



DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)



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**PROGRESS REPORT ON THE BANK-FUND
FINANCIAL SECTOR LIAISON COMMITTEE (FSLC)**

Attached for the September 27, 1999 meeting of the Development Committee is a Progress Report on the activities of the joint Bank-Fund Financial Sector Liaison Committee prepared by the staffs of the Bank and the Fund as background to item 2.A of the Provisional Agenda. Ministers may wish to address this topic in their prepared statements.

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Progress Report on the Bank-Fund Financial Sector Liaison Committee (FSLC)

Prepared by the Bank-Fund Financial Sector Liaison Committee

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In September 1998, the Boards of the Bank and the Fund endorsed their respective managements' decisions to set up the Bank-Fund Financial Sector Liaison Committee (FSLC), comprising senior staff from both institutions, to enhance the collaboration process between the two institutions.¹ This paper reports on the activities of the FSLC in the period since the initial report on progress which was provided in April of this year.²

The importance of stronger Bank-Fund collaboration has been highlighted on many occasions. In the communiqués issued at the 1998 Annual Meetings, both the Interim and the Development Committees stressed the importance of stronger cooperation to help countries strengthen their financial systems and to improve operational mechanisms, information sharing, and the dissemination of international standards.³ More recently, in their report on strengthening the international financial architecture at the economic summit in Cologne in June 1999, the G7 Finance Ministers called for an increase in the “breadth and pace” of efforts of collaboration by the Bank and the Fund and with relevant national and international regulatory and supervisory bodies. They noted that the desired outcome is more effective organization and deployment of resources to improve: early detection of weaknesses in financial systems and crisis response; the design and delivery of financial sector programs; and technical assistance for member countries.⁴

The Committee's activities since April

¹ See *Review of Bank-Fund Collaboration in Strengthening Financial Systems*, SM/98/224 and SecM98-732, paragraph 28. The FSLC has six members, three senior staff from the Bank and three from the Fund. It is co-chaired by Carl-Johan Lindgren from the Fund's Monetary and Exchange Affairs Department (MAE) and, as of July 1, 1999, Gerard Caprio of the Bank's Financial Sector Strategy and Policy Group. The other members on the Fund side include representatives of MAE and the Policy Development and Review Department (PDR), and on the Bank side, representatives of the Poverty Reduction and Economic Management Department (PREM) and the Financial Sector Vice-Presidency (FSEVP).

² See *Progress Report on the Bank-Fund Financial Sector Liaison Committee (FSLC)*, SM/99/89 and SecM99-248.

³ See *Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund*, Washington D.C.; October 4, 1998, page 6, *Communiqué of the Development Committee*, Washington D.C., October 5, 1998, page 2.

⁴ See *Strengthening the International Financial Architecture-Report of G7 Finance Ministers to the Köln Economic Summit*, Cologne, 18-20 June, 1999, paragraph 34.

The main objective of the FSLC is to enhance operational coordination and effectiveness between the Bank and the Fund in financial sector work. Facilitating early and continuous agreement on the allocation of work between the two institutions will help to ensure that the two institutions deliver high quality, sound, and timely advice and support to member countries, and that the limited expert resources available are engaged in the most effective way. In the period since April the Committee has worked to:

- help launch the Financial Sector Assessment Program (FSAP) pilot;
- improve financial sector work program coordination;
- provide a forum to broaden the policy consensus in financial sector issues between the Bank and the Fund;
- ensure that the Bank and the Fund contribute to the various international efforts pertaining to the financial sector in a coordinated way; and
- consider ad-hoc topics pertaining to the two institutions' activities in various financial sector initiatives.

Financial Sector Assessment Program⁵

In May of this year, the managements of the Fund and the Bank decided to undertake jointly, and on a pilot basis, the Financial Sector Assessment Program (FSAP). A detailed report on progress to date with the FSAP is being provided separately. In summary, the new program is intended to provide better coverage and analysis of member countries' financial systems and a better utilization of limited expert resources through closer collaboration, including joint missions. The resulting assessments will feed into the work of both institutions in the financial sector area including, in particular, the Fund's Article IV Consultations and the Bank's Social and Structural Reviews and Country Assistance Strategies. As such, it is expected that this program will underpin a more effective policy dialogue with national authorities and therefore help countries reduce vulnerabilities within their financial sectors and identify priorities for longer-term financial development.

While the FSLC is not directly involved in individual country assessments, or in defining the scope of assessments, under the FSAP, much of the early developmental work, as well as the general task of overseeing this collaborative program, has been coordinated by the Committee. In particular, the Committee has coordinated the selection of countries for the pilot and the establishment of procedures for mounting joint missions, including such aspects as those related to: terms of reference for the missions; allocating mission responsibilities between the Bank and the Fund; and the types and formats of reports to be produced.

