Implementing international standards for stronger financial systems

A broad strategy

In the wake of recent financial crises, the international community has emphasised the need for concrete steps to make domestic financial systems less crisis-prone. The development and implementation of standards to promote sounder policies and stronger institutional and market underpinnings has been central in this effort to safeguard national and international financial stability.

The various initiatives taken by the international community involved in the standards area effectively form the building blocks of a broad strategy to help foster standards implementation. Drawing on this work, an Implementation Task Force was brought together last year by the Financial Stability Forum (FSF) comprising standard-setting bodies, supervisory agencies, national authorities from emerging and developed countries as well as international financial institutions and groupings. In framing such a strategy, the Task Force articulated the need to:

- foster a sense of ownership among countries on the need to implement standards;
- set priorities for the implementation of standards taking account of individual country circumstances;
- develop methodologies to provide practical guidance in assessing compliance with the core standards;
- undertake assessment exercises coordinated by the IMF and the World Bank to help identify vulnerabilities, implementation priorities and technical assistance needs;
- provide adequate official and market incentives for implementing standards; and
- mobilise the necessary international resources to provide technical assistance and training to foster capacity building for effective and durable implementation.

12 The Task Force on Implementation of Standards was chaired by Andrew Sheng, Chairman of the Hong Kong Securities and Futures Commission. See www.fsforum.org/reports/ for the group’s report, which was endorsed and issued by the FSF in March 2000.
This special feature provides more detail as to how each of these requirements for a successful implementation strategy might be met.

Ownership

A strong sense of country ownership – including domestic consensus and political commitment – is critical for fostering successful implementation of international standards. Given the complexity of financial systems, a large number of domestic agents will be involved and many entrenched interests may be affected in the course of implementing the standards. This can raise difficult issues for domestic officials responsible for aspects of financial stability, many of whom would like to implement standards and already know where improvements need to be made. Generating an adequate domestic political consensus on the need for implementation can help overcome these issues. External assessments, by providing an objective outside view on weaknesses, may help muster the domestic political consensus required to push forward changes that are necessary and desirable. The international community also has a keen interest in the implementation of sound practices given that the impact of financial crises can be felt in other countries. But international “pressure” needs to be sensitively applied so as not to hinder efforts to put together the necessary domestic consensus. A key challenge is striking an appropriate balance between the pace of implementation dictated by domestic ownership and capacity considerations and that desirable from a global perspective.

Priorities

Implementation of all the various standards (some 60 plus are available in the FSF compendium) would be an arduous task and more than most economies could reasonably achieve in the foreseeable future. Thus, it is clear that priorities will need to be set on a country by country basis, while recognising that many standards are interdependent (for example, the effectiveness of supervision and regulation depends on the quality of the underlying accounting practices and legal framework). To help facilitate implementation, a set of 12 key standards for strengthening financial systems has been suggested by the FSF as deserving priority implementation, depending on specific country circumstances (see the box on pages 51-53). These key standards fall into three main categories: macroeconomic policy and data transparency, institutional and market infrastructure, and financial regulation and supervision. These standards are highlighted in the compendium of standards available on the FSF’s website (www.fsforum.org).

Assessment methodologies

In order to establish implementation priorities, it is important to know where there may be material gaps in an economy’s current practices vis-à-vis international standards. Most standards are in the form of fairly general principles. In consequence, significant expertise will be required with respect
both to the standard itself and to an economy’s actual practices, if adequate assessments of adherence to standards are to be made. To assist in implementation, many standard-setting bodies have developed, or are in the process of developing, well defined criteria or methodologies to provide practical guidance in assessing observance of their standards. By using the methodologies, an overall profile of strengths and weaknesses in the assessed system can be obtained.

**Assessment framework**

Regular assessments of progress towards implementing standards can play an important role in developing action plans to enhance implementation and to identify technical assistance and training needs. Assessments can be carried out in various ways: by self-assessment, by peers, or by hired experts. The assessment methodologies developed by the standard-setting bodies should serve as useful guides in this regard.

While beneficial as an initial stocktaking exercise, experience has generally shown that it is important that self-assessments be complemented by an independent external check on compliance with standards. The IMF and the World Bank have recently developed an organising framework for assessing observance of standards and relevant policies in cooperation with national authorities and other international bodies. One of the most important initiatives in this area is the joint IMF-World Bank Financial Sector Assessment Programme (FSAP) aimed at assessing financial sector vulnerabilities and identifying development priorities. The FSAP involves, inter alia, an assessment of financial sector standards and is a collaborative effort involving a range of national agencies and standard-setting bodies. Another important initiative has been the experimental IMF-World Bank Reports on the Observance of Standards and Codes (ROSCs). This is a vehicle for assembling summary assessments of an economy’s progress in observing internationally recognised standards and codes across a range of areas. These assessments currently include financial sector standards evaluated in the context of FSAPs while ROSCs provide a vehicle for public information on implementation

**Incentives**

Self-interest should be the key motivation for implementing standards. Given the costs of financial crises, countries have an interest in making their economy

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13 All FSAPs include assessments of the Core Principles for Effective Banking Supervision and the Code of Good Practices on Transparency in Monetary and Financial Policies. Depending on country circumstances, assessments may also be prepared on the implementation of the core principles for securities regulation, insurance supervision and payment and settlement systems.

