This information booklet has been developed by the Secretariat on the basis of the text of the OECD Code of Liberalisation of Capital Movements and other Investment Committee official documents. It is intended to foster a better understanding of the OECD Code and its review process as agreed by the Code’s Adherents; it does not in any way alter or modify rights and obligations of Adherents, the interpretation and implementation of which remain the sole responsibility of the Investment Committee.

The OECD Investment Committee is mandated by the OECD Council to consider all questions concerning the interpretation and implementation of the provisions of the OECD Code of Liberalisation of Capital Movements or other Acts of the Council relating to the liberalisation of capital movements.

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ABOUT THE OECD CODE OF LIBERALISATION OF CAPITAL MOVEMENTS

OECD report to the G20 IFA WG, February 2017

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SUMMARY

This document was prepared by the OECD Secretariat at the request of the co-chairs of the G20 International Financial Architecture Working Group as background documentation in support of the Information Workshop on the OECD Code of Liberalisation of Capital Movements to be held in Paris on 15 February 2017.

The OECD Code of Liberalisation of Capital Movements is an instrument for international co-operation on capital flow management and liberalisation. Currently adhered to by thirty-five OECD countries, including twelve G20 countries, the OECD Code is the sole multilateral agreement among State parties dedicated to openness and transparency in cross-border capital flow policies. While there is no presumption that full liberalisation is an appropriate goal for all countries at all times, the Code is based on the premise that long-term business investment and growth potentials cannot be achieved with closed capital accounts and that “beggar-thy-neighbour” approaches to capital flow policies can result in negative collective outcomes.

The Code brings benefits to adherents. Since its inception in 1961, the Code has served as a platform to get international recognition for reform efforts, compare progress, and exchange good practices among Adherents in their path toward open and orderly capital account movements. It has served as an anchor for countries’ policies in times of financial turmoil, by providing a due process - transparency and accountability – to observe when Adherents reintroduce capital flow restrictions while wishing to signal their continued commitment to openness.

The Code provides flexibility to maintain or reintroduce capital flow restrictions in light of circumstances. Adherents can lodge reservations with respect to operations which they are not in the position to liberalise at the time of adherence. They can also do so at any time when new restrictions on short-term operations may be needed; over the last five years, two countries have availed themselves of this facility. The on-going review of the Code will verify that this facility adequately covers such operations. In situations of serious balance-of-payment difficulties or economic and financial disturbance, adherents can also invoke the derogation clauses of the Code for introducing new restrictions on other operations. Over the last five years, two other countries have implemented these clauses.

Commonly used macro-prudential tools typically fall outside the scope of the Code. This includes limitations on net open positions of banks and currency matching requirements for institutional investors. While the Code provides for the freedom to use foreign currencies to settle and denominate operations abroad between residents and non-residents, it does not cover operations among residents and it does not require allowing operations, including in foreign currency, in the country with non-residents that are not permitted between residents. On-going discussions in the context of the review of the Code are clarifying that national adaptations of liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements differentiating by currency are not capital flow restrictions.

The Code supports the implementation of the G20 Coherent Conclusions. It echoes the Coherent Conclusions’ call for Capital Flow Management measures (CFMs) to be “transparent, properly communicated, and be targeted to specific risks identified” and for “multilateral surveillance to assess both their individual impact and aggregate spillover effects”. While the Code and the IMF’s Institutional View are distinct in nature and purpose, both approaches assist countries in ensuring that measures are not more restrictive or maintained longer than necessary; they do not give rise to any conflicting legal requirements. The on-going review of the Code will consider formalising the possibility to elicit inputs from relevant international organisations to assist in informing Adherents’ deliberations and decisions.
The Code is open for adherence by non-OECD countries with equal rights and responsibilities. All G20 members are invited to continue to participate actively in the discussions on the review of the Code at the OECD. Countries are encouraged to apply for adherence to the Code. By adhering to the Code, new adherents will enjoy the benefit of the protection of the Code against potential discrimination by other adherents while reinforcing their role and reputation as responsible international players. Four non-G20 countries are currently in the process of adhering to the Code. Bilateral discussions with several non-adhering G20 members are also well engaged.

1. OVERVIEW OF THE CODE’S FRAMEWORK

1. The OECD Code is one of the key elements in the international framework for economic co-operation since the post-war period. While the GATT was adopted to oversee open trade, and international current payments and transfers were brought under the jurisdiction of the IMF’s Articles of Agreement, the OECD Code has since its inception in 1961 promoted a collective view and common disciplines on capital flow management and liberalisation policies among adhering countries.

