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2011 Review of the Standards and Codes Initiative

Prepared by the Staffs of the International Monetary Fund and World Bank

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List of Acronyms

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BCBS	Basel Committee on Banking Supervision
BCP	Core Principles for Effective Banking Supervision
CAS	Country Assistance Strategy
CFSA	Committee on Financial Sector Assessment
CMU	Country Management Unit
CPSS	Committee on Payments and Settlements Systems
DAR	Detailed Assessment Report
DQAF	Data Quality Assessment Framework
ECB	European Central Bank
FIRST	Financial Sector Reform and Strengthening Initiative
FAD	Fiscal Affairs Department
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSLC	Bank-Fund Financial Sector Liaison Committee
FSRB	FATF-style regional body
FSSA	Financial Sector Stability Assessment
GDDS	General Data Dissemination System
IAIS	International Association of Insurance Supervisors
ICR	Insolvency and Creditor Rights
ICRG	International Cooperation Review Group
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
ISP	Insurance Supervisory Principles
LEG	Legal Department
MCM	Monetary and Capital Markets Department
MFPT	Code of Good Practices on Transparency in Monetary and Financial Policies
NCJ	Non-Cooperative Jurisdictions
OBP	Office of Budget and Planning
OECD	Organization for Economic Cooperation and Development
OTM	Office of Technical Management
RAP	Regional Assistance Plan
RBI	Reserve Bank of India
ROSC	Report on Observance of Standards and Codes
RSN	Regional Strategy Notes

RSSS	Recommendation for Securities Settlement Systems
SCI	Standards and Codes Initiative
SCSI	Standing Committee on Standards Implementation
SDDS	Special Data Dissemination Standard
SPR	Strategy, Policy and Review Department
STA	Statistics Department
TA	Technical Assistance
TTF	Multi-Donor Topical Trust Fund
UNCITRAL	United Nations Commission on International Trade Law

Executive Summary

The Standards and Codes Initiative ("Initiative") has been identified as one of several building blocks for the overhaul of the global financial architecture after the Asian crisis in the late 1990s. Twelve policy areas were selected as key for sound financial systems and a framework for Reports on the Observance of Standard and Codes (ROSCs) was established and has been implemented by the Bank and the Fund for about a decade.

Since the Initiative's inception, a majority of member countries have had one or more ROSCs, although—in part due to the voluntary nature of ROSCs—the coverage is not fully complete.

After peaking in 2003, the annual number of ROSCs completed has declined considerably. In particular, the number of fiscal transparency and data ROSCs has dropped, reflecting the downsizing of the Fund, and changes in departmental priorities. The reduction in financial sector ROSCs—generally done as a part of the Financial Sector Assessment Program (FSAP)—has been less, although fewer ROSCs have been done per FSAP.

Revisions to the standards to incorporate the lessons from the crisis, the initiatives of the Financial Stability Board (FSB), and changes to financial surveillance are likely to have important implications for the future of the Initiative. In particular, the commitment by FSB members to undergo FSAPs every 5 years and the FSB's framework to enhance adherence to international financial standards are likely to boost demand for financial sector ROSCs. These resource pressures impose a greater burden on the prioritization process, and strategic decisions will have to be made to augment resources for the Initiative or on where the resource cuts could come from in order to maintain adequate coverage of non-G20 countries.

Drawing on the lessons from the recent crisis and the experience in implementing the Initiative, the 2011 Review proposes reform options that would:

- *Adapt the coverage of the Initiative to better safeguard financial stability;*
- *Cooperate with other bodies that use ROSCs for their own initiatives but continue to refrain from participating in NCJ-type processes;*
- *Improve presentation and access to ROSC findings; and*
- *Implement modest changes to improve the efficiency of resource use.*

I. BACKGROUND

1. **The Standards and Codes Initiative was launched in the wake of the Asian economic and financial crisis in the late 1990s.** It was one of several building blocks in the post-crisis efforts to strengthen the global financial architecture. The Standards and Codes Initiative (hereafter "Initiative") was intended to increase financial and economic stability by strengthening domestic economic and financial institutions, focusing on three areas: policy and data transparency; financial sector regulation and supervision; and market integrity.

2. **Standards and codes in 12 policy areas (henceforth "standards") were selected as key for sound financial systems** (Box 1). The standards are maintained and revised by the relevant standard setters in consultation with the Bank and the Fund and key market players. The Fund is the standard setter for three (data, fiscal transparency, and monetary and financial policy transparency) of the 12 policy areas. The Bank is the standard setter, in consultation with the United Nations Commission on International Trade Law (UNCITRAL) and Fund staff, for the standard on insolvency and creditor rights. Standards in eleven of these 12 policy areas have been endorsed by the Bank and Fund Boards.[1]

3. **To foster implementation of these standards, an assessment program was established under the auspices of the Bank and the Fund.** Reports on the Observance of Standards and Codes (ROSCs) have been prepared for a large majority of Bank and Fund members. Many, but far from all, ROSCs are done in the context of FSAPs.[2] The program is entirely voluntary. They are administered by different departments both at the Fund and the Bank and there is no overall system that decides on the selection of countries or standards to be assessed. Similarly, no overall budgetary envelope exists for the Initiative and financing is drawn from the different departmental budgets. For standard assessments that are included

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[1] In 2005, a revised version of the World Bank Principles for Effective Insolvency and Credit Rights Systems was submitted to the Bank Board and published. A unified standard based on the 2005 World Bank Principles and the Recommendations included in the UNCITRAL Legislative Guide on Insolvency Law has been developed, in consultation with the Fund; the unified standard has been published and presented to the Bank's Executive Directors for information in March 2009. A new methodology based on the Insolvency and Creditor Rights (ICR) Standard was agreed among the Bank, Fund, and UNCITRAL, and is currently being used for ROSC assessments. In light of recent developments, the ICR Standard was updated in January 2011; the updated Standard will be submitted to the Bank's Board for endorsement for use in the ROSC program.

[2] Six of the standards are generally assessed as part of the FSAP, although stand-alone assessments are also possible. In the context of the FSAP, Banking Supervision, Securities, Insurance, Payments and Securities Settlement Systems, and Monetary and Financial Policy Transparency are assessed by the Fund or the Bank. The Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) standard is the only standard that is assessed by other assessor bodies (i.e., the FATF and FATF-style regional bodies) in addition to the Fund and the Bank; it is also the only standard required for all full FSAPs and FSAP updates. The Fund assesses Monetary and Financial Policy Transparency. Corporate Governance, Accounting, Auditing, and Insolvency and Creditor Rights are typically assessed by the Bank either as a stand-alone assessment or as part of the FSAP, depending on country circumstances. Finally, the Data and Fiscal Transparency standards do not form part of the FSAP and are assessed on a stand-alone basis by the Fund.

Box 1. Standards and Codes under the Initiative[1/]

Policy Transparency

- **Data:** the Fund's *Special Data Dissemination Standard* and *General Data Dissemination System* (SDDS and GDDS).[2/]
- **Fiscal Transparency:** the Fund's *Code of Good Practices on Fiscal Transparency. 3/*
- **Monetary and Financial Policy Transparency:** the Fund's *Code of Good Practices on Transparency in Monetary and Financial Policies* (MFPT).

Financial Sector Regulation and Supervision

- **Banking Supervision:** Basel Committee on Banking Supervision's (BCBS) *Core Principles for Effective Banking Supervision* (BCP).
- **Securities:** International Organization of Securities Commission's (IOSCO) *Objectives and Principles of Securities Regulation*.
- **Insurance:** International Association of Insurance Supervisors' (IAIS) *Insurance Supervisory Principles* (ISP).
- **Payments Systems:** Committee on Payments and Settlements Systems' (CPSS) *Core Principles for Systemically Important Payment Systems*, complemented by *Recommendations for Securities Settlement Systems* (RSSS) for countries with significant securities trading.
- **Anti-money Laundering and Combating the Financing of Terrorism**: Financial Action Task Force (FATF)'s *Forty Plus Nine Recommendations*.

Market Integrity

- **Corporate Governance (CG):** Organization for Economic Cooperation and Development's (OECD) *Principles of Corporate Governance*.
- **Accounting:** International Accounting Standards Board's *International Financial Reporting Standards (IFRS).*
- **Auditing:** International Federation of Accountants' *International Standards on Auditing* (ISA).
- **Insolvency and Creditor Rights (ICR):** A standard based on the Bank's *Principles for Effective Insolvency and Creditor Rights Systems* and the United Nations Commission on International Trade Law (UNCITRAL) *Legislative Guide on Insolvency Law*.[4/]

1/ Links to full descriptions of the standards and codes and published reports are available at: http://www.financialstabilityboard.org/cos/key_standards.htm

2/ Since early 2001, the Data ROSC is based on the Fund's Data Quality Assessment Framework (DQAF), which was last revised in July 2003, and which identifies quality-related features of governance of statistical systems, processes, and products. It provides a framework to assess existing practices against best practices, including internationally accepted methodologies. The Fund's Data Dissemination Initiatives (the Special Data Dissemination Standard and the General Data Dissemination System, SDDS and GDDS, respectively), are reviewed separately by the IMF Executive Board, and also apply the DQAF, which provides a common structure for all of these efforts.

3/ The supplementary Guide on Resource Revenue Transparency is used for resource-rich countries.

4/The World Bank, working with UNCITRAL and internationally recognized experts, has completed and implemented the ICR ROSC Assessment Methodology. The ICR ROSC Methodology is based on the current Creditor Rights and Insolvency Standard (ICR Standard), derived from the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, and the recommendations included in the UNCITRAL's Legislative Guide on Insolvency Law.

under an FSAP (financial sector standards), the prioritization process for the selection of countries and standards to be assessed follows the FSAP process.

4. **Publication regimes for different reports that cover standards assessments vary.** ROSCs can be published as stand-alone documents, or annexed to the FSSA report when standard assessments are done in the context of an FSAP. DARs can be published as stand-alone documents or as part of FSAP documents. For the Fund, publication of ROSCs is "voluntary but presumed" while publication of the underlying detailed assessment reports (DARs) is at the discretion of the member with the consent of Fund management.[3] For the Bank, under the new Access of Information Policy[4] effective July 2010, the existing practices regarding the publication of ROSCs and DARs remain unchanged because these documents normally fall under one of the exceptions to the policy (e.g., information provided on a confidential basis).

5. **The last review conducted in 2005 concluded that the Initiative had been broadly successful, but more efforts were needed to increase its effectiveness.**[5] In particular, more could be done to increase countries' participation; improve integration of ROSCs into Fund surveillance and Bank capacity building; and enhance follow-up efforts through Bank and Fund technical assistance and operational work. Directors also called for enhancing the clarity of ROSCs' findings.[6] The Fund's medium-term strategy reconfirmed the membership's support for the Initiative.[7]

6. **The Initiative's 10-year anniversary and especially the recent economic crisis make this review particularly timely**. The crisis has placed the observance of standards at the forefront of the policy agenda and has also raised questions about the adequacy and gaps of existing standards. Ongoing reviews by standard setters and recent efforts to strengthen adherence to international standards will have implications on how the Initiative will be conducted in the future.[8] In particular:

- Lessons drawn relating to the adequacy, scope and effectiveness of regulatory arrangements and the capacity to transparently monitor risks and economic vulnerabilities have provided renewed impetus for tighter regulation of financial markets and institutions. The experience has also triggered initiatives to fill data gaps

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[3] ROSCs are covered under the Fund's transparency policy, while DARs are not.
[4] See *The Bank's Access to Information Policy*, July 2010.
[5] See *The Standards and Codes Initiative—Is it Effective? And How Can it Be Improved?* (International Monetary Fund and World Bank, July 1, 2005.
[6] See Public Information Notice 05/106, *IMF Executive Board Reviews the Standards and Codes Initiative*, August 8, 2005.
[7] See *The Managing Director's Report on The Fund's Medium-Term Strategy*, September 1, 2005.
[8] See Background Paper, Chapter II.

critical to national and multilateral surveillance.[9] The result has been a range of activity including at the G20 level that has led to the revision in nearly all the standards covered by the Initiative and the emergence of new ones.

- FSB members have committed to undergo an assessment under the Financial Sector Assessment Program (FSAP) every five years, and to publish the detailed assessments of the ROSCs on Banking Supervision, Insurance Supervision, and Securities Regulation. In addition, FSB members have launched peer reviews which will be undertaken in between FSAP updates. The FSB has also launched a process of promoting global adherence to standards, focusing on information exchange and cooperative arrangements in banking, insurance and securities supervision.[10] This initiative envisages the creation of a toolbox of measures to promote adherence to these standards. However, some aspects, including the option of publishing the names of non-cooperative jurisdictions (NCJ), may create tensions with the voluntary nature of the Initiative (see section IV.G.)

7. **This report focuses on the Initiative's effectiveness in meeting its objectives and makes proposals for adaptations in light of the global crisis and experiences with implementation.** In particular, it will seek to address the following issues: (i) the appropriateness of the key standards covered by the Initiative; (ii) the prioritization of standard assessments; (iii) efficiency in resource utilization; (iv) the integration of ROSCs into Bank and Fund work; (v) communication with private sector participants; (vi) use of ratings; and (vii) the Fund's and Bank's position on NCJ-type processes.

