April 17, 2020
Approval: 4/24/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/2-1

10:00 a.m., January 15, 2019

1. Independent Evaluation Office—IMF Financial Surveillance

Documents: SM/18/286 and Supplement 1; and Supplement 10; and Supplement 10, Correction 1; and Supplement 2; and Supplement 2, Correction 1; and Supplement 3; and Supplement 4; and Supplement 5; and Supplement 6; and Supplement 7; and Supplement 8; and Supplement 9

Staff: Collyns, IEO; Lamdany, IEO

Length: 2 hours, 10 minutes

Executive Board Attendance

C. Lagarde, Chairman

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
M. Raghani (AF)	
	J. Di Tata (AG)
	G. Preston (AP), Temporary
A. Tombini (BR)	
	K. Lok (CC), Temporary
L. Villar (CE)	
L. Levonian (CO)	
R. Kaya (EC)	
H. de Villeroché (FF)	
	K. Merk (GR)
	M. Roy (IN), Temporary
D. Fanizza (IT)	
M. Kaizuka (JA)	
J. Mojarrad (MD)	
H. Beblawi (MI)	
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
	B. Alhomaly (SA), Temporary
J. Agung (ST)	
P. Inderbinen (SZ)	
S. Riach (UK)	
	M. Svenstrup (US), Temporary

G. Bauche, Acting Secretary
J. Morco, Summing Up Officer
J. Acheson / M. Gislen, Board Operations Officers
L. Nagy-Baker, Verbatim Reporting Officer

Also Present

Asia and Pacific Department: N. Choueiri. Communications Department: Nagwa Riad. European Central Bank: K. Nikolaou, R. Rueffer. European Department: A. Weber. Independent Evaluation Office: A. Abrams, C. Collyns, R. Darius, L. de Las Casas Perez de Orueta, M. Kell, R. Lamdany, P. Loungani, K. Monasterski, C. Rustomjee, L. Stedman. Legal Department: J. Ams, K. Christopherson Puh, N. Rendak. Middle East and Central Asia

Department: S. Lall. Monetary and Capital Markets Department: T. Adrian, P. Ananthakrishnan, M. Cihak, U. Das, M. Erbenova, E. Eriksson von Allmen, J. Morsink, M. Savastano, T. Xu. Office of Budget and Planning: B. Christensen, P. Kongsamut. Office of Internal Audit and Inspection: B. Lim. Office of Risk Management: Q. Chen. Strategy, Policy, and Review Department: J. Dutra Pessoa de Araujo, P. Gitton, M. Gonzalez Miranda, V. Haksar, F. Valencia Palau. Executive Director: G. Lopetegui (AG). Alternate Executive Director: P. Fachada (BR), A. Guerra (CE), A. McKiernan (CO), P. Moreno (CE), H. Razafindramanana (AF), D. Ronicle (UK), B. Saraiva (BR), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI), M.Gilliot (FF), G. Heim (SZ), R. Morales (AG), W. Nakunyada (AE), R. N'Sonde (AF), P. Pollard (US), S. Potapov (RU), M. Sidi Bouna (AF), T. Sitima-wina (AE), F. Spadafora (IT), A. Tivane (AE), G. Vasishtha (CO), J.Weil (CO), C. Williams (CO). Advisors to Executive Directors: P. Al-Riffai (MI), A. Arevalo Arroyo (CE), M. Bangrim Kibassim (AF), X. Cai (CC), K. Carvalho da Silveira (AF), D. Cools (NE), K. Florestal (BR), I. Fragin (GR), J. Garang (AE), A. Grohovsky (US), J. Hanson (NE), T. Manchev (NE), L. Nankunda (AF), R. Pandit (ST), A. Park (AP), I. Skrivere (NO), A. Srisongkram (ST), N. Vaikla (NO), C. Wehrle (SZ), J. Montero (CE).

1. INDEPENDENT EVALUATION OFFICE—IMF FINANCIAL SURVEILLANCE

The Managing Director submitted the following statement:

I welcome the report of the Independent Evaluation Office (IEO) on the IMF's financial surveillance. The report recognizes the substantial upgrade the Fund has made in its financial surveillance work since the Global Financial Crisis (GFC) and offers valuable and constructive insights on how to further improve its quality and impact. Accordingly, I broadly support the IEO's recommendations to make IMF financial surveillance more effective.

The IEO report provides a welcome opportunity to reflect on the IMF's initiatives to expand and deepen its financial surveillance work in response to the Global Financial Crisis, which were made explicit in the 2012 Integrated Surveillance Decision [1] and the 2012 Financial Surveillance Strategy.[2] Reflecting its macroeconomic and financial expertise, global membership and governance, the IMF is well placed to make members aware of global financial stability risks while advising them on policies tailored to their circumstances.

I welcome the report's overall findings that the Fund's efforts have delivered a substantial upgrade of its financial surveillance work, including by developing a broad range of diagnostic tools, exploring new policy approaches, and stepping up attention to macrofinancial linkages in bilateral surveillance. I am also pleased that the report recognizes that the Global Financial Stability Report (GFSR) and Early Warning Exercise (EWE) are leading sources of insights on the outlook for and risks to the global financial system; and that the IMF is now better prepared to detect financial vulnerabilities and risks.

At the same time, I agree that there remains room to improve the quality and impact of the Fund's work in this area; therefore, I broadly support the report's findings and suggested priorities. I wish to highlight that the 2020

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1 https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=2ahUKEwiHxumdh53fAhXHqFkKHS6zD7cQFjABegQICBAC&url=https%3A%2F%2Fwww.imf.org%2Fexternal%2Fnp%2Fpp%2Feng%2F2012%2F071712.pdf&usg=AOvVaw0j0EGuyS4IlMvTe24nYx5c

2 https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=2ahUKEwjFuuTTh53fAhUSvlkKHRF_BfMQFjAAegQICBAC&url=https%3A%2F%2Fwww.imf.org%2Fexternal%2Fnp%2Fpp%2Feng%2F2012%2F082812.pdf&usg=AOvVaw2tRz04lGordb8ozY6Qkv5f

Comprehensive Surveillance Review and Financial Stability Assessment Program (FSAP) Review will provide important opportunities to consider some of the report's key recommendations, while recognizing the constrained resource environment for the Fund. To this end, I appreciate that the IEO identifies areas of highest priority and clarifies that fully implementing all recommendations to meet the IMF's responsibilities and objectives would require significant additional resources. Below is my proposed response to each of the six recommendations presented in the IEO report.

RESPONSE TO RECOMMENDATIONS

Recommendation 1—*Strengthening financial and macrofinancial analysis in Article IV surveillance: To improve the relevance and traction of bilateral financial surveillance, the IMF needs to deepen financial and macrofinancial analysis, particularly in Article IV consultations, including by taking practical steps to better integrate FSAP analysis in Article IV consultations and by increasing financial skills and expertise among staff.*

I agree with the objective of further strengthening financial and macrofinancial analysis in Article IV surveillance, which resonates with the conclusions of the 2018 Interim Surveillance Review. Further integrating FSAP analysis in Article IV consultations can help achieve that objective. The upcoming FSAP and Comprehensive Surveillance Reviews will consider this recommendation and the related specific suggestions laid out in the report. As major strides in improving financial analysis in Article IV consultations will also require further developing the skillset of country teams, I note that it could entail substantial additional resource costs (see also recommendations 5 and 6).

Recommendation 2—*Refocusing FSAP country selection and scope: The IMF should revisit the current approach to allocating FSAP resources to achieve a more flexible, dynamic and risk-based allocation across countries and issues.*

I broadly concur with the proposal to review the number of mandatory Financial Stability Assessments (FSAs). Without prejudging the outcome of the FSAP review, I would note that any revised approach to allocating FSAP resources would need to strike a balance among several factors, including evenhandedness and transparency in the selection process; the current voluntary nature of FSAs for most member countries; and the market signaling risks inherent in any selection of countries based on vulnerabilities.

While I agree with the proposal to review the scope and focus across FSAPs (to be considered in the FSAP review), I do not concur with the recommendation to cut back on Fund stress testing in jurisdictions and areas where the authorities already conduct detailed stress tests. The experience so far has shown that stress tests conducted by the authorities in advanced countries vary in quality and in ambition, while the Fund's independent stress tests have continued to add value in many instances and are integral to the Fund's bilateral surveillance.

Recommendation 3*—Increasing traction of multilateral surveillance: The IMF should continue to work to enhance the impact of IMF multilateral surveillance by increasing rigor and transparency, and by deepening collaboration with international partners.*

I welcome the conclusion that IMF's work on multilateral financial surveillance is generally well regarded and agree with the recommendation to make more GFSR material available online, subject to copyright constraints. Disclosing more details and data would help improve the traction of the GFSR by ensuring more solid and transparent analytical and empirical backing of Chapter 1 narratives.

I also broadly support the recommendation to deepen collaboration with international partners. In fact, the improved cooperation in recent years between the IMF and the FSB on the EWE has been very successful in achieving the objectives outlined in the report. We plan to continue deepening this cooperation without compromising our capacity to raise out-of-the box issues. However, I continue to believe that further dissemination of the EWE would weaken its effectiveness.

On scaling up the Fund's work with the international regulatory agencies to assess the impact of reforms, the Fund has undertaken several assessments of different aspects of the reforms following the 2012 Financial Surveillance Strategy. Some of these have been conducted jointly with the Standard Setting Bodies (SSBs). We will continue to conduct such assessments, subject to resource availability, while recognizing the challenges that emerge when there is a divergence of views between these regulatory agencies and IMF members that are not represented in them.

Recommendation 4*—Enhancing the IMF analytical tools: To enhance the value added of its financial surveillance, the IMF should strengthen efforts to be a global center of excellence on financial and macrofinancial research.*

Enhancing the Fund's analytical toolkit is a constant endeavor. Improving the understanding of macrofinancial linkages remains a high priority for the Fund's multilateral and bilateral surveillance. Exchange of views between the IMF and major central banks can further support that purpose. Furthermore, developing simplified tools and increasing internal outreach to further disseminate existing ones could help strengthen the monitoring of financial risks and assess their implications for financial stability and growth. Staff is currently working on deepening and broadening the application of the Growth-at-risk framework and is developing models to study specific issues related to the intersection of macroeconomics and finance.

The proposal to conduct global stress tests in partnership with the BIS and FSB (see also recommendation 3) is interesting. But I am not convinced that it is feasible, particularly considering the data constraints acknowledged in the report.

With respect to fintech, the Fund is gaining expertise and is active in building international support for cooperative action where appropriate. At the same time, staff is conducting significant analytical work, including recently on central bank digital currencies. These efforts are oriented toward delineating the Fund's role in fintech and focusing on its comparative advantages, in line with its mandate.

Recommendation 5*—Building financial skills and expertise: The IMF should intensify efforts to attract, develop and retain a deeper pool of financial talent, as well as to ensure that area department fungible macroeconomists have the knowledge and support to integrate financial and macrofinancial analysis into Article IV consultations.*

I agree with the overall message that the IMF has made significant efforts to upgrade the macrofinancial skills of its economists, and that this area remains work in progress. Targeted enhancements from the HR strategy (including a talent inventory and a potential expert track) will help ensure that macroeconomists and experts combine their expertise to support effective macrofinancial surveillance across the membership. The talent management challenges to disseminate and strengthen macrofinancial skills, including through recruiting, will also be considered in the context of the forthcoming comprehensive compensation and benefits review.

Recommendation 6—*Increasing budgetary resources: To fully meet its responsibilities and objectives, the IMF should consider devoting significant additional resources to financial surveillance.*

I acknowledge that strengthening financial surveillance requires adequate resources. I take note of the recommendation to significantly increase the resource envelope for financial surveillance. Budgetary issues will be considered in the context of the IMF's budget discussions and will need to reflect the areas of the Fund's comparative advantages, medium-term trade-offs, and strategic objectives defined by the Executive Board. In this context, we should also acknowledge the importance of making sure that we assist our members in the most cost-effective way possible.

Table 1. The Managing Director's Position on IEO Recommendations

Recommendation	Position
(i) Strengthening financial and macrofinancial analysis in Article IV surveillance: To improve the relevance and traction of bilateral financial surveillance, the IMF needs to deepen financial and macrofinancial analysis, particularly in Article IV consultations,	Support

including by taking practical steps to better integrate FSAP analysis in Article IV consultations and by increasing financial skills and expertise among staff.	
(ii) Refocusing FSAP Country Selection and Scope: The IMF should revisit the current approach to allocating FSAP resources to achieve a more flexible, dynamic and risk-based allocation across countries and issues.	Qualified Support
(iii) Increasing Multilateral Surveillance: The IMF should continue to work to enhance the impact of IMF multilateral surveillance by increasing rigor and transparency, and by deepening collaboration with international partners.	Qualified Support
(iv) Enhancing the IMF Analytical Tools: To enhance the value added of its financial surveillance, the IMF should strengthen efforts to be a global center of excellence on financial and macrofinancial research.	Support
(v) Building Financial Skills and Expertise: The IMF should intensify efforts to attract, develop and retain a deeper pool of financial talent, as well as to ensure that area department fungible macroeconomists have the knowledge and support to integrate financial and macrofinancial analysis into Article IV consultations.	Support
(vi) Increasing Budgetary Resources: To fully meet its responsibilities and objectives, the IMF should consider devoting significant additional resources to financial surveillance.	Qualified Support

Mr. Kaizuka, Mr. Saito and Mr. Naruse submitted the following statement:

We thank the IEO for providing the reports regarding the IMF financial surveillance. The reports provide a wide range of constructive recommendations. We also thank the Managing Director for her statement on her position on the IEO's recommendations. We broadly concur with the IEO's recommendations, so we will limit our comments to the following points:

We positively note that the IMF launched initiatives to strengthen financial surveillance to better advise member countries of vulnerabilities and risks and to foster greater resilience. We are pleased to see the evaluation's conclusion that the IMF's efforts have yielded an upgrade of its financial surveillance work, such as high-quality in-depth assessments in the FSAP, increasing attention to macrofinancial linkages in the Article IV, and insights on the global financial system in the GFSR and EWE.

We agree with the IEO's view that it is critical to build synergies and integrate the FSAP and Article IV to deliver timely and effective bilateral financial surveillance. As the IEO points out, given the lower frequency than the Article IV, the FSAP cannot provide the continuous assessment of fast-developing financial stability risks or conduct an ongoing discussion with the authorities. Thus, we agree with the importance on the adequate follow-up of the FSAP in the subsequent Article IV. We also concur with the need to continue efforts to deepen financial and macrofinancial analysis in the Article IV. Given the rapidly evolving new areas, such as fintech, it is difficult for the mandatory FSAP every five years to deliver timely assessments on these areas. The Article IV teams, which have regular contact with the authorities, could have a greater role to play in conducting these assessments. Therefore, we expect that the IMF would deploy financial experts to the Article IV teams in major market economies. In addition, we note the IEO's assessment that the FSAP teams often lack in-depth country knowledge. As for Japan's last FSAP, some FSAP team members also worked for Japan's Article IV, so the FSAP team seemed to have a certain knowledge on the environment Japan's financial system faced. In general, it is important to ensure that the FSAP teams are well-briefed by the Article IV teams which conduct the routine surveillance of the financial and economic situations and the policies of the country. This would contribute to the useful and constructive discussions between the FSAP teams and the authorities based on the common understanding of financial system and the practices of the country.

While the FSAP is useful, it puts a large burden on the authorities' time and resources. Therefore, the design of the FSAP should be continuously reviewed to enhance the efficiency of the operation and to focus on important risks. We believe that the FSAP helps identify risks and vulnerabilities, serve as a catalyst for measures to address vulnerabilities, and provide a useful sounding board for the authorities' assessments and plans. At the same time, we encourage the IMF to ease the burden on the authorities by streamlining assessments and enhancing efficiency. To do so, as the IEO recommends, the FSAP's scope and focus should be tailored to the size and level of development of the country's financial sector, the sophistication of regulatory agencies, and an assessment of risks, vulnerabilities, and regulatory gaps. Related to this, because the models and scenarios in stress tests differ across countries, we agree with the IEO's view that stress tests in the FSAP should be more flexible and tailored to country circumstances and not overly rely on international best practice. In those countries already conducting regular high-quality stress test, we urge the IMF to promote collaboration and exchange of views with the authorities in order to limit the resource burden on the authorities and the IMF. Consequently, we believe that resources could be more efficiently allocated and used. Regarding the frequency of the FSAP, we could go along with the IEO's proposal that S5 would continue to be covered by the mandatory FSAP every five years and the rest of the membership would be covered based on a systemic Fun-wide approach to country selection. We look forward to the discussion on the FSAP's country selection, frequency, and scope in the context of the upcoming FSAP review.

We agree with the IEO's view that the IMF could make a contribute to the global reform agenda, particularly by drawing on the IMF's comparative advantage in its analytical work. We believe that to ensure the credibility of the global regulatory reforms, the IMF could analyze the benefits and unintended consequences of the reforms. The IMF's multilateral surveillance (for example, Analytical Chapter 2 in the latest GFSR) provides the timely and useful analysis in this regard. However, we should bear in mind that the IMF is not a standard setter. It should be strictly avoided to re-open discussions that have been already completed by standard setters. In addition, while we see merit in the IMF's work of analyzing macrofinancial linkages and cross-border spillovers, we are cautious about the IEO's call on the IMF's increased access to granular data on G-SIFIs. On this issue, we believe that the IMF should streamline the authorities' burden on the data reporting for the IMF. The IMF could use publicly available data and might be able to explore possible synergies with international partners that receive and disseminate similar data.

We concur with the need to intensify efforts to attract, develop, and retain staff with financial skills and expertise. It is encouraging that the IMF has continued to upgrade its financial sector skills and expertise, including through training and recruitment. On the other hand, we note the IEO's assessment that there is still need for more staff with deep skills and expertise to be able to conduct effective financial surveillance across the membership. And we note that the IMF has had difficulties to attract and nurture staff with high-level financial and macrofinancial skills, in part because the Fund career path to senior positions normally requires rotations to establish fungibility. In this light, the Human Resources strategy, currently under developed, could provide an opportunity to consider ways to improve incentives to help attract, develop and retain more financial talent.

We acknowledge the importance of the IMF's high quality and effective financial surveillance, but the IMF should strive to address the new demands through the reprioritization and reallocation of the resources. The IEO's reports discuss the IMF financial surveillance. Accordingly, the recommendation 6 pays utmost attention to budgetary resources on financial surveillance among the IMF's various initiatives. However, as the MD's statement says, whether the resource envelope for financial surveillance would be increased should be considered in the context of the IMF's overall budget discussions. And such a budgetary decision should be made by the Executive Board, reflecting the areas of the Fund's comparative advantages, medium-term trade-offs, and strategic objectives. Given the IMF's limited resources for financial surveillance, we encourage the IMF to closely examine the need for the increase in resources based on macro criticality and the IMF's expertise compared to other institutions. Also, we believe that the IMF could endeavor to increase the value added of its financial surveillance through an efficient operation and a refocusing of efforts without devoting significant additional resources.

Mr. Ostros, Mr. Gade and Mr. Vaikla submitted the following statement:

We commend the IEO for a very thorough and enlightening evaluation of one of IMF's core functions, surveillance of the financial sector. In our view, it gives a comprehensive overview of the strengths and challenges that characterize IMF's financial surveillance and it provides a very useful basis for further strengthening of an already strong area of the Fund's work. We welcome the Managing Director's statement on the Report. The Fund has come a long way since the global financial crisis in enhancing financial surveillance by promoting better integration of financial sector issues into the Fund's surveillance processes.

We support Recommendation 1 to strengthen financial and macrofinancial analysis in bilateral surveillance, including by better integrating FSAP analysis in Article IV consultations and by improving financial expertise among staff. We note that such efforts have been launched before with both positive and mixed results, and it is not evident what measures would be the most efficient ones. As suggested, an avenue worth exploring is to produce a template for financial stability assessment and monitoring, based on FSAP, to be followed-up by Article IV consultations. In countries where no recent FSAP has been conducted, a standardized template for ensuring sufficient coverage of financial stability issues may still be warranted. These countries would also particularly benefit from increased skills and resources of Article IV teams in financial and macrofinancial areas.

We note that, in some cases, a high staff turnover in the country teams and therefore lack of country-specific knowledge might be a part of the explanation for insufficient coverage of financial issues in Article IV reports. We see merit in the suggestion to involve ED offices more fully in the preparation and organization of FSAPs, similar to the current practice for Article IV consultations, and to use Article IV consultations to discuss topics for upcoming FSAPs. Additionally, an early selection of FSAP mission chiefs would help the Fund and the authorities to jointly prepare for the assessment.

While we are open to discuss how to achieve a more dynamic selection and timing of FSAPs (recommendation 2), we are very sceptical of moving to mandatory FSAPs for only the 5 most systemic jurisdictions. It is imperative that all financial sectors with systemic importance or strong cross-border linkages are sufficiently covered over time, which implies that a maximum/minimum frequency should be maintained. The pros and cons, including resource implications and possible negative signalling effects of a more risk-based approach, of such reforms should be further explored.

We agree that the IMF should strive to increase the value added of FSAPs and make even more efficient use of staff and authorities' time and resources, e.g. by greater selectivity and flexibility in what modules an FSAP would need to include. At the same time, the comprehensive three-pillar approach developed in earlier reviews should be preserved.

Also, the Fund should be sensitive to the administrative burden on country authorities, especially related to exhaustive data requests, which should be balanced with the potential added benefits. Another factor to bear in mind is that much of the framework within the EU is harmonized. The FSAPs for EU countries might therefore focus to a large extent on areas where there is room for national discretion. Avoiding duplication or overlap with multilateral or regional standards and codes assessments should also be sought as a way to improve the value-added of FSAPs.

On multilateral surveillance, we are broadly satisfied with the GFSR and the EWE as they look today. That said, there may always be room for improvement of readability and traction of the GFSR as suggested in recommendation 3. We agree that the GFSR should make better and earlier use of country teams to ensure that country references are factually correct and reflect an adequate understanding of country circumstances and institutions. We support the suggestion to improve availability of analytical details and data.

We do not agree that chapter 1 and the analytical chapters of the GFSR necessarily should be more closely aligned. Chapter 1 should identify the main risks, developments and policy recommendations in a consistent format over time. However, the technical complexity of this chapter is, in our view, sometimes too high and may reduce the report's policy relevance. The analytical chapters can focus more narrowly on a current financial sector subject of high relevance for the membership and with less constrain on the use of technical complexities.

While there may be room for increased coordination between the IMF and FSB ahead of the EWE, we emphasise the value of somewhat different perspectives represented by the IMF and FSB contributions respectively. We agree that the EWE key messages should be disseminated more broadly among senior authorities in member countries, while respecting the strict confidentiality of the EWE meeting. Also, methods should be developed to ensure regular and formalized follow-up to EWE risk discussions and recommendations, possibly as suggested e.g. in the report of the Eminent Persons Group (proposal 13).

It is of course highly desirable that the IMF be a global center of excellence on financial and macrofinancial research as suggested in recommendation 4. In our view, this is already true to a large extent, although the IEO report shows that some country authorities develop more sophisticated models in some areas. We agree with the IEO that streamlining and simplifying of existing tools is desirable in some areas to make them more user-friendly and allow FSAP and Article IV teams to make greater use of them. Also, a discussion of the division of labor and responsibility between international financial institutions (FSB, BIS, and OECD) including regarding research, could be warranted.

We agree that the IMF may have its strongest comparative advantages in cross-border macrofinancial linkages, and global and regional aspects of stress testing, and we see merit in developing tools for a cross-border global stress test, to be presented for example as a part of the GFSR. The IMF should ensure that its strengths in cross-border analysis also benefit bilateral analysis and recommendations. Furthermore, we believe that IMF stress tests provide an important second opinion to national stress tests, even in countries with highly sophisticated models for stress testing.

We agree that there is a need for a deeper pool of financial specialists and room to improve the depth and breadth of financial and macro-financial skills of country teams. An analysis is warranted, in connection with the next budget discussion, on the potential budgetary effects of enhancing financial surveillance to meet the main challenges identified in the IEO report. The point of departure should be to explore strengthened capacity (recommendation 5 and 6) within the current budget.

There seems to be a complex set of HR related challenges related to enhancing macrofinancial skills within the Fund, including career paths, compensation, internal training, and recruitment. These issues need to be further discussed, in connection to e.g. the medium-term budget, the upcoming HR strategy review and the FSAP review, or even as a separate work stream.

Mr. Mouminah, Mr. Alkhareif and Mr. Rouai submitted the following statement:

We commend the Independent Evaluation Office (IEO) for an excellent evaluation and, like the Managing Director, broadly support the recommendations to make IMF financial surveillance more effective. We also welcome the Managing Director’s statement on the report. Financial surveillance is a critical area of the Fund’s crisis prevention and resolution toolkit, particularly in the aftermath of the Global Financial Crisis (GFC). We agree with the IEO that while important progress has been achieved in upgrading financial surveillance work, more needs to be done to improve its quality and increase its impact and effectiveness.

The focus of the evaluation on the period since the IMF adopted the 2012 Financial Surveillance Strategy (2012 FSS) is appropriate. However, it is important to note that the relevance for the Fund of financial sector issues goes back to the 1990s, which witnessed the first wave of financial crisis, leading to establishment of the Financial Stability Assessment Program (FSAP) as a tool to identify financial stability challenges and help prevent crisis. Later, and in parallel to the conduct of FSAPs and of making FSAPs mandatory for jurisdictions with systemically important financial sectors, we note that important financial sector initiatives and products were introduced over the years, including the Global Financial Stability Report (GFSR) and the Early Warning Exercise (EWE). With the adoption of the 2012 FSS, constant efforts have been made to better identify financial sector risks and integrate financial and macrofinancial analysis in bilateral and multilateral surveillance.

Before addressing the evaluation’s recommendations, we would like to make the following two comments:

First, the price of success or why the Fund needs to adjust its relevance in a more sophisticated global financial environment it helped to create. Because of the leading role of the Fund in promoting financial sector stability, including through the reliance on the rigor of FSAPs and stress testing, and the emphasis on compliance with agreed international standards and codes, national authorities have made considerable advances, in some cases with

Fund assistance, in developing tools for analysis and monitoring of financial risks and vulnerabilities to adjust to the rapid evolution of financial sectors. Against this background the IEO findings that “many S29 officials feel that there have been diminishing returns over time in the value added of FSAPs” or that “advanced economies authorities are at best mixed and mostly skeptical of the value added by the Fund’s stress testing”, should be viewed by the Fund as a sign of success rather than an indication of a lack of interest.

Second, while the evaluation recognizes that the Fund has upgraded its financial surveillance work, it rightly points out that these initiatives have not been yet tested by a major crisis. It is therefore critical that the Fund should continue to expand the scope and coverage of financial surveillance, including in some emerging technologies-related issues in finance like cyber risks and cyber security, crypto assets, and fintech in general. We also need to be cognizant that the next crisis may not emanate from the financial sector, which requires the Fund to remain alert to risks arising from non-conventional sources.

