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FOR AGENDA

SM/11/101

May 18, 2011

To: Members of the Executive Board

From: The Secretary

Subject: **2011 Report on Risk Management**

Attached for consideration by the Executive Directors is the 2011 report on risk management, prepared by the Advisory Committee on Risk Management (ACRM), which will be brought to the agenda for discussion on **a date to be announced**. Issues for discussion appear on page 23.

The staff does not propose the publication of this paper given its confidentiality and because it relates to the internal operations of the Fund.

Questions may be referred to Mr. Fisher, FIN (ext. 38755) on financial risks; Mr. Desruelle, SPR (ext. 34373) on strategic and core mission risk; and Mr. Kincaid, OIA (ext. 37356) on the ACRM Secretariat and operational risks.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

2011 Report on Risk Management

Prepared by the Advisory Committee on Risk Management

May 17, 2011

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I. Introduction

1. **This report presents an overview of the principal risks currently facing the Fund as assessed by the Advisory Committee on Risk Management (ACRM).** The previous report (SM/10/115) was discussed by the Executive Board in May 2010 and an informal Board briefing on risk management took place in March 2011.

2. **The 2010 Report on Risk Management highlighted three principal changes implemented by the ACRM to better tailor risk management practices to the Fund's circumstances.** One, risk categorization was streamlined to eliminate overlaps, while avoiding gaps; specifically, core mission risks were distributed among the strategic and operational risk categories. Two, departmental self-assessment surveys were replaced by structured interviews with key department heads as surveys were viewed as providing too little value for money. Three, progress was made in the mainstreaming of incident reporting mechanisms and the development of key risk indicators (KRIs) relevant to the Fund. Directors broadly endorsed these modifications that followed-up on previous Board guidance (BUFF/10/65). They also broadly concurred with the ACRM's assessments of the main risks. In particular as regards strategic risks, Directors noted that the Fund faced heightened expectations concerning its role and responsibilities in the global financial system that created both opportunities and challenges. Financial risks were seen as having shifted toward credit risks, while liquidity and income risks had receded somewhat. Directors took note of the updated operational risk profile, particularly the five main ones, and the efforts at mitigation.

3. **Directors also called last year for further improvements to the Fund's risk management framework and welcomed the proposed review by a panel of independent external experts.** During the past year, the ACRM has worked with departments to improve incident reporting and to examine the Fund's exposure to WikiLeaks-type risks, including possible mitigation steps. In December 2010, the Managing Director appointed a high-level external panel to provide an objective expert assessment of all aspects of the Fund's risk management framework (see Press Release 10/54), recognizing the Fund's unique role in the international financial system. Given the broad nature of this review, the panel was given latitude to determine the scope, depth, and timeline of its work. The Panel has met with management, Executive Directors, and the ACRM, as well as various relevant senior staff on separate occasions and has hired a consultant. The Panel is currently engaged in drafting its report, which is to be submitted to the Managing Director, and then circulated to the Board. The development of further steps related to the Fund's risk management framework awaits their assessment and recommendations.

4. **This report is organized as follows.** Section II describes recent developments in the approach taken by the Fund to its risk management framework. The subsequent sections present the main results of the 2011 risk assessment, note changes to perceived risks over the last year, and identify current, or planned, mitigation measures. In particular, Section III

provides an overview of the Fund's risk profile, while Sections IV, V, and VI lay out the main strategic, core operational and financial risks, respectively. Section VII discusses the principal operational risks in support functions (HR, IT, data management, and research). Finally, Section VIII presents some issues for discussion.

II. Recent Developments in the Risk Management Framework

5. **The Fund's risk management framework was introduced in 2006 and is broadly based on enterprise risk management (ERM) principles.** The Fund's risk management environment was seen by Directors (BUFF/06/24; 02/06/06) as incorporating a system of checks and balances, operating within a set of policies that are regularly reviewed and approved by the Executive Board, and reflecting the Fund's unique character and governance structure. Nevertheless, Directors generally saw value in introducing a systematic exercise for gathering, synthesizing, and reporting information on risks and controls throughout the Fund. This exercise would promote active risk management. Since then, this risk assessment exercise has been conducted annually and reported to the Board (see Box 1).

6. **Risk management controls are embedded in the Fund's normal operations via departmental procedures and interdepartmental processes.** Such controls include the various reviews that underlie discussions of country programs and surveillance documents, both within departments and interdepartmentally, as well as by management. Departmental procedures typically incorporate the "four eyes" principle to mitigate risks (e.g., TA-departments backstop their expert-based TA, area departments' front office review their mission chiefs). Interdepartmental processes provide checks and balances (e.g., dual signature for policy and country papers, the review process, the Senior Review Committee). Overlaying these practices is a comprehensive independent audit and evaluation framework consisting of the Office of the Internal Audit, an external audit firm, the External Audit Committee, and the Independent Evaluation Office.

7. **The ACRM is the Fund-wide body that supports implementation of the Fund's risk management framework.**[1] It reviews and synthesizes the risks facing the Fund; proposes any modifications to the Fund's risk management framework (taking account of external best practices); and monitors progress in the implementation of proposed mitigation measures, based on departmental submissions. In particular, assessments of financial risks (by FIN) and strategic and aspects of operational risks (by SPR) are submitted. The Committee met several times over the past year as required by specific issues (e.g., annual risk assessment exercise, incident reporting, and exposure to "WikiLeaks-style risks"). It also conducts business electronically between meetings. The Committee was interviewed by the External Panel in early 2011 and OIA—in its capacity as the ACRM secretariat—has assisted the Panel.

[1] The ACRM is chaired by Mr. Zhu, Special Advisor to the Managing Director, and includes senior representatives drawn by rotation from each of the three main areas of the Fund (area, functional, and support services departments)—currently WHD, OTM, and OBP—and senior representatives from EXR, FIN, HRD, OIA, and SPR, who serve in an *ex officio* basis. OIA serves as the Committee's Secretariat.

Box 1. The Fund's Risk Management Framework

The Fund's risk management framework was established in 2006 following extensive work by a Task Force and various discussions with Executive Directors.[1] The Fund's framework uses the ERM concepts promulgated by COSO.[2] As part of this framework, the ACRM was established to assist Fund management in: analyzing, synthesizing, and reporting risks; enhancing the awareness in departments of risk management; and reporting to the Board on risk management matters.

The Fund's risk management framework, which initially incorporated four risk categories, now has three main risk categories as the elements of the fourth risk—core mission—have been distributed amongst the remaining three risks:

- **Strategic risk**—the risk that the Fund's medium-and longer-term objectives and formulation of its strategies does not meet the evolving needs of the Fund's membership.
- **Financial risk**—the possibility of direct, or indirect, losses or other negative effects on the Fund's financial position arising from risks in the areas of credit, income, liquidity and investment and budget management.
- **Operational risk—**The risk that the Fund does not foster macroeconomic and financial stability in member countries, promote international macroeconomic cooperation, contribute to development initiatives in low-income countries, and provide capacity building services. The exposure of the Fund (and individual Fund organizational units) to direct or indirect losses or negative effects, including reputational, resulting from failures or inadequacies in business processes, people, or systems, as well as from external events.

Reputational risk, which is of key importance to the Fund, was not included as a separate category but rather implicitly covered in the three other categories, as it can materialize as a consequence of adverse events in any or all of the other risk categories. Compliance with national legislative and regulatory requirements, which is typically included among the three broad risk categories, was deemed less material to the IMF. Therefore, it did not merit a separate risk category, but instead is covered under the operational risk category.

Annual assessments of risks have been conducted to: (i) inform management and the Board of perceived residual risks by departments, after taking account of mitigation measures; and (ii) apprise departments of risks and of efforts to mitigate risk in other areas of the Fund. These assessments also recognize that the risks associated with achieving the Fund's various objectives depends in part on the external environment, in particular actions by member countries.

