FOR AGENDA

SM/14/172

June 20, 2014

To: Members of the Executive Board

From: The Acting Secretary

Subject: **2014 Report on Risk Management**

Attached for consideration by the Executive Directors is the 2014 report on risk management, prepared by the Advisory Committee on Risk Management (ACRM), which is tentatively scheduled for discussion on **Friday, July 18, 2014**. Issues for discussion appear on page 39.

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

Broad questions may be referred to Mr. Meyers, OIA (ext. 35912). Specific questions may be referred to Mr. Fisher, FIN (ext. 38755) on Fund governance reforms; Mr. Bayoumi, SPR (ext. 36333) on evenhandedness, market vulnerabilities, and political turbulence; Mr. Hemus, TGS (ext. 38263) on field security and HQ1 renewal; Mr. Hinderdael, TGS (ext. 38546) on IT security; Mr. Alhusseini, HRD (ext. 37085) on the employment framework; Mr. Henderson, OBP (ext. 34745) on resource adequacy; and Mr. Marston, RMU (ext. 35631) on the new risk management architecture.

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

2014 REPORT ON RISK MANAGEMENT

June 19, 2014

EXECUTIVE SUMMARY

This report provides an overview of the nature and significance of the key risks that are currently facing the Fund and the actions that are being taken to manage them.

Incidents reported to the Advisory Committee on Risk Management (ACRM), which substantially related to the Fund's non-core operations, showed a marked increase in FY 2014. Serious incidents, those reported to the Fund's management, rose from 31 in FY 2013 to 37 in FY 2014, largely reflecting a significant uptick in field security events.

Nonetheless, the ACRM assesses that institutional risk, on the whole, remains moderate. While strategic and non-core operational risks are seen as having increased, core operational risks appear to have moderated modestly. Underlying this, a few high-intensity risks were identified in the strategic and non-core operational areas, and moderate risks were identified in each of the risk framework's broad categories.

Annual risk surveys have enabled the ACRM to draw on Fund departments to inform its annual risk assessments. A review of the accuracy and relevance of the 2012 and 2013 surveys found that survey responses tended to overstate risk and that risk specifications tended to be unfocused. To address these concerns, for the 2014 risk management exercise, the ACRM strengthened the approach followed by explicitly linking identified risks with institutional consequences and with the operational areas in which mitigating action would be taken.

Based on the range of inputs provided through the survey, incident reporting and other strategic and core operational risk analyses, the ACRM assessed the Fund's current key risks areas. Key strategic risks include the Fund quota and governance reforms, and perceptions regarding the non-uniform treatment of members. Key core operational risks include market vulnerabilities and political turbulence, and key non-core operational risks include field security, the Fund's employment framework, resource adequacy, IT security, and the HQ1 renewal program.

Next steps in the Fund's approach to risk management will include the establishment of a new risk management framework.

Approved By
Advisory Committee on Risk Management

Prepared by Secretariat to the Advisory Committee on Risk Management (ACRM)

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INTRODUCTION

1. This report provides an overview of the nature and significance of the key risks facing the Fund and the actions being taken to manage them. The framework for risk management aims to provide a systematic approach to identifying, assessing, and mitigating the risks faced by the Fund.

2. In the Executive Board's consideration of the previous report on risk management (SM/13/195), which was discussed on July 26, 2013, while Executive Directors broadly concurred with the overall risk assessment that was presented, a number of Executive Directors noted that future reports would benefit from a more extensive analysis of mitigation strategies, including a review of past implementation, and a few other Directors saw room for further developing comprehensive-risk indicators and the quantitative analysis of risks. In that discussion, Executive Directors took note of risks related to the concentration of Fund programs in Europe, continuing significant liquidity and credit risks, delays in governance reforms, the persistence of information security and human resource risks. Executive Directors also looked forward to the strengthening of the Fund's risk management framework, building on the recommendations of the high-level external panel and the report of the Working Group on Risk Management.

3. As noted in EBAP/14/52, action to implement a new risk management framework is now underway, addressing a key concern expressed by Executive Directors at last year's Board discussion. As some time will be needed for the new framework to become fully operational, the ACRM-managed risk management process was followed for the current cycle. Recognizing the value of Executive Directors' comments, a number of steps have been taken to improve this year's exercise, including a review of the accuracy and operational relevance of the 2012 and 2013 risk surveys, and an assessment of that review's implications for this year's exercise. In response, this year's risk management exercise has been strengthened by explicitly linking identified risks with institutional consequences and the operational areas in which mitigating action would be taken, and specifying an associated timeline.

4. This report also summarizes incidents that were reported during FY 2014, and provides an assessment of the Fund's current risk profile. Building on a retrospective analysis of recent risk surveys, the report incorporates enhanced procedures for risk assessment in the current cycle, and sets out the key risks that the ACRM appraises to be facing the Fund, along with associated mitigation measures.

INCIDENT MONITORING AND RISK PROFILE

A. Incidents Reported during FY 2014

5. An incident, as defined by the ACRM, is any failure in people, processes, technology, or an external event, which caused, or if not discovered could have caused, a significant disruption in Fund operations, or damaged reputation, or led to financial loss or unbudgeted costs. The collection of information on incidents is one of the tools employed by the ACRM for gaining insight into the Fund's continuing and emerging institutional risks. With the most serious developments followed on

an ongoing basis, and a comprehensive exercise conducted semi-annually, incident tracking provides a modality for the ACRM to liaise with departments and offices, review failures from an institution-wide perspective, assess their significance, identify root causes, and ensure that remedial action has been taken or is about to be implemented.

6. While reporting guidelines encourage departments and offices to focus on major operational risks, including their involvement in remediation, departmental practices for incident collection and reporting vary, and for the most part relate to events in the Fund's non-core operations. In this regard, FIN, HRD, OBP, and TGS continue to provide the most significant inputs for this aspect of the Fund's risk management.

Table 1. Reported Incidents FY 2013-2014

	FY 2013		FY 2014	
	1st Half	2nd Half	1st Half	2nd Half
Serious	17	14	20	17
Of which: physical security	8	8	12	13
Less Serious	64	94	170	134
Of which: HQ1 Renewal	…	1	114	68
Other	64	93	56	66
Near misses	10	9	4	5
Total	91	117	194	156
Excluding HQ1 Renewal	91	115	80	88

7. During FY 2014, a total of 350 incidents were reported to the ACRM, of which 37 were considered serious enough to warrant direct reporting to the Fund's management or Executive Board (Table 1). Incidents related to the physical security of the staff constituted by far the largest factor in this regard, accounting for over two-thirds of serious events. The killing of the Fund's Resident Representative in Afghanistan, in January 2014, was the most grave of these incidents. Physical security incidents also included threatening security situations in a range of operational locations, in Africa, Europe, and the Middle East, a number of which led to mission suspensions, and temporary staff relocations. The experience with respect to the physical security of Fund personnel in FY 2014, in which the number of serious incidents increased by about 50 percent relative to FY 2013, confirms the importance of the ongoing efforts to assure that the Fund can effectively deliver support across its membership while ensuring, to the full extent possible, the safety of the Fund's personnel.

8. Other serious incidents reported during FY 2014 were distributed across non-core operational areas, including the operation of administrative systems, information security, and information technology. While these incidents, which included, for example, a denial of service attack against the Fund's external websites, did not signal any apparent systemic weaknesses, additional mitigating actions have been taken. Reviews were initiated to analyze root causes for incidents, as required, and appropriate mitigating actions have been implemented or are being assessed.

9. The HQ1 Renewal Project is an area in which incident reports are providing some initial encouraging signs. As noted in the 2013 Report on Risk Management, an extensive HQ1 Renewal Program control framework was established to identify, assess, and proactively manage risks associated with the HQ1 project. In this regard, reports on the project, which noted a significant increase in less serious incidents with the start of construction in the first half of FY 2014, indicate a substantial decline during the second half of the year, with no serious incidents related to the project during the financial year.

10. In addition to insights provided through departmental incident reports, supplementary information on human resource aspects of non-core operational risks is gleaned from reporting that takes place through the Fund's Integrity Hotline. In 2013, 297 reports were made to the Integrity Hotline, of which 77 were information requests and 220 were complaints, representing a 35 percent rise in information requests, and a 5 percent increase in complaints, compared to the preceding year. The majority of complaints received, as in 2012, related to e-mail scams, while a small number were associated with substantive issues ranging from human resource-related issues to the misuse of Fund resources, and the Fund's conflict of interest policy.

B. The Fund's Risk Profile

11. As indicated in the latest Early Warning Exercise briefings, WEO, and GFSR reports, while recovery from the financial crisis of 2008-09 is progressing, required adjustment has not been completed, financial stability conditions are far from normal, and downside risks continue to dominate the global context in which the Fund carries out its mandate. Related concerns include geopolitical developments, risks of secular stagnation accompanied by deflation or low inflation in advanced economies, and rebalancing-related vulnerabilities in emerging market economies, mostly localized, because capital inflows could slow or reverse.

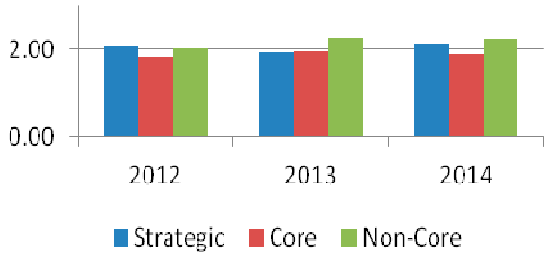
Box 1. Risk Categories

The Fund's risk management framework identifies three main categories: strategic, operational, and financial risks. While some aspects of financial risks are noted in this report, financial risks are principally addressed outside of this report.

- **Strategic**: the risk that medium- and long-term objectives and strategies will not meet the Fund's evolving needs.
- **Core Operational**: the risk that *core objectives,* including economic and financial stability in member countries, international macroeconomic cooperation, contributing to development initiatives in low-income members, and capacity building services, will not be realized.
- **Non-core *Operational***: risks arising from exposure of the Fund to direct or indirect losses resulting from failures in business processes, people, systems, and/or external events.

12. While risks to the global economic context provide an important indication of the potential for developments having a negative impact on the Fund, the correspondence between progress in the global economic and financial environment and the Fund's risk profile is not one-to-one. This reflects the fact that, in particular, some key Fund strategic risk factors play out over a longer time scale, core operational risks derive from developments in non-systemic as well as systemic members, and various non-core operational risks are unrelated or weakly-related to the economic and financial climate.

Figure 1. Risk Profile



13. In line with this, risks facing the Fund stem from potential limits to the achievement of its institutional objectives, both in the short and over the longer term, and may be strategic and/or

operational in nature (Box 1). In this regard, as set out in the most recent Managing Director's Global Policy Agenda (SM/14/73 Rev. 1, 4/15/14), the Fund has, in particular, targeted supporting members in managing the operational and communication challenges associated with the unwinding of monetary accommodation, in designing policy options that will advance the consolidation of member fiscal positions while safeguarding growth, in supporting the transition from liquidity- to growth-driven financial markets, in understanding interactions between structural reforms and public finances and the impact of regulatory reforms, and in strengthening the Fund's governance to ensure its continued legitimacy, relevance, financial strength, and effectiveness.

