



AFRICAN DEVELOPMENT BANK GROUP

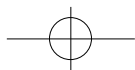
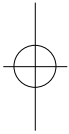
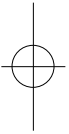
► Framework for the Implementation of Banking and Financial Standards in Africa



Prepared for the NEPAD Steering Committee



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implementation of
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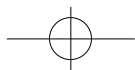
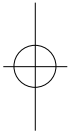
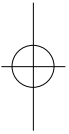
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The establishment of strong institutional market underpinnings and implementation of sound policies to stabilize the financial sector and deal with the high-perceived risk and financial practices that constitute barriers to strengthening financial integration and harnessing the benefits of globalization should be central to the continuing endeavour to improve upon Africa's economic performance. These standards are a way of doing things above board, and they call for economic affairs of countries to be conducted in a transparent and predictable way.

At the national level, the adoption of internationally recognized standards of good practice in key areas of economic and financial policy should help improve the transparency, accountability, and credibility of policy, and increase the robustness and effective functioning of markets. A robust and healthy financial system should contribute to faster income growth through the attraction of investment, better resource allocation and a more efficient provision of financial resources. The standards themselves also provide policymakers with guideposts or benchmarks for implementing structural reform, building institutional and supervisory capacity, and promoting an enabling environment for investment. Assessment of country practice against these standards can help highlight potential vulnerabilities, identify priorities for reform and so help prevent crisis and boost investment and growth. Increasingly, private sector investors are also using a country's performance on implementation of international standards as benchmarks for their investment decisions and credit risk assessments.

At the regional level, the adoption of international standards should help enhance regional integration and improve the prospects of growth by (i) supporting and underpinning the creation of a good policy and institutional environment; (ii) facilitating the coordination of national investment policies towards developing a common investment area; (iii) promoting cross-border and regional financial market networks; and (iv) underpinning collective action for reducing the level of investment risks.

The most relevant standards for achieving financial system soundness would relate to:

- Macroeconomic Policy and Data Transparency – for Government policymaking and operations;
- Corporate Governance Standards – for enterprise and market integrity;
- Financial Regulation and Supervision – for financial system stability.

Many of the standards and codes in these areas deal with general economic and corporate gover-

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finance issues but those particular to the banking and financial sector include the Code of Good Practices on Transparency in Monetary and Financial Policies, as well as all those standards dealing with Financial Regulation and Supervision (banking, securities and insurance core principles) and Market Integrity (including payments and settlements and anti-money laundering standards).

International standards have only recently been developed, and there is limited awareness of them. The review of the experience of African countries with compliance of standards shows that only few countries have made progress in implementing standards, and even for these countries coverage of the key standards is not adequate. The experience indicates the importance of taking into consideration certain factors in the assessment and design of implementation of standards, including variation in implementation of the different standards, the establishment of certain key preconditions, particularly macroeconomic conditions and legal and accounting framework, complexities due to interconnectedness of the standards, and the country-specific factors. The experience also indicates that, generally, progress in implementing standards will depend on:

- raising awareness about them and explaining their role;
- assessing the constraints and formulating measures to address them;
- formulating appropriate guidelines to reflect national characteristics and specificities of the African economies, most of which are in transition;
- promoting country ownership;
- providing a judicious blend of market and official incentives for the adoption and implementation of standards;
- adopting a peer review mechanism; and
- mobilising resources towards the implementation of standards.

The centerpiece for facilitating progress in adopting financial banking standards under NEPAD is the proposed African Peer Review (APR) mechanism, the implementation of which could also be designed to incorporate the other above requirements for progress. The mechanism will help African countries identify constraints they face in implementing good governance, including the international financial standards and codes, and facilitate formulation of credible and action-oriented programs that can be implemented to address the constraints in collaboration with bilateral and multilateral donors and African regional institutions. The peer reviews will also enable African countries to share each other's experiences in tackling the constraints. In addition, they will help monitor the performance in the different countries and furnish the basis on which other

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African countries can provide encouragement and advice for the progress of peer countries. However, countries are at different stages of development and what would be peer-reviewed would not be the base conditions but the assessment of progress being made to redress weaknesses. Using an independent team for the assessments would reinforce the commitment to objectivity and help consistency across different countries. Therefore, the peer reviews would be based on external or assisted assessments. The organization of the peer reviews would be undertaken in three stages involving the organization of assessments of the base situation; development of action plans; and peer review of progress.

The first stage of the peer review process would be the assessment of the base conditions through either the financial sector Assessment Programs (FSAPs), where they have been done for the country, or assisted assessments organized by the African Peer review Unit to be housed in an African institution, with support from the standard setting bodies as well as bilateral and multilateral donors and African regional institutions. While a lead agency may be designated to assist the APR Unit in coordinating the process, relevant African financial and professional associations such as the Association of African Central Banks and the East and Southern Africa Banking Supervisors group (ESAF) may also be drawn into playing a key role. The assessments would accommodate different degrees of financial system development and range of administrative capacities. They would, however, identify gaps and weaknesses in the implementation of standards and make recommendations to facilitate the formulation of an action plan.

Following the initial assessments, countries will draw time-bound Action Plans to deal with the identified weaknesses in their compliance with financial standards and codes. These plans would design a sequence in implementation to facilitate success and link the pace of implementation to the speed by which adequate preparations could be made in terms of mobilising the necessary resources, building the requisite technical capacity, and equipping the relevant institutions. The action plans would also take into consideration the country's level of financial system development. Particular attention would also be paid to the establishment of the critical preconditions (including the legal framework and relevant institutional capacity). To promote country ownership and wide public acceptance, the action plans would be widely discussed at national workshops.

Progress in the implementation of the action plans would be subjected to peer reviews to ensure that countries keep the commitments they have made. In view of the highly technical nature of the financial standards and codes, it is proposed that the regional/sub-regional

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Associations of African Central Banks and of Banking Supervisors be given key roles in the reviews.

While cost has been a major preoccupation regarding the implementation of NEPAD, it is not expected that the cost of undertaking assessments would be formidable. However, additional costs would relate to the other activities to foster implementation of standards, including the organization of the assisted assessments; dissemination activities, capacity building, developing the legal framework, developing specific standards for the core principles, and the legislative and administrative processes. It is expected that countries would have access to donor funds to implement some of these programs.

Fostering implementation of standards has to be a shared responsibility. Primary responsibility for the effort will rest with the African countries that would be the principal beneficiaries of the positive impact of compliance with standards. However, the international financial institutions (such as the IMF, World Bank, and the Financial Stability Forum (FSF) that have worked on developing the standards and the frameworks for assessing their promulgation and observance), bilateral donors (that can provide technical and financial support) and African regional organizations (especially the African Development Bank that is mandated to be in the lead role) will also have to play major roles. Such collaboration would not only help to avoid duplication but would also ensure that programs to foster implementation of banking and financial standards are consistent with other national economic reform programs. ■

I BACKGROUND AND CONTEXT

African leaders in their articulation of NEPAD have committed themselves to adhere to international standards in the conduct of policy. These standards are a way of doing things above board, and they call for economic affairs of countries to be conducted in a transparent and predictable way. Specifically, financial standards set out what are internationally accepted as good principles, practices or guidelines in the financial sector, and they cover a wide variety of subjects, including good ways of compiling and publicly disseminating data (for the public to know what is happening in the economy), of conducting macroeconomic policy and regulating financial markets to reduce risks and prevent crisis, and of supervising and structuring many of the institutions' activities (to protect both enterprise and market integrity)¹. It is expected that the greater clarity in the framework for economic and business decisions as well as the strengthened regulation of financial institutions that come with the implementation of standards would help increase investor confidence in financial sector transactions and support the creation of a good policy and institutional environment and, thereby, help attract investment and contribute to national growth and stability as well as poverty reduction. The benefits would be impacted at both national and regional levels.

¹ See Annex I for details on the key standards for promoting financial system soundness.

² La Porta, Rafael; Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, "Investor Protection and Corporate Valuation," forthcoming *Journal of Finance* 2002. La Porta, Rafael; Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, "Law and Finance," *Journal of Political Economy*, 1998, vol. 106, number 6. La Porta, Rafael; Florencio Lopez-de-Silanes, Andrei Shleifer and Robert Vishny, "Investor Protection and Corporate Governance," *Journal of Financial Economics*, 2000, vol. 57. Mulder, Perrelli, and Rocha (forthcoming). Johnson, Simon; Peter Boone; Alisdair Breach, and Eric Friedman, "Corporate Governance in the Asian Financial Crisis," *Journal of Financial Economics*, 2000, volume 58.

