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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 01/110

10:00 a.m., October 29, 2001

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Executive Board Attendance

A. Krueger, Acting Chair

Executive Directors	**Alternate Executive Directors**
S.M. Al-Turki	
	A.R. Ismael, Temporary
I.E. Bennett	
M.J. Callaghan	
	W. Szczuka
K. Bischofberger	
	F. Manno, Temporary
	M.P. Bhatta, Temporary
V.L. Kelkar	
	I. Ábel, Temporary
	A. Fidjestøl, Temporary
	M. Lundsager
	G. Bauche
	M. Daïri
A.V. Mozhin	
	F. Varela
S. Pickford	S.P. Collins
	A.A. Tombini, Temporary
	J. Mafararikwa, Temporary
	S.S. Farid, Temporary
Wei Benhua	Jin Qi
	P.A. Nijsse, Temporary
K. Yagi	
A.G. Zoccali	

A.S. Linde, Acting Secretary
S. Soromenho-Ramos, Assistant

Also Present

Asia and Pacific Department: I. Lee. External Relations Department: M. Bell, W. Murray. International Capital Markets Department: E.L. Psalida, H.Q. Tran. Legal Department: T. Laryea. Monetary and Exchange Affairs Department: B. Johnston. Policy Development and Review Department: T. Geithner, Associate Director; M. Allen, Deputy Director; L.J. Lipschitz, Deputy Director; N. Blancher, S. Dodzin, R. Glennerster, Y. Metzgen H. Monroe,. Secretary's Department: L. Hubloue, P. Ramlogan. Western Hemisphere Department: K. Honjo, A.M. Jul. Office of the Managing Director: E.-A. Conrad, R. Moghadam, B. Potter. Advisors to Executive Directors: A. Baukol, S. Boitreaud, P.R. Fenton, M.F. Melhem, J. Milton, H.E. Phang, S. Rouai, K. Sakr, F. Vermaeten, M. Yanase, F. Zurbrügg. Assistants to Executive Directors: G.M. Blome, N.J. Davidson, M. Di Maio, N. Joicey, A. Maciá, R. Maino, R. Manivat, J.W. Ralyea III, Wei X.

1. FUND CRISIS PREVENTION INITIATIVES—DRAFT REPORT OF MANAGING DIRECTOR TO INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

Documents:	Draft Report of the Managing Director to the International Monetary and Financial Committee on the Fund's Crisis Prevention Initiatives (SM/01/315, 10/18/01).
Staff representatives:	Mark Allen, PDR; Metzgen, PDR
Discussion:	1 hour, 10 minutes

The Deputy Director of the Policy Development and Review Department (Mr. Allen) informed Executive Directors that the sections of the text not yet inserted into the document would be circulated to the Board shortly, including the section on vulnerability.

Mr. Daïri made the following statement:

> I thank the Managing Director for this draft paper. I found it extremely helpful and well-focused. I have a few suggestions to the draft report. In the introductory section (paragraph 4), some reference could have been made to the need to strengthen ownership as one of the major objectives, particularly as far as conditionality is concerned. Perhaps some reference to the need to avoid moral hazard would also have been appropriate, given the existing concerns on this issue among the public at large.
>
> The reference to contributions from various fora in paragraph 5 is somewhat confusing. It would be better to follow the format of Appendix I on progress made on international financial architecture reform in major international fora. The Financial Stability Forum (FSF) and the G-20 are the only bodies explicitly mentioned in the appendix. All other bodies are captured in a general section on other organizations. If we mention the G-7 and G-10 in paragraph 5 of the report, we should include the G-24.
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> In paragraph 7, line 5, there is a reference to "increasingly relying on such assessments" without clarifying what these assessments are. Some clarification is warranted.
>
> In paragraph 8 of the introduction, some reference to technical assistance is probably needed, in addition to the reference to the need for "consistency and tenacity in implementation."
>
> The reference in paragraph 12, to "encouraged feedback from national authorities and the public on the transparency initiatives" is excessively restrictive. We should also encourage feedback on other key policy issues.
>
> There is a serious governance issue in paragraph 18, where initiatives carried out by the Fund in the area of standards and codes are listed. The

Board has decided on several occasions that standards and codes should not be regarded as benchmarks or checklists against which members' practices should be assessed. The language in this paragraph deviates from this principle, as we are indicating that the Fund's initiatives are allowing participants and policy makers to "compare information on country practices against agreed benchmarks of good practice." We should clarify that the purpose is to detect major areas of weakness and priority actions needed to improve country practices in particular situations, taking into consideration the country's stage of development, its particular circumstances, and any existing resource constraints. A qualification should be made to clarify that we are not asking all countries to implement the same set of standards immediately.