Annual reports on risk management have been discussed by the Executive Board in 2007, 2009, and 2010. In addition, since 2007, updates, informal briefings and interim reports have been prepared, including (in 2008), on the risks of the downsizing and associated restructuring.[3]

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[1] *Report of the Task Force on Risk Management* (EBS/06/4; 1/09/06 and BUFF/06/24; 2/06/06), *Second Report of the Task Force on Risk Management—Task Force Proposals on the Implementation of a Risk Management Framework at the Fund* (EBS/06/74; 6/26/06), *Statement by the Managing Director on the Second Report of the Task Force on Risk Management* (BUFF/06/07; 6/19/06), and *Risk Management—Further Considerations* (SM/06/386; 12/04/06).

[2] ERM (Enterprise Risk Management) is an integrated framework to manage risks across the organization, and COSO (The Committee of Sponsoring Organizations of the Treadway Commission) is a leading organization in risk management.

[3] *2007 Report on Risk Management* (SM/08/90; 03/06/07, BUFF/07/42; 03/23/07 and BUFF/07/65; 05/04/07), *Report on Strategic and Core Mission Risks in the Fund* (SM/07/90, Supplement 1; 03/09/07), *Report on Financial Risk in the Fund* (SM/07/90, Supplement 2; 03/09/07), *Risk Management—Update* (FO/DIS/08/7; 01/16/08), *Risk Management—Interim Update* (FO/DIS/08/53; 06/02/08, and BUFF/08/79; 06/04/08), *2009 Report on Risk Management* (SM/09/44; 02/13/09, and BUFF/09/42; 03/12/09), *2010 Report on Risk Management* (SM/10/115;05/07/10) and BUFF/10/65; 05/28/10).

8. **Given the limited experience with the recently revised risk categories and new risk assessment techniques, the ACRM decided not to make further changes at this time.** While the ACRM's terms of reference should be updated to reflect the evolution in various risk management practices, this effort was deferred to allow any recommendations by the Panel to also be incorporated. Following the approach adopted in 2010 to gather information on risk perceptions, the ACRM primarily utilized two tools—in addition to the usual FIN and SPR inputs—to develop its assessment of the Fund's overall risk profile—bilateral interviews with key departments and the findings of incident reports (see Box 2). In 2010, five department heads were interviewed for the annual risk assessment; two departments were also represented on the ACRM. To expand the interview coverage, nine interviews (EUR, FAD, MCM, SEC, SPR, STA, TGS plus the CIO, and OMD advisors) were conducted. A summary was discussed by the ACRM, which added the perspectives of the seven additional departments or offices. The ACRM's discussions were also informed by incident reports, knowledge of various working groups tasked to address specific organizational concerns (e.g., Economic Data Management Initiative, three Working Groups on technical assistance), and findings and results of OIA reviews. The ACRM initiated a drill down into the Fund's potential exposure to "WikiLeaks-style risks" and potential mitigation strategies (see ¶55). As key risk indicators (KRIs) are still in the developmental stage, they did not figure in this process. KRIs will need to prove their value and gain traction in business units. This remains an area for further work.

Box 2. Developments in Incident Reporting

The reporting, cataloguing, and analysis of incidents serve two functions. One, incident reporting provides a snapshot of past problems, or in some cases, an early warning of similar problems in other areas. Over time, the cataloguing and subsequent analysis of incidents allows for an understanding of the probabilities associated with different incidents; clarification of the sources of incidents; and the implementation of procedures to reduce their likelihood in the future. Two, incident reporting also sensitizes staff to the importance of proactive and informed risk mitigation efforts. In particular, it is important to establish a reporting culture where the messengers are not blamed and instead, reporting is seen as an opportunity to learn and improve internal controls.

Steps have been taken to develop a more formalized incident reporting framework. In 2009, the ACRM defined tentatively what constitutes an "incident" and three degrees of severity (serious, less serious, and near misses).[1] Incidents are flagged to management in real time as needed. Following a pilot project, incident reports have been prepared at roughly six month intervals. A number of limitations exist including: partial coverage, inadequate recording tools, operational difficulties arising from an insufficiently clear and precise definition, and a reluctance to report. These limitations are typically encountered during the start-up phase of incident reporting. During 2010, the number of reporting departments/offices doubled from a year earlier. Departmental practices with respect to incident reporting logs remain varied. OIA therefore developed a secure SharePoint application and after some "road testing," this application has been made available to departments and offices. However, a single tool may not meet the needs of every department or office.

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[1]/ The difference between serious and less serious incidents is a matter of degree. Departments are expected to report serious incidents to management and/or the Board, while less serious incidents are expected to be dealt with on a departmental basis. Near misses are events characterized by pre-emptive action that averted what would, or could otherwise have been, a serious or less serious incident.

9. **Although the number of reported incidents increased in the second half of 2010 from earlier periods, this increase was considered to be the result of improved reporting**, in particular adoption by some departments of more systematic and timely logging systems. (A phenomenon often observed in other organizations at a similar stage.) Indeed, roughly 85 percent of the reported incidents emanated from two departments, which also have the most developed logging systems.

10. **The Fund's "Integrity Hotline" paints a similar picture**. In 2010, which was its second full year of operation, the hotline recorded 140 calls or web reports compared with 143 in 2009. Within these 140 calls/reports, 49 were requests for information; a small decline from 2009. Of the 91 complaints in 2010, most related to alleged email scams that employed the Fund's name. The Fund has posted a public warning on its external website about such scams. Only six complaints in 2010 were deemed substantive by the Ethics Officer; there were seven substantive complaints in 2009.

III. The Fund's 2011 Risk Profile

11. The 2011 assessment of risks took place as the global economic recovery gathered strength, although member countries face diverse challenges. Job poor growth, weak public balance sheets, still vulnerable financial sectors in advanced economies mean that the recovery is subject to significant downside risks, while overheating and incipient financial imbalances are a major concern in many emerging market economies. These external developments have shifted the contours of the Fund's strategic, financial, and operational risks from last year to now. This section provides an overview of how the Fund's main risks have developed. (Box 3 provides an illustrative risk profile.) Subsequent sections provide additional details. As regards reputation risks, these were seen to have increased somewhat and shifted from strategic to operational matters with the Fund's more prominent role, most notably in the G20 processes and members' Fund-supported programs.