2. Thirty-five OECD members, including twelve G20 countries have adhered to it. Since 2012, the Code is also open to non-OECD countries, which can adhere without any engagement to join the OECD. All Adherents have an equal say in the governance of the agreement.

3. The establishment of the Code in 1961 was based on several premises validated by evidence and experience:

   - An open multilateral regime for international capital flows, which also take into account countries’ own circumstances, serves the global economy better than closed capital accounts. The Code favours a gradual liberalisation approach (giving priority to liberalising long term investment), which allows each Adherent to progress at its own pace.

   - Reintroducing capital flow restrictions can play a role in specific circumstances. In these circumstances, transparency and international co-operation are important. While restrictions may be considered justified from an individual country’s viewpoint, a “beggar-thy-neighbour” approach to restrictions can lead to negative collective outcomes.

4. The Code was established at a time when many OECD countries were in the process of economic recovery and development and when the international movement of capital faced many barriers. When the Code was first established, its coverage was rather limited. Since then, national economies have become more integrated, financial market regulation more harmonised and financing techniques more sophisticated. Over time, the Code has been revised to reflect both these changing economic realities and new aspirations of adhering countries (Box 1).
1.1 What is the Code and how is it structured

5. The Code consists of a set of Articles. Article 1 spells out the central idea: members subscribe to the general aim of progressively eliminating between one another restrictions on capital movements. The remaining provisions describe the framework under which Adherents shall work towards reaching this goal.

6. Examples of provisions include:

- the right to proceed gradually towards liberalisation through a process of lodging and maintaining reservations;
- the obligation not to discriminate among Adherents;
- exceptions for reasons of public order and essential security interest;
- derogations in case of balance of payments, economic and financial disturbance;
- provisions to ensure compatibility with regional arrangements such as the European Union and its special processes;
- a system of notification, examination and consultation which is run by a special body, the Enlarged Investment Committee.

7. The Code has two principal annexes: a list of operations covered, and a list of current Adherents’ reservations. The list of operations of the Code covers all long- and short-term capital movements between residents of Code Adherents. Examples of such movements are the issuing, sale and purchase of shares, bonds and mutual funds, money market operations, and cross-border credits, loans and inheritances. In addition, it covers Foreign Direct Investment (FDI) – for instance acquisition of an existing company by a foreign enterprise or establishment of a subsidiary by a multinational corporation. Section 3 of this note discusses further the standards of the Code and its safeguards, such as the Code reservation system and derogation. Box 6 in section 3 illustrates the full list of operations. Annex I provides more details on the adherence process and requirements.
1.2 Forum for international dialogue and co-operation

8. The Code has provided an established and tested process of international dialogue and co-operation. The process is managed and controlled by Adherents through a dedicated forum at the OECD in which each country can explain its policies and raise questions about the policies of others. The IMF and other relevant international organisations are invited to this forum.

9. The process is peer driven. Over time, Adherents have developed a well-established jurisprudence (as reflected for instance in the User’s Guide) regarding implementation of the Code’s rights and obligations and the conformity of individual country measures. Notification and examination of country measures enhance transparency and mutual understanding.

10. The OECD Enlarged Investment Committee has formal responsibility to look after all Codes matters. Together with the other two relevant Committees (the Committee on Financial Markets and the Committee on Insurance and Private Pensions), it has established an Advisory Task Force on the OECD Codes (ATFC), which is open to all G20 and FSB members to examine issues under the Code, including its review (Box 2).

<table>
<thead>
<tr>
<th>Box 2. The Advisory Task Force on the OECD Codes (ATFC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The ATFC is composed of governmental experts from Adhering countries, non-adhering G20 and FSB members, other non-OECD economies, as well as experts from relevant international organisations such as the IMF and the BIS.</td>
</tr>
<tr>
<td><strong>Agenda items considered recently by the ATFC include:</strong></td>
</tr>
<tr>
<td>- Adherents’ invocation of the Code’s derogation clauses for new restrictions (e.g. Greece, Iceland).</td>
</tr>
<tr>
<td>- Implications of certain measures such as limitations on banks’ foreign exchange derivatives positions for Adherents’ reservations under the Code of Liberalisation of Capital Movements.</td>
</tr>
<tr>
<td>- National applications by currency of Basel III Liquidity Coverage and Net Stable Funding Ratios as alternatives to CFMs falling under the Code (e.g. Iceland).</td>
</tr>
<tr>
<td>- Presentations by G20 members that have not adhered to the Code on their plans regarding capital flows liberalisation and management (e.g. China, South Africa, and Indonesia).</td>
</tr>
<tr>
<td>- Discussions on recent changes in regulatory requirements for establishment of foreign banks (e.g. US new Federal Reserve Rule and UK’s new requirements for branches of foreign banks).</td>
</tr>
<tr>
<td>- Discussions around the ongoing review of the Code of Liberalisation of Capital Movements.</td>
</tr>
<tr>
<td>- New work on trends in the use of currency-based measures, including CFMs.</td>
</tr>
</tbody>
</table>

1.3 Agreement adapted to different levels of development

11. A country wishing to adhere to the Code is reviewed and its measures assessed on their merits in addressing legitimate policy goals and in light of the specific circumstances of the country, including its level of economic and financial development and taking into account the provisions of the Code (Box 3).