8. **Staff used a combination of techniques to evaluate the effectiveness of the Initiative and to seek stakeholders' views on how it could be improved.** The views of authorities, market participants, and standard setters were sought through a combination of questionnaires and discussions. Similarly, a questionnaire was sent to mission chiefs and assessors, to seek their views on: (i) the usefulness of the overall Initiative and specific ROSCs; (ii) quality of assessments; (iii) the Initiative's link to Fund surveillance and Bank capacity building; and (iv) follow-up efforts through Bank and Fund technical assistance and operational work. Staff also consulted with outside experts and previous staff members and conducted a desk review of Article IV reports and a few selected case studies. A consultant was hired to review selected country experiences with the implementation of the Initiative.

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[9] See *The Financial Crisis and Information Gaps – Progress Report, Action Plans, and Timetable*, IMF Staff and FSB Secretariat, May 2010.

[10] See *FSB Framework for Strengthening Adherence to International Standards*, FSB, March 10, 2010.

II. Evolution of the Initiative

Over the past decade, most countries have been covered by ROSC assessments (Table 1 and Figure 1). After peaking in 2003, the annual number of ROSCs has been more than halved, partly reflecting budgetary considerations and a shift in priorities as many countries have had initial assessments of standards and codes. However, this trend may be reversed consequent to the comprehensive overhaul underway across most standards under the Initiative and the renewed momentum to enhance adherence to those standards.

9. **While a large number of countries have now undergone one or more ROSCs, the coverage of ROSCs remains uneven, both in terms of the type of ROSCs conducted and their regional coverage.** The most common standard assessments have been on banking supervision, payment and settlement systems, and on fiscal transparency. The standards on corporate governance and insolvency and creditor rights are assessed the least frequently. Securities and insurance sectors for emerging and developing economies are sometimes reviewed with reference to the standards rather than being formally assessed given the incipient level of development of these sectors in these economies. Regionally, Europe and the Americas had the highest participation rates, whereas Asia had the lowest.

10. **After reaching a peak in 2003, the annual number of ROSCs dropped significantly** (Table 1). The annual number of ROSCs conducted is now close to its level during the early pilot years. Four factors may explain most of this reduction: (i) a decrease in the overall budget allocated to ROSCs; (ii) a reduction in the number of countries undergoing initial assessments; (iii) a shift from formal ROSCs towards technical notes; and (iv) a sharp decline in FSAP-related ROSCs (the average number of standards assessments conducted during FSAP missions dropped from about four in the initial years of the Program (2000-2004) to about one in 2008 and 2009).[11]

Table 1. All ROSCs Completed: 1999 - 2010 [1]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total
Total	43	49	118	139	157	124	77	108	60	73	67	62	1077
Banking supervision	10	9	20	18	23	20	8	18	9	16	14	11	176
Payments Systems 2	0	6	20	20	25	11	4	12	4	5	1	4	112
Fiscal policy transparency	10	8	15	21	9	11	9	7	7	4	6	3	110
Data	9	2	12	9	16	12	16	14	8	5	2	4	109
Accounting & Auditing 3	0	0	3	8	12	16	11	13	11	12	16	11	113
Monetary and financial policy transparency	10	9	18	18	20	10	2	6	2	3	0	1	99
AML/CFT	0	0	0	0	13	12	12	11	10	14	15	9	96
Securities regulation	3	5	11	14	12	10	1	7	3	4	2	5	77
Corporate governance	0	4	7	11	8	8	10	7	4	4	7	4	74
Insurance supervision	1	6	11	15	9	6	3	7	1	1	3	6	69
Insolvency and creditors rights	0	0	1	5	10	8	1	6	1	5	1	4	42

[1] Includes initial assessment and reassments. Does not include the "factual" updates (which do not change the ratings).
[2] Includes Recommendations for Securities Settlement Systems.
[3] Accounting and Auditing have been two separate policy areas, but are presented as one ROSC in this Table.
Source: IMF and World Bank ROSC Database and staff calculations.

[11] See Table 9 in *The Financial Sector Assessment Program After Ten Years: Experiences and Reforms for the Next Decade*, International Monetary Fund and World Bank, August 28, 2009

Figure 1. ROSCs, Global Coverage: 1999–2010

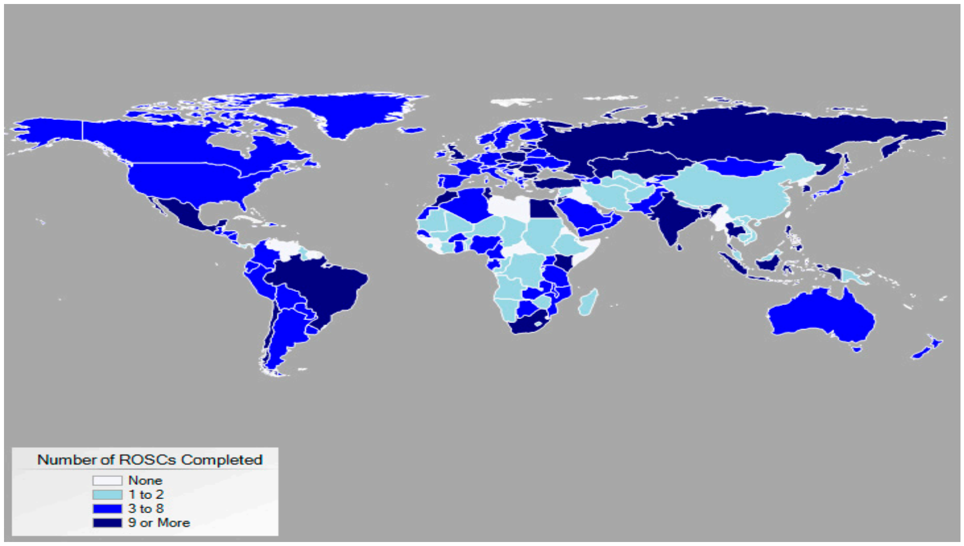
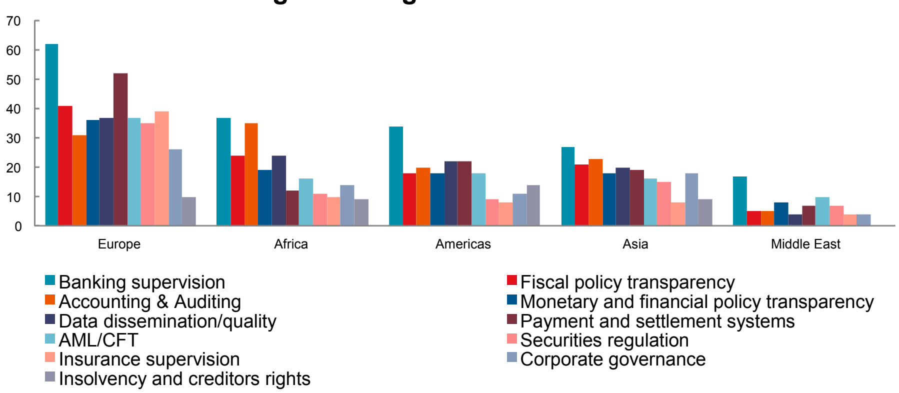


Figure 2. Regional Distribution of ROSCs

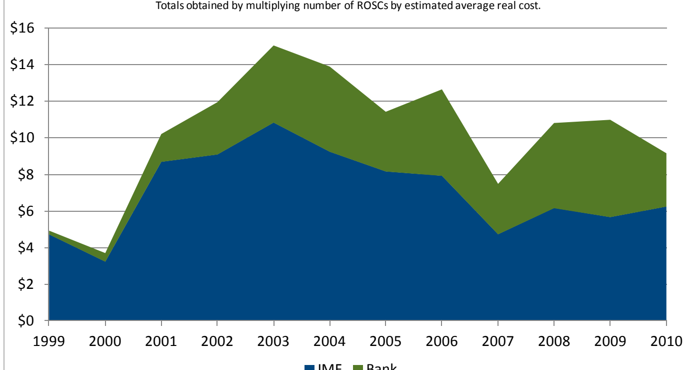


11. **Reflecting the drop in the number of ROSCs, the overall resources use to the Initiative has declined significantly in real terms**. Overall, real expenditure fell by about 40 percent from its peak in 2003 to 2010. The Fund experienced a drop of 42 percent, while the Bank experienced a drop of 31 percent.[12]

Estimated Real Expenditures on ROSCs by Institution

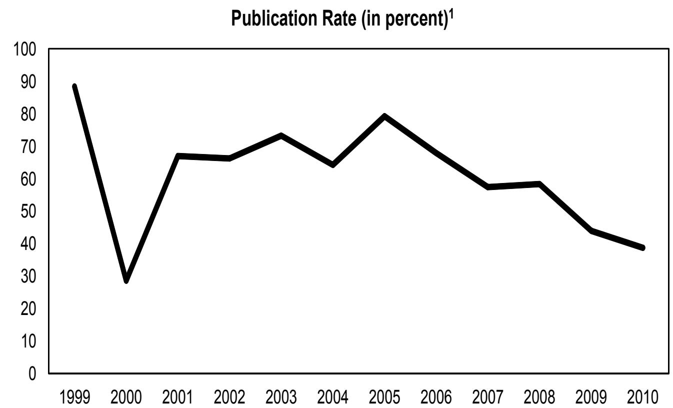
(US$ Millions, 2009 dollars)

Totals obtained by multiplying number of ROSCs by estimated average real cost.

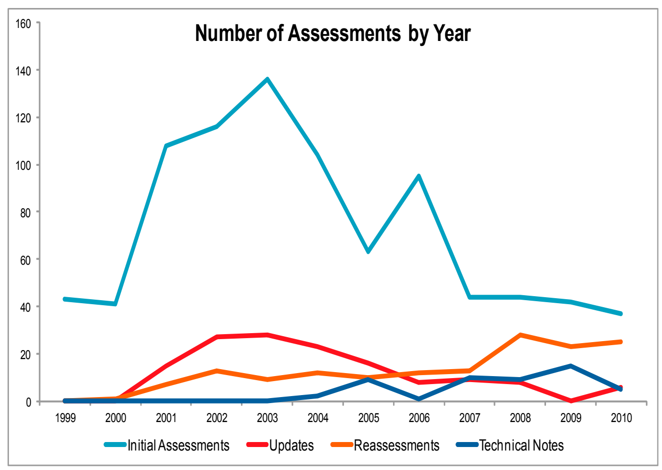


[12] More information on the cost of the Standards and Codes Initiative can be found in Appendix II.

12. **Contrary to the experience with most other Bank and Fund documents, the annual publication rate for ROSCs has declined** (see figure). Although no clear explanation emerged from the surveys and staff discussions with country authorities on the reasons for this drop, it likely reflects a combination of: (i) a drop in the relative share of ROSCs done in countries with generally high publication rates (e.g., European countries) and (ii) a reduction of the number of ROSCs on standards with high publication rates (e.g. Data and Fiscal Transparency ROSCs).



1/ A ROSC module is considered published when the date of publication is within six months of the date of completion of the ROSC.



13. **Looking forward, ongoing efforts to ensure financial sector strengthening and enhanced compliance with international standards are likely to have significant, yet uncertain, implications for the Initiative.**[13] However, on balance, it is expected that the net effect will be an increase in the number of ROSCs:

- *FSB commitments.* FSB members have committed to undergo an FSAP and publish the DARs of three financial sector regulation and supervision ROSCs (banking supervision, securities regulation, and insurance supervision) every five years. FSB has also launched a framework for enhancing adherence to international standards. This will likely result in an increased demand for these ROSCs. Initial estimates already indicate a substantial increase in the number of FSAP requests and the

[13] In the past, for the most part, country requests for non-financial sector ROSCs have been met (i.e., DATA ROSCs, Fiscal Transparency, and AML/CFT). However, due to the recent increase in requests for FSAPs and financial sector ROSCs combined with the resource-constrained environment, some requests from non-systemically-important countries had to be deferred.

corresponding number of ROSCs per FSAP for FY2011 compared to previous years, including for G20 countries.[14]

- *Mandatory financial stability assessments*. In September 2010, the Fund's Board decided to make the stability module of FSAPs mandatory for 25 jurisdictions with systemically important financial sectors every 5 years. A financial stability assessment will mainly focus on macro-financial stability issues but can be accompanied by ROSC assessments on a voluntary basis. The effect on the number of ROSCs is uncertain.

- *Targeted ROSCs*. The requirement that financial sector ROSCs had to be carried out through comprehensive detailed assessments resulted in reductions in the number of formal standard assessments and led to shifts towards less resource-intensive alternatives such as factual updates and technical notes. In the context of increasing the effectiveness of FSAPs, the principle of targeted ROSCs was introduced for BCP, IAIS and IOSCO assessments.[15] These targeted ROSCs will allow more focused financial sector ROSCs in the context of FSAPs. The selection of principles to be assessed will be based on an evaluation of relevant risks and vulnerabilities in each country.[16] This could make it less costly to provide a reassessment—albeit partial. Thus, the net impact of these changes could be an increase in the number of ROSCs.

- *Fiscal Transparency Assessments*. As budgetary support is withdrawn after the recent crisis and governments both in advanced and emerging economies undertake fiscal adjustment measures, fiscal transparency assessments could become a key component in restoring fiscal sustainability. This would likely increase the number of fiscal ROSCs.

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[14] ROSCs for G20 countries tend to be more resource-intensive. In addition, the expected increase in the complexity of standards assessments on account of recent or ongoing standards revisions, as well as increased scrutiny from the authorities given the latter's commitments to publish assessment results add to the resources required for undertaking ROSCs.