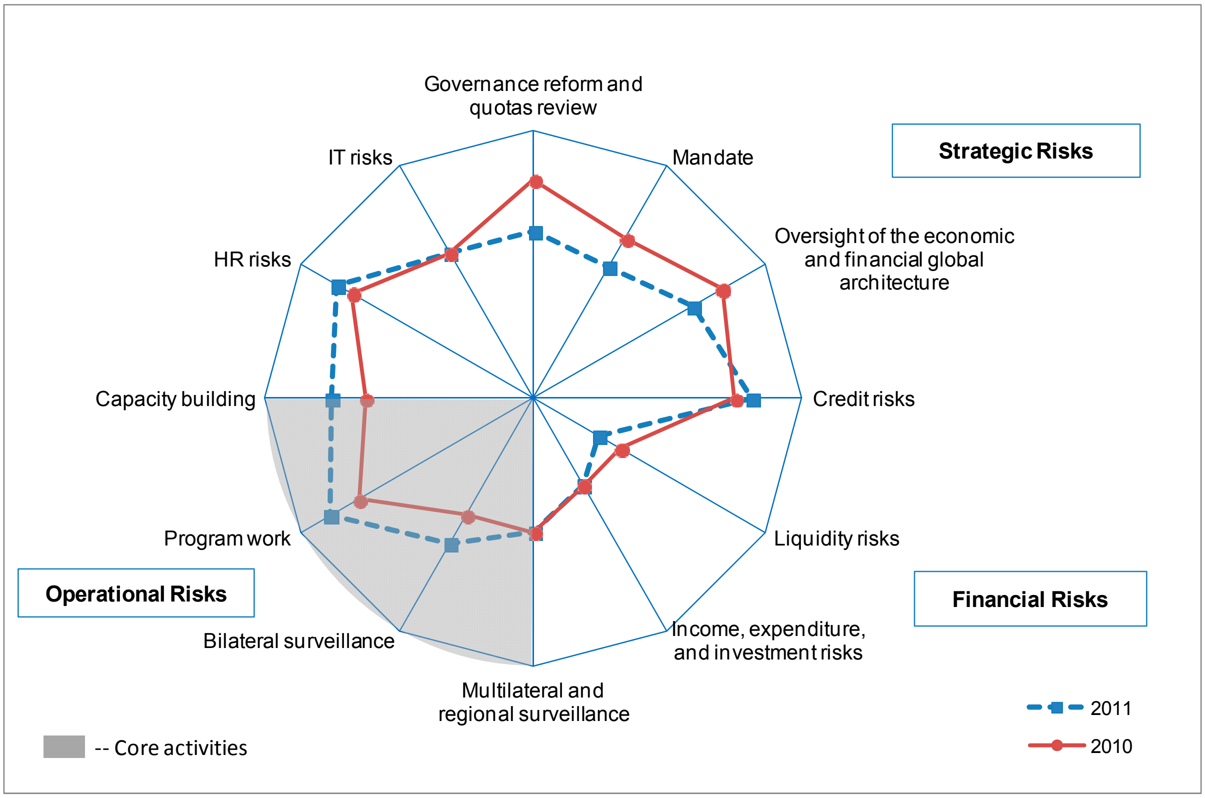
- **Strategic risks have declined in all subcategories.** Immediate risks in the governance area have receded for now with the ratification of the 2008 quota and voice reforms and the agreement on the significant 2010 quota and governance reforms. While new initiatives should lower risks, expectations associated with the oversight of the economic and financial global architecture have risen, owing to the focus on reforms to the International Monetary System including global liquidity in times of systemic stress, the role of SDR, and managing capital flows. Risks associated with the IMF's mandate have altered with the respective roles of the IMF, FSB, and the G20 more clearly defined. That said, complacency and reform fatigue can heighten these risks.

- **As to financial risks, credit risks have increased, while liquidity and income risks have receded.** Credit risks have increased as GRA credit outstanding is substantial, rising, and very concentrated. Moreover, undrawn commitments have reached historic highs. Liquidity risks have declined owing to the putting in place and activation of the new NAB. Income risks have fallen with higher lending and implementation of the new income model.

Box 3. The Fund's 2011 Risk Profile Relative to 2010

This box provides an illustrative overview of the Fund's 2011 risk profile relative to the 2010, as assessed by the ACRM and departments. While drawing upon sources and analysis presented in this paper, this risk-map incorporates a high degree of judgment.

The definition of each risk subcategory was presented in the 2010 Report on Risk Management. The risks covered have very different natures and dimensions and cannot be measured in a fully consistent manner. For example, the measurement of financial risks draws upon various quantitative indicators, while the assessment of strategic risks is clearly more judgmental. Also, some risks are linked to the Fund's output activities (e.g., bilateral surveillance, program work) and other risks (e.g., HR, IT) are related to support functions. Because of these differences, the relative position of risks on the map should be seen as reflecting implicit magnitudes. As the Fund continues to strengthen its risk management framework, a variety of qualitative and quantitative techniques, including additional indicators, should help measure more precise risk positions in future risk assessments.



- **Operational risks in core activities have edged higher, most importantly due to program risks.** Although most programs are on track, some major programs face important challenges related to public debt and fiscal sustainability as well as implementation fatigue. Multilateral surveillance has adapted well to the G20 MAP demands, although new surveillance modalities (e.g., spillover reports) will require careful attention. Capacity-building risks have increased, reflecting the greater reliance on donor funding, an expanded field presence, and new TA delivery modalities. Bilateral surveillance of all Fund members will benefit from the enhancements to multilateral surveillance, including the focus on the policies of the largest Fund members. At the same time, operational risks arise from incorporation of mandatory FSAPs for systemically important financial systems, broader integration of macro-financial linkages, and pressures on resources devoted to non-systemic members.

- **Operational risks in support functions have increased in some areas.** Work pressure indicators and the recent Staff Survey reveal that human resource risks are still elevated, while implementation of the HR renewal program introduces new risk. Continued vigilance over IT risks remains necessary, although these risks were not seen as heightened in 2011. Nonetheless, awareness to WikiLeaks-style threats has prompted action. Improved data management represents a continuing challenge.

IV. Strategic Risks in 2011

12. **This section provides an overview of strategic risks faced by the Fund, and describes mitigation strategies.** A number of these risks have become clearer as a consequence of the global financial crisis; others were already being grappled with long before. Through the efforts of Fund management, staff and the Executive Board, important actions have been taken to mitigate these various risks, thus leading to an assessment of lower strategic risks. These remain important risks that require close attention.

13. **The main area of strategic risk remains the effectiveness of the Fund following the crisis, although the various strands have shifted.** Last year the main areas of strategic risks were identified as governance reform and quotas review, the mandate of the Fund, and the oversight of the economic and financial global architecture. With the entry into effect of the 2008 Amendment on Voice and Participation in early March 2011, clear progress has been made to update the Fund's governance structure. Significantly, the Board of Governors approved a package of far-reaching reforms of the Fund's quota and governance, completing the Fourteenth General Review of Quotas. It will result in an unprecedented 100 percent increase in total quotas and a major realignment of quota shares to better reflect the changing relative weights of the IMF's member countries in the global economy. Member approval of the 2010 agreement before the 2012 Annual Meetings will be a challenge. The April 2011 IMFC Communiqué highlighted that the IMFC tends to enhance its role as a "key forum for global economic and financial cooperation." On the mandate of the Fund and oversight issues, progress has also been made in the areas of surveillance, financial safety nets, and the stability of the international monetary system (IMS). It is the last issue that is now attracting more attention and could pose new risks in the future.

14. **There are a number of upcoming important reviews that should help set future directions.** The Triennial Surveillance Review (TSR), which is scheduled to be completed before the 2011 Annual Meetings, should help strengthen and focus surveillance in all its forms. Next year a further review of new lending instruments is scheduled, which will include a review of both the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL). A review of LIC facilities is also due in 2012.

15. **Most current strategic risks pertain to how new initiatives are implemented.** The work program calls for stronger Fund participation and leadership in multilateral and systemic surveillance, enhancing bilateral surveillance, sharpening the focus on macro-

financial issues, and supporting low-income country (LICs) members. On multilateral and systemic surveillance (and related technical assistance), the Fund's contribution to the G20 MAP continues and will be reviewed in late-May, while the new spillover reports for China, the Euro Area, Japan, the U.K., and the U.S. are underway and are expected to be discussed by the Board with the relevant Article IV staff report. One strategic risk is that these initiatives are not incorporated into surveillance efforts more generally. The proliferation of surveillance products has also been recognized as a risk. In particular, the IMFC has called for "coherence and integration of surveillance products" and looks forward to "discussing a consolidated multilateral surveillance report at our next meeting [September 2011]." Work is now proceeding on this request, but it is still at a preliminary stage. On macro-financial issues, a series of papers is planned ahead of the Annual Meetings. After the global crisis, it has been acknowledged that there is a need for significant economic and financial reforms. There is a risk that the Fund's effectiveness in contributing to global stability will be weakened if progress is not made on this front. Refinements to the Flexible Credit Line and the new Precautionary Credit Line should help meet members' needs, although their take-up has been limited so far. Analytical work on LICs is also proceeding, with recent efforts to develop a Vulnerability Exercise for LICs. These efforts are important, but there is a risk that other needs may detract attention from the needs of LICs.