12. Countries can pursue liberalisation progressively over time, in line with their level of economic development. Emerging economies such as Chile, Korea and Mexico have adhered to the Code. Other countries, specifically Spain until 1962, Greece until 1977, and Turkey until 1986, availed themselves of a special dispensation from their obligations under the Code for countries in the process of development while still enjoying the same rights as other adhering countries.
1.4 Inclusive governance of the Code

13. Article 20 of the Code, as amended in 2012, states that “in this Code: “Member” shall mean a country which adheres to this Code...”. This means that non-OECD countries can adhere to the Code with equal rights and responsibilities as OECD countries.

14. Should the existing text of the Code need to be amended, the amendment decision would need to be agreed both in the Enlarged Investment Committee (i.e. including Code's Adherents that are non OECD countries), which governs discussions and implementations of decisions around the Code, and in Council, the OECD decision-making body. This “double consensus rule” also applies to the decision to invite an additional country to adhere to the Code.

15. Accordingly, no decision regarding the Code can be made without the consent of all Adherents, including those which are not members of the OECD.

2. BENEFITS OF THE CODE AND ITS CONTRIBUTIONS OVER TIME

16. An open and transparent international system of orderly capital flows can underpin global growth and stability. In light of the increasingly interconnected global financial and economic system, as well as heightened capital flow volatility. Significant value is attached to credible commitment mechanisms that signal to economic partners that investment channels will remain open. This, in turn, can help countries to continue to attract the long-term, high-quality capital needed to support inclusive growth and sustainable development. Since the Global Financial Crisis, worries about financial stability have tended to bring about some protectionist measures. OECD research on economic resilience suggests that greater capital account openness is associated with overall faster growth, as the positive pro-growth effects outweigh the possible negative impact on financial stability. Capital flow restrictions are second best solutions to be used when alternative policy remedies appear ineffective to address stability concerns. Resilience is best achieved through sound macroeconomic policies and structural policies, including reducing the tax bias towards corporate debt and lowering barriers to FDI.

2.1 Serving the collective interest

17. Article 2(d) of the Code enjoined members to “pursue their efforts to reduce or abolish obstacles to the exchange of goods and services and current payments and to maintain and extend the liberalisation of capital movements”. In this spirit, the Code was designed to reflect members’ search for a balanced and orderly process where liberalisation could be pursued in a safe manner, taking into account individual countries’ specific needs and preferred pace of liberalisation.
18. Over time the Code has contributed to:

- entrenching the capital account opening process as undertakings by Adherents;
- pushing the opening process forward and consolidate it on a broad multilateral and non-discriminatory basis;
- guiding sequencing of liberalisation, thanks to the structure and tenets of the Code’s obligations;
- providing a benchmark for regulation in this area, which has then served a reference for other treaties such as the Treaty on the Functioning of the European Union, whose provisions on capital movements have been inspired by the Code;
- providing a forum for discussion and exchange of information on country measures;
- establishing a peer-review mechanism in the context of a multilateral agreement, which has provided incentives for policy makers to undertake reforms and policy adjustments.

2.2 Individual benefits

19. In addition to these collective benefits of the Code, the Code brings additional benefits to individual Adherents (Box 4).

<table>
<thead>
<tr>
<th>Box 4. The Code brings significant benefits to individual Adherents</th>
</tr>
</thead>
<tbody>
<tr>
<td>The country receives support by its peers for its actions and clear recognition as a responsible international player.</td>
</tr>
<tr>
<td>The peers owe the country transparency in their measures.</td>
</tr>
<tr>
<td>The country sends reassuring signals to the market at times of turbulence.</td>
</tr>
<tr>
<td>A country enjoys the liberalisation measures of others regardless of its own degree of openness.</td>
</tr>
<tr>
<td>The country is protected against discrimination and other unfair treatment by their peers.</td>
</tr>
<tr>
<td>The country shapes the jurisprudence and evolving rules under the Code.</td>
</tr>
</tbody>
</table>