14. For the year ahead, strategic guidance to departments on the alignment of their work with key institutional priorities, as set out in the Management Key Goals for FY15,[1] helps to secure the feeble global recovery in a sustainable way as an overarching objective. In support of these goals, departments have been tasked with developing relevant policy advice and programs, improving core outputs, creating a more enabling environment for staff, and strengthening Fund governance and ensuring the adequacy of its resources.

15. Risks currently facing the Fund can be viewed through the frame of developments that will impede the achievement of the Fund's key near- and longer-term objectives, raise the cost of realizing those objectives, and/or undermine the Fund's medium- to long-term effectiveness. The assessment of those risks takes into account recent incidents and the analysis of factors underlying those incidents, including multi-year trends, staff's forward-looking analysis of developments in their areas of responsibility, and the ACRM's overall evaluation of the information on risks and the impact of current and planned mitigating actions on the related outlook.

16. As observed by several Executive Directors during last year's risk management discussion, it is recognized that the process of identifying and analyzing risks might benefit from more comprehensive risk indicators and quantitative analysis. Looking ahead, it is expected that quantitative techniques that could further strengthen the analysis of potential risk exposures, including the development of regularly tracked relevant indicators, will be introduced.

Risk Sub-Categories

Strategic
- Strategic Directions (STR.D)
- Financial Resources (FR)
- People (PP.S) 1/
- Governance (GOV)

Core Operational
- Surveillance (SRV)
- Lending Operations (LND)
- Technical Assistance (TA)

Non-Core Operational
- People/HR (PPL) 2/
- Business Processes (BU.PR)
- IT Systems (IT)
- Safety and Security (EXT)
- Other (OTH)

1/ Human resource strategy
2/ Human resource administration

[1] See http://www-intranet.imf.org/departments/OMD/Documents/FY2015%20Accountability%20Framework%20Documents/Other%20AF%20Documents/ManagementKeyGoalsforFY2015.pdf

17. In the interim, in the context of the above-noted environment, the ACRM assesses that the profile of perceived risks facing the Fund is similar to that reported in 2012 and 2013 (Figure 1).[2] Institutional risk, on the whole, remains moderate, although strategic risks are viewed to have increased, and non-core operational risks remain above the 2012 level. In informing institutional risk assessments, area departments, as a group, indicate that they perceive the level of strategic risk relative to 2012 and 2013 as having increased, while functional departments, on average, indicate an increasing trend level for non-core operational risks. Underlying these broad assessments, there is significant variation at the disaggregated level. A few high-intensity risks have been identified in both the strategic and non-core operational areas and moderately high risks have been identified in each of the categories. The specifics of key risks will be set out and discussed later in this report.

Risk Ratings

Impact
- Serious: major disruption (4.0)
- Medium-High: significant impact (3.0)
- Medium-Low: modest impact (2.0)
- Minor: low impact

Likelihood
- Very likely/almost certain (4.0)
- Likely (3.0)
- Unlikely but possible (2.0)
- Very unlikely but not negligible (1.0)

18. As an approach to better understanding the distribution of risks across and within the risk categories, departmental survey responses were indexed into risk sub-categories, and for each sub-category, the corresponding impact and likelihood ratings were averaged.[3] As the same methodology was used in last year's risk management exercise, this approach allows for a comparison with the evaluation for FY 2013, and assessment of possible emerging trends.

19. Consistent with the information provided by the incident reports, departmental assessments indicate that safety and security (EXT) issues are viewed as posing a pronounced risk to the Fund, having both high impact and likelihood ratings (Figure 2). Fund governance (GOV) and strategic financial resource (FR) issues, followed by a range of lower likelihood sub-categories (surveillance, lending operations, strategic directions, and information technology), were also, on average, viewed as areas of relatively high-impact risk. While risks related to technical assistance issues (TA) were seen as being relatively likely, their impact, along with that of other sub-categories was rated to be somewhere between medium-low and medium-high.

[2] The profile presented in Figure 1 is an aggregated index of the highest intensity risks in each category, as assessed by the ACRM based on departmental input. Weights were assigned as follows: serious/very likely=4, serious/likely or medium-high/very likely=3, serious/unlikely or medium-high/likely or medium-low/very likely=2, all other=1.

[3] These sub-categories were developed in line with enterprise risk management concepts formulated by the Committee of Sponsoring Organizations of the Treadway Commission, a leading risk management body.

Figure 2. Intensity of Impact and Likelihood 2014

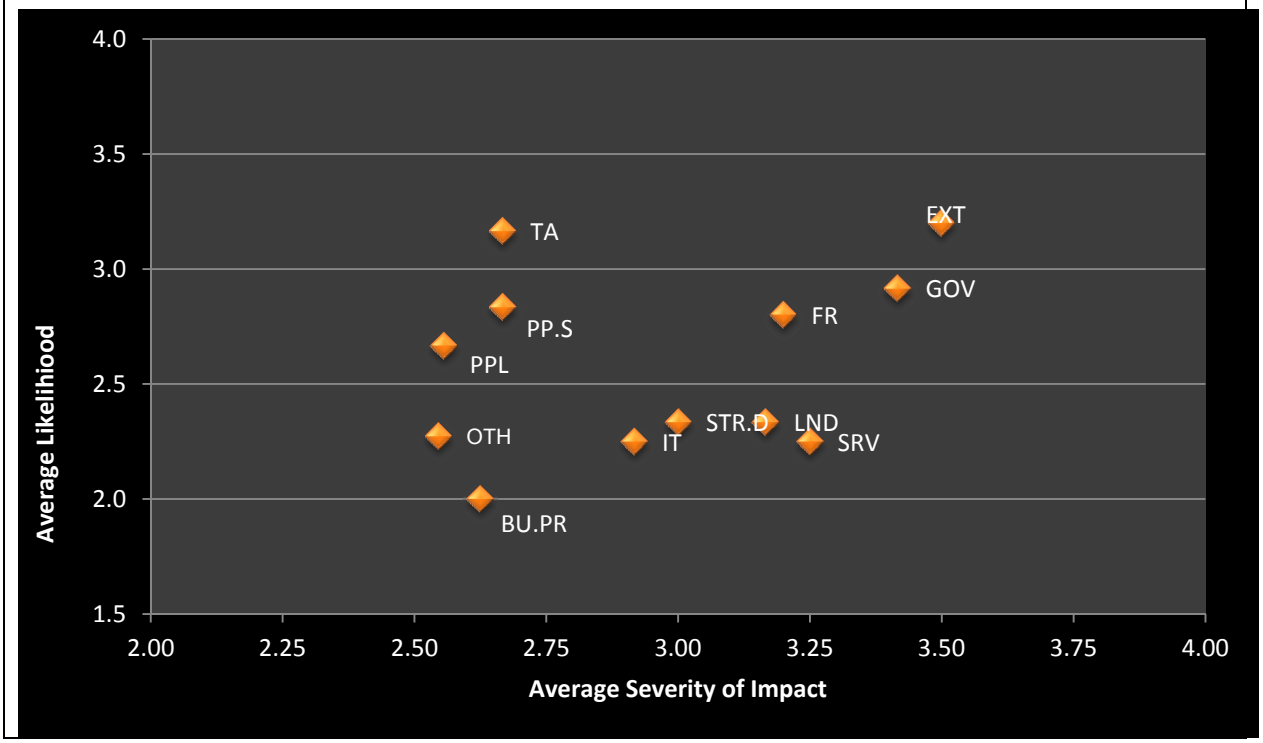
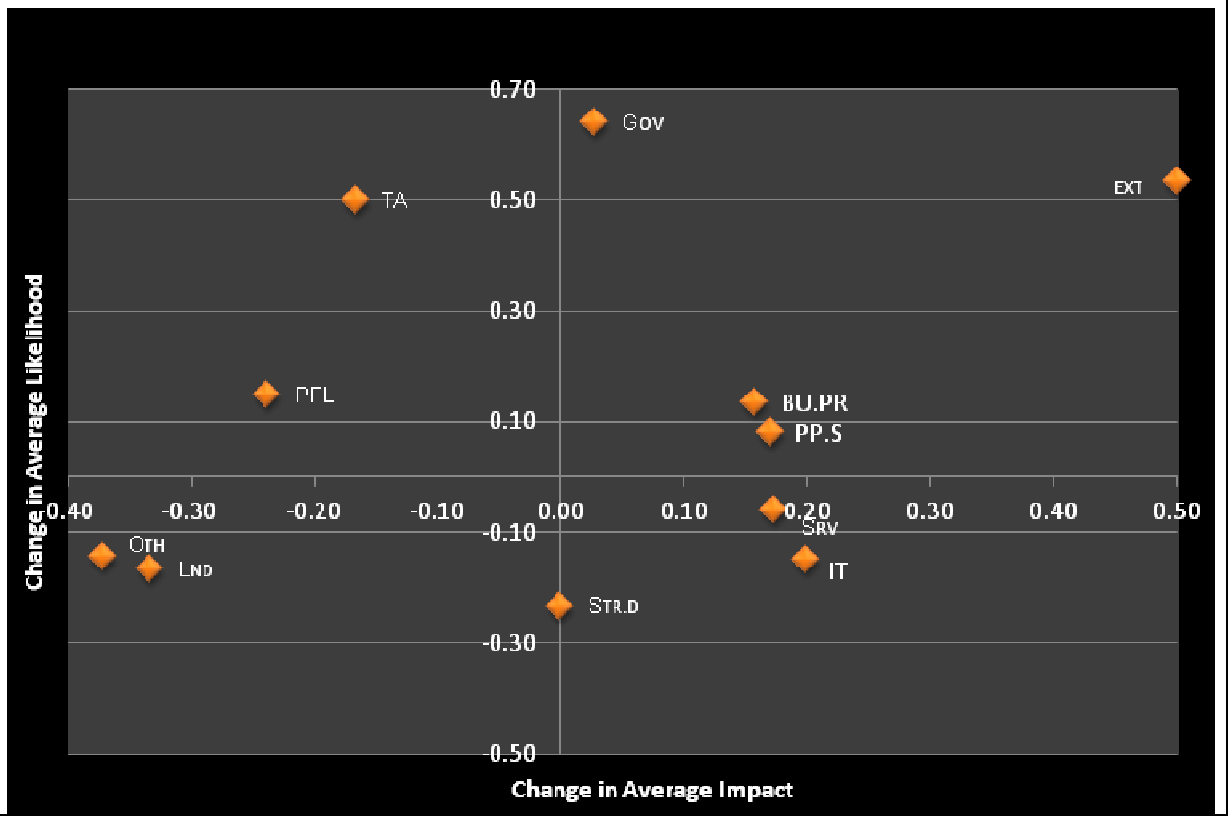


Figure 3. Changes in Perception of Impact and Likelihood, 2013-2014



20. The change in the distribution of risk ratings at the sub-category level in relation to 2013 was significant (Figure 3). The impact and likelihood and risks associated with staff safety are viewed as having increased substantially, and the rise in the likelihood of governance- and technical assistance-related risks was also significant. At the other end of the spectrum, the impact of adverse outcomes associated with the Fund's lending operations, and the "other" activities sub-category, a residual catchall, declined markedly. Taken together, the assessed distribution of institutional risks and the directional changes in their viewed impacts and likelihoods helped to set the focus for the ACRM's review of risk developments in FY 2014.

