The Acting Chair's Summing Up
Independent Evaluation Office—Evaluation of the
Financial Sector Assessment Program (FSAP)
Executive Board Meeting 06/7
January 27, 2006

Executive Directors commended the Independent Evaluation Office (IEO) for its insightful and comprehensive evaluation of the Financial Sector Assessment Program (FSAP). They saw the discussion of the IEO report as a key input into the Fund's efforts to strengthen financial sector surveillance, in line with priorities identified in the Fund's medium-term strategic review and in the McDonough report.

Directors agreed with the key IEO conclusion that the FSAP program represents a distinct improvement in the Fund's ability to conduct financial sector surveillance and to understand linkages between financial sector vulnerabilities and macroeconomic stability. Directors were encouraged by the IEO's assessment that FSAPs and FSAP Updates help articulate policy recommendations, prompt better discussions with authorities, and help support policy and institutional changes. Some Directors especially noted the report's finding that FSAPs often had an impact on the internal policy debates regarding relevant measures.

At the same time, Directors considered that the IEO report provided a balanced and candid assessment of areas for improvement. In particular, Directors concurred that the main challenges facing the FSAP relate to "mainstreaming" financial stability assessments as an integral part of the Fund's bilateral and multilateral surveillance, and to ensuring participation by those countries where a strengthening of financial sector surveillance is most needed. Directors recognized that resources available for financial sector surveillance are already stretched, and that any adjustments and improvements would need to take into account possible resource implications.

Most Directors agreed with the report's assessment that incentives to participate in FSAP assessments and FSAP updates are critical for maintaining the effectiveness of the program. They were concerned that some countries that are systemically important and/or may have vulnerable financial systems still have not volunteered for initial assessments, and that some countries have been reluctant to volunteer for updates. Although there was some discussion of the possibility of moving to mandatory FSAPs and FSAP Updates, most Directors considered that the voluntary nature of the FSAP should be maintained, and emphasized that FSAPs have been most effective in building capacity where they have been owned by authorites. A number of these Directors called on the staff to explore the reasons for non-participation and identify remedial actions. A few other Directors suggested that the most efficient way to ensure adequate coverage of critical financial sector vulnerabilities in member countries would be to ensure that the FSAP analysis is an integral part of regular Article IV consultations.

Directors welcomed the discussion in the IEO report on whether the criteria for prioritizing FSAPs and FSAP Updates are adequate in a context of scarce resources (Recommendation 1). While a few Directors considered that the IEO report does not provide sufficient evidence that current mechanisms are inadequate, many Directors agreed on the need for clearer guidance—including on the trade-off between assessments of vulnerability and development issues—as part of a medium-term strategy aimed at efficient resource allocation in line with the Fund's core mandate.

To align FSAP coverage better with the needs of surveillance, most Directors agreed with the IEO proposal that management should indicate to the Board which countries it considers the highest priorities for FSAP assessments and updates (Recommendation 2). Annual reporting on country participation, as instituted following the 2005 internal FSAP review, could in this context provide useful information to guide discussion of priority cases. In addition, most Directors considered that Article IV staff reports should explicitly recommend an initial FSAP or FSAP update in priority cases, although the way this was reported would have to be mindful of potential market sensitivities. Some Directors, however, cautioned against putting peer pressure on countries, as they judged that this runs counter to the voluntary nature of FSAPs. A number of Directors also pointed to the report's finding that the burden of FSAPs on the authorities is high, and stressed that reducing this burden through better planning and focus is critical for achieving increased participation.

Directors welcomed the report's call for deeper country-specific analysis of priorities for financial sector surveillance, and noted that staff has been taking steps in this direction, including through adoption of more focused FSAP assessments and Updates and increased use of scoping missions. Many Directors saw merit in the IEO proposal for staff to develop country-specific plans for financial sector surveillance. It was noted, however, that this proposal goes to fundamental questions as to how the Fund should conduct financial sector surveillance. Directors agreed that the proposal, as well as any possible adjustments to resource allocation and other modalities (including the frequency of FSAPs), would be considered in the broader context of the ongoing discussion on enhancing the effectiveness of Fund financial sector surveillance.