14 For more information on ROSCs and the ROSC modules that are available for a number of economies, see the IMF’s website at www.imf.org/external/standards/index.htm.
less crisis-prone. Moreover, a strong, healthy financial system contributes to faster growth in per capita income through higher savings rates, better resource allocation and the more efficient provision of financial services.

While self-interest should be a key motive, official and market incentives can help foster implementation. Following the report of the FSF’s Implementation Task Force, a follow-up group was asked to consider the range of incentives that might be used to encourage countries to implement international standards.\(^{15}\) The incentives covered included those that could be provided by market participants as well as those that could be provided by supervisory, regulatory and market access-type means.

Given that standards can help strengthen both national and international financial systems, the official sector has an interest in providing incentives to foster implementation. Incentives provided by the international community include encouraging countries to undertake and disclose assessments, to engage in policy dialogue with the IFIs and to participate in peer review discussions. Such encouragement needs to be supported by the provision of technical assistance and resources, where needed. Some official financing has also been made specifically conditional ex ante on progress towards implementing standards such as the IMF’s Contingent Credit Line. Domestic supervisors and regulators could also provide incentives: for example, by encouraging the use of information on standards observance in financial institutions’ risk assessment processes, and in considering decisions about market access.

While self-interest and official incentives have a role in fostering implementation, they are unlikely to be sufficient. Market incentives – the reflection of observance of standards in asset pricing and allocation decisions – are likely to be most effective over time. For market incentives to work, however, a number of preconditions need to be met. Market participants need to be familiar with international standards and must consider them to be relevant to their risk assessments. In addition, market participants must have access to credible and timely information on the observance of standards, and reflect this information in their asset pricing and allocation decisions.

The follow-up group conducted an informal dialogue with a variety of market participants from major financial centres (covering more than 100 financial institutions from 11 jurisdictions) to assess the degree to which these preconditions are met. From the outreach efforts that have been undertaken by the FSF, the IMF and the World Bank to date, it has become clear that the potential for market incentives to work is there. Nevertheless, it is also clear that significant efforts are still needed on many fronts to raise market awareness of international standards and to foster their reflection in pricing and

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\(^{15}\) The Follow-up Group on Incentives to Foster Implementation of Standards is chaired by Axel Nawrath, Director General of the German Ministry of Finance. See [www.fsforum.org/reports/](http://www.fsforum.org/reports/) for the group’s report, which was endorsed by the FSF in September 2000.
allocation decisions. Efforts to this end are being continued by national authorities, the IMF, the World Bank and standard-setting bodies, as well as the FSF, including through publications, conferences, seminars and further outreach sessions. In addition, several complementary private sector initiatives are under way. Further analytical work on the relevance of standards implementation to risk assessments as well as efforts to enhance the presentation of information on economies’ progress in implementing standards useful for risk assessments are also desirable to help foster market incentives.

Resources

The implementation of standards is a highly resource-intensive activity, and many countries face serious practical constraints. Capacity building efforts are a key success factor for a durable strengthening of financial systems. To this end, national authorities, international financial institutions such as the BIS, the IMF and the World Bank, and standard-setting bodies are all supporting implementation efforts through technical assistance and training. For its part, the FSF has sponsored the creation by the BIS, the IMF and the World Bank of a global directory of training opportunities that provides online information about the courses available through relevant bodies to enhance the quality of financial supervision. While initially focused on banking supervision, the directory will be enlarged to reflect training opportunities across a broad spectrum of financial activities, including insurance supervision and payment and settlement systems. The Financial Stability Institute, associated with the BIS in Basel, is working with the Basel Committee on Banking Supervision and increasingly other standard-setting bodies to provide in-depth training for supervisors to improve and strengthen their financial systems.

The potential demands for assistance in standards implementation are very large and, inevitably, the international community will also face resource constraints. To ensure that resources are effectively employed, it will be important for technical assistance to be well targeted and durably utilised in the countries where it is received.

Conclusion

The implementation of standards in itself is not sufficient to ensure financial stability. Nor are standards an end in themselves, or some kind of magic “cure-all”. Instead, they should be viewed as a means for promoting sound financial systems and, in turn, sustained economic growth. In particular, by helping to improve the functioning of the financial sector, the implementation of standards can help minimise the build-up of risks and vulnerabilities in the financial system that can lead to crises with significant costs in terms of output and employment.