Table 1 in the report leads to a somewhat surprising and very welcome conclusion, that Africa ranks third in the list of leading regions in terms of participation in Reports on the Observance of Standards and Codes (ROSCs). Perhaps this should be included in paragraph 22, which currently only mentions the regions ranking first and second in the list.

Regarding strengthening the financial sectors, the report appears to focus more on assessments than on regulatory and prudential frameworks at the international level. There is no reference in paragraph 26 to the new Basle capital accord, or to the emphasis recently given to strengthening internal controls of banking systems. The last sentence in paragraph 45, as currently drafted—"in this regard, market participants welcomed the decision to publish Financial System Stability Assessments (FSSAs), though noted that few as yet had been posted on the Fund's website"—appears to put the blame on the Fund, which would be unfair. It would be better to say that we welcome decisions to publish FSSAs, which are subject to members' consent.

The reference to the collapse of Long-Term Capital Management (LTCM), in paragraph 46, should be qualified to reflect that there was a near collapse of the financial institution. This would be consistent with references to LTCM in other reports.

The reference to the need to provide information in the last sentence of paragraph 48—"this work will include continued outreach to the private sector as a vehicle for providing information and receiving feedback"—is somewhat worrisome. Does this sentence refer to confidential information that members share with the Fund and which members do not want to have published, or is it referring to something else?

It would be useful to make some reference in Appendix I to the degree of observance of standards by the G-20 members in order to add some credibility to their work and commitment.

Some reference, in table 2, to transparency with regard to the Fund's own governance and budget process would also be appropriate. There is currently not much reference to the internal governance of the institution in this list.

Ms. Lundsager made the following statement:

The report summarizes the many areas in which we have made substantial progress and notes additional steps that are planned or need to be considered. Highlighting transparency is appropriate, which we emphasized last Monday. The review of standards and codes, FSAPs, our work to counter money laundering, our discussion of capital account liberalization are all usefully compiled here. I have just a few suggestions to emphasize certain points.

Introduction

With respect to the introduction, we note that the architecture effort placed significant emphasis on encouraging the adoption of more robust exchange rate regimes, as well as encouraging countries to develop more resilient financial structures.

We think, paragraph 1 could be revised to reflect better this emphasis by inserting after: "particularly prudential supervision," "encourage the adoption of consistent monetary and exchange rate regimes that are less prone to crisis, avoid policies that lead to excessive reliance on short-term foreign currency debt and result in a dangerous imbalance between liquid foreign currency assets and maturing foreign currency debts, and improve the Fund's own vulnerability analysis."

Introduction of the Fund's Crisis Prevention Initiatives

Assessing External Vulnerability

To continue on this note, emerging markets are becoming more focused on reserve adequacy in part as a result of efforts to increase transparency. The paper should highlight the importance of careful Fund surveillance of reserve adequacy, including stress testing. But we trust this will be included when our discussion last Monday is inserted into the "Assessing External Vulnerability" section.

Transparency

On the issue of transparency, the paper notes that the Fund plans to "review the policy on modifications to country papers." At this point, I would just note that we should be very vigilant against any step backward in this area.

Standards and Codes

Turning to the Standards and Codes section, we note that the staff's target number of country assessments per year under the FSAP does not match the Board's suggested pace of up to 30 per year. Therefore, we do not quite understand how the Fund decided that up to 24 country assessments are sufficient.

Strengthening Financial Sectors

Also, the international effort to combating money laundering has become all the more important in the aftermath of September 11. In that regard, we believe the report could and should give greater prominence to the Fund's anti-money laundering efforts. We suggest the following footnote be added to Box 1. "The Fund is consulting with FATF regarding the preparation of a ROSC module on money laundering." We look forward to the discussion on November 12 of the work of the IMF's task force.