[15] See *Revised Approach to Financial Regulation and Supervision Standards Assessment in FSAP Updates*, International Monetary Fund in collaboration with World Bank, August 28, 2009.

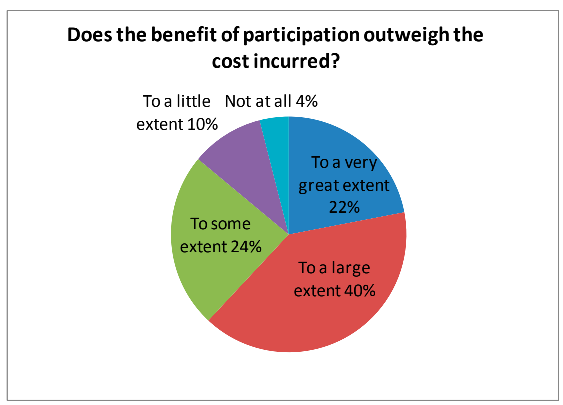
[16] See *Guidance Note for Staff on Undertaking Targeted (Risk-based) Reports on the Observance of Standards and Codes (ROSCs) in Financial Regulation and Supervision*, International Monetary Fund and World Bank, October 4, 2010.

III. Lessons from Implementing the Initiative

The Initiative has been particularly useful in framing capacity building needs. Members consider it useful in identifying gaps, setting the reform agenda, strengthening institutions, and promoting transparency. Country ownership and consistent follow up are key for successful implementation. Market participants find the Initiative less useful, given the lack of frequent updates and easily accessible quantitative information. The integration with Bank and Fund financial assistance seems stronger than with surveillance; although staff reviews suggest that in some cases ROSCs results played a key role in surveillance.

14. **The Initiative seems to have been broadly supportive of economic and financial stability**. Staff case studies suggest that ROSCs have been useful in identifying weaknesses in institutional frameworks and helped focus Fund surveillance, particularly in the financial sector.[17] While the ROSC program aims at building frameworks supportive of financial stability, its focus on the arrangements for regulatory oversight means that the more difficult issue of effective supervision is not directly addressed by the Initiative. In this regard, country ownership to invest in the resources/training and the independence of agencies entrusted with execution of oversight, is critical in strengthening the Initiative's contribution to financial stability. One important observation of the crisis has been that in many cases, there was often a failure to utilize existing powers as opposed to these powers being absent. In fact, empirical evidence suggests that standard observance is related to smaller spreads on sovereign bonds, although there is no strong evidence that, on a broad scale, minimum standard observance mattered significantly on how countries fared during the recent crisis (see Chapter IV in the Background Paper).

15. **Largely reflecting perceived positive effects on capacity building, the Initiative continues to be well-received by member countries.[18]** Nonetheless, both staff interviews of country authorities and responses to the questionnaire indicate that a majority of members consider ROSCs useful. Ninety-six percent of respondents to the country authorities' survey found that participation in the Initiative outweighed its costs; and 53 percent considered that the net benefit from participation was large or very large. In particular, country authorities from advanced economies, emerging markets and developing economies, found ROSCs most useful in identifying vulnerabilities and priorities for strengthening institutions, and in



[17] See Background Paper, Chapter V.
[18] See Background Paper, Chapter VI.

increasing policy transparency. Emerging markets and developing economies also found the Initiative most useful in identifying weakness in institutional capacity.

16. **While the Initiative remains well-received, it could be better aligned with current needs.** In this context, many country authorities—particularly those in advanced countries, but also some representatives of emerging market economies—found that one or more standards were outdated given the current focus on second-generation issues instead of the need to introduce basic financial sector infrastructure as was the case in most countries when the Initiative started. The perceived high cost of undergoing a ROSC seems to be another area of concern, although it is unclear whether this remains a bigger concern now than it was in 2005.

17. **Largely in line with the 2005 Review, the payment and settlement systems, fiscal transparency, and data ROSCs were considered the most useful by all countries in relation to different objectives (identify vulnerabilities, strengthen institutions, identify and prioritize TA).** All standards were seen as specifically useful by at least one group of countries (advanced economies, emerging economies, developing economies) for at least one objective. Advanced countries differed from emerging markets and developing economies in considering the ROSCs on AML/CFT more useful than ROSCs on any of the other standards.[19] Respondents from emerging markets and developing economies found ROSCs on payment systems most useful, followed by fiscal transparency ROSCs. The quality of assessments was considered to be good for all standards with payment and settlement systems and fiscal transparency ROSCs deemed to be of highest quality.

18. **A study of 22 country cases, conducted by an external expert,[20] suggests that: (i) adequate preparatory work; (ii) prioritized recommendations; (iii) country ownership; and (iv) effective follow-up are essential for successful ROSCs.** The country cases were selected to shed light on (relatively recent) successful and less successful cases under each standard and were drawn from all regions and income levels (Box 2).

19. **The study concluded that improvements are needed across several dimensions.** Ensuring availability of quality self-assessments is a first step for a successful assessment and an indication of country ownership. A dedicated TA program ensures follow up of ROSC recommendations in some cases. For example, there are allocated follow-up resources for AML/CFT ROSCs. Ownership is another dimension that could be improved, potentially by shifting the focus from compliance scoring to prioritized recommendations and ensuring more frequent reassessments.

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[19] A forthcoming Board paper, *"Anti-Money Laundering and Combating the Financing of Terrorism - Review of the Fund's Program,"* is tentatively scheduled for Board discussion in May 2011.

[20] See *2011 Review of the Standards and Codes Initiative: ROSC Case Studies*, Claudio Pardo, February 2011.

Box 2. Summary of Findings of External Expert Study

Based on a study of 22 country cases conducted by an external expert, the following observations were made:

Preparatory work. There is a need to standardize pre-mission work and availability of key documentation, especially quality self-assessments from local counterparties.

Prioritized recommendations. Prioritized recommendations are essential to prepare an implementable action plan. There is a trade-off on the way ROSCs may be used, as either an instrument for informing surveillance or for strengthening institutions and capacity building. If the surveillance aspect dominates, ratings may become the dominant issue during assessments, and less time and effort is spent on shaping the agenda for the necessary financial sector reform.

Country ownership. Without a high degree of ownership, ROSCs are not likely to trigger any action to reform the institutional framework, even if the ROSCs are of high quality and vulnerabilities are correctly identified. The most successful cases are often characterized by explicit integration of ROSC recommendations into a reform program. Reform implementation requires sustained commitment by key government agencies and private stakeholders over a long time period, generally much longer than the few months needed to plan, undertake and finalize a ROSC.

Follow-up implementation. Follow-up implementation is critical, particularly for developing countries. ROSCs represent a valuable source of knowledge that should be used to prioritize technical assistance and commit the Bank and the Fund to help countries address the development needs identified in the ROSCs. Bank and Fund support is mostly useful when it goes beyond addressing a specific gap to play a catalytic role by giving more credibility to reform efforts, galvanizing support behind the ROSC-promoted agenda, and attracting concerted support from others (e.g., FIRST Initiative, donors) to implement the reform agenda.

A two-stage process was followed in the selection. First, based on discussions with ROSC programs coordinators and assessors, a list of between 6 to 12 country experiences per standard was selected. Then, the 22 cases were selected from this list by using a set of predetermined criteria. The geographical region and the type of standard were the main two criteria used in the selection to ensure that all regions and standards were represented in the sample. In addition, a few other criteria were applied to the sample selection, including: (i) a review of two detailed experiences per standard; (ii) coverage of advanced economies, emerging markets and development economies; and (iii) ROSCs completed in the last five years.

20. **A review by staff of ROSCs over the last five years also suggests that efforts in meeting the objectives of the 2005 Review have achieved some success.**

- ***Country coverage and prioritization.*** Country coverage has increased. For ROSCs done under the FSAP, prioritization is linked with the broader prioritization exercise conducted for FSAPs twice a year. The country prioritization of stand-alone ROSCs is largely done by the department responsible for conducting the assessments.

- ***Integration into Fund surveillance.*** The integration of ROSCs into Fund surveillance is mixed.[21] A review of staff reports shows that ROSC recommendations are only selectively integrated into these reports. But case studies of crisis countries suggest that the follow up on key ROSC recommendations in some cases has been good. The integration is sometimes indirect, either through the FSAP or, in the case of data, through the established framework for assessing the adequacy of data for surveillance purposes.

- ***Integration with other Bank and Fund work.*** The Bank holds review meetings with the participation of the Country Management Units (CMUs) and FIRST Initiative staff. Close coordination between the FSAP Unit, ROSC programs and FIRST Initiative is being increased to achieve better follow-up.[22] ROSC recommendations are sometimes integrated into Bank lending programs (e.g., Uruguay) but integration into country assistance strategies (CAS) is limited.[23] More progress has been made in integrating ROSCs with technical assistance, for instance, through the efforts in prioritizing technical assistance at the Fund and programs such as the Fund topical trust fund dedicated to technical assistance to follow up on ROSCs on AML/CFT which started in 2009 (Box 3). Moreover, ROSC recommendations have been largely integrated as structural benchmarks in several of the recent Fund arrangements (e.g., Greece and Iceland).

- ***Clarity and timeliness of ROSCs.*** A larger number of ROSCs now include a prioritized list of recommendations, particularly those on data, fiscal transparency, corporate governance, accounting and auditing, and AML/CFT. On timeliness, most, although not all, are issued within the six-month target set in the 2005 Review.

21. **However, the use of ROSCs by market participants remains low, and seems to have dropped further since the 2005 Review.** Discussions with market participants indicated a desire for more frequent updates (ideally annually), more quantitative ratings, and comparable indicators for ease of comparison across countries. Where ROSCs were considered at all relevant, they were generally seen through the prism of FSAPs, which was considered a well-recognized program.

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[21] From a legal perspective, ROSCs are part of the Fund's technical assistance activities. However, from a budget perspective, ROSCs are treated as Fund surveillance.

[22] The FIRST (Financial Sector Reform and Strengthening) Initiative is a multi-donor grant facility providing technical assistance to promote financial sector strengthening. The World Bank manages the FIRST Initiative on behalf of the donors. FIRST has been recently extended to 2012 with funding of $100 million.

[23] According to the Bank paper, *"Building a Monitoring and Evaluation Framework for the Financial Sector,"* (November 2008), overall ROSC coverage in Bank CAS is poor. Financial ROSCs have particularly poor coverage while Bank ROSCs have slightly better coverage.

Box 3. TA Follow-up on AML/CFT Recommendations[1]

Donors expect the Fund to finance AML/CFT ROSCs as part of its mandate. However, technical assistance activities are funded by the Multi-Donor Topical Trust Fund (TTF) which was established in late 2008 and began operations in May 2009. Twelve donors oversee a five-year TA program (amounting to about US$29.3 million) through a Steering Committee, which reviews, revises as necessary, and endorses annual work plans recommended by Fund staff. The TTF finances TA to prepare national authorities for the conduct of an AML/CFT ROSC and a significant amount of TA following up on the ROSC recommendations.

Prioritization. TA financed by the TTF is targeted at emerging markets where economic growth has outpaced regulatory reforms and/or where there is a significant risk of money laundering and/or financing of terrorism. Other factors include the extent of TA by other providers and the views of the relevant area department. In 2012, an independent evaluation of the TTF will assess the effectiveness and sustainability of the technical assistance and make recommendations for improvement, thereby informing discussion on the remainder of the initial five-year phase and beyond.

Experience so far. Although in some cases, the authorities were not prepared to implement recommended reforms, in most cases, the ROSC created a level of trust and understanding between Fund staff and the authorities that facilitated effective follow-up TA.

Qatar, which was assessed by the Fund in 2007, relied upon follow-up TA from the Fund to become the first country to be removed from the FATF's public list of countries with strategic deficiencies in their AML/CFT regimes. Thailand, which was assessed by the Fund in 2007, similarly has committed to a long-term follow-up TA engagement involving a comprehensive overhaul of its AML/CFT regime. Fund AML/CFT assessments of Armenia, Mauritius, Mexico, and Uruguay have also led to productive follow-up TA.

The Bank AML/CFT ROSCs follow-up is fully integrated into the Bank technical assistance program — which client countries also seek out of the ROSC process. This technical assistance is funded through a dedicated budget, through specific windows in TA loans or grants on a case-by-case basis, through IDF grants as well as through bilateral agreements and funding from key donors— such as Canada, Korea or the United Kingdom.

As the Fund, the Bank has a good experience of follow-up technical assistance in countries where it led an AML/CFT assessment and a ROSC— at times with some delay. Some examples of such follow-up assistance include Haiti, Malawi, Mauritania, and Namibia.

[1] AML/CFT ROSCs are prepared and/or finalized by the Fund's Legal Department on the basis of detailed assessments conducted by the Fund, the World Bank, the FATF and eight FATF-style regional bodies (FSRBs).