Recommendation 1 - Strengthening financial and macrofinancial analysis in Article IV surveillance. We support the recommendation. Despite the efforts made in this area, we agree on the need for enhanced integration between the FSAP and Article IV consultations to improve the traction of bilateral financial surveillance. The suggestion made by the IEO for the FSAP to develop a template for financial stability assessment and monitoring to be followed up by Article IV consultations is noteworthy, as it could help in addressing the limited financial sector expertise in area departments and ensuring regular follow-up of FSAP recommendations. Our Office has a positive experience in the preparation and organization of FSAPs for Saudi Arabia and we therefore support the suggestion to fully involve ED offices, as is now done for Article IV consultations.

Recommendation 2 - Refocusing FSAP Country Selection and Scope. The IEO makes several sensible suggestions to improve the relevance and traction of the FSAP. In our view, what is important is to strike the right balance between the responsibilities of IMF surveillance with respect to member’s financial policies under the 2012 Integrated Surveillance Decision and the need for evenhandedness, on the one hand, and the perception of some jurisdictions that the added value of FSAPs and IMF stress tests are diminishing because of the rapid improvement in national expertise. While we continue to support the last proposal by staff regarding the list of mandatory FSAPs and are open to reviewing and tailoring IMF stress testing to country circumstances and expertise, we prefer to address these issues with the benefit of the additional inputs of the forthcoming FSAP Review.

Recommendation 3 - Increasing Traction of Multilateral Surveillance. We share the MD's qualified support to the recommendation. We welcome the finding that important progress has been achieved in ensuring consistency and better integration between the GFSR and the WEO. However, we also agree on the need to further enhance the traction of multilateral surveillance and support the IEO's suggestions to further enhance the narrative, analysis, and content of Chapter 1 of the GFSR and address some of the identified presentational weaknesses. We also support further enhancing collaboration with international partners, in particular the Financial Stability Board (FSB) and the Standard Setting Bodies (SSBs). However, and like the MD, we consider that further dissemination of the EWE would weaken its effectiveness.

Recommendation 4 - Enhancing the IMF's Analytical Tools. We support the recommendation to enhance the IMF's analytical tools and further strengthen financial sector expertise. We understand, however, the MD's reservation about developing tools to stress test the global financial system because of data constraints. One option is to initiate this exercise for the S29 jurisdictions where data is not an issue. Another option is to stress test regions or interconnected countries to assess the spillover impact of developments in a major financial center. Staff elaborations would be welcome.

Recommendation 5 - Building Financial Skills and Expertise. We support the recommendation and look forward to the contribution of the HR Strategy in helping to further build financial sector expertise in the Fund. The forthcoming Comprehensive Compensation and Benefits Review (CCBR) should also address the issue of how to attract and retain staff with high-level macrofinancial skills.

Recommendation 6 - Increasing Budgetary Resources. We prefer to consider the budgetary impact of the evaluation's recommendations in the context of the Management Implementation Plan (MIP) in response to the Board-endorsed recommendations. We encourage staff to provide, at that time, preliminary costing of the various recommendations and suggestions for financing.

Finally, we would like to make the following comments on the evaluation itself:

We note from Supplements 8 and 9 that in-depth studies covering 14 countries and the Euro area were conducted to inform the evaluation. These studies cover all the Fund's area departments, except the MENA region.

As suggested by the recent external evaluation, we encourage the IEO to promote this evaluation by hosting a "learning day" together with management and senior staff to provide an opportunity for staff to learn more about and discuss findings and recommendations of the IEO.

Ms. Pollard, Mr. Grohovsky and Ms. Svenstrup submitted the following statement:

We thank the IEO for a very comprehensive, provocative, and timely report.

Macro-financial surveillance continues to be at the heart of the Fund's mandate. Although Fund surveillance has long-since included coverage of the financial sector, the global financial crisis highlighted the critical need to more routinely and rigorously integrate financial sector linkages and potential spillovers in macroeconomic surveillance. Since then, the quality of macro-financial surveillance has increased substantially and is now better integrated into baseline projections and assessments of macro-critical risks. We agree with the IEO that these efforts must be further strengthened to maximize the efficiency and effectiveness of limited resources, and to better integrate macro-financial analysis across the Fund's various surveillance and analytical tools. In this regard, we find many of the IEO's recommendations constructive starting points for further thought.

We look forward to discussing these issues in more detail in the upcoming Board reviews of the FSAP, the HR strategy, compensation and benefits, and surveillance. While we are still forming our views, we offer preliminary responses to the issues raised by the IEO:

Budget: This chair firmly supports a flat real budget for the Fund. In the context of the enhanced post-crisis focus on financial sector work, we found it striking that MCM personnel spending has remained relatively flat as a share of total expenses and FTEs. Therefore, within the overall real flat real budget envelope, we would be supportive of a modest re-allocation of resources toward financial sector work.

Core mandate: Given resource constraints, we think it is important for the Fund to remain focused on issues that are truly macro-critical and within the Fund's mandate. It is up to the Board and management, with input from the IEO, to help identify lesser priority issues that can be trimmed to make room for financial sector work. For example, the Fund has spent considerable effort on the broad topic of fintech in recent years without specifying to the Board its comparative advantage or focus in this space. We would thus welcome a closer look at how much staff time is being spent on broader fintech work versus enhancing core, macro-critical financial sector surveillance efforts.

Surveillance: The Board has long since endorsed the Fund’s global financial sector surveillance mandate, and the international community has tasked the Fund with assessing a range of critical financial sector standards. We appreciate the Fund’s efforts to date and expect staff to continue to be “ruthless truth tellers.” We strongly urge that the upcoming FSAP review not focus exclusively on one tool but evaluate more broadly how the Fund can most effectively and efficiently fulfill its macro-financial surveillance mandate using all available modalities – e.g., the FSAP, Article IVs, the GFSR, and capacity development.

While we think the FSAP program is generally working well, we are open to re-examining the perimeter and scope to maximize efficiency and even-handedness while ensuring that key risks to the global financial system are thoroughly covered. We think it will be important for the program to maintain a regular and thorough focus on a select number of the largest and most interconnected jurisdictions and focus on assessment of potential financial stability risks and post-crisis reforms. The IEO’s “S5” recommendation is a reasonable starting point for discussion, although careful analysis of the full list will be needed. Management and the Board must also consider the scope of these systemic FSAPs – both balancing the desire to hone in on key risks while still undertaking a comprehensive enough assessment so as not to overlook developing but difficult to discern risks, as well as leveraging the work from a jurisdiction’s prior FSAP and other standard setting bodies’ surveillance efforts.

Given the growing degree of interconnectedness of the global financial system and the difficulties of identifying risks ex ante, we think it would be a mistake to move away from mandatory reviews for the broader group of internationally or regionally systemic jurisdictions. We are open to examining the frequency, depth, and nature of these second tier, yet still mandatory, analyses.

A clear way to make the FSAP more effective – and help justify streamlining – would be to further strengthen the macro-financial analysis in

Article IVs. We appreciate the IEO's recommendation to integrate an expert from MCM on the regular surveillance teams for the largest and most interconnected jurisdictions. With greater financial sector expertise, Article IV missions could include more intensive follow-up of vulnerabilities identified in the FSAP, produce a deeper analysis of a special topic, or produce an updated assessment against standards if relevant.

Finally, the GFSR is an integral piece of the Fund's financial sector surveillance, and we agree with staff that the analytical chapters are highly valuable. We urge staff to maintain the analytical rigor of this product. Staff could also consider making the first chapter more focused on analyzing systemic risks of the major jurisdictions to complement and contextualize annual bilateral surveillance efforts.

Staff skills and retention: We appreciate the IEO's ideas to help increase staff's ability to analyze financial sector topics, including enhanced and mandatory macro-financial training programs for economists throughout the Fund. We are not convinced though that offering higher compensation to financial economists is the key to improving recruitment. The IEO report highlights other issues that deter recruits in this space, such as the lack of offers to qualified applicants, difficulties in integrating financial economists in area departments, and the lack of a robust career path. We look forward to discussing these issues more in depth in the upcoming HR strategy and compensation and benefits review.

Early Warning Exercise: We agree that wide dissemination of the EWE discussion would undermine candid discourse on out-of-the-box issues. That said, we recognize that there is often a disconnect for the Board, which is asked to weigh in on the initial concept but in most cases never sees the final product. We therefore urge management to debrief the Board on the key themes after the EWE, without attribution, so we could better assess how the discussion is integrated into the Fund's broader work and be equipped to provide more helpful feedback for future EWE discussions.

Mr. Mojarrad submitted the following statement:

We thank the IEO for the excellent evaluation, which offers a thorough assessment of the progress achieved in strengthening the IMF financial surveillance since the global financial crisis (GFC) and the launching of the 2012 Financial Surveillance Strategy, and puts forward insightful and constructive recommendations. We appreciate the extensive efforts that went into this evaluation, including the survey of views of country authorities, Executive Directors, and staff. We also thank the Managing Director for her statement and generally positive response to the IEO recommendations. Below, we address the evaluation's key findings and recommendations.

Key Findings

Our first take away is that the IMF has come a long way in strengthening its financial surveillance. Moving simultaneously on many fronts, it has reinforced the role of FSAP, including the mandatory stability assessments for jurisdictions with systematically important financial systems (S-29 countries), improved on macrofinancial risk assessment and policy advice in Article IV consultations, broadened the scope of multilateral surveillance, and effectively cooperated with the Financial Stability Board (FSB) and standard setting bodies (SSBs). Much progress has been made in the widespread use of stress tests, cross-border risk analysis, the mainstreaming of macroprudential tools, and the contribution to regulatory reform. Not surprisingly, this has elicited generally positive views from country authorities, the private sector, and partner institutions.

However, not all parts of this major undertaking have progressed as the same speed and with the same depth. As clearly laid out in the report, a number of bottlenecks have hindered both bilateral and multilateral financial surveillance, including slow build up of in-house expertise on critical financial sector issues, limited staff resources with the needed skills to carry out a rather ambitious agenda, uneven synergy between FSAPs and Article IV consultations, and weak policy traction of multilateral surveillance with many advanced economies. Moreover, financial surveillance, especially through the FSAP, has become cumbersome, costly, and less prioritized, whereas it should have moved in the opposite direction as many countries have addressed key financial risks and upscaled their capabilities in this area.

Important advances have been made in multilateral financial surveillance. The GFSR is now a well-established high-quality surveillance product that is appreciated by central banks and government officials. Some of the concerns expressed by private sector readers, including the tendency to cover too many risks and the lack of follow up on identified risks across reports, are worthy of consideration, as is the need for greater transparency with regard to the data used in the reports. The Semi-annual Early Warning Exercise (EWE), with presentations by both the IMF and the FSB, has provided a useful opportunity for select central bank governors and ministers of finance to discuss tail risks and emerging issues with potentially global stability effects. Although not fully integrated, the parallel presentations do generate a great deal of interest. Here too, there is significant room for improvement to enhance the traction of these products, which is addressed in the IEO recommendations.

Recommendations

While we take a positive note of the Managing Director's "support of the report's findings and suggested priorities", we note from her statement that implementation of some of the recommendations will be considered in the context of the 2020 Comprehensive Surveillance Review and the FSAP Review. We wonder, however, if there are some "low hanging fruits" among the recommendations that could be considered at an early stage to facilitate full implementation of Board-approved recommendations soon after the two reviews. Staff or the Managing Director may wish to comment.

Recommendation 1: Strengthening financial and macrofinancial analysis in Article IV consultations. This is a critical objective that should be pursued on continual basis. We concur with the need to strengthen the financial skills of Article IV missions staff by building technical skills in area departments and participation of MCM staff. Closer integration of Article IV consultations with the FSAP and greater focus on country specific circumstances would help enhance the effectiveness of surveillance and its traction. Notwithstanding the operational challenges in this area, as highlighted in the report, it could be helpful to have FSAP teams provide "periodic deep dives" to identify key risks and vulnerabilities, while Article IV missions would more systematically follow up on identified risks and vulnerabilities and related policies. We agree that greater involvement of country authorities and Executive Directors can be helpful in exploring issues to be covered by FSAPs in line with the current practice for Article IV consultations.

Recommendation 2: Refocusing FSAP country selection and scope. We note that making FSAPs mandatory for the S-29 countries, which was warranted in the immediate aftermath of the GFC, has led to diminishing returns as many countries upscaled their capabilities in this area, and the process has become cumbersome for some of them. We agree that mandatory FSAPs every five years should be limited to the S-5 countries, while FSAPs for other countries would remain voluntary and should be well focused and better tailored to country circumstances. This would inevitably shift more of the burden of financial surveillance for most of the current S-29 to Article IV consultations, which should be given significantly more resources in quantity and quality. Prioritization of FSAPs for all countries must be based on risk, value added, and local capacity to identify vulnerabilities and risks. In doing so, care must be taken to avoid that country selection becomes a de facto rating by the Fund of financial sector's strength in member countries.

Recommendation 3: Increasing the traction of multilateral financial surveillance. It is incumbent on the Fund to continually strive to enhance its financial surveillance through a variety of means and provide high quality analysis and well thought-out policy advice. The report's recommendations to strengthen the rigor and transparency of analysis in the GFSR, and more systematically take into account countries' specific circumstances, are sensible and can move the needle in the right direction. We also see merit in close collaboration with the FSB, SSBs, and the BIS, including for the coordinating of topics for the EWE presentation with the former. Still on the EWE, we are in favor of examining how best to communicate its analysis and policy recommendations to non-participating officials without undermining the confidentiality of the discussion during the presentations.

Recommendation 4: Enhancing the IMF's analytical tools. The Fund should continue to build its analytical skills and expertise in financial sector issues, as is well argued in the report and the accompanying papers. This will require devoting more resources to research and modeling of macrofinancial risks, and better access by Fund staff to granular data, including from G-SIFIs. While central banks in advanced economies have achieved notable progress in this area, the IMF could usefully draw on their expertise, rather than duplicate their work, while paying due attention to capacity constraints in other countries. Improving financial surveillance tools and making them user-friendly and available to "fungible" macroeconomists in area departments and MCM, as well as to country officials, would in our view, better serve the membership at large. That said, we support further analytical work on cross-border risk transmission channels, contagion from non-bank institutions, and selected fintech issues in response to the membership needs. Like the Managing Director, we are not sure about the feasibility of developing stress tests for the global financial system in cooperation with the BIS and FSB. On the suggestion to assess the impact of financial reform at the country level, we can support the assessment for relatively small and simple financial systems, while those for larger and more sophisticated ones would need to be examined from a cost-benefit perspective.

Recommendations 5: Building financial skills and expertise. Despite the progress achieved since the GFC, hiring and retaining of financial specialists and macroeconomists with financial skills remain challenging. The IMF must find the right institutional mechanisms to balance its needs for financial specialists and "fungible" macrofinancial economists in both MCM and area departments. We agree with the IEO that a starting point would be to develop and maintain a staff skills inventory to guide the deployment of talent across the institution and better manage hiring and training. Also making macrofinancial courses mandatory in the structured curriculum for all "fungible" macroeconomists would be a step in the right direction. While we support provision of adequate incentives and better career prospects for staff with specialized financial skills, we caution against the risk of undervaluing the contribution of core staff working on non-financial areas (fiscal, structural, and poverty issues, among others), whose skills are equally valuable for the Fund's work.

Recommendation 6: Increasing budgetary resources. The IEO report makes a convincing case that the resource envelope for financial surveillance, which is at about the level before the GFC, is inadequate and would need to be increased to achieve the Fund's strategic goals. We are pleased that in her statement, the Managing Director acknowledges this fact, and we concur that the issue should be taken up in the context of the IMF's budget discussions. That said, we stress the importance of giving the highest priority to Article IV consultations in the allocation of resources to financial surveillance.

Mr. Fanizza and Mr. Spadafora submitted the following statement:

Financial surveillance has become an integral part of the Fund's core activities. We thank the IEO for an excellent Evaluation, supported by an impressive set of analytical contributions. We also thank the Managing Director for her insightful statement and broadly share her views. The Evaluation's analyses and recommendations, which we largely support, provide high-quality inputs into the 2020 Comprehensive Surveillance and FSAP Reviews. The latter will constitute the proper venues for further, more informed discussions on many critical issues raised by the Evaluation.

The Evaluation covers the aftermath of the Global Financial Crisis (GFC), which marked the start of a new phase of the Fund's involvement in financial surveillance, notably by accelerating and broadening several initiatives toward an objective – making financial surveillance a core part of the Fund's activities – that was being actively pursued ever since the Mexican crisis of 1994-95.

We welcome the Evaluation's overall assessment that substantial progress has been made in achieving key milestones toward the objective of bringing financial surveillance to the same analytical rigor and effectiveness of macroeconomic surveillance. The multi-faceted initiatives undertaken in the response to the GFC – including the 2012 Financial Surveillance Strategy – have resulted in a relevant expansion in the scope, coverage and depth of the Fund's financial surveillance.

At the same time, the Evaluation clearly emphasizes that many efforts remain work in progress and that the quality and impact of the Fund's financial surveillance has been uneven. These recurrent findings depend to a relevant extent on the fact that, more often than in other areas, improving financial surveillance amounts to targeting a moving goalpost, given the rapidly changing nature of financial markets, intermediaries and products.

It is thus far from surprising that some of the Evaluation's recommendations, most notably on bilateral surveillance – e.g., better integrating financial and macroeconomic analysis as well as FSAP findings in Article IV reports; developing staff's financial skills and expertise, including in area departments – broadly echo the conclusions of past studies[3]. This confirms the relevance of the view that the quest for making the Fund a center of excellence in financial sector analysis is more "a marathon than a sprint", as recognized by the 2005 McDonough Report. The fact that the IEO recommendations "would not entail a major shift in the IMF's goals and strategy" (page vi) is consistent with this view.

Our overarching takeaway is that further progress on improving financial surveillance mainly depends on the adequacy of resources and expertise. Resources for financial surveillance have been back to the pre-GFC level (paragraph 17) and are uncertain going forward. The IEO is candid in underscoring that financial surveillance remains under-resourced, thus facing the Fund membership with the critical choice of whether to provide a significant increase in resources. At the same time, once one recognizes the existing constraints, efforts need to concentrate on better exploiting the synergies between the two key vehicles of financial surveillance, FSAPs and Article IVs.

Mainstreaming financial and macrofinancial surveillance in Article IV consultations should remain firmly at center stage for area departments to achieve the "driver's seat" status for financial surveillance, as recommended by the 2014 Triennial Surveillance Review. In this regard, we recall that the 2018 Interim Surveillance Review pointed to the risk of a stall in this mainstreaming effort.

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[3] C. Gola and F. Spadafora (2009), Financial Sector Surveillance and the IMF, IMF Working Paper No. 247.

We also stress the need for paying utmost attention to the Evaluation's finding that insufficient knowledge of a country's institutional framework is a key factor that undermines the quality of financial surveillance and its traction.

The unevenness in the quality and impact of the IMF's financial surveillance depends in part on some difficult tradeoffs. The Evaluation's recommendations should be properly heeded for their potential to help improve these trade-offs. While some of them are long-standing (e.g., depth of FSAPs versus frequency of Article IVs), new trade-offs may arise from the need to cover emerging macro-critical issues as well as emerging technology-related issues in finance (the Bali Fintech Agenda), which might amplify resource pressure.

The FSAP is a source of value-added for Article IV surveillance. The case study of IMF financial surveillance in Italy – which we have greatly appreciated – highlights that the 2013 FSAP shaped the discussions in subsequent Article IV consultations. At the same time, the tension underscored by the Evaluation between the perceived diminishing value of FSAPs and the increasing administrative burden for the authorities (and the Fund) needs to be addressed. In this regard, the Evaluation provides useful insights on the factors that have hindered the value-added of FSAP assessments. There seems to be a potential for meaningful and likely low-cost improvements, notably during the preparatory work preceding FSAP missions, including a better focus on identifying key issues, risks and vulnerabilities.

On Recommendation 2, we share the underlying principle of achieving a more risk-based allocation of FSAP resources. This is in line with our emphasis, reiterated at the time of the 2018 Interim Surveillance Review, on the importance of complying with the principle of risk-adjusted surveillance. We thus look forward to discussing the options for modifying the criteria for allocating FSAP resources, including a possible revision of the list of countries subject to a mandatory FSAP, in the broader context of the 2020 FSAP review. The IEO's call for the Fund to focus on developing stress test techniques in areas where it has comparative advantage is a valid one. In the same vein, the value of FSAP stress tests in validating the authorities' own exercises should not be underestimated.

The Evaluation confirms that improvements in financial surveillance rest to a notable degree also on organizational and human resources factors.

Building adequate financial expertise is a perennial of the Fund's involvement in financial surveillance. Financial sector experts have trebled since the beginning of the GFC and now constitute about half of MCM professional staff. This notwithstanding, the Evaluation finds that expertise to analyze macrofinancial linkages is scarce and that financial sector skills remain located mostly in MCM, echoing the findings of previous stock-taking exercises. We share the view that substantial progress may come from developing financial expertise by training fungible macroeconomists, including through on-the-job experiences. Further benefits can come from better integrating RES and MCM research agendas and from more effectively disseminating the financial knowledge and analytical tools to area departments.

It is somewhat surprising that despite that many gaps have long been identified, remedial measures have been undertaken only recently (development of a structured training curriculum on macrofinancial analysis) or remain at the planning stage (establish a career track for financial sector experts in the context of the new HR strategy).

Mr. Kaya and Mr. Stradal submitted the following statement:

We thank the Independent Evaluation Office (IEO) staff for their comprehensive and well-written set of reports on financial surveillance, which is one of the core competencies of the IMF. The evaluation is timely as it has important implications for a number of upcoming Board deliberations in 2019 and beyond. We call on staff to draw on the relevant conclusions of the evaluation in the context of the Comprehensive Review of Compensation and Benefits, HR Strategy, FSAP Review, Comprehensive Surveillance Review, as well as the Medium-Term Budget.

Our Chair has on many occasions pointed to the trilemma of expanding the Fund's remit under a constant overall resource envelope, while preserving the expected quality of work in areas that this institution has been traditionally tasked with. This IEO Report repeatedly identifies the budget constraints preventing the Fund from effectively conducting its financial surveillance in a risk-based way that serves its broad membership. We recall the Board discussion on the Fiscal Year 2019 Budget last April when staff stated that the emerging agendas do not present a significant burden on the Fund's resources with the caveat that the estimates do not include the costs of work on these topics outside of the pilot cases. As the IEO Report states that the attention to financial surveillance has increasingly competed with a variety of demands in recent years, we are of the view that the bulk of the resource demand stemming from these emerging issues does indeed come from outside of the pilot cases. The Executive Board should be adequately informed on the resource implications of the Fund's expanding coverage of emerging issues. While recognizing other dimensions of the Fund's surveillance, we see a clear need to refocus on the prioritized areas. In this vein, we are encouraged by the Managing Director's broad support for the IEO's recommendations, including the acknowledgement that strengthening financial surveillance requires adequate resources.

We broadly concur with the IEO's assessment and recommendations and offer the following comments:

Recommendation 1: We fully agree that Article IV surveillance would benefit from improved coverage of financial and macrofinancial issues, as well as from better integration with FSAP surveillance. This is a recurring important issue and a deep-dive analysis of the Fund's less than satisfactory performance may be needed. We support efforts to staff Article IV teams with MCM experts for countries where heightened macrofinancial risks have been identified or where an FSAP mission took place recently to ensure an appropriate follow-up on FSAP recommendations. We also encourage richer interaction between the FSAP team and the Article IV team ahead of an FSAP mission to improve the understanding of country specific circumstances and institutional developments. Staff rotation is an important factor in this context which also merits a serious rethink.

Recalling the recent Board discussion on the Managing Director's Statement on the Work Program of the Executive Board, we also would like to highlight the relevance of the integrated policy framework process which looks at the interaction between monetary and macroprudential policies, capital flow management measures and foreign exchange policies. We reiterate our view that incorporating the broader perspective would serve the membership well in dealing with external shocks and their impact on domestic real and financial sectors.

Recommendation 2: We fully support refocusing FSAP country selection and scope, which will require a rethinking of the underlying methodology as well as of the network analysis currently used for defining the systemic importance. Overall, we stand ready to support a significant reduction in the number of systemically important jurisdictions subject to mandatory FSAPs every five years. This would free up resources for countries not currently classified as systemic which suffered from a lack of available resources dedicated to FSAPs. We support efforts towards a more risk-based allocation of limited resources. An important source of savings could be generated by streamlining FSAPs in Euro area countries based on the findings of the recently completed Euro area FSAP. Two key planks of the FSAP – bank supervision and bank resolution – are no longer a primary responsibility of the national authorities for systemic institutions that can be a source of contagion, while regulatory harmonization in the non-bank parts of the financial sector is advancing.

We take note of the positive impact which FSAPs had in many systemic jurisdictions where it helped to upgrade the authorities' own risk monitoring and risk mitigation frameworks and we acknowledge the diminishing returns from repeated FSAPs over the past decade in some jurisdictions. On the specific issue of banking sector stress testing, we support a streamlined approach where warranted. However, we stress the need for the Fund to be able to conduct effective and evenhanded surveillance across its full membership. In this vein, it should be solely staff's thorough judgement which determines the scope and extent of its own stress testing and countries should not be grouped in this respect based on simplistic criteria, such as advanced vs. emerging economies. The country authorities can significantly improve the outcomes of the stress tests by providing sufficiently granular data in line with domestic legislation and data protection.

We look forward to discussing these issues in the context of the FSAP Review.

Recommendation 3: We welcome the finding that IMF work on multilateral financial surveillance is well regarded and influential. We concur that the right balance is generally struck between voicing concerns and taking care not to heighten market instability, and that assessments are often more candid as staff does not directly interact with country authorities. Obviously, there is always room for improvement. We support efforts to improve transparency of the applied models, as well as transparency concerning how various metrics used are put together.

At the same time, we caution against both too academic perspective and excessive simplification of the Global Financial Stability Report (GFSR) presentation motivated by improving the readability and enhancing its influence. The narratives of the GFSR are inherently nuanced and staff should strive to present them as such, with a view to be useful for policy makers.

On the Early Warning Exercise (EWE), we appreciate the relevance of the content and thought-provoking nature of the exercise. We, nevertheless, believe that the traditional risk factors stemming particularly from global monetary policy normalization, growing indebtedness, and oil price fluctuations, still account for the bulk of the stress mounting in many economies. The IMF, therefore, should not lose its focus on these usual suspects neither in its operations nor optically in its communication efforts.

Recommendation 4: We broadly agree with the recommendation that the Fund should expand research on issues within its comparative advantage, particularly on models to analyze macrofinancial linkages and cross-border spillovers. In this vein, we believe that the current staff's emphasis on cross-border spillovers have been predominantly concentrated on the spillovers from major advanced markets to the rest of the world. While we appreciate such analyses, we also see merit in further extending the scope onto the spillbacks from the rest of the world to major advanced markets, as well as regional spillovers as pertinent.