16. **Another area of strategic risk in 2011 is the direction of reforms to the International Monetary System (IMS).** Problems in the IMS include persistent current account imbalances and inadequate global adjustment mechanisms as well as the lack of a comprehensive oversight framework for growing cross-border capital flows, covering both source and recipient countries, among others. On capital flows, the Board recently endorsed an initial articulation of the Fund's institutional views on appropriate policy responses to manage large capital inflows. The April 2011 IMFC Communiqué underscored the importance of developing a comprehensive and balanced approach to address policies that give rise to outward capital flows and the management of inflows. There is also a need for strengthened policy collaboration and multilateral commitments from all countries, and a strengthening of the structure of the IMS through financial deepening and reserve asset diversification, including possibly through expanded use of the SDR.

17. **Strengthening the IMS and sustaining the relevance of the Fund will require shifts in its role.** More intensive surveillance could create new strains in relationships with members as they are subject to increased scrutiny. Greater policy coordination also requires a deft touch: the Fund has to ensure a credible result, but must also be seen to be even-handed. The Fund's relevance to members will thus also depend on its staff maintaining traction through good relationships with country authorities. If the appropriate balance is struck, the Fund can maintain its position as a trusted partner and venue for discussions. Should the Fund be seen as not being responsive in this area, there is a risk that the Fund will become less effective in contributing to global stability.

V. Core Operational Risks in 2011

Country Program work

18. **Operational risks in most Fund-supported programs are moderate but could rise. Risks are elevated in a few programs.** Most GRA Fund-supported programs remain

broadly on track, with relatively high implementation rates overall in terms of program conditionality.[2] There are also a large number of PRGT-supported programs that face challenges posed by recurring macroeconomic volatility, particularly from food and energy prices. Most program reviews have been completed on schedule, though some delays have been experienced. Safeguards assessments have been carried out, consistent with Fund policy, for all programs, and any issues identified are to be addressed. Nevertheless, operational risks exist and are at elevated levels in a few programs, most notably related to: employment and inflation dynamics, implementation/fatigue associated with extended periods of reform/fiscal consolidation, current adverse market sentiment, and the frameworks for support from regional partners, notably the European Union. The more recent prominent programs also carry reputational risks that could increase quickly if these programs encounter difficulties or prove unsustainable.

19. **Operational risks in Fund programs are expected to be primarily affected by developments in Europe and the Middle East.** The hollowing out of the traditional investor base for government bonds in the most vulnerable euro-area sovereigns continued as new rules for bondholder bail-ins were announced at the same time that markets questions the sustainability of public debt levels in some economies. Decisions taken by the European Union on the EFSF and ESM constitute an important step toward strengthening the EU's capacity to address the ongoing crisis, but the issues facing the euro-area continue to require a more consistent and comprehensive approach, including further policy actions in individual countries as needed, further steps to accelerate repair and reform of financial systems, and further strengthening of EU economic governance. The April 2011 GFSR contains a fuller analysis of the risks, including from contagion. Recent events have dramatically impacted countries in North Africa and the Middle East, adding to work pressures. The Fund is already helping several countries in the region through this transition, and stands ready to support efforts to maintain macroeconomic stability through financial assistance as needed, even though staff work pressures will intensify further. In May 2011, Portugal agreed with the ECB, EU, and IMF on policies that would permit financial support from these institutions.

20. **In the context of approving the SBA with Greece (May 2010), the Board modified criteria in the exceptional access framework to take into account systemic spillover effects.** In particular, although staff considered public debt to be sustainable over the medium term, significant uncertainties made it difficult for staff to state categorically that debt was sustainable with a high probability. Even so, Fund support was deemed justified given the high risk of international systemic spillover effects. Going forward, this aspect of the exceptional access policy would be available in similar cases where systemic spillover risks are pronounced. This provision was applied in the case of Ireland and Portugal. As these cases are also euro-area members, Fund resources flow to the budget and repayment will ultimately depend on the ability of these governments to regain access to capital markets.

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[2] The interdepartmental review process for country papers—program and surveillance—is designed to mitigate operational risks associated with lending and giving policy advice to members. In September 2010, OIA completed its study of the streamlined review process introduced in early 2009, concluding that it had resulted in a sharper prioritization on issues and countries and making several recommendations to improve further this process. (The full report is available on the OIA intranet website.)

21. **In response to concerns raised in the 2010 Report, additional steps were approved to mitigate risks from the use of Fund resources for budgetary purposes.** While Fund resources have been used for budgetary purposes for some time, the larger volume of budget financing (including recapitalization of domestic banks) was seen to have shifted risks. When reviewing the safeguards policy in 2010, Directors noted that the current safeguards framework focused solely on central banks and replicating the process across governments in cases receiving budget support would prove challenging. They welcomed progress in establishing framework agreements between central banks and treasuries to ensure timely servicing of member obligations to the Fund. They encouraged the staff to highlight fiscal safeguards risk in budget support cases, drawing on available sources.

22. **Operational risks in country programs are being monitored closely.** Fund programs, particularly those presenting heightened risks, are subject to high-frequency reviews. In addition to these individual program reviews, reviews of developments across the whole spectrum of Fund programs have been done regularly. The 2011 Review of Conditionality will allow the Fund to assess the effectiveness of recent reforms of conditionality, as well as analyze program design and outcomes.

Surveillance

23. **Operational risks in surveillance relate closely to strategic risks and, more particularly, to the implementation of new initiatives.** During the global crisis, the membership saw an urgent need for stronger international cooperation. The recent IEO report on the Fund's performance in the run-up to the global crisis made suggestions to address perceived weaknesses in the Fund's surveillance practices and institutional culture. Several initiatives have been launched to improve surveillance and related activities (e.g., EWE, contribution to the G20 MAP, cross-country thematic reports). The forthcoming Triennial Surveillance Review (TSR) will comprehensively assess the extent to which they helped Fund surveillance regain traction. The Management Implementation Plan for the aforementioned IEO Report will be taken up after the Board discussion on the TSR and would present concrete plans to address identified weaknesses. Translating surveillance policy innovations (including "spillover" reports and mandatory FSAPs for globally systemic financial centers) should enable a more effective dialogue with the whole membership remains a key area of risk. However, implementation of these initiatives presents new risks. It will entail proper identification of major global developments, thorough analysis of the impact of these developments on different segments of the membership, and the design of appropriate policy recommendations that provide value to Fund members and gain broad acceptance among them.

24. **With regard to *multilateral surveillance*, the analytical and policy challenges associated with the dual-track recovery and the European sovereign debt crisis remain a concern as does the possible overheating in some emerging market economies**. The expansion of multilateral surveillance vehicles creates risks of overlapping and duplication, message dilution, and reinforced silos. These risks are mitigated by increased inter-departmental collaboration, most notably for the EWE and spillover reports. The need for information security, particularly pertaining to crisis cases, may diminish cross-country analysis. While the work involved in multilateral surveillance may offer benefits to G20 bilateral surveillance, the demands placed on the staff to meet the needs of multilateral

surveillance may compromise the time required for effective country-specific analysis. The Board will review the Fund's involvement in the G20 MAP in early June. In its April 2011 meeting, the IMFC called for concrete proposals by end 2011 for the fostering of the coherence and integration of surveillance products, including a consolidated multilateral surveillance report. This work is now under way.