³ Kopits, George and Jon Craig, 1998, "Transparency in Government Operations," IMF Occasional Paper 158, January; Alesina, Alberto, Ricardo Hausmann, Rudolf Hommes, and Ernesto Stein (1996) "Budget Institutions and Fiscal Performance in Latin America," NBER Working Paper 5586, May; von Hagen, Jurgen and Ian Harden (1994) "National Budget Processes and Fiscal Performance," in *European Economy: Towards Greater Fiscal Discipline, Reports and Studies*, No. 3 (Brussels: European Commission, Directorate-General for Economic and Financial Affairs); Wagner, Richard E. (1976), "Revenue Structure, Fiscal Illusion, and Budgetary Choices," *Public Choice*, Vol. 25 (Spring), pp. 45-61.

⁴ Kydland F.E. and E.C. Prescott "Rules rather than discretion: The inconsistency of optimal plans," *Journal of Political Economy* 1997, 85:473-492. Nolan, C. and E. Schaling "Monetary policy uncertainty and central bank accountability" 1996, Bank of England Working Paper 54.

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At the national level, the adoption of internationally recognized standards of good practice in key areas of economic and financial policy should help improve the transparency, accountability, and credibility of policy, and increase the robustness and effective functioning of markets. There is increasing empirical evidence that countries that adopt international standards in the key areas develop faster and are less prone to crisis than other countries. For example, extensive research confirms that countries with strong shareholder and creditor rights (key elements of the securities, corporate governance, and insolvency standards) have more developed financial markets, allocate capital more efficiently within the country, are less prone to crisis, and were less severely impacted by the fall out from the Asian crisis than countries with weaker shareholder and creditor rights.² There is also evidence that greater fiscal transparency is associated with improved governance and fiscal discipline³ while transparency in monetary policy improves policy credibility and so helps control inflation.⁴ A robust and healthy financial system should contribute to faster income growth through the attraction of investment, better resource allocation and a more efficient provision of financial resources. The standards themselves also provide policymakers with guideposts or benchmarks for implementing structural reform, building institutional and supervisory capacity, and promoting an enabling environment for investment. Assessment of country practice against these standards can help highlight potential vulnerabilities, identify priorities for reform and so help prevent crisis and boost investment and growth⁵.

Increasingly, private sector investors are also using a country's performance on implementation of international standards as benchmarks for their investment decisions and credit risk assessments. Surveys have shown that the capital markets are increasingly using standards, and assessments of observance against these standards, in their decisions. One of the largest pension funds in the US (the California Public Employees Retirement System, CalPERS) with \$151 billion under management recently published the criteria by which it determines which countries it will invest in. One criterion used was the extent to which countries observed the standards for fiscal and monetary and financial transparency. One of the countries to be selected for investment by CalPERS using this methodology was South Africa.

At the regional level, the adoption of international standards should help enhance regional integration and improve the prospects of growth by (i) supporting and underpinning the creation of a good policy and institutional environment; (ii) facilitating the coordination of national invest-

⁵ Assessments can also be used to plan and support requests for technical assistance.

ment policies towards developing a common investment area; (iii) promoting cross-border and regional financial market networks; and (iv) underpinning collective action for reducing the level of investment risks.⁶ ■

⁶ See Ndulu, 'From Vision to Reality of African Economic Integration', paper presented at the 2001 General Assembly of the Association of African Central Banks, Johannesburg, August, 2001.

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II KEY FINANCIAL STANDARDS AND CODES

Many new international standards and codes (up to 80 different ones) have been developed by various bodies in recent years. However, for the objectives of NEPAD, the most relevant standards would relate to:

- Macroeconomic Policy and Data Transparency – for Government policymaking and operations;
- Corporate Governance Standards – for enterprise and market integrity;
- Financial Regulation and Supervision – for financial system stability.

There are 12 key standards generally identified in these areas by the international financial institutions (IFIs) as key for enhancing financial sector soundness. Many of the standards deal with general economic and corporate governance issues, while others are more particular to the banking and financial sector. Considering the mandate given to the United Nations Economic Commission for Africa (UNECA) to develop, under NEPAD, guidelines for Economic and Corporate Governance, the present report will focus on those standards that are of particular relevance to the banking and financial system. These include all those standards dealing with Financial Policy and Regulation and Financial Market Integrity (see Table 1).

TABLE 1
Key Standards for Sound Financial Systems⁸

Subject Area	Key Standard	NEPAD Lead Agency
<i>Financial Policy and Regulation</i>		
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	ADB/UN-ECA
Banking Supervision	Core Principles for Effective Banking Supervision	ADB
Securities regulation	Objectives and Principles of Securities Regulation	ADB
Insurance supervision	Insurance Core Principles	ADB

key financial standards and codes

Payment and Settlement	Core Principles for Systemically Important Payment Systems	ADB
<i>Financial Market Integrity</i>		
Market integrity	The Forty Recommendations of the Financial Action Task Force on Money Laundering	ADB
<i>Fiscal Policy</i>		
Fiscal policy transparency	Code of Good Practices on Fiscal Transparency	UN-ECA
<i>Data Transparency</i>		
Data dissemination	General Data Dissemination System (GDSS) Special Data Dissemination Standard (SDDS)	Not assigned under NEPAD
<i>Corporate Governance Standards</i>		
Insolvency	Principles and Guidelines on Effective Insolvency and Creditor Rights Systems	Not assigned under NEPAD
Corporate governance	Principles of Corporate Governance	UN-ECA
Accounting	International Accounting Standards (IAS)	UN-ECA
Auditing	International Standards on Auditing (ISA)	UN-ECA

Monetary and Financial Policy transparency is one of the standards and codes relating to macroeconomic policy that are aimed mainly at promoting increased transparency in government policymaking. The macroeconomic policy standards and codes (which also include the fiscal transparency and data dissemination standards) ensure that a sufficiently comprehensive picture of the structure and finances of government and of government fiscal and monetary policy is publicly available, thus paving the way to a reliable assessment of the soundness of monetary and fiscal policy. Improved transparency (or disclosure) should lead to better-informed public debate about the design and results of economic policy and make governments more accountable for the implementation of policy, strengthening the credibility and public understanding of the choices particular policies represent. Transparency should also improve the efficiency of markets by making participants better informed.

⁷ See, for example, Financial Stability Forum: 'International Standards and Codes to Strengthen Financial Systems, FSF, April 2001.

⁸ These exclude the best practices in micro-finance that will be recommended for implementation and assessment because of the tool's importance in poverty reduction in African countries.

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Standards and codes relating to financial system regulation and supervision are critical to crisis prevention. They mainly focus on ensuring that there is a sound and consistently applied regulatory and supervisory environment for financial institutions. Effective supervision of financial institutions is an essential component of a strong economic environment in that the financial system plays a central role in making payments and mobilizing and distributing savings. The task of supervision is to ensure that the institutions operate in a safe and sound manner and that they hold capital and reserves sufficient to support the risks that they undertake in their business. Strong and effective supervision provides a public good that may not be fully provided in the marketplace and, along with effective macroeconomic policy, is critical to financial stability in any country. Besides, good supervision of financial institutions fosters an efficient and competitive financial system that is responsive to the public's need for good quality financial services at a reasonable cost. Together with efficient payment systems (as embodied in the CPSS core principles) as well as effective actions against money laundering (in line with the recommendations of the FATF), financial regulation and supervision provide the essentials for a sound, efficient and credible financial system.

Standards and codes relating to corporate governance are also important for the financial system to operate well and to protect the integrity of markets, and they cover principles of corporate governance, insolvency and creditors' rights as well as accounting and auditing.

It is worth noting, however, that the separation between the banking and financial standards so categorized from the other key standards for financial system soundness identified in Table 1 is for working convenience only, as the areas are interdependent. For example, fiscal policy transparency has a significant impact on the conduct of monetary and financial policy and vice versa, while transparency in data dissemination is important for the conduct of macroeconomic policy. At the same time, transparency in the conduct of macroeconomic policy, the adoption of appropriate accounting and auditing standards and implementation of good corporate governance and insolvency principles are prerequisites for successful banking regulation and supervision. Significantly also, anti-money laundering efforts cannot be successful pursued as separate from implementation of good accounting and auditing standards, the appropriate legal framework and the conduct of effective banking regulation and supervision⁹.