Recommendations 5 and 6: We are concerned by the IEO's overall judgement that financial surveillance remains under-resourced given its centrality to the Fund's mandate and the membership's desire to strengthen the Fund's capacity for high-quality work in this area. In light of the accompanying analysis, we view hiring and retaining experienced experts with deep knowledge of the financial sector and enhancing the cooperation and knowledge sharing between the Article IV and FSAP missions as two major priority areas. We would appreciate first steps towards addressing them already in the context of the next fiscal year budget which will be discussed by the Board in the next few months. We also underscore the need to take these considerations duly into account during the Comprehensive Review of Compensation and Benefits.

Mr. Beblawi and Ms. Abdelati submitted the following statement:

We thank the IEO for a comprehensive set of reports that take an in-depth look at the state of financial surveillance by the Fund. The report highlights the substantial upgrade in financial surveillance work since the Global Financial Crisis and suggests areas for further improvement. We also thank the Managing Director for her statement that appreciates the work of the IEO and offers broad support, sometimes qualified, for the specific recommendations. We broadly concur with the IEO's recommendations, and trust that it will be possible to incorporate most if not all the suggested changes, and support allocating adequate budgetary resources. We offer the following specific comments.

We agree with the desirability of further strengthening macrofinancial analysis in Article IV consultations, and closer integration with the FSAP. This would call for further developing the skillset of country teams. There may be some merit in the proposal to produce a template for financial stability assessment and monitoring, based on the FSAP to be followed up by Article IV teams. However, it is not entirely clear how this differs from current practice.

We support the proposal to streamline resources by moving away from a mandatory assessment for each of the S29 identified countries and adjusting the scope in line with country circumstances. We support the proposed alternative approach of maintaining the mandatory five-year FSAP for the 5 most systemically important countries (S5) while proposing a rolling list for 2-3 years in work program discussion. This would allow wider and more risk-based country coverage. The "Response to Recommendations" raises the concern that some stress tests conducted by the authorities in advanced countries vary in quality and in ambition, and that the Fund's independent stress tests have continued to add value in many instances. We seek clarification on whether the value added of higher quality would not be obtained, and resources preserved, if Fund staff participate, early on, in the design of specific stress tests and discussion of their results, without the need for conducting the stress tests themselves. Like others, we believe the Fund should be sensitive to the administrative burden on country authorities related to exhaustive data requests, which should be balanced with potential added benefits.

Regarding multilateral surveillance, we take positive note that the report considers the GFSR and the EWE as leading sources of insights on the outlook and risks to the global financial system. We see the rationale to have EWE key messages disseminated more broadly among senior authorities in member countries (as many do not attend the EWE exercise), but we recognize the need to respect strict confidentiality of the EWE meeting. We see scope for the Fund to increase its contribution in multilateral surveillance for example by enhancing collaboration with international partners. The Fund has had important contributions to the development of the global regulatory agenda and monitoring its implementation, and it would be desirable to continue to strengthen this contribution to the extent feasible, including in terms of analyzing cross-border transmission channels. We see scope for the Fund to increase its contribution by collaborating with other international institutions on the impact of regulatory reforms at the country level. We would appreciate staff views.

We fully endorse the recommendation to further enhance the IMF's analytical tools and to strive to be a global center of excellence. We agree that streamlining and simplifying some of the existing tools is desirable to make greater use of them by staff. We also agree that the Fund should focus more on developing tools in the areas of strongest comparative advantages, namely cross-border macro-financial linkages and global or regional aspects/spillovers of stress testing. We recognize that this is an ongoing endeavor, and it may be one of the areas affected by resource constraints. In this regard, we see a need to attract and to retain financial talent. The Fund lost a large part of its expert talent in the 2008 restructuring, and some of this experienced talent was replaced by new recruits that have a narrower knowledge (on the country of origin) and need more training and exposure. The Fund may want to consider reaching out more to experts with broader knowledge, including those with prior Fund experience. We look forward to consideration of incentives, including enhancing career paths, for financial experts as part of the HR strategy and compensation review.

We recognize that addressing all the recommendations, to allow the Fund to better fulfill its mandate, will entail resources. We look forward to the budget discussion, which should prioritize the need to make IMF Financial surveillance more effective, and we recognize that the IMF is well placed to make members aware of financial stability risks and advise on policies tailored to their circumstances. The budget envelope should be adjusted to adequately allow us to effectively deliver on this important core function.

Mr. Lopetegui, Mr. Di Tata, Mr. Morales and Ms. Moreno submitted the following statement:

We thank the IEO for a comprehensive and well-written set of papers on IMF Financial Surveillance and the Managing Director for her thoughtful statement.

We concur with the IEO's view that recent efforts have delivered a substantial upgrade of the Fund's financial surveillance work. The FSAP has focused on systemically important jurisdictions (the S29), providing high-quality country assessments; Article IV consultations have paid increased attention to macrofinancial linkages; and staff has contributed to developing a broad range of diagnostic tools, as well as exploring and disseminating new policy approaches and innovations across the membership.

Notwithstanding clear and significant progress in these areas, we share the views expressed in the IEO evaluation that the Fund still faces a number of challenges to improve the quality and impact of its work on financial surveillance. In particular, the expansion of financial surveillance activities has resulted in difficult trade-offs, with resource constraints limiting the build-up of the required expertise. As a general point, we agree with the Managing Director that the issue of strengthening financial and macrofinancial surveillance and related IEO suggestions deserves thorough consideration in the context of the upcoming FSAP and Comprehensive Surveillance reviews, the Comprehensive Compensation and Benefits Review, and the HR Strategy.

Against this backdrop, we have the following initial reactions to the IEO recommendations:

Recommendation 1 – Strengthening financial and macrofinancial analysis in Article IV surveillance: To improve the relevance and traction of bilateral financial surveillance, the IMF needs to deepen financial and macrofinancial analysis, particularly in Article IV consultations, including by taking practical steps to better integrate FSAP analysis in Article IV consultations and by increasing financial skills and expertise among staff.

We concur on the importance of improving the integration of FSAPs and Article IV consultations through a better coordination of both processes. We also agree on the need to increase MCM support to Article IV teams but, given the budgetary constraints faced by the institution, we think that any such increase should be limited and targeted to countries with financial vulnerabilities that could have serious contagion implications, paying special attention to providing the right fit for the task at hand (a condition that is not always satisfied). To enhance integration, we strongly recommend adhering to the practice of having FSAP and Article IV teams share senior members, with FSAP mission chiefs participating in Article IV discussions. Regarding the allocation of resources, footnote 18 of the IEO report provides examples of an imbalanced allocation of MCM staff to area departments, which suggests that there is room for improvement in this area.

We also believe that improving financial analysis in Article IV consultations requires further substantial efforts to develop the required skills through training. In this regard, we are somewhat disappointed that only about a quarter of area departments' fungible macroeconomists have attended the Structured Training Curriculum (SC) on macrofinancial analysis offered by ICD, which suggests that adequate incentives are not in place. We are of the view that completion of the SC in this area should be mandatory and subject to evaluations, and that it could become a prerequisite for promotion to senior economist.

Recommendation 2 – Refocusing FSAP country selection and scope: The IMF should revisit the current approach to allocating FSAP resources to achieve a more flexible, dynamic and risk-based allocation across countries and issues.

We broadly concur with the IEO proposal for a more flexible and risk-based approach to FSAPs, and for limiting mandatory Financial Stability Assessments to the S5. We concur with the IEO report that the selection process for the allocation of the resources freed by this decision should seek to strike a proper balance between evenhandedness and transparency, risks and vulnerabilities, and the voluntary nature of FSAPs for most member countries. We would also welcome any suggestions to limit the scope of FSAPs for advanced countries to those areas that are absolutely essential, guided by the countries' own periodical Financial Stability Reports, which are produced by many, if not all, S29 jurisdictions (these reports are not mentioned in the main IEO paper). Regarding stress testing, we tend to agree with the Managing Director's position that the Fund's independent tests are an integral part of bilateral surveillance. However, there might be scope for determining the need for stress testing on a case by case basis, relying on the authorities' tests only when they are of high quality and/or using the authorities' models to test alternative scenarios.

Figure 3b of the IEO report shows that about 130 non-S29 countries had FSAPs completed more than five financial years ago or never had an FSAP. Could staff provide some information as to how many of these countries present vulnerabilities that could lead to serious contagion effects at global or regional levels, if any? On a related matter, could staff elaborate on the role played by Financial System Stability Reviews (FSSRs) and the Financial Stability Reports prepared by member countries and the extent to which these instruments can help address, in part, the unmet demand for FSAPs? The IEO report notes that a 2017 staff assessment of the quality of macrofinancial analysis in pilot cases related to the mainstreaming initiative found a small deterioration in quality as the number of countries increased from 2016 to 2017. To what extent is this related to competition from other pilot programs underway in area departments?

Recommendation 3 – Increasing traction of multilateral surveillance: The IMF should continue to work to enhance the impact of IMF multilateral surveillance by increasing rigor and transparency, and by deepening collaboration with international partners.

We agree with the conclusion presented in the IEO report that multilateral surveillance is generally well regarded and influential, but that there still room to enhance its impact. We also welcome the efforts made in recent years to ensure that messages in the GFSR are broadly consistency with the WEO and the Article IVs of the S29. Looking forward, we encourage staff to continue with its efforts to strengthen the GFSR's analytical rigor and transparency, develop closer connections between the financial stability overview in Chapter 1 and the analytical chapters, improve readability, and avoid factual errors or misunderstandings when discussing country-specific issues. We also support the proposal to make GFSR background material available online.

We welcome the important contributions made by Fund staff to the post-crisis regulatory reform process, including by providing a global perspective of macrofinancial risks. We broadly support the proposal to deepen collaboration with international partners, including the FSB, without compromising the Fund's capacity to raise out-of-the box concerns. Moreover, we agree with the IEO that, with due regard to resource availability and working closely with other partners, the Fund could play a greater role in assessing the macrofinancial effects of reforms at the country level, as well as the cross-border and global impact of regulatory changes. At the same time, we concur with the Managing Director that further dissemination of the EWE would weaken its effectiveness.

Recommendation 4 – Enhancing the IMF analytical tools: To enhance the value of its surveillance, the IMF should strengthen efforts to be a global center of excellence on financial and macrofinancial research.

The IEO evaluation found that the Fund has made important contributions in macrofinancial modeling, indicators to monitor financial risks, and tools for stress testing. However, IMF macrofinancial modeling has not advanced as quickly as in several AE central banks. Moreover, effectively using the growing battery of indicators to monitor financial risks at global and country levels has proven a challenge, and many of these tools are not applied consistently.

We take positive note of the ongoing efforts to broaden the application of the Growth-at-Risk framework and the development of models to study specific issues related to the intersection of macroeconomics and finance.

However, we agree with the IEO that it is difficult for the Fund to keep up with the research on macrofinancial modeling being conducted by the central banks of AEs, given the larger amount of resources available to these institutions. Consequently, we tend to agree with the IEO that the Fund should seek to focus its research resources on areas of comparative advantage, such as tools for assessing cross-border transmission of shocks and stress testing based on publicly available data. At the same time, we concur with the IEO that there is a need to streamline and better disseminate best practices and analytical tools. This would also require enhanced training and better interdepartmental cooperation.

We agree with the Managing Director that the proposal to conduct global stress tests in partnership with the BIS and FSB, although interesting, does not look feasible at this stage because of the data constraints acknowledged in the IEO report.

The Fund should continue with its efforts to gain expertise on Fintech. The next step would be to decide where to concentrate the limited resources that are available, focusing on areas where the Fund has a comparative advantage to assist member countries.

Recommendation 5 – Building financial skills and expertise: The IMF should intensify efforts to attract, develop and retain a deeper pool of financial talent, as well as to ensure that area department fungible macroeconomists have the knowledge and support to integrate financial and macrofinancial analysis in Article IV consultations.

We agree with the IEO report that the efforts made in recent years to upgrade the Fund's financial sector skills and expertise, though significant, have been insufficient, which constrains the quality and effectiveness of financial and macrofinancial surveillance. Given the limited scope to upgrade these skills through recruitment, we concur with the IEO that future efforts should focus on training and on-the-job experience. In this regard, as already noted above, we are of the view that there is a need for a substantial change in the structure of incentives to encourage economists and managers to attach due importance to training. Regarding recruitment, given budgetary considerations, we believe that it should probably focus on hiring people with experience on Fintech and cyber security, which are emerging areas that require specific expertise. We agree that the HR Strategy should consider establishing an attractive career track and adequate incentives for experts, including financial sector economists, and should develop comprehensive data on the financial skills of staff. We welcome current plans to also consider the talent management challenges faced by the institution to strengthen macrofinancial skills in the context of the forthcoming Comprehensive Compensation and Benefits Review.

Recommendation 6 – Increasing budgetary resources: To fully meet its responsibilities and objectives, the IMF should consider devoting significant additional resources to financial surveillance.

The IEO report recommends a significant increase in the resources available for financial surveillance, with the highest priority assigned to strengthening surveillance in Article IV consultations. The recommendation is for a budgetary increase commensurate with the resources spent on the mainstreaming pilot, which would be allocated mainly to MCM and area departments.

Although we agree that the resources available for financial surveillance should be increased, we believe that there is a need to develop a detailed costing of the various initiatives, taking into consideration possible increases in efficiency. We also think that a substantial training effort is likely to be the most cost-effective way to enhance the staff's financial skills. Consideration should also be given to increasing reliance on financial experts under short-term contracts to assist Article IV missions, which are less expensive. Ultimately, as noted in the Managing Director's statement, the distribution of budgetary resources should be considered in the context of the discussions on the Fund's budget, taking into consideration the areas of the Fund's comparative advantage, medium-term trade-offs, and the strategic objectives defined by the Executive Board.

Mr. Agung, Mr. Shaari, Ms. Ong and Mr. Srisongkram submitted the following statement:

We thank the IEO for their comprehensive reports, and the Managing Director for her buff statement.

IMF financial surveillance has come a long way in the aftermath of the 1997 and 2008 financial crises. However, the process is far from complete as evident from the persistent shortcomings flagged in this evaluation, as well as last year's Interim Surveillance Review. It is also apparent that efforts to further deepen the Fund's work in this critical area are pushing up against increasingly binding resource constraints. In this light, we hope that upcoming medium-term policy reviews, including the FSAP Review, the Comprehensive Surveillance Review, and relevant Budget discussions will build on the IEO's findings as they seek to integrate, refocus and strengthen the Fund's financial surveillance efforts. In the interim, we urge management to consider quick-wins that can be achieved through gains in operational efficiency. We broadly concur with the IEO's recommendations and offer the following remarks for consideration.

Bilateral Surveillance (Recommendations 1 and 2)

We agree with the IEO that scarce FSAP resources could be better allocated both in terms of country selection and scope. Reducing the number of jurisdictions subject to mandatory FSAPs is one plausible solution, as is MCM's earlier proposal to lengthen the mandatory FSAP cycle for most systemic financial sectors. We look forward to seeing both options considered in the FSAP review. Should the IEO recommendation be preferred, we agree with the MD that the revised approach must ensure evenhandedness and transparency while also taking care not to generate negative perceptions for the selected countries. This calls for sound and transparent analysis to underpin country selection process. We invite the IEO to elaborate on the proposal to confine mandatory FSAPs to only the 5 most systemic countries, as the cut-off seems somewhat arbitrary. In addition, does the IEO envisage that the systemic importance of a jurisdiction would be a factor in determining the rolling list under their proposal?

We also agree that the scope and focus of FSAPs could be more selective to deliver greater value. We recognize that the Fund's FSAP stress tests may seem duplicative and burdensome for authorities that already conduct sophisticated stress tests. Nonetheless, we share the MD's sentiment that Fund stress testing remains valuable, even if only to independently validate the authorities' stress testing results for the benefit of the global community. More broadly, we also see merit in having a sharper focus on emerging risks and issues on which the Fund can offer a cross-jurisdictional perspective to complement the authorities' work. Aside from refocusing FSAP scope, we strongly encourage staff to also find pragmatic ways to secure efficiency gains in the conduct of FSAPs. This could include better information sharing by Article IV teams with their FSAP counterparts to reduce duplicative information requests, streamlining questionnaires, and leveraging technology to reduce the number of man-hours spent on missions. We also echo the IEO's view that FSAP recommendations must be anchored in the country context and not be solely based on a mechanistic application of international "best practices".

Given the infrequency of FSAPs for most of the membership, Article IV consultations must serve as the primary vehicle for macrofinancial surveillance. The IEO's finding of uneven surveillance quality across Article IV reports dovetails with ED survey results from the Interim Surveillance Review. This underscores that Article IV mission teams need adequate access to practical financial sector expertise in areas relevant to the characteristics of the country under surveillance. In the same context, there may also be value in having more year-on-year continuity in MCM staff that participate in Article IV missions. Page 16 notes a decline in analytical quality in the later stages of the macrofinancial exercise, as pilot phase resources were withdrawn and other pilot programs posed competing demands. We wonder if this suggests that the resource costs of new workstreams in 'emerging areas' might have been underestimated. We invite management's comments please. Where FSAPs are conducted, we agree with the IEO's recommendation to better integrate what are currently two discrete processes. More active and early involvement of Article IV mission chiefs and inclusion of country desk economists in the FSAP team would foster greater continuity and deeper country knowledge. With regard to post-FSAP follow-up, we agree that a financial vulnerability matrix could help guide subsequent Article IV surveillance. That said, it should not perpetuate a prescriptive tick-box approach, nor foster overreliance on backward-looking templates and metrics. Can IEO elaborate on how this could be ensured?

Multilateral Surveillance (Recommendation 3)

The Fund should build on existing achievements in multilateral surveillance by further enhancing the Global Financial Stability Report (GFSR) and the Early Warning Exercise (EWE). With its universal membership and analytical capacity, the Fund is in a unique position to advance multilateral surveillance, in collaboration with other international organizations. On the GFSR, we agree that Chapter 1 offers a rich but dense conjunctural narrative, and support the recommendations to enhance its digestibility and data transparency. We also feel that the GFSR's analytical chapters raise the profile and reach of MCM's research and are highly valued by authorities. In this regard, we invite management's comments on the IEO finding that "reducing the number of analytical chapters is a step in the wrong direction". On the other hand, the EWE was established to "connect the dots" between different risks, understand their systemic impact, and facilitate downstream policy discussions.[4] The EWEs today (especially the IMF presentations) are undeniably thought-provoking, but the FSB and IMF

[4] The IMF-FSB Early Warning Exercise: Design and Methodological Toolkit, September 2010.

presentations often seem disconnected and we are not fully convinced that it fulfils its original aim as a macrofinancial "flag-raising" exercise. We see scope for stronger integration between the FSB and IMF presentations, and a more structured mechanism for policy follow-up. We are also open to thoughtful ways of enhancing dissemination of the key messages of the EWE presentations, while taking care to preserve the strict confidentiality of IMFC discussions. It is important to preserve the Fund's flexibility to highlight long-term transformational trends, as it has done in some recent EWEs. We wonder if this can be done through a new discussion vehicle so as to allow the IMF's EWE contribution to more closely complement the FSB presentation? More broadly, when will the Board be able to discuss options for enhancing the effectiveness of the EWE? Finally, on the theme of multilateral surveillance, we would like to see the IEO consider more directly whether bilateral surveillance products adequately discuss outward spillovers from systemic economies.

Analytical Tools and Resources (Recommendations 4 to 6)

We concur with the IEO that the Fund must continue to sharpen its analytical tools to enhance the value-add of its financial surveillance. We also join the IEO in stressing that the Fund should specialize in areas that play to its comparative advantage, while leveraging those of its international counterparts such as the FSB and the BIS. In this regard, we welcome the Fund's ongoing efforts to improve the understanding of macrofinancial linkages, develop and disseminate tools to assess financial risks, and build expertise and international support in areas of fintech.

Ensuring Article IV mission teams possess sufficient financial sector expertise will be key to improving value-add and traction of the Fund's financial surveillance. With financial economists and financial experts in short supply, we welcome the Fund's approach to upgrade the macrofinancial skills of its economists through in-house training and mobility programs. These ongoing efforts are pertinent given recruiting challenges and low staff turnover at the Fund. However, their benefits will only emerge over time as the necessary skillsets are put into use and honed on the field. Meanwhile, we agree with the IEO that the Fund will need to compete harder to attract macrofinancial experts. Given that the expertise required for financial stability assessment is likely to be found among mid-career central bankers with many years of experiences, providing an attractive career path will be key. Further analysis is warranted and we look forward to the CCBR discussion on how to address these challenges in meeting the growing needs of the membership.

We are open to considering an appropriate increase in the resource envelope for financial surveillance. We would like to once again reiterate the importance of continually seeking efficiency gains through process improvements. That aside, it is difficult to reconcile the post-crisis recognition of the importance of financial surveillance, with the finding that overall resources for this work are barely back to their pre-GFC levels. Hence, we would appreciate a comprehensive budget discussion considering the options and trade-offs of increasing resources for financial surveillance work. Specifically, we also agree with the IEO recommendation that any additional resources should first be aimed at strengthening macrofinancial surveillance in Article IVs.

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

We thank the IEO for this thorough and candid evaluation and the Managing Director for her helpful BUFF statement. We welcome that IMF financial surveillance has steadily improved over time. Nonetheless, the report underlines that significant challenges remain, in particular with respect to further improving the impact and value-added of IMF surveillance and advice. In our view, a more flexible and risk-based allocation of FSAP resources is needed to ensure greater value-added and cost-efficiency. A better integration of Article IV and FSAP work could also improve the timeliness and efficiency of financial surveillance. We also support further efforts to develop staff's financial skills. We have the following specific comments:

We agree with the continued need to strengthen the traction and timeliness of financial and macrofinancial analysis in bilateral surveillance, especially by better integrating FSAPs with Article IV consultations. Better integrating financial and macroeconomic analysis remains work in progress, notwithstanding the identified examples of best practice. We fully support that FSAPs and Article IV consultations should be more systematically conducted as parts of the same process, including through greater overlap in the composition of FSAP and Article IV mission teams. There is still a need to better coordinate the two exercises to avoid a duplication of efforts and information requests. We see merit in using Article IV consultations as an opportunity to discuss the scope of upcoming FSAPs with country authorities.

We also support refocusing FSAP country selection and scope to allow a more flexible, dynamic and risk-based allocation of FSAP resources. The FSAP has stimulated discussion and progress, but the marginal benefit of repeated FSAPs has diminished. Meanwhile, the FSAP remains a very resource-intensive exercise, both for the Fund and country authorities. We support maintaining the 5-year FSAP cycle only for the S5, as the current distinction between the S29 countries and the rest of the membership is clearly too inflexible. Nonetheless importantly, FSAP country selection should in any case follow an evenhanded process in which financial and macro-vulnerabilities are key criteria. Further, we agree that the scope and focus of FSAPs should be more flexible and better tailored to country circumstances to improve their value-added and traction. FSAPs should focus on the key areas of risks within countries and their financial sectors and move away from the observed tendency to aim at comprehensiveness. In particular, standards assessments should increasingly become more focused on areas in which (i) standards have changed, (ii) standards had not been fully met previously, and (iii) the authorities have achieved significant progress. On stress testing, we acknowledge the value-added of independent stress tests by the Fund, as well as its comparative advantage in analyzing cross-border linkages.

The Fund's efforts to build financial skills and expertise will be key to ensure that it provides value-added to the membership on financial and macrofinancial issues in the future. Building further capacity within area departments and skilling up fungible macroeconomists to conduct macrofinancial surveillance will be important. Area departments should take the ownership and responsibility for integrated macrofinancial assessments. Both the HR strategy and the Comprehensive Compensation and Benefits Review should look into incentives and opportunities for staff to acquire and use needed skills. Improvements in knowledge management and streamlining existing analytical tools to make them more user-friendly could also be beneficial. We also agree that deep financial expertise will be needed to continue providing useful advice to members in strengthening financial resilience. We thus would see merit in increasing mid-career hiring, in offering better specialist career paths for staff with high-level macrofinancial skills, and greater flexibility in terms of compensation.

Financial surveillance should be adequately resourced. We take note that the overall resources for financial surveillance are roughly at pre-GFC levels, which raises the question whether these are adequate to fulfill its expanded surveillance mandate with the adequate depth and rigor. Given the centrality of financial surveillance, we advocate reallocating and reprioritizing resources from other activities that are on the fringe of the Fund's mandate to financial surveillance. These resources should primarily be used to strengthen financial and macrofinancial surveillance in Article IV consultations, and to further develop staff's financial and macrofinancial skills. Furthermore, we believe that there is scope for using existing resources more effectively. In particular, the country coverage and value-added of FSAPs can be increased by making resource allocations more risk-based.

Ms. Riach, Mr. Ray, Mr. Tombini and Mr. De Lannoy submitted the following statement:

We thank the IEO for their comprehensive and timely report and the Managing Director for her buff statement. The past decade has seen major changes to the financial system, including new regulations, frameworks and supervisory structures. IMF surveillance must evolve with the systems it surveils. The IEO provide valuable insight into the experience to date. We broadly endorse their recommendations. Most importantly, we agree that properly resourced financial surveillance is critical to ensuring that the Fund delivers for its membership and that targeting these resources to areas with the greatest value added will increase the effectiveness of the IMF's financial surveillance.

Resourcing

We see it as critical that IMF financial surveillance is adequately resourced (Recommendation 6) given the importance of efficient and resilient financial systems to the Fund's mandate and the priority the membership has placed on this issue. We are particularly concerned that overall financial resources for financial surveillance seem to be barely back at their pre-GFC levels while the scope and complexity of the Fund's financial surveillance responsibilities has been increasing. We agree that the IMF should consider devoting significant additional resources to financial surveillance alongside a more efficient and value driven approach. We agree with the Managing Director that the budget discussion is the appropriate forum to discuss resource prioritisation and call on management to present alternative budget proposals, including possible ways to increase resources to financial surveillance in line with the IEO recommendation. We believe the Comprehensive Surveillance Review and FSAP review should also present costed options for managing these tradeoffs as we recognize meeting demand from non-systemic countries and providing proper scrutiny of systemic countries will require facing hard decisions about the overall budget for the Fund, as well as with respect to FSAP policy and surveillance policies more generally. To inform such a decision, we would be grateful for more information on what drives the large variation in costs for FSAPs.

Adequate resourcing includes adequate human resources. The IEO report rightly identifies that the skills and expertise of IMF staff are key to delivering financial surveillance (Recommendation 5). The report usefully outlines the experience to date and recommends areas for further progress. We emphasize the need to maintain momentum on these efforts, noting that progress has been slower than in many national authorities. We look forward to discussing this issue in the context of the HR strategy as part of wider efforts to build a diverse Fund workforce, including recruiting those with practical policy making experience. We agree with the IEO that recruiting a deeper pool of financial talent is part of the answer. Ensuring an attractive career path for these and other specialists is a critical piece of the solution. Continuing to develop the skills of fungible economists is also critical, particularly for embedding macro-financial analysis into Article IVs, and we welcome the recommendations in this area.