IV. A WAY FORWARD

The Initiative is at an important cross-road. It remains appreciated by member countries, but there is a need to incorporate key lessons from a decade of implementation and the recent crisis. The latter raised fundamental questions about the adequacy of the standards and the effectiveness with which they are assessed. Gaps need to be filled in the current architecture of key standards and standard assessments, especially on cross-border issues. The Initiative also needs to strengthen its focus on raising the level of "compliance in practice" especially among countries with systemically-important financial systems. Staff recommendations for the 2011 Review focus on the following areas of potential improvement:

- **Selection of key standards.** Primary recommendations: (i) adapt the coverage of the Initiative to better safeguard financial stability; (ii) improve coordination between standard setting and standard assessment; and (iii) encourage Bank-led ROSCs in advanced countries;
- **Prioritization of standards assessments across policy areas, countries, and principles**. Primary recommendations: (i) include ROSCs in existing prioritization processes for TA and (ii) establish topical trust funds for ROSC TA follow up;
- **Efficiency.** Primary recommendations: (i) extend targeted ROSCs to all ROSCs other than AML/CFT[24] and (ii) increase use of country self-assessments;
- **Integration into Fund surveillance and Bank operational work**. Primary recommendations: (i) better prioritize ROSC recommendations and (ii) improve link between ROSCs and TA follow up;
- **Communication**. Primary recommendations: (i) establish a centralized database for ROSCs and (ii) introduce a publicly-available system that would facilitate country-driven updates;
- **Ratings**. Primary recommendation: maintain current system on the use of compliance ratings; and
- **FSB efforts to promote adherence to international financial standards**. Primary recommendation: cooperate with other initiatives that may use ROSCs but continue to refrain from participating in the coercive elements of NCJ-type processes.

The sections below elaborate on the issues and recommendations above.

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[24] A move to targeted ROSCs in the area of AML/CFT raises separate issues that will be discussed in a forthcoming Board paper reviewing the AML/CFT policy.

A. The Selection of Key Standards

Issue: The list of key standards is not up-to-date.

22. **Work to adapt and refine key standards is underway amongst standard setters.** The world has changed since 1999, and new standards, or the refinement of current standards, are required to ensure that they are up-to-date (Box 4). While in the aftermath of the Asian crisis, standards were developed to ensure minimum standard compliance across all countries, the focus has been augmented to sharpen the standards' relevance for countries with potentially destabilizing financial systems.

23. **In particular, the recent crisis has highlighted the importance of strengthening arrangements for dealing with weak financial institutions and for cooperating on a cross-border basis, and fiscal transparency.** The greater attention to public sector and fiscal sustainability issues has also renewed the relevance of fiscal transparency and calls for a review of the Fiscal Transparency Code. Also, the absence of appropriate institutional arrangements and tools to monitor and limit systemic risk—stemming either from pro-cyclicality (time dimension) or from systemically-important institutions, markets and instruments (cross-sectional dimension)—has been a distinguishing feature of this crisis, and is among the drivers for reform in the coverage and design of standards.

24. **In this context, the FSB is reviewing the "compendium of standards,"[25] including a reassessment of the 12 policy areas that are at the core of the Initiative.**[26] The FSB Standing Committee on Standards Implementation's (SCSI) proposal on revising the key standards for sound financial systems will be subject to approval by the FSB plenary on February 28, 2011. The SCSI agreed to a set of criteria for selecting key priority standards and has proposed the following amendments to the list of key standards:[27]

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[25] Under the auspices of the FSB, the Compendium of Standards lists the various economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems.

[26] Bank and Fund staffs have been participating in a working group established under the Standing Committee on Standards Implementation (SCSI) to undertake this review. Other member institutions include: US Department of Treasury (chairman), Hong Kong Monetary Authority, Italy's Department of the Economy and Finance, Japan's Financial Services Agency, Russia's Ministry of Finance, UK's HM Treasury, US Securities and Exchange Commission, Basel Committee on Banking Supervision, Committee on Payments and Settlement Systems, International Association of Insurance Supervisors, International Organization of Securities Commission, and the Organization for Economic Cooperation and Development.

[27] See Appendix III for the list of criteria for selecting key standards.

Box 4. Lessons from the Global Crisis

The literature on the lessons from the crisis has reached a few conclusions relevant for the current review:

- ***Regulatory arbitrage.*** Differences in regulatory requirements across types of institutions conducting similar activities allowed some institutions to engage in relatively unregulated albeit risky activities.
- ***Macroprudential risk.*** The level of capital and liquidity buffers needs to be better aligned with macroeconomic and systemic evolution of risks.
- ***Crisis resolution mechanisms.*** No system is foolproof and safety nets and resolution mechanisms are needed. This includes the ability of the accounting system to evaluate impaired assets.
- ***International coordination.*** There is a need for stronger and more globally-coordinated supervision and crisis resolution frameworks for internationally active and systemically important financial institutions.
- ***Better information.*** Better disclosure and accounting of information is needed on a wider range of financial institutions and markets. Information gaps are particularly critical regarding off-balance sheet and counterparty exposures, complex structured products, and OTC derivatives.
- ***Lack of coverage of systemic risks in regulatory frameworks.*** The Joint Forum has identified areas where systemic risks have not been captured by the regulatory framework, with particular focus on certain unregulated or lightly regulated entities or activities such as in the areas of banking, insurance, and securities sector; supervision and regulation of financial groups; mortgage origination; hedge funds; and credit risk transfer products.[2]

More recently, issues surrounding fiscal sustainability have increasingly come into focus. In particular, the European debt crisis has highlighted the importance of fiscal transparency and the need to communicate fiscal consolidation strategies, specifying the measures and timetable for implementing them, to reassure markets and restore confidence.

"Lessons of the Financial Crisis for Future Regulation of Financial Institutions and Markets and for Liquidity Management , IMF, February 4, 2009; *"Initial Lessons of the Crisis,"*, IMF, February 6, 2009; *"The Fund's Response to the 2007–08 Financial Crisis—Stock Taking and Collaboration with the Financial Stability Forum*, September 15, 2008; *"Corporate Governance and the Financial Crisis: Key Findings and Main Messages,"* OECD, June 2009.

[2] The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates.

- Combine the accounting and auditing standards under one "policy area";
- Include a new policy area on crisis resolution and deposit insurance. This would incorporate the Core Principles for Effective Deposit Insurance Systems and standard(s) on crisis resolution. On the latter, the options under consideration are: (1) the BCBS *Recommendations on Cross-border Bank Resolution*, and subject to a review in 1-2 years, the possible inclusion of or substitution with the FSB *Key Attributes of Effective Resolution Regimes*; or (2) both the BCBS *Recommendations* and the draft *Key Attributes* (although the latter standard is still work in progress);[28] and
- Keep the total number of key policy areas to the current 12.

25. **The Fund is also in the process of revising the standards for which it is the standard setter**. For the Data ROSC, the Fund is updating the Data Quality Assessment Framework (DQAF) to respond to the experience from the crisis and incorporate updated methodologies.[29] For example, financial corporation data needs be expanded beyond the banking sector. Similarly, the Fiscal Transparency ROSC will be revamped to address issues of fiscal rules and fiscal responsibility. Finally, the Fund will revise the Code of Good Practices on Transparency in Monetary and Financial Policies (MFPT) to remove the overlap on financial policies currently covered by other standards and update the monetary policy transparency standards in light of the crisis. These revisions should be completed sometime in 2012.

26. **The Standard for Insolvency and Creditor/Debtor Regimes is being updated**. The World Bank, in response to the experience from the recent financial crisis and to incorporate updates to UNCITRAL's Legislative Guide on Insolvency Law, has reviewed and revised the Standard for Insolvency and Creditor/Debtor Regimes, in close consultation with the UNCITRAL Secretariat. In January 2011 the World Bank, together with UNCITRAL and the IMF staff, reconvened the Global ICR Task Force (consisting of representatives of international organizations and over 85 internationally recognized experts, policy makers and judges from all regions), to finalize the 2011 Standard for Insolvency and Creditor Debtor Regimes. The 2011 ICR Standard will be presented to the Executive Directors of the Bank and Fund for formal endorsement for use in the ROSC program.

27. **Not all of the new standards added are currently ready to be supported by a ROSC program.** While an assessment methodology exists for the Core Principles for Effective Deposit Insurance Systems, there is as yet no such methodology for the

[28] The FSB has agreed to include the CPSS-IOSCO Recommendations for Central Counterparties as a key standard under payment systems. The Fund and Bank have already been using this standard in the context of FSAPs.

[29] For example, see *System of National Accounts (SNA) 2008*, the sixth edition of the *Balance of Payments Manual (BPM 6)*, and *Government Finance Statistics Manual (GFSM) 2001*.

Recommendations of the Basel Committee on Cross-Border Bank Resolution. Moreover, the international community's work on a framework for cross-border bank resolution is ongoing in several international fora, such as the FSB, and includes the participation of Bank and Fund staff.[30]

28. **Staff welcomes the proposed amendments to the list of key standards specified in paragraph 24, but greater coordination between standard setting and standard assessment would be desirable.** There is a need to establish a more systematic feedback mechanism from assessing the implementation of standards (mainly by the Bank and the Fund) to standard setting. Today, Bank and Fund involvement in standard-setting activity and assessment methodologies is mostly ad hoc, depending on the standard; a more systematic feedback mechanism would not only ensure that the standards were kept up to date but also that the standard setters were kept better informed about progress on standard implementation on a global basis.[31] The FSB Standing Committee on Standards Implementation, which has Bank and Fund representation, could usefully provide a forum for continuous exchange of views on the adequacy of standards and their implementation.

B. Prioritization

Issue: Prioritization across countries has effectively moved toward a focus on systemically important members. The Initiative lacks an overall framework for prioritization across standards and there is no mechanism to ensure that the choice of ROSCs is aligned with Bank and Fund priorities.

Across Members

29. **Decisions regarding the conduct of ROSCs across members are largely demand-driven and are conducted differently by standard.** There is currently no coordination across various departments conducting different ROSCs. For example, country selection for Data and Fiscal Transparency ROSCs are determined separately by the IMF's Statistics and Fiscal Affairs Departments. An exception is for financial ROSCs where the IMF conducts an FSAP prioritization exercise which is coordinated between the Bank and Fund through the Bank-Fund Financial Sector Liaison Committee (FSLC), but only for joint FSAPs. The

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[30] See *"An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency,"* prepared by the staffs of the Fund and Bank, April 2009; *"Resolution of Cross-Border Banks—A Proposed Framework for Enhanced Coordination"*; and *"Intensity and Effectiveness of SIFI Supervision: Recommendations for enhanced supervision,"* Financial Stability Board, November 2010.

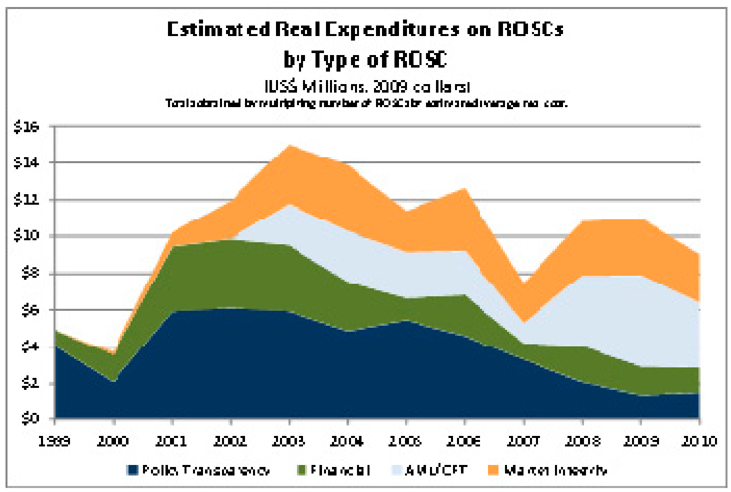
[31] To a certain extent, existing mechanisms help facilitate the exchange of information between standard setters and the Bank and Fund. For example, for financial ROSCs, the IMF and the WB conduct periodic reviews of the level of implementation of the principles, the reports of which have been shared with standard setters. In the case of IOSCO, the IFIs are members of the Implementation Task Force, which is in charge of the review of the principles and the assessment methodology.

decision to conduct a ROSC is generally taken as a result of the perceived need for coverage of a sector in the FSAP.[32] Other ROSCs have their own systems for prioritizing across countries. Since ROSCs are voluntary, lack of interest by members can also impact prioritization.

30. **Developments in the G20, FSB, and IMF are expected to divert resources to systemically-important members**. FSB members have committed to undertake FSAPs every 5 years and the IMF has decided to implement mandatory stability assessments for members with systemically-important financial systems. Similarly, FSB members have committed to undergo financial standard assessments and encourage all countries to adhere to international financial standards. The maintenance of the current prioritization processes across countries would likely result in a relative increase in resources allocated to the Initiative unless resource cuts are implemented elsewhere.[33]

Across Standards

31. **There is no mechanism that ensures that prioritization of ROSCs across standards is aligned with the evolving priorities of the Bank and the Fund.** At the Fund, resources for ROSCs are determined by functional departments, in competition with other activities such as surveillance and technical assistance. At the Bank, resources come from the FSAP (for BCP, IAIS, IOSCO, CPSS) or through functional department budgets (for the Accounting and Auditing, CG, FATF and ICR ROSCs). Thus, there is little or no prioritization of ROSCs across standards, except for ROSCs undertaken under an FSAP. Also, the FSB framework for international cooperation and information exchange is *de facto* creating a prioritization of financial sector regulation and supervision standards (BCP, IOSCO, IAIS) in all countries. As a result, the allocation of resources across standards may not necessarily reflect the Fund's or Bank's strategic priorities.