Capital Account Liberalization

Looking at capital account liberalization issues, we believe the paper does not sufficiently emphasize the benefits of capital account liberalization. Recent experience suggests that the international community should combine support for liberalization with a clear message that liberalization only succeeds when accompanied by strong reforms, including of exchange regimes and financial sectors.

We recommend replacing the last two sentences of paragraph 34 with the following: "These principles are consistent with various speeds of capital account liberalization; they do not imply that liberalization should be delayed. Liberalizing long-term flows poses fewer risks than liberalizing access to short-term external debt. However, the key to success is not the pace or sequencing of liberalization, but rather the pace of reforms required to make liberalization a success."

Response of Members and the Private Sector

Response by Markets

We have two suggested modifications to the "Response by Markets" section. We believe that, with these edits, the report will reflect more accurately the state of play concerning regulation of highly leveraged financial institutions.

First, we suggest replacing the last sentence in paragraph 41 with the following: "As discussed below, national regulators are currently reviewing whether imposition of mandatory requirements are still necessary in light of steps taken by the hedge fund industry itself to enhance disclosure."

Second, in paragraph 46, insert the following after the second sentence: "and the dramatically different structure of the industry, as shown by its increasingly competitive nature. Therefore, HLIs are not viewed as presenting a systemic risk."

Appendix II

Finally, Appendix II on spread dispersion is extremely interesting and useful. It might be helpful to forward the full analysis and relevant graphs to the Board.

Mr. Pickford made the following statement:

The report is useful and helpful. Over the last few years, the Fund has introduced significant reforms to strengthen the financial system. Its role in crisis prevention has been a central part of these efforts. There has been considerable progress in surveillance, financial systems, and in reducing vulnerabilities, but the report emphasizes the need to do more.

One area where I think the report is probably a little too coy is on the Contingent Credit Lines (CCLs). The IMFC emphasized at its last meeting the role of CCLs in promoting strong policies and minimizing contagion. I think that the lack of discussion on CCLs in the report is a cause for concern, especially as one of the conditions for CCL eligibility is that countries make progress toward adherence to internationally-accepted standards.

I do not have drafting suggestions, but would like to share our reaction to some issues addressed in the report. First, on codes and standards, we now have a range of codes and standards covering a number of extremely important issues. One area that is not explicitly mentioned in the report that I think should be mentioned is the development of guidelines on debt and reserve management. More generally, the report does not emphasize sufficiently that codes and standards will only be effective if they are supported by comprehensive and well-coordinated surveillance, in particular Fund surveillance. While ROSCs and FSAPs have started to feature in Article IV consultation discussions, we will need to integrate them more fully into the surveillance process. We also need to find mechanisms to increase coordination on surveillance between the Fund and other standard-setting bodies. At the moment, the World Bank is probably the only institution formally involved in collaborating with the Fund on the preparation of ROSCs.

I was also struck by the results from the private sector survey. The feedback on ROSCs highlights the importance of keeping them short, having a standardized format, and ensuring they all have equally high quality. This is particularly valuable feedback. Achieving these aims will require strong involvement from management and the Board in the process of reviewing ROSCs. In this regard, earlier proposals to change the procedures relating to ROSCs as part of the initiative to reduce work pressures should be revised to avoid a weakening of ROSC review processes.

The increase in the number of modules being prepared is helpful, but I am struck by the unevenness of participation. We need to counter the impression that codes and standards are not applicable to all countries. Perhaps ensuring that all countries are involved in the formation and development of ROSCs would help. Mr. Daïri is right in pointing to the need to take account of differences in stages of development for the implementation of codes and standards. Efforts should be prioritized based on the particular needs of different countries. Effective technical assistance by the Fund and other agencies will also be needed, given the resource-intensive requirements linked to the implementation of ROSCs.

Finally, on dialogue with the private sector, the section which discusses market awareness is particularly helpful. The work of the capital markets consultative group and the FSF to build private sector awareness has been extremely helpful. The inclusion of Special Data Dissemination Standards (SDDS) in some bond contracts is a good example. But more will need to be done to enhance and increase market awareness of codes and standards.