Bilateral Surveillance

Notwithstanding the clear improvements to financial surveillance over the past decade, we agree that there is significant scope for more risk-based targeting to areas where the value added is greatest. We see this as one of the most important conclusions of the IEO report and encourage staff and management to reflect on this theme in the upcoming reviews of surveillance and FSAPs.

Integration with Article IV

We agree that financial and macro-financial analysis in Article IVs for all member countries could be strengthened including through better integration with FSAPs (Recommendation 1). We see promise in ensuring that Article IV teams have access to sufficient financial expertise to allow them to meaningfully pursue financial stability issues. With sufficient expertise, Article IV missions could be used to scope upcoming FSAPs. We support shifting to a more risk-based perspective in allocating FSAP resources across the membership , and see this as complementary to and complemented by greater integration of macro financial surveillance into Article IVs.

Risk-based allocation of FSAP resources

Overall, reflecting developments in recent years, we agree with the IEO that there is scope for a “greater differentiation in scope and focus across FSAPs, to increase value added and make better use of staff and authorities’ time and resources” and that the “key goal must be to substantially increase the scope for a more risk-based allocation of FSAP resources”.

In particular, the FSAP does not need to yield an all-encompassing list of financial vulnerabilities and recommendations for remediation but needs to target the vulnerabilities where increased supervisory or regulatory attention is needed. Increasing value added need not mean the Fund's constantly taking on more tasks and we agree that ways should be found to streamline individual FSAPs while satisfying their main purpose. For example, we believe there remains scope to reduce duplication between similar processes undertaken by the Fund, FSB, standard setting bodies and national authorities.

In this light, we highlight four points:

First, the report rightly suggests that certain areas of financial surveillance need not be covered every five years. We see real value in the graded supervisory assessments, but if resource pressures are binding, they could include a set of key principles, applied consistently across country and then focus on a subset of issues where compliance has been least and/or changes have been significant. In this light, we consider the practice of limiting the assessment of the Basel Core Principles, or other sets of Principles, to a relevant subset to be sensible given the development in system wide regulation in recent years.

Secondly, we also agree with the IEO (Recommendation 2) that Fund staff could leverage more off the analysis and models produced by national central banks for the risk assessment. In countries that have their own sophisticated stress tests, there may be a case for FSAPs to focus on designing risk scenarios and reviewing the authorities' models rather than running their own separate stress tests. That said, whenever staff assess that the potential for adding significant value by running their own tests is material, they should do it.

Thirdly, we would suggest further focusing FSAPs on items with a pronounced relevance for the member country, and not be overly reliant on off-the-shelf 'international best practice'. In that light, we agree with the suggestion to strengthen ex ante outreach to the ED offices, as is the standard for Article IV assessments.

Fourthly, further streamlining can be achieved by focusing on emerging areas. In the past, the Fund has contributed to promoting stress testing as an indispensable tool of supervision. In a similar vein, the IMF should now use the FSAP to promote awareness for emerging vulnerabilities stemming in particular from climate change or cyber risk.

Frequency of financial surveillance

The proposed change in frequency for the mandatory FSAP contained in Recommendation 2 tries to address two concerns: (i) the burden on authorities; and (ii) the little attention to countries outside the S29, given resources constraints. While having different views about this specific proposal we share the following understanding: (i) this issue will be addressed in the upcoming FSAP review taking into account a holistic view about the overall adjustments in the program; and (ii) we must ensure that systemically important financial jurisdictions will continue to be monitored regularly, in order to avoid overlooking the emergence of vulnerabilities that could result in a crisis of systemic impact. As we are skeptical that reducing the frequency of bilateral financial surveillance is the best approach, we encourage management to fully explore options that would maintain the frequency of coverage of financial stability issues in the surveillance of systemically important financial centers and mitigate the underlying risk identified by the IEO. Therefore, within the risk-based approach, we would also welcome IEO comments on other options to increase efficiency and reduce burden of bilateral financial surveillance in each county.

Traction

We also see scope to increase the traction of bilateral surveillance. Prioritizing and tailoring recommendations could go a long way in leveraging bilateral financial surveillance. We also encourage staff to think creatively about how the analysis and recommendations are presented for impact among different groups (including the authorities, the rest of the membership, academics and market participants). This could include separately discussing FSAP and Article IV reports at the Board. In addition, we favor the creation of an easily accessible public database containing FSAP recommendations, underpinned by relevant sets of public data.

Analytical Toolkit

We also agree that the IMF should continue to sharpen its analytical toolkit and research (Recommendation 4). Proper identification of comparative advantages is critical, given resource constraints and the possibility of better exploring the synergies with other institutions (e.g., BIS, FSB, central banks, academia). The areas where we think it would be most fruitful to focus on in the short-term are cross border analysis, market-based finance and – building on recent Fund work – capital flows at risk.

Multilateral Surveillance

Lastly, the traction and transparency of multilateral surveillance could also be increased (Recommendation 3). For example, on the IMF/FSB Early Warning Exercise, one way to get more traction would be to have more policy follow up.

Mr. Raghani, Mr. Razafindramanana and Mr. N’Sonde submitted the following statement:

We welcome this discussion of the IEO Report on IMF Financial Surveillance and thank IEO staff for the candid, in-depth analysis of Fund’s work in this area. We greatly appreciate the recommendations on how to further enhance the quality, delivery and impact of Fund financial surveillance, recognizing the significance of past decade’s financial changes and the unique role of the Fund in promoting global financial stability.

We also appreciate the Managing Director’s statement which lays out views on each of the IEO recommendations, and note her broad support albeit caveats on some of IEO’s specific prescriptions.

General Remarks

We share the assessment that considerable progress has been made by the Fund in upgrading its financial surveillance work notably through the initiatives launched in the aftermath of the global financial crisis (GFC), particularly the FSAP on the 29 systemically important financial centers (S29), development of stress tests, various diagnostic instruments, the introduction of macroprudential tools, and their application to the broader membership. As background papers make evident, there is general satisfaction among end-users (country authorities and international institutions) with the quality of Fund’s financial sector analysis. We also welcome, among others, the traction of relevant Fund flagships (GFSR, EWE) and the improved expertise of Fund economists on financial sector issues.

We take note of the assessment that the improvements in Fund financial surveillance have been uneven. The IEO’s thorough analysis points to problematic trade-offs in this Fund activity (e.g. bilateral vs. multilateral surveillance; systemically important financial sectors vs. other financial sectors; financial surveillance vs. other surveillance activities) and slower acquirement of financial and macro-financial expertise than in other institutions mainly due to resource constraints. In addition, there is room to improve country-specific knowledge among staff teams.

Against this backdrop, and given the Fund's mandate and core responsibilities, we share the view on the need to further improve the effectiveness of its financial surveillance. In this regard, we support the IEO-recommended approach of refining priorities to meet evolving needs while complementing the ongoing work with additional initiatives to further strengthen Fund financial surveillance. While we see areas for fine-tuning, we broadly support these recommendations which are sensible and mindful of the need to consolidate the gains already achieved. We look forward to the upcoming Comprehensive Surveillance and FSAP Reviews, the HR strategy and the Comprehensive Compensation and Benefits Review as venues to address some of the recommendations. We underscore the resource implications of meeting Fund's financial surveillance responsibilities.

IEO's Specific Recommendations

Recommendation 1—Strengthening Financial and Macro-Financial Analysis in Article IV Surveillance.

We strongly support strengthening financial and macro-financial analysis in Article IV surveillance including through proposed practical steps to better integrate FSAP analysis in Article IV consultations and by increasing financial skills and expertise among staff. We see merits in the proposal for a new, more detailed financial vulnerability matrix in FSAPs to identify key risks and vulnerabilities, and in the suggestion to have Article IV consultations track these FSAP concerns. We welcome the Managing Director's indication that the upcoming FSAP Review and 2020 Comprehensive Surveillance Review will consider these proposals.

Recommendation 2—Refocusing FSAP Country Selection and Scope.

We support the recommendation to revisit the Fund's current approach to allocating FSAP resources with the aim of achieving a more risk-based allocation across countries, including through a reduction in the number of mandatory FSAPs. We concur with the proposal to focus mandatory FSAPs on emerging issues and on analyzing risks that may have received little attention in the past.

In countries that conduct sophisticated stress tests, we see merit in the IEO's suggestion to limit detailed stress tests to areas not covered by authorities and focus instead on reviewing their models and discussing test results, given resource constraints. However, we also note that the Managing Director does not concur with this proposal, pointing that “stress tests conducted by the authorities in advanced countries vary in quality and ambition”. In our view, the added value of the Fund’s stress tests should be assessed in the context of the upcoming FSAP Review, and a decision to limit or not stress tests in countries that undergo mandatory FSAPs should ensue.

We would like to emphasize the importance of a transparent, rules-based and evenhanded process for the selection of countries that would undergo non-mandatory FSAPs, as well as maintaining a balance across regions and levels of financial development. Our main concern, however, is that countries with relatively limited financial sectors would still have infrequent FSAPs, as rightly cautioned in the report. Given that the countries with limited financial sectors are mostly low-income members, we regret the absence of proposals to increase the frequency of FSAPs within this group of countries, with the view to help promote financial sector development. We would like to recall that for developing countries, FSAPs also include a financial development assessment component. While this component is the responsibility of the World Bank, FSAP assessments in LICs are conducted jointly by the IMF and World Bank.

Recommendation 3—Increasing Multilateral Surveillance.

We broadly support this recommendation. Given the concerns raised by the membership on the readability and complexity of the GFSR presentation, we agree that the material and empirical data used in this flagship work should be made publicly available online. This should be complemented by continuous effort to adapt and simplify the presentation.

We see merit in strengthening Fund collaboration with international partners to improve the quality of the EWE, keeping in mind however that this exercise should remain a Fund product. While collaboration with the Financial Stability Board (FSB) is somewhat successful, we agree that there could be synergies from greater coordination on the choice of topics without jeopardizing the innovative features of this exercise. Moreover, while there is a need to strike the right balance between expanding EWE dissemination and preserving its effectiveness, we concur with the IEO that the impact of the EWE could be enhanced by disseminating its message more than is currently done as only less than one-third of member countries have direct access to these presentations.

We take note of the benefits of stepping up the work with international regulatory agencies in assessing the impact of the global reform agenda. That said, given the large investment involved, we share the concern that such work should be mindful of possible divergence of views between the Fund and these agencies and continue to be contingent on resource availability.

Recommendation 4—Enhancing the IMF Analytical Tools.

We broadly support this recommendation, with some caveats. We agree that the Fund should adapt its analytical tools along with evolving global risks and meet the highest standards while responding to the need of transparency and usability by members. In this context, we welcome the substantial upgrade achieved in developing advanced analytical tools and bringing innovations such as the Growth-at-Risk (GaR) framework and the Global Macro-Financial Model (GFM) which, in our view, should enjoy wider dissemination.

That said, we also share the view that prioritizing will help better achieve the Fund's objectives. The institution should focus on areas of comparative advantage while leveraging collaboration with other international financial institutions on other relevant issues. Moreover, as the report mentions that the IMF lags central banks in macro-financial modeling and that its contribution to research on macro-financial issues could be strengthened, it is critical for the institution to close gaps in areas where its expertise and reputation could be at risk, including by deepening research. This entails additional resources.

Regarding analytical tools, we see merit in having a range of efficient specific tools applicable to various country circumstances rather than a unified framework which might not capture relevant risks. As for risk indicators, we agree that they should be streamlined and Fund analysis be based on core indicators to ease monitoring and increase the impact of Fund recommendations.

Recommendation 5—Building Financial Skills and Expertise.

We support this recommendation as we agree that developing and strengthening macro-financial knowledge and skills among country teams is key to ensuring that the Fund's financial surveillance role remains valuable in an increasingly advancing and innovating global financial landscape. In this respect, we appreciate Management's focus on this issue in both the HR strategy and the forthcoming comprehensive compensation and benefits review. We also commend the institutional efforts put through staff training and mobility initiatives, and the increased attention to both financial and macro-financial skills—including by hiring experts and enhancing the skills of country teams—and to departmental coordination in Article IV consultations. Attention should also be paid to incentives and career development for financial sector experts.

Recommendation 6—Increasing Budgetary Resources.

We agree with the need of allocating additional resources to financial surveillance to allow the Fund to meet responsibilities under its mandate. However, continued efforts will be critical to accommodate new priorities in a cost-effective manner. This can be achieved through resource reallocation and improved budget efficiency as highlighted in the 2018 Risk Report. However, the IEO analysis underscores that the budgetary envelop for financial surveillance, while increasing since 2012, has not kept pace with augmented Fund activity in this area. Going forward, we remain concerned by the diminishing scope for the Fund to meet its expanding activities in an effective way without compromising the overall quality and relevance of its work unless additional resource implications are drawn.

Mr. Mozhin, Mr. Palei, Mr. Potapov and Ms. Smirnova submitted the following statement:

We thank the Independent Evaluation Office (IEO) staff for the high-quality report with background papers on the Fund's financial surveillance. We concur with the IEO's findings that since the global financial crisis, the Fund has made significant progress in strengthening its financial surveillance. At the same time, the IEO and external experts participating in this evaluation see substantial room for additional improvements. We welcome the IEO's recommendations as a valuable input to the upcoming Comprehensive Surveillance Review (CSR) and the FSAP Review.

Resources

The lack of resources devoted by the Fund to financial sector work is one of the most disturbing observations by the IEO. Recommendation 6 calls on the Fund "to fully meet its responsibilities and objectives" by addressing this challenge. The lack of resources negatively affects the quality of the Fund's work. The IEO noted that many advanced economies' authorities, who had the privilege to collaborate closely with the Fund, no longer consider it to be a leading expert on financial stability issues (paragraphs 23, 24, 27, 28, and

31 of the report). The experts also cited a confidential memo from the MCM to Management highlighting the lower quality of macrofinancial surveillance in a broad group of members (paragraphs 33 and 34 of Supplement 1 on IMF Bilateral Financial Surveillance). Ultimately, the lack of resources devoted to financial surveillance puts at risk the Fund's reputation and undermines traction of its advice to the membership.

The IEO was explicit in stating that the lack of resources cannot be addressed only by reallocation of resources between the key three areas of financial sector work, including bilateral surveillance, FSAP, and technical assistance. The overall size of resources has to be increased. Similar to the IEO, we find it regrettable that the "resource constraints have slowed the needed build-up of financial and macrofinancial expertise and that financial surveillance remains under-resourced given its centrality to the Fund's mandate". We fully support recommendation 6.

Bilateral financial surveillance

We support the IEO's recommendation 1 that financial and macrofinancial analysis in Article IV consultations should be strengthened. The IEO recalled that, at the time of the 2014 Triennial Surveillance Review, the Fund decided to put a much stronger emphasis on the role of the Article IV consultations in financial surveillance. The intention was to put the area departments "firmly in the driver's seat for financial surveillance". We agree with the IEO that since the beginning of the pilot in 2015 staff's efforts to integrate macrofinancial analysis into Article IV reports have started to bear fruit.

At the same time, we agree with the IEO that the quality and depth of the IMF's financial surveillance in Article IV reports has been uneven, and in many cases it was assessed to be pro forma. Based on the evidence provided by the IEO and the Fund's previous discussions, we see a need to revisit the role of the area departments in financial surveillance and to significantly strengthen it, as it is already the case with fiscal and monetary policy issues. This would require a more active participation of MCM staff as a part of country teams and much more proactive dissemination of best practices within the Fund through knowledge exchange, training, and upgraded HR strategy. In this context, we believe that the second option presented in Supplement 2 "Assessing the FSAP" (paragraph 70) should be carefully considered within the upcoming CSR and FSAP reviews. Could the IEO staff elaborate on country cases seen as successful in the coverage of macrofinancial issues, in the absence of the recent FSAP, say, in the previous two or three years before the Article IV consultations?

This shift to emphasis on the more prominent role of the area departments in financial surveillance as opposed to excessive reliance on the MCM should be supported by other changes suggested by the IEO. We agree that the relatively slow progress is also affected by the overall budget constraints at the Fund, allocation of financial surveillance resources with overwhelming pressures from mandatory FSAPs assessments, insufficient coordination between MCM staff and area departments, remaining gaps in financial expertise of country teams, data limitations, and still developing analytical frameworks.

There is room to reallocate resources between FSAPs, macrofinancial surveillance in Article IV consultations, and technical assistance. The Fund should continue to move away from resource-intensive and infrequent FSAPs toward broader integration of macrofinancial surveillance into the Article IV consultations supported by a flexible provision of well-tailored and efficient technical assistance. Recent changes, including the move toward modular approach to FSAPs and the pilot on mainstreaming financial surveillance, were in the right direction. An approach anchored on the Article IV consultations would allow to focus on innovations and best practices in financial surveillance and to fully leverage the Fund’s comparative advantages and core expertise.

The IEO suggested to reconsider the role of FSAP by restoring its efficiency und usefulness for the IMF membership and by supporting a continuous dialog on the progress on FSAPs’ recommendations. The IEO evaluation reflects the diminishing role of FSAPs in S29 countries, including the Fund’s stress testing, over the recent years. At the same time, the use of FSAPs in S29 countries for providing a sounding board or a public validation of financial stability frameworks does not seem to be the most effective way of using the Fund’s stretched resources. At this stage, many central banks and/or supervisory authorities conduct regular reviews of their work by independent and reputable experts. These good practices can facilitate external validation of financial stability frameworks, if necessary. We see benefits in the IEO staff’s proposal to reduce the number of mandatory FSAPs to S5 (recommendation 2) and would appreciate additional comments on how the IEO came to this new number. The Managing Director in her BUFF statement appropriately reminded us about the need for evenhandedness and transparent criteria for the choice of a subgroup of economies for any specific objectives. We would also appreciate additional information from staff on the size of potential savings from implementation of this initiative. Could staff elaborate on any common practices used by the S29 authorities to validate their monetary and financial stability frameworks, including internal stress testing techniques?

Multilateral financial surveillance

The IEO report rightly reflects the increasing role of the GFSR and EWE in identifying and assessing risks to the global financial system. We welcome staff efforts to strengthen the analytical underpinnings and transparency of the GFSR. At the same time, we agree with the Managing Director that the EWE is designed as a strictly confidential exercise in order to raise outside-the-box issues and generate an informed exchange of views among the world's highest finance officials.

We commend the IEO staff for highlighting one of the proposals made by the G20 Eminent Persons Group on Global Financial Governance (EPG) to integrate the surveillance efforts of the IMF, FSB, and BIS by developing a global risk map of financial linkages and vulnerabilities (recommendation 4). Could staff elaborate on the pros and cons of this initiative?

Analytical framework

Given the complexities of macrofinancial linkages, expertise and modelling capacity at the Fund could be strengthened. The work in this area should be based on strategic considerations and positive experience of the leading central banks. In its macrofinancial modelling, the Fund should focus on particular areas where it has specific responsibilities and competitive advantage, while providing more value added to members.

The current range of risk indicators is impressive. We agree with the IEO recommendation to deepen the use of existing core indicators and to sharpen the overall focus on their effective use, rather than designing the new ones.

Many central banks have developed sophisticated stress tests, in part due to the fact that they have more granular data and more resources to deploy to this work. Indeed, standard stress tests for member countries could be limited to the cases when a country requests a stress test and is prepared to share data or when the mission chief for the country considers a stress test as a necessary element of surveillance. The Fund could focus more on unresolved issues, such as incorporating in stress tests non-bank financial institutions to better grasp systemic risks and to better capture interactions between different forms of risks. Non-bank financial institutions could include fintech firms in those countries where their activities are substantial. We also agree with the IEO recommendation that the work on global liquidity stress test would be of high importance and would allow to utilize a full potential of the Fund's global role.

Talent management

We agree with the IEO that the process of absorbing the cutting-edge expertise from external sources, as well as intensifying macrofinancial knowledge exchange within the Fund should be accelerated. This work requires additional efforts in training, tool development, and knowledge management (recommendation 5). The report highlights that salaries at the IMF are not competitive enough to attract staff with special, high demand skill sets. We note the IEO's opinion that the Fund needs to offer specialist career paths and financial incentives to economists. These challenges should be explored and addressed by the ongoing human resource initiatives, including the HR Strategy and CCBR.

Further improvements in the Fund's Knowledge Exchange should better support internal and, importantly, external dissemination of best practices in macrofinancial surveillance. Information should be provided to a broader pool of users on a continuous rather than ad-hoc basis. We continue to believe that the Fund should allow the authorities and other interested parties broader access to accumulated experience and the tools currently used by staff only. We call on management and staff to explore specific next steps to improve training and knowledge management in the area of macrofinancial surveillance.

Data access

According to the report, limited access to data remains an important barrier to the Fund's work on financial stability issues at the global and country levels. The lack of access to granular data on global systemically important financial institutions (G-SIFIs) prevents the deepening of the Fund's analysis of cross-border transmission channels in the global financial system, as well as impedes the assessment of impact from global financial regulation reforms. Supervisory data limitations in S29 countries have also contributed to the falling effectiveness of FSAPs and the Fund's stress testing. Could staff elaborate on the progress in implementing the Data Gaps Initiative? We would also appreciate staff comments on how the Fund can overcome data constraints in jurisdictions with systemically important financial sectors.

Budget constraints

The IEO's findings confirm our long-standing concerns about poorly justified emphasis on keeping the Fund's real spending constant. This mechanical approach leads to a situation where important work streams are not taken up or are neglected. While we agree that the Fund should remain cost-effective in assisting its members, the need for additional resources to financial surveillance should be accommodated by the increase in the overall budget or, if necessary, by the reallocation of resources from other areas. We agree that this issue should be addressed in the FY 20 Medium-Term Budget Process. Moreover, inadequate financing of the IMF's core functions may require a dedicated Board's session on these issues. Staff may want to comment.

Ms. Mannathoko and Mr. Tivane submitted the following statement:

This is an important and timely evaluation, and we appreciate the valuable assessment it provides. We thank IEO for the excellent work and commend management and staff on the significant progress made in strengthening financial surveillance.

We are largely in agreement with the conclusions of the IEO. They are consistent with the experience and perceptions of our constituency, and we see significant merit in pursuing the six recommendations provided. We also welcome the broadly positive response to the recommendations in the Managing Director's statement. In this regard, we are inclined to support management's concern on the issue of stress testing in recommendation 2. We believe it is important that the Fund maintain its own independent stress testing in the main systemic economies. With respect to budgetary resources for financial surveillance (recommendation 6), we believe that increasing these is an urgent imperative. Given the significant expansion in the financial surveillance work program for both Article IVs and FSAPs since the global financial crisis (GFC) alongside the advent of fintech and regtech needs, it is difficult to justify restricting resources in this core area to pre-GFC levels. The potential global cost of new systemic crises due to inadequate financial surveillance is too high to ignore. Regarding the early warning exercise, EWE (recommendation 3), we seek more information on the reasons for management's position on the restricted dissemination of EWE information. We provide some additional comments below on other issues of interest.

Bi-lateral Surveillance in Low Income and Developing Countries (LIDCs)

Attention to effective financial surveillance across the membership is important and the pilot program to support the mainstreaming of macro-financial analysis into Article IV consultations is widely appreciated. We urge staff to safeguard the robustness seen in the pilot programs and ensure that mainstreaming does not compromise the analysis, specificity (tailoring to country circumstances) and general quality in the programs.

We note that there has been a significant decline in FSAPs in non-S29 jurisdictions, at the same time that the need for new resources and expertise devoted to financial surveillance has increased in constituencies such as ours. This is a concern, given rising financial sector risks and new regulatory needs with the expansion of fintech, the withdrawal of correspondent banking relationships (impacting the cost of cross-border transactions) as well as the escalation of cyber-risks targeting LIDC financial balances. We note that as more stringent Basel requirements are applied to the banking sector, surveillance in many of our countries nevertheless fails to properly cover new developments and technologies in the non-bank financial sector. In some of our countries, however, we now see an increase in money shifting out of banks into the less regulated non-bank financial sector, generating new risks. Flows between countries are also growing as SSA moves towards increased integration. Efforts to improve macro-financial surveillance across both the bank and non-bank financial sector (including fintech) in LIDCs – and across regions - are therefore important. We encourage increased use of FSSRs to augment periodic FSAPs, as well as further efforts to update Article IV financial surveillance so it is in keeping with the times. We also urge focused support to LIDCs in their efforts to build the regulatory frameworks and payment systems development capacities that are required to tackle new challenges. Improved coordination with EDs offices in preparation for FSAPs would also help to support country ownership and improve traction.

On cyber-security preparedness, in-house analysis to date has been limited. We however note the AML/CFT work stream in the Fintech Agenda and that analysis by RES and MCM of cyber-threats to financial stability will become necessary. In the meantime, mission chiefs should be aware of Kopp’s 2017 working paper (Supplement 7, #8 and #29) and MCM should be able to provide a template guiding country missions on cyber-risks to the financial sector – with sample questions and country experience text-boxes and case studies.

Multilateral Surveillance and Systemic Countries

The IMF has still not crafted a solution to the underlying challenge of a global financial system that transfers the costs of major crises (attributable to private financial institutions) from the financial sector to governments (and taxpayers). This system is unsustainable – it contributes to global inequality by protecting wealth at the expense of poorer taxpayers globally and has contributed to reduced welfare and the social instability we now see globally. A new system is needed and the responsibility for that falls on our lap. At some point this will be an issue we have to take up in the GFSR or elsewhere. We encourage the Fund to pursue greater influence in the FSB at operational levels, in order to promote greater focus and traction in addressing current factors (such as channels and market behaviors) that could generate new global financial crises. On the GFSR and transparency, we too would encourage staff to make what data they can available, and to pursue greater transparency on the various metrics used, so that readers are able to judge their relevance and value.

Given the perception of diminishing value-added and impact from FSAPs in the main systemic economies (paragraph 24), there is clearly a need to rethink bi-lateral financial surveillance to major financial centers such as the US and UK and augment S5 work with research by top experts. While it is essential for staff to have ongoing engagement on new and old risks, stress tests and macro-financial issues in these economies, the IMF also needs to consider how it could best add more value. This could include work exploring behavioral economic solutions, and analysis encouraging good practice and limits in leverage etc. when risks are elevated; or it could cover the promotion of mechanisms to help monitor enforcement - as the literature shows that countries with less complex and better enforced regulations tend to have fewer (or no) crises.

Resources

Bilateral and multilateral financial sector surveillance is a core component of the Fund's mandate, therefore decisive efforts are needed to increase the resource envelope for these activities going forward. As financial surveillance issues and risks gain prominence with growing macro-financial challenges, cyber-risk expansion, digital money, fintech entrenchment, and new cross-border payments systems issues; the potential for new financial crises rises. However, we face a situation in the Fund where resources allocated to financial surveillance have barely recovered to pre-GFC levels, despite the emergence of these new challenges. An augmentation of financial surveillance resources and expertise and possibly a re-prioritization of resource allocations clearly has to take place sooner – rather than later. Regarding the definition used to identify systemic economies, like IEO, we believe a Board review of the S29 selection would be beneficial in better prioritizing financial surveillance resources. We are amenable to the IEO proposal to reconsider the allocation of FSAP resources provided surveillance in major markets of the main sources of systemic risk is not compromised, and the concerns outlined above are addressed. We believe these resource concerns will receive further attention in the context of the next budget discussions.

