)

Obtain IMF internal approval of focus of mission, and establish mission timeline

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FSAP Timeline

T-3 months: data request submitted to authorities

T- 1 month: authorities complete all data requests

FSAP On-site Date (T) the FSAP team descents upon the country

T+2 or 3 weeks: on-site work is completed and draft reports (AM, and DAR or TN) left with the authorities

T+5 weeks: authorities provide comments on the draft reports

T+2 months: internal reviews completed, and draft reports finalized

T+ 4 months: reports approved by IMF Board; issued and published where appropriate

Output of FSAP

- The FSAP team prepares an **Aide-Mémoire** (AM) for the country authorities summarizing the main findings and recommendations of the mission. The Aide-Mémoire is confidential and cannot be published or shared with third parties by either the authorities or the Fund.

- **Technical notes** (TNs) on selected topics or **detailed assessment reports** (DARs) of compliance with international standards and codes are also prepared, as appropriate. Publication of the TNs and DARs is voluntary.

- A **Financial Sector Stability Assessment** (FSSA) report is prepared for discussion at the IMF Executive Board. Publication of the FSSAs is voluntary but presumed. In cases where the WB is involved in the FSAP, the WB prepares a Financial Sector Assessment (FSA) for its Executive Board.

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INSURANCE

Insurance Assessment Process

Data Collection

- See next slide.

Self Assessment

- Full Assessment: Authorities complete a self-assessment of observance of the 26 ICPs. Four rating categories.
- Focused Assessment: selected areas; no ratings.

On-Site Visit

- Discuss with the authorities; review supervisory files.
- Discuss with selected insurers, industry associations, audit firms, and relevant insurance sector participants.
- Present preliminary assessment to authorities.

Report Publication

- Comments by authorities.
- Quality review by IMF staff or external experts.
- IMF Board approval.

Data Collection Before On-site

- Official Data Request:
  - Data from regulatory reporting for the past five years: market structure, premiums, assets and liabilities, solvency, surrenders, top 10 insurers, embedded guarantees, etc.
  - Questionnaire designed to understand the supervisory practices.
- Unofficial Data Researches:
  - Laws and regulations governing the insurance sector
  - Market information
  - Major developments
  - Sources of data: regulator's website, industry association reports, reports by audit firms and rating agencies, etc.
  - My BFF: Google

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Basis of Assessment

- Insurance Core Principles (ICP) issued by the IAIS.
- ICPs were first issued in 2003, significantly enhanced in 2011, and last amended in November 2018 (356 pages). Currently being comprehensively reviewed.
- **26 principle statements**: the essential elements to promote a financially sound insurance sector and provide an adequate level of policyholder protection. Structured in 5 categories:
  - Powers, responsibilities and independence of supervisors
  - Supervisory issues – licensing and techniques
  - Qualitative requirements – governance and risk management
  - Quantitative requirements – capital and valuation
  - Market conduct issues and insurance intermediaries
- Ratings: O (observed), LO (largely observed), PO (partly observed), NO (not observed).

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Structure of ICPs

- Structure of each ICP -

  i. **Principle statement**: Essential elements of the principle.

     ii. **Standards**: key high-level requirements that are fundamental for implementation.

         iii. **Guidance**: Description of requirements and examples of implementation.

- Currently seeking public comments on proposed amendments to various ICPs.
- All ICPs apply at insurance entity and group levels; private and government-controlled entities.

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ICP 1 - Objectives, Powers and Responsibilities of the Supervisor
The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.

1.1 Primary legislation clearly defines the **authority (or authorities)** responsible for insurance supervision.

1.2 Primary legislation clearly defines the **objectives** of insurance supervision and the **mandate** and responsibilities of the supervisor and gives the supervisor **adequate powers** to conduct insurance supervision, including powers to issue and enforce rules by administrative means and take immediate action.

1.3 The principal objectives of supervision promote the maintenance of a **fair, safe and stable insurance sector** <u>for the benefit and protection of policyholders</u>.

1.4 Where, in the fulfilment of its objectives, the supervisor identifies conflicts between legislation and supervisory objectives, the supervisor **initiates or proposes correction in legislation**.

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1.1.1 The authority (or authorities) responsible for insurance supervision should be clearly identified in primary legislation. Where there are multiple authorities responsible for insurance supervision (e.g. separate authorities for prudential and market conduct supervision, for macro and micro prudential supervision, or for licensing and ongoing supervision), it is important that **the institutional framework and the responsibilities of the respective authorities are clearly set out in legislation** for clarity and to ensure all the objectives of insurance supervision are met.