My final point is on money laundering and countering of terrorist financing. We have agreed that the FATF provides an appropriate basis for the Fund's work, and I think the establishment of a task force on anti-money laundering is extremely helpful. But the FATF is now in the process of considering changes that might be needed to strengthen measures to counter the financing of terrorism. The coverage of this area in the report is appropriate, given the attention currently paid to this issue, and given that the IMFC November meeting is going to have a substantive discussion on this issue. The Fund should stand ready to make any changes required in this area.

Mr. Bauche made the following statement:

I would like to thank the Managing Director for this useful report. It is even more interesting given that the circumstances following the September 11 events are revealing the extent to which members remain vulnerable to financial economic turmoil. The conclusion reached in the book recently published by Paul Blustein—a well-informed correspondent of the Washington Post—that the world might remain as prone to financial crises as it was in 1997/98 calls for continued efforts in furthering the Fund's crisis prevention initiatives.

I welcome the analysis on crisis prevention, Offshore Financial Centers (OFCs), anti-money laundering and hedge funds in the report. On money laundering, the report should mention that the FATF has extended its mandate beyond money laundering and is currently dealing with the financing of terrorism. The ongoing work between the Fund and the FATF on the preparation of specific ROSC modules on anti-money laundering and the countering of terrorist financing, which will be based on the 40 recommendations of the FATF, should also be mentioned. The outcome of our forthcoming discussions on the paper of the internal task force on money laundering should also be incorporated in the report, as it will be presented to the Ministers at the IMFC meeting. The paper indicates that there is little evidence that there has been increased disclosure on the part of hedge funds to investors in general. The report should also mention—probably in Appendix I—that the FSF intends to review these issues in March 2002. The publication of the assessment of an OFC mentioned in the report is welcome. A comment should be added to show that publications are encouraged by the Fund, and that strong emphasis is placed on undertaking more assessments in a timely manner. I would also like to associate myself with the comments made by Mr. Pickford on the CCL, and also on the incorporation of ROSC and FSAP findings in Fund surveillance.

I would like to emphasize one point which may not be of crucial importance to the Fund's undertakings in crisis prevention, but which is nevertheless important. In paragraph 17, page 6, it is stated that the Fund's official language is English, and I guess it will not come as a total surprise to this Board if this chair insists that English is the Fund's working language.

Mr. Bennett made the following statement:

This was a very good report which I enjoyed reading. I would just like to make one observation and perhaps one suggestion. As Mr. Pickford has said, it is striking to note how many changes have been made over the last couple of years. To some extent, that is acknowledged by observers outside the Fund, including NGOs and civil society. In a recent meeting with Executive Directors, representatives from NGOs grudgingly admitted that progress has been made in the Fund. It would have been useful to have a report like the one currently under discussion, or a slightly more user-friendly version of this, to show them the extent to which changes have been made in the Fund. I would suggest using this as a communication device to our advantage in meetings with NGOs and other members of civil society.

Mr. Callaghan made the following statement:

I thought it was a good report too, and I have a few comments. One is just a general comment. While it was a good report, I do think there is a little bit of a tendency sometimes that we seem to portray our work on crisis prevention as being rather process-generated. The impression you do get from the report at times is that we are measuring progress by the number of PINs published, number of ROSCs undertaken, FSAPs completed, subscribers to the SDDS, etc. They are, of course, important indicators and are relevant, but they are just that, indicators, and they are only a means to an end. Of course, that end is crisis prevention, and that is what we are aiming for, and the way we are trying to address it is through influencing members' policies.

In that sense, that aspect of it was underplayed in the report. For example, in paragraph 37, it states that "members' policies are changing in response to the lessons of the emerging market crises of recent years." But then it goes on in the discussion to focus on the size of reserve levels, the number of subscribers to the SDDS, etc. So I think what is missing is a little bit of the recognition of what we are doing to influence members' policies per se, bringing all this to influencing and getting the right policy response. In this regard, I note that there is not much reference at all to our work on surveillance, except a reference in where we say that Article IV reports are being widely reported. But I think we do need to have a little bit more reference to our work on surveillance, which in some respects is at the cutting edge of our crisis prevention activities. I think it is mentioned in paragraph 7 that where it says "there is evidence that the reforms are influencing members and markets," but I think the bit about how we are actually influencing members in terms of influencing their policies is an area that needs to be emphasized a bit more.

