Staff Response to the Evaluation by the Independent Evaluation Office of the Financial Sector Assessment Program Executive Board Meeting January 27, 2006

1. The staff congratulates the Independent Evaluation Office for the comprehensive and candid analysis of the Fund-Bank Financial Sector Assessment Program (FSAP).

2. We endorse the IEO's key conclusion that the FSAP represents a distinct improvement in the Fund's ability to conduct financial sector surveillance and in understanding the key linkages between financial sector vulnerabilities and macroeconomic stability. Overall, we agree with most of the report's analysis and areas identified for improvement. Indeed, many similar points have been made in previous internal FSAP reviews, and efforts are underway on many of these fronts—including promoting the FSAP program more actively and encouraging country participation; strengthening the integration of FSAP in Article IV consultations, as a means of improving the monitoring of financial systems for surveillance purposes; enhancing the quality and organization of FSAP assessments and updates (including through greater focus and selectivity); and making technical assistance (TA) follow up more systematic.

3. The FSAP clearly constitutes a central pillar of the Fund's approach to financial sector surveillance. At the same time, we need to recognize that the resources in the area of financial sector surveillance are already stretched. The McDonough report and the broader strategic discussions may have implications for the relative emphasis to be given to the various components of financial sector surveillance. Thus, the inputs from all these exercises will need to be considered together.

4. At the heart of the IEO's recommendations lies the need to strengthen the links between the FSAP and surveillance (recommendation 3) and to improve further the quality of the FSAP and strengthen its impact (recommendation 4). Staff concurs, in particular, that the follow-up in Article IV missions of major issues raised by FSAPs is critical, and that improved follow-up may require adjustments to ways the Fund's financial expertise is utilized in surveillance. The most appropriate modalities to achieve this—including the merit of the specific proposals put forward in recommendation 5—are being assessed as part of the medium-term strategic review.

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5. We also agree strongly with the need to strengthen the incentives for members' participation in FSAP and FSAP updates (recommendation 2). We thus support the report's call for Fund management and the Board to play a more active role in encouraging countries to volunteer. By contrast, the report in our view puts excessive emphasis on the need to refine the criteria for prioritization (recommendation 1), and does not provide convincing evidence that prioritization mechanisms are inadequate. While selectivity is important, we think it can be achieved within the existing prioritization guidelines. Prioritization is particularly important as countries will increasingly need to volunteer for FSAP updates. For its part, staff is continuing to refine the scope of updates, make them a more focused exercise, and integrate them more closely into the Fund's work.

6. The staff is in broad agreement with the IEO's views on Bank-Fund collaboration on the FSAP (recommendation 6). As noted by the IEO, the Financial Sector Liaison Committee (FSLC) has been reasonably effective in this regard, and could work to enhance further the alignment of each institution's contribution with its comparative advantage.

7. We share the IEO's view that it is important to improve coordination of follow up TA activities, based on the country's own action plans (recommendation 7). The staff already has taken steps in this direction, which include, as a result of the latest FSAP review, efforts to organize, in appropriate country cases, follow-up meetings on technical assistance among the authorities, staff, and possibly other donors. More generally, actions to improve coordination with authorities and their involvement are underway in response to the recommendations of the IEO evaluation of TA. As we go forward in strengthening TA follow-up to FSAPs, we will need to avoid excessively formal approaches that could both overburden the Fund and the Bank and reduce country ownership.