INFORMING RISK MANAGEMENT

A. Accuracy and Relevance of the 2012-13 Surveys

Background

21. Annual risk surveys have, in past years, enabled the ACRM to draw on Fund departments and offices as a source of information on the institutional risks faced by the Fund. After suspending the conduct of enterprise risk surveys in 2009, the ACRM introduced a streamlined departmental survey in 2012. The survey, which asks departments to identify the three most important risks facing the Fund in its strategic, core, and non-core operations; to assess their impact and likelihood; and propose mitigating action, was repeated in 2013 and 2014.

22. In responding to the survey, the Fund's staff of highly trained professionals draws on its access to a wide range of information and operational experience to supply the ACRM with insights into continuing and emerging developments that pose risks to the Fund. Unlike the more structured risk analysis that supports the Fund's strategic and operational decision-making, the open-ended survey provides substantial leeway in characterizing pertinent issues.

23. Sufficient time has passed since the conduct of the 2012 and 2013 surveys, to allow for a retrospective look at the value derived from previous risk management surveys, to help inform the use of the 2014 survey in this year's exercise. In this regard, it is worth asking whether identified key risks materialized, important risks were missed, what follow-up actions were taken to mitigate their impact, and at what cost, and what the associated institutional consequences were. The intention is to support the process leading to the July 2014 Board discussion on risk management, and not to substitute for an in-depth assessment of the Fund's risk management framework.

24. Looking back at the 2012 and 2013 surveys, this section focuses on the three highest intensity risk groups—those identified by at least one department as having a serious impact (the highest impact rating) and a likelihood rating of either very likely/almost-certain or likely, and those viewed to have had medium-high impact and very likely/almost-certain probability of materializing. The identified risks that met these criteria in either the 2012 or 2013 survey are set out in Table 2.

Interpreting Survey Responses

25. To encourage openness in the risk assessment process and draw on the full information set available to departments, risk surveys have been loosely structured. Specified risk categories are broad, and the definitions given for the various rating levels for impact severity and likelihood are general. A serious impact risk is defined as typically involving "a major disruption to work, a crisis, or a major deleterious impact, financial or otherwise, on desired outcomes" and requiring urgent action by senior management.

26. Reflecting this relatively flexible rating structure, departments reported a range of risks with similar descriptions and varying impact and likelihood assessments. For example, the risk that budget constraints and changing institutional demands would limit the staff's ability to deliver core outputs was viewed by a range of departments, variously, as a strategic or a core-operational risk, with serious, medium-high, or medium-low impact, and with very likely, likely, or unlikely but possible probabilities. While the commonality of the broadly described event could be taken as an indication that it had a clear institutional relevance, survey responses often provided a mixed assessment of importance for risk management.

Table 2. Risks Rated as Very Likely or Almost Certain in 2012 and 2013

Risks that materialized

1. Governance reforms not implemented
2. Lack of promotion prospects affect staff morale and the quality of output 1/
3. HQ1 Renewal -- facilities do not meet changing departmental business needs 2/

Risks with unclear outcomes

1. Fund viewed as excessively Euro-centric; not evenhanded
2. Limit on contractual staff tenure and lack of new staff position will result in loss of key contributors/ability to deliver

Risks that did not materialize

1. Budget constraints and/or changing work demands constrain ability to deliver core or expanded outputs
2. Fund seen as ineffective in dealing with developments in advanced economies
3. Programs in Middle East fail to stabilize economies and restore growth
4. Inadequate policy traction in surplus countries
5. Negative reaction to cost of HQ1 renewal
6. IT Breach

1/ The risk assessed as having materialized relates to the effect on staff morale, not output quality.
2/ This response reflected the concern that the growing number of staff in the Fund could have an impact on space planning and affect the HQ1 renewal program.

Were Likelihood Expectations on Target?

27. Of 11 serious and medium-high risks that were identified as very likely or almost certain, only three can be clearly assessed as having materialized (Table 2). While some elements of the other listed risks may have been realized, they did not do so in a way that had the specified operational impact. For example, continuing to hold the Fund's budget constant in real terms did have an impact on work practices and coverage. However, neither management nor the Board indicated that the Fund failed to deliver core outputs.

28. The fact that nearly three-quarters of very likely/almost certain risks did not materialize, signals an apparent limitation of departmental surveys. As reported, many of the risks are compound descriptions of an environmental context and a Fund-relevant outcome. For example, for the risk that programs in the Middle East fail to stabilize economies and restore growth, it is true that the political and economic situations in many Middle Eastern countries remain in disarray. However, arrangements in place for Jordan, Morocco, Tunisia, and Yemen remained on track. (Yemen's ECF arrangement ended in April 2012.) While the likelihood of continued turmoil appeared to be strong, programs were still able to achieve some successes. It appears that survey respondents may have overrated the likelihood of risks, but mitigating actions may also have helped prevent risks from materializing. Moreover, some risks may have long life spans and might still materialize.

Table 3. Risks Rated as Serious Impact in 2012 and 2013

Strategic

1. Fund viewed as excessively Euro-centric; not evenhanded
2. Governance reforms not implemented (Likely)
3. Modification or lending policies under pressure from EUR members undermines effectiveness (Likely)

Strategic/Core Operational

1. Program failure in Europe leads to loss of credibility and legitimacy; worsening crisis in EUR weakens Fund effectiveness

Core Operational

1. Programs in Middle East fail to stabilize economies and restore growth (Very likely)
2. Missing key risks, including insufficient focus on long-term issues (Likely)
3. Fund blamed for failed programs and advice due to unduly optimistic assumptions

Core Operational/Non-Core Operational

1. Budget constraints and/or changing work demands constrain ability to deliver core or expanded outputs (Likely)

Non-Core Operational

1. Negative reaction to cost of HQ1 renewal
2. IT Breach
3. Political, security and social conditions could expose staff to life threatening situations at significant financial cost

29. Of five serious risks that were identified as likely (Table 3), only one can be clearly assessed as having materialized. This would appear to be consistent with the assessment that, even in the areas of greatest concern, respondents may have tended to overestimate likelihoods. At the same time, while frequency estimates may not be reliable indicators for small samples and non-recurrent events, in relative terms, the likelihood assessment for this group of risks does not appear to be out of line.

30. The bottom line appears to be that departmental respondents, in 2012 and 2013, may have overrated the likelihood of the operational risks and/or were less careful than would have been appropriate in identifying relevant events. Thus, for risk management purposes, the interpretation of survey inputs needs to be adjusted appropriately. Going forward, there may be scope for refining the design of surveys to help address some of these issues.

Specification and Rating of Impacts

31. Looking at the listing in Table 4, it is apparent that each of the risks that were rated as having a serious impact was an issue that merited institutional consideration and follow up. That

said, respondents tended to focus more on general situations, and less on the risks that they posed for the Fund.

32. For example, it is not clear what the respondent thought the impact on the Fund of being seen as excessively Euro-centric would be. This lack of clarity does not effectively support risk management in several dimensions: (i) the risk management focus is not clearly set out; (ii) the *ex-ante* assessment of the potential cost to the Fund is not provided; (iii) the formulation of appropriate options for mitigation is not effectively informed; and (iv) the institutional impact is unclear.

Table 4. Reflection of Risk Survey In Risk Management Reports: Serious/Very Likely Risks

Risk Cited in Survey	Reference in Report on Risk Management
1. Fund viewed as excessively Euro-centric; not evenhanded	Total credit outstanding and total commitments have both reached new highs with credit exposure highly concentrated given the substantial increase in lending to Euro area members. This presents elevated operational, credit, and reputational risks.
2. Programs in Middle East fail to stabilize economies and restore growth	New programs negotiated with several countries in the Middle East present significant reputational risk if the programs were to encounter difficulties or perceived to contribute to political upheaval.
3. Negative reaction to cost of HQ1 renewal	The HQ1 Renewal Program is the largest capital project undertaken by the Fund.
4. Budget constraints and/or changing work demands constrain ability to deliver core or expanded outputs	Workload pressures could lead to errors by staff or lower quality of work, as well as pressures limiting the delivery of some key outputs (e.g., general research). Difficulty of retaining experienced staff could have potential consequences for the Fund's reputation. This could lead to increased operational or reputational risks if there are not enough staff resources to provide adequate coverage of evolving risk.
5. IT Breach	The IT breach (May 2011) led to unauthorized access to and theft of sensitive information and reputational damage resulting from negative media attention.

33. Given this, determining whether impact ratings reported by departments were appropriate requires some judgment. Of the 10 serious impact risks that are listed above only one, exposure of staff to life threatening situations at significant cost, is assessed to have materialized. In this case, the event clearly met the criteria noted in paragraph 4, above, and its rating was unquestionably appropriate. For the others, it would be possible to link the specified description with an institutional consequence that met the definition for serious impact. It seems likely, however, that this further specification would have had an impact on the related likelihood assessment.

Relevance for Risk Management

34. In practice, despite the evidence that there is a general upward bias in the estimation of likelihoods and the indications that risk specifications can be unfocused, experience has shown that risk surveys provide useful inputs into the ACRM's assessment process. Survey responses present a wider range of possibilities than generally reviewed in the structured, operationally-oriented, G-RAM, VE and EWE exercises, and allow them to be presented from alternative viewpoints. While survey responses are not definitive, they help to ensure that relevant risks are not overlooked and may serve to overcome silo mentalities, and identify additional aspects of familiar risks.

B. Strengthening the Process for the Current Cycle

35. As indicated in the previous section, it seems clear that past risk management reports could, in some instances, have presented key risks more effectively. Drawing on survey responses that, at times, highlighted underlying economic, financial, and political events associated with potential risks, which are also key foci of ongoing institutional risk exercises, the sometimes extensive coverage of factors underlying institutional risks in past reports may have overshadowed the analysis of the risks themselves. In this regard, the focus on contextual developments may have been accompanied by an overstatement of likelihood, and a less thorough exploration of direct institutional consequences.

36. To help address this concern, for the current risk management cycle, the ACRM augmented the procedures followed in the lead-up to this report as follows:

a. *Risks to be reviewed by the ACRM included*: (i) all risks viewed by any department as having a significant impact (high or medium-high ratings) and significant likelihood (in practice, this would correspond with very likely and likely ratings); and (ii) similar risks identified by a number of departments as having a significant consequence for the Fund, independent of reported likelihood assessments. The ACRM, through the interventions of its members, also took into consideration the risks set out in recent G-RAM, Vulnerability, and Early Warning Exercises.

b. *Information to be considered by the ACRM included*: for each risk considered, an identified institutional consequence, along with an assessment of the anticipated timeframe during which the risk poses a threat, and its potential cost to the Fund.

37. The augmented information for consideration provided a focus for the ACRM's assessment of whether: (i) institutional consequences and potential costs to the Fund have been accurately and adequately detailed; (ii) assessments of impact and likelihood are appropriate; and (iii) listed risks cover the full range of threats to the Fund that warrant consideration.

38. In addition, the approach to risk management themes was strengthened by explicitly linking identified risks with institutional consequences and, then, with the operational areas in which mitigating action would be taken. This helped to ensure that the full range of institutional risk consequences was explored and that associated mitigating actions were addressed.