3. FLEXIBLE FRAMEWORK FOR COPING WITH CAPITAL FLOW VOLATILITY

3.1 Robust standard

20. Under Article 1, members (Adherents to the Code) “shall progressively abolish between one another, in accordance with the provisions of Article 2, restrictions on movements of capital to the extent necessary for effective economic co-operation. Measures designed to eliminate such restrictions are hereinafter called measures of liberalisation”. 
21. **Article 2** establishes that: “Members shall grant any authorisation required for the conclusion or execution of transactions and for transfers specified in an item set out in List A or List B of Annex A to this Code” (Box 6). In the context of the 1992 review of the Code which expanded the scope of the obligations substantially, members agreed that “equivalent measures”, or those techniques that raise the effective cost of an operation without preventing it, were to be covered. Members also agreed that the (Investment) Committee would be responsible for making the determination of whether a specific measure is to be considered an “equivalent measures” and thus deemed to be a restriction.

22. **The Code does not cover operations among residents.** A key test is non-discrimination in the treatment of non-residents relative to the treatment afforded to residents.

### 3.2 Safeguards and policy space

23. **Capital flows are an integral component of international finance.** They allow for savings to be channelled from surplus countries to deficit countries, where returns to investment are typically higher. However, these flows can also pose important challenges to open economies. The Code contains flexibility mechanisms to cope with situations of economic and financial instability:

- Reservations and derogation allow countries to limit the scope of their liberalisation obligations and so maintain restrictions on operations which they are not in a position to liberalise at the time of adherence to the Code or they need to reintroduce after adherence.
- Certain operations are not covered in the liberalisation lists A and B of the Code such as financial credits and loans by non-residents to residents other than enterprises.
- Furthermore, Adherents have agreed to exclude certain types of measures from the scope of their Code obligations. Such understandings are formalised as decisions of the Enlarged Investment Committee. For example, Adherents have agreed that rules on the net foreign exchange positions of banks are exempted from Code obligations.
- Other ways in which the Code’s provisions protect countries’ policy space are discussed in Box 5.

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**Box 5. The protection of countries’ policy space**

In addition to the Code’s provisions allowing for the reintroduction of restrictions on capital flows on operations under List B, the protection of countries’ policy space in a range of other aspects is granted, for example, by:

- **Article 3:** contains safeguard provisions relating in particular to public order and essential security interests deemed to address exceptional situations.
- **Article 5:** affirms Adherents’ rights to prevent fraud connected to transactions and transfers, to act against evasion of their laws and regulations.
- Liberalisation obligations under the liberalisation lists provide scope for prudential measures, for example for operations in securities (items IV, V, VI and VII of the Code). Adherents “may require that transactions and transfers be carried out through authorised resident agents”; and that “residents may hold funds only through the intermediary of such agents”; and that members may “take measures for the protection of investors, including the regulation of promotional activities”.
- Regarding financial credits and loans, “Members may regulate the net external positions of domestic financial institutions dealing in foreign exchange”.
- According to understandings reached among Adherents, Adherents “would be free to regulate for prudential purposes the foreign exchange exposure of certain key institutions, such as banks, pension funds and life assurance companies”.

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At present, putting aside reservations to reflect restrictions on FDI and portfolio investment abroad by pension funds and insurance companies which many Adherents have, four Adherents maintain reservations for some forms of CFMs, another is in the process of lodging a reservation, and two Adherents are under the derogation regime.

In the event of recourse to new restrictions on capital movements, countries have agreed under the Code to well-tested guiding principles such as transparency, non-discrimination, proportionality and accountability: Capital flow restrictions are measures that could best be considered when alternative policy responses are insufficient to effectively achieve the objective pursued.

- Their implementation needs to be transparent. Measures should be subject to accountability, including open for international discussion.
- Measures should not discriminate among investors from different countries, and avoid unnecessary damage, especially when they have a bearing on the interests of another country.
- The severity of restrictions should be proportional to the problem at hand, with measures disrupting business as little as possible and in particular minimising adverse impacts on operations such as FDI and commercial credits.
- Restrictions and corresponding reservations may be maintained for as long as needed, but should be removed once non-restrictive means become available to address legitimate policy concerns.
- Countries should be mindful of their rights and obligations under international agreements, including IMF’s Articles of Agreement.

### 3.3 Code’s reservation system

Article 2 of the Code protects the right of Adherents to reintroduce and maintain measures which limit liberalisation obligations. The way to do so is to lodge reservations with respect to operations on List A, which they are not in the position to liberalise, at the time of adherence, when obligations are added or expanded, and at any time when needed for List B operations.

By lodging reservations, adherents can maintain measures in force while still placing them under the disciplines of the Code’s provisions, both procedural (transparency and peer review) and substantive (granting of equal treatment to all adherent countries and commitment to standstill).