32 AML/CFT ROSCs are required to be included in every full FSAP and FSAP update.

33 See Section IV, Section H.

ROSCs and Capacity Building

32. **ROSCs are to a limited extent prioritized in the context of Fund TA and Bank operational work.** At the Fund, the Regional Strategy Notes (RSN) prepared by area departments outline technical assistance priorities for regions and include ROSCs when they fit into the TA strategy for a given country. However, the link between the RSNs and the actual provision of resources for ROSCs is generally weak.[34] The Fund's Committee on Capacity Building is tasked with setting high-level strategies for ROSCs, but in practice this has not happened.[35] At the Bank, ROSCs are prioritized on a demand basis taking into account needs of Bank operational work for countries (e.g., TA, preparatory work for lending).

33. **Given the dominance of the FSB commitments in the G20 countries, efforts to enhance prioritization could usefully focus on improving the ROSC's role in capacity building.** This could largely build on existing prioritization processes, and would also help forge the links between standard assessment and TA, which is critical for countries with lower institutional capacity:

- First, at the Fund ROSCs could be more systematically included in area departments' Regional Strategy Notes. This would promote consideration of ROSCs in the context of area departments' overall surveillance and TA priorities.

- Second, ROSCs could be included in the discussion of area departments' Regional Assistance Plans (RAPs) with the Office of Technical Management (OTM) and in the Committee on Capacity Building. This would raise awareness of the ROSCs and improve the link between ROSCs and follow up TA.

- Third, at the Bank ROSCs findings and recommendations should be better integrated into CAS and in discussions of the CMU's work programs.

- Finally, consideration could be given to establishing one or more topical trust funds to provide external financing for follow up TA, modeled on the topical trust fund for technical assistance for AML/CFT (Box 3).

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[34] FAD consults closely with area departments in the context of annual RAP discussions and based on RSNs in prioritizing fiscal transparency ROSCs. If requests exceed FAD's budget envelope, priorities are set based on criteria such as fiscal risks and time lag since the latest fiscal ROSC reports. STA also consults closely with area departments to prioritize countries for Data ROSCs.

[35] Minutes of the Committee meetings for the past three years do not reflect any discussions on ROSCs.

C. Efficiency

Issue: The demand for ROSCs is likely to increase on account of the FSB commitments and the introduction of new standards or refinement of existing standards. Concurrently, there is a need for focus in assessments and to provide more frequent updates.

34. **The broad-based nature of a full ROSC has the advantage of providing a systematic overview of all the features of the institutional framework that affect the standard.** Indeed such a comprehensive assessment is necessary when a given standard is assessed for the first time in a country. Yet, more targeted assessments may be called for when other analysis suggests that particular weaknesses could have larger systemic repercussions. In such cases, more targeted reassessments could be made on key principles that are considered to be of more critical importance.

35. **A methodology for targeted ROSCs has been developed for three financial standards (banking, securities, and insurance).**[36] This methodology only applies to cases where: (i) there has already been a complete ROSC; (ii) the time elapsed between the initial assessment and the reassessment does not exceed seven years; and (iii) there has not been a major overhaul of the regulatory system. While there would be significant discretion from case to case, targeted ROSCs are expected to focus on principles where there has been identification of particular weaknesses or risk and principles in areas where large changes have taken place.[37]

36. **Extending the methodology for targeted ROSCs to a larger group of ROSCs could increase the frequency and relevance of reassessments.**[38] Targeted ROSCs make better use of resources by allowing ROSC assessors to focus on key areas of weakness. They also bring more transparency and consistency to updates by providing a clear framework for conducting them. Targeted ROSCs may also result in some savings.[39]

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[36] See *Guidance Note for Staff in Undertaking Targeted (Risk-Based) Reports on the Observance of Standards and Codes (ROSCs) in Financial Regulation and Supervision*, October 6, 2010.

[37] The main benefits of targeted ROSCs relate to: (i) better use of resources by allowing ROSC assessors to focus their time and effort in key areas of weaknesses, and (ii) bringing more transparency and consistency to updates, by providing a clearer framework to conduct them, instead of the FSAP Technical Notes and factual updates.

[38] As noted above, the possibility of extending the targeted approach to AML/CFT ROSCs will be discussed separately in a forthcoming Board paper.

[39] To a certain extent, a targeted approach is already being implemented for fiscal transparency ROSCs, although a formal methodology has yet to be developed. A targeted approach is also followed for data ROSCs when only a subset of macroeconomic statistics is evaluated.

37. **Increased use of self-assessments by members across all standards could complement ROSCs and be another tool to promote ownership and build capacity.**[40] Such self-assessments have been used in some countries such as India (Box 5) to support a domestic reform program. Possible drawbacks of self-assessments include the risk of politicization, assessments conducted by assessors who may not be sufficiently experienced or qualified, and a lower bar for compliance resulting in an overly optimistic assessment. However, there is a clear advantage in terms of ownership and in learning by doing.

38. **While it is critical to avoid a perception that the Fund and Bank endorse the results of self-assessments or that they could substitute for ROSCs, staff should stand ready to help countries conduct them.** For example, in assessing the compliance with BCP, the staff could assist the authorities in following the self-assessment methodologies issued by standard setters (such as that prepared by the BCBS). In standards and codes where the Bank or the Fund is the leading standard setter, effort should be given to expand the existing manuals (e.g., the Manual on Fiscal Transparency and the Fund's Code of Good Practices on Transparency in Monetary and Financial Policies) into a guidebook for self-assessments on practices relative to the requirements of the Code. Moreover, the Bank and Fund have explored the possibility of developing training workshops for assessors, in coordination with standard setters, in the context of financial ROSCs. Increased use of self-assessment may not only be beneficial for authorities, but it is likely a cost effective way for the Fund and the Bank to help countries with capacity building, as the operationalization of the self-assessment would help meet the need for more frequent ROSC updates.

39. **Establishing a closer link between financial sector ROSCs and country peer reviews conducted by the FSB could also help fill in the gaps from infrequent ROSC updates.** Peer reviews conducted by the FSB could help inform about progress made by authorities in addressing the weaknesses identified in ROSCs. Establishing a formal system for closer coordination on the timing and country coverage of ROSCs and peer reviews, as well as a mechanism for acknowledging the outcomes of peer reviews by the Bank and the Fund would be useful in this regard (Box 6).

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[40] Recent self-assessments already serve as inputs in connection with financial ROSCs.

Box 5. India: Self-Assessment of International Financial Standards and Codes

In September 2006, the Committee on Financial Sector Assessment (CFSA), set up by the Government of India and the Reserve Bank, carried out a comprehensive assessment of the country's financial sector. This evaluation drew on the experience of the 2001 pilot FSAP, the subsequent assessment of 2002 and its review in 2004, and the publication of the Handbook of Financial Sector Assessment by the WB and the IMF in 2005, which served as reference points for countries undertaking such assessments.

Although a self-assessment, the impartiality of the evaluation was enhanced through:

- *Four external independent Advisory Panels* comprised of non-official domestic experts to evaluate the inputs provided by the Technical Groups. In their reports, the Advisory Panels identified gaps with regard to India's adherence to international standards and codes and suggested possible corrective policy actions.
- *Peer review by reputable international experts in the field.*[1]
- *The publication of the Advisory Panel reports, the peer review reports, and the final CFSA report*.

The CFSA's Financial Sector Self-Assessment report of March 2009 indicated that India's financial sector was generally sound, resilient and fairly liquid. The financial infrastructure also was deemed to be robust. Concerns were, however, expressed about corporate governance in the co-operative banking sector, the funding constraints of Non-Banking Finance Companies and the lack of up-to-date data to assess household debt. The report also found gaps in the timely implementation of bankruptcy proceedings.

There was strong consensus among officials interviewed that the self-assessment had served India well. It provided the authorities with an important opportunity to gain an in-depth understanding of how to deal with its complex financial system. It formed an important part of a comprehensive reform agenda including strengthening liquidity management, stress testing by financial institutions, periodic scenario test by the Reserve Bank of India (RBI), and setting up of the Financial Stability Unit.

To some extent, the Indian authorities adjusted international standards in light of local circumstances. Sometimes this meant going beyond what was required under international standards. For example, their standard assessment on BCP was extended to cover Non-Banking Financial Companies and Housing Financing Companies.

[1] Experts included Messrs. V. Sundararajan and Andrew Sheng on Financial Stability Assessment and Stress Testing; Eric Rosengren on BCP; Sir Andrew Large on Corporate Governance and Transparency in Monetary Policy; Thomas Baxter Jr. on Bankruptcy Laws; Vito Tanzi on Fiscal Transparency; Ranjit Ajit Singh and Shane Tregillis on IOSCO Principles; Carl Hiralal and Michael Hafeman on IAIS Principles; Greg Johnston on Payment and Settlement Systems; Neil Patterson on Data Dissemination Standards; and Ian Mackintosh and Kamal Gupta on Accounting; and Ian Mackintosh and N.P. Sarda on Auditing.

Box 6. The FSB's Peer Review Process

At the time of the establishment of FSB in 2009, its member jurisdictions committed to undergo periodic peer reviews to complement existing assessment mechanisms such as FSAPs and ROSCs by providing an opportunity for members to engage in dialogue on steps taken to address relevant FSAP recommendations:

- ***Thematic peer reviews*** focus on cross-country implementation of particular policies or standards with a view to ensuring consistency across FSB membership (e.g., mortgage origination practices and risk disclosure).
- ***Country peer reviews*** evaluate the implementation and effectiveness of policies and standards in a single country (or member jurisdiction) through systematic and timely follow-up of FSAP/ROSC recommendations.
- ***Process.*** A draft report for discussion is prepared by a team of experts drawn from FSB member institutions and is presented to the FSB SCSI; the final report, including the key elements of the discussion in the SCSI, is approved and published by the Plenary (the FSB's decision-making body).
- ***Status.*** As of early 2011, the FSB has completed three thematic peer reviews (on compensation practices, risk disclosures and mortgage underwriting practices) and country peer reviews for Mexico, Italy, and Spain, based on FSAPs conducted in these countries in 2006. A follow up thematic review on compensation practices, as well as reviews of deposit insurance, and country reviews of Australia, Switzerland, and Canada are planned for 2011. Based on this experience, later in 2011, the FSB will review the scope and process of thematic and country peer reviews.

D. Integration of ROSCs with Bank and Fund Work

Fund surveillance

Issue: Attempts to improve the link between the Initiative and Fund surveillance have had limited success despite recommendations following the 2005 Review.

40. **An intermediate target of the Initiative is to support surveillance.** The hope is that by acting through surveillance, ROSCs could serve indirectly to improve the effectiveness of a country's policy making environment. However, staff's analysis as well as questionnaires of mission chiefs, suggest that surveillance does not consistently pick up on key recommendations of most ROSCs, although ROSC recommendations mentioned in FSSAs are more likely to be followed up on.[41] In some cases, the link between key ROSC

[41] For Data ROSCs, major recommendations are regularly appended to Article IV reports through the statistical issues appendix.

recommendations and structural conditionality in Fund financial arrangements seems stronger than the link with surveillance.

41. **Attempts to mandate a stronger link may, however, not be desirable and go against efforts to streamline and increase the focus of Article IV staff reports.** A need to follow up on ROSC recommendations that are not directly relevant for external and domestic stability would likely undermine the effectiveness of surveillance. However, efforts should be made to revive the post-mission meetings suggested in the 2005 Review. Also, if the Article IV mission discovers significant risks and vulnerabilities in a particular sector, it could usefully recommend undertaking a ROSC assessment, as suggested in the 2005 review of the Initiative.

42. **Steps to further sharpen the message and public availability of ROSCs recommendations could also be helpful**:

- All ROSCs should have clearly prioritized recommendations. While a list of recommendations is generally prepared, prioritization is not always clear. Internal review efforts could help ensure that such greater clarity is achieved as a matter of practice.
- Establish a system that ensures that Bank-led ROSCs and Fund-led ROSCs not done under an FSAP (e.g., accounting and auditing, and fiscal transparency) are available to Fund area department teams and Bank regions (for emerging markets and developing economies), respectively, on a systematic basis.[42]

43. **Encouraging Bank-led ROSCs in advanced countries could also be considered**.[43] Imperfections on accounting and auditing and corporate governance—both subjects for ROSCs led by the Bank—played an important role in the recent crisis, particularly in advanced countries. Currently, Bank-led ROSCs can only be conducted in advanced countries, when the country provides the financing. Keeping in mind the voluntary nature of the Initiative, it may be useful to encourage advanced countries to conduct and finance such ROSCs on a more systematic basis.

[42] For example, a shared IMF/WB repository of all ROSCs conducted (published and unpublished) could be created. Note that while Fund and Bank staff may normally exchange information on technical assistance activities, in some instances, there may be a need for confidentiality.

[43] In this context, Bank-led ROSCs refer to ROSCs on accounting, auditing, corporate governance, and insolvency and creditor rights.

Capacity building

Issue: While ROSCs' impact on capacity building seems relatively strong, country authorities indicate that the follow up and assistance on key recommendations could be more systematic.