C. Continuity with the 2013 Cycle

39. While some of the risks faced by the Fund are short-lived and do not continue from one risk management cycle to the next, others pose a continuing, if evolving, threat. In line with the global context that leads to key risks, mitigating action is usually implemented over an extended period and residual risks are often significant. In the context of the 2013 risk management exercise, Fund departments and offices highlighted the following concerns:

Strategic

- Due to the perception that the Fund is overly focused on Europe, the risk that the Fund's traction in other regions would be reduced, and its reputation harmed; and
- The failure of a Fund-supported program or the perception of ill-conceived policies could lead to losses in credibility, effectiveness, legitimacy, and reputation.

Core Operational

- Fund-supported programs could fail, and difficulties in coordination with partnering institutions could undermine traction in policy discussions;
- Surveillance could miss critical risks; and
- Resources for technical assistance and staffing could be inadequate.

Non-Core Operational

- Deteriorating staff morale due to pay constraints, limited promotion prospects, and excessive work pressures;
- The possibility of IT security breaches;
- Personal security arising from political instability or terrorism;
- HQ1 Renewal project-related risks; and
- The Fund's outdated employment framework.

40. The 2013 Report on Risk Management, responding to these concerns, provided detailed assessments of risks and directions for mitigating action in the Euro area and the MENA region, on potential spillovers, credit and liquidity risks, governance and legitimacy risks, the longer planning horizon, and a range of non-core operational risks including, information security, human resource and budget risks, and risks related to the HQ1 Renewal Project. In 2014, as outlined below, some, but not all, of these issues remain as key areas of risk.

D. Risk Areas in 2014

41. Applying the takeaways from the analysis of the 2012 and 2013 survey exercises, the ACRM assessed the range of inputs provided by departments in the 2014 exercise, which, taken together with indications provided through incident reporting and other strategic and core operational risk analyses, pointed to key risks areas for additional review and reporting. The concerns identified in this process for key risk areas in 2014 are summarized below.

Strategic Risks

42. Delays in the effectiveness of **Fund governance reforms** constituted the most commonly cited and most elevated risk cited by Fund departments in 2014. Outcomes associated with this risk included the potential loss of institutional legitimacy and related Fund disempowerment, and continued reliance on borrowed resources to meet crisis financing needs.

Strategic Risk Areas

- Fund Governance Reforms
- Perception of evenhandedness

43. The **perception of a lack of evenhandedness in the treatment of members** was also seen as an area of concern. In this regard, related impacts included the possibility that the continued perception of the Fund as being Eurocentric could limit its traction with other parts of the membership. In a similar vein, there was an indication that, with the continuing staff resource focus on major program cases, associated reduced attention to developing countries, the perceived quality of Fund support to LICs could be impaired.

44. Secondary themes in the *Strategic* category, included the risk that crisis relapse, market vulnerabilities, and the impact of exit from unconventional monetary policies could lead to a reduction in the credibility of the Fund's analytic and operational work. Similarly, there was some concern that the failure of proposed reforms to the Fund's lending framework could lead to a loss of the Fund's relevance, and that the Fund's objectives will not move enough (in terms of speed, clarity and/or resources) to meet the needs of a changing world.

Core Operational Risks

45. Concerns related to the complexity of the current economic environment pointed to the build-up of **market vulnerabilities**. In this context, there was a view that global turbulence and unconventional monetary policy could lead to a balance of payments crisis, with an associated call on Fund involvement and financial resources. Additionally, related concerns included the possible spread of fiscal and financial crisis to Asia, the possibility of prolonged Euro area stagnation, and the risk that surveillance would miss important turning points.

Key Core Operational Risks

- Market Vulnerabilities
- Political Turbulence

46. The possibility of **political turbulence** leading to crisis was also viewed as major concern. In assessing the impact of political turbulence on surveillance and program activities, political, security, and social conditions were seen as also potentially impeding the ability to staff missions to such areas and to find Resident Representatives for some countries. Similarly, security concerns were seen as disrupting the provision of technical assistance. Both of these facets of political turbulence can be seen as the core operational counterparts to staff safety risks, which are discussed below.

47. In this current complex and turbulent global environment, the risk that high profile programs could off-track continues to be a concern. Several departments also pointed, in this context, to core operational risks related to institutional resource constraints. This included the risk

that internal resources might be insufficient to help members achieve structural reforms targeted in Fund programs and, similarly, the risk that the tight budget envelope could limit the ability to meet core operational demands. Also counted among resource-related core operational concerns was the possibility of significant reductions in funding for capacity development from fiscally-constrained donors, and the risk that heavy reliance on donor-funded technical assistance could skew work towards priorities differing from recipient needs.

48. Departments also highlighted a range of lower severity and likelihood data-related concerns, including the risk that limited participation could lead to the failure of the SDDS Plus initiative, and the risk that unreliable and irregular balance of payments-financial account data for African frontier market countries, that are integrating in global financial markets, could complicate the management of financial flows and mask the buildup of a balance of payments crisis.

49. Other lower severity/likelihood core operational concerns that were noted by departments included the risk that unclear or diffused mandates could lead to a proliferation of models and methodologies across departments; that crisis fatigue could undermine the quality of advice that the Fund provides to emerging market members, and could constrain innovative thinking; and the risk that the pace of changes in financial policies and other major initiatives could lead to inadequate oversight and monitoring.

Key Non-Core Operational Risks

- Field Security
- Employment framework
- Resource Adequacy
- HQ1 Renewal
- IT Security

Non-Core Operational Risks

50. In the wake of the death of the Fund's Resident Representative in Afghanistan in a terrorist attack in Kabul, **field security** was the most cited risk by departments. In that regard, a few departments rated staff security risks as serious/very likely and noted that the security situation in a large number of countries put staff and technical assistance experts at risk. Other departments also cited this as a less serious, less likely risk.

51. Various risks related to the Fund's **employment framework** were highlighted by departments. Higher impact and likelihood risks in this area included the impact on the Fund's work associated with low staff turnover and the Fund's relatively rigid employment framework, which constrains the hiring of personnel with required specialized skills. Difficulties in the recruitment of external candidates and in the retention of key staff were also seen as important risks. Risks assessed as having a lower likelihood of materialization included the potential effect of intensification in the global crisis on staffing, as more experienced staff moved from routine to "front line" assignments. There was also a continuing concern that low promotion rates, in particular at grades A14 and A15, could lead to de-motivation and low productivity, and, similarly, the risk of losing high performing staff and having difficulty in recruiting staff as the global economy picks up.

52. A number of identified staffing risks were seen as being related to **resource adequacy** for the administration of the Fund. These included constrained resources limiting the ability to deliver on commitments, the possible inability to maintain an appropriate level and breadth of skills, and

reduced management credibility due to workload reductions that did not achieve goals for limiting overtime. There was also a concern that budget constraints could undermine the ability of staff to adequately work on all vulnerable countries including low-income members.

53. Risks related to the ongoing **HQ1 renewal** project continued to concern respondents. In this regard, survey respondents identified HQ1-related risks, including the failure of building systems, budget overruns, unfavorable publicity, asbestos problems, office space inadequacy, and work disruption.

54. Several departments noted concern that an **IT security** breach could lead to Fund internal information being compromised. Other IT-related risks included the possibility that IT support might not meet business needs, including that the IT support framework might not adequately maintain critical financial systems, and, more generally, that problems with IT systems could lead to a reduction in productivity.

KEY RISKS AND THEIR MITIGATION

A. Status of Mitigation Measures

55. Two areas in which assessed risks are seen to have diminished are the Euro area and MENA. The following assessment of the status of related mitigation measures provides an update on progress achieved and the level of related residual risk.

Euro Area

56. The 2013 Report on Risk Management noted that a few large programs with Euro area members continued to present elevated, operational, credit and reputational risks to the Fund. These risks related to reform fatigue and political ownership of fiscal adjustment and structural reform programs, employment and inflation dynamics, divergence in competitiveness, and risks of unsustainable debt dynamics, which would be heightened by a prolonged period of slower growth. The approval of each of the three major programs—Greece, Ireland, and Portugal—on the basis of the modified second exceptional access criterion on debt sustainability, underscored the risk to realizing external viability during the program period. An extended arrangement under the Extended Fund Facility was approved for Cyprus in May 2013. Of these, only Greece and Cyprus had active arrangements as of end-June 2014. In addition, the Fund deployed non-financial means of assisting Euro area members, including the monitoring of the Spanish financial sector reform.

57. In the period following the 2013 Report, the Euro area has emerged from recession, after shrinking by about half percent in 2013.

- *Financial market sentiment has improved dramatically*. Sovereign and corporate yields have fallen markedly, benefiting from increasing foreign demand. This has narrowed sovereign spreads between stressed and core economies, and supported corporate bond issuance and

equity markets across the region. Bank funding costs have also declined, helping banks to raise capital and deleverage their balance sheets.

- *Strong policy actions have boosted investor confidence and laid the foundations for recovery***.** At the national level, governments have made further progress repairing sovereign and bank balance sheets and implementing structural reforms to restore competitiveness. At the area-wide level, the ECB has taken a wide range of measures to support demand and address fragmentation. The Comprehensive Balance Sheet Assessment of systemically important banks is on track to be completed in October 2014 before the ECB assumes supervisory responsibilities in November 2014. Further progress on building a banking union—such as the agreements on a Single Resolution Mechanism (SRM), backed by a Single Resolution Fund (SRF), the Bank Recovery and Resolution Directive (BRRD), and the deposit insurance harmonization directive—has demonstrated the collective commitment to EMU.

58. While conditions for a return to growth have improved and tail risks have markedly declined with beneficial effect on stressed economies, challenges remain and obstacles to strong, sustained growth remain substantial. The appetite for further integration has diminished**.** The euro-skeptic outcome of the European elections may pose risks to the single market (particularly the free flow of labor) and test the credibility of the nascent fiscal governance framework. However, key facets of the risk environment, including high unemployment, weak private and public balance sheets, contracting credit, and a large debt burden, and longer-term impediments to growth have yet to be fully addressed.

- *Insufficient aggregate demand* is weighing on real activity and pulling down inflation across the Euro area, as corporate entities, households and banks all attempt to repair their balance sheets. Despite the reduced drag from fiscal policy, contracting credit and high borrowing costs are constraining investment in countries with large output gaps, large debt burdens, and high unemployment.

- *Impaired balance sheets* continue to inhibit monetary transmission and the flow of credit, particularly to SMEs. Weakness in banks' balance sheets and uncertainty about their quality are contributing to fragmentation, constraining the ability and willingness of banks to support credit and investment. Corporate and household debt overhangs in some countries are further reinforcing fragmentation along national borders.

- *Remaining structural gaps* in capital, labor, and product markets present hurdles to financing investment, deploying resources from non-tradable to tradable sectors, adjusting relative prices, raising productivity, and creating jobs.

Middle East and North Africa (MENA)

59. The 2013 Report on Risk Management noted that programs being negotiated with several countries in the Middle East presented significant reputational risks to the Fund, as ongoing social and political uncertainty limited the room for needed policy adjustments, in the context of

weakened fiscal and external positions. The Report indicated that, to mitigate these risks, the Fund would continue to take a proactive role in communicating the need for adjustment under strong country ownership, supported by IMF engagement. In 2013, an SDR 1.15 billion Stand-by Arrangement (SBA) was approved for Tunisia, and an SDR 4.39 billion Extended Fund Facility arrangement was approved for Pakistan.