25. **Risks related to the conduct of *bilateral surveillance*, especially for smaller countries, appear higher in 2011 than 2010.** Close attention to the Fund's largest members, including spillover reports, aims to benefit surveillance operations across the entire membership. Mandatory FSAPs for members with systemically important financial sectors should mitigate risks from macro-financial linkages, but may elevate operational and reputational risks, especially given the heightened analytical challenges. The heightened focus on surveillance of systemic economies and program cases may have adversely affected the availability of resources for surveillance (including financial surveillance) for other Fund members. The Fund also faces reputation risks if inclusive-employment growth challenges are insufficiently covered in its Article IV staff reports. Prolonged delay in Article IV consultations with certain members also remains an issue that will be discussed by the Board in a forthcoming meeting. (Data reporting under the GDDS/SDDS and Article VIII continued to be problematic for a few members, raising both operational and reputational risks.) The TSR will use outside experts and an External Advisory Group to ensure objectivity and independence and it will constitute an important mitigation measure with regard to both bilateral and multilateral surveillance.

26. **The evolution of Fund surveillance operations has implications for IT and data related risks, which are discussed in more substantial details below**. A stronger emphasis on early warnings as well as on the analysis of tail risks raise the possibility of causing market disruption through a breach of confidentiality—a risk that will continue to be managed through appropriate procedures on the handling of sensitive information. Data inconsistencies in Fund multilateral documents (and with the G20 MAP) may pose a reputational risk. Efforts are now underway to mitigate this latter risk through a review on data controls for the key multilateral surveillance instruments.

Technical Assistance delivery

27. **The scaling up of TA-activities via regional technical assistance centers (RTACs) and topical trust funds (TTFs), pose various challenges.** Over time, it has become clear that apart from the larger size of RTACs compared to resident representative offices, they are significantly more complex entities to manage as are their reporting relationships to headquarters. Moreover, some donors and beneficiary countries have become more demanding with respect to RTAC governance and reporting requirements. Backstopping of experts is the primary measure, or control device, that is used to mitigate associated operational and reputation risks.[3] It seeks to maintain the quality of expert-based TA and ensure that these experts provide advice consistent with international best practices and Fund policies. In response to the downsizing of Fund staff, which has affected resources for backstopping, and to accommodate the expansion of expert-based TA, a new external

[3] In July 2010, OIA completed a review of TA backstopping.

financing instrument was approved to allow staff time to be billed to donors and not counted against notional FTE ceilings. The shift in TA delivery toward program countries, with a considerable decline in the resources devoted to non-program countries (especially low-income countries) represents another risk. Departments need to upgrade their financial and administrative systems to meet the operational challenges posed by their scaling up efforts, donors' expectations, and fragmented monitoring systems across departments.

28. **Reliance on donor funding also carries a number of risks**, including the fact that (i) donors have TA priorities—earmarking funds for topics/countries—that could differ from those set by Fund staff, resulting in both excessive and insufficient attention; (ii) staff have been required to devote more time to TA administration and less time to TA delivery and backstopping, which could adversely impact the quality of Fund TA-advice; (iii) donors have stressed objective performance measures, such as indicators of progress for attaining outcomes, which may have the unintended effect of increasing TA-delivery costs; (iv) funding gaps have required TA missions to be delayed and have complicated the hiring of long-term experts, whose contracts extend beyond donors' funding commitments; (v) a mismatch may emerge between internally-financed TA and externally-financed TA, with the latter dominating TA mission schedules at times; (vi) the Fund might incur unexpected budgetary costs arising from shortfalls or delays in external financing, particularly with respect to the funding of RTACs; and (vii) financing might be interrupted as donor and beneficiary countries become increasing vocal about the terms of their participation. In this regard, OTM is closely monitoring whether possible shortfalls from external financing are exposing the Fund to excessive budgetary risks and whether efforts to articulate the Fund's Regional Allocation Plans for TA over a longer time horizon are successful in better integrating internally-financed TA with the medium-term budget (see FO/DIS/11/69).

29. **To mitigate further these risks and issues, in the middle of 2010, management created three interdepartmental Working Groups pertaining to: (i) RTAC governance; (ii) results-based management; and (iii) TA financing.** A report from the WG on TA Financing has been submitted to management. Reports by the other WGs are expected shortly. In general, these reports will be considered and acted upon jointly to ensure a coherent and consistent approach is adopted. Given the work of these WGs, the ACRM did not think a drilldown related to TA would be productive at this time.

VI. Financial Risks in 2011

30. **Since the 2010 Report, the balance of financial risk facing the Fund has shifted toward credit risks, while liquidity and income risks have receded.** This section summarizes the recent evolution of these risks and discusses their approaches to mitigation.

Credit Risks

31. **Fund lending activity has continued to increase at a substantial pace in support of members' response to the global financial crisis.**

- **The Fund has committed resources at a substantial pace using its reformed GRA tool kit.** To better address members' potential financing needs, the Fund's lending tool kit was modified in August 2010. The cap on access to the Flexible Credit Line was removed and the maximum term for such arrangements was extended to two years. At the same time a new Precautionary Credit Line (PCL) was introduced. Fund commitments under the GRA amounted to about SDR 143 billion as of end-March 2011 compared to SDR 110 billion in the previous year.[4] About 80 percent of these commitments were accounted for by new five arrangements (i.e., Colombia, Greece, Ireland, Mexico, and Poland). Other arrangements approved over this period included five Stand-By Arrangements, one extended arrangement, and one arrangement under the PCL.

- **Credit outstanding increased to SDR 65.5 billion by end-March 2011, an increase of SDR 24 billion over the previous year.** Assuming the full disbursement of scheduled drawings under arrangements approved to date, outstanding credit would peak at around SDR 92 billion in FY 2013.

- **Credit has remained highly concentrated, though the share of the largest users of Fund resources in total GRA credit outstanding has continued to decline.** As of early April 2011, the largest user, Greece, accounted for 19.5 percent of credit outstanding, compared with 20.0 percent (Romania) in April 2010. The three largest users—Greece, Romania, and Ukraine—accounted for about 50 percent of total credit outstanding, while credit to the five largest users of Fund resources accounted for about 70 percent, compared to about 78 percent in April 2010.

32. **Substantial uncertainty exists concerning the potential demand for Fund financing in the period ahead.** The WEO notes that, while improving, financial conditions in advanced countries remain unusually fragile. Financial risks are therefore tilted to the downside as uncertainty persists about the ability of some sovereigns and banks to meet their high funding requirements despite continued extraordinary interventions by central banks. A number of members remain vulnerable, and may need to seek financial support from the Fund. The Portuguese authorities have recently requested such financial support. In addition, Greece may request that its current stand-by arrangement be cancelled and replaced by a new extended arrangement, so as to better align the schedule of repurchases with the prospects for a strengthening of its external position as well as its ability to access private markets.

33. **The Fund has in place a comprehensive set of measures designed to mitigate credit risk.** These include policies on access, program design and monitoring, including conditionality, safeguards assessments, remedial measures to cope with the financial consequences of financial arrears, and the establishment of precautionary balances. Nevertheless, a number of programs pose significant challenges, including some in which markets' view that debt sustainability is not assured. The Fund's credit risks are also mitigated by recent reaffirmations of the Fund's preferred creditor status.