On the markets, the wording in Appendix II is very interesting. I think the impression I get is that we are saying this increased differentiation is directly related to the private sector's reactions to the Fund's initiatives. I think it is a little bit too early to draw that conclusion. I would agree with what Mr. Dairi said in terms of paragraph 5 on other bodies mentioned in Annex 1, the work of a number of other bodies is excluded, so I think it is right that we should reduce the reference there to the number and perhaps have a more general statement.

Mr. Nijsse made the following statement:

This is a very good and comprehensive report. I only have a few remarks. On money laundering, an important qualification should be added to show that most Directors consider that the Fund should concentrate on those recommendations of the FATF which refer to the core of the Fund's work—financial supervision and financial regulation—whereas those issues more closely related to the legal or criminal areas should be left to other institutions. I guess this is implicit in the text, but the point could be made more explicitly.

Regarding prioritization of financial stability assessments, systemically important countries should be the first ones in the list, and OFCs should also be high on the list. Perhaps the reference to fiscal stability assessments and OFCs should be made in the same paragraph.

The comparison in paragraph 47 between the current dispersion of spreads on emerging markets and the dispersion seen in 1997 should be made more specific by clarifying whether this refers to the whole year, before the start of the crisis, or after the crisis.

Mr. Kelkar made the following statement:

I would like to thank the Managing Director for this draft report. I agree with comments made by Messrs. Daïri and Callaghan, and by Ms. Lundsager, except for two points. I think Ms. Lundsager's point about the exchange rate and financial sector should be inserted in the right place in the paragraph.

Although the report is excellent, it is unbalanced in a very significant way. It identifies all crisis prevention initiatives, but seems to suggest that crises can occur only in emerging markets. The current economic situation shows that crises can come from other sources and affect all types of countries. As Mr. Callaghan has said, we should emphasize how the Fund is improving surveillance of all economies, including major economies, and also improve multilateral surveillance of the capital markets. The Fund's advice on efforts to improve the coherence between economic policies of major economies is also important, as that is a very important source of crisis prevention for the world economy. The report on crisis prevention should also cover these areas. This is a major area which is currently missing.

Similarly, Private Sector Involvement (PSI) also has a role to play in crisis prevention, and not just in crisis management. The Fund has taken a number of initiatives in this area, which are still in progress.

The two points made by Ms. Lundsager that I do not share refer to capital account liberalization. She is right in saying that this can be beneficial, but that analysis is not conclusive regarding the benefits of capital account liberalization. Perhaps we should be a little more cautious in expressing the potential benefits of capital account liberalization, and all caveats observed by the staff should be retained. Similarly, on HLIs, the Fund's own work has so far suggested that they can continue to be a potential source of instability.

Mr. Pickford, building on Mr. Kelkar's comments on the importance of surveillance, considered that it would be useful to introduce a separate section on that subject in the report. The section could bring together comments on surveillance already made in the report to emphasize the ways in which it had been improved and extended over the preceding years. That would also address Mr. Bennett's concern that the report did not sufficiently emphasize the specific initiatives taken under the umbrella of Article IV consultations.

Mr. Tombini made the following statement:

> I would like to associate our chair with other Directors in praising the Managing Director's report. I just have a few comments.
>
> First, the paragraph on vulnerability assessments, which will be circulated shortly, as noted by the Deputy Director of the Policy Development and Review Department, should reflect that this is work in progress.
>
> The second issue refers to standards and codes. We associate ourselves with Mr. Daïri on trying to rescue the voluntary nature of the exercise on standards and codes.
>
> Third, regarding the fourth bullet in paragraph 31—"including anti-money laundering concerns in its surveillance and other operational activities when macroeconomic relevant"—we believe that money laundering issues are relevant even if not macroeconomic relevant in advanced economies.
>
> Fourth, we find the conclusion in paragraph 47 that there is evidence of increased differentiation over the recent period excessively optimistic. Such a conclusion cannot be drawn from the lower cross-correlations observed between emerging market spreads over treasuries, as this is a backward-looking indicator, and the period elapsed since September 11 is not sufficient to reach such a conclusion.