60. As indicated below, while regional and domestic security tensions, set-backs in the political transition, and weaker economic activity in major trading partners continue to provide challenges, the Fund has continued to take a proactive role in communicating the need for adjustment under strong country ownership, supported by IMF engagement.

Examples include:

61. During FY 2014, Jordan, Morocco, and Tunisia made significant progress with reforming their expensive energy subsidies and building more targeted safety nets for the vulnerable.

62. MENA Ministers meetings (October 2013 and April 2014): the Fund urged countries in the region to continue with reform efforts aimed at maintaining macroeconomic stability, while also putting more emphasis on medium-term agenda to achieve more jobs and growth. The Fund has also presented on these occasions an early assessment of flexibility in its arrangements with the Arab Countries in Transition over the past two years. This analysis resulted in the conclusion that the Fund has been flexible, within limits, in accommodating external shocks to maintain country ownership, for example related to the Syrian crisis. Flexibility has taken the form of reprogramming adjustment paths over time (more gradualism for Tunisia, Morocco, Jordan), without however changing the medium-term anchors guiding the adjustment efforts—the target fiscal balances remained broadly unchanged.

63. A departmental paper on the medium-term reform agenda ("Toward New Horizons: Arab Economic Transformation Amid Political Transitions") spelled out the reform needs for the ACTs in a number of areas, including core macroeconomic fields, but also financial sector development, labor market policies, and business climate. The paper was received well by regional policy makers.

64. Amman conference (May 2014): the Fund brought together high-level policy makers from across the Arab region to discuss the challenges of maintaining macroeconomic stability while laying the foundation for job-intensive growth. There was broad acceptance among policy makers of the need for deep and sometimes painful adjustment, for example in the area of energy subsidies (acceptance that was not always there among policy makers in the beginning). Emphasis was also placed on the need to complement expenditure measures with stronger efforts to increase revenues and thereby also enhance fairness, including in taxation.

B. Key Risks in 2014

65. Based on the identified risk areas that were set out in previous sections, the ACRM reviewed the institutional impact of identified risk areas and the likelihood of their Fund-specific incidence,

and agreed on a set of key strategic, core operational, and non-core operational risks that merit more detailed assessment and, possible, mitigation. The following paragraphs provide an overview of the key risks viewed by the ACRM.

Strategic Risks

Fund Governance Reforms

66. In December 2010, the Board of Governors agreed on a package of quota and governance reforms to enhance the Fund's legitimacy and effectiveness. These reforms built on a process of reform initiated in 2006 and included a doubling of quotas, a major realignment of members' quota shares in favor of dynamic emerging market and developing countries (EMDCs), and the protection of the voting power of the poorest members under the Fourteenth General Review of quotas. The Board of Governors also supported an amendment to the Articles of Agreement that would facilitate a move to a more representative, all-elected Executive Board, and the reforms included a commitment to reduce the number of Executive Directors representing advanced European countries in favor of EMDCs by two. The Board of Governors committed to using best efforts to implement the package by the 2012 Annual Meetings. The Board of Governors also requested that the timetable for completing the Fifteenth Review be brought forward to January 2014 and the Executive Board to complete a comprehensive quota formula review by January 2013.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Loss of legitimacy and effectiveness	Ongoing	Diminished global role in lending and surveillance, and risks to Fund resources	Management and staff outreach to facilitate passage of reforms; membership to consider next steps if reforms are not passed by end-year

67. While progress was made, the necessary conditions for making the reforms effective are not yet in place. Two of the three general conditions were met by the target date of the 2012 Annual Meetings: the required consents to quota increases under the Fourteenth General Review (members having at least 70 percent of quotas as of November 5, 2010) and entry into force of the Amendment on Voice and Participation. Regarding the third condition, i.e., the entry into force of the Board Reform Amendment, the acceptance of the required number of members (three-fifths of the membership) has been obtained, however, the required 85 percent majority of the total voting power has not yet been secured.[4] The acceptance of the amendment by the United States is needed for it to enter into force. Notwithstanding the delay in implementing the Board Reform Amendment,

[4] As of May 12, 2014, 145 members having 77 percent of total voting power had accepted the proposed Board Reform amendment, while 159 members having 79 percent of total quota had consented to their proposed quota increases. Real-time updates on the status of acceptances are posted on the IMF's external website at http://www.imf.org/external/np/sec/misc/consents.htm.

a number of advanced European members moved to consolidate their representation at the Board in the 2012 election of Executive Directors—Belgium and Luxembourg moved to the Netherlands constituency, and a new Central and Eastern European constituency emerged.[5] The comprehensive review of the quota formula was completed in January 2013, but it was not possible to reach agreement on a new quota formula. Rather, it was agreed that achieving the necessary broad consensus on a new quota formula would best be done in the context of the Fifteenth Review. [6] The Executive Board agreed to postpone the work on the Fifteenth Review, pending implementation of the 2010 reforms, and the Board of Governors set a new deadline for the completion of the Fifteenth Review of January 2015.[7]

68. Risks to the Fund's legitimacy and effectiveness have intensified on account of the prolonged delay in implementing the 2010 reforms. The delay in implementing the Fourteenth Review means that the rebalancing of quota shares and voting power agreed in 2010 to better reflect the relative positions of members in the global economy cannot come into effect. The Fund will also continue to rely heavily on borrowed resources to finance its lending operations, thereby departing from the principal that the Fund is and should remain a quota-based institution. In addition, the timetable for concluding the Fifteenth Review by January 2014 had to be delayed. Continued delays in governance and quota reform could compromise the effectiveness of the Fund's engagement with its members across a broad spectrum of its operational activities and poses risks for Fund resources, which depend heavily on borrowed resources.

69. In light of these concerns, staff and management are actively engaged in facilitating the adoption of the 2010 reforms, and will assist the membership in considering options for next steps as required. During the 2014 Spring Meetings, the IMFC stated its commitment to ensuring that the Fund has adequate resources, and urged the United States to ratify the 2010 reforms at the earliest opportunity. The work program of the Executive Board includes an informal discussion of an update of the quota database and quota share calculations in July. In addition, if the 2010 reforms are not ratified by year-end, the IMFC will call on the Fund to build on its existing work and develop options for next steps, and will schedule a discussion of these options.[8]

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[5] In addition, Switzerland and Poland have agreed to rotate their chair, although this agreement is contingent on the 2010 reforms coming into effect.

[6] See *Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review* at http://www.imf.org/external/np/pp/eng/2013/013013.pdf

[7] See *2010 Reforms and Fifteenth General Review of Quotas—Report of the Executive Board to the Board of Governors* at http://www.imf.org/external/np/pp/eng/2014/011614.pdf

[8] See *Communiqué of the Twenty-Ninth Meeting of the International Monetary and Financial Committee (IMFC)* at http://www.imf.org/external/np/cm/2014/041214.htm

Perceived Lack of Evenhandedness in the Treatment of Members

70. Uniformity of treatment is a core principle of the Fund as a multilateral institution, and in light of this related perceptions are an important risk area.[9] Treating member countries in an evenhanded manner helps the Fund effectively deliver on its mandate in surveillance and other areas, including by reinforcing the credibility of its policy advice. The main associated institutional risk is that, if member countries believe that the Fund is not being even-handed in its scrutiny of countries' policies, its policy advice or its lending and conditionality, they may question the Fund's legitimacy or be less receptive its advice. This poses a reputational risk that can undermine the traction of the Fund's advice and its ability to achieve its broader objectives. In this regard, even if there is no evidence of actual lack of uniformity of treatment, perceptions can be as detrimental to the Fund's credibility and effectiveness. Moreover, perceptions in one area, such as access to resources, can influence views in another.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Reduced member receptiveness	Ongoing	Limits Fund effectiveness	Triennial Surveillance Review will establish framework for analysis

71. The principal instrument to mitigate these risks is the inter-departmental review process. To be effective, any measures must respond to both evidence of actual and perceived lack of uniformity of treatment. In this regard, the external study on evenhandedness in the 2014 Triennial Review of Surveillance aims to provide a clearer conceptual framework to analyze the nature and extent of any lack of evenhandedness in the area of surveillance, along with recommendations on how to address related concerns.

72. Perceptions regarding the uniformity of treatment pose an ongoing risk. The costs could be considerable if the Fund's legitimacy were questioned by enough members. However, mitigation costs seem manageable within existing resource envelopes. Whatever measures are put in place, there may be residual concerns; as a differentiation based on country circumstances cannot be avoided. For example, a member with systemic impact may warrant a different treatment under surveillance than members that do not have a systemic role, or the conditionality in Fund-supported programs may depend on the type of imbalances that are addressed under the program.

[9] Except as otherwise provided in the Articles of Agreement, members have the same rights and obligations under the Articles and the policies of the Fund adopted in the exercise of its financial and regulatory functions must not discriminate among members. Uniformity does not require that all members be treated identical, but any differentiation between members either in the design or implementation of policies has to be based on criteria that are relevant for the power to be exercised.

Core Operational Risks

Market vulnerabilities

73. Global activity has strengthened further and while the balance of risks has improved, important downside risks remain, particularly those related to emerging market economies. Rising bonds rates in advanced economies, a reassessment of growth fundamentals, and rising concerns about domestic vulnerability by investors have resulted in a marked tightening of financial conditions and bouts of financial and capital flow volatility, which are weighing on domestic demand. Going forward, there could be growth disappointments as countries adjust to lower-than-projected medium-term prospects and higher financing costs. Moreover, unexpectedly rapid normalization of U.S. monetary policy or other bouts of risk aversion by investors could lead to portfolio reallocations and capital outflows, resulting in lower investments and potentially further financial turmoil and difficult adjustments in some emerging market economies.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Challenges capacity to meet member financial needs	Ongoing	Unable to fulfill mandate	Members' commitment to implement Fourteenth Review quota increases as soon as possible; maintain adequately resourced IMF

74. The Fund's capacity to respond to needs of its members is substantial, but depends heavily on borrowing, reflecting in part the delay in effectiveness of the doubling of quotas agreed under the Fourteenth General Review of Quotas. The New Arrangements to Borrow (NAB),[10] which has been continuously activated since April 2011 after its enlargement, accounts for about 60 percent of the Fund's forward commitment capacity (FCC), which stood at SDR 265 billion at end-April 2014.[11] Without the NAB, the FCC would fall to about SDR 107 billion.

75. The temporary 2012 bilateral borrowing agreements, amounting to some US$428 billion, provide an important second line of defense. They are intended to serve as a bridge to the Fifteenth

[10]The NAB is a set of credit agreements between the IMF and 38 member countries. The NAB is used in circumstances in which the IMF needs to supplement its quota resources for lending purposes. Once activated, it can provide supplementary resources of up to SDR 370.0 billion (about $575 billion) to the IMF for a period up to six months.

[11] The forward commitment capacity measures the Fund's capacity to make new financial resources available to members from the General Resources Account (GRA) over the next 12 months, and takes into account resources available for the entire 12-month period.

Review.[12,13] Together with the Fund's quota and NAB-based financing resources, resources under the 2012 agreements bring the Fund's total potential lending capacity to over US$1 trillion.