Directors concurred with the IEO recommendation to strengthen links between FSAPs and surveillance (Recommendation 3). Specifically, they underscored the need to follow up on key vulnerabilities and gaps relevant for stability and macroeconomic developments and respective recommendations raised in FSAPs/FSAP Updates in country work, and to integrate such issues into Article IV surveillance reports. To facilitate this, Directors agreed that each Financial Sector Stability Assessment should contain a short (1-2 page) section that summarizes in candid language the main macro-relevant findings of FSAPs and potential macroeconomic implications arising from key financial sector risks. Directors stressed that in cases where financial stability issues, including any potential global repercussions, are judged to be of high importance, they should be a major focus of Article IV consultations, and Article IV reports should convey candid and focused assessments in this area. Directors also agreed that it would be helpful if Article IV Board discussions themselves paid greater attention to significant macro-relevant issues raised by FSAPs. In this context, FSAP team leaders could be given greater opportunities to clarify macro-relevant FSAP findings during Article IV Board meetings.

Directors also encouraged the staff to explore how internal processes could be better targeted at the objective of enhancing the use of FSAP findings. They saw potential both to strengthen the internal review process to ensure integration of key FSAP findings in the surveillance process, and to identify and disseminate better cross-cutting messages from FSAP assessments, including through better integration in regional and multilateral surveillance.

Directors encouraged the staff to follow up on IEO recommendations to improve further the quality of FSAPs and strengthen their impact (Recommendation 4). They noted that recommendations should be clearly prioritized and the potential consequences of not addressing key weaknesses candidly discussed. Directors emphasized in particular the importance of treating financial sector and cross-border linkages more systematically in FSAP analysis in light of the growing importance of regional and global spillover effects as a result of financial globalization. They concurred that to improve the quality and clarity of stress-testing analysis, the reports need to contain more informative and candid discussions on methodological and data limitations and the staff should not refrain from carrying out analysis of politically sensitive shocks. Some Directors also called for clearer definition of the role of Financial Soundness Indicators in FSAPs and for improved prioritization and sequencing of relevant ROSCs. Some other Directors stressed the need for the staff to have comprehensive knowledge of the domestic institutional background to ensure production of high-quality FSAPs aligned with country circumstances and priorities.

Directors discussed the implications of the publication policy of the Financial System Stability Assessment (FSSA) for the effectiveness of FSAPs. While some Directors considered that a move to presumed publication of the FSSA would enhance the impact of FSAPs on country authorities, donors, and market participants, many other Directors argued that such a move would not be consistent with the voluntary nature of the program.

Many Directors welcomed the IEO's recommendation to introduce changes in the organization of IMF mission activities to utilize scarce financial sector expertise, especially from MFD and ICM, more effectively in the surveillance process (Recommendation 5). Directors noted that this will be considered in the broader context of improving financial sector surveillance, as part of the medium-term strategic review. They took note of the message from the evaluation that the effectiveness of financial sector surveillance is constrained in important ways by the scarcity of financial sector and capital markets expertise. Directors also noted the IEO finding that, to date at least, only FSAP Updates appear to have had the capacity to undertake an in-depth tracking of implementation in specific areas.

While the view was expressed that the Fund should take the lead on all FSAPs, most Directors were in broad agreement with the report's recommendations regarding Bank-Fund collaboration (Recommendation 6). They concurred that the current joint approach, including the central role for the Bank-Fund Financial Sector Liaison Committee (FSLC), should be maintained. At the same time, further efforts should be made to take full advantage of the distinctive contributions that the two institutions can make—with the Fund focusing on stability issues and the Bank on financial sector development and institution building—including in the context of FSAP follow-up. Directors noted that the ongoing review of Bank–Fund collaboration will provide additional insights on the effectiveness of current coordinating mechanisms.

Directors concurred that there is room to improve the coordination of FSAP-related technical assistance activities, based on the country's own action plans (Recommendation 7). They noted that steps in this direction are underway in the context of past FSAP reviews, and in the broader context of the Fund's response to the recommendations of the IEO report on evaluation of technical assistance. These steps include the organization, in appropriate country cases, of follow-up meetings on technical assistance among the authorities, staff, and sometimes donors. At the same time, Directors cautioned against overburdening the FSAP with additional expectations regarding the assessment and planning of technical assistance needs, and against excessively formal approaches to follow-up that could overtax already stretched Fund resources and discourage ownership by the authorities.