Financial Surveillance Expertise

In our constituency, those countries that get FSAPs derive a lot of value from them, examples being Kenya and Nigeria where the IMF has supported innovative work. More FSAPs are therefore welcome. With respect to Article IV missions, however, authorities have noted the inadequate financial expertise in teams and the difficulty in engaging on fintech and IT-related financial inclusion. They also indicate that the lack of traction in Article IV surveillance on some emerging and macro-financial issues arises because mission team expertise in these areas is in doubt. There is clearly a need to increase the financial sector expertise on Article IV missions.

As we have indicated in our previous comments relating to the ongoing review of the HR strategy, the review is an important window of opportunity to tackle the long-standing need to improve career paths, progression and incentives for specialized professional staff – including those working on financial surveillance issues. This is essential in order to attract, retain and deploy staff with specialized knowledge and skills in financial economics, fintech and the digital economy, and other areas related to the modern financial sector.

Omitted Issues

Finally, we note that missing from this financial surveillance discussion is the role of the IMF in curbing illicit flows channeled through financial systems, out of LIDCs. We would value IEO's perspective on this and comments from the Fund.

In closing, we would like to thank the IEO once again for a well written report and commend them on the informative and helpful background papers.

Mr. Villar, Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We want to thank the IEO for the comprehensive and in-depth analysis on IMF's Financial Surveillance and the Managing Director for her useful buff statement. The reports are clear and deliver high quality findings. While we support several of the IEO's recommendations, we wish to make it clear upfront that we consider that there are many details of these recommendations that require further careful discussion by the Board in the context of the upcoming FSAP and Comprehensive Surveillance Reviews, as well as reviews of the HR strategy and compensation policies.

After the global financial crisis, the IMF was tasked with a clearer and increased role for financial sector oversight, both at the bilateral and multilateral level. The Executive Board took a strategic decision to reinforce the central role in detecting vulnerabilities and promoting resilience. In this regard, we agree with the IEO that the continued efforts have been reflected in a substantial upgrade of the Fund's financial surveillance but that there is the need to further address several challenges to strengthen its effectiveness. While we acknowledge the enhancements to financial surveillance have yet to be tested in a crisis, it is timely for the Board to reflect on how we can assure the adequate resources for the IMF to deliver on these increased responsibilities and objectives.

Recommendation 1. Strengthening financial and macrofinancial analysis in Article IV surveillance. We support this recommendation.

We welcome the first recommendation and fully agree on the need to deepen financial and macrofinancial analysis in order to strengthen bilateral financial surveillance. We agree that Article IV consultations do not necessarily conduct a continuous follow-up on FSAP recommendations. For a better integration of these two processes, we agree that Article IV consultations are a good opportunity for the mission team and authorities to periodically discuss specific topics that merit attention in the next FSAP. This feedback from the Article IV to the FSAP could help bilateral financial surveillance be more timely and relevant and would benefit from country-specific knowledge. Moreover, a financial stability assessment template could be a good starting point for FSAP-Article IV integration. However, it should be considered that the template cannot be too rigid as vulnerabilities and risks are an evolving matter and engagement with the authorities in the identification of the potential risks must be fostered.

Synergies and integration between Article IV and FSAP should increase but being mindful to maintain the differentiation between these products. As stated before, we consider useful to have macrofinancial elements in the Article IV, but the potential risk of having the Article IV become a heavily financial oriented product, or a “mini-FSAP” should be avoided. Moreover, in the years in which the Article IV and the FSAP coincide, it will be necessary to clearly define how the analysis and work will be distributed in order to avoid overlap and coordination problems.

Recommendation 2. Refocusing FSAP Country Selection and Scope. We have reservations about this recommendation.

We do not support to change the current approach of having the S29 countries covered every five years by an FSAP. We can support to revisit, under the upcoming FSAP review by the Board, the different aspects of the FSAP process in order to make it more effective and flexible. Reducing the mandatory FSAP for the S29 is not a desirable strategy for IMF financial surveillance. We agree with the Managing Director that there are market signaling risks inherent in any selection of countries based on vulnerabilities. Additionally, given current developments in global liquidity conditions and possible changes to regulatory and supervisory frameworks in response to, among others, Fintech or shadow banking, it would not be advisable to exclude any country from the S29 group from periodic FSAPs. Finally, we believe that an expansion of the new FSSR diagnostic tool and closer cooperation with the World Bank should be considered to meet the demands for countries with a relatively less developed financial sector.

We support further work towards greater differentiation in scope and focus across FSAPs taking into consideration the authorities’ view of the areas which could deliver the most value added.

Regarding stress tests, the IMF should have the flexibility to adapt to country-specific circumstances and decide on the way forward. There is no one-size-fits-all model given the variety in institutional and regulatory contexts. We support a greater Fund involvement in discussing risk scenarios, but this should not be the only focus of the stress test agenda. An area where the IMF could play also an important role is as a third-party evaluator of the stress test methodology used by the authorities, an activity included in the best practices recently updated by the SSBs. As reported by the IEO, the IMF is in a unique position to make these assessments and present a truly global view of the best practices in stress testing across different jurisdictions.

Recommendation 3. Increasing Traction of Multilateral Surveillance. While supporting the overall recommendation we have some reservation.

We support the assessment that IMF's work on multilateral financial surveillance is well regarded and influential. Traction could be increased by the ongoing efforts to strengthen the analytical rigor and ensuring adequate recognition of country-specific circumstances. In particular, we support the call for an early engagement of country teams in order to ensure that content reported in the GFSR is correct and coherent with the Art. IV analysis.

We have reservations regarding the recommendations on the EWE process. While closer coordination should always be a goal, the nature and success of the EWE process comes from the IMFC discussing and assessing potential new risks in a candid and effective way. It would be challenging to increase dissemination of the EWE key messages while respecting strict confidentiality and taking care of communication aspects of the tail risks. The objective of is to have a timely and candid exchange of views regarding new developments and out-of-the-box ideas that could become important for policy purposes. Producing a public statement of key messages could defeat such purpose.

We concur with the MD that the current availability and different characteristics of data across countries makes it very difficult and costly to develop at this stage a cross-border stress test exercise. Efforts by the IMF could have more value added in identifying international contagion channels in cross border risk and in evaluating the post-reform impact assessment activities.

Recommendation 4. Enhancing the IMF Analytical Tools and Recommendation 5. Building Financial Skills and expertise. We support recommendations 4 and 5 and believe they are closely interlinked.

We agree it is complex for the Fund to develop cutting edge research or expertise on all topics, but it must leverage its comparative advantage to develop and enhance its analytical tools. The IMF could face an opportunity cost in the medium-term for not developing the necessary tools and financial skills, which may hamper the Fund's ability to provide good policy advice. Moreover, quick developments, for instance in the Fintech sector, illustrate the need for developing updated toolkits and expertise. Hence, it is important to give preeminence to the research agenda and make the necessary investment to be able to cope with present and future challenges.

In this regard, we consider that one of the Fund's comparative advantages is its engagement with the membership and other partners. The IMF must leverage on central banks and other IFIs to enhance knowledge sharing on cutting edge financial stability and macrofinancial analysis. Moreover, while some central banks and other official agencies have developed cutting edge tools and research, the IMF has a specific mandate and a global membership. It must be noted that many countries do not have the resources to develop this type of expertise and rely on the TA and CD provided by the Fund to identify and assess their financial vulnerabilities and risks. Therefore, the Fund must take advantage of its global role to keep updated with new tools, methodologies and research from countries and be able to disseminate this knowledge throughout the membership.

In line with what will be discussed in the forthcoming CCBR, there is scope to generate incentives for outside expertise to join the Fund with a career path that allows promotion, as well as encouraging fungible economist rotations to MCM or participation in secondments with central banks, other IOs or even the private sector, as on-the-job training can be useful to develop economists' expertise. Moreover, we agree that macrofinancial courses should be considered mandatory in the structured curriculum.

Recommendation 6. Increasing Budgetary Resources. We support this recommendation with some reservations.

We concur with IEO's assessment that significant additional resources will be needed to increase the IMF's capacity to fulfill its responsibility for high quality and effective financial surveillance. In fact, the IEO report clearly states that we are already late in many areas, losing comparative advantage to other institutions that have invested heavily. Nevertheless, our qualified support relies on the fact that this increase in resources cannot be attained by diminishing the resources of other substantive activities of the IMF.

A few years ago, the Executive Board took the strategic decision to upgrade the mandate regarding the IMF's financial supervisory activities. During the upcoming Budget discussion, we should take that into account in order to fulfill these objectives, including the possibility of increasing the overall budgetary envelope. We consider this to be one of the most important and strategic topics of the IEO report on Financial Supervision.

Mr. de Villeroché, Mr. Castets and Ms. Gilliot submitted the following statement:

We first wished to underline the great quality of this IEO report that has been very helpful in understanding the progress made by the IMF in enhancing one of its core function since the global financial crisis. We thus thank the IEO' staff for their very exhaustive and informative set of documents that demonstrate that the Fund has striven to give its membership a clearer oversight of financial sector vulnerabilities and macrofinancial developments. We agree with the global picture that some challenges remain to be overcome to make the surveillance more risk-based and efficient. Nevertheless, as the conclusions of this review not only affect the financial surveillance role of the Fund but are also interconnected with other upcoming reviews like the Comprehensive Surveillance Review and the FSAP review, some recommendations require careful consideration to fully understand their potential implications.

We nonetheless broadly share the IEO's appraisal that the quality and the effectiveness could be further enhanced especially since, with the experience of the crisis, financial surveillance and supervision has become to be deep-ingrained concept and priority in many countries. We concur with the IEO that more risk-based approach is required for both the Fund's bilateral and multilateral surveillance as well as a deeper analysis of the macrofinancial connections that link financial market development (both from a banking and nonbanking perspective), monetary policy and the real economy. Consistently with the latter, the Fund should enhance efforts to build-up a large and diverse talent pool.

This report and its supplements cover largely and in detail all areas of concern and ways of improvement. Due to the linkages with other critical issues, some of the following comments may be preliminary and not considered as definitive pending the conclusions of other reviews this year.

Bilateral surveillance

On FSAPs, we broadly concur with the IEO's conclusions on the need for a more dynamic, flexible, risk-based approach of these assessments. Greater differentiation in scope and focus across FSAPs should be given to increase value added and make better use of staff and authorities' time and resources. The best is the enemy of the good and, as emphasized many times in the past in our grays, we reiterate the need for the Fund not to duplicate the work done by other institutions, be they standards setters, monetary or supervisory authorities and focus on areas that have not been yet or insufficiently covered. This said, we note a tendency to reduce the perimeter of the assessments, progressively excluding the review of some internationally accepted standards like the BCP and the ICP. We wonder if this withdrawal is a sign of the difficulties for the Fund in catching up with newly emerging and rapidly changing issues and risks.

The IEO proposed a drastic change of the number of members covered by mandatory FSAP every five years. We clearly see merit in opening the discussion and share IEO's views that the current list does not meet the goal of focusing on the more systemic financial sectors, nor does it allow the best allocation of limited resources. Nonetheless, the selection of the S5 members as proposed is debatable as it excludes several important financial systems and financial centers from 5 years mandatory review process. Furthermore, the case of the coverage of Euro Area financial systems might have deserved a more in-depth analysis. Indeed, one could see the need for taking stock of the realization of the first Euro Area FSAP, a development this chair very much welcome, to reflect on what could be the right articulation between financial surveillance the Euro Area level and at the members' level. In particular, we would see merit in reducing more forcefully the risk of overlap and redundancy for financial risks identification in the Euro Area financial sector assessment.

We see an urgent need for ensuring a more even financial surveillance coverage among the membership thanks to the streamlining actions mentioned above. It is quite disturbing that a very significant number of members had no FSAP review done for the past 16 years or more. The rest of the membership should be given an opportunity to be in the list of countries for which FSAPs would be initiated during the following two or three years giving priority to countries with less capacity, where financial risks call for an assessment and that has not been reviewed for a long time. Moreover, the added value of FSAP reviews is higher, from a domestic perspective, for low income countries which are less susceptible to rely on other sources of financial expertise.

On stress tests, we largely favor a tailored coverage to country circumstances as recommended in the report. In countries where financial risks are fully covered by adequate regulation and supervision as it is the case in the Euro Area, national FSAPs' stress tests do not provide much value added while resulting in an excessive workload for both IMF's and authorities' teams. In the case of France, stress testing banks' solvency and liquidity or reviewing the Basel Core Principles 'implementation for Less Significant Institutions (LSIs) will have rather limited additional value compared to the conclusions of the Euro Area FSAP on the same issues. As the survey's results demonstrate, they moreover appear to be redundant with the exercises conducted by other supervisory bodies (at a national or regional levels) and entail the risks of incorrect communication and misleading interpretations of the results. Maintaining the regional level for the stress test in the Euro Area makes sense as a result of the integrated supervision of the Single Supervisory Mechanism and the ECB's centralization of individual banking data.

We fully concur with the recommendation to put more emphasis on the review of authorities' stress testing models and methodologies than on the duplication of more sophisticated stress tests locally undertaken. This recommendation rightly draws the lessons of the progress made by several supervision authorities since the financial crisis to develop more sophisticated and accurate stress testing tools. Nonetheless, it remains to be determined how this dialogue on the stress test methodology would be translated into FSAP reports concretely for the members concerned, in particular in cases where there would be no agreement between staff and competent authorities. Additionally, we wonder to what extent the resource burden on the staff would be alleviated since such reviews would also be time-consuming tasks. Comments from the IEO are welcome here.

At last, while the recommendation to develop global stress tests in partnership with the FSB and the BIS is interesting, over the question of its technical feasibility remains. In line with the MD's statement, we remain skeptical on the capacity of these institutions to solve accurate methodological and institutional problems that would stem from the divergences of their mandates, the access to data, countries' specificities and publication of results.

On FSAP-Article IV integration, an improvement is necessary as it would make it easier for staff to identify and ensure a more frequent follow up of financial stability risks. The Fund should seek to avoid the temptation of "one size fits all" approach of its financial surveillance. The financial expertise and implication of country desks' staff in the FSAP missions should be strengthened to better understand and consider country's specific assets and vulnerabilities in the FSAP analysis. Synergies could help avoid unnecessary additional costs by sharing techniques and templates used by the FSAP.

Multilateral surveillance

We concur with the IEO's recommendations on the need to increase traction, rigor and transparency of the GFSR and to deepen the cooperation with international bodies. Analytical and empirical approaches underlying the GFSR's analysis should be enhanced and made publicly available. We support the full transparency of data and methodologies as well as the consideration of countries' specificities reflecting an adequate understanding of the country circumstances. In this sense, we would greatly appreciate that national authorities' comments or responses be considered by staff and better integrated in the reports. We will however continue to monitor that this is case in the coming reports.

This chair has repeatedly advocated for a closer collaboration of the Fund with worldwide standard setters not only to provide a deeper analysis of macrofinancial and stability risks but also to avoid duplication of work, inconsistencies possibly blurring the global message sent to countries. In line with the IEO, we support an intensified cooperation with the international regulatory agencies to conduct deeper cross-border risks analysis, while paying attention to respect each institution's mandate.

Mr. Gokarn and Mrs. Roy submitted the following statement:

We thank the IEO for an informative set of papers on the IMF financial surveillance. We also thank the Managing Director for her statement on her views on the IEO's recommendations. The recommendations include: strengthening financial and macro-financial analysis in Article IV surveillance, refocusing FSAP country selection and scope, increasing traction of multilateral surveillance, enhancing the IMF's analytical tools, building financial skills and expertise and increasing budgetary resources.
We broadly concur with the IEO's recommendations.

In response to the GFC, the IMF launched many initiatives to strengthen financial surveillance in order to better advise member countries of vulnerabilities and risks and foster greater resilience. Though the efforts have delivered a substantial upgrade of the Fund's financial surveillance work, the quality and impact of the IMF's financial surveillance has been uneven. To rectify this, the IEO's recommendations, while not calling for a major shift in strategy, suggest that some new initiatives be combined with sustained efforts to build on ongoing work and a willingness to fine-tune priorities to meet evolving needs. We agree that making concrete progress will require providing significant additional resources – both human and financial – as well as taking steps to use existing resources more effectively.

In regard to Recommendation 1 on strengthening financial and macro-financial analysis in Article IV surveillance, the IEO has suggested taking practical steps to better integrate FSAP analysis in Article IV consultations and increasing financial skills and expertise among staff. A 2014

IMF report found that financial and macroeconomic analyses remain fragmented due to the tendency of fungible-generalist macroeconomists to see financial surveillance as an MCM responsibility, and for MCM experts to look at financial issues divorced from the macro picture. Even though country teams rely on MCM for financial sector expertise, due to resource constraints, MCM staff has participated in only half of the Article IV missions to S29 countries and only 20 percent to non-S29 countries since 2011. Similarly, each year in FY2013-17, MCM reviewed on average two-thirds of Article IV reports for the S29 but only one-fifth for non-S29. While with the mainstreaming of macrofinancial analysis into Article IVs, MCM plans to increase the number of countries it reviews each year to 100, it is essential that the country team economists are trained adequately in macrofinancial issues. In this regard, it is a matter of concern that participation in internal training focused on financial issues overall began to decline in FY2015, albeit with a slight recovery in FY2018. Also, as has been mentioned in several IEO reports earlier, recruitment efforts have yielded a very modest flow of economists with the required skills. Would the forthcoming comprehensive compensation and benefits review be able to improve the intake as required?

The IEO report states that in 2017, the IMF launched the Financial System Stability Review (FSSR), a demand-driven, donor-financed instrument mainly directed to low- and lower-middle-income countries. FSSRs help identify a country’s financial vulnerabilities and catalyze technical assistance follow-up. While FSSRs may thus help address some of the unmet demand for IMF engagement and expertise on financial stability issues, so far, the World Bank – which provides advice on required financial sector development – has not been involved in FSSRs. Given that low- and lower-middle-income countries have greater need of advice on financial development, how soon can World Bank be co-opted into participating in the FSSRs?

We agree with the finding that many officials noted that FSAP teams were often not fully on top of domestic conditions and institutions and policy advice sometimes relied too heavily on off-the-shelf approaches that were not necessarily appropriate for their circumstances. We believe that country-specific conditions should be taken into effect in FSAP recommendations.

Recommendation 2 suggests refocusing FSAP country selection. While we agree that FSAP resources should be allocated more evenly across countries and issues, instead of focusing only on the S29 countries, we agree with MD’s view that this should not result in cutting back on Fund stress testing in advanced economies where the authorities already conduct detailed stress tests, since these vary in quality and in objective. Here, the issue is that the IMF staff are themselves not confident of conducting the stress tests. As the IEO report finds, staff were least comfortable with their skills related to simple stress testing for banks. Sixty-three percent judged themselves minimally or not qualified and even fewer believed themselves likely to be able to conduct sophisticated stress testing in advanced jurisdictions, which require years of training and experience. If the Fund is to remain a trusted advisor for all its members, it is necessary to build up staff skills in the area of stress tests. Is an ICD training module being offered in this area?

Recommendation 3 deals with increasing traction of multilateral surveillance. The biannual Global Financial Stability Report (GFSR) and Early Warning Exercise (EWE) are the key vehicles for IMF multilateral financial surveillance. In 2002, the GFSR replaced an earlier flagship report – the International Capital Markets Report. It is a matter of concern that as part of a budget streamlining effort, the IMF has recently taken steps to control costs of financial surveillance along with other activities. In May 2018, management decided to cap the resources available for individual FSAPs and to limit the analytical chapters of the GFSR to one per issue. This reduction, coming as it does in a period when financial market risks are building up from several sources, could adversely affect the focus of GFSR on assessing global financial markets and identifying vulnerabilities that could pose a risk to financial market stability and sustained market access by emerging market borrowers. This, in turn, is likely to reduce traction of multilateral surveillance. Given that the EWE has a very restricted audience and the Vulnerability Exercise for EMEs (VEE) is an internal exercise for discussion between IMF staff and management only, is it prudent to curtail the scope of GFSR?

Recommendation 4 deals with enhancing the IMF's analytical tools. While IMF staff has developed about 20 indicators to monitor financial risks at the global and country levels, in multilateral surveillance and in Article IV consultations, using these effectively has proven a challenge. Often these tools are not applied consistently or coherently, and they may yield results and forecasts which run counter to factual developments and intuitive conclusions. It is necessary not only that proper judgment on which approach to use in which circumstance is exercised but mission chiefs have also asked for better dissemination of best practices and analytical toolkits among country teams. Given that financial conditions vary from country to country and also over time, apart from sensible application, it is also essential that the indicators are reviewed periodically. Is there a practice of regular review of the indicators in the IMF toolkit?

Recommendation 5 deals with building financial skills and expertise where the IMF faces different challenges in recruiting and retaining, managing and developing financial sector experts (FSEs), fungible macroeconomists and expert financial economists. The IEO Report states that the Fund has had less scope to upgrade through hiring, given its low staff turnover and the fact that the overall size of the IMF has been capped for the past decade. The IMF has had therefore to rely more on training and especially on on-the-job experience, which have been slow as well. As a result of the shortage of qualified and experienced staff, the Fund has at times been overtaken by central banks in developing cutting-edge techniques. Authorities in many countries, including but not limited to officials in S29 central banks, perceive IMF staff expertise and experience deployed on financial sector issues, particularly in Article IV consultations, to be not on par with their own staff. If the Fund is to maintain traction of its advice with all its members, it is necessary that it does not fall behind in developing cutting-edge techniques so that it can maintain its intellectual heft and improve effectiveness in financial surveillance.

On Recommendation 6 which advises increasing budgetary resources, we agree with IEO that financial surveillance deserves top priority treatment given its centrality to the IMF's mandate, and the reality that efforts to reinforce the Fund's financial surveillance work will continue to fall short unless adequately resourced. In the budget-making process, increasing budgetary resources for financial surveillance purpose should be given utmost consideration.

Ms. Levonian, Ms. McKiernan and Ms. Vasishtha submitted the following statement:

We thank the IEO staff for their comprehensive review of IMF financial surveillance and the Managing Director for her buff statement. We welcome the report's recognition of the many initiatives undertaken by the Fund, particularly since the Global Financial Crisis (GFC), which together have contributed to substantial enhancements to the Fund's financial surveillance work and strengthened its critical role in promoting global financial stability. Given the increasing size and complexity of the financial sector and enhanced regulatory frameworks, it is timely to consider how the Fund's financial surveillance activities could evolve to deal with the changing landscape. We agree with the broad thrust of the IEO's assessment and recommendations – some of which are mutually reinforcing – and offer the following specific remarks for consideration.

Bilateral surveillance

We agree on the need to strengthen financial and macro-financial analysis in Article IV consultations, including through closer integration with the FSAP (Recommendation 1). The report rightly notes that FSAPs and Article IV consultations should be conducted more systematically as parts of the same process. We support the IEO recommendations in this regard, including closely tailoring FSAPs to specific country circumstances and closer involvement of ED offices in organization of FSAPs in line with the practice for Article IV consultations. Given the practice of less involvement of ED offices in FSAPs, we would welcome staff to elaborate on the reasons for the differences in the approach for Article IV and FSAPs missions.

Incorporating financial stability issues more closely into the Article IV process would help ensure that both systemic and non-systemic countries would continue to benefit from Fund surveillance and advice on financial sector issues. But coverage of financial sector issues in Article IVs will need to be more extensive than follow-up on FSAP issues alone, to adequately capture evolving financial sector risks. Enhancing staff's analytical toolkit will be important in this regard, consistent with Recommendation 4. However, we recognize that the limited – albeit important – progress to date in integrating macro-financial analysis into Article IV surveillance reflects deep-rooted expertise and resource issues, and many competing demands. We would welcome comprehensive suggestions regarding how to deal with these issues in the forthcoming reviews of the FSAP and surveillance, as well as the budget and HR strategy discussions.

Relatedly, we are supportive of the IEO's recommendation to intensify efforts to attract, develop and retain a deeper pool of in-house financial expertise (Recommendation 5), including those meant to enhance skills of country teams and develop attractive career opportunities.

We generally agree with the IEO's recommendation to review the scope and focus of FSAPs (Recommendation 2). However, we do not support the specific proposal to significantly scale back mandatory FSAPs to the very limited set of 'S5'. Rather than simply reducing the number of systemically important financial system reviews, we believe that risk-based and value-added perspectives, including taking account of expertise in individual countries and institutions, should be guiding principles of financial stability assessments. Freeing-up resources for more voluntary FSAPs, especially for smaller economies that greatly value the IMF and World Bank's help in strengthening their financial systems and detecting vulnerabilities, should be an area of focus. Moreover, costs associated with FSAPs need to be weighed against the potential costs and disruptions associated with financial crises. We would, therefore, welcome further elaboration on alternative approaches to achieve these goals, besides the one proposed. We concur with the Managing Director that any revisions to the current approach to allocating FSAP resources across countries would need to respect the principles of evenhandedness and transparency in the selection process. We would welcome views on any enhanced role for the new FSSR tool to further bridge the gap between demand and supply of FSAPs.

The Fund should continue to strive for closer coordination with other international agencies, standard-setting bodies and national authorities to exploit synergies, minimize overlap, and identify opportunities for greatest value-added. We continue to be supportive of a more streamlined and tailored approach to standards assessment, varying by country circumstances, focusing on the principles most relevant for financial stability.

Multilateral surveillance

We commend the efforts made by the IMF staff over the years in strengthening the GFSR and the EWE, as reflected in their strong global reputation. Notwithstanding this, we agree on the need to enhance traction of multilateral surveillance by increasing rigor, transparency, clarity of message, and impact (Recommendation 3), for instance by making more analytical details and data available online. We also encourage the Fund to consider disseminating the EWE key messages more broadly among senior authorities in member countries, while respecting the confidentiality and sensitivity of views around tail risks.

Budgetary resources for financial surveillance

With regard to Recommendation 6, we recognize the need to ensure that the Fund has adequate resources for financial surveillance if it is to meet its goals and mandate in an increasingly complex financial environment. As such, we are concerned that the overall resources for financial surveillance are close to their pre-GFC levels and agree that this is an area that appears to justify an increase in resources. Since this is an issue that involves a broader discussion of priorities and resources at the organizational level, we agree with the Managing Director that this discussion should take place during the next Fund budget discussion.

At the same time, we believe there is some scope for reallocation of resources to address budgetary needs and would welcome efforts from management and staff to explore ways in which FSAPs could be conducted more efficiently.