Mr. Zoccali made the following statement:

> I join other colleagues in thanking the Managing Director for a very well-focused and helpful report. I have three brief comments.
>
> The first relates to what Mr. Kelkar has mentioned, that the surveillance process is important, and also picked up by Mr. Pickford, and what happens in major economies is relevant for the process of international adjustment, and crisis prevention more generally. This needs to be reconciled with some of the proposed text. For example, paragraph 26, on strengthening financial sectors associates banking sector problems with the Asian crisis and in paragraph 33 it is noted that "following the financial crises in emerging markets, the Fund has strengthened its work on capital account issues." I think

it is important here to come to grips with the fact that financial crises are not just the exclusive domain of emerging market countries. The text should reflect this fact and the interlinkages involved.

On the issue of vulnerability assessments, I concur with what Mr. Tombini has said that this is very much work in progress, and should be reflected in the insert. On money laundering, I also share his comment regarding the fourth bullet in paragraph 31. Finally, on the general issue of investors becoming more discriminating and the differentiation in investors' attitude toward emerging market countries, I would caution about drawing too firm conclusions at this stage; in fact, Appendix II draws conclusions exclusively from some price indicators. Perhaps, it would be fair to take on board also what is happening with the quantity. I think here it might be useful to include a graph or table suggesting how net flows have, in fact, evolved for emerging market countries and, in particular, how foreign direct investment has behaved. These are my comments.

Mr. Daïri supported the points made by Messrs. Callaghan and Kelkar on surveillance. However, the whole report would have to be changed if surveillance was to be covered adequately, as the focus of the report was on Fund crisis prevention initiatives. Perhaps an introductory section should clarify that the report did not cover all the areas of traditional work of the Fund, but only the most recent initiatives. The issue of strengthened bilateral and multilateral surveillance could be addressed in a different paper.

The Acting Chair (Ms. Krueger) considered that the role of improved surveillance and strengthened policies in preventing crises could be acknowledged in the report without having to cover in detail the initiatives taken in that area.

Mr. Szczuka made the following statement:

The staff has decided to focus on certain areas, such as capital account liberalization or the financial sector, which are considered to be more closely related to the prevention of crises. While, as Mr. Kelkar and other Directors have stressed, surveillance or private sector involvement are also closely related to crisis prevention, the decision taken by the staff should be accepted at this stage, even if questions remain as to where the line should be drawn, and whether issues like OFCs are critical for crisis prevention.

The reference in footnote 2 in page 3 of the report to a Board of Governors of the IMFC should be amended, as there is no such thing as a Board of Governors of the IMFC. The staff should clarify what period is covered by the analysis, as there are inconsistencies in different parts of the report. For example, in paragraph 13 the staff refers to 1994, while in paragraph 14 there is a reference to 1997. While we might sometimes need to go beyond the last six-month period, the main focus should be on reporting the progress made during this period.

I have noted with satisfaction that countries in Central and Eastern Europe are among the leaders in ROSCs, in transparency and in other initiatives.

I am surprised that there is no reference in paragraph 21 to our efforts to draft guidelines for reserve management. Debt management guidelines are mentioned, but there is no mention of efforts to create something for the management of external reserves.

In paragraphs 24 and 25, there is an indication that the geographical coverage of outreach missions to obtain feedback from users of ROSCs is limited. Only Australia, Asia, the Middle East, and the U.S. are mentioned. There should be an indication that other regions should also be involved in this process. Like Mr. Pickford, I was also struck by the response from users of ROSCs, which to some extent contradicts the statements in the report that ROSCs are helpful and of good quality. The feedback shows a number of weaknesses in the process. Perhaps we should be more careful in praising ourselves if the private sector does not entirely share our positive assessment.

In paragraph 41, we have a kind of blanket statement that "the private sector has welcomed the Fund's international system reform initiatives". I am not sure that they welcomed every initiative; particularly the initiative on private sector involvement has not been welcome. Perhaps the staff should be more careful in indicating which initiatives have been welcome by the private sector and which have not been so warmly welcomed.

There is an indication in paragraph 43 that the SDDS has been mentioned in bond contracts. Perhaps it would be better to use the word prospectus rather than contracts, given that this is where the information has been provided, although the issue of whether prospectuses are part of contracts is a legal matter.