In addition to the above standards, it would also be useful for African countries to pay attention to and implement best practices in microfinance, particularly financial self-sufficiency and outreach to the poor, because of its importance in poverty reduction. The best practices that cut

key financial standards and codes

across policy, financial infrastructure (regulation and supervision) and institutional management (especially accounting, auditing and evaluation of projects) that should be taken into account in assessing financial sector vulnerabilities and contribution to development and poverty reduction in African countries (see Annex V). ■

⁹ See Section III and Annex III on the preconditions and interconnectedness of the implementation of banking and financial standards.

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III EXPERIENCE OF AFRICAN COUNTRIES IN IMPLEMENTING STANDARDS

Compliance with standards is regarded as something to be aspired to by countries; they are not conditionalities for access to official financing but, as explained above, they support the creation of a good economic and institutional environment and help build investor confidence and improve access to private capital. So far, a few African countries have begun to gradually strengthen their capacity to implement standards. Their efforts have been assessed by the IMF through its Reports on the Observance of Standards and Codes (ROSCs) as well as within the framework of the Financial Sector Assessment Program (FSAP).

Table 2 gives a list of African countries for which ROSC modules have been published as well as the areas assessed. Two countries (South Africa and Tunisia) have subscribed to the Special Data Dissemination Standard (SDDS) while thirteen (Benin, Burkina Faso, Cameroon, Côte d'Ivoire, The Gambia, Guinea Bissau, Mali, Mauritius, Niger, Senegal, Tanzania, Togo and Uganda) are participating in the General Data Dissemination System (GDDS). Four of them, Cameroon, South Africa, Tunisia and Uganda, have been assessed against these standards. Five African countries have been assessed against the Basel Core Principles for Effective Banking Supervision (Algeria, Cameroon, Tunisia, Senegal and Uganda); six against fiscal transparency standards (Cameroon, Mali, Mozambique, Tanzania, Tunisia and Uganda); four against monetary and financial policy (Cameroon, Senegal, Tunisia and Uganda). In addition, Cameroon has been assessed against insurance regulation and payments systems, Senegal against insurance regulation and securities markets regulation, Egypt and Zimbabwe against corporate governance standards, and Kenya against accounting and auditing standards.

The review of the experience of African countries with compliance of standards shows that only few countries have made progress in implementing standards, and even for these countries coverage of the key standards is not adequate¹⁰. The experience indicates the need to take into consideration the importance of certain factors in the assessment and design of implementation of standards, including:

Variation in implementation of different standards: Generally, countries assessed were making effort to overcome constraints in macroeconomic policy and transparency and inadequacies in data dissemination. Indeed, the pursuit of macroeconomic reforms generally helped the creation and/or strengthening of the relevant institutions as well as improvements in professional

experience of african countries

capacity, as compared to the other standards. Regional cooperation efforts have also facilitated progress in improving banking regulation and supervision in the West African Economic and Monetary Union (with the establishment of a regional banking supervision agency) and the Eastern and Southern African region (with the activities of the East and Southern African Banking Supervisors Association). Although there are no ROSCs for corporate governance, accounting, auditing and insolvency rights, other indications are that these are also the standards for which progress in compliance has been little. In several countries also, there was little progress regarding compliance with the core principles of insurance and securities supervision.

TABLE 2
Reports on Observance of standards and Codes (ROSCs) modules published on RMCs

Data Dissemination	Fiscal Transparency	Monetary & Financial Policy	Banking Supervision	Insurance Regulation	Payments Systems	Securities Regulation	Corporate Governance	Accounting & Auditing
Cameroon	Cameroon	Cameroon	Algeria	Cameroon	Cameroon	Senegal	Egypt	Kenya
South Africa	Mali	Senegal	Cameroon	Senegal			Zimbabwe	
Tunisia	Mozambique	Tunisia	Senegal					
Uganda	Tanzania	Uganda	Tunisia					
	Tunisia							
			Uganda					
	Uganda							

[Source: Compiled from IMF ROSCS]

Preconditions: Effective implementation of the core principles for the regulation and supervision of financial institutions require the establishment of certain preconditions that are lacking in several African countries. These include sound and sustainable macro-economic policies; a well developed public infrastructure, with, for example, a sound legal and accounting system; effective market discipline; procedures for efficient resolution of problems in the financial institutions; and mechanisms for providing an appropriate level of systemic protection (or public safety net). In addition, as indicated earlier, these preconditions as well as effective banking regulation

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and supervision, good corporate governance and the appropriate legal framework would also be important for the success of anti-money laundering efforts. Where such elements do not exist, the government needs to put them in place (see annex IV).

Interconnectedness: Consideration of the interlinkages between the regulatory standards (BCP, Insurance CPs, and IOSCO Principles) and standards relating to accounting, auditing, corporate governance, insolvency, and financial policy transparency (see Annex IV) is especially important in assigning priorities in implementation and in ensuring effective implementation of each standard. For instance, where the legal system is inadequate, or accounting practices are deficient, the effective implementation of BCPs has been questionable. Also, issues of accounting and corporate governance are common to all the financial sectors, and resources can be deployed in a manner that can help in enhancing its use and applicability across all sectors. Therefore, where standards implementation has been carried out in an uncoordinated manner, resource intensity has also been high.

Country specific factors: In standards assessment and implementation, cognizance needs to be given to instances where a country can demonstrate that the "practice" has been achieved through different means. Conversely, due to the specific conditions in individual countries, the main assessment criteria may not always be sufficient to judge that compliance with a given "practice" is achieved and, therefore, attention to one or more criteria and/or other measures may also be deemed necessary. Even though the stage of development of the financial sector and its complexity were also important in determining progress that can be achieved and, therefore, priorities to be assigned in fostering implementation of standards, country-specific factors are also important in determining the direct relevance of the different standards. Interagency coordination and the cooperation of the government are also key institutional aspects for the beneficial effects of standard implementation to be realized by the financial sector agencies. ■

¹⁰ Specific findings regarding implementation experience with the various standards and codes are summarized in Annex II.

experience of african countries

IV ENHANCING PROGRESS IN IMPLEMENTATION OF STANDARDS

International standards are of limited value unless they are implemented and unless African countries see them as helpful in their own efforts to strengthen their domestic economies. However, these standards have only recently been developed, and there is limited awareness of them, while some standards have still not gained general acceptance. The experience of African and other countries indicates that progress in implementing them will be facilitated by:

- raising awareness about them and explaining their role – several countries need to raise awareness and understanding of the key standards among both government officials and market practitioners;
- assessing the constraints and formulating measures to address them – the Bretton Woods institutions have established mechanisms for assessing constraints. However, African countries are also encouraged to undertake their own assessments;
- formulating appropriate guidelines to reflect national characteristics – while standards have been developed to be universally relevant, it would be useful also to provide appropriate guidelines to facilitate application of some of them, especially those relating to the core principles of financial regulation and supervision. For African countries, these guidelines should reflect the specificities of transitional economies where all the necessary preconditions may not prevail,
- promoting country ownership – political commitment at the highest levels of government will be required to introduce the necessary legislative and administrative changes, to establish and empower the regulatory and judicial authorities, and to foster a culture of transparency and accountability;
- providing a judicious blend of market and official incentives for the adoption and implementation of standards – experience of developed countries where implementation of standards is advanced suggests that fostering the implementation of standards is successful when regulatory and voluntary actions are combined;
- establishment of the proposed African Peer Review (APR) mechanism; and
- mobilising resources towards the implementation of standards (including for funding reforms in the financial sector, strengthening or establishing the relevant institutions, development of the necessary professional skills, and undertaking of assessments) – there is a mismatch between the requirements of standards compliance and the skills and resources needed to implement them.

ASSESSMENTS, ACTION PLANS AND PEER REVIEW

Although African countries have determined to implement international financial standards and codes, existing internal structures, processes, and procedures will have to be identified and tackled in an operational way. The starting point should be identification of constraints in implementing international financial standards and codes, and the formulation of credible and action-oriented programs that could be implemented to address the constraints, in collaboration with bilateral and multilateral donors and African regional institutions. The establishment of a peer review mechanism would also enable African countries to share each other's experiences in tackling the constraints. Peer reviews would also help monitor the performance in the different countries and furnish the basis on which other African countries can provide encouragement and advice for the progress of peer countries. However, countries are at different stages of development and what would be peer-reviewed would not be the base conditions but the assessment of progress being made to redress weaknesses. Using an independent team for the assessments would reinforce the commitment to objectivity and help consistency across different countries. Therefore, the peer review should be based on external or assisted assessments. The proposed peer reviews would be managed jointly by the African Peer Review (APR) Unit to be located in an African institution, and the lead agency for financial and banking standards and codes.