Mr. Sun and Ms. Lok submitted the following statement:

We thank the Independent Evaluation Office (IEO) for the comprehensive set of reports, which provide a thorough assessment of the Fund's financial surveillance work. We found this latest evaluation extremely important, given the centrality of financial surveillance to the Fund's work and contribution to the global community. Substantial progress has been made since the Global Financial Crisis in strengthening the Fund's financial surveillance, but there remains room for further improvement. Further efforts are needed to enhance the evenhandedness, consistency, and transparency of the Fund's surveillance work, while taking into account country-specific circumstances. The IEO recommendations are a step in the right direction, and we take positive note from the buff statement that the Managing Director is broadly supportive of the IEO recommendations to make IMF financial surveillance more effective.

We largely support the IEO's recommendations, and wish to make the following comments on a few specific issues:

On bilateral surveillance

We support further strengthening financial and macrofinancial analysis in the Fund's Article IV surveillance. Greater integration between the FSAPs and Article IV consultations would enhance the effectiveness of the Fund's financial surveillance. But this should go hand-in-hand with ensuring sufficient and well-targeted financial expertise in Article IV teams. Otherwise, there could be a risk that initiatives such as producing a template for financial stability assessment and monitoring during Article IV consultations would become a routine check-list process without in-depth understanding and assessment of financial vulnerabilities and associated risks. At the same time, we see merit in building up country-specific knowledge among the Fund's financial experts. One way to do so is more consistent involvement of MCM staff in Article IV consultations.

We share IEO's view that the scope and focus of FSAPs should be better tailored to raise value added and traction. On FSAP country selection and scope, we are open to IEO's suggestion of revisiting the Fund's current approach with a view to achieve a more flexible, dynamic, and risk-based allocation. We look forward to further discussion on the proposed alternative approach of covering only the “S5” by mandatory FSAPs every five years while selecting countries from the rest of the membership based on a systematic Fund-wide approach. We stress that any selection process will need to be underpinned by transparency and evenhandedness. Could IEO clarify on whether the “S5” list would also be subject to periodic review, both in terms of its composition and whether five remains an appropriate number? If so, how will this process go about and what are the relevant criteria? More consideration could also be given to what “risk” should consist of in a more “risk-based” allocation of Fund resources – while resources should be allocated to those countries that could pose greater risks to the global financial system, what about those countries whose very weak financial systems pose significant risk to the countries themselves but not to others?

We recognize that stress tests are very resource-intensive, and countries are increasingly capable of conducting their own sophisticated stress tests. However, we continue to see value in the Fund’s independent stress tests even in areas where countries already run their own detailed tests, as the Fund could offer a fresh set of eyes on a country’s potential risks and weak spots. The key is to ensure the Fund can maintain the quality and relevance of its stress tests. Greater two-way knowledge exchange between Fund staff and the authorities could contribute in this regard. We also encourage efforts to enhance the efficiency of the stress testing process and seek ways to minimize the resource burden both on the authorities and the Fund.

On multilateral surveillance

We continue to value the Global Financial Stability Report (GFSR) and Early Warning Exercise (EWE) as highly important products of the Fund’s multilateral surveillance. We share the IEO’s view, however, that there can be room to further enhance the impact of these valuable products. Besides making the GFSR more rigorous and transparent, we believe it is also important for the GFSR’s analysis of global financial conditions to be adequately balanced. Over the course of IEO’s evaluation, some have suggested that the GFSR could tend to focus more one-sidedly on risks. Given the global public attention on the GFSR as one of the Fund’s flagship publications, care must be exercised to prevent an over-emphasis on risks alone that could potentially trigger unnecessary overreaction in markets. More coordination and engagement with Area Departments in the development of GFSR would help ensure a good understanding of country circumstances and buffers that could contribute to a more balanced assessment.

We see room for closer coordination between the IMF and the Financial Stability Board in the EWE. Topic selection is crucial in this thought-provoking exercise, and it is important to draw policymakers' attention to the key vulnerabilities that may lead to global systemic crises. A more integrated message could help better focus discussion, as well as facilitate appropriate follow up.

On enhancing the Fund's capacity to conduct financial surveillance

Further sharpening of the Fund's analytical tools in its area of comparative advantage and expertise is welcome. We are supportive of efforts to strengthen the Fund's capacity to analyze macrofinancial linkages and cross-border spillovers. At the same time, we caution against getting too caught up with developing overly-complex models that are hard to apply and understand. The development of analytical tools and monitoring indicators would also need to be complemented by efforts to deepen country-specific knowledge, such that appropriate judgement can be applied when interpreting model outcomes and figures.

The strengthening of the Fund's financial surveillance capacity in a well-rounded manner requires a comprehensive HR strategy that is supported by sufficient resources. We look forward to further discussions in this regard and are open to considering an increase in budgetary resources for financial surveillance.

Other issues

On next steps, we believe the IEO recommendations are interconnected and should be considered in a holistic manner. While we welcome the consideration of IEO recommendations in various upcoming policy reviews and discussions on the Fund's HR Strategy and budget, we wonder if there is a need to comprehensively discuss these issues together, and if not, what are the mechanisms in place to effectively translate outcomes in policy reviews into concrete HR and budgetary actions?

On future evaluations, while we found that the case studies prepared by various external consultants for this evaluation offered a fresh perspective on country experiences with the Fund's financial surveillance, going forward, we believe more could be done by the IEO to enhance the consistency across case studies for better comparability and encourage authors to remain objective and impartial, particularly when documenting differences in views between the Fund and authorities.

Mr. Merk and Mr. Fragin submitted the following statement:

We thank the Independent Evaluation Office (IEO) staff for their thorough and candid analysis on the Fund's financial surveillance.

The IEO has delivered a comprehensive, insightful and valuable evaluation of the IMF's financial surveillance which we share for the most part. A number of the IEO's proposals to further improve financial surveillance are pleasingly specific and detailed in nature. In this respect we are looking forward to their further elaboration in the implementation plan.

We acknowledge the IEO's finding that the IMF's initiatives to strengthen financial sector surveillance have delivered a "substantial upgrade of the Fund's financial surveillance work". At the same time, we take note of the IEO's finding that "the quality and impact … has been uneven" and that the IMF needs to tackle a number of challenges to further strengthen effectiveness in this area (pp. vi, vii).

While we broadly agree with the IEO's recommendations, there are two recommendations (2 and 3) where we see things differently:

Recommendation 2:

We share the assessment that there are trade-offs in surveillance, primarily between bilateral and multilateral surveillance, but also between the 29 systemically important jurisdictions with mandatory FSAPs (S29) every five years and those which are not. Owing to resource constraints, the financial sectors of 46 jurisdictions (25 percent of members; we ask for a list of the respective countries) have not yet been assessed since the FSAP was launched in 2000. We also share the view that the value added of FSAPs for many advanced countries with highly sophisticated institutions and authorities will be smaller in some instances than of FSAPs for non-systemic countries where vulnerabilities/risks could be identified generating more value added.

We agree with the conclusion that more resources need to be made available for FSAPs in non-systemic jurisdictions. It appears problematic that a large percentage of countries have gone without FSAPs for such a long period of time. Of course, the conduct of FSAPs should not follow a scatter gun approach; a greater part of the non-systemic countries should be selected for an assessment according to actual/potential vulnerabilities and risks.

However, we do not agree with the IEO recommendation to substantially reallocate resources and to select just five (S5: China, the Euro Area, Japan, the UK and the US) out of the S29 for continued assessments every five years, while the FSAPs for other jurisdictions would be prioritised in the work programme according to needs, so that the resources freed up as a result can be dedicated to more to FSAP assessments in non-systemic jurisdictions:

Reallocating resources towards non-systemic jurisdictions and away from systemically important jurisdictions is not consistent with the 2014 Board decision of "...continuing to strengthen the systemic risk focus of all components of the FSAP" (SM/14/249, p. 6). While it is undoubtedly likely that there will be some non-systemic jurisdictions with very risky financial sectors, these are less important in systemic terms; this is underpinned by the selection of the S29. Risks and crises originating in systemic jurisdictions can, by definition, have a bigger impact and thus present a greater risk to global financial stability. Therefore, the (legitimate) need for FSAP exercises in non-systemic jurisdictions should be covered in addition to, and not instead of, FSAPs in systemically important jurisdictions. Also, we are not fully convinced by the IEO proposal to take into account the presumed need "to maintain a balance across regions…". Why should this be a suitable FSAP selection criterion in terms of the importance of systemic risk and vulnera-bilities?

Instead, as an option to free up FSAP resources, it could be considered to conduct reviews of standards and codes of the S29 at wider intervals[5] and separating them from the FSAP exercise. This proposal would not alleviate the overall cost burden for the IMF, but streamline the assessments as to enable FSAPs at a higher frequency in [selected] non-systemic jurisdictions.

To streamline FSAPs further - with cost-saving effects - and gain more value added and traction from FSAPs in highly sophisticated financial systems, we explicitly support the IEO's suggestion that in "those countries already conducting regular high-quality stress tests, FSAPs could focus on reviewing the authorities' models, designing risk scenarios, and discussing the results of the tests and critical stability risks". To top up existing stress tests in the above described cases would not bring further value added in our view. An

[5] The IEO found that standards are not necessarily devised primarily under stability aspects as one might expect (Suppl.2, para 45). If so, this would support the argument to separate them from the FSAP exercise.

exchange of views between staff and national authorities on the tests and /or a review of the tests and their variables and design promise actually higher return for all participants in the exercise.

Consideration could also be given to the idea of extending the FSAP assessment cycle for the S29 to six years, or to handle the principally valuable 5 years cycle more flexibly in cases of financially very stable jurisdictions (which are most probably fewer than the remaining S24 jurisdictions). Additionally, in such cases the FSAP follow-ups could be intensified significantly as part of the Article IV consultations – as proposed by the IEO – so that vulnerabilities and fast-paced risk developments can be identified in reasonable time.

Overall, the focus of financial surveillance has to remain on the timely identification of actual and potential risks/vulnerabilities and their impacts on global stability. At the end of the day a solution has to take into account the cost-benefit ratio, efficiency and efficacy aspects of FSAPs specifically, and of financial surveillance in general, in order to fulfil the FSAP and surveillance objectives adequately. More flexibility in terms of scope, focus and maybe frequency of FSAPs might be needed. The upcoming FSAP review (2019) will be a forum for the respective discussions.

Recommendation 3:

We support the IEO's recommendation to enhance the "…traction of multilateral surveillance" by formulating clearer, more transparent and more compelling messages in Chapter 1 of the Global Financial Stability Report (GFSR) to increase the likelihood of policy implementation.

Consistency of the two IMF flagship reports is of utmost importance when interlinked issues on the macro level (WEO) and the macrofinancial level (GFSR) are discussed in both reports. Messages should consider the overall perspective, as well as country-specific circumstances. This will be especially important when rising interest rates will challenge financial sectors. Country-specific risks then have to be analysed from both perspectives.

We are concerned by the IEO finding that the forecast certainty of the GFSR is limited: "Of six 'near-crisis' events during 2013-2017 only one event was discussed in any depth as a financial stability risk ahead of time" (Suppl. 3, v). Improvements are therefore needed with regard to vulnerability analyses.

We do have reservations concerning “closer coordination with the FSB on topic selection to achieve greater synergies” (para 93) as part of the Early Warning Exercise. We agree that a closer coordination with the FSB on topic selection can help increase synergies, however, each institution must be able to identify those topics in the Early Warning Exercise it deems most important. If different views exist, these should be presented by the institutions.

We furthermore have reservations concerning a strengthening of the “IMF’s contribution to the global regulatory agenda”. We believe that the IMF should not only respect the “lead role of the FSB and SSBs in developing new rules and regulatory frameworks”, but acknowledge that this is the “principal task” of the FSB, as per the joint letter of MD Strauss-Kahn and FSF-Chair Draghi dated November 13, 2008. The global membership of the IMF – as compared to other institutions – is not a compelling enough argument, in our view, for granting the IMF a widened role in the regulatory and standard-setting field over and above analytical work supporting the FSB. While we could envisage the IMF scaling up its work with the FSB, SSBs, and BIS in the area of assessing implementation and impact of reforms, we would not support the idea of granting the IMF greater access to more granular data on global systemically important financial institutions (G-SIFIs) given strict confidentiality regimes for such data.

Remarks on the other recommendations:

Recommendation 1:

We share the IEO’s view that the core IMF task of financial surveillance must have the resources needed to ensure effective surveillance operations by highly qualified personnel. We generally support greater integration between FSAPs and Article IV Consultations. More intense involvement of MCM staff members in Article IV consultations will then be needed.

We agree with the IEO that information exchange with regard to FSAPs between staff and ED offices is important. At the same time, we doubt that involving ED offices more fully in the organisation of FSAPs can create value added (para. 104). Organising national FSAPs in the euro area e.g. takes a great deal of time and effort, with on-site coordination being most time-consuming (six authorities/institutions alone are involved); less time-consuming is the coordination with IMF staff.

Recommendation 4:

We support the recommendation to enhance the value added of financial surveillance, in particular by state of the art research. The IMF cannot be expected to be at the cutting edge on all topics, however, it should expand research on issues within its core mandate and comparative advantage.

The IEO recommends developing global stress tests in cooperation with FSB and BIS. We support all projects that aim at improving the analytical tools. However, the question is, whether this objective will be implementable in terms of available data and how the validation for the member countries would have to be designed to ensure that incorrect indications are prevented.

It would be interesting to learn why coverage of macrofinancial issues was noticeably higher for all groups, except for the G7 (para 38).

We fully support the IEO advice on external communication of the Fund's analysis, in particular, to take care not to become a catalyst for the risks that it identifies (para 4).

Recommendation 5:

We agree with the IEO that IMF financial surveillance can only be further expanded if expert staff is available. Alongside building up in-house knowledge, the IMF has to position itself better in order to compete for financial market experts. Like the IEO, we see merit in reconsidering the personnel strategy with the objective to give financial economists career prospects that allow for promotion to senior managerial levels without requiring fungibility and mobility (so far, a specific requirement for economist careers at the Fund).

We support the IEO's proposed staff rotations in the Monetary and Capital Markets Department (MCM) and greater inclusion of MCM in Article IV consultations. The IEO rightly emphasises that this would improve the quality of financial surveillance of all countries. We also welcome the proposed IMF staff rotations in central banks as a way of expanding staff expertise and to gain mutual benefits. Could the IEO elaborate a bit more about the idea of IMF staff rotations in the private financial sector?

Like the IEO, we would generally encourage to make greater use of the Fund's internal training measures, suited to expanding expertise.

(42 percent of IMF staff stated that they had not taken part in any training on financial and macrofinancial topics in the last three years. They cited time pressures and general workload pressure as reasons for this. (Suppl. 8, para 29/30))

Recommendation 6:

We support IEO's recommendation to consider increasing the resources for financial surveillance by reprioritization or rationalization within the overall flat budget framework for the Fund as a whole.

The Chairman made the following statement:

I would like to thank the Independent Evaluation Office (IEO) and the head of the IEO for the thorough report and accompanying background materials and case studies on how to strengthen the Fund's work on financial surveillance. I read the report carefully and I found some interesting findings. I found a comforting assessment of the significant improvement and efforts that have been deployed in order to strengthen the capacity of the Fund to provide better and improved services in the area of financial surveillance.

I would like to preface those comments by acknowledging that the cooperation between the IEO and all other departments, including the Monetary and Capital Markets Department (MCM), the Strategy, Policy, and Review Department (SPR), and others, has been nothing less than exemplary and a good demonstration of how the Kaberuka report is walked and not just talked. We did good work together, and I was pleased to see that. It was good to read the positive part of the report, and it was also good and helpful to read not only the six recommendations but everything that led to those six recommendations in terms of improving what we do, whether it is the fine-tuning of the stress testing; appropriate deployment of specialists and experts, including from MCM to the area departments as part of the streamlining of the work that has been now done; or whether it is in relation to the good coordination between the various financial authorities that have competence in those fields.

The Board has received my statement. Many of the IEO's recommendations will find their way into other exercises that are coming up in the next few weeks and months, whether it is the Financial Sector Assessment Program (FSAP) review or other exercises, including the annual budget and the HR review that we are doing.

The Director of the Independent Evaluation Office (Mr. Collyns) made the following statement:

> I thank all Directors and the Chairman for carefully reading our report and the thoughtful comments that were already provided and the broad support for the recommendations that we are making. I believe that this evaluation will be making an important contribution to the discussion that will be continuing over the next year on this central question of how to further strengthen Fund financial surveillance.
>
> We recognize the important progress that has been made over the past 10 years, but we believe that further work is needed; and as the Chairman pointed out, there is a series of processes over the next year—the Comprehensive Surveillance Review (CSR), the FSAP review, also the HR strategy, and the various budgetary processes—where these issues can be taken up.
>
> One point I would like to emphasize up front is that our recommendations are interrelated and mutually supportive, so it will be important to consider them as a package and not entirely piecemeal. For example, the recommendation to strengthen the quality and value added from bilateral surveillance in the Article IV process in the area of financial stability and macrofinancial depends on changes not just in how the Article IV consultations are done, but also in how the FSAP is done, how it provides materials on vulnerabilities for the Article IV consultation. It also depends on upgrading Fund financial skills and providing adequate resources. That is a good example of how these various recommendations fit together. Similarly, it will be important as these various reviews go forward over the year ahead that the interrelationship between the different workstreams is always kept in mind.
>
> The six high-level recommendations that we made in our report received broad support from the Board, from management, with some qualifications, but I believe the overall objectives are broadly endorsed. We made a number of specific recommendations responding to the call in the Kaberuka report to try to be more precise, more concrete, and many of the recommendations received mixed support, some in favor, some against. I believe part of the problem is that while there is broad agreement that the allocation of resources needs to be more dynamic, more risk-based, that is difficult to do because to shift resources to areas of greatest vulnerability, greatest value added, we also need to take resources away from other areas

where the value added may be less, and it is difficult to reach agreement on that.

One area where the greatest room for finding resources can be found is the allocation of FSAPs across countries. We did make a recommendation to reduce the frequency of FSAPs for systemic jurisdictions other than the five globally systemic jurisdictions. That did receive some resistance, but I would note a modest change on the frequency can lead to a significant release of resources for countries that are particularly vulnerable, where the value added of an FSAP could be particularly great, but can only expect an FSAP very infrequently. To provide a back-of-the-envelope calculation, if we reduce the frequency from five years to every seven years, that could allow an additional three FSAPs per year for the countries outside the 29 jurisdiction with systemically important financial sectors (S29), which is a 50-percent increase; meaning over 10 years, we can do an additional 30 countries that otherwise we would not be able to do.

If we move in this direction, it will obviously be important to make sure that the Article IV process for the systemic countries is a high-quality, robust process. That underlines the importance of recommendations to strengthen the linkages between the FSAP and the Article IV and the recommendation to strengthen the expertise of Fund staff and provide adequate resources for Article IV consultations.

There were a number of questions from Directors in the gray statements. One question was if we do not want to reduce the frequency of the FSAPs for the systemic jurisdictions, where else can efficiencies be found? In the report, we do make some suggestions in this area. One area where considerable efficiency gains could be found is the approach to stress testing, taking a more tailored approach, adjusting the approach to the country's sophistication and the extent of vulnerabilities. Our basic conclusion is that we can save significant resources and also increase the value added from the FSAP by moving to a more tailored approach to stress testing.

Another area where some savings could be found is in the treatment of regional financial surveillance. We now have an FSAP for the euro area which covers the most systemic banks within the euro area. That should allow for some phasing back in resources devoted to FSAPs for the individual countries within the euro area.

A number of Directors asked how we came up with our group of five globally systemic jurisdictions that would continue to be looked at every five years under our recommendation. Frankly, we did not do a comprehensive rigorous exercise, but we used our judgment of what the five most important jurisdictions would be. I generally believe that the judgment we made seems to make sense, and is broadly supported. No one has challenged the group of five, but certainly if we move in this direction, it would be important to establish a more rigorous data-based approach to show that these five are clearly different from the others.

I looked back at the 2013 paper that provided the underpinning for the choice of the S29, and it is interesting in that paper. If one looks at the group of globally most interconnected jurisdictions identified in Figure 1 of that paper and make an adjustment—one to consolidate the euro area countries into one and make an adjustment for the increasing interconnectedness of China—I believe one would come quickly to the group of five that we identified.

Mr. Merk asked about the idea of Fund staff rotations with the private financial sector. One of the concerns that was identified in the HR background paper was the diminishing extent to which there is interchange between the Fund and the private sector. We do believe that is a significant concern. Having people with market experience helps the Fund understand market dynamics and the market implications of policy choices. Clearly it is quite difficult for the Fund to attract economists from the financial sector, in part because of remuneration, but also because the Fund does not necessarily offer a particularly good entry point or particularly good career prospects. I have known a number of private sector economists who are interested in coming to the Fund who have been discouraged. Rotation schemes can help, but the experience has not been good in part because the conditions for the rotations have been tightened in recent years to require Fund staff going on external assignment at A15 and above to resign from the Fund in order to take an external assignment. There is also the question of reentry. The experience of people who have gone on external assignment and tried to come back to the Fund with the reentry has sometimes been quite disappointing in the sense that they do not feel that their external experience has benefited them in terms of promotion prospects.

It is worth looking at to see whether the rotation schemes could be revised, but it would require dealing with these issues of inflexibility and providing greater recognition for external assignments. But in the past, the experience has been that rotation schemes do not always attract the best economists, and therefore the private sector has also lost interest in these schemes because they do not find they are getting particularly strong people working for them.

The Deputy Director from the IEO (Mr. Lamdany), made the following statement:

I will address three specific questions. Mr. Mozhin asked whether there are good cases of macrofinancial analysis in Article IV consultations that were not preceded by a recent FSAP. In our sample, we found five. Two of them, Timor-Leste and Bhutan, were preceded by intensive technical assistance (TA). The other three—Chile, Republic of Korea, and Peru—all had FSAPs at a little more than the three years, but Chile and Republic of Korea were part of the macrofinancial pilot when those Article IV consultations were produced. In two of the missions, Chile and Peru, there was staff member from MCM in the mission, so no magic.

Mr. de Villeroché asked about the relative cost of scrutinizing the systems that countries have for preparing the FSAP, and how much savings there would be by moving into that direction, and also how the mechanics would work. We believe that there will be significant savings because there is no need to deal with confidential data and how to manage that, and also the second time, unless there has been a significant change, it is unlikely that one will need to go so deep. With respect to the mechanics, in those cases in which the staff believes that assessing the system would be sufficient, it is unlikely that there will be significant differences on what are the scenarios and what are the risks. If there are significant differences, the staff would have to go ahead and do the study. If these discussions are done during the preparatory time of the FSAP, then these will be able to be reported in the Financial System Stability Assessment (FSSA).

Finally, Ms. Mannathoko asked about the Fund's involvement in advising countries on activities related to illicit flows of funds through the financial sector. The Fund has three entry points for this. One is the assessment of the Anti-Money Laundering (AML); two is TA; and three is research activities. In our case studies, we found that the authorities were very appreciative of the three. Since 2012, Article IV consultations are supposed to report on the results of whatever is included in the FSAP and the AML activities assessment. That does not always work because it is difficult to coordinate the timing.

Ms. Riach made the following statement:

I welcome the Managing Director's remarks about the close working between the IEO and staff, and that close working is evident in the rich and comprehensive report.

The Fund's role in financial surveillance is enormously important. As the IEO has said, the Fund is the only international financial institution (IFI) with the mandate and ability to conduct financial and macrofinancial surveillance over a full range of countries as well as the global economy. For my authorities, and for a number of others, there is no part of the Fund's work that is more important than its role in financial surveillance. In that light, we warmly welcome the real and substantial progress that has been made to strengthen the Fund's financial surveillance over the last 10 years, and we broadly endorse the IEO's recommendations.

I have issued a joint gray statement, so I will focus on a few key points. First, on the frequency and prioritization of FSAPs, we recognize that the issues that Mr. Collyns raised and the difficulty of balancing the comprehensive coverage with the frequency. Given the value that the membership places on FSAPs, it is understandable that there is concern about any suggestion of a reduction in the frequency with which FSAPs will take place in systemically important countries. Five years is already quite a long time, and much can change in that period. The FSAP review will be the right place to discuss this issue in more detail, and we are open to considering proposals to extend FSAP coverage to a wider set of countries, but in light of the IEO's recommendation, I want to be clear that we will be looking to ensure that any proposals do not negatively affect the timeliness of valuable analysis undertaken in FSAPs.

There probably is a debate to be had about whether there are truly 29 systemically important financial centers or whether it makes sense to include them all in the list of mandatory FSAPs. However, we also feel that the number of systemically important centers is well above five, and we see real value in the Fund continuing to undertake FSAPs in all these countries, at least every five years.

Second, on the integration of bilateral financial surveillance, we strongly support the IEO's first recommendation on the potential benefits of strengthening financial and macrofinancial analysis in Article IV consultations, in particular through better integration with FSAPs. Better integration and sharing of expertise between the teams has the potential to provide broader coverage of these important issues and to strengthen country knowledge underpinning FSAP reviews. It is possible that this could be taken even further in the parallel Article IV and FSAP reviews, considering how the financial sector issues are covered and with what frequency between the surveillance products. We see the potential for some real improvement in efficiency, impact, and timeliness.

Third, we support the IEO's view that an FSAP need not be exactly the same in every case but should be adjusted to what is relevant to the country on the basis of risk. For example, Mr. Collyns has raised the issue of stress tests, and we see that in the years since the financial crisis, FSAP reviews have played a key role in setting best practices for stress testing, but now that many advanced economies have well-developed stress testing systems in place, the Fund's role in those cases could move more toward one of quality control.

Finally, on resources, it is essential that the Fund has both the financial and the human resources in place for this work. The United Kingdom is one of the members that has argued for the maintenance of a flat real budget. Nevertheless, we do believe that it should be possible to shift resources within that budget. Given the importance that the membership placed on financial surveillance, we believe that it must be properly resourced, if necessary taking priority over other issues. We agree with the Managing Director that the budget discussion is the right place to consider these tradeoffs, and we hope that the Board can consider some options to increase resources for financial surveillance in line with IEO recommendations, even if that means hard choices elsewhere.

Mr. Di Tata made the following statement:

We issued a detailed gray statement, but I would like to emphasize a few points. First, we concur with the IEO's view that the effort made in recent years has delivered a substantial upgrade to the Fund's financial surveillance work. However, notwithstanding significant progress in several areas, we agree with the IEO that the Fund is still facing a number of challenges to improve the quality and impact of its work on financial surveillance. I would like to briefly focus on four issues.

The first is training. The issue of training impinges directly or indirectly on at least four out of the six recommendations made by the IEO, specifically recommendations one, four, five, and six. Clearly there is a need for further substantial efforts to enhance training in the financial and macrofinancial areas to develop the required skill of staff. In this regard, we are somewhat disappointed that only about a quarter of area departments' fungible macroeconomists have attended the structured training curriculum on macrofinancial analysis offered by the Institute. We believe that the structure of incentives needs to be changed to encourage economists and managers to attach due importance to training. In our view, completion of the structured curriculum in the macrofinancial area should be mandatory for economists and subject to evaluations and could become a prerequisite for promotion to senior economist. Staff already promoted to senior economist level should also complete this training on a mandatory basis.