44. **The capacity building effort that derives from the diagnostic reflected in a ROSC can often benefit from more systematic follow up and in some cases, assistance.** Assessments typically establish a benchmark identifying the areas where improvement is needed. In most cases, an action plan is elaborated when significant deficiencies are identified. Authorities in emerging and low income countries see a need for a more systematic follow up on progress in addressing key ROSC recommendations. Moreover, in some instances, authorities see a need for actual assistance from the IFIs. The disconnect in this process, however, is that funding is only available for the diagnosis and not for any TA that might be necessary for adequate follow up.[44]

45. **The following specific suggestions on how to improve ROSC follow up could be considered:**

- The creation of a database with information on key recommendations. This could be created across standards and departments at the Bank and the Fund, and made available to all staff. Such a database would constitute a repository of key recommendations. The same database could be used to allow the tracking of progress, with input from staff (area/regional and functional departments) as they are informed about progress.
- Establish an expectation that in countries where capacity building is seen as needed, ROSCs will be followed up by an action plan and offer of technical assistance to support the implementation of this action plan.[45] One way to establish such a clearer link could be to explore donor interest in establishing topical trust funds for follow up technical assistance linked explicitly to each type of ROSC, as is currently the case for AML/CFT.
- Use the available funding options (e.g., FIRST Initiative) for the Bank and Fund to go beyond addressing specific gaps to play a catalytic role in galvanizing support behind the ROSC-promoted agenda and attracting concerted support from other institutions (e.g., donors) to implement the necessary reforms. This could be done, for example, through conducting joint outreach activities with donors to proactively engage decision makers and the general public in countries.

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[44] Unlike other ROSCs, funding is available for follow up TA to AML/CFT ROSCs (see Box 3).
[45] The successful implementation of proposals to extend follow up TA would depend on the availability of additional resources.

E. Communication

Issue: ROSCs are not widely known by the public and, in particular, rarely used by market participants.

46. **Market participants that staff interviewed indicated three main reasons that they do not use ROSCs extensively:**

- The lack of easily accessible quantitative information.
- The lack of frequent updates publicly available. This means that most ROSCs are in fact out of date and it is very hard to compare across countries.
- The lack of clarity in the key messages.

47. **Although there are benefits of greater use of ROSCs by market participants, this is not an area where there is a solid consensus.** Moreover, there is clearly a tension between the needs of market participants (frequently updated quantitative ratings) and the need to support capacity building and surveillance (clearly prioritized recommendations).

48. **Taking into account these tensions and the lack of consensus for a stronger market profile of ROSCs, staff proposes the introduction of a publicly-available system that would facilitate more frequent and country-driven updates.** This system, that would be entirely voluntary, could allow countries to record progress vis-à-vis ROSC assessments. While, to the extent possible, staff would verify the accuracy of the information provided, no change in assessments would be made on this basis.[46] Such updates would also be clearly labeled as coming from the authorities and not endorsed by staff.

49. **Other options for improving market participants' use of ROSCs could be considered:**

- Encourage further publication of ROSCs. Building on the commitment of the G20 members to publish their DARs, G20 members, by leading through example, could help encourage non-members to publish ROSCs (and DARs, if relevant).
- Creating a unified IMF/World Bank ROSC website that contains all available information on ROSCs and published assessments. The website could also include a calendar of planned ROSCs in each policy area for the upcoming year.

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[46] Verification by staff of information provided by the authorities in this context would entail additional resources.

F. Ratings

Issue: Renewed efforts at promoting adherence to standards could reinvigorate tensions between the use and publication of ratings and reform and country ownership. Against this background, the Bank and the Fund need to consider whether to encourage greater use of ratings for members and for all ROSCs.

50. **In the wake of the crisis, international fora such as the G20, FSB, and standard setters are promoting greater adherence to international financial standards.** For example, the FSB plans to evaluate certain jurisdictions' adherence to the relevant standards and FSB members have agreed to undergo peer reviews and publish their DARs for financial standards.

51. **The disclosure of compliance ratings in ROSCs has several benefits, but also suffers from certain drawbacks.** On the positive side, ratings give concrete feedback to country authorities regarding how their laws and institutions compare with other countries and an incentive to address vulnerabilities. Ratings can also promote more evenhanded treatment across countries. On the negative side, compliance ratings can make the assessment process more contentious and politicized, focusing attention on the ratings themselves rather than on reform efforts and addressing gaps. Ratings may also give a false sense of precision and lead to misleading cross-country comparisons.

52. **The history of proposals on compliance ratings reflects the tension between greater transparency on the one hand and a focus on reform and country ownership on the other.** Several early ROSCs included compliance ratings.[47] However, subsequent reviews noted that assessments generally avoid assigning country ratings or pass-fail grades (the 2001 review) and proposed clear conclusions and prioritization of recommendations without advocating the use of ratings (the 2003 review). During the 2005 review, the IMF Executive Board favored steps to enhance the clarity of ROSC findings while avoiding a rating or "pass or fail" report. To avoid misleading summary ratings while increasing clarity, in 2006 the Fund introduced principle-by-principle matrices of observance for new ROSCs for which it was the standard setter. These are based on a four point scale, with comments to diminish the risk of misinterpretation and enhance cross-country comparability. This proposal was implemented for the Fiscal, Monetary Transparency, and Data ROSCs but not for other ROSCs.[48]

53. **Taking account of recent developments, staff recommends maintaining the current system in which some ROSCs have compliance ratings but others do not and**

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[47] Data ROSCs have included compliance ratings along with explanatory comments since 2001.

[48] For the AML/CFT assessments, a four-point compliance scale has been used by the FATF and Fund staff since 2002.

reaffirming the importance of focused and prioritized recommendations. For countries that choose to publish DARs, ROSCs would no longer be required to avoid duplication. This recommendation retains the focus on forward looking reforms and increases ownership for members that might not receive high compliance ratings. However, absence of ratings could generate less incentive for reform, create some tension with the FSB evaluation process, and mean less comparable information for market participants.

G. The FSB Framework to Enhance Adherence to International Standards ("Non-Cooperative Jurisdictions," NCJ)

Issue: International bodies other than the Fund and the Bank have used ROSCs in the context of initiatives aimed at encouraging increased compliance with international standards. Most recently, in an effort to ensure global compliance with key financial standards, the FSB has launched an initiative to provide incentives for improved compliance with a subset of principles deemed most relevant for international cooperation and information sharing. However, while this initiative may help ensure increased compliance, some potentially coercive elements of the FSB process pose a challenge to the Bank/Fund and the role of the Initiative, which is based on voluntary participation. More broadly, the FSB process raises questions as to the circumstances in which the Fund and the Bank shall cooperate in initiatives led by other bodies to encourage compliance with international standards.

54. **In March 2010, the FSB launched a Framework for the Adherence to International Standards.** The purpose of this initiative is to encourage adherence by all countries and jurisdictions to international financial standards, which includes the identification of non-cooperative jurisdictions and provision of assistance to them in improving their adherence. In particular, the FSB has identified a subset of 14 principles drawn from the three core financial sector standards (i.e., banking, insurance, and capital market supervision) deemed relevant for "international cooperation and information sharing."

55. **The FSB has identified the three core finance sector ROSCs for use as a basis for the FSB's non-cooperative jurisdiction (NCJ) process.** The FSB has identified a group of about 60 member and non-member jurisdictions that were asked to share their confidential DARs prepared in the context of Fund and Bank ROSCs to establish a country's degree of compliance with these principles. Countries that have not undergone a ROSC or failed to comply with two or more of these principles were asked to engage in a dialogue with the FSB and request a ROSC. The FSB will determine by spring 2011 jurisdictions that are not cooperating fully with this evaluation process or that show insufficient progress to address weak compliance with these principles.[49] At the end of this process, the FSB may start publishing a list of countries considered non-cooperative, possibly followed by a call for sanctions.

[49] See *The G20 Seoul Summit: Leaders' Declaration*, November 11-12, 2010.

56. **NCJ-type processes present challenges to the cooperative and voluntary nature of ROSCs.** The FSB's efforts aim to strengthen compliance with international standards and codes, which is also the objective of the Standards and Codes Initiative. However, the coercive nature of an NCJ process threatens to undermine the cooperative nature of the relationship between the Bank and the Fund and their members, as well as the ROSC's voluntary approach.

57. **The Fund and the Bank have to balance their participation in initiatives that include coercive elements against their need to safeguard the interests of their broader membership and the voluntary, cooperative nature of the ROSC process**.
This is especially relevant for the FSB initiative, since the Fund and Bank are FSB members.[50] The approach adopted by the Fund and the Bank towards the FSB NCJ process has been informed by, and developed on the basis of the Fund's and the Bank's past experiences, in particular, a similar exercise conducted by the FATF[51] (Box 7). Under the approach adopted for the FSB, even though ROSC findings will inform the FSB's NCJ process, the Fund and Bank have refrained from—and will continue to avoid--direct involvement in the decision making on, and any resulting publication of, non-cooperative jurisdictions. Moreover, staff has voiced its concerns in the FSB about the NCJ process, and has regularly stressed the importance of ensuring that they work in a way that is transparent, objective, and consistent with the principles underlying the Bank and Fund's ROSC program.[52]

58. **More generally, the use of ROSCs for the NCJ and similar processes highlights the need for the Fund and Bank to have a clear, coherent policy with regard to their collaboration with entities involved in such processes.** Based on past experience, the Fund and Bank would, as a general principle, be prepared to cooperate in such initiatives to the extent that such cooperation does not undermine their ability to implement the ROSC initiative under the voluntary and cooperative approach. As a participant in such a process, the Fund and Bank may play a "good offices" role in providing relevant information with the member's consent and providing TA to members that are subject to such a process and are working to enhance their compliance, while refraining from participation in those aspects of the process that are coercive in nature. In particular, the Fund and the Bank would:

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[50] See *"IMF Membership in the Financial Stability Board"*. The decision on Fund's membership in the FSB expressly provides, inter alia, that the Fund will participate in the FSB in accordance with the Fund's legal framework and policies; and will reserve the right in specific circumstances not to take part in the decision-making of the FSB where such participation would not be consistent with the Fund's legal or policy framework. *Decision No. 14730-(10/86), adopted September 8, 2010.*
[51] The Fund and the Bank have an observer status in the FATF.
[52] These interventions have been based on Board guidance with respect to the "non-cooperative countries and territories" initiative undertaken by the FATF between 1999 and 2006 which publicly identified 23 jurisdictions as lacking an effective AML/CFT system.

- carry out ROSCs requested by members;
- provide TA, when requested, to enhance compliance with international standards;
- if requested by the relevant member, provide input into assessing members' compliance with the principles subject of the evaluation;
- if requested, share relevant information with other participants, subject to the consent of the member involved; and
- provide input into the decision making process, while not participating in decisions related to the coercive elements of NCJ–type processes.

Box 7. The FATF ICRG Process

Since 2008, the FATF has engaged in a process that has raised issues similar to those raised by the recent FSB initiative. The FATF has identified and issued a series of public statements expressing concerns about significant deficiencies in AML/CFT regimes of a small pool of jurisdictions. These statements have resulted from the FATF's International Cooperation Review Group (ICRG) process, whose findings are based, in part, on assessment reports prepared by the Fund and the Bank. The process enjoys strong support from G20 leaders and finance ministers.

Throughout this initiative Bank and Fund staff have stressed the importance of ensuring – as much as possible—that it be conducted in a manner that respects the principles underlying the ROSC. These interventions have been based on Board guidance with respect to the "non-co-operative countries and territories" (NCCTs) initiative undertaken by the FATF between 1999 and 2006 which publicly identified 23 jurisdictions as lacking an effective AML/CFT system. In 2002, the Executive Board conditioned the Fund's involvement in AML/CFT assessments and cooperation with the FATF – including the Fund's recognition of ROSCs prepared by the FATF and FATF-style regional bodies – on the suspension of the NCCT initiative. Then, in 2004, in the context of the decision to make AML/CFT a regular part of the Fund's work, Directors agreed on the importance of continuing collaboration with the FATF and welcomed the fact that the FATF had no plans to conduct a further round of the NCCT exercise. However, some Directors noted that if the FATF were to proceed with a new round of the NCCT exercise, the Fund would need to reconsider the collaborative relationship since the exercise was at odds with the uniform, voluntary, and cooperative nature of the ROSC exercise.

The FATF has acknowledged staff's concerns with regard to the design and the implementation of its ICRG process and has endeavored to conduct it in a manner that respects the ROSC principles. Thus the FATF relies almost exclusively on the results of assessments that are conducted in a uniform and cooperative fashion. Before issuing any public statements about a jurisdiction's deficiencies, the FATF engages in dialogue with the jurisdiction's officials both to confirm facts and to provide the jurisdictions an opportunity to outline their plans to address the deficiencies. The statements themselves differentiate between jurisdictions that have committed to an action plan from those that have not. The public statements are designed to encourage rapid progress toward compliance with the FATF standard, but they also recognize the commitments that jurisdictions have made to improve their position.

H. Resource Implications

59. **On balance, the recommendations under this review as well as growing demands on the Initiative will result in higher costs.** The expected rise in assessments for G20 countries, the increased complexity in assessing existing standards, and the addition of standards for which assessments would have to be made will all entail higher costs. In particular, if it is decided to develop assessment programs for deposit insurance and crisis resolution, this will require additional resources.

60. **Under a resource-constrained environment, tradeoffs will be unavoidable.** For example, balancing the additional requirement from the G20 versus the need for assessments of emerging markets and low-income countries. The assessment of new standards could imply less frequent assessments of other standards. These resource pressures impose a greater burden on the prioritization process, and strategic decisions will have to be made to augment resources for the Initiative or on where the resource cuts could come from in order to maintain adequate coverage of non-G20 countries.