The appropriate steps to foster implementation of financial and banking standards and codes would, therefore, involve three stages, namely: (i) organization of assessments of the base situation; (ii) development of specific guidelines and action plans (with the necessary programs to raise awareness about them and ensure political commitment to them); and (iii) peer review of implementation of the action plans to encourage progress.

STAGE I: ORGANIZATION OF ASSESSMENTS

The first stage of the peer review process would be the assessment of the base conditions. Ideally, Financial Sector Assessment Program (FSAP) that has become the internationally recognized standard for evaluating implementation of financial standards and codes, among its other objectives (see Annex II), should be used to assess the base situation. The use of the FSAP would have several advantages. First, it is based on a collaborative effort and receives expert support from various cooperating institutions, which helps to economize on scarce resources and enhances the legitimacy of the program. Moreover, it also draws on an independent team of experts to assist countries in undertaking assessments so as to enhance objectivity in the assessments and reinforce their consistency across the various countries a wide range of analytical tools

enhancing progress

and utilizes internationally agreed criteria for very comprehensive assessments. Most importantly, the FSAPs are not concerned with a pass-fail evaluation but rather an identification of areas of strengths and weaknesses, of the relative importance of gaps in the implementation of standards and codes and, the making of suggestions that could help draw up programs for improvements. The FSAPs are programmed for a country upon agreement of its authorities. Nevertheless, because of their heavy costs and global coverage, if all African countries were to volunteer for an FSAP assessment, it would take several years (about 8 years) for all African countries to be assessed.

Therefore, where a country has not gone through an FSAP and where one is not programmed in the short-term, the APR Unit should mobilize assistance (from the standard setting bodies as well as bilateral and multilateral donors and African regional institutions) to facilitate an assessment. While it is recognized that countries are encouraged to undertake self-assessments, the use of an independent team of experts to assist countries in undertaking assessments would enhance objectivity in the assessments and reinforce their consistency across the various countries¹¹. While a lead agency may be designated to assist the APR Unit in coordinating the process, relevant African financial and professional associations such as the Association of African Central Banks and the East and Southern Africa Banking Supervisors group (ESAF) may be drawn into playing a key role¹². The design and organization of the assisted assessments (Aas) would not be as comprehensive as the FSAPs but would utilize templates developed by the standard setting bodies for self-assessments and accommodate different degrees of financial system development and range of administrative capacities.¹³ As in the FSAPs, the assisted assessments would identify the elements of a standard that have been met and those that have not, and would make recommendations that would facilitate the formulation of an action plan.¹⁴ They would, therefore,

¹¹ The preference for assisted assessments is also based on the recognition that if self-assessments are not done objectively or if for cost reasons countries are compelled to cut corners in their assessments, the resulting false results that mask the true weaknesses can cause resistance to accepting results of external assessments undertaken subsequently.

¹² The AACB aims at promoting financial integration and financial development in African countries while the ESAF members commit themselves to implementing internationally acceptable standards of banking supervision and promoting banking system soundness.

¹³ Workshops to familiarize countries with the conduct of FSAPs and the templates could be organized in various African regions before the Aas are undertaken.

¹⁴ See Annex III for the areas of focus of assessments and the extent of compliance with the various standards and codes.

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give countries a head start in identifying weaknesses in their standards implementation and adopting corrective programs even before undergoing an FSAP assessment.

Two categories of African countries are, therefore, recognized with regards to the organization of assessments. Category 1 countries would comprise those countries that have undergone the FSAP as well as those countries for which an FSAP is programmed in the short term (say during 2003). All other countries would be in category 2. For category 1 countries, no further financial sector assessments would be required, and this group of countries would move directly to draw up action plans (that is, Stage II in the process).

For category 2 countries, an Assisted Assessment exercise should be undertaken. Countries would be expected to volunteer for the assessments by informing the APR secretariat of their intention to undergo an assessment, as well as which particular standards and codes they would wish to be assessed on. On receipt of a country's request, the APR Unit, in collaboration with the lead agency, would decide on the composition of the assistance team (at least two professionals, but depending on the standards to be assessed) to be sent to the country. The responsibilities of the assistance team would be to co-ordinate the process, provide technical assistance inputs, and generally ensure that, as much as possible, the assessments are conducted in line with internationally accepted procedures, utilizing templates developed by the standards setting bodies. The lead agency would assist in developing the Terms of Reference for the assistance team, as well as in identifying suitable candidates for the team. In addition to assisting the country in preparing the report on the findings of the assessments (for which the country could have the responsibility), the assistance team would prepare a separate report on the general conduct of the assessments (giving its opinion on the efficacy of the process) for submission to the lead agency and the APR Unit.

STAGE II: DEVELOPMENT OF ACTION PLANS AND GUIDELINES

Both FSAPs and AAs would have identified gaps and constraints in the implementation of banking and financial standards and codes. Specific recommendations would have been made on how to deal with the identified weaknesses in the country's level of compliance with financial standards and codes. In stage II of the process, countries would be expected, based on the recommendations, to develop specific time-bound Action Plans to improve compliance with the standards and codes.

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Experience has also shown that sequencing the implementation of standards would be necessary, as countries would neither have the capacity in terms of financial resources and skills, nor the necessity to implement all the standards at the same time. The pace of implementation would depend on the speed by which adequate preparations could be made in terms of mobilising the necessary resources, building the requisite capacity, including the professional skills, and equipping the relevant institutions. The action plans should, therefore, also include technical assistance and other external resources that countries would require to implement the plans.

In drawing the action plans it is also crucial to take into consideration country-specific factors. In this regard, it should be noted that African countries are at vastly different levels with respect to the development of their financial systems, and therefore would have different priorities as regards the different standards. It would, therefore, be necessary to prioritise the different standards for which implementation would be very relevant, in reflection of the level of development of the financial systems in the country. For this purpose, African countries can be divided roughly into three groups:

- Group 1 would comprise those countries where financial systems are relatively less developed and overwhelmingly dominated by banks. The priority standards for this group of countries would be the monetary and financial policy standards (and other macroeconomic policy and data standards¹⁵ etc.) as well as banking supervision (to ensure that the basic elements of banking supervision are in place – such as an independent supervisory body, prudential guidelines, as well as basic accounting and legal frameworks). For many of these countries, the requisite institutions, such as ministries of finance, central banks or independent supervisory bodies already exist or can be fairly quickly established because of policies already established in the context of ongoing economic reforms;
- Group 2 would comprise those countries where financial markets are more developed, e.g. including fledging securities and insurance markets. For these countries, in addition to the standards of concern to Group 1 countries, attention to implementation of securities and insurance supervision standards would be necessary. Assessment and action plans should facilitate orderly development of the securities and insurance markets (disclosure standards, establishment of clearing and settlement systems, etc.);

¹⁵ Countries in this group may choose to be assessed either against the GDDS or SDDS even if they subscribe to the GDDS.

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- Group 3 would comprise those countries where financial markets are relatively well developed and the country has access to or is close to achieving access to the international capital markets. These countries would need to have made substantial progress in implementing all the key standards. A key difference with the other two groups would be the level of assessments of the different standards. For example, assessment of banking and insurance supervision should be against the full Basle Core Principles and the ICP respectively and assessment of data dissemination would be expected to be against the SDDS. The countries should also be assessed against the Principles of Securities Regulation as well as the Core Principles for Systemically Important Payment Systems.

Irrespective of which of the three groups above a particular country belongs, it is understood that there are critical preconditions that need to be present in all countries before the implementation of standards can provide the expected benefits to the countries. Probably the most important of these is the legal framework in the countries. The legal system is the foundation of the financial system, which ensures the honouring and enforcement of financial contracts. Good laws are not enough. A body of ethical and professional lawyers and judges, and a reasonably efficient court system whose decisions are enforceable must support them. Thus any assessment and, therefore, action plan for any country should be concerned with the establishment of these preconditions. Progress in establishing these preconditions would also facilitate implementation of anti-money laundering measures that African Heads of State recommend that all countries implement.¹⁶

In many African countries, these preconditions may not be present and the development of specific guidelines to accommodate transitional characteristics would be useful. This is particularly the case with the capital standard in the Core Principles, which may not appropriately reflect the risk of financial institutions' assets in transitional economies. The guidelines would, therefore, include the development of risk-based regulations in loan-loss provisions and the esta-

¹⁶ See the resolution of the NEPAD Heads of State Implementation Committee at their meeting held in Abuja in March, 2002.