Second, with regard to career tracks for experts, we agree with the IEO that the HR strategy should consider establishing an attractive career track and adequate incentives for experts, including financial sector economists. It should also develop comprehensive data on the financial skills of the staff.

The third is FSAP country selection and scope. We broadly concur with the IEO proposal for a more flexible and risk-based approach to FSAPs and for limiting mandatory FSAPs to the five systemic economies (S5). The selection process for the allocation of resources should seek to strike a balance between global and regional systemic relevance, risks and vulnerabilities, and evenhandedness.

Regarding stress testing, we tend to agree with management that the Fund's independent tests are an integral part of bilateral surveillance. However, to save resources, there might be scope for determining the need for stress testing on a case-by-case basis, relying on the authorities' tests only when they are of high-quality and/or using the authorities' models to test alternative scenarios. Moreover, financial system stability reviews and financial stability reports prepared by member countries already mitigate the need for full-fledged FSAPs in some cases.

Finally, on budgetary resources, although we agree that overall some increase in the resources available for financial surveillance seems justified, we believe that the staff needs to develop a detailed costing exercise of the various initiatives incorporating possible increases in efficiency. Moreover, because of budgetary constraints, we would reemphasize that a substantial training effort is likely to be the most cost-effective way to enhance the staff's financial skills. Ultimately, the distribution of budgetary resources should be determined in the context of the discussions on the Fund's budget, taking into account the institution's competing priorities.

Mr. Mojarrad made the following statement:

I appreciate the Managing Director's broad support for the recommendations, albeit with qualification for some of them. I would like to add the following points to our gray statement.

We understand from the Managing Director's statement that the IEO's recommendations will be considered in the context of the upcoming FSAP review and CSR in 2020. It is not clear whether the Management Implementation Plan of the Board-approved IEO recommendations will need to await these reviews or if some preliminary plan would be prepared and only finalized once the reviews are completed.

While we cannot prejudge the outcome of these reviews, we are concerned about the possible loss of momentum if implementation of the Board-approved IEO recommendations is delayed. In our gray statement, we asked if there are any low-hanging fruits that could be taken up in the interim period. The inadequate budget resources allocated to financial surveillance has received strong prominence in almost all the gray statements with broad support for recommendation six to increase the overall size of resources.

It is clear that the Fund's ambitious agenda in this area cannot be achieved with the pre-crisis level of resources, and there are limits to how much existing resources can be redeployed without adversely affecting other activities or evenhandedness in the provision of services to the membership at large.

We look forward to the next budget discussion focusing on adequately funding the recommended strengthening of financial sector surveillance and we ask for proper costing of emerging activities, such as cyber risk and fintech, as well as increased hiring of financial experts. That being said, the priority in resource allocation should be toward strengthening the effectiveness of Article IV consultations in financial surveillance.

On the integration of FSAP and Article IV consultation, we support suggesting FSAP terms to provide periodic deep dives as warranted by country circumstances and for the preparation of financial stability assessment templates as a tool to be used by Article IV missions with the necessary adaptations to country circumstances.

We support the IEO recommendations to reduce the number of mandatory FSAPs to five to make room for a larger number of FSAPs for non-systemic financial jurisdictions. Moreover, while financial sector development under FSAPs, which is mainly the focus of the World Bank, is not part of the evaluation, we see merit in providing informative material on the achievements and challenges in this area as part of the upcoming FSAP review.

On a related matter, we join Ms. Mannathoko and Mr. Tivane in supporting the development of regulatory frameworks and payment system in low-income and developing countries (LIDCs).

Finally, in the case of Ghana, which was reviewed as part of three country studies in sub-Saharan Africa, we agree that the FSAP has helped identify financial sector risks with some follow-up through Article IV consultations, TA, and program conditionality. The Ghanian authorities appreciate these efforts and see merit in further Fund TA to develop internal capacity to use analytical tools of diagnosis and risk assessment. We concur with the need for the Fund to more systematically bring regional perspective to bear in financial surveillance.

Mr. Merk made the following statement:

We broadly agree with the IEO's recommendations. As we have issued a detailed gray statement, I can focus my remarks on a few key points.

We agree that more resources need to be made available for FSAPs in non-systemic jurisdictions. However, we would not support limiting regular assessments on a five-year cycle to just five jurisdictions. The legitimate need for FSAP exercises in non-systemic jurisdictions should be covered additionally. We support the IEO's suggestion to streamline FSAPs further in highly sophisticated financial systems, aiming for a stronger focus on the value added in the area of stress tests. As well, consideration could be given to ideas such as handling the five-year FSAP assessment cycle more flexibly in cases of financially very stable jurisdictions, or extending the FSAP assessment cycle for the S29 moderately to six years.

On a more general note, we support the IEO's recommendation to consider increasing the resources for financial surveillance by reprioritization or rationalization within the overall flat budget framework for the Fund as a whole.

Mr. Doornbosch made the following statement:

In our joint gray statement with Ms. Riach and Mr. Ray and Mr. Tombini, we commented on all recommendations, so I would just like to emphasize three points. First, we believe that the Fund should keep pushing for regulatory reform and continue improving the presentations of new and emerging systemic risks in the Global Financial Stability Report (GFSR). Second, we do not see much need to change the Early Warning Exercise. It works. Thirdly, on the FSAPs, we believe we want to keep the frequency but reduce its comprehensiveness. Let me say a few words on each of these points.

First, we appreciate and agree with the proposal to enhance the impact of Fund multilateral surveillance by making more GFSR material available online. We feel it is equally important that the efforts to improve the GFSR's readability continue. The Financial Conditions Index and the growth-at-risk models are powerful tools to assess global financial risks. However, to gain traction, they need to be understood by a wide audience, and for this, consistency and timeliness is crucial. In that context, I was wondering whether it could be considered to update those quarterly and publish them together with the World Economic Outlook (WEO) update.

In the context of improving the surveillance of macrofinancial risk, we would be interested to hear from the IEO whether it has been discussed to integrate the external sector in the spillover report into macrofinancial surveillance.

On the international financial regulatory architecture, the Fund should remain firmly engaged to advance the global reform agenda, and I would argue that it could even step up its efforts. By being careful not to be perceived as a standard setter or overstepping our mandate, we are sometimes too careful. The Fund's broad membership but also its independent risk assessment, requires the Fund to speak up on these issues.

On the Early Warning Exercise, we believe it works well in identifying tail risks and encouraging debate and out-of-the-box thinking. Although I see the logic of trying to improve the follow-up, I feel that closer integration between the Financial Stability Board (FSB) and Fund and broader dissemination of messages is on balance probably going to cause more harm than good. The risk is that further formalization could lead to watered-down and mean-reverting risk assessment, which would diminish the quality of the discussions; and broader dissemination afterwards could lead to pressure up front to tone down inconvenient messages. Actually, the track record of the Early Warning Exercise in terms of follow-up is pretty good, even without broader dissemination and extensive coordination on integrated messages. Topics have been picked up by subsequent GFSRs and WEOs, and themes have been disseminated to a broader audience by blogs and speeches by management.

With regard to frequency and communication of the FSAPs, we have debated this intensely within our constituency, but we do not concur with the proposal to reduce the frequency for countries with systemic financial sectors. Doing so would be inconsistent with the firm preference of the International Monetary and Financial Committee (IMFC) for a risk-based FSAP. Given the increasingly rapid transformation of the financial sector, we are afraid that the lower FSAP frequency for systemic countries would fail to capture vulnerabilities with significant spillover effects. That being said, while we favor an increase in resources dedicated to financial surveillance, we also understand that resources should be allocated strategically and efficiently.

My final point is that the FSAP should be a tool to promote the awareness of the financial stability impact of issues such as climate change and cyber risk as new and emerging issues where emphasis should be placed.

Mr. Ostros made the following statement:

This is a timely set of reports and exactly how the IEO should work. We have these big workstreams ahead of us, and we get this thorough evaluation that will be part of our discussion, and it also kicks off discussion with our capitals early on, so it is highly commendable. It fits into our surveillance review, the FSAP review, but it also comes into our budget discussion, which is important. Often in our budget discussion in recent years, we have concentrated on the cost of the emerging issues, which is a small part of the budget, but here we are discussing a big chunk of the budget and a core mandate. Do we have enough resources for financial surveillance? That is a relevant discussion, and it should be used for budget discussions.

On FSAPs and bilateral surveillance, we are open to discussing a more risk-based selection of FSAPs, but we must ensure that systemic jurisdictions or regions with strong cross-border linkages are sufficiently covered over time. I have a strong preference for maintaining the mandatory nature of a large part of the global asset coverage on a frequent basis, but we are ready to discuss the frequency and the scope of FSAPs.

The regional aspects remain relatively unexplored in the IEO report, and that is a field that we should think through more thoroughly. I represent a region which is probably the most integrated region in terms of financial markets globally, and we would like to see a regional FSAP effort to see what are the weaknesses, interlinkages, spillover effects, where we can use knowledge from national FSAPs to understand better how it affects the whole region.

I would also like to echo the Chairman's statement to maintain stress tests for countries.

Second, on the bilateral surveillance and staff skills, the report recommends deepening financial expertise in country teams. In our experience in recent Article IV consultations, experts from other functional departments have joined the mission and have been consulted by country teams. The same can likely be done with experts from the MCM. Of course, it is a research-intensive thing to do, but we could also explore if there are more standardized approaches to integrate financial surveillance into Article IV consultations, so that is a path we should look deeper into.

Third, and going back to the resource implications, the report assessed a need for increasing the budgetary resources for financial surveillance. That is also echoed in the Chairman's statement, and we need to discuss this in the context of the FSAP review and in the budget process. Our starting point is a flat real budget, but we should explore all options and also explore options in which we can prioritize much more clearly within the full envelope that we have today. That could be a useful path going forward.

The Fund has come a long way in enhancing its financial surveillance. My authorities place great value on the Fund's financial surveillance work, and the IEO evaluation has made an important contribution for the discussion that we have ahead of us.

Mr. Raghani made the following statement:

We have issued a gray statement expressing our views and broad support for the IEO recommendations. After reading Directors' gray statements, I would like to focus on a few specific points for emphasis.

As indicated in our gray statement, we look forward to the forthcoming surveillance, HR, and compensation and benefits reviews, to address some of the IEO recommendations. That being said, like Mr. Sun, we wonder whether a comprehensive discussion of these issues together would not be preferable given their interconnection.

We support the recommendation to refocus the selection of countries and the scope of FSAPs. We note the interesting suggestion to consider a second tier of regionally systemic jurisdictions for the purpose of FSAPs with possibly different frequency, depth, and nature. We share the view that the choice of FSAPs should be based on risk and value added, should pay attention to evenhandedness, and be mindful of countries' capacity to assess financial vulnerabilities.

We see merit in the IEO suggestions that in countries that conduct sophisticated stress tests, limiting Fund stress tests to areas not covered by the authorities' own tests would help free up the resources that could be used to conduct FSAPs in countries that currently have very infrequent FSAPs. That being said, we also believe that the Chairman makes a strong point on the fact that there are instances where the Fund's independent stress tests have an important value added. In our view, like Mr. Mouminah, the issue of whether to cut back on Fund stress tests would be better addressed in the context of the forthcoming FSAP review.

We share Mr. de Villeroché's and Ms. Levonian's view that countries with less capacity and small economies should have access to more voluntary FSAPs given the critical role the Fund and the World Bank play in detecting vulnerabilities and strengthening the financial systems. We also stress the importance of assisting those countries build capacity in assessing financial vulnerabilities and identifying risks, including through stress testing.

On multilateral surveillance, the Fund should continue to leverage its collaboration with other institutions while being attentive to the need to remain independent and continue to produce distinct flagship reports. We welcome the institutional efforts put in staff hiring, training, and mobility to enhance financial skills and expertise. To maintain such talent within the institution, it is important to provide incentives and prospects for career development to financial sector experts without prejudice to other core economists. We would like to emphasize that in these efforts, attention should be paid to diversity and inclusion.

Regarding the budgetary implications, the resource envelope for financial surveillance has not kept pace with augmented Fund activity in this area. We would see merit in the next budget discussion considering options and tradeoffs of increasing the resource for financial surveillance, including the suggestion of financing, as called for by Mr. Agung, Mr. De Lannoy, Mr. Tombini, and others.

Mr. Beblawi made the following statement:

We issued a gray statement in which we commended the comprehensive and insightful set of reports, and we welcome the Chairman's broad agreement with its assessment and recommendation. Our views are in line with those of many other Directors, as expressed in their gray statements. I will add a few remarks for emphasis.

There is no doubt that we need to better integrate financial surveillance in Article IV work and to encourage the staff to further strengthen efforts to achieve this while recognizing the progress achieved so far.

Regarding FSAPs, we see scope for more focused country selection and scope to address the balance of financial resources for financial surveillance between the systemic and other countries. We share the views expressed by others on the need for the staff to bear in mind and avoid undue burden on the authorities in the context of financial surveillance, including with respect to the data demands that may not always seem necessary or consistent with potential risks. To further strengthen financial surveillance, we see a need to improve the skills of existing staff as well as increase recruitment and retention of highly skilled and experienced experts.

Members count on the Fund to be the center of excellence in financial sector analysis, and this should continue to be improved. We are among those Directors who believe the Fund should devote significant additional resources to financial surveillance alongside a more efficient and value-driven approach. We are particularly concerned that such resources are back to the pre-crisis level. We look forward to future discussion of possible ways to increase resources to financial surveillance.

Mr. Agung made the following statement:

For us, the key takeaway from the evaluation is that we need to find ways for financial surveillance to deliver more value to members under tight resource constraints. The question is how to operationalize this. Let me focus on three points. First, while the IEO has made six distinct recommendations, as pointed out by Mr. Collyns, most are deeply intertwined. For example, to improve FSAP accessibility for the broader membership, we may need to scale back the scope and frequency of mandatory FSAP; but to do so safely, we first need to strengthen Article IV macrofinancial surveillance. To ensure the bilateral advice is anchored in the country context, we need to look at HR policies on staffing, rotation, and information-sharing process, both within and between MCM and area departments. Given the interlinked recommendation, we hope that the MIP will articulate the integrated strategy that pulls together our recommendation in a holistic way.

My second comment is on the EWE. Certainly it is important to protect the candor of discussion by keeping the views expressed confidential, but we think this can be done even if we more broadly disseminate a key message of the presentation. After all, these messages are relevant to all our principals, not just the 50 or so who are allowed into the meeting.

Regarding the coordination, like other Directors, we would encourage closer Fund-FSB collaboration and a more structured follow-up mechanism. This does not mean that the Fund and FSB have to adopt the same views, nor does it mean sacrificing the more forward-looking themes that the Fund has explored. But stronger coordination would yield a more cohesive and productive discussion.

My final comment is on resources. Given the importance of financial surveillance to the Fund's mandate, we agree that more budgetary resources may be required. As some Directors have stated, this means the Board and management need to take a hard look at where and how to reprioritize. In this regard, we look forward to having a discussion at the earliest opportunity.

Mr. Tombini made the following statement:

I signed a joint gray statement with Ms. Riach, Mr. Ray, and Mr. De Lannoy, which conveyed our opinion on most critical issues raised by this evaluation.

The Fund is in a unique position to integrate macrofinancial and macroeconomic surveillance and has made important strides in this respect that many acknowledge. However, the evaluation shows that macrofinancial analysis in the context of Article IV consultations can be improved. The IEO recommendations addressed the main deficiencies to revamp Fund financial surveillance and their associated resource constraints. My comments will focus on three issues.

First, regarding the frequency of FSAPs, I have sympathy for the proposal restricting the five-year cycle for FSAPs to only the most systemic jurisdictions, the S5. It goes in the right direction of addressing several concerns. To ensure that sufficient attention will be given to the financial systems that are most crucial for global stability, it opens space for a broader share of the membership to benefit from the program, and it may alleviate the burden in the non-core systemic jurisdictions of an extensive exercise that may be yielding marginal decreasing benefits.

My reading of the Chairman's statement and the interventions points to a larger number of Directors supporting this proposal or being open to consider the proposal than the numbers that are summarized in the Main Themes in Grays. With the understanding that we will discuss those issues in the upcoming FSAP review, I want to highlight that any change here cannot compromise the quality and closeness of financial surveillance of the systems with potential for significant spillovers. In fact, the thrust of the IEO recommendation is to bring financial surveillance more forcefully into Article IV consultations while reshaping the FSAP to make it more focused and risk-based. In the integration of financial surveillance and FSAPs into Article IV consultation, we should avoid the so-called tick-box integration, a point that was made by Mr. Agung.

Second, I want to underscore the acumen of one of the main messages of the report, "The FSAP advice should be fully anchored in local circumstance and not overly reliant on off-the-shelf international best practice." In the case of the recent FSAP of Brazil, we had the example of a recommendation to make the deposit insurance a public institution, while the focus of the authorities, which could have benefitted more from the advice of the Fund, has been to increase the quality of information of the deposit insurance and reduce or eliminate the conflict of interest.

Finally, I want to raise a procedural issue. Many of the IEO recommendations flagged here will be addressed formally by the Board on other occasions: the budget discussion, the FSAP review, the CSR, and the Comprehensive Compensation and Benefits Review (CCBR), among others. But Mr. Mojarrad noted the issue of considering the whole recommendation as a package and not piecemeal, and it is important for management to have a Management Implementation Plan. I do not know how they would do that. It is important that management give guidance on those recommendations that were endorsed by the Board for those specific tracks of reviews.

Mr. Inderbinen made the following statement:

We broadly support the IEO's recommendations. We believe that implementing recommendations one and two would go some way toward a risk-based approach for financial surveillance and for the FSAP process in terms both of country selection and scope of assessments under the FSAP.

Independently of the question of country coverage and frequency, to which we obviously need to get back, there would be much merit in defining a clearer process for the FSAP to address the concerns raised by a number of Directors and to make the assessment process more efficient. Among the elements are certainly early FSAP mission, chief selection, definition of the scope by Article IV teams, focus standards, assessments, encouraging FSAP missions to leave out unproblematic areas and to focus on the most relevant issues and vulnerabilities, and suggested templates for Article IV follow-ups.

All this would also be important to alleviate the heavy burden of FSAPs on country authorities. Much of this hinges on a better integration between the Article IV and the FSAP processes, which would also help tailor recommendations and advice to country circumstances and improve traction.

In our gray statement, we emphasized that Fund financial surveillance needs to be adequately resourced; and in the context of a flat budget, which should be retained, this might require reallocating resources from areas that are less at the core of the Fund's mandate, as also mentioned by Ms. Pollard, Ms. Svenstrup, Mr. Merk, and Ms. Riach.

In general, we hold that the Fund should focus on areas where it has comparative advantage and strengthen the cooperation with the FSB, the Bank for International Settlements (BIS), and the standard-setting bodies, to exploit synergies and avoid duplication. The synergies with the Early Warning Exercise could be further developed, and we would see much merit in the concrete suggestion by Ms. Pollard and her colleagues that management debrief the Board on Early Warning Exercises after the Spring and Annual Meetings, and this would also go some way in alleviating the concerns that Mr. Agung mentioned earlier.

On the HR issues, we support the recommendation on building financial skills and expertise, and one aspect that we underline in our gray statement is to increase mid-career hiring and to offer better career prospects for mid-career hires. In our own experience of FSAP exercises, it is often the outside experts that have hands-on experience, not necessarily in private financial sector institutions, but in supervisory regulatory agencies, that add value to the discussions and to the recommendations that come out of the FSAP process.

Ms. Svenstrup made the following statement:

We agree with Mr. Ostros that the timing of this review is quite helpful. We strongly believe that macrofinancial surveillance continues to be a core component of the Fund's work. The staff are already undertaking high-quality and valuable work in this area. Yet it is important that we continue to refine the approach incorporating the lessons learned since the crisis to further improve the effectiveness and efficiency of these efforts. This rethink will involve considering difficult tradeoffs in the context of limited resources, in particular, how to make the financial sector surveillance program more focused and efficient while still ensuring a comprehensive enough assessment so as not to overlook developing but difficult-to-discern risks.

We agree with Mr. Tombini and many others that it will be important to consider all available surveillance modalities and proposals in parallel to better understand the tradeoffs. We also agree with Mr. Inderbinen on the importance of leveraging the work of the standard-setting bodies and national authorities to reduce duplication. Further, in principle, we would be supportive of a modest reallocation of resources toward financial sector work in the context of a flat real budget. It will be up to the Board and management to prioritize work efforts. In this context, we fully agree with Mr. De Lannoy, Mr. Ray, Ms. Riach, and Mr. Tombini that the upcoming CSR and FSAP review should present costed options to help the Board manage these tradeoffs.

With that, we thank the IEO again and look forward to engaging with our Board colleagues, staff, and management on these issues.

Mr. Kaya made the following statement:

We thank the IEO for their comprehensive and insightful set of reports and the Chairman for her statement, which broadly supports the IEO's recommendations, as does our Chair. We trust that management's support will help develop tangible and timely improvements. Several policy and strategy reviews expected to be discussed by the Board in 2019 will provide suitable launchpads for required reforms. Financial surveillance has always been one of the Fund's core business lines, the importance of which increased even further after the global financial crisis. We welcome the IEO's assessment that the Fund issued a substantial upgrade of this financial surveillance work. However, the report clearly shows that the room for further improvements is ample. Bilateral financial surveillance weaknesses and the lack of adequate resources are the two most burning issues.

We fully support the recommendation to strengthen financial and macrofinancial analysis in Article IV consultations, including through closer integration with the FSAPs. Effective knowledge transfer toward the surveillance cycle between the FSAP and Article IV teams will improve the quality of the surveillance engagement with the authorities as well as the traction of the Fund's advice. We see staffing the Article IV missions for low-income FSAPs with an MCM expert as particularly valuable in this respect.

We also support the recommendation to intensify efforts to attract staff with high-level macrofinancial skills. Their retention then critically depends on the possibility of promotion to senior manager levels without requiring fungibility and mobility. Strengthening the role of macrofinancial courses in the structure cycle for fungible macroeconomists is also warranted. None of what I have just said will be possible unless available resources are strengthened. Like other Directors, we are of the view that increased budgetary allocation for financial surveillance should be prioritized without delay. We expect that to be taken in the context of the budget for the next fiscal year, which will be discussed by the Board in February and April.

We are cognizant of the strong preference of many chairs for keeping the resource envelope constant in real terms. The reallocation of resources away from the new and emerging issues outside of the core purview of the Fund will thus be necessary under the hard budget constraint.

Ms. Levonian made the following statement:

It is clear from the IEO's report that significant progress has been made in the area of financial surveillance since the global financial crisis, and it is extremely important that this continue, especially in the rapidly changing global financial landscape. We are broadly in support of the thrust of the IEO's recommendations, and given the cross-cutting nature of the proposals, we look forward to having discussions in the specific areas as we discuss them.

We are in support of the joint gray statement that was issued by Mr. De Lannoy, Mr. Ray, Ms. Riach, and Mr. Tombini. I would like to highlight three specific points.

First, we agree that macro-financial analysis in the Article IV consultations needs to be strengthened further. While important progress has been made, we recognize that deep-rooted expertise and resource issues set against many competing demands continue to constrain this progress. We support Ms. Pollard and her colleagues in emphasizing that the upcoming FSAP review not focus on just one tool, but examine how the Fund can most effectively use all available venues, for example, the Article IV consultations, FSAP, the GFSR, and capacity development to fulfill its macro-financial surveillance mandate.

Second, we are open to reviewing the scope and focus of the FSAP but do not support the specific proposal to significantly scale back mandatory reviews to just the 'S5'. However, we support a more risk-based allocation of the FSAP resources and look forward to a more fulsome discussion on alternative approaches for allocating resources, including possible revisions to the S29 list in the broader context of the upcoming FSAP review.

We also see some scope for reallocating existing resources across countries. For example, some cost saving could perhaps be achieved by streamlining the FSAP further and coordinating more closely with international agencies, standard-setting bodies, and national authorities in minimizing duplication of efforts and better exploiting synergies. I would like to reiterate that any revision to the current approach to allocating resources across countries should respect the principles of evenhandedness and transparency.

Third, it is critical to ensure that the Fund has adequate resources for financial surveillance. Given the increasing complexity of the global financial environment and the priority the membership has placed on macro-financial surveillance, the IEO's work appears to justify an increase in resources to financial surveillance, but we agree that this is most appropriately done in the broader context of the Fund's budget discussions. I, however, also support Mr. Di Tata's point that appropriate analysis should be provided to make that assessment. I also want to lend my support to Mr. Tombini's point about the Management Implementation Plan. That is extremely important.

Finally, I want to note that we had a question in our gray statement that was not addressed in writing or orally.

Mr. Kaizuka made the following statement:

I thank Mr. Collyns and his team for the comprehensive and high-quality report. Supplementary papers are extremely helpful for us to understand the current situations, issues, and challenges. We issued a gray statement covering all six recommendations, so I will limit myself to discuss only a few points.

We believe recommendation one is a core of this exercise, which has implications for other recommendations and ultimately for the human resource strategy and budget process. In today's fast-changing environment of financial business markets and risk profiles, which are intensified by the development of the fintech and the crypto assets, the current FSAP framework has limits in capturing emerging risks in a timely manner. Consequently, country teams that have continuous contact with country authorities have to play larger roles in financial surveillance. For this, country teams have to be sufficiently equipped with the financial expertise, and therefore there should be a critical mass of financial experts in the institution.

Training is one of the possible ways to enhance expertise, but Supplementary Paper No. 5 indicates the still-low participation rate in macrofinancial structure curriculum courses, as Mr. Di Tata mentioned. There should be proper incentive mechanisms for macroeconomists to take part in the courses.

I also echo the Chairman's point on the necessity of a reliable and usable talent inventory in this particular regard. At the same time, we would encourage the Fund to utilize more leave-without-pay schemes in order to let staff have more external experiences, and the playbook could include the merits of such external experiences. There should also be more occasions for staff exchange programs with financial supervisory authorities, central banks, and possibly some private financial sectors, while Mr. Collyns did indicate some conservative views on the rotation scheme.

On top of this, we expect substantive discussions on how we could restructure the career track for experts in order to attract and retain highly-qualified and capable specialists in the Fund in the forthcoming HR strategy consideration.

Mr. Fanizza made the following statement:

Like many Directors, I need to start saying that the IEO did excellent work that provides high-quality inputs for both the CSR and the FSAP review.

I want to focus on what I see as the main issue, which is not new. Much work is needed to mainstream financial and macrofinancial surveillance in Article IV consultations. This has become the holy grail of financial surveillance review. This has been said several times, and it is a bit disappointing that we are still at this point.

What the report makes clear is that efforts in this direction are unlikely to be successful if we do not make additional resources available for financial surveillance. It is striking that the resources for financial surveillance are back to the pre-crisis level. It is surprising. Have we learned anything from that? While efficiency gains may be feasible, and we by all means support them, we believe that we need to acknowledge the existence of tradeoffs among different Fund activities and fully agree with Mr. Inderbinen and Mr. Kaya on that. We need to take decisions. We cannot say financial surveillance is important and then we do not choose between that and other activities.