V. Issues for Discussion

Directors might wish to focus on the following issues:

- Do Directors agree with the proposed changes to the list of key standards under the Initiative? Do Directors agree that assessment programs should be developed for standards on deposit insurance and crisis resolution?
- Do Directors consider that there is a need for better prioritization across standards?
- Do Directors agree to extend targeted ROSCs beyond banking, securities, and insurance as proposed above?
- Is there a need to strengthen the use of ROSCs in Fund surveillance?
- Is there scope to improve the follow up of ROSC recommendations through TA? Should there be a closer link between the ROSC program and topical trust funds, as is the case for the ROSC program on AML/CFT? Should self-assessments be encouraged?
- Is there scope for the establishment of a voluntary system that would allow countries to update information on a set of key principles of a set of standards?
- Do Directors agree to maintain the current system in which some ROSCs have compliance ratings but others do not and to stress focused ROSC recommendations?

- Do Directors agree with the general principles of the Bank's and Fund's participation in other global initiatives set forth in section IV.G?

- In light of the nature of the Initiative, the proposed recommendations and the time needed for them to yield tangible results, staff recommends that the next comprehensive review take place in five years. Do Directors agree?

APPENDIX I. DIFFERENT REPORTS UNDER THE INITIATIVE

Initial Assessment: An assessment of observance of a standard done for the first time. An initial assessment results in a DAR/ROSC. For financial standards, the main findings of the DAR/ROSC are included in the FSA (Bank)/FSSA (Fund) that are circulated to the Bank and Fund Boards respectively after an FSAP. ROSCs may also be circulated to the Boards of the Bank and the Fund for information.

Reassessment (also known as a Substantive Update): An assessment repeated following an initial assessment. It includes a reassessment of the underlying (principle-by-principle) grading and results in a ROSC that replaces a previous ROSC. This may be circulated to the Boards of the Bank and Fund for information.

Targeted Reassessment focusing on particular principles: An assessment following an initial assessment or reassessment that focuses on a set of selected principles following the Guidelines for Targeted Assessments and Report on the Observance of Standards and Codes that have been produced in consultation with BCBS, IAIS and IOSCO. Currently it is only applicable to BCP, IOSCO and IAIS standards.

Update (also known as a Factual Update): An analysis of key developments regarding observance of a standard. It does not include a reassessment of the underlying grading. It results in a ROSC Update, which complements but does not replace a previous ROSC. This can be issued as a stand-alone paper for the Bank and Fund Boards' information. A Factual Update can be issued as an FSAP Technical Note.

A detailed principle-by-principle assessment of a country's compliance with a given standard under the Initiative is a **Detailed Assessment Report (DAR)**. DARs may or may not include ratings depending on the standard assessed. **Reports on the Observance of Standards and Codes (ROSCs)** present a summary of the DARs sometimes including principle-by-principle ratings, while others without ratings.

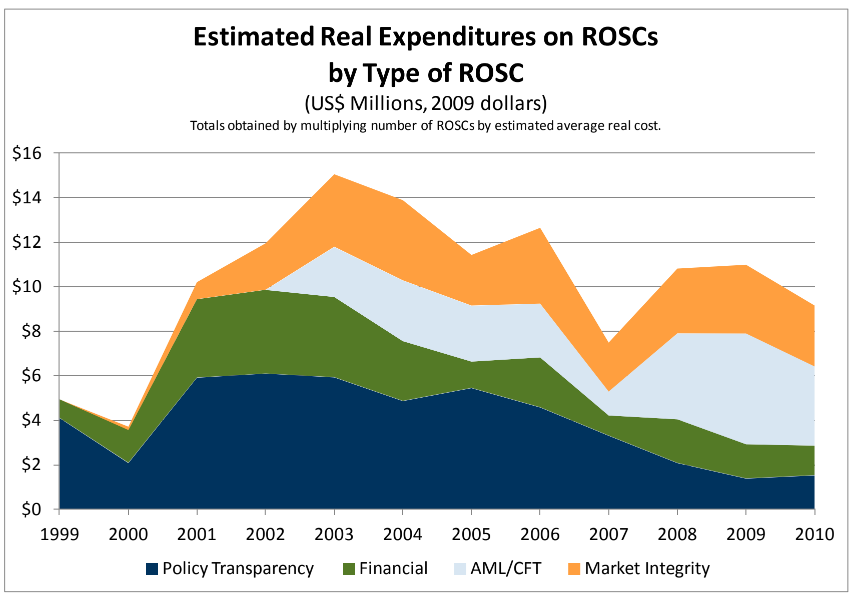
APPENDIX II. ESTIMATED COSTS OF THE STANDARDS AND CODES INITIATIVE

Background

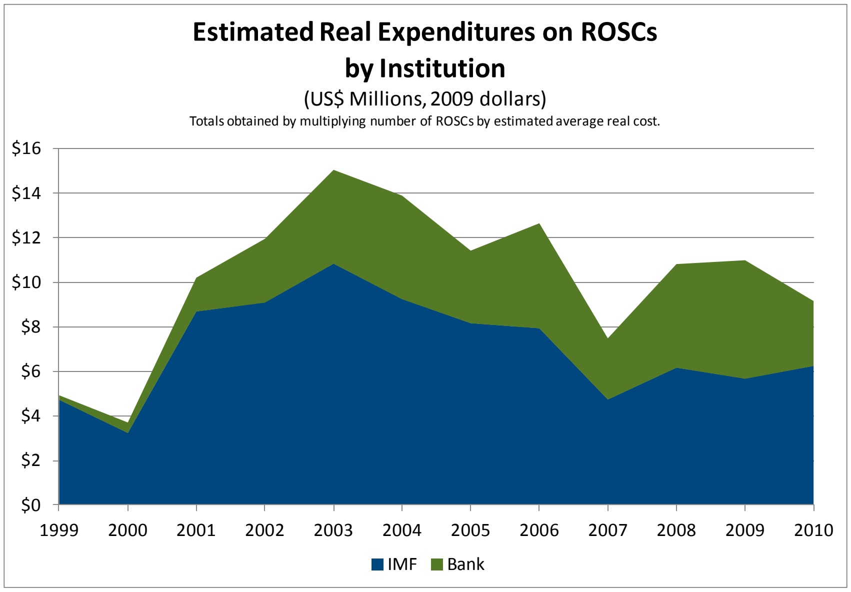
1. This appendix provides an overview of the estimated costs of the Standards and Codes Initiative. Expenditure data come from two sources. Program (World Bank) and departmental (IMF) budgets provide information on staff time and travel expenses for ROSCs. Centralized budget data from the IMF's Office of Budget and Planning (OBP) provides information for the IMF on other expenses such as standard setting, preparation, review, and overhead costs.[1]

ROSC Expenditures

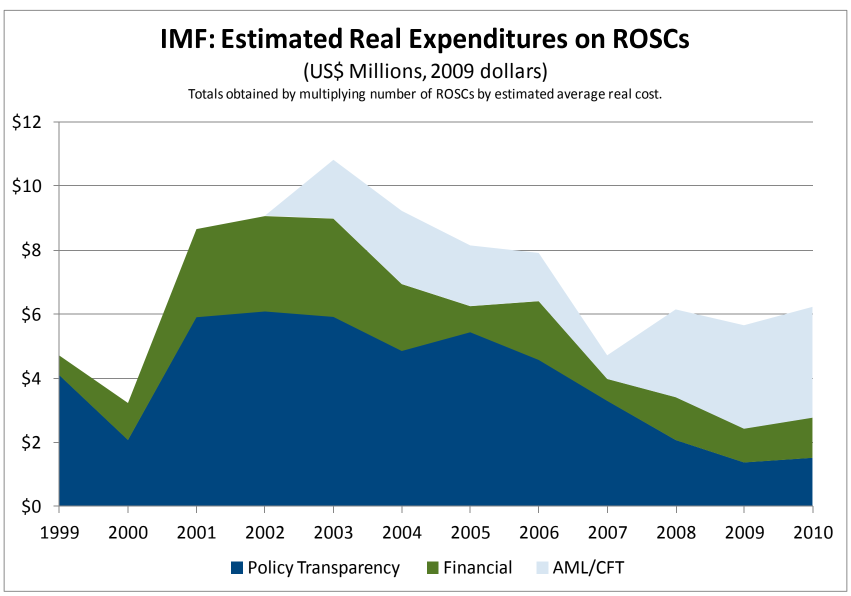
2. Real expenditures on Reports on Standards and Codes (ROSCs) peaked in 2003 at $15 million (in 2009 dollars) before declining by about 40 percent over time to $9 million in 2010.

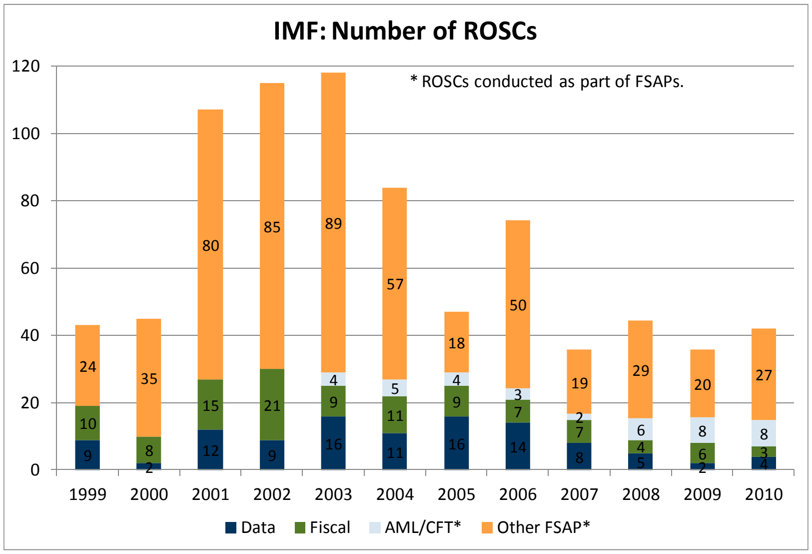


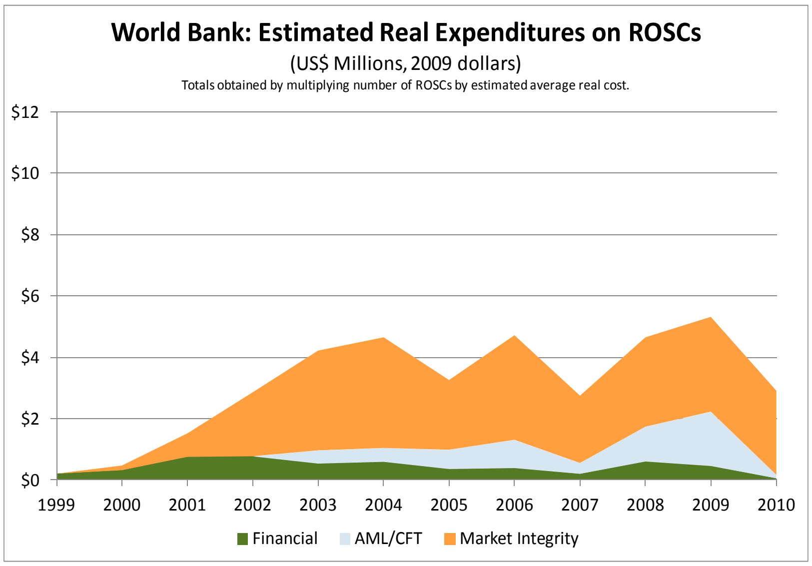
[1] Similar centralized data is not available from the World Bank.

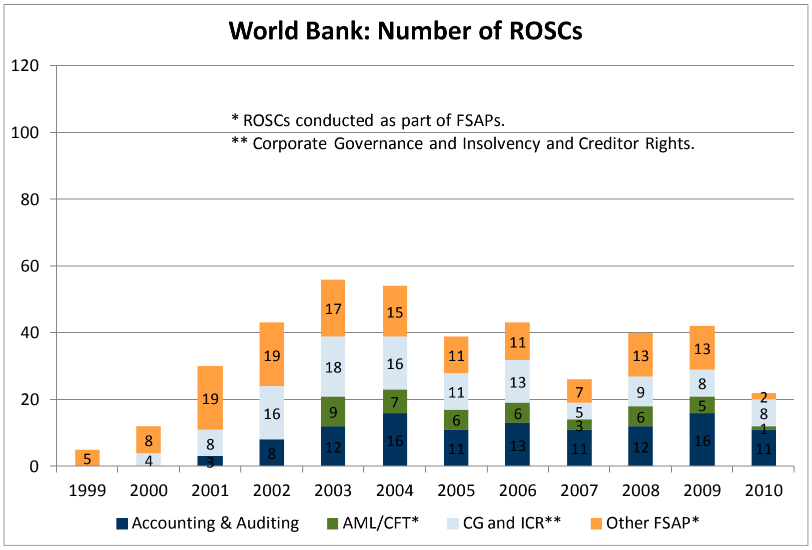


3. Real expenditures on Policy Transparency ROSCs (Data, Fiscal, and Monetary) declined from a peak of $6.1 million in 2002 to $1.5 million in 2010, a real decline of 75 percent. Expenditures on Financial ROSCs (Banking, Securities, Insurance, and Payments Systems) declined from $3.8 million to $1.3 million, a real decline of 65 percent. Expenditures on Market Integrity ROSCs (Corporate Governance, Accounting and Auditing, and Insolvency and Creditor Rights) peaked at $3.6 million in 2004 before falling to $2.7 million in 2010, a real decline of 24 percent. In contrast, expenditures on AML/CFT ROSCs have increased gradually over time, peaking at $5.0 million in 2009. As of 2010, AML/CFT ROSCs comprised almost 40 percent of all ROSC expenditures.