¹⁷ See Lilliana Rojas-Suarez: 'International standards for Strengthening Financial Systems: can regional Development Banks Address developing Countries Concerns?', paper presented at the Conference on Financing for Development: regional Challenges and the regional Development Banks, Washington, February, 2002.

ishment of appropriate risk categories and asset classifications to reflect the appropriate risk exposure of the financial institutions¹⁷.

In view of the different interest groups in the different countries whose support would be crucial in implementing the action plans, it is also proposed that the plans be extensively disseminated and publicized, and subjected to wide-ranging discussions to promote national ownership before they are finalized. Efforts should be made to adequately inform, and enlist the support of important interest groups such as the legislative and judicial branches of the government, professional associations (of bankers, insurers, lawyers, accountants, etc.), labor organizations, the civil society (NGOs, the media, etc.), the academia, etc. It is proposed that seminars and workshops, to which representatives of these different interest groups as well as representatives from countries that have had assessments, those that are about to be assessed, those undertaking peer reviews, the standard setting bodies, the APR Unit and relevant African regional would be invited, be organized to discuss the plans before they are finalized. Where convenient, the discussions of the action plans should be made part of the process of formulating the national PRSP.

STAGE III: THE PEER REVIEW PROCESS

Progress in the implementation of the action plans to address identified weaknesses in compliance with the banking and financial standards would be subject to peer reviews. The main objective here would be to use peer scrutiny and encouragement to ensure that countries keep the commitments they make in their action plans. In view of the highly technical nature of many financial standards and codes, it is proposed that the regional/sub-regional associations of African supervisors in the different areas of the financial sector be given key roles in the reviews. Thus, the association of banking supervisors should play a lead role in peer-reviewing the assessments as well as action plans related to banking supervision, with similar responsibilities for the association of insurance supervisors for the insurance industry, and the securities market regulators for the securities markets.

It is proposed that countries be encouraged to submit themselves to the reviews as least once every two years. The reviews might start with countries that have already undertaken assessments (through FSAPs), and that could, therefore, quickly develop their action plans. A country ready to submit itself to peer review on financial standards would indicate its intentions to the APR Unit. The unit, in collaboration with the lead agency, would assemble the review team as well as

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prepare the team's terms of reference. As proposed above, the review team would include representatives of the supervisors' associations in the areas in which the reviews are to be undertaken, e.g. banking or insurance supervision, as well as outside experts.

The review team would undertake a mission to the country under review. The team would meet and hold discussions with the relevant financial and monetary policy authorities, as well as with all other interest groups that it considers relevant in undertaking the review. The team would prepare a report on its findings, a draft of which will be discussed with the country. The country would be free to prepare written responses to the team's findings, which would be appended to the team's report.

The team's report will be submitted to the APR Unit, with copy to the lead agency. A standing Financial Standards Peer Review Committee of Ministers of Finance and Central Bank Governors could also be established to discuss the review reports. Meetings of the Committee would be conveyed periodically by the APR Unit. The Committee's discussions, including recommendations regarding the next steps, may be conveyed to the NEPAD Heads of State Implementation Committee through the NEPAD Steering Committee.

RESOURCE REQUIREMENTS AND MOBILIZATION

The major cost to African countries relating to the activities to foster implementation of standards would include the organization of the assisted self-assessments; dissemination activities (stakeholders seminars, conferences and publications); professional training (workshops and training courses); developing the legal framework (consultants fees, workshops and conferences); developing specific standards for the core principles (consultations, workshops and conferences); legislative and administrative processes (reviews, documentation and consultations); institution building; research and publications.

It is difficult to provide an exact estimate of these activities, as the details have to be worked out. However, it has been estimated that the cost of undertaking an assessment of compliance with one group of standard or code is between US\$50,000 to US\$70,000 (with the assessment of the macroeconomic transparency and data standards being at the lower end). The programs to foster implementation of standards would add other costs. While African countries would have the primary responsibility of implementing these programs, there are some encouraging initiatives to provide technical assistance:

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- FIRST: A new multi-donor partnership – the Financial Sector Reform and Strengthening (FIRST) Initiative – has been recently established. It will provide a mechanism to ensure systematic follow-up of TA from FSAP/ROSC efforts, and to increase financial resources available for this purpose. The partners in FIRST have pledged to provide some US\$13-15 million a year over the next three years, held in a trust fund, to support FSAP/ROSC TA exercises. The main objective of FIRST is to promote robust, stable, and diverse financial systems in low and middle income countries by providing financial TA support to strengthen the financial system, to implement measures to increase compliance with internationally accepted standards and codes in the financial sector area, and to bolster work on anti-money laundering, combating the financing of terrorism and protecting the financial system integrity. Coordination within FIRST would serve to avoid duplication and conflicting advice where the Bank, Fund, and other providers are giving assistance in the same financial sector areas;
- AFRITAC: In order to increase effectiveness (by intensified presence in the field) and ownership of TA programs, the IMF's management has agreed to the establishment of the African Regional Technical Assistance Centers (AFRITACs). As a first step, it is expected to open a center in Eastern Africa, and another one in Western Africa. These centers would play an important role in capacity building to foster implementation of financial standards. ■

V PARTNERSHIP IN IMPLEMENTING STANDARDS

Fostering implementation of standards has to be a shared responsibility. Primary responsibility for the effort will rest with the African countries that would be the principal beneficiaries of the positive impact of compliance with standards. However, the international financial institutions (such as the IMF, World Bank, and the Financial Stability Forum (FSF) that have worked on developing the standards and the frameworks for assessing their promulgation and observance), bilateral donors and African regional organizations (especially the African Development Bank that is mandated to be in the lead role) will also have to play major roles, as follows.

5.1 Role of African Countries

African countries should encourage the adoption of standards by:

- i pursuing policies to establish the necessary preconditions for effective implementation of standards, including the implementation of sound and sustainable macroeconomic policies, development of the public infrastructure, such as sound legal system and other dispute-settling mechanisms;
- ii the formulation and enactment of the relevant laws and establishment of the specific guidelines for the core principles;
- iii establishing strong and reliable regulatory authorities and national statistical agencies;
- iv mounting a sustained education effort to help raise the general level of awareness of standards among their agencies, national public and private institutions, and market participants;
- v demonstrating leadership and political commitment by undertaking assessments of their own observance of standards;
- vi demonstrating leadership and commitment to disseminate information on self and external assessments; and
- vii encouraging voluntary disclosure of material information on observance of relevant standards.

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5.2 Role of Development Partners and the International Financial Institutions

The international community, and especially the developed countries that are already far advanced in implementing standards and the international financial institutions, has a key role to play in encouraging the use of international standards by raising awareness about them and explaining their role. In particular, they could:

- i enhance their dissemination efforts to raise the level of awareness of relevant individual standards;
- ii better demonstrate how information on observance of standards can help provide insights on the risk factors in which market participants are most interested;
- iii enhance the availability of information on observance of standards;
- iv continue enhancing the clarity, relevance, presentation, and user-friendliness of the Reports on Observance of Standards and Codes (ROSCs);
- v continue enhancing the conduct of external assessments of observance of standards; and
- vi consider how the mechanism for policy advice could be further enhanced with a view to helping economies identify an appropriate set of standards for priority implementation and develop effective action plans; and
- vii help build the capacity of African countries to implement standards;
- viii provide technical assistance to African countries towards implementation of standards; and
- x assist African countries as well as regional and sub-regional associations to mobilise resources to implement programs related to implementation of standards.