76. Continued reliance on temporary borrowing poses risks. Without the doubling of quotas under the 2010 reforms, maintaining the FCC around its current resource envelope will require continued six-month activations of the NAB, which has to be supported by an 85 percent majority of the NAB participants. In addition, the 2012 borrowing agreements, which have a maximum term of four years, will mostly expire by 2017. Given the time needed to conclude a quota review and the time typically required to achieve the necessary consents, quota increases under the Fifteenth General Review of Quotas might not be in place before the 2012 bilateral borrowing agreements expire. These risks are mitigated by the membership's commitment to implement the 2010 reforms as soon as possible and to maintain a strong and adequately resourced IMF.[14]

77. Precautionary balances remain essential to help mitigate credit risks and protect the value of members' reserve positions in the Fund. In April 2012, the medium-term indicative target was increased from SDR 15 billion to SDR 20 billion. This took into account the sharp increase in commitments and in actual and projected Fund lending, the projected rise in individual exposures, in particular to European members, and the current limited capacity of the burden sharing mechanism. The adequacy of precautionary balances was recently reviewed in February 2014 on the regular two-year cycle. The review was undertaken against the backdrop that, while the overall balance of risks facing the Fund remains broadly unchanged, the Fund still faces large concentrated exposures, mainly to euro area countries, and that this regional concentration is expected to remain high for some time. The review concluded that the current indicative target of SDR 20 billion should be retained. Precautionary balances at end-April 2014 totaled SDR 12.7 billion, and on current projections, the proposed SDR 20 billion target would be reached in FY 2017–FY 2018.[15]

78. *Scope for Concessional Lending*: The strategy to make Fund concessional lending to its low-income members self-sustained is being implemented. The Executive Board endorsed the strategy of a self-sustained Poverty Reduction and Growth Trust (PRGT) in September 2012. The subsidy

[12] The IMFC and G-20 Finance Ministers and Governors jointly announced on April 20, 2012, an agreement to further enhance IMF resources for crisis prevention and resolution through a new round of temporary bilateral borrowing. Of the total pledged by 38 members (US$461 billion), agreements totaling US$428 billion are effective.

[13] The modalities of the 2012 agreements help to mitigate the Fund's liquidity risks from encashment provide protection for the Fund against mismatches between its borrowing and lending maturities.

[14] IMFC Communiqué, April 2014, states "[w]e are deeply disappointed with the continued delay in progressing the IMF quota and governance reforms agreed to in 2010 and the Fifteenth General Review of Quotas (GRQ), including a new quota formula. We reaffirm the importance of the IMF as a quota-based institution. The implementation of the 2010 reforms remains our highest priority and we urge the United States to ratify these reforms at the earliest opportunity. We are committed to maintaining a strong and adequately resourced IMF. If the 2010 reforms are not ratified by year-end, we will call on the IMF to build on its existing work and develop options for next steps and we will schedule a discussion of these options."

[15] The pace of reserve accumulation is sensitive to possible changes in the structure and thresholds for surcharges and commitment fees following the effectiveness of the Fourteenth General Quota Review. (See Annex 1 of *The Consolidated Medium-Term Income and Expenditure Framework* EBAP/14/39).

resources to establish an average lending capacity of about SDR 1.25 billion are being secured through the transfer to the PRGT of resources linked to two distributions of general reserves from windfall gold sale profits. The necessary approvals for the first distribution were received in October 2012 and for the second distribution in October 2013. The required amendments to the PRGT instrument to permit PRGT commitments after 2015 (until 2020), and to allow eventual transfers of investment income from the PRGT Reserve Account for subsidy purposes, were approved by the Executive Board in April 2014 and will come into effect following the receipts of consents from all PRGT lenders. The Executive Board has also approved an increase in the PRGT borrowing limit and authorized the negotiation of new or extended bilateral loan agreements *with lenders to the PRG Trust* that will allow commitments under the Fund's concessional financing facilities through 2020.

Political turbulence

79. Political turbulence remains a salient—if unpredictable—feature clouding the outlook of many members, with potential implications for the Fund. Most recently, tensions between Russia and Ukraine have resulted in a series of sanctions against Russia. So far the sanctions have been limited, but they have nonetheless already taken a toll on investor confidence and Russia's near-term growth prospects—increasing the vulnerability of program countries that rely on Russia for remittances or funding (e.g., Armenia, Kyrgyz Republic, Bosnia Herzegovina), and further stressing the balance sheets of regional international banks with Russian exposure. Looking forward, an escalation of sanctions cannot be ruled out, which may disrupt global energy markets (both oil and gas), and increase the demand for Fund resources from members confronting a sudden adjustment need. In the case of Ukraine, fragmentation of the country may render the current program nonviable; requiring a fundamental reconsideration of program strategy and potential assistance in the restructuring of Ukrainian debt.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Challenge to conduct of operations, and to program success	Ongoing	Stress on mission operations	Ongoing review of approach to working in high risk locations

80. More broadly, political risk indicators remain elevated across much of the Middle East and portions of Latin America. In these cases, heightened political opposition may compromise the authorities' ability to implement much needed adjustment or reform. In the Middle East, rising imbalances and political disruptions will place an added premium on the Fund's efforts to encourage inclusive growth, and will simultaneously complicate staff efforts to address the region's often-complex subsidy-based safety nets. In Latin America, domestic tensions are growing in Argentina and Venezuela, with clear and serious consequences for their local economies. Accelerating imbalances may ultimately induce their authorities to re-engage with the Fund. But even short of this, political and economic turmoil in these economies may add to the vulnerability of their neighbors—Venezuela, for example, provides favorable loans to several Latin American and Caribbean countries through a number of energy cooperation agreements.

81. Beyond the general trends that are evident in political risk indicators, specific idiosyncratic events may also have implications for the Fund. Many of these are difficult to identify ex ante, but some individual possibilities may need to be considered—for example, a newly independent Scotland could require a substantial surge in staff resources and technical assistance.

Non-Core Operational Risks

Field security[16]

82. As indicated in incident monitoring reports, field security risks associated with terrorism or volatile political, security and social conditions in some countries could jeopardize staff safety. Despite the strengthened security policy for high-risk locations, the risk of serious incidents remains non-trivial. These longstanding, and ongoing mid- to long-term risks, coupled with staff perceptions regarding various aspects of the decision-making process regarding mission travel, reduce the Fund's capability to field missions or identify suitable personnel to staff permanent postings.

83. Although risk mitigation measures have been provided for mission travelers to high-risk locations, in a number of locations where the threat is terrorism related, significant residual risks to Fund personnel remain.

84. Following the death of the Fund's Resident Representative in Kabul, management established a Working Group (WG) to review operations in High-Risk Locations. The WG had a two part mandate:

- Conduct a fact-finding exercise to develop a full understanding of the January 17, 2014 Kabul attack that resulted in the death of the Resident Representative and identify any weaknesses in the Fund's security policy framework for operating in high-risk locations.

- Undertake consultations with Fund employees in regard to the security-related aspects of operations in high-risk locations and assess whether there are aspects of the Fund's security policy framework that should be improved or modified.

Based on the findings of the Working Group, which were submitted to management in early May 2014, it is expected that a range of mitigating actions will be implemented.

[16] While field security is presented as a non-core operational risk, it also has a core risk dimension, especially in fragile states and other high-risk locations. In this regard, worsening security conditions in a growing number of countries are defining the operating environment, reducing or eliminating the Fund's field presence and/or mission visits. In many cases, this affects the quality of Fund surveillance, policy advice, and technical. When prolonged, high residual security risks will undermine the quality of the services the Fund can provide to these members and its ability to carry out its mandate.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Reduction in ability to field missions or staff postings; potentially undermines effectiveness and legitimacy	Ongoing	Increased field security budget	Field security framework

85. In the meantime, Security Services continues to provide significant risk mitigation measures to all travelers to high-risk locations in line with the Security and Business Continuity Accountability Framework and Staff Bulletin 12/1, Planning and Approval Procedures for Missions to Fund-Designated High-Risk Locations. These measures include providing pre-departure security briefings to all travelers and the provision of a Mission Security Assessment (MSA) document. The MSA identifies the current security conditions, risk mitigation measures, and the residual risks even when all risk mitigation measures are adhered to. Additionally and dependent on the specific mission and location, further security measures may be provided such as armored vehicles, armed escorts, an accompanying security professional, or additional communication systems. Alternative and off-site mission locations are also used when residual risks are high.

86. An assessment of mitigating costs and residual risks can be developed once any recommendations of the Working Group have been endorsed by management.

Employment Framework

87. A tight budget environment in the post-downsizing period combined with increased crisis-driven work led departments to use a variety of coping strategies to meet additional workforce requirements. As a result, inconsistent use of the categories of employment has given rise to perceptions of unfair treatment. Specifically, (i) limited-term and fixed-term appointments have been used interchangeably; (ii) the distinction between staff and contractual tasks has been blurred by stretching the duration of contractual appointments from a norm of two years to a norm of four years; and (iii) contractual appointments have been used as a recruiting ground for staff appointments.

88. Failing to address these problems will fuel perceptions of unfairness, already reflected in staff survey results, lowering morale and productivity, with consequent problems for the Fund in managing a heavy workload. These risks are likely to increase over time, as frustrations grow, until changes are made to resolve the underlying issues.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Reduced staff morale and productivity	Ongoing	Additional budgetary resources; work program adjustments	Proposed changes to categories of employment

89. In the 2014 Fund Enterprise Risk Survey, additional risks associated with the current employment framework were identified. Some departments cited low turnover and the Fund's relatively rigid employment framework, which constrained hiring of staff with required specialized skills, particularly by functional departments. Others cited the inability to recruit and retain top candidates due to contractual limits, with adverse impact on quality of outputs.

90. An initial set of proposals for a new employment framework designed to address the problems and risks above, and taking into account the need to maintain the Fund's competitiveness and ensure staff diversity, is being discussed with departments and stakeholder groups Fund-wide. Specifically, preliminary proposals (i) combining limited-term and fixed-term appointments into a single three-year term appointment, which could be allowed to lapse, renewed for up to three years, or used as a basis for selection to an open-ended appointment after 3-6 years of service; this would increase the flexibility of the staff appointment instrument to meet both medium- and longer-term business needs; (ii) developing criteria that would be consistently applied to ensure that contractual appointments are used, as intended, for temporary tasks and functions where the benefits of periodic skill renewal outweigh the costs of turnover; and (iii) avoiding the use of contractual appointments as informal, lower cost testing periods for ongoing tasks for which staff positions may be the appropriate vehicle.

91. A key element of the review and consultation process will be to determine whether the proposals need to be amended, or mitigation steps taken, to ensure that the new framework does not adversely impact the Fund's international competitiveness or its ability to attract diverse staff. These proposals, as modified through the consultation process, are scheduled to be put forward for Board discussion in the fall, with implementation in FY 2016. The consultation process is of critical importance given the recent difficulty in recruiting candidates for the Economist Program and the findings of a longer term study on the Fund's competitiveness in the Economist job market. These outcomes confirm that the Fund has lost its ability to attract the highest ranked entry-level economists and is also facing strong competition for specialized skills among mid-career economists. At the EP level, competitiveness has been impacted by financial and qualitative factors including the erosion of the Fund's salary premium when compared to its main competitors. For mid-career hiring, the hiring of technical assistance and financial sector experts remains a challenge. Internal working groups are actively developing both policy and practical options to address these issues.