34. **At the last review of the adequacy of precautionary balances in September 2010, most Directors agreed to raise the medium-term indicative target from SDR 10 billion to SDR 15 billion.** This took into account the sharp increase in commitments and actual and projected Fund lending. The increase in the indicative target also took into account the

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[4] This total includes new commitments under FCL arrangements with Mexico and Colombia following the cancelation of their existing FCLs. On a net basis new commitments amounted to SDR 98 billion.

projected rise in individual exposures, and the current limited capacity of the burden sharing mechanism. Most Directors also supported a more transparent and rules-based framework for adjusting the precautionary balance target over time, which would maintain the precautionary balance target within a range of 20 to 30 percent of total credit outstanding, subject to a minimum floor (EBS/10/161, p. 23).[5]

35. **Precautionary balances have increased, although they are still below the SDR 10 billion floor.** Precautionary balances were about SDR 8.1 billion at end-April 2011, SDR 0.8 billion higher than a year before. The pace of reserve accumulation is projected to accelerate significantly in coming years such that the indicative target would be reached by end FY 2016. The adequacy of precautionary balances is expected to be reviewed again before the SDR 10 billion floor is reached. The next review will also provide a further opportunity to take stock of and refine the framework for assessing the reserve target.

Liquidity Risks

36. **Despite the continued high level of commitments, the Fund's liquidity position in the GRA has strengthened substantially.** On April 1, 2011, the Executive Board completed the activation of the expanded and amended New Arrangements to Borrow (NAB) for a period of six-months for commitments up to SDR 211 billion. Following the activation of the NAB, most bilateral creditors that are NAB participants have agreed to keep their bilateral loan and note purchase agreements open to finance disbursements under pre-NAB arrangements, though these can no longer be used to finance post-NAB commitments. In addition, the 2008 Quota and Voice Reforms, which include ad hoc quota increases for 54 members, became effective on March 3, 2011, and most of the quota subscriptions have now been received. Reflecting these developments, the Fund's forward commitment capacity (FCC), has increased to SDR 270 billion compared with SDR 169 billion in late April 2010. Fund liquidity will continue to be monitored closely, and toward the end of the NAB activation period (end-September 2011), it will be necessary to assess whether or not the establishment of a further activation period is warranted.

37. **Augmenting the Fund's liquidity required the adoption of policies to mitigate risks arising from the use of borrowed resources.** In particular, in the context of the recent enlargement and modification of the NAB, the NAB decision was amended so as to allow the Fund to make special calls on the NAB in order to finance the early encashment of participants' credit arrangements. In determining the size of the NAB activation, the Fund has set aside 20 percent of total credit arrangements to provide a liquidity buffer against the possible encashment of credit arrangements. All NAB participants that are bilateral creditors have folded their exposure into the NAB, and so it is not necessary to maintain a quota based liquidity buffer for these lines. In addition, the Fund maintains a liquidity buffer in quota resources of 20 percent of the size of the four bilateral agreements with members that are not participants in the NAB.

[5] The Board also amended the decision on burden sharing to allow for a "carry-forward" of excess amounts generated from the minimum adjustment of 1 basis point to the rate of charge and the rate of remuneration (see EBS/09/202).

38. **The Fund has in place policies to mitigate risks associated with its use of quota resources.** The Fund's unique financing mechanism depends crucially upon the ability of members providing quota resources for GRA lending to be able to regard these resources as fully liquid international reserves. The Fund therefore maintains a prudential balance of 20 percent of quota resources available under the FTP that provides a liquidity buffer in the event that members need to encash their reserve tranche positions.

39. **In addition, in order to conserve quota resources which provide the greatest assurance of Fund liquidity, in the period through end-July 2011, borrowed resources from bilateral creditors are being used in a ratio of 1:1 with quota resources.** Resources available under the NAB will be used in a ratio of 3:1 with quota resources. Borrowing ratios for subsequent periods will be established in subsequent Financial Transaction Plans.

Concessional financing

40. **Significant progress has been made towards completing the financing package, approved by the Board in July 2009 to strengthen the Fund's concessional lending capacity.** As was noted in the 2010 Risk Report, the package aims to boost the lending capacity of the PRGT to SDR 11.3 billion during 2009–14, and includes new subsidy resources of SDR 1.5 billion (end-2008 NPV terms). Most of the additional subsidy resources would come from the Fund's internal resources, including use of resources linked to the recent gold sales, and additional bilateral subsidy contributions of SDR 0.2-0.4 billion (end-2008 NPV terms). The mobilization of new loan resources of SDR 10.8 billion (including the liquidity buffer to enable the voluntary encashment regime) is needed to meet the projected demand. Significant progress has been made towards these fund-raising targets—pledges of SDR 9.8 billion in loan resources and SDR 154.5 million in subsidies have been received.[6] The Board-endorsed measures to facilitate the mobilization of loan resources—including establishing a voluntary encashment regime that allows lending of participating creditors to qualify as reserve assets, and issuance of PRGT notes—became effective on June 1, 2010, and have allowed additional resources to be pledged and secured.

41. **The financing package remains adequate through 2014, but the PRGT's lending capacity will drop sharply after 2014 and require additional resources to meet LIC demand over the long term.** The recently secured PRGT loan resources have increased the available resources—uncommitted PRGT loan resources increased to about SDR 6.3 billion as of end-February 2011. Looking ahead, total projected demand for PRGT loans for the period 2009–14 remains broadly consistent with earlier estimates of SDR 11.3 billion, and consequently the financing package that was approved in July 2009 remains appropriate. However, staff projections suggest that the PRGT Reserve Account could subsidize annual lending of SDR 0.7 billion on a sustained basis starting in 2015, compared to the projected longer-term demand of between SDR 1.1-1.9 billion for the period 2015–2034. Additional resources would be needed to replenish the PRGT's longer-term lending capacity, and the

[6] See *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* (SM/11/61; 4/1/11).

Executive Board had an initial discussion of this issue on April 6, 2011, in the context of the options for use of gold sale profits.[7]

Arrears and HIPC/MDRI debt relief

42. Outstanding arrears to the Fund (including administered trusts) have remained stable for a number of years at about SDR 1.3 billion. Three countries (e.g., Somalia, Sudan, and Zimbabwe) account for all the protracted arrears. The costs for providing debt relief under the HIPC Initiative to Somalia and Sudan were not included in the original estimates, requiring additional financing if there were agreement on such support; to provide debt relief to Zimbabwe, if it were assessed to be eligible, would also necessitated additional resources (for details see SM/11/61; 4/1/11). The authorities of South Sudan applied for admission to the Fund after South Sudan becomes an independent country on July 9, 2011. While Sudan will remain a Fund member, retaining all its quota and arrears, various economic indicators will be reduced most notably export receipts, which will affect the possible magnitude of needed debt relief. Provision of MDRI-type "beyond HIPC" debt relief would also require additional resource mobilization, similar to the case of Liberia.

SDR market liquidity

43. **Policies are also in place to mitigate risks to the liquidity of the SDR market.** Since the 2009 SDR allocations, which increased SDR holdings by SDR 182.6 billion, the number of SDR voluntary trading agreements increased to more than double the pre-allocation level and now exceed SDR 71 billion, more than 20 times the aggregate sales volume since the 2009 SDR allocations. The absorption capacity has recently increased by a further SDR 3 billion on the account of quota payments since March 3, 2011 made in the context of the 2008 ad hoc quota increase. While the SDR Designation Plan also remains an important backstop, it is expected to remain precautionary given the current capacity available in the voluntary agreements. Staff also developed informal modalities to assist in the trading decisions which aim at promoting equitable burden sharing across the voluntary arrangements over time.