5.3 Role of the African Development Bank and other African regional institutions

The African Development Bank has been designated by the NEPAD Steering Committee to lead the NEPAD effort in fostering implementation of standards in African countries. The Bank Group will collaborate, in the assignment, with other relevant African organizations, in particular, the UN Economic Commission for Africa that is also leading NEPAD's effort to foster governance. The efforts of the Bank and its partner regional institutions will also complement those of African countries and the other IFIs, and will include:

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- i collaborating with the regional economic communities, ministries of finance and of justice, central banks as well as relevant financial and professional associations to articulate the relevance of the standards and address any gaps relating to the situation of African countries, especially on specific guidelines needed to implement the core principles and in undertaking the peer review assessments;
- ii collaborating with standards setting bodies to enhance the clarity, relevance, presentation and user-friendliness of the reports and guidelines on various standards;
- iii extending their dissemination efforts (including workshops, seminars, publications and use of information technology) to raise the level of awareness of the relevant standards;
- iv assisting African countries to prioritise implementation of standards in reflection of developments in their financial sectors and of their capacity in terms of skills and resources required to achieve compliance;
- v collaborating with the regional economic communities and other relevant organisations to draw up special programs to facilitate the adoption and implementation of standards and to establish mechanisms for monitoring and reviewing of performance in this regard;
- vi assisting African countries to undertake the necessary review of the legal frameworks and institutional arrangements required to enhance implementation of standards;
- vii organising the self-assessments and peer review process for banking and financial standards and codes;
- viii helping to build the capacity of African countries to implement standards;
- ix providing technical assistance to African countries towards implementation of standards; and
- x assisting African countries as well as regional and sub-regional associations to mobilise resources to implement programs related to implementation of standards. ■

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The promotion of Africa's integration into a globalized economy is one of the key cornerstones of the New Partnership for the Development Africa. Inter alia, the principal purpose of this endeavour is to put African countries in a position where they can more robustly participate in globalized international trade and international capital markets. Among a number of things that NEPAD must do to achieve this cornerstone would be to require its members to conduct and manage their economies in conformity with internationally agreed standards and code of conduct relating to various sectors of their economies. Where its members do not have the requisite technical expertise to achieve the needed standards and codes, it could be the responsibility of NEPAD to mobilize the technical assistance that would enable its members to perform. In view of NEPAD's primary reason for requiring its members to conform to these standards it would be contradictory for it to advocate the pursuance of other standards or so called " African " standards. In view however of the multiplicity of standards in the various areas of the economy and the fact that some can only be achieved by sophisticated economies, NEPAD could encourage implementation of the very basic standards and codes that have to be observed in order to assure the market the soundness of economic management in a country . The time table for implementation would be drawn out to permit proper sequencing of activities according to each country's stage of financial system's development, and allow time for mobilization of resources and the building of necessary capacity. The peer review process, coordinated by the AU, and assisted by the lead agency and other relevant international organizations, would encourage progress in implementation of the standards and codes. ■

THE KEY STANDARDS FOR SOUND FINANCIAL SYSTEMS

The Code of Good Practices on Transparency in Monetary and Financial Policies identifies transparency practices for central banks in the conduct of monetary policy and, together with other financial agencies, in their conduct of financial policies. Here, transparency refers to an environment in which the central banks and financial agencies supply the public with clear, acceptable, adequate and timely information with regards to the goals and instruments of monetary and financial policy, and the data relevant to these policies. Two transparency principles are relevant for this code:

- **Effectiveness and credibility:** in order for monetary and financial policies to be effective, the public should be well informed about the goals and objectives, and the authorities must demonstrate a willingness and commitment to meeting these goals and objectives;
- **Accountability:** central banks and financial authorities should be accountable to the public.

The transparency practices listed in the code include the following:

- Clarity of roles, responsibilities and objectives of central banks and financial agencies;
- The processes for formulating and reporting of monetary policy decisions by the central bank and of financial policies by financial agencies;
- Public availability of information on monetary and financial policies; and,
- and assurances of integrity by the central bank and financial agencies.

FINANCIAL SYSTEM REGULATION AND SUPERVISION

The Core Principles for Effective Banking Supervision are composed of 25 principles in seven sections, briefly described below:

- preconditions for effective banking supervision requires clear responsibilities and objectives for each agency involved in the supervision of banking organizations. It also requires having in place a suitable legal framework, providing powers to address compliance with laws as well as safety concerns, and legal protection for supervisors;

- licensing process and approval for changes in structure deals with the licensing process for banks, the privileges and obligations to be conferred on licensed banks, the powers of the licensing authorities, and oversights of changes in the controlling interests of existing banks;
- prudential regulations and requirements These standards are at heart of banking supervision. Bank supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks, reflecting the risks that the banks undertake. Bank supervisors must be satisfied that banks have and adhere to adequate policies, practices and procedures for evaluating the quality of assets, identify concentrations within the portfolio, prevention of connected lending, identifying, monitoring and controlling market and other material risks, and the establishment of effective internal controls that are adequate for the nature and scale of their business;
- arrangements for ongoing banking supervision Banking supervisory systems should have in place both on-site and off-site supervision, have means of collecting, reviewing and analyzing prudential reports and statistical returns from banks, and an independent means of validating the supervisory information collected;
- information requirements requires supervisors to ensure that banks prepare their records in line with consistent and accepted accounting policies and practices, and that a bank's published financial statements fairly reflect its financial condition;
- formal powers of supervisors requires authorities to provide banking supervisors with adequate powers to bring about timely corrective action when banks fail to meet prudential requirements, or violate regulations;
- cross-border supervision deals with the effective supervision of international banks.

The Core Principles for Securities Market Regulation also cover seven sections as follows:

- measures designed to enhance the authority of securities regulators in a timely and objective manner in enforcing securities laws and investigating potential violations requires national governments to establish necessary legislation that gives adequate powers to securities market regulators to investigate securities violations and enforce securities laws;
- regulatory responsibilities for licensing and regulation of securities market participants and transactions Securities legislation should clearly spell this out. A set of principles, setting out the basic standards of business conduct for financial firms, has been adopted by IOSCO, which member organizations are encouraged to implement;

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- auditing, accounting and disclosure standards for securities issuers, and corporate governance standards Several measures have been taken to improve disclosure standards in securities transactions, including the development of international standards for non-financial statements disclosures, recommendations for minimum disclosure standards for public securities offerings, and guidelines for the reporting of material events by issuers of publicly traded securities in emerging markets. Internationally accepted accounting and auditing standards for use by securities firms have also been developed;
- laws and regulations against fraud and market manipulation requires the establishment of audit trails with respect to trading, clearance and settlement activities;
- supervision of market intermediaries, including financial responsibility requirements IOSCO, together with the Basle Committee, have jointly established eight major principles of supervision for securities markets intermediaries. These principles are closely related to those established for banking organizations;
- establishing open, transparent stock exchanges and other self-regulatory organizations These will serve to deepen securities markets and engender self regulation;
- standards of regulation for collective investment schemes Core principles for the development and supervision of collective investment schemes (CIS) have been developed, which securities regulators are encouraged to implement.

The structure of the Insurance Core Principles include:

- organization of the insurance supervisor requires that the insurance supervisor in member countries be organized in a way that it is able to accomplish its primary task of maintaining efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders;
- requirements for licensing and changes in control The insurance supervisor should have the authority to grant licenses for companies wishing to engage in insurance business, and powers to review changes in the control of licensed companies;
- corporate governance dealing with the roles and responsibilities of the board of directors and management of insurance companies;
- internal controls Supervisors should be able to review the internal controls set up by companies, and request the strengthening of the controls if necessary;

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- prudential rules dealing with such issues as the treatment of assets and liabilities, capital adequacy and solvency, derivatives and “off-balance sheet” items, and reinsurance;
- market conduct requiring supervisors to ensure that insurers exercise the necessary knowledge, skills and integrity in dealings with their customers;
- monitoring and inspection dealing with standards for financial reporting and on-site inspection of insurance companies;
- sanctions requiring insurance supervisors to have the powers to take remedial action where problems involving licensed companies are identified;
- cross-border business operations dealing with the effective supervision of international insurance companies;
- coordination, cooperation and confidentiality dealing with issues of liaison among insurance supervisors in different countries, as well as ensuring the confidentiality of any information that might be exchanged.

The Core Principles for Systemically Important Payment Systems are intended for use as general guidelines to encourage the design and operation of safer and more efficient payment systems. Payment systems are the means by which funds are transferred between financial institutions, and the most important payment systems (systemically important payment systems) are a major vehicle by which shocks can be transmitted across domestic and international financial systems and markets. In African economies they are likely to be of particular relevance, because of the need in these countries to improve existing systems or to build new ones in order to handle better the increasing payment flows from national and international financial markets. Safe and efficient payment systems are, indeed, crucial to the effective functioning of the financial system, and are vital in maintaining and promoting financial stability in African economies. The Code sets out 10 Core Principles, and 4 responsibilities of central banks in applying them including the key characteristics of design and operation that all systemically important payment systems should satisfy.