92. Other risks are also associated with the proposed employment framework changes. Their successful implementation would require budgetary resources (either through reallocation or a higher appropriation) and work program adjustments to ensure that contractual and staff appointments are used appropriately. In addition, effective oversight and monitoring processes for future contractual appointments would be required to ensure that the distinction between contractual and staff work is no longer blurred. There are other HR issues that cannot be addressed through changes to the employment framework, but that require attention; these include performance management.

Resource adequacy

93. The FY 2015 budget seeks to deliver on strategic priorities while containing workload pressures. The approved flat budget assumes a gradual reduction in program work while maintaining focus on risks and vulnerabilities. The budget was formulated after extensive consultations internally with departments and management, and following early consultations with the Executive Board. The consensus view is that the budget envelope will be sufficient to deliver on priority work, including meeting emerging demands. Success in this regard reflects progress made on these fronts:

- *Budget discussion process*—the Accountability Framework (AF) is becoming a more effective tool in guiding the alignment of departmental resources to Management's evolving strategic goals, in part thanks to experience and more focused objective setting. As a result, departmental budget envelopes are now better mapped to concrete work programs and strategic priorities.
- *Budgetary resources allocation*—room was provided to finance priority initiatives through better utilization and reallocations of existing resources. For instance, additional resources will be available to support work on jobs and growth and also for additional activities in fragile states and the Arab countries in transition. Room has also been made to accommodate higher spending on IT and physical security, and increased training of staff.[17]
- *Monitoring of key indicators*—a quarterly monitor that tracks AF and other indicators has been introduced and is being posted on the OMD website. OBP is also coordinating efforts to enhance the quality of the time reporting system (TRACES), a precondition to ensuring the quality of the output costing (ACES) information; OBP intends to include ACES estimates in the quarterly monitor to support ongoing analysis of the link between budgetary resources inputs and outputs.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Constrained ability to adequately carry out mandate	Ongoing	Continued high level of overtime	Prioritization of operations; reallocation of resources

94. The FY 2015 budget envelope is also expected to be sufficient to respond to changes in country situations should there be an unexpected deterioration of the global environment. Were such a deterioration to occur, several actions would be considered to ensure that adequate resources were deployed in response. The first response on staffing would be to reallocate people from non-crisis country teams and lower priority activities and there would be some inevitable increase in overtime while it takes time to hire additional staff if the overall work load went up. In the near term, financing additional costs associated with program activity would come from the contingency and the remaining carry-forward. If the deterioration persisted and was large enough, the case for a larger budget envelope in the period ahead would have to be considered.

[17] Capacity building for member countries is also set to grow further, although much of it is financed by external donors.

IT Security

95. The Fund is required to facilitate information-sharing, while safeguarding its information assets, including member country information entrusted to it, from accidental or intentional unauthorized use, modification, disclosure, or destruction. Realization of these threats could compromise the Fund's effectiveness in discharging its responsibilities. In this regard, TGS continues to make good progress on the execution of the Enterprise Information Security Program (EISP) and carry out risk mitigations activities, as noted in the 2013 Report on Risk Management, although the threat environment remains challenging.

96. The Enterprise Information Security Program (EISP) seeks to address the high impact and high likelihood information security risks faced by the Fund. The EISP is based on the findings and recommendations from the comprehensive information security risk assessment conducted by PricewaterhouseCoopers (PwC) in 2012 after a major cyber security incident in 2011. While the program is prioritized to target high risks, the EISP must also establish foundational capabilities that change how the Fund manages information security risk to ensure the approach is balanced and consistent, while maintaining operational efficiency. The impact of not addressing these risks is summarized as a potential loss of confidentiality, integrity and availability of information that could disrupt operations and result in reputational damage and loss of trust from member countries. The EISP seeks to reduce these risks over a five-year period at a cost of $37M. The key priorities for FY 2014 as stated in the 2013 ACRM Report are: (i) remediation of PwC identified vulnerabilities; (ii) hiring of IT security personnel; (iii) improving information security governance, risk management and compliance; (iv) defining strengthened technical controls; and (v) continuing to raise security awareness.

97. *Risk Remediation*: TGS is reducing risks to the Fund's operations and reputation through remediation of 400 vulnerabilities identified by PwC. The effort focuses on critical, high and medium impact vulnerabilities as a matter of priority. As of May 2014, 95 percent of the PwC-identified vulnerabilities have been remediated, which includes 100 percent of all critical, 94 percent of all high, and 98 percent of all low-impact vulnerabilities.

Acquisition of Security Expertise

98. TGS is strengthening the Fund's information security posture through the acquisition of skilled security talent to establish, operate, and maintain critical information security functions to protect Fund information assets (FY 2014). Three of the four FY 2014 target staff positions have been successfully hired and TGS is awaiting acceptance of a job offer for the remaining staff position. Tactically, highly skilled external IT security operations services were engaged as an immediate response to address the lack of capacity/capability for IT security operations.

99. The hiring of skilled IT security personnel will: (i) increase the Fund's capacity for conducting risk assessments of IT solutions and services; (ii) deliver improved security monitoring and incident response; (iii) ensure solutions are secure from design through implementation; and (iv) ensure access to Fund information is properly set and controlled. The tactical engagement of IT security

monitoring and response services has already protected the Fund against cyber attacks and the productivity loss associated with a breach. In FY 2015, TGS will hire security operations personnel to deliver enhanced threat detection and response to protect against increasingly sophisticated and changing attacks.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Compromise of financial, country, or personal information	Ongoing	Constrained information sharing	Enterprise Information Security Program

Improved Security Governance, Risk Management and Compliance

100. TGS implemented an information security governance and risk management charter that defines a *risk-based* framework for governing and managing information security at the Fund and clarifies responsibilities and accountabilities for establishing and operating information security capabilities in TGS.

101. Security standards were refreshed (effective May 1, 2014) to align with the information security policies and detail security control requirements for the institution's IT systems. The security standards include an information security target posture, which addresses OIA recommendations pertaining to inadequate IT security control standards. Improved compliance with these standards will help the Fund defend against high probability, high-impact and easily exploitable vulnerabilities, and allow TGS to measure to compliance with information security policies. For FY 2015 and FY 2016 the focus on compliance will be on assessing new systems moving into production and sustainable compliance monitoring.

Strengthened Security Controls for Laptops/Desktops and Mobile Devices

102. The information security policies approved by Management in 2013 has allowed for a much needed tightening of security around the Fund's end user computing systems. For example, the Fund now, as part of the laptop and desktop refresh, has implemented three key controls to improve security while minimizing user impact: (i) limiting administrative privileges on staff computers; (ii) white-listing business approved applications (and preventing all other applications from executing); and (iii) blocking of known malicious and unknown websites that present a risk of hosting malicious software that could infect Fund computers.

103. All Fund-issued mobile devices are now managed through a Mobile Device Management (MDM) solution, effectively automating the enforcement of basic security controls, such as information encryption and detection of compromised devices to prevent the Fund's information from getting into the wrong hands. Similarly, all Fund laptops are now encrypted and further investments have been made to deliver the capability for Fund staff with laptops to encrypt sensitive information on USB drives.

104. The improvements in mobile device and laptop security have reduced the risk that a lost or stolen mobile device will result in unauthorized access to sensitive information. This investment further brings the use of mobile devices into compliance with the Fund's information security policies and standards, and addresses several OIA recommendations related to mobile device security.

Enhanced Security Awareness

105. TGS is promoting a risk-aware culture and equipping staff with training and knowledge to respond to targeted attacks. TGS continued to promote security awareness training in FY 2014 with the integration of the information security awareness course with the staff on-boarding process. Currently, 99 percent of Fund personnel have completed the information security awareness course. Additionally in Q4 of FY 2014, TGS conducted a simulated "spear phishing" exercise to measure the effectiveness of the security awareness efforts, where an email was sent masquerading as a legitimate Fund e-mail and seeking unauthorized access to confidential data. The message went to 920 Fund personnel and 85 percent responded appropriately by reporting the suspicious email to TGS. Those who did not react appropriately were automatically provided additional education on how to identify spear phishing attacks.

Current Risk Level

106. Despite ongoing risk mitigation activities, the likelihood of an information security event remains medium to high. The controls implemented as part of EISP program have greatly reduced the risk of future compromise using similar vectors as the 2011 attack that resulted in a major breach. However, the general security posture of the Fund still needs continued focus as the threat actors are diverse and regularly change their vectors of attack. We continue to see a range of threats aimed at compromising our information assets from common hackers to advanced threat actors. Meanwhile, our defenses are only as strong as our weakest link so continued vigilance is needed. Challenges we face are in the areas of sufficient security awareness, the Fund's security culture, and the difficulty of sourcing scarce information security talent due to a global shortage and high demand for cyber security services.

Key EISP Initiatives for FY 2015

107. In response to ongoing threats, the EISP program is focused on delivering on several key initiatives including:

- Establishment of an IT security center to improve detection and response to cyber threats;
- Establishment of a vulnerability management program to comprehensively and consistently identify and prioritize remediation of IT security vulnerabilities;
- Implementation of a information security metrics program to measure the Fund's security posture against defined targets;

- Delivery of a cloud-based secure file sharing solution;
- Remediation of remote office security vulnerabilities; and
- Implementation of an enterprise governance, risk management and compliance solution to record and track vulnerabilities, residual risks, non-compliance to policies and standards, and progress on remediation efforts.

Reliability and Performance

108. The major reliability and performance issues affecting Fund PCs were resolved through the PC Refresh Project that replaced aging desktop and laptop computers with much faster equipment. The refresh was implemented using a new streamlined software image on Fund computers to reduce the number of unnecessary applications running on each staff person's PC. The overall improvement is reflected in a lower call volume to the Help Desk and improved IT survey results. Overall satisfaction with IT services increased from 72 percent to 86 percent while satisfaction with Fund PCs averaged 94 percent compared with 48 percent in FY 2013.

109. TGS implemented a new software distribution system to enable software updates to be deployed without impacting staff productivity. The old Marimba system contributed to PC performance problems and frequently resulted in time-consuming software downloads at login time. With the new MS System Center Configuration Manager (SCCM) updates usually occur at night and with a much higher level of reliability. Staff are mostly unaware that updates are being rolled out on a regular basis to keep the Fund's PCs up-to-date.

110. The removal of local administrative rights and the activation of application white-listing have resulted in a more stable software configuration for Fund PCs. In addition to the security benefits cited in the previous section, these restrictions have reduced the number of non-work related applications on Fund computers and resulted in a cleaner configuration. This has helped to sustain the performance gained during the refresh. The trade-off has been that staff are sometimes not able to install needed software on their computers in a timely manner. The impact has been felt more significantly by staff working in the field.

Application Support

111. In-sourcing of application support for complex applications has been initiated to address risks introduced through the offsite support model. The in-sourcing effort aims to address the timeliness and quality of software support and maintenance services, and thereby reduce operating risk for the departments. In accordance with the FY 2014 plan, the in-sourcing of application support for the two most critical complex applications, iFIN and PeopleSoft HCM, was tackled first. Although the hiring of vendor resources took longer than anticipated, PeopleSoft HCM and iFIN are now fully supported by onsite vendors. A stock-taking exercise has been initiated and will be performed over the next six months to measure the success of the insourcing, before deciding whether the remaining four applications (DMXPlus, ICS, PeopleSoft FACTS and PATS) will also be insourced.