Finally, I share the comments made by Ms. Lundsager on the HLIs with one reservation. I do not think that we should send the message that we are no longer concerned with what is going on in this sector. The Code of Conduct drafted by the five big hedge funds does not solve all the issues of behavior and transparency. More generally, there are still significant problems in the private sector. Therefore, I would be careful in indicating that risks have been addressed through self-imposed guidelines, and that there is no systemic risk coming out of this sector.

Mr. Bhatta made the following statement:

I support the comments made by Messrs. Kelkar and Daïri and I have three more observations.

First, the last sentence in paragraph 20 under the section on standards and codes—"the Executive Board also discussed the possible inclusion of financial soundness indicators in the SDDS; while a number of Directors believed this would be a useful development, it decided to return to the issue at a future date"—provides only a one-sided view of the issue. A number of Directors did not feel that those indicators should be included in the SDDS at all. It will be necessary to correctly reflect the different views if we are going to leave this information in.

Second, the word "supervisory" should be inserted between "financial" and "standards" in the last line of paragraph 21, to indicate that the Fund's involvement in money laundering should only relate to financial supervision. These views were expressed during the discussion on money laundering.

Third, could the staff elaborate on the sentence in paragraph 46 which requires hedge funds to reveal more information to their primary creditors?

Mr. Mozhin made the following statement:

I am broadly satisfied with the comprehensive, balanced, and well-written report. I have one general comment and two small, factual corrections.

My general comment is related to the omission of the word "globalization" from the report. I found several instances where the authors of the report must have tried very hard to avoid using that word. For example, the first sentence in paragraph 5—"a key aspect of the changed financial system has been the recognition of the need for greater coordination within the international community on the reform agenda"—is somewhat confusing, as it does not specify whether changes have taken place in national systems or in the international financial system. The crises witnessed recently are clearly related to the process of globalization in financial markets. A key aspect of international financial globalization is the need for coordination within the international community. That should be clearly stated in a report on the Fund's crisis prevention initiatives. While tactical considerations might explain the omission of the word "globalization" from the report, I am afraid that any independent reader could notice this and conclude that the Fund is not being sufficiently honest or courageous.

Regarding factual corrections, there is a footnote on page 21 which lists the G-20 countries, excluding the United States. I think we should add this country to the list in the interest of transparency. The same type of comment applies to Column 4 of Table 1 in page 26 of the report. The sum of the number of CIS countries, which comprises 12 countries, and Mongolia amounts to 13 countries, and not 12 as stated in the report.

Mr. Wei made the following statement:

First, I associate myself with Mr. Daïri's comments on the voluntary nature of standards and codes, including FSAP issues. This should be mentioned in the document. Second, I associate myself with the comments made by Messrs. Kelkar and Callaghan on surveillance issues. On HLI issues, I associate myself with the comments made by Mr. Kelkar. On anti-money laundering issues, I agree with Mr. Pickford that there should be a sentence reflecting that there will be a future Board discussion on this issue, and that there might be some changes in this area coming out of the FATF meetings currently underway

Mr. Yanase made the following statement:

I agree with other Directors that this report is well-written, very comprehensive, and easy to read. I would like to pick up a few issues from the discussion.

First, regarding surveillance, I agree with Mr. Callaghan that this is a very important issue. However, I do not think that the new section on surveillance suggested by Mr. Pickford is needed, as different aspects of surveillance are covered in the discussions on different initiatives. Perhaps paragraph 1 or 2 could be expanded to explain the initiatives to strengthen surveillance, and that surveillance is key for the Fund to prevent crises.

Second, on capital account liberalization, I agree with Ms. Lundsager that we should probably place more emphasis on the benefits and merits of capital account liberalization. However, Ms. Lundsager's drafting suggestions are excessively strong. I think they are not consistent with the conclusions reached in our discussions on this issue that care should be exercised in the area of capital account liberalization.

Finally, on hedge funds, I agree with the comments made by Mr. Szczuka.

Mrs. Farid made the following statement:

We can associate ourselves with Mr. Kelkar's comments on including PSI in the report, and with his comments on capital account liberalization. We

> can also associate ourselves with Mr. Daïri's comments on the standards and codes. On money laundering, we are concerned with regard to the suggestion to remove the phrase "when macroeconomic relevant" from the last bullet in paragraph 31. I realize that removing this phrase would help ensure that money-laundering issues are also covered in industrial country surveillance. However, I think we should try to reflect that in some other way. We feel it is important to keep the phrase "when macroeconomic relevant."