The FATF Recommendations on Money Laundering set out the basic framework for anti-money laundering efforts and cover the measures required in the areas of criminal justice and law enforcement, the financial system and its regulation, and international co-operation. Countries have diverse legal and financial systems, and therefore the FATF recommendations allow countries a measure of flexibility in implementing the necessary anti-money laundering measures.

The other key standards for financial sector stability are briefly described below:

The Code on Fiscal policy transparency places emphasis on being open to the public about the structure (government revenues, expenditures, borrowing and financing) and functions of government, fiscal policy intentions, public sector accounts, and fiscal projections. Its role is that of strengthening accountability and increasing the political risk associated with maintaining unsustainable policies thereby enhancing credibility, lower borrowing costs, and stronger support for sound macroeconomic policies by a well-informed public. In the process, the chances for destabilization, inefficiency and inequity are reduced.

The data standards – The General Data Dissemination System – GDDS and the Special Data Dissemination Standard – SDDS – serve to guide countries in the provision to the public of comprehensive, timely, accessible and reliable economic, financial and socio-demographic data. However, while the SDDS guides countries that have, or that might seek, access to international capital markets in the dissemination of economic and financial data, the GDDS is the relevant standard for all other countries.

The General Data Dissemination System (GDDS) focuses on encouraging countries to improve data quality and helping them evaluate needs for data improvement. It provides countries with a framework for the development of their national systems for the production and dissemination of macroeconomic, financial, and socio-demographic data. The GDDS prescribes two to four monitorable elements--good practices that can be observed, or monitored, by the users of statistics in the following four dimensions, namely: coverage, periodicity, and timeliness with which the data are disseminated; ready and equal accessibility by the public; integrity (determined by the objectivity and professionalism of the agency producing the statistics and the transparency of its practices and procedures); and quality of the disseminated data (as indicated by the accuracy, adherence to international statistical guidelines, and consistency of data produced).

Countries participating in the GDDS are committed to work towards the standards set under the GDDS over time, albeit at their own pace and following their own priorities. The SDDS subscribers (normally countries that have, or that might seek, access to international capital markets), by contrast are expected to have more developed statistical systems, and even though the SDDS is built around the same dimensions as the GDDS, it requires subscribers to comply with the standards immediately (with few exceptional transition arrangements). Whereas the SDDS

does not cover socio-demographic statistics, for economic and financial statistics it is generally much more demanding than the GDDS.

A more recent initiative by the IMF is the Data Quality Assessment Framework (DQAF), which, in addition to the data standards, is designed to assess the characteristics of relevant outputs, systematically reviewing sources, processes, and institutional aspects to improve the quality of data provided.

Corporate governance standards are essentially concerned with the laws, rules, practices which regulate the internal relationship between the key players in the corporations (management, the board, shareholders, creditors and other stakeholders) and the external forces (notably policy, legal, regulatory, and market) that govern the behaviour and performance of firms. Although the systems of corporate governance differ from country to country, in recent years there is a growing tendency towards convergence, as with globalization, corporations compete for capital in international markets and tend to harmonise corporate governance practices largely to reduce risk to investors and hold down the cost of capital. The international corporate governance standards, also known as the OECD Principles, provide a basis for policy makers to "evaluate and improve the legal, institutional and regulatory framework for corporate governance in their own countries". In other words, the Principles represent a starting point from which countries can base the development of their individual systems according to their unique circumstances.

The need for appropriate insolvency systems (as in the Principles and Guidelines on Effective Insolvency and Creditor Rights Systems) became most apparent with the financial crises that hit emerging markets especially in Asia in mid-1990s. The multilateral bank community responded with a series of initiatives to encourage and assist emerging market economies to build effective insolvency systems. Most international groups and insolvency practitioners agree that it is not possible, nor is it recommended, to attempt to devise a single or uniform law or approach to an insolvency regime. Instead the approach is to provide a range of guidelines and principles from which a country can select as it develops or fine-tunes its insolvency system within its existing legal regime.

International Accounting Standards (IAS) have been developed to provide accurate, reliable and timely accounting information, which is fundamental for economic efficiency and financial stability. The practical effectiveness of many key standards relies heavily on the quality of the underlying data and associated accounting and auditing practices. Banking supervisors, securities

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regulations (IOSCO) and insurance supervisors (IAIS) have all recommended adoption of several of the IAS that have been issued.

With greater cross-border capital movements, the need for increased consistency, transparency and comparability of financial information has become more acute. International Standards on Auditing (ISAs) have, therefore, been developed to provide consistent, high-quality and comparable audits based on IAS and other standards of a high and internationally accepted quality. ■

EXTERNAL ASSESSMENTS OF IMPLEMENTATION OF STANDARDS AND CODES¹⁹

There are two types of external assessment mechanisms for international standards, namely: the Financial Sector assessment Program (FSAP) and the Report on Observance of Standards and Codes (ROSCs). The FSAP was introduced in May 1999 by the IMF and the World Bank, in the wake of the financial crises of the late 1990s, to strengthen the monitoring of financial systems in the context of the IMF's bilateral surveillance and the Bank's financial sector development work. The program is designed to help countries enhance their resilience to crises and cross-border contagion, and to foster growth, by promoting financial system soundness and financial sector diversity. The value added from the program derives importantly from its collaborative nature, and the expert support it receives from various cooperating institutions, which helps to economize on scarce expert resources, and enhances the legitimacy of the program. Assessments of financial systems undertaken under the FSAP identify the strengths, risks and vulnerabilities in the financial system, and the two-way linkages between financial sector performance and the macroeconomy; ascertain the sector's development needs; and help national authorities to design appropriate policy responses. The FSAPs also assess observance of the financial standards, including the Code of Transparency in Monetary and Financial Policies, Core Principles for Systematically Important Payment systems, Core Principles for effective banking Supervision, Objectives and Principles of securities Regulation, and Insurance Core Principles. The comprehensive nature of these assessments requires a wide range of analytical tools and techniques, including macroprudential analysis, stress testing and scenario analysis, and assessments of observance and implementation of relevant international financial sector standards, codes and good practices.

The ROSCs also offer a standard mechanism for assessing implementation of standards. Participation in the ROSC exercise by member countries is voluntary. The choice of standards to be assessed, and the sequence in which these are assessed, is based on country circumstances, taking into account potential synergies in the preparation of standards assessments. Production of summary assessments – standard by standard – is generally staggered over time to allow staff and members to avoid bottlenecks and prioritize efforts. While members still face a significant burden in participating in the preparation of standards assessments, there are important sectoral interlinkages that argue for several financial sector standards to be considered simultaneously in reaching judgments on stability and developmental needs in the context of the FSAP.

¹⁹ Information in this Annex has depended to a large extent on IMF and World Bank: 'Assessing the Implementation of Standards – a review of Experience and Next Steps', Washington, January, 2001.

ROSC modules are prepared across a range of standards using the Bank-IMF collaborative approach. Detailed assessments of progress in implementing and adhering to selected standards may be prepared, using assessment methodologies where available, to benchmark country practices against the relevant standard. Summary assessments ROSC modules - may be derived from these detailed assessments or may be prepared without the prior preparation of a detailed assessment. Modules also attempt to discuss the underlying quality of the information being released publicly to the extent possible for disclosure standards, and to discuss the materiality and contribution to stability of country practices in areas subject to regulatory and system design standards.

ROSCs avoid assigning country ratings or pass-fail grades. Modules attempt to provide an appropriate context for assessments by reporting on both the absolute extent to which standards are being effectively implemented and by noting the extent of progress over time. Specific, prioritized recommendations are made in the light of country circumstances, on how to improve implementation of the standard.

The following important lessons that have been drawn on the early IMF-World Bank assessments of standards in member countries can help design the assessment mechanism for African countries.

Lesson 1

Experience suggests that the modalities are working well. The value of the modular approach and the importance of prioritized recommendations have been reaffirmed. Efforts to improve implementation of standards need to be placed in the context of a broader reform framework so as to prioritize between adherence to standards and other reforms.

Lesson 2

Assessments need to be independently and consistently applied across countries.

Lesson 3

The assessments undertaken so far have been able to appropriately allow for consideration of the different stages of economic development, the range of administrative capacities, and the different cultural and legal traditions across the membership.

Lesson 4

The experience so far suggests that information on progress in implementing standards can be useful in underpinning policy dialogue with multilateral development finance institutions and sharpening the focus of capacity building efforts.