HQ1 Renewal

112. The HQ1 Renewal Program, the largest capital project undertaken by the Fund, has recently completed the first year of construction. TGS remains committed to minimizing and mitigating risk from several perspectives, including (i) disruption to work; (ii) health and safety concerns; and (iii) cost and schedule.

113. The risk framework, developed during the design phase of the HQ1 Renewal project, was updated to reflect risks that have been further characterized during the implementation phase. Some risks related to additional costs and schedule delays have materialized. The relevant ongoing risks to the HQ1 Renewal program are as follows.

Disruption to the Fund's Operations

114. Recent informal surveys of staff have indicated that by and large staff is well informed of ongoing construction activities. However, feedback has indicated that improvements can be made in better forecasting upcoming disruptions. While forecasting these activities has been constrained by a number of factors such as, greater than expected complexity of renovating the lower levels of the building and the ever increasing size of the Fund's staff, TGS expects these constraints to be mostly overcome in the first half of 2015.

Fund Consequence	Timeframe	Cost to Fund	Mitigation
Potential shutdowns of facilities; Health risks	FY 2015-2017	Additional budgetary resources; Reputational losses	Implementation of project related controls

115. While there have been day-to-day disruption incidents, they are being handled effectively by the framework that was established to manage the renewal project. There remain ongoing risks for the balance of the project for disruption to the Fund's operations, as is always a risk in a construction project of this type. Safeguards are monitored on a regular basis to minimize any potential incident that could impact the Fund's operations.

Impact to Staff Health and Safety

116. By and large, staff health and safety has been safeguarded throughout the HQ1 Renewal project and procedures and protocols have been followed. However, some staff have felt impacted. To address staff concerns and their environmental sensitivities, they were provided with various options, such as "opt out" space, the use of touchdown space in HQ2, or access to telework.

117. These controls will continue to be followed throughout the HQ1 Renewal project and are implemented through various governance groups, including the (i) Health, Safety and Environment

Committee (HSEC); (ii) Emergency Operations Response Team (EORT); and (iii) Crisis Management Team (CMT).

118. In the last year, both an Emergency Operations Response Team (EORT) exercise and a scenario based table top exercise have been conducted to ensure that Security, Facilities, HR and COM's immediate procedures are in place, practiced by the teams involved, and improvements identified are incorporated in the procedures.[18] In the past year, all asbestos removal work has been completed in a manner that allowed for an "all clear" message to be sent to staff prior to the open of business the following day. TGS will continue to carefully monitor and enforce the Fund's requirements for the safe removal of hazardous materials.

119. In addition to the HQ1 Renewal governance and control framework, management established an Environmental Monitoring Committee (EMC), whose primary responsibility is to provide independent confirmation that protocols relating to asbestos and indoor air quality are being followed by the General Contractor.

Cost and Schedule

120. A number of cost and schedule risks have arisen over the last year involving increased costs and potential schedule delays. Many of these risks were anticipated and contingencies were established in the HQ1 Renewal Project to address them. These risks are:

- Staff Growth: The Fund has grown substantially since the initial planning phases of HQ1 Renewal, necessitating the use of Program Reserve for additional lease space needed to absorb the Fund at its current size. To mitigate further risk for the remainder of the project duration, departments were limited to Management established space allocations. Management has provided guidance to staff to maintain this requirement while effectively managing their workforce. The risk exists for the duration of the HQ1 Renewal Program (present through FY 2018).

- Scope Costs Increases: At various points during the project, risks to the program were identified and quantified. As the design is finalized, and construction progresses, risks have been reevaluated to reflect materialized risks, mitigated risks and eliminated risks. With 25 percent of the overall project and about 50 percent of the most complicated aspect of the construction complete, the controls in place can accommodate the updated risk profile. This risk exists for the duration of the HQ1 Renewal Program (present through FY 2018).

- Additional asbestos removal: Additional asbestos containing material (ACM) on typical floors, which will likely put pressure on the project contingencies for costs associated with schedule delay, are anticipated to be resolved within the project budget envelope. The risk timeframe is from present through FY 2018, the duration of the HQ1 Renewal Program.

[18] Incident response to date has followed these protocols which have proved successful in the execution of remedial activities and the communication of status and impact to management and staff. Incidents are monitored closely and logged in an "incident report summary" attached as an appendix to this report.

- Other Schedule Risks: The complex nature of the renovation has resulted in expanded duration for activities on the "critical path" for completing the project. The need to maintain continuous operations while systems are undergoing replacement, the differing conditions uncovered once floors, ceilings and columns are demolished, and the limited space for routing of systems have resulted in longer coordination and final design phase. Contingencies exist within the program to mitigate all other aspects of this risk; however the overall project completion date has slipped, with implications for the completion of the public spaces by the end of 2014. In large part these issues are now well understood for the remainder of the project, though the potential for added delay exists with the complicated renovation of the penthouse mechanical systems. The risk timeframe is the duration of the HQ1 Renewal Program (present through FY 2018).

NEXT STEPS

Background

121. In its report to the Board on November 21, 2011, the External Panel reviewing the Fund's risk management framework noted the unique dimensions to risk management in the Fund. While acknowledging a range of strengths in embedded procedures and policies, the Panel flagged opportunities for a more corporate and proactive recognition of inter-relationships among risks across the full range of functions of the Fund.[19] They assessed that the starting point for strengthening the Fund's risk assessment and mitigation capabilities was to introduce a formal, institution-wide risk management framework led by senior management, but cautioned that to ensure that the framework meets the IMF's unique needs would require careful design.

122. A staff-led Working Group on the Fund's Risk Management Framework (WG) was set up in March 2012 by the Managing Director to follow up on the recommendations of the Panel and to examine the role of quantitative analysis in the management of financial risks. The WG contracted the services of experts and consulted widely with central banks, international organizations, and private sector institutions. Besides broadly endorsing the conclusions of the Panel, the WG articulated elements of a medium-term work program to strengthen risk management, including clarifying the Fund's risk management structure; bringing greater coherence to risk analysis and mitigation; and broadening the application of risk management tools and techniques that are adapted to work well in the Fund.

123. Both analyses converged on the basic elements of a prospective architecture, and envisaged a framework where:

[19] The External Panel for the Review of the Funds Risk Management Framework comprised Messrs Guillermo Ortiz (Chair), Jacob Frenkel, Malcolm Knight, and Thomas O'Neill. It submitted its report to the Managing Director in November 2011 (FO/DIS/11/232, November 21, 2011).

- In line with comparator organizations, a risk management function in the Fund would rely more fully on three lines of defense, complementing embedded risk management practice. The first, operational units responsible for identification, evaluation, and management of risks within each operational unit; a central risk management function, to bring coherence to the framework, an institution-wide perspective, and independent judgment from operations; and the internal audit function, conducting independent evaluations of the effectiveness of the risk management function and the adequacy of controls embedded in operational units.

- With respect to the central function, the *advisory* ACRM would be superseded by an *operational* and senior executive level risk management committee, the work of which would be supported by dedicated staff. The risk management Committee and all aspects of this central function would be overseen by Management.

- The Executive Board would agree in general terms on the scope, objectives and chains of responsibility of risk management and in that context be kept informed of overall developments related to the risk management framework and periodically discuss the Fund's risk profile and mitigation measures.

124. This said, both the External Panel and the WG framed the process of strengthening the risk management framework as a multiyear effort. The Panel noted that "building and sustaining a risk management framework require fine-tuning to the specific needs and aims of the institution. Though first steps might best be gradual, they must be taken with determination and commitment. Moreover, even fully-functioning systems cannot be static. New risks emerge. Old risks subside." They conclude that the process of introspection producing proposals for strengthening the integration, independence and transparency of risk management, should be seen as a "long journey."

Risk Management Architecture—Next Steps

125. A response to these reports takes account of, the current environment of risks facing the Fund and mitigation measures as characterized in this report, the progress facilitated by the ACRM and developments in comparator organizations. Since the launch of the ACRM in 2006, initial risk management building blocks have been developed, including a taxonomy of risks faced by the Fund, incident reporting, risk surveys, and a reporting structure to produce across-the-board analysis of the Fund's risk profile. From the outset however, the impact of the ACRM was limited by its design. Given its advisory nature, the ACRM had limited influence on major decisions affecting the Fund's risk profile. Moreover, the ACRM has had very limited dedicated resources at its disposal, which forced it to rely extensively on operational units for inputs, including for its annual reports.

126. Comparator institutions are reassessing their risk management frameworks. While a recent benchmarking survey indicated that many comparators have relatively mature and resourced risk management functions, geopolitical developments, cyber-attacks, market volatility and rating

agency expectations have created new challenges. In this regard, the inaugural meeting of the Chief Risk Officers of IFIs, MDBs, and ECAs[20] flagged risk appetite, concentration and correlated exposures, operational risks, governance arrangements and risk reporting as key issues under consideration. Also of concern was the increased challenge of framing the risk management function as both a protector of value and a business enabler.

127. The proposed architecture closely follows the shared view of the External Panel and internal WG and is consistent with the staff briefing of the Executive Board on May 16, 2014.

The Risk Management Unit (RMU) established on June 9, 2014, and reporting to the First Deputy Managing Director, on behalf of Management will have initial responsibility for:

- Developing the main elements for a strengthened risk management framework for the Fund;
- Fostering development of additional tools to analyze and monitor risk, including new risk methodologies and techniques, and their use over time by operational units; and
- Ultimately, producing reports on the Fund's risk profile at regular intervals; where and when needed, highlight areas where additional risk analysis or mitigation efforts need to be undertaken.

128. The Unit will operate under the guidance of a Risk Committee to be chaired by the FDMD and composed of selected Department Directors. The selection of Directors is tilted in favor of a model where representation on the Committee reflects the primary "owners" of risk exposure in Fund operations and those responsible for policy development to manage such risks. The Committee would provide overall guidance to the implementation of the terms of reference of the RMU, and would review the Fund's risk profile, discuss mitigation measures, and take up issues brought by the RMU. This architecture will replace the ACRM and in addressing the transition, RMU staff has been liaising closely with the Secretariat of the ACRM to ensure an orderly transfer of relevant information and processes.

129. Mindful of the "journey," architectural initiatives to strengthen risk management will be evolutionary. The scope, mandate and resourcing of the RMU will be reviewed after an initial two years. In this first phase, the expectation is largely developmental, including staffing, developing methodologies and establishing operating modalities. Moreover, the ramping up of the Risk Committee's work is not envisaged from inception, but will develop over time. This will ensure that the Fund continues to make informed decisions in strengthening the overall framework for risk management as the more operational management of risks, by the RMU, takes root. The Executive

[20] The Chief Risk Officers Forum was hosted by the IFC on May 15, 2014, with representation from the European Investment Bank, Overseas Private Investment Corporation, European Bank for Reconstruction and Development, the European Investment Fund, the Inter-American Development Bank, Islamic Corporation for the Development for the Private sector, Islamic Development Bank. World Bank Group. Nordic Investment Bank, OPEC Fund for International Development, Export Development Canada, International Finance Corporation and the African Development Bank.

Board would be kept informed of overall developments related to the risk management framework. Moreover, as the framework evolves, modalities for periodic reporting on the Fund's risk profile and mitigation measures will be developed.

ISSUES FOR DISCUSSION

130. Do Directors agree with the risk assessments in this report? Are there any significant risks that Directors find missing or, alternatively, overstated?

131. What are Directors' views on the analysis and mitigation measures?