Income and expenditure risks

44. **Income risks have declined further since the last risk assessment.** Lending income is expected to remain elevated in the medium-term with credit outstanding now projected to peak above SDR 90 billion in FY 2013 as the Fund responds to the needs of members affected by the crisis. The higher lending income is likely to be temporary but is projected to substantially exceed expenditures in the coming years. This will allow the Fund to build precautionary balances, which is needed to help protect the Fund's balance sheet in light of the heightened credit risks and will also provide a source of income. Substantial progress has also been made in implementing the new income model which remains essential to provide sustainable and broader sources of income when lending income declines. The limited gold sales program was successfully concluded in December 2010 and the amendment to the

[7] See *Use of Gold Sale Profits—Initial Considerations and Options* (SM/11/53; 3/16/11); *Demand Projections for the Fund's Concessional Resources* (SM/11/53 Sup.1; 3/16/11); and *The Chairman's Summing Up—Use of Gold Sale Profits—Initial Considerations and Options* (BUFF/11/57; 3/8/11).

Articles to expand the Fund's investment authority entered into force in February 2011. A work program on the implementation of this expanded authority is now underway.

45. **The financial and economic crisis has had a major impact on Fund expenditures.** Temporary budget spending has increased to meet the needs related to the crisis, particularly new programs; this higher spending has been more than financed by lending income. A small real increase in the structural budget has been agreed in order that the Fund is able to perform the enhanced role endorsed by the membership (EBAP/11/27; 3/31/11); reallocation of resources within and across departments has contributed to moderate the real budget increase. A number of risks exist on the expenditure side. One, temporary spending pressures may not abate as envisaged and the distinction between temporary and structural spending may become less meaningful the longer the crisis continues. Second, rolling back temporary spending (e.g., field offices) will be no easy task. Three, structural spending pressures remain and only limited scope exists for further reallocations among departments and activities. These issues will be considered in more detail by the Board before the discussions on next year's budget. Also, the steady state outlook for income has not changed significantly from the 2008 outlook when the Board endorsed the new income model (EBAP/11/32); as these income projections remain highly uncertain and sensitive to key assumptions, expenditures will need to be kept under close watch. Finally, the renovations of HQ1 and the Concordia pose challenges to project and budget management and increase the Fund's risk exposure in these areas as well as reputation risk. Given the complexity of these projects and the magnitude of the budget appropriations, additional financial and administrative controls are envisaged along with periodic reporting to the Board (EBAP/11/33).

Investments

46. **In the short-term the main risk to the Investment Account stems from the possibility of underperformance and possible capital losses in a rising interest rate environment**. Under the current investment policies, holdings in the Investment Account are limited to fixed income securities issued by sovereigns that issue currencies in the SDR basket, and by international financial institutions, while Trust Fund resources are invested in a broader range of assets. In both cases, exchange rate risks are mitigated by holding investments denominated in and weighted according to the constituent currencies of the SDR. Counterparty, credit, and exchange rate risks associated with the investment account and balances in the Trusts are also limited. Both portfolios have performed well in recent years as a result of declines in interest rates, but face a risk of underperformance should yields rise faster and further than current market expectations.

47. **With the entry into force of the amendment to the Article of Agreement to expand the Fund's investment authority, work has commenced on implementing the Fund's broadened investment authority, particularly, the establishment of the gold endowment.** This is a key element of the Fund's new income model. The development of the new rules and regulations will be based on a detailed analysis of the risks and returns of alternative portfolios. The investment account is likely to be more exposed to various market risks than has been the case to date.

48. **With regard to the Staff Retirement Plan, the Investment Office and the SRP's Investment Committee monitor closely the performance and risk-taking and have**

developed an extensive control system. These risks are further mitigated by the portfolio's diversification, its disciplined investment practices, and its strong funding position. The latter, combined with a budgetary reserve mechanism, serves to buffer funding changes required from the administrative budget. As an example, in FY 2011, the high return on the SRP's investments would have allowed the Fund to make no contribution to the SRP in FY 2012. Fund policies will nevertheless include a 14 percent contribution on the pensionable gross remuneration, all of which will supplement SRP reserves and mitigate risks of any future adverse investment performance by the SRP.

VII. Operational Risks in Support Functions in 2011

49. **Among the operational risks relating to support functions, two have been discussed in previous reports—IT and human resources.** One area—exposure to WikiLeaks-type risks—was selected for further analysis and mitigation efforts. Two additional risks—relating to data controls and research—permeate Fund operations and surveillance and have been the subject of internal review.

IT services, including WikiLeaks

50. **IT service and system delivery risks fall into four broad areas: Business Continuity** (risk of failure of existing systems), **Change Enablement** (risk of late or poor delivery of new systems and work practices needed to respond to new Fund needs and mandates), **Information Security** (risk of unauthorized disclosure of sensitive information), and **General Alignment** (risk that IT projects are poorly aligned with Fund needs). TGS has also developed an IT risk mitigation plan which identifies the key risks and the relevant mitigation measures. It was reviewed by an external expert in May 2010.

51. **The availability of critical business systems remains generally high but a recent outage has prompted a re-examination of remote access capabilities**. Experience with remote access during the 2010 snow storms that closed the IMF (and U.S. government) was satisfactory. However, Citrix systems outages during the 2011 Spring IMFC Meetings were serious and disruptive for those staff working from home, particularly FIN staff that needed to perform financial transactions with the membership. These outages greatly undermined confidence in the Fund's ability to provide reliable remote access. Infrastructure failure risks are mitigated through the use of multiple data centers and regular business continuity and disaster recovery simulation exercises. Application failure is mitigated through maintenance contracts with global service providers and replacement and refreshing of systems to ensure that they are using current, supported, versions of software. Nonetheless, a comprehensive review will be undertaken of the remote access systems' performance, architecture, change management, and testing procedures. Following such a review, a Fund-wide retest of the remote access environment will be carried out.

52. **The risk of disruptive attacks on the Fund's IT systems is increasing**. Most attempts to infiltrate the Fund's network appear to have the objective of intelligence gathering, which could embarrass the IMF with unauthorized publication. In addition, business continuity could be at risk. In early 2011 the "cyber activist" group called "Anonymous" issued a call to members to disrupt the business of the U.S. Federal Reserve and other institutions such as the World Bank and the IMF. "Anonymous" has the capacity to

be disruptive—mainly through large scale "denial of service" attacks that might disrupt the Fund's policy evolution or its credibility. TGS has contracted with a specialist firm to provide enhanced protection, leveraging their 84,000 servers worldwide to detect and block rogue traffic closer to the source. The service is planned to be activated in the near future.

53. **Delivery of new systems to schedule budget and assure quality is monitored closely by the TGS Business Portfolio Team.** The risk profile around new projects is changing as effort shifts—from the delivery of major new systems required to support reforms and new mandates—to the delivery of improved data and information management systems, where user requirements are less defined and governance arrangements are more complex, given the number of stakeholders.

54. **In the area of information security, the Fund continues to be subjected to persistent and sophisticated attempts to breach its network**. Risks are mitigated through a variety of technical controls and constant monitoring of network traffic and system activity. The most serious information security incidents were those where it was detected that Fund information was insufficiently secured and therefore vulnerable to unauthorized access, as opposed to incidents where information was actually withdrawn surreptitiously.

55. **The WikiLeaks incident prompted a drill down by the ACRM on the Fund's risks and the adequacy of controls around unauthorized disclosure by trusted individuals**. Risk perceptions have certainly increased in this area even if actual risks may not have. Nonetheless, the WikiLeaks incident served as a "wake-up" call. TGS is now in the process of implementing a program to enhance staff awareness of the potential threats and to provide staff with appropriate knowledge and skills to protect the Fund's information assets. TGS is also testing IT tools to monitor data traffic on the Fund's network and is planning to adopt minimum security standards for personal devices—i.e., non-Fund issued—that connect to the Fund's email system. These measures were considered as enhancing information systems without imposing undue burdens. Residual risks clearly remain.

56. **OIA's review of the effectiveness of IT governance observed that the major strategic planning exercise, conducted in late 2010, was a healthy step in promoting alignment of IT strategies and plans with Fund business needs and directions.** The planning exercise was undertaken in partnership with SPR and involved discussions with senior staff of all departments. The proposed IT Capital plan for FY 2012 is well aligned with the needs identified in this strategic planning process.