16 See www.fsforum.org/training/home.htm.
Key standards for sound financial systems

The 12 standards below have been highlighted by the FSF as being key for sound financial systems and deserving of priority implementation depending on country circumstances. While the key standards vary in terms of their degree of international endorsement, they are all broadly accepted as representing minimum requirements for good practice. Some of the key standards are relevant for more than one policy area (see www.fsforum.org/standards/keystuds.htm).

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\(^1\) Economies that have, or might seek, access to international capital markets are encouraged to subscribe to the more stringent SDDS and all other economies are encouraged to adopt the GDDS. \(^2\) The World Bank is coordinating a broad-based effort to develop these principles and guidelines. The United Nations Commission on International Trade Law (UNCITRAL), which adopted the Model Law on Cross-Border Insolvency in 1997, will help facilitate implementation. \(^3\) The International Accounting Standards Committee (IASC) and the International Federation of Accountants (IFAC) are distinct from other standard-setting bodies in that they are private sector bodies.

Major standard-setting bodies

**Basel Committee on Banking Supervision (BCBS)**

The BCBS, established by the G10 central banks, provides a forum for regular cooperation among its member countries on banking supervisory matters. The BCBS formulates broad supervisory standards and guidelines and recommends standards of best practice in banking in the expectation that bank supervisory authorities will take steps to implement them (www.bis.org).

**Committee on Payment and Settlement Systems (CPSS)**

The CPSS, established by the G10 central banks, provides a forum for regular cooperation among its member central banks on issues related to payment and settlement systems. It
monitors and analyses developments in domestic payment, settlement and clearing systems as well as in cross-border and multicurrency netting schemes. It also provides a means of coordinating the oversight functions to be assumed by the G10 central banks with respect to these netting schemes. The CPSS formulates broad supervisory standards and guidelines and recommends standards of best practice in the expectation that the relevant authorities will take steps to implement them (www.bis.org).

Financial Action Task Force (FATF)
The FATF, established by the G7 summit in Paris in 1989, set out an initial programme of 40 recommendations to combat money laundering. These recommendations were modified in 1996 to take into account recent money laundering trends and potential future threats. Comprising 26 member countries, the FATF monitors members’ progress in implementing measures to counter money laundering. It relies on an annual self-assessment together with a more detailed mutual evaluation. In addition, the FATF reviews money laundering trends, techniques and countermeasures and their implications for the 40 recommendations, and it actively promotes the adoption and implementation of the FATF recommendations by non-member countries (www.oecd.org/fatf).

International Accounting Standards Committee (IASC)
The IASC is an independent private sector body, formed in 1973, with the objective of harmonising accounting principles used for financial reporting by businesses and other organisations around the world. The Board of the IASC is responsible for developing and approving international accounting standards. To date, a total of 40 international accounting standards have been promulgated by the IASC (www.iasc.org.uk).

International Association of Insurance Supervisors (IAIS)
The IAIS, established in 1994, is a forum for cooperation among insurance regulators and supervisors from more than 100 jurisdictions. It is charged with developing internationally endorsed principles and standards for effective insurance regulation and supervision. After having developed the IAIS Core Principles, Insurance Concordat and several other standards, the IAIS’s recent work on standard-setting has focused on solvency, the provision of cross-border services, asset risk management, oversight for financial conglomerates, reinsurance, market conduct and electronic commerce (www.iaisweb.org).

International Federation of Accountants (IFAC)
IFAC comprises national professional accountancy organisations that represent accountants employed in private practice and the public sector, as well as some specialised groups that interface frequently with the accounting profession. IFAC strives to develop the accounting profession and harmonise its standards worldwide to enable accountants to provide consistent and high-quality services. Through its International Auditing Practices Committee (IAPC), IFAC has formulated the International Standards on Auditing (ISAs) and International Auditing Practice Statements (IAPSs) (www.ifac.org).

International Monetary Fund (IMF)
The IMF develops and monitors international standards in areas having direct operational relevance to its mandate to carry out surveillance of the international monetary system. In collaboration with other standard-setting bodies, it has developed international standards for data dissemination and compilation and transparency practices in fiscal, monetary and financial policies, and has contributed to the assessment and implementation of international standards for banking supervision. In addition, the IMF has prepared for several countries, on an experimental basis, reports on their progress in implementing internationally recognised standards and codes of best practices (www.imf.org).
International Organization of Securities Commissions (IOSCO)
IOSCO is an organisation for cooperation among national securities regulators. Its regular membership consists of government regulators of securities and futures markets. IOSCO develops and promotes standards of securities regulation in order to maintain efficient and sound markets. It draws on its international membership to establish standards for effective surveillance of international securities transactions and promotes the integrity of markets by a rigorous application of the standards and effective enforcement against offences (www.iosco.org).

Organisation for Economic Co-operation and Development (OECD)
The OECD aims to promote policies designed to achieve sustained economic growth and employment in its member countries. In the area of promoting efficient functioning of markets, the OECD encourages the convergence of policies, laws and regulations covering financial markets and enterprises (www.oecd.org).