As part of its coordinating role for the FSAP, the Committee has sought ways to broaden the awareness and understanding of the FSAP's objectives and its processes within the two

⁵ A general description of the FSAP was provided to the Boards of the Bank and the Fund in May 1999 (SecM99-371 and SM/99/116, respectively).

institutions. To this end, in late July the FSLC sponsored a joint meeting for Bank and Fund staff to discuss these and other issues of coordination.⁶

Further work program coordination

Collaboration between the staffs of the Bank and the Fund working on financial sector issues is generally good. Where coordination problems have occurred, a major cause has been the absence of full communication or information sharing. In addition, the increased level of collaboration between the Bank and the Fund in financial sector work within the FSAP, as well as in crisis situations, gives rise to the need for more specific guidelines for collaboration at the operational level in financial sector work. Therefore, the FSLC, in discussion with the Bank's regions and the Fund's departments and in the context of Bank-Fund collaboration more generally, prepared the *Guidelines on Collaboration between the Bank and the Fund in Financial Sector Work*, which the two managements distributed to staff in June 1999.⁷

The *Guidelines* detail the specific standards of collaboration that should be met as regards: frequent and regular communication between Bank and Fund staff through the exchange of contact and publication lists; shared documentation of work programs and mission schedules; and joint discussions of policy matters and operational issues such as the appropriate ways to handle sensitive and confidential information. Further, staff are encouraged to arrange joint missions where this will result in more efficient use of expert resources and avoid duplication of work. The *Guidelines* also note that, in crisis situations where financial sector issues are a significant focus, joint missions or participation in each other's missions are expected to be the norm.

As a further step to improved work program coordination, both the Bank and the Fund are working on setting up improved databases of work program information including in the financial sector area. The databases will include mission schedules and contact persons.

Broadening the policy consensus

In June, the Committee instituted a periodic seminar series on financial sector issues with the objectives of improving the sharing of institutional knowledge and experience between the Bank and the Fund, and aiding the achievement of a consensus on specific policy issues. The intended audience for these seminars consists of regional staff and others who work on financial sector issues in the two institutions. The first seminar in this series focused on issues relating to deposit insurance schemes. A second seminar on failure resolution is slated for early October.

⁶ This meeting was the second in an ongoing series focused on improving coordination of work programs in the financial sector area. The first meeting, in March 1999, focused on modes of coordination.

⁷ The intention to prepare the Guidelines (at that stage referred to as a "Code of Conduct") was noted in the initial FSLC report to management.

Coordinating participation in international efforts

The Committee plays a role in coordinating the contributions made by the Bank and the Fund to various international initiatives in the financial sector. For example, the Committee was instrumental in defining an initiative, also involving the BIS, to form a consolidated directory of training opportunities offered by national authorities and international financial institutions on financial sector issues. The directory is now under the umbrella of the Financial Stability Forum. The Committee's earlier work on cataloguing international standards and identifying good practices that relate to the financial sector, for use by Bank and Fund staff, has also fed into the Forum's work in this area.

In recent months, the Committee has coordinated the work of the staff of the Bank and the Fund with the Basle Committee to draft a methodology for assessing compliance with the Core Principles for Effective Bank Supervision. The Committee has also had some preliminary discussions regarding the institutions' views on the proposed revisions to capital adequacy standards.

Consideration of ad hoc issues

The Committee discussed various other issues relating to financial sector work on an ad-hoc basis. Since the last report, the Committee reviewed the on-going work in the Bank and the Fund intended to help countries identify Y2K problems in the financial sector and make contingency plans. The Committee also discussed the intentions of the two institutions in the rehabilitation of Kosovo. Finally, the Committee remains ready to resolve issues between Bank and the Fund staff working on financial sector matters that cannot be handled at the country level. The few such problems which have arisen have been addressed informally by the co-Chairs.

The Committee's work program in the coming period

Over the next six months, the intention of the Committee is to focus on the following areas:

- Facilitating the next stages of the **FSAP pilot**. The Committee will also monitor the experiences gained during the pilot, including any problems that may arise in individual country cases, and ensure that these are taken into account in the work on later pilot countries. The Committee will also focus on ways to ensure that the knowledge gained during FSAP missions is retained at the operational level so as to provide the basis for future work.
- While issues of confidentiality and information sharing arise in all areas of the work of the Bank and the Fund, a specific **protocol on handling confidential financial information** and appropriate disclosure under FSAP is required. The FSLC will work on

developing this protocol, while also assisting in the more general resolution of information sharing issues at the Bank/Fund wide level.

- The Committee will continue to work to achieve a more systematic and on-going **exchange of information** among all interested staff in the Bank and the Fund on work programs in the financial sector, document publication schedules, data and analysis available from external sources and contact lists of staff. The meetings of the Liaison Committee will remain open and the minutes will continue to be distributed. This exchange of information will contribute to eliminating duplication of effort and enhancing the delivery of consistent policy advice and a strategic view of financial sector development.
- To further enhance the quality of policy advice, the Committee will continue to focus on ways to **improve knowledge sharing and consensus building** between the Bank and the Fund on financial sector issues, through the sponsorship of seminars and other forms of interaction.

Conclusions

In the year since its inception, the FSLC has worked to achieve a closer degree of coordination of the financial sector work of the Bank and the Fund. While the Committee's activities to date have achieved some success, the work of improving the collaboration between the Bank and the Fund is ongoing. A further report on the Committee's progress and activities will be provided in about six months.