Human Resources

57. **Since the 2010 Risk Report, HR and staffing risks have increased, although progress had been made in some areas identified previously**. Positive gains have been made over the past year toward filling gaps in the skills mix of Fund employees. The economist workforce has benefited from increased training programs in key strategic areas (e.g., financial sector issues and debt management), and the Fund has increased the share of its recruitment of mid-career economists with substantial policy experience. Of 76 mid-career economist recruits, two-thirds were hired in functional departments (predominantly in FAD, MCM, and SPR). In addition, the Fund hired on contract 24 professionals with financial sector experience, and 15 with fiscal and debt policy expertise. This represents a doubling in

the number of hires with specialized skills compared with the previous year. Difficulties could emerge in attracting specialist expertise as the economic recovery continues and demand from academia picks up.

58. **Progress has also been made in enhancing staff diversity in national representation among the staff, although competitiveness presents a challenge in certain underrepresented regions and market segments** (see 2010 Diversity Annual Report). The Diversity Scorecard has raised awareness, while the recently-introduced B-level diversity program will improve diversity at senior staff levels.

59. **The significant volume of external recruitment combined with high levels of internal mobility have led to heavy demands on departmental HR management.** An exceptionally high volume of new recruits (475 new staff and 439 long-term contractual appointments in 2009-10) has placed a heavy burden on people management in departments. In addition to carrying the heavy crisis-related operational workload, experienced staff and supervisors have had to take on a critical role in coaching, mentoring and monitoring new staff. An on-boarding program to facilitate integration of new recruits into the Fund has helped to some extent. The number of staff hired on limited-term appointments has risen sharply and reliance on contractual resources, especially long-term contractual appointments, has increased. While providing the Fund with flexibility to adjust its workforce in the years ahead, these shifts also raise new issues, including loss of institutional memory, with turnover and increased search and on boarding costs. Effective workforce planning has already been initiated in a few pilot departments. HRD will establish a new unit to focus on workforce planning at the Fund-wide level.

60. **Even though most departments are now close to full staffing levels, work pressures remain high,** with unpaid overtime remaining high, both Fund-wide and in crisis departments facing an increased mission load. Annual leave usage continues to be low and the 2010 Staff Survey indicates concern about the heavy workload and work/life balance. To alleviate work pressures, managers have been encouraged to support flexible work arrangements for their staff. The policy on working remotely has also recently been expanded to permit more flexibility for staff (see EB/CB/11/1; 1/13/11). Field security risks have increased, rising staff's safety concerns and complicating the work of area and TA-delivery departments.

61. **The 2010/11 Staff Survey identified several areas of strength but also identified important areas for improvement**. The staff has a very strong connection to the organization, generally believes that they are treated with respect and fairness, and have confidence in decisions made by Fund Management**.** The three main staff concerns were:

- On **career development and accountability**, very few staff consider that the Fund does a good job of developing people to their full potential (28 percent), of taking appropriate action when dealing with poor performers (17 percent) or poor managers (11 percent), or of promoting the most competent people (28 percent);
- In terms of **openness to change**, only a quarter of respondents indicated that they feel there is a climate where staff can challenge traditional ways of doing things; less than half said that they feel comfortable voicing their opinion on matters that affect them;

- On **empowerment**, staff satisfaction was relatively low with involvement in decisions that affect their work and in having sufficient authority to do the job. Scores in this area have declined since 2003.

62. **These messages are consistent with findings of other reports, including the IEO report on IMF Performance in the Run Up to the Financial and Economic Crisis, the Task Force on HR Management, and the Working Group on A14 Economists.** The draft report of the Working Group, with recommendations to enhance career development opportunities for A14 staff, was forwarded to management in January 2011. Together with HRD and SAC, departments will develop action plans to build on the strengths that have been identified in the survey and address areas for improvement. The new Deputy Managing Director will carry this work forward over the coming year.

63. **HRD's capacity to address these issues and more generally to support HR management and service delivery, could be challenged by its own re-organization and downsizing.** Under HRD's renewal program, the department would reduce its headcount from 99 at end-FY 2011 to 78 in FY 2014 and upgrade its skill sets, shifting toward higher value added responsibilities.[8] A successful transition will depend, *inter alia*, on the devolution of certain responsibilities to departments, continued streamlining and automation of HR procedures, and outsourcing of some functions. Each element involves risk. The findings of the Task Force on HR Management, established in February 2011 will help guide HRD's restructuring and readjust the roles and responsibilities of HRD vis-à-vis departments. Additional measures to mitigate potential operational and reputational risks include the appointment of a senior HRD staff member to oversee HRD's renewal program, access to outside expertise, and close collaboration and feedback from the SPM community.

Fund-wide data coordination, manipulation, and reliability

64. **Strengthening economic data management within the Fund will enhance the quality of the Fund's policy advice by improving the underlying data.** Although considerable progress has been made in enhancing data management activities, data systems are still fragmented owing to "siloed" operations and duplicative efforts, methods, and tools.[9] These weaknesses, and the risks to which they can give rise, only become more serious particularly with the heightened complexity of financial and fiscal systems. The tightened budgetary environment has reduced data quality checking that occurs for externally published country reports, increasing reputation risks associated with publishing incorrect information. To mitigate these issues, management set in motion in 2010 the Economic Data Management Initiative (EDMI) that comprised a Steering Group (SG), chaired by a DMD plus a Task Force (TF), chaired by a B4-level staff member. A "stock-taking" report was provided to the SG by the TF in mid-2010 and the SG provided guidance for further work. Pilot projects were launched to: develop a more coherent governance structure to facilitate the Fund's institutional policy framework for data management; enhance cross-country data

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[8] In conjunction with the development of HRD's renewal program, OIA conducted a follow-up review of HRD. This OIA review can be found on OIA's intranet website.

[9] Controls over multilateral vehicles (WEO, GSFR, Fiscal Monitor, and REOs) have been enhanced to reduce the probability of data errors. OIA has reviewed these enhanced controls and the findings can be found on the OIA intranet site.

sharing; facilitate the migration to “structured databases”; exploit greater use of commercial sources of financial data; explore options to increase STA’s support for operational data; and examine approaches to improve the historical WEO data. Their findings and recommendations are expected to be sent to management soon.

65. **Despite the recognized importance of greater adherence by countries to high quality standards of data reporting, the multilateral effort through ROSCs to achieve these objectives has not progressed as rapidly as might be desired**. The difficulties arise from limited staff and financial resources, questions as to the adequacy of the existing standards (particularly with regard to financial indicators), and a drop off of use by market participants concerned with the timeliness of reports and the lack of cross-country and cross-sector data comparability. The global financial crisis also revealed that data gaps may have contributed to a weakness in the capacity of the Fund and market analysts to discern potential weaknesses in the financial sector that contributed to the crisis. Work is now underway to fill these gaps. In late 2010, the GDDS and SDDS frameworks were updated, enhancing alignment of the GDDS with the SDDS, and incorporating a broader coverage of financial indicators including a new table on external debt by remaining maturity. The Board also accelerated the timetable for the Eighth Review of the Fund’s Data Standard Initiatives, and is considering a possible enhanced data dissemination standard (SDDS plus) for IMF member subscribers to the SDDS with systemically important financial sectors. Possible refinements to the SDDS will be proposed at the time of the Eighth Review in 2012.

VIII. Issues for Discussion

Executive Directors’ views are sought on the following issues:

- Do Directors agree with the risk assessments in this report? Are there any significant risks that Directors find missing or alternately over stated?

- What are Directors’ views on the analysis and mitigation measures?