On the recommendations on the reduction of frequency of FSAPs and things like that, we are open to them, but this discussion should be done in the context of the FSAP review in 2020. For the moment, I do not believe it is a very fruitful discussion, but my personal view is that it will be difficult to change lists and priorities. Maybe we should focus on making FSAPs less cost intensive, and I support what Mr. Di Tata was saying before, relying more on the work of the authorities.

Ms. Preston made the following statement:

We acknowledge the significant efforts of the Fund to deliver a substantial upgrade of its financial surveillance work since the global financial crisis. While the Fund has been playing catch up, the scope and flexibility of its financial surveillance responsibilities have been increasing.

My first point is about resourcing. Financial surveillance is unquestionably at the heart of the Fund's mandate, and so we take seriously the IEO's judgment that an increase in spending on financial surveillance will be important for further concrete progress to be made. This is best left to the budget discussion where resources and their allocation can be considered in the context of institutional priorities, risks, and informed tradeoffs. On this, we agree with the points made by Ms. Riach, Mr. Inderbinen, and Mr. Merk, among others, and we ask that the budget discussion include an option that significantly reallocates resources toward financial surveillance activities within the Fund's existing overall budget envelope.

Alongside adequate resourcing of financial surveillance is the need to ensure a more efficient and value-driven approach. We appreciate Mr. Collyns's further elaboration on options to do this. It is also important to appreciate the thinking of the IEO's recommendations as a package.

My second point is that strengthening macrofinancial analysis in Article IV reports is a must, as Article IV consultations are the most important channel for financial surveillance, and this is a point Mr. Agung has also made. This requires ensuring we have a deeper pool of financial talent available to conduct macrofinancial analysis, and part of this is developing the talent we already have, but the other part is recruiting experts in the field who already have the practical experience. On this, we support the remarks of Mr. Inderbinen. We look forward to discussing the issue further in the context of the HR strategy and ask that the recruitment of experts with practical experience is explicitly addressed along with the challenges of private-sector recruitment and rotation raised by Mr. Collyns.

My final point is that we strongly support the proposal to shift to a risk-based allocation of financial surveillance resources and support Mr. Collyns's remarks on this today. FSAPs have been an important tool in the implementation of the post-crisis regulatory agenda, but it is concerning that members see a decline in the value of these assessments given the considerable resources that go into them, both from the Fund and from national authorities.

We maintain strong support for regular FSAPs to a small group of the most important systemic economies but see merit and are open to taking a more state-dependent or risk-based approach to assessing when deeper financial surveillance is warranted. Such an approach could still mean that all of the S29 to receive FSAPs regularly, but that would be the result of an active rather than a mandated assessment, and FSAPs could be more tailored to the areas of most concern. This approach could help better align the balance between the "over-FSAPS" and the "un-FSAPs," both of which exist in our constituency.

Support for this risk-based approach goes hand in hand with my second point on strengthening macrofinancial surveillance in Article IV consultations, which would help to inform the risk-based judgment on the appropriate frequency for an FSAP, again noting the importance of considering these recommendations together. We look forward to discussing these issues in more detail in the upcoming FSAP reviews.

I will stop there on FSAP issues, but I wonder if I can make a remark on the structure of the meeting. I found it helpful to have the IEO respond up front to the questions Directors' raised in gray statements, and I wonder if that is a structure that we can think about taking forward more broadly.

Mr. Villar made the following statement:

The reports are clear and deliver high-quality findings. We issued a gray statement in which we present our thoughts on each one of the six main recommendations made by the IEO report. We broadly agree with most of them, but we have reservations and qualifications on some details, on which I will focus.

We strongly support recommendation one and fully agree on the need to deepen financial and macrofinancial analysis in Article IV surveillance. Article IV consultations are a good opportunity to enhance the follow-up of the FSAP recommendations.

With regards to recommendation two, we have reservations about the specific proposals of the IEO about refocusing FSAP country selection and scope. We support further work toward greater differentiation in the scope and focus across FSAPs, taking into consideration the authorities' views of the areas in which could deliver the most value added. However, we do not support changing the current approach of having the S29 countries covered every five years by an FSAP. We agree with the Chairman that there are market-signaling risks inherent in any selection of countries based on vulnerabilities. Like other Directors, we call for more use of financial sector stability reviews (FSSR).

On recommendation three, we agree on the importance of increasing traction on multilateral surveillance. The Fund's work on multilateral financial surveillance is well regarded and influential. In particular, we support the call for an early engagement of country teams. However, we concur with the Chairman that the current availability and different characteristics of data across countries makes it difficult and costly to develop a cross-border stress test exercise. Efforts by the Fund could have more value added in identifying international contagion channels and cross-border risks and in evaluating the post-reform impact assessment in activities.

We also have reservations regarding the recommendations on the EWE process and the dissemination of its results. The success of the EWE process comes from discussing and assessing potential new risks in a candid and effective way. Producing a public statement of key messages could defeat this purpose.

With regards to recommendations four and five, they are closely interlinked. We agree with the goals of enhancing the Fund’s analytical tools and building financial skills and this practice. It has been noted that many countries do not have the resources to develop this type of expertise and rely on the TA and capacity development provided by the Fund to identify and assess their financial vulnerabilities and risks. Therefore, the Fund must take advantage of its global role to keep updated with new tools, methodologies, and research and be able to disseminate the knowledge throughout the membership.

Finally, on recommendation six, we concur with the IEO’s assessment that significant additional resources will be needed to increase the IMF’s capability to fulfill its responsibility for high-quality and effective financial surveillance. In fact, the IEO report clearly states that we are already late in many areas, losing comparative advantage to other institutions that have invested heavily. Nevertheless, we have reservations about the idea that this increase in resources can be obtained by diminishing the resources of other substantive activities of the Fund.

A few years ago, the Board took the strategic decision to upgrade the mandate regarding the Fund’s financial supervisory activities. During the upcoming budget discussion, we should take that into account in order to fulfill these objectives, including the possibility of increasing the overall budgetary envelope. We consider this to be one of the most important and strategic topics of the IEO’s report on financial provision.

Ms. Mannathoko made the following statement:

We welcome the broadly positive response from the Chairman, but I would also like to thank Mr. Collyns and Mr. Lamdany for their comments this morning. It clarified a few things. We have issued a gray statement where we broadly support the recommendations given, so I will just highlight a few points.

The first is with respect to the importance of ensuring adequate resource allocations to financial surveillance, and we hope that the budget discussions will be approached with a view to addressing this need.

Second, we hope that the financial surveillance approach that is taken is approached in a manner that addresses the needs of the broader membership while closely monitoring key markets with truly systemic risks.

Third, as a general point, we note that even while significant progress has been made by the Fund and by the FSB since the global financial crisis, we are still in a situation where elevated risks to the system remain, and so clearly more needs to be done. Various outstanding issues or concerns keep coming up, whether it is the high non-bank sector leverage, or the fact that the banking system to some extent is still exposed to opaque illiquid assets, to foreign currency rollover risks. There is opacity in derivatives. Some analysts are still questioning conflict-of-interest issues in rating agencies. There are over-the-counter derivative questions based on some complexity even in terms of the large size of banking organizations with multiple separate legal entities. There are also the new financial instruments which are coming up and the rise of fintech, which raises the possibility of disruption. There are many challenges coming up, and we hope that in the discussion of resource allocations, we take into consideration the new environment.

Like Mr. Di Tata, we also believe that a focus on macrofinancial training is essential and would enhance efficiency and help contain costs. Like Mr. Mojarrad, Mr. Agung and many others, we believe that a focus on strengthening Article IV financial surveillance is key.

On the FSAPs, we believe that the FSAP review will address this. The details beyond engaging, sustaining engagement with S5, the details on determination and frequency of coverage of FSAPs will be addressed there, so we will not go into that.

Finally, we look forward to the Management Implementation Plan.

Ms. Roy made the following statement:

We have issued a gray where we have supported most of the recommendations but would like to mention some additional points.

We agree that financial surveillance has improved vastly since the global financial crisis and the reforms, but there appears to be a skewed conduct of FSAPs between the S29 and the rest of the Fund's membership. As the report says, about two-thirds of FSAP resources have been devoted to the S29, and FSAPs in non-S29 countries have become less frequent, and their share in the overall resources has diminished. Most of these countries have had only one or no FSAPs since 2010, so some modest changes could be attempted. Earlier speakers have already spoken on this, and we would say that in addition to increasing the period of FSAP from six to seven years from five years currently, it could be a good idea to combine Fund-led FSAPs and self-assessment. This would economize on the resources being expended on the S29. The S29 countries are generally bigger countries with greater resources and capacity; hence, after each FSAP conducted by the Fund-Bank team, the next exercise could be a self-assessment conducted by the authorities and regulators in some of the S29 countries. The countries could be pre-selected on a rolling basis based on the risk perception related to them, and there is a handbook on self-assessment that was published by the Fund-Bank in 2005, which would be helpful in this process, as we have seen when we did the self-assessment exercise in India.

The Fund-Bank team can peer review the assessment. After completion, this will need much less resources than a full-fledged three-mission FSAP exercise, which the requirement could then re-channel to the non-S29 countries. We agree with Mr. Agung that this could work well if the macrofinancial surveillance in Article IV consultations is done thoroughly. All these ideas could be considered in the context of the upcoming FSAP review.

Second, the latest innovation of conducting FSSRs in the non-S29 member countries, while certainly expedient, could do them a disservice by omitting the financial development advice of the World Bank, which these countries require. It will help if the World Bank is brought on board for FSSRs from now on.

We agree with Mr. Tombini that the advice given after the FSAP needs to be tailored to the needs of the country and not follow off-the-shelf techniques based on international best practices, as has been pointed out by some authorities in the IEO report.

We would also like to flag some efficiency issues. There is a need for greater coordination between the Fund and other IFIs like the World Bank and the FSB. Since the FSAP is conducted along with the Bank, and 80 percent of recommendations are common between the two, there could be a common report, which would save resources both on the Fund-Bank's end and at the authorities' end.

Third, there is often an overlap between the topics selected by the Fund and FSB peer review, which is a waste of resources, especially when the FSAPs and FSB evaluations are done close to each other.

There is little value in duplicating these assessments, and such overlap of evaluation between IFIs is best avoided for efficiency gains.

Ms. Gilliot made the following statement:

Like many Directors, I would like to emphasize the great progress made by the Fund since the global financial crisis in its bilateral and multilateral surveillance role in terms of reliance, comprehensiveness, and transparency. France is now dealing with an FSAP, so our position stems directly from a real time experience.

I would like to react to some recommendations of the IEO. To start with, we broadly concur with the IEO's conclusions on the need for a more dynamic, flexible, risk-based approach to FSAPs. As emphasized many times in the past in our grays and as Mr. Inderbinen and Ms. Svenstrup noted, we reiterate the need for the Fund not to duplicate the work done by other institutions—be they standard setters, monetary or supervisory authorities—and focus on areas that have been yet insufficiently covered.

We clearly see merit in opening a discussion on the reduction of the number of mandatory FSAPs. However, the selection of the five members as proposed by the IEO is debatable as it excludes several important financial systems and financial standards from the five-year monetary review process.

One could also question the exclusion from the list countries with similar features of the financial system. The coverage of the euro area financial system might have deserved a more in-depth analysis, particularly on the right articulation between the financial surveillance at the euro area level and at the members' level. The risk of overlap and redundancy for financial risk identification in the euro area financial sector assessment should be addressed. However, we believe that the discussion should continue on how to tailor FSAPs for the euro area countries.

We would be in favor of three bucket systems: a first bucket for the more systemic members covering a reduced number of members with mandatory FSAP every 5 years; a list of less systemic members but still with mandatory FSAP at a more regular pace than for the first bucket, for example, every 10 years; and at last, the rest of the membership with voluntary FSAPs.

Greater attention should be also paid to what would be the first bucket. We see, in line with Mr. Raghani, an urgent need for ensuring more even financial surveillance coverage among the membership. It is quite disturbing that a significant number of members had no FSAP review done for the past 16 years or more.

I would also like to recall how important FSAPs are for low-income countries (LICs) for which the Fund and the World Bank are jointly one of the sole providers of high-quality analytical work on the financial system. The rest of the membership should be given an opportunity to be in the list of countries for which FSAPs would be initiated by giving priority to countries with less capacity where financial risk calls for an assessment and that has not been reviewed for a long time.

Last, on stress tests, we largely favor coverage tailored to countries' circumstances, as recommended in the IEO report. In countries where financial risks are fully covered by adequate regulation and supervision, as is the case in the euro area, national FSAP stress tests do not provide much value added while presenting an excessive workload for both the Fund and the authorities' teams.

Mr. Alhomaly made the following statement:

We issued a detailed gray in which we covered all the six recommendations, so I will focus my remarks on a few issues.

We consider that financial surveillance is a critical area of the Fund's crisis prevention and resolution toolkit. Here, while important progress has been achieved in upgrading financial surveillance work, the evaluation concludes that more needs to be done to improve its quality and increase its impact and effectiveness. Against this background, we broadly support the recommendation to make the Fund's financial surveillance more effective, and we look forward to the forthcoming FSAP review and the CSR to finalize some of the issues under consideration.

In this respect, as mentioned by some Directors today, we believe that the issues of refocusing FSAP country selection and scope are better addressed with the benefit of additional inputs from the forthcoming FSAP review. We also consider that the Board reviews of compensation and benefits and the HR strategy are crucial to address some of the issues underscored in the evaluation.

Mr. Palei made the following statement:

We welcome the IEO report and the background studies. They do not call for a revolution in the Fund's work on financial surveillance, and it is recognition of the progress achieved by the Fund so far, so we should be realistic and pragmatic in our aspirations as financial surveillance is not easy to conduct and also not easy to integrate into Article IV reports.

On resources and identifying priorities for financial surveillance, as the IEO clearly explained, we cannot get by just by reallocating resources, and an overall increase is necessary for the Fund to adequately fulfill its mandate. We have mentioned it in our gray statement, and I want to reiterate it here for the record once again.

We should ask ourselves what the best way is to identify priority areas, and in accordance with this, to reallocate resources. I do not believe that we can answer these questions as a part of the budget discussion. It is not a realistic approach. It is the issue of substance, and we should do it as a part of the CSR and to a certain extent also the FSAP review.

Mr. Collyns gave us an example of the savings that could be achieved by reallocation of the FSAP resources from S29 countries to other Fund members that are dreaming or maybe just wishing for their FSAP exercise as well. I understand it is just an example to illustrate the issue, but reallocation should not be limited to the FSAP exercise only because we allocate resources for financial surveillance between Article IV reports, TA, and FSAPs. We cannot resolve these issues and identify priorities as a part of the FSAP review only because this is a broader issue. The best way would be to address it as part of a Comprehensive Surveillance Review (CSR). We will discuss the scoping notes for this review. It is scheduled for this February. I do not know what the timing is, but that is where we should look.

Mr. Lamdany reminded us about five countries where we did not have recent FSAP reports, but there was a very good macrofinancial analysis without an FSAP. There was either presence of people from MCM, of specialists, or there was in-depth TA, so those are other approaches we should look at when we try to identify priorities.

Mr. Fanizza and Mr. Spadafora reminded us about the key conclusion of the 2014 CSR. We wanted the area departments to be firmly in the driver's seat in financial surveillance. The question we should answer now is has it happened yet, or is there still a long way to go before area departments become fully engaged in financial surveillance?

A broader question is how we identify the best practices and how we disseminate the positive experience. We support the proposal to open up the data file used for the GFSR, but we have to have a broad approach. We have to identify success stories not just occasionally when we have an IEO report, but on a continuous basis, and the best practices should be disseminated through the Knowledge Exchange within the Fund and also opened up outside the Fund to broader participation, unless they are strictly confidential.

Ms. Lok made the following statement:

I commend the Fund for its substantial upgrade of its financial surveillance since the global financial crisis and also thank the IEO for the comprehensive report and will save the more specific comments on FSAP reviews and surveillance for the upcoming CSR and the FSAP review.

We just wish to emphasize the point we made in the gray statement that the IEO's recommendation should be considered together as a package and should be discussed in a more integrated way across the upcoming policy discussions and also the budget and HR discussions.

The Director of the Independent Evaluation Office (Mr. Collyns), in response to further questions and comments from Executive Directors, made the following additional statement:

It has certainly been a rich discussion, and we are pleased by the appreciation for the report, and we hope that it will contribute to a good discussion of how to deal with these difficult issues over the year ahead. At this point, I will respond to two specific questions and say something about the process going forward.

Mr. Doornbosch asked whether we had looked at the integration of macrofinancial work in the External Sector Report (ESR) and the Spillover Report. We did not do so in the context of this evaluation, but in our next evaluation on Fund Advice on Unconventional Monetary Policy, one of the issues we look at there is the integration of macrofinancial in the spillover reports, so in a few months we will come back to the Board with a thorough answer to that question.

On the ESR, that is a potential topic for future evaluation, so we will be coming back to discuss with Directors in a few weeks what will be our future topics, so that could be discussed then.

Ms. Levonian asked a question related to whether there is scope for the FSSR tool to be used to bridge the gap between the demand and the supply of FSAPs, and a number of Directors raised that issue in the discussion. I would agree that the FSSR is a potentially useful tool, particularly for LICs with less developed markets which are less likely to be priorities for the FSAP in the near future. In fact, there are 40 countries that have never had an FSAP, and those countries mainly fall into this category. However, in order to use the FSSR tool more extensively, it will be important to raise donor resources. Up to now it has been deployed on a pilot basis, but to mainstream the FSSR, it would require resources. It would also be important to reach an understanding with the World Bank on what is the appropriate role of the Fund and the World Bank in providing developmental TA in the financial area. In the past, it was the World Bank that took the main responsibility for TA on developmental issues, and the World Bank is interested in discussing with the Fund what is the best way of benefitting from the comparative advantages of the two institutions.

With regard to the process forward, at the conclusion of this meeting, we will be preparing our reports for publication. We will make some minor revisions to the country case studies to reflect the factual inaccuracies that have been identified. We are also going to be doing some outreach, both external and internal, and that outreach has been planned together with Fund staff, and we have had close cooperation with Fund staff throughout the process up to now, and we look forward to continuing to work closely with Fund staff, including on the outreach.

We are also looking forward to the Management Implementation Plan in six months’ time, and as a number of Directors have pointed out, it will be important for that plan to take on this issue of how to ensure an appropriately integrated approach dealing with the many issues across a spectrum of different channels for advancing changes.

The Chairman made the following concluding statement:

When it comes to what is next, I was very attentive to Mr. Mojarrad’s comments about the low-hanging fruits and what can be done very early on. In response to Mr. Agung, clearly the Management Implementation Plan that will be prepared and released in six months—though it might be earlier—will focus on those particular items, the low-hanging fruits and the ways in which sequencing will address as comprehensively as possible the six recommendations. This will be important. I have no doubt that within the Management Implementation Plan we will not be able to cover the existential issues that Mr. Palei has identified. That will be addressed more comprehensively in the FSAP review and the CSR, both taking place in 2020. This is under way. Work is going on, and clearly the discussions on the budget, the HR Strategy, as well as the CCBR, will be taking place as part of that same timing, so we will need to be sure not to draw overly quick conclusions from one or the other. My suspicion is that the current budget discussion is likely to be not particularly innovative in view of constraints that have been indicated and in view of the necessary tradeoffs that need to be predicated on an appropriate review of what is critical, what should be focused on, what should be alleviated or abandoned, and with the understanding of what risks we are taking in so doing. For example, I was mindful of some of the comments, and if our conclusion was to actually focus as much resources as possible on the macrofinancial aspect of our bilateral surveillance—where we are already reviewing 100 Article IV consultations and fielding 50 Article IV missions—and by the same token we were to decide to completely give up on our understanding and our risk analysis of cybersecurity, or our understanding and assessment of rapid fintech developments in some parts of the world, we would do a disservice to our mission of being attentive to financial stability. We will need to have those debates, and I am looking forward to them, but we need to be as comprehensive as possible in so doing.

In response to, Ms. Preston, it was interesting to have Mr. Collyns and his colleague focus on some of the key issues with oral answers in addition to anything else that has been done beforehand. We will see how we can use that as a pilot.

The Director of the Independent Evaluation Office (Mr. Collyns) made the following statement:

I would like to take a few moments to pay tribute and give thanks to my Deputy Director, Mr. Lamdany, who has been one of the foundations of the IEO for 12 years now. He has reached the 12-year limit and will be departing us. This evaluation will be his last one.

He has made a fantastic contribution to the work of the IEO over the past 12 years. He has been responsible for seven full evaluations, many of the most influential evaluations over this period, including evaluations of Fund governance, Fund performance in the run-up to the crisis, the Fund's response to the crisis, and now this high-quality evaluation of financial surveillance.

While doing all that, he has also been responsible for much of the work of running the IEO as the senior personnel manager and senior budget manager. What is probably less well-known within the institution is that he is also a well-known, widely respected, and influential member of the broader evaluation community. In fact, he has been sought on many occasions for counsel by other institutions interested in building up their evaluation work. He gave advice to the Bank of England when the Bank of England set up an IEO a few years ago. He has given advice to the Banque de France, to the ESM, and also to the European Court of Auditors, so he is well recognized in the broader community. He has a relentless work ethic. He is fully committed to delivering and fully committed to making a difference in his reports. He brings a professional evaluator's eye. He was in the Evaluation Office at the World Bank for a number of years, as well as being a top-notch economist, and he always brings strong, original insights. He has thought deeply about the behavioral dynamics of large institutions and is a committed enemy of groupthink, of silos, of institutional inertia; and he always makes us think hard about how we effect change in an institution.

We will miss him, but I am sure we will look for opportunities to bring him back to advise us when we find ourselves in a difficult spot. I just wanted to thank him and recognize everything that he has done for the IEO.

The following summing up was issued:

Executive Directors welcomed the report of the Independent Evaluation Office (IEO) on IMF Financial Surveillance. They welcomed the IEO's recognition of the substantial upgrade to the Fund's financial surveillance work as a result of the many initiatives launched to strengthen the Fund's work in this area since the Global Financial Crisis. At the same time, they shared the view that there is scope to further enhance the quality and impact of the Fund's financial surveillance. In this regard, they welcomed the Managing Director's broad support for the IEO findings and recommendations.

Directors supported Recommendation 1 on strengthening financial and macrofinancial analysis in Article IV surveillance, including by further integrating analysis from the Financial Stability Assessment Program (FSAP) in Article IV consultations and increasing the financial skills and expertise of country teams. Further progress in this area will require finding a right balance in the allocation of financial surveillance resources between FSAP and Article IV surveillance. A number of Directors supported the suggestion to strengthen the follow-up of FSAP-identified vulnerabilities and risks in Article IV consultations. Directors noted that the upcoming Comprehensive Surveillance Review and FSAP Review will provide an opportunity to consider Recommendation 1 and related specific suggestions.

Directors broadly concurred with Recommendation 2 to revisit the current approach to allocating FSAP resources to achieve a more flexible, dynamic, and risk-based allocation across countries and issues. Most Directors agreed with the proposal to review the number of mandatory financial stability assessments, but some were skeptical about reducing the number of jurisdictions subject to mandatory assessments (S29) or the frequency of their assessments, including because of the high speed of change in financial markets. Many Directors were open to reducing the number of jurisdictions subject to mandatory assessments every five years. A number of these Directors supported or were open to limiting mandatory assessments every five years to the five jurisdictions with the most systemically important financial sectors (S5). A number of other Directors, however, were opposed to limiting mandatory assessments to the S5. Directors stressed that the revised approach to allocating FSAP resources should strike a balance among several factors, including evenhandedness and transparency in the selection process, the systemic nature of national financial systems, the voluntary nature of financial stability assessments for most of the membership, and market signaling risks from selecting countries based on vulnerabilities. Directors also agreed that the scope and focus across FSAPs could be reviewed to better tailor assessments to country circumstances including risks and regulatory gaps while also avoiding over-reliance on off-the-shelf international best practice. This will help increase value added and make better use of staff and authorities' time and resources. Many Directors agreed or were open to the suggestion that in jurisdictions that conduct sophisticated stress tests, FSAPs should focus on designing risk scenarios and reviewing authorities' models to limit the resource burden on the Fund and the authorities. Other Directors felt, however, that the Fund should not cut back on stress testing in advanced economies to ensure a consistent quality of such tests. Directors looked forward to discussing the above issues in the context of the FSAP review.

Directors welcomed the finding that the Fund's multilateral financial surveillance is well regarded and influential. At the same time, they noted room to enhance its traction by increasing rigor and transparency, and by deepening collaboration with international partners. Along these lines, they broadly supported Recommendation 3, including making more GFSR data and analysis available online, subject to copyright constraints, and adapting the GFSR presentation to make it an easier read for busy country officials, who are its main audience. Directors also supported continuing to deepen cooperation with international partners, such as on the Early Warning Exercise (EWE) with the Financial Stability Board (FSB), without compromising the Fund's capacity to raise out-of-the-box issues. Some Directors supported wider dissemination of the EWE to senior officials, while others cautioned that wider dissemination could weaken its effectiveness. Directors stressed the need for the Fund to continue its work with international regulatory agencies to assess the impact of reforms, drawing on its areas of comparative advantage and subject to resource availability.

Directors supported Recommendation 4 that the Fund should continue to enhance its analytical tools to improve the understanding of macrofinancial linkages. They considered that exchange of views between the Fund and major central banks, as well as developing simplified tools and increasing internal outreach, is helpful for this purpose. While a few Directors encouraged staff to explore the feasibility of conducting global stress tests in partnership with the Bank for International Settlements and the FSB, others expressed doubts in view of data constraints.

Directors welcomed the recognition of the Fund's significant efforts to upgrade the macrofinancial skills of its economists but agreed that this area remains work in progress. They underscored that it is critical to ensure that country teams have the knowledge and support to integrate financial and macrofinancial analysis into Article IV consultations. In supporting Recommendation 5, Directors noted that targeted enhancements from the HR Strategy can help ensure that Fund staff develop the expertise needed for effective macrofinancial surveillance. They also looked forward to discussing issues pertaining to attracting and retaining a deeper pool of financial talent in the context of the Comprehensive Compensation and Benefits Review.

Directors agreed that to fully meet its responsibilities and objectives, the Fund should devote adequate resources to strengthening financial surveillance and concurred with Recommendation 6 on the need for additional resources for this work. Most Directors considered that an increase in resources should come from reallocation of some resources from other activities and seeking efficiencies. A few Directors thought that there should be an overall budget increase. Many Directors called for costed options for resource reallocation to help the Board in making an informed decision. Directors noted that relevant tradeoffs will be considered in the context of the Fund’s budget discussions, the FSAP Review, and the Comprehensive Surveillance Review.

In line with established practice, management and staff will give careful consideration to today’s discussion in formulating the management implementation plan, including approaches to monitoring progress and to discussing the interrelated recommendations in an integrated manner.

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JIANHAI LIN
Secretary