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**Statement by Mr. Bevilaqua, Mr. Saraiva, Mr. Velloso, and Mr. Barroso on FSAP
Review
(Preliminary)
Executive Board Meeting
May 12, 2021**

We thank staff for a comprehensive, well-written and sensible set of papers as well as for the effective outreach, including to our authorities, throughout the process. We generally welcome the results of this review, which builds on the 2014 Review and tackles some new pressing issues, but want to make the following points.

The FSAP already makes an invaluable contribution to our policy dialogue, and improvements should be proportionate to its already effective role in surveillance. After the Global Financial Crisis (GFC), the FSAP evolved from largely technical assistance to become a very important part of the surveillance toolbox, with a list of mandatory assessments being established. In 2014, the FSAP Review strengthened a more focused and risk-based approach and the thrust of that review's recommendations remains adequate. Accordingly, we were not expecting an overhaul of the FSAP at this point. That notwithstanding, we welcome the opportunity to reflect on the program and the proposed refinements that would make it more attuned to current and forthcoming financial stability challenges, further sharpening the role of the Fund as a trusted advisor in such matters.

Looking ahead, the main FSAP priority should be to address the challenges associated with exiting the pandemic, which will shape the financial stability landscape in the next few years. The forceful policy and regulatory responses taken during the pandemic, while instrumental to avert further economic collapse, mitigate the impact on vulnerable households and sectors, and support the recovery going forward, fueled substantial balance sheet vulnerabilities. While the financial sector withstood well the shock –due to the enhanced resilience stemming from post-GFC regulatory reforms and the breadth and depth of the policy response – the withdrawal of policy support, even as the recovery takes hold, may pose significant challenges to financial stability. With the global recovery taking place at different timing and paces, challenges for policy makers will be substantial, especially in

countries where exiting the crisis may take longer or entail surprises. In addition, where vulnerabilities have been stretched, further shocks may lead to important episodes of financial instability.

More specifically, on scoping, the three-pillar approach remains valid and should provide the basis for more customized and focused assessments. The development towards less use of graded assessments of standards and codes and more focused, thematic reviews is welcome. Such decisions should continue to be made flexibly and in agreement with country authorities. We agree that proper prioritization of the analysis on the most critical risks is becoming even more important. Balancing resource constraints with emerging risks will be of the essence, as deep and thorough examination of the most critical risks tends to be more valuable than trying to be more encompassing but losing depth in the analysis. Hence, the use of standardized, simplified tools may yield some savings, but it should never disregard in-depth country-specific analysis. We agree that staff will likely face an increasing demand for support on issues related to the evolving methodology on resolution and early intervention frameworks.

Coverage of systemic liquidity issues as well as those related to nonperforming loans management should be strengthened. While the policy responses have so far dampened the impact of the crisis on those critical dimensions, support withdrawal may pose significant challenges going forward. Given that first best solutions may take longer than what would be required to address rising pressures within the current cycle, we encourage staff to think about pragmatic approaches that could feasibly improve resilience in a timely manner. Furthermore, some of those issues may require international cooperation to be effectively addressed. Risks related to climate change, cybersecurity and fintech should also be approached with practicality and a degree of humility, regarding what the Fund could offer. That notwithstanding, defining a clear focus and relying on collaboration with relevant institutions remain instrumental. Ultimately, country circumstances and open dialogue with the authorities should dictate the right balance between traditional and emerging topics, with effective prioritization. Scarce Fund resources must be used where they can have greater impact, and where the countries need most.

We agree that strengthening the macroprudential stress testing framework is a priority going forward. Such a task entails analytical developments to integrate complex interactions between different risks and diverse sectors. The combined use of different models to measure macrofinancial interactions seems to be a promising avenue and we look forward to reports on any early results in this area. That said, reliance on any such experimentation for policy advice should proceed with extreme caution and the appropriate disclaimers. Moreover, data requirements will need to be addressed, coping with data access constraints and without overburdening country institutions. Close interaction with national officials could lead to important results in developing such tools.

Despite the perception that FSAP traction is strong, steps should be taken to improve it further. Country authorities are generally satisfied with the policy dialogue and recommendations entailed by FSAPs. However, we have seen many instances in which the

authorities perceived that their views (or their country's specificities) were not being properly considered. The proposal of having a section of authorities' views, as successfully incorporated in Article IV reports, may go a long way to address such concerns. Having the authorities' views expressed clearly and faithfully would not only provide additional information to the readers but also improve the perception by the authorities that their views are being treated fairly. Therefore, we strongly support staff's proposal to add an authorities' views section in the FSSA. Also, we strongly suggest including a similar section in all other FSAP reports that are expected to be published. Moreover, the Fund must avoid weakening traction by expanding FSAP coverage to areas in which it does not have sufficient expertise and risk losing credibility.

Further and effective integration of FSAP recommendations into Article IV consultations should be a priority. However, this should not be a box-checking exercise of questionable efficacy. Indeed, FSAP and Article IVs can complement each other more fundamentally with many synergic gains, as the former considers more structural issues, while the latter provides higher-frequency assessment of financial risks. Moreover, the interaction of specialized expertise and country-specific knowledge is crucial for the quality of macrofinancial surveillance. Developing simplified analytical tools as suggested may be helpful, but we caution against putting too much emphasis on it. Simplified analytical tools cannot replace proper macrofinancial expertise and analytical capacity of financial sector specialists. We believe cross-mission participation is of the essence. However, we would suggest going beyond having the Article IV mission chief participating in the concluding FSAP mission. Having MCM experts in Article IV missions remains critical for advancing integration, which can be complemented by occasional participation of highly specialized MCM staff, including through remote means, on specific Article IV meetings. We welcome the proposal for early engagement of MCM and the FSAP team in the review of the Article IV policy note.

Mandatory FSAP participation should be defined by risk-based criteria. Both the list and frequency of mandatory FSAPs should reflect the systemic importance of a jurisdiction's financial sector and its interconnectedness. In addition, the Fund should be prepared to meet a potentially larger demand for voluntary FSAPs without undue delays. We have repeatedly expressed our opinion that higher-frequency mandatory FSAPs (every five years) should apply only to the core systemically important jurisdictions, with an intermediate category of systemically important jurisdictions having a mandatory FSAP every 7 years and a larger group of less systemic jurisdictions in a mandatory 10-year cycle. In this way, financial surveillance would be more adequately spread based on risk assessment and there would be more room for voluntary FSAPs, with benefits for the membership as whole. Having said that, we can go along with the staff proposal that garnered sufficient consensus at this point.

We should closely monitor the cost impact of this FSAP Review as changes are implemented. In addition to transitional costs that are difficult to estimate at this point, we are concerned about the potential impact of further enhancing the scope of FSAPs to areas in which the Fund has no expertise and, therefore, little value to add. We encourage staff to

return to the Board with a better estimate of costs eighteen months into the implementation of the recommendations approved in this review.