Role of Insurance Guarantee Schemes (IGS) in Insurance Supervision

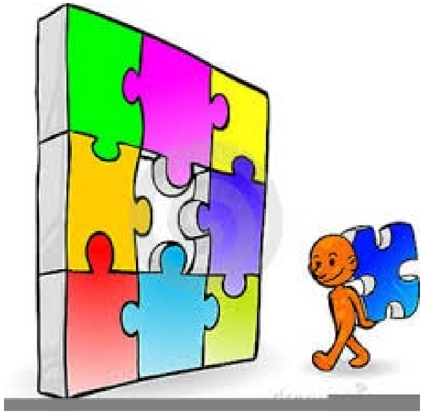
- An effective system of insurance supervision needs a number of **preconditions** on which to rely, as they can have a direct impact on supervision in practice, including:
  - sound and sustainable macroeconomic and financial sector policies;
  - a well developed public infrastructure;
  - effective market discipline in financial markets;
  - mechanisms for providing an appropriate level of systemic protection (or **public safety net)**;
  - efficient financial markets.
- As these preconditions are normally outside the control or influence of the supervisor, the **supervisor should not be assessed against these preconditions**.
- An overview of the appropriateness of **safety nets** could, include the following elements:
  - an analysis of the functions of the various entities involved such as supervisors, the policyholder protection fund and, if appropriate, the central bank.
  - a review of the extent to which supervisors are prepared and equipped to manage crises involving one or more insurers, including whether simulation exercises are undertaken and the availability of appropriate skills and adequate resources.
  - a review of any arrangements for the use of public funds (including central bank funds) and whether measures are in place to minimise moral hazard.

Source: Insurance Core Principles, IAIS November 2018

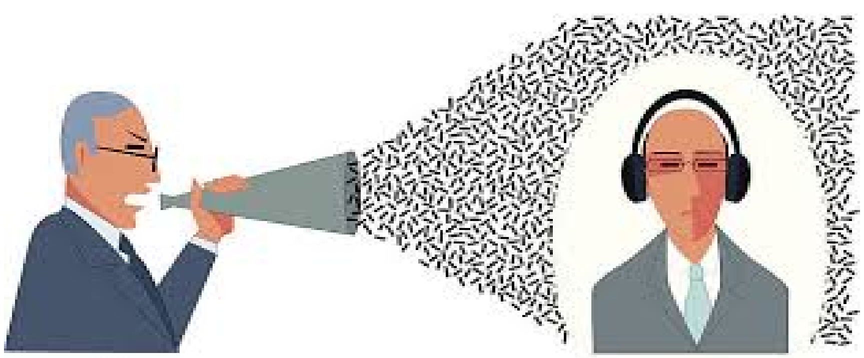
Types of Work I Do

Assessment

Assistance



Anecdotes on FSAP Missions



Challenges of FSAPs … From an assessor's perspective

- Language
- Authorities' Attitude
- Timing of comments from reviewers

thank you!

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Supplemental Slides

Reference to IGS in ICPs

- 12.0.3 The legislation should establish the priority that policyholders receive in winding-up an insurer. However, it is also common in many jurisdictions that priority is given to other stakeholders, such as employees or the fiscal authorities. In some jurisdictions, a **policyholder protection fund** provides additional or alternative protection.
- 18.3.4 Intermediaries should be knowledgeable regarding the status of the insurers whose products they sell. For example, they should be satisfied that the insurer is licensed to sell insurance in the relevant jurisdiction, as a branch or subsidiary, and should be aware of the financial status and credit rating of the insurer and the applicability of any **policyholder protection schemes** to that insurer's products.
- 19.7.17 Where applicable, the customer may also be provided with information on any **policyholder protection scheme** or compensation scheme in the case of an insurer not being able to meet its liabilities and any limitations on such a scheme.
- 19.13.1 The supervisor should publish the **policyholder protection arrangements** that are in place for insurance contracts sold within its jurisdiction and insurers subject to its supervision, and confirm the position of policyholders dealing with insurers and intermediaries not subject to oversight or supervision within its jurisdiction.
- 26.0.2 Effective cross-border crisis management requires international cooperation between supervisors and other relevant authorities (e.g. Ministries of Finance, central banks, other financial sector supervisors**, guarantee schemes**, **policyholder protection schemes**) through appropriate mechanisms for information exchange.....

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