Mr. Tombini suggested removing only the word "macroeconomic" and keeping the word "relevant" as a possible compromise to address Mrs. Farid's concern about his earlier suggestion to remove the phrase, "when macroeconomic relevant".

The Deputy Director of the Policy Development and Review Department (Mr. Allen) informed Directors that the staff would carefully consider their drafting suggestions, and would discuss them bilaterally with Directors if they were deemed to be inconsistent with earlier Board decisions. The staff would also solicit comments from Directors on the vulnerability section through the Secretary's Department.

Regarding comments from Directors on the need for additional explanations on anti-money laundering and financing of terrorism initiatives, it should be recalled that a separate note on those issues would be submitted to the IMFC, the Deputy Director observed. That report would draw on the conclusions reached during an earlier discussion on the staff report on anti-money laundering and financing of terrorism. While some of the smaller drafting changes proposed by Directors would be reflected in the report, a specific section on that issue in the report would probably not be needed.

As far as the issue of surveillance was concerned, the staff shared Mr. Yanase's view that the report of the Managing Director should focus on the Fund's initiatives in the area of crisis prevention, the Deputy Director affirmed. While additional emphasis on the linkages between those initiatives and the general framework of surveillance activities could be made in the introductory section of the report, a more detailed analysis on the Fund's Article IV surveillance work should only be undertaken once the general Board discussion on surveillance had taken place. The discussion on the biennial report on surveillance was currently scheduled for early 2002.

The staff had tried to follow the wording already discussed by the Board in its paper on capital account liberalization, the Deputy Director clarified. The staff had been cautious in the wording of comments on capital account liberalization, as the Board had not reached firm conclusions in that discussion.

The staff representative from the Policy Development and Review Department (Ms. Metzgen) explained that the work carried out in the important areas of reserve management guidelines had not been listed in Box 1 or mentioned in paragraph 21 because the staff had only included in Box 1 the 11 standards already approved by the Board. The staff had referred in paragraph 21 to ongoing efforts to develop anti-money laundering standards, because that area was currently under discussion. An update had also been provided on recent work in the area of debt management guidelines. It should also be noted that the coverage of outreach missions to obtain feedback on ROSCs had been considerable.

On Ms. Lundsager's suggestion to provide Directors with the analysis underlying the information presented in Appendix II on market differentiation, the staff representative noted that the Board had received several updates prepared by the International Capital Markets Department, on issues such as flight to quality. They would also be covered in the emerging markets financing report, which would be distributed to the Board shortly.

As regards the number of country assessments per year under the FSAP, the staff representative responded that the decision had been taken during the budget discussion to limit that number to 24, rather than having 30 assessments per year as initially proposed by the staff.

Mr. Mozhin reiterated his question on the possible existence of a policy against the use of the word "globalization" in staff papers.

The Acting Chair (Ms. Krueger) clarified that there was no such policy. The reference to changing financial conditions had been considered to be more appropriate in the context of the report on crisis prevention initiatives, because globalization did not refer specifically to international financial markets. Nevertheless, management was open to suggestions to introduce changes if the current wording was considered to be ambiguous.

Mr. Pickford considered that a reference to reserve management guidelines should have been included to show that the staff was currently working in that area. He also asked if his suggestions regarding the CCL would be taken on board.

The Deputy Director of the Policy Development and Review Department (Mr. Allen) considered that the CCL could be mentioned as part of the broader initiatives described in the opening section. He would also ask the External Relations Department to work on Mr. Bennett's suggestion to produce a document presenting the issues covered in the report in a more NGO-amenable manner. Some reference to the reserve and debt management guidelines would also be included, specifying that the Board had not yet approved any specific standards in those areas.

The Acting Chair (Ms. Krueger) observed that revisions to the report would be circulated before submitting it to the IMFC.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/01/109 (10/26/01) and EBM/01/110 (10/29/01).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 00/121 are approved.

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/01/123 (10/25/01) is approved.

APPROVAL: February 6, 2002

SHAILENDRA J. ANJARIA
Secretary