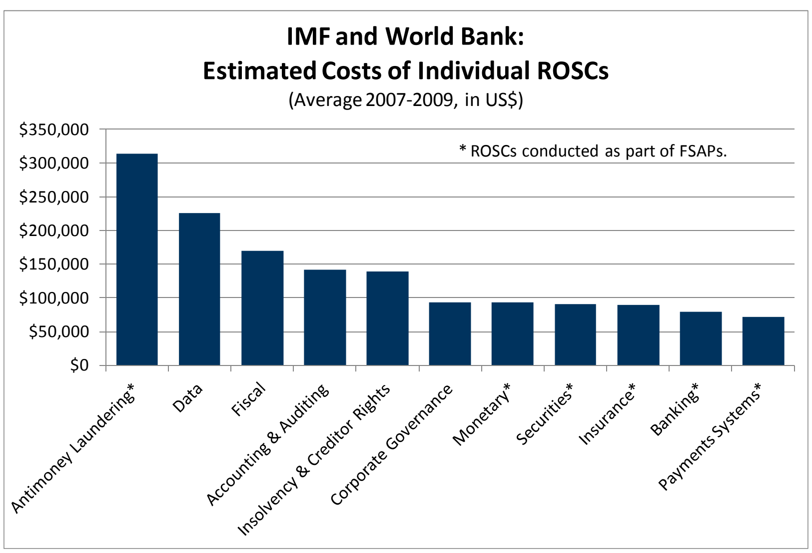


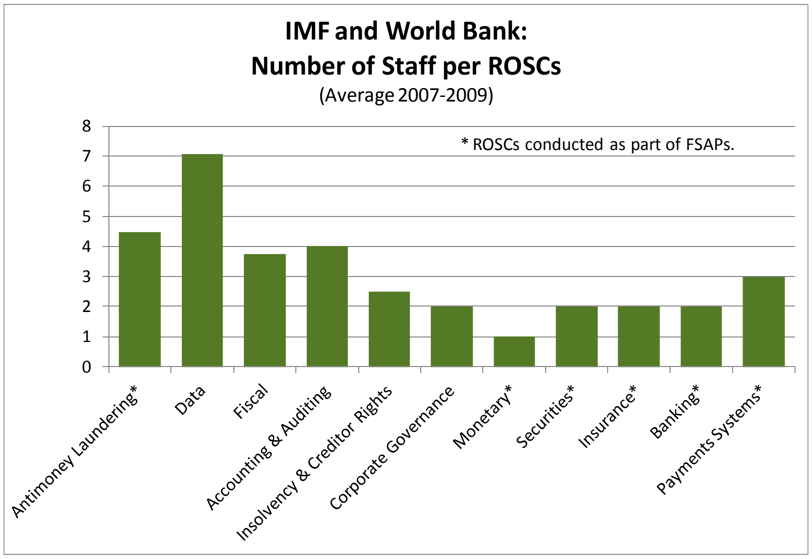

IMF: Number of ROSCs
* ROSCs conducted as part of FSAPs.
120
100
80
60
40
20
0
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
Data
Fiscal
AML/CFT*
Other FSAP*


World Bank: Estimated Real Expenditures on ROSCs
(US$ Millions, 2009 dollars)
Totals obtained by multiplying number of ROSCs by estimated average real cost.
$12
$10
$8
$6
$4
$2
$0
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
Financial
AML/CFT
Market Integrity



4. In terms of expenditures on individual ROSCs, the AML/CFT and Data ROSCs have the highest estimated average costs. For AML/CFT ROSCs, this reflects a combination of high staff costs and the breadth of the methodology (49 recommendations + 260 criteria) which leads to large number of staff being required. For Data ROSCs, this primarily reflects a greater number of specialists needed to cover several macroeconomic datasets with specific methodologies. At the lower end, ROSCs conducted as part of FSAPs generally have lower estimated average costs. The lower costs reflect cost savings due to sharing staff time and travel costs between the ROSCs and other FSAP activities. To the extent that these ROSCs become stand alone activities, their average costs may rise.



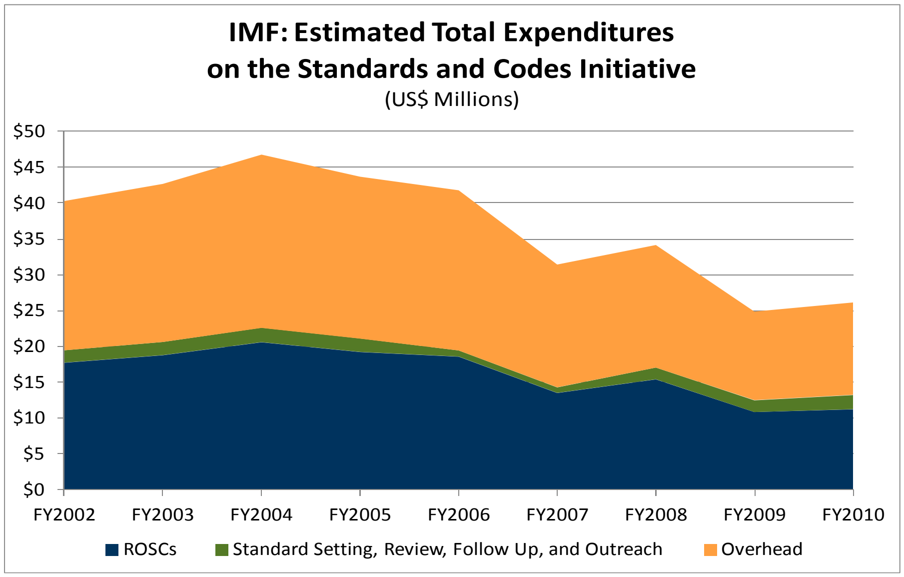


5. In evaluating the data on ROSC expenditures, it should be kept in mind that these are estimates rather than precise figures. In particular:

- ROSCs that are conducted as part of FSAPs are not recorded separately but included as part of FSAP expenditures. As a result, some assumptions are made about the allocation of expenditures between ROSCs and FSAPs. There is some error inherent in this process.
- ROSCs straddle budget years and the date an expenditure is recorded may not reflect the period during which the expenditures were incurred.
- The IMF and World Bank operate on different fiscal years. The data were converted to calendar years for comparison purposes but figures for particular years may not be precise.
- Expenditure estimates are derived by estimating the cost of an average ROSC and multiplying by the number of ROSCs conducted in a year. The costs of individual ROSCs can vary greatly from country to country depending on travel costs and the complexity of the institutions being evaluated. For example, advanced countries may require more staff resources than developing countries.
- The estimates do not distinguish between full ROSCs and ROSC updates.

Other Expenditures

6. The estimates of ROSC expenditures above do not include other expenditures on the Standards and Codes Initiative such as standard setting, review work, and general overhead. For the IMF, the OBP collects data that captures these additional expenditures. Data on total costs for FY2002-2010 is given in Table 1. Detailed data for FY2005-2010 are shown in Table 2. Note that these represent overestimates as financial ROSCs are included in FSAPs for budget reporting. As a result, the figures include FSAP expenditures that are not related to ROSCs. Non-ROSC related FSAP expenditures are estimated at $5-10 million per year.



7. The data show that for the IMF total costs are approximately double direct ROSC costs (i.e. expenditures on staff and travel). In FY2002, total expenditures on the Standards and Codes Initiative are estimated at $40 million or 5.6 percent of gross expenditures. Expenditures on the Initiative peaked in FY2004 at $47 million or about 5.8 percent of gross expenditures. Expenditures declined steadily to approximately $26 million in FY2010 or 2.7 percent of gross expenditures.

Table 1. Costs to the Fund of standards and codes initiative-related work, FY 2002-2010
(In millions of U.S. dollars)

Key Output Excluding Governance	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Standards and codes and financial sector assessments	**40.3**	**42.7**	**46.8**	**43.7**	**41.8**	**31.4**	**34.1**	**24.8**	**26.1**
(percent of gross expenditures)	5.6	5.6	5.8	4.9	4.5	3.3	3.5	2.7	2.7

Note: There is a break in the series starting in FY2006 as the IMF switched to a new budgeting system.

Table 2. Costs to the Fund of standards and codes initiative-related work, FY 2006-2010
(In millions of U.S. dollars)

Key Output Excluding Governance	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Standards and codes and financial sector assessments	**41.8**	**31.4**	**34.1**	**24.8**	**26.1**
Labor	15.2	11.6	13.4	10.1	10.9
Travel	4.2	2.7	3.6	2.4	2.3
Buildings and other	8.1	5.1	4.1	2.4	3.7
Overhead	14.4	12.1	13.0	10.0	9.2
of which SDDS (211)	2.5	2.7	2.5	2.2	2.0
Labor	1.6	1.6	1.5	1.2	1.2
Travel	0.0	0.0	0.0	0.1	0.1
Overhead	0.8	1.0	1.0	0.9	0.7
of which GDDS (212)	0.6	0.5	0.6	0.6	0.5
Labor	0.4	0.3	0.4	0.4	0.3
Travel	-	-	-	-	-
Overhead	0.2	0.2	0.2	0.3	0.2
of which Other Standard Setting (213)	0.2	0.2	0.5	0.2	0.5
Labor	0.1	0.1	0.3	0.1	0.3
Travel	-	-	-	-	-
Overhead	0.1	0.1	0.2	0.1	0.2
of which Data Standards (221)	0.6	0.4	0.3	0.3	0.2
Labor	0.4	0.2	0.2	0.2	0.1
Travel	-	-	-	-	-
Overhead	0.2	0.1	0.1	0.1	0.1
of which Data Quality (222)	0.5	0.5	0.4	0.3	0.4
Labor	0.3	0.3	0.2	0.2	0.3
Travel	-	-	-	-	-
Overhead	0.2	0.2	0.1	0.1	0.1
of which FSAPs (313)	15.4	12.0	15.2	10.9	11.5
Labor	7.4	5.7	6.7	4.6	5.8
Travel	2.7	1.7	2.7	1.9	1.7
Overhead	5.3	4.6	5.8	4.4	4.1
of which ROSCs (314)	6.5	4.5	3.7	2.2	1.9
Labor	2.9	1.9	1.6	1.0	0.8
Travel	1.4	0.9	0.7	0.3	0.4
Overhead	2.2	1.7	1.4	0.9	0.7
of which AML/CFT (315)	3.2	2.2	2.8	2.3	1.4
Labor	2.0	1.4	1.6	1.3	0.9
Travel	0.1	0.0	0.1	0.1	-
Overhead	1.1	0.9	1.1	0.9	0.5
of which Policy on S&C including Financial (334)	-	-	0.9	1.5	1.6
Labor	-	-	0.5	0.9	1.0
Travel	-	-	-	-	-
Overhead	-	-	0.3	0.6	0.6
of which Review on S&C including Financial (383)	-	0.1	0.3	0.3	0.2
Labor	-	0.1	0.2	0.2	0.1
Travel	-	-	-	-	-
Overhead	-	0.1	0.1	0.1	0.1
of which Outreach on S&C including Financial (392)	-	-	0.2	0.2	0.2
Labor	-	-	0.1	0.1	0.1
Travel	-	-	-	-	-
Overhead	-	-	0.1	0.1	0.1
of which Buildings and other	12.3	8.3	6.7	4.0	5.8
Program and Fund-wide costs	8.1	5.1	4.1	2.4	3.7
Overhead	4.2	3.2	2.6	1.6	2.1
Total Gross Expenditures (including standard setting, FSAPs and ROSCs)	930.3	965.8	967.0	930.3	952.4
in percent of total	4.5	3.3	3.5	2.7	2.7

Sources: Time Reporting System (TRS), Travel Information Management System (TIMS), and Office of Budget and Planning.

APPENDIX III. FSB-PROPOSED SELECTION CRITERIA FOR KEY STANDARDS

Individual standards are grouped under 12 key policy areas. In some cases, the policy areas include several individual standards (see Box 1). In determining the standards to be included in the list of key standards, the SCSI has recommended to the FSB Plenary the following criteria:

- The list of key standards should be kept short, i.e. it should comprise only the most *relevant* and *critical* standards for sound financial systems (including in light of the lessons from the financial crisis) in order to impart a sense of prioritization to them;
- The standard should cover areas that are important in nearly all jurisdictions, i.e. that they are *universal* in their applicability;
- The standard should be general enough to offer some flexibility in implementation to take into account different country circumstances (*flexible*).
- The standard should have been issued by an internationally-recognized body in the relevant area in extensive consultation with relevant stakeholders. To satisfy this criterion, the standard should preferably undergo a public consultation process. This criterion would also be satisfied when the standard-setting body has wide representation, or when the standard has been endorsed by IFIs; and
- The standard should be implemented in a form that can be assessed by national authorities or by third parties such as IFIs (*assessable*). This criterion does not require the existence of an assessment methodology as a prerequisite for inclusion in the list of key standards, although it is expected that a clear and objective methodology would need to be developed by, or in consultation with, the relevant standard-setting body to enable a standard to be properly assessed in the context of IMF-World Bank ROSCs.