Lesson 5

While interest in, and awareness of, the work underway on standards has increased over time, much more remains to be done to raise the general level of awareness, with potential resource implications for supporting donor institutions.

Lesson 6

The preparation of FSAPs and ROSCs involves significant resource costs; the programs have highlighted that preparing assessments is time consuming and requires specialist expertise, with significant implications for resource needs. ■

**SUMMARY OF RESULTS OF ASSESSMENT OF AFRICAN COUNTRIES
BY MAJOR GROUPS OF FINANCIAL STANDARDS**

AREA ASSESSED	SUMMARY OF RESULTS
<p><i>Transparency on Monetary and Financial Policy</i></p> <ul style="list-style-type: none"> • clarity of roles and responsibilities; • public availability of information; • process of formulating and reporting monetary policy; • accountability and assurances of integrity of the central bank. 	<p>African countries assessed were making effort to overcome constraints in macroeconomic policy. The pursuit of macroeconomic reforms in preceding years helped the creation and/or strengthening of the relevant institutions as well as improvements in professional capacity, as compared to the other standards. In several countries also, there was some clarity in financial relations between government and cency was generally affected by:</p> <ul style="list-style-type: none"> • the need for further rationalisation and more transparent relationship between the central government and public enterprises to reduce quasi-fiscal activities; • lack of sectoral strategies and the existence of cumbersome procedures that caused difficulties in program implementation and mobilization of external resources; • lack of information, especially of the stock of external and domestic debt arrears, which complicate macroeconomic policymaking; • need for greater effort to clarify and explain the goals of macroeconomic policy to the market; • need to strengthen the external audit function through training, increased resources and legal backing; and • inadequate legal framework to underpin implementation of certain aspects of the standards.
<p><i>Financial Regulation and Supervision</i></p> <ul style="list-style-type: none"> • Preconditions for effective supervision; • Licensing and structure; • Prudential regulation and requirements; • Methods of ongoing supervision; • Information requirements; • Formal powers of supervisors, 	<p>Compliance with most of the individual principles by the 26 assessed countries (5 of whom are African countries) were found to be "far from satisfactory". The areas needing particular attention included the drafting of legislation and regulations, improving implementation, and the building of institutional capacity to enable improved and effective supervision. The review identified 8 out of the 25 core prin</p>

including remedial powers and exit;

- Cross-border supervision.

principles where compliance is particularly weak. These included:

- the principle on credit policies. There were frequently lack of comprehensive policies for credit granting and monitoring.;
- the principle on country and transfer risk. Many countries do not yet require banks to apply comprehensive systems and procedures for identifying and monitoring cross-border risks, including guidelines for setting aside provisions;
- the principles on market risks, other risks and internal control. The review found tendencies for regulations to focus on legal formalities without taking a comprehensive view of the overall risk and control environment. Risk management systems and internal control functions need to be well designed, especially for those banks entering into more sophisticated activities;
- the principle on money laundering. Rules for the prevention of money laundering and fraud need to be strengthened;
- the principle on consolidated supervision. In view of the increasing complexity of banks in many countries, new regulations and resources need to be deployed to enable their supervision on a consolidated basis; and
- the principle on remedial measures. Bank supervisors need to be given the powers to apply prompt corrective actions in order to prevent bank problems from escalating or becoming systemic.

As regards insurance supervision, IMF's report on its experiences with the assessment of countries' compliance with the Insurance Core Principles (ICP) also identified several areas where supervisory practices were weak. These included: organization of insurance supervisor; changes in control; corporate governance; internal controls; and prudential rules – assets, reinsurance, market conduct, and

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derivatives and off-balance sheet items. The report then made several recommendations to address the shortcomings in the observance of the ICP.

Money Laundering

The Forty Recommendations of the Financial Action Task Force on

The success of anti money laundering efforts is enhanced by the existence of the relevant legislations, high standards of accounting and auditing, and effective banking supervision. ■

[Source: Various IMF reports on observance of standards and codes]

IMPORTANCE OF PRECONDITIONS AND INTERCONNECTEDNESS OF STANDARDS²¹

A well developed public infrastructure would need to cover the following facilities, which, if not adequately provided, can significantly contribute to the destabilization of financial systems: (i) a system of business laws, including corporate, bankruptcy, contract, consumer protection and private property laws, that is consistently enforced and provides a mechanism for fair resolution of disputes; (ii) comprehensive and well-defined accounting principles and rules that command wide international acceptance; and (iii) a secure and efficient payment and clearing system for the settlement of financial transactions where counterparty risks are controlled.

Effective market discipline depends on an adequate flow of information to market participants, appropriate financial incentives to reward well managed institutions, and arrangements that ensure that investors are not insulated from the consequences of their decisions. Among the issues to be addressed are corporate governance and ensuring that accurate, meaningful, transparent and timely information is provided by borrowers to investors and creditors.

Sufficiently flexible powers are necessary in order to effect an efficient resolution of problems in banks. Where problems are remediable, supervisors will normally seek to identify and implement solutions that fully address their concerns; where they are not, the prompt and orderly exit of institutions that are no longer able to meet supervisory requirements is a necessary part of an efficient financial system. Forbearance, whether or not the result of political pressure, normally leads to worsening problems and higher resolution costs. The supervisory agency should be responsible for, or assist in, the orderly exit of problem banks in order to ensure that depositors are repaid to the fullest extent possible from the resources of the bank (supplemented by any applicable deposit insurance) and ahead of shareholders, subordinated debt holders, and other connected parties.

In some cases, the best interests of depositors may be served by some form of restructuring, possibly takeover by a stronger institution or injection of new capital or shareholders. Supervisors may be able to facilitate such outcomes. It is essential that the end result fully meets all supervisory requirements, that it is realistically achievable in a short and determinate time frame, and that, in the interim, depositors are protected.

Deciding on the appropriate level of systemic protection is by and large a policy question to be taken by the relevant authorities (including the central bank), particularly where it may result in a commitment of public funds. Supervisors will also normally have a role to play because of their in-depth knowled-

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ge of the institutions involved. In order to preserve the operational independence of supervisors, it is important to draw a clear distinction between this systemic protection (or safety net) role and day-to-day supervision of solvent institutions. In handling systemic issues, it will be necessary to address, on the one hand, risks to confidence in the financial system and contagion to otherwise sound institutions, and, on the other hand, the need to minimize the distortion to market signals and discipline. Deposit insurance arrangements, where they exist, may also be triggered. ■

²¹ Source: Basle Committee of Banking Supervision sources.

NEW PARADIGMS IN MICRO-FINANCE

Improving Micro-finance: New Paradigms, Productive Roles, and Actions

ACTORS	PARADIGMS, ROLES, AND ACTIONS
<i>Governments</i>	<p>Encourage autonomous, catalytic, second – tier institutions that can mobilize funds for capitalization, and institutional development for those retail-level intermediaries that meet performance and reach standards;</p> <p>Liberalize interest rates;</p> <p>Create regulations that encourage a range of intermediaries;</p> <p>Create incentives for the intermediaries with the commitment and capacity to provide financial services to target groups.</p>
<i>Donors</i>	<p>Support the development of national financial systems that work for the poor;</p> <p>Build appropriate financial instruments and vehicles that respond to large number of small intermediaries at different stages of development;</p> <p>Support retail institutions that meet agreed standards of performance and client reach, directly and through second – tier and network arrangements.</p>
<i>Banks</i>	<p>Seek market opportunities;</p> <p>Make changes in organization, systems and products to reduce costs and risks of lending to large and growing client group;</p> <p>Establish bank-NGO-client credit lines.</p>
<i>NGOs, MFIs and other Specialized Financial Institutions</i>	<p>Build reach and role of financial intermediaries;</p> <p>build self-sustaining, self-determined organizations responding to local needs;</p> <p>Make changes in organization and systems to comply with best practices and meet performance and reach standards;</p> <p>Use practitioner networks to build mutual accountability, Standards, lateral learning, and efficient financing mechanisms.</p>
<i>Low-income Women and Men</i>	<p>Gain access to information on available finance, business, and legal services and use them to build income, assets, and a voice in decision-making;</p>

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Build and join organizations that are geared to expanding low-income entrepreneurs' economic access and participation;
Organize into sector and area groups for visibility, access; and economic power;
relationships with solid financial intermediaries. ■

[Source: Women's World Banking: The Missing Links: financial Systems That Work For The Majority]