Reservations are to be reviewed with an aim of “making suitable proposal designed to assist Members to withdraw their reservations”. Restrictions and corresponding reservations may be maintained for as long as needed, but are expected to be removed once non-restrictive means become available to address legitimate policy concerns.

Restrictions on most short-term capital operations fall under Liberalisation List B (Box 6) and can be introduced at any time, even if no reservation had been initially lodged (the usual “standstill” rule does not apply). Restrictions can be re-imposed on other operations (List A) by invoking the Code’s “derogation” clauses.
### Box 6. Operations covered by liberalisation lists A and B of the Code

<table>
<thead>
<tr>
<th>LIST A</th>
<th>LIST B</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Standstill&quot; applies to these operations (i.e. derogation needed to reintroduce restrictions)</td>
<td>No &quot;standstill&quot; applies to these operations</td>
</tr>
<tr>
<td><strong>I. Direct investment</strong></td>
<td><strong>VIII. Credits directly linked with international commercial transactions or rendering of international services</strong></td>
</tr>
<tr>
<td><strong>II. Liquidation of direct investment</strong></td>
<td>In cases where a resident participates in the underlying commercial or service transaction</td>
</tr>
<tr>
<td><strong>III. Real estate – Sale</strong></td>
<td>In cases where no resident participates in the underlying commercial or service transaction</td>
</tr>
<tr>
<td><strong>IV. Operations in securities on capital markets</strong></td>
<td><strong>IX. Financial credits and loans</strong></td>
</tr>
<tr>
<td><strong>VII. Collective investment securities</strong></td>
<td><strong>X. Sureties, guarantees and financial back-up facilities</strong> (see List B)</td>
</tr>
<tr>
<td><strong>VIII. Credits directly linked with international commercial transactions or rendering of international services</strong></td>
<td><strong>X. Financial back-up facilities</strong> in cases not directly related to international trade, international current invisible operations or international capital movement operations, or where no resident participates in the underlying international operation concerned</td>
</tr>
<tr>
<td><strong>IX. Financial credits and loans</strong></td>
<td><strong>XI. Operation of deposit accounts</strong> by non-residents of accounts with resident institutions</td>
</tr>
<tr>
<td><strong>X. Sureties, guarantees and financial back-up facilities</strong></td>
<td><strong>XI. Operation of deposit accounts</strong> by residents of accounts with non-resident institutions</td>
</tr>
<tr>
<td><strong>X. Financial back-up facilities</strong> in cases not directly related to international trade, international current invisible operations or international capital movement operations, or where no resident participates in the underlying international operation concerned</td>
<td><strong>XII. Operations in foreign exchange</strong></td>
</tr>
<tr>
<td><strong>XII. Operations in foreign exchange</strong></td>
<td><strong>XIII. Life assurance</strong></td>
</tr>
<tr>
<td><strong>XIII. Life assurance</strong></td>
<td><strong>XIV. Personal capital movements</strong> Except Gaming</td>
</tr>
<tr>
<td><strong>XIV. Personal capital movements</strong> Gaming</td>
<td><strong>XV. Physical movement of capital assets</strong></td>
</tr>
<tr>
<td><strong>XV. Physical movement of capital assets</strong></td>
<td><strong>XVI. Disposal of non-resident-owned blocked funds</strong></td>
</tr>
</tbody>
</table>
3.4 Derogation of Code’s obligations

30. For measures with a bearing on List A operations, for which standstill applies, restrictions can be imposed by invoking the Code’s derogation clause under Article 7, which is allowed:

- if an Adherent’s "economic and financial situation justifies such a course", as per Article 7(a); or
- in case of “serious economic and financial disturbance”, as per Article 7(b); or
- if the “overall balance of payments of a Member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious”, as per Article 7(c).

31. Over the last 5 years, two Adherents have invoked Article 7 (b).

32. The invocation of derogation for balance of payments (Article 7(c)) and for economic and financial disturbance (Article 7(b)) is well tested for cases of temporary departures from standstill obligations, and there is precedent for long-lasting derogations justified under the “economic and financial situation” clause (Article 7(a)) for countries in process of development (a case by case assessment approach applies). However, the use of Article 7 to introduce preventive measures to deal with capital inflow surges that might threaten stability or to cover a measure introduced for an indeterminate time period and intended as a permanent feature of the financial regulatory regime, are not tested practices that are supported by precedent.

4. MACROPRUDENTIAL MEASURES

33. Commonly used macro-prudential measures (MPMs) typically fall outside the scope of the Code, even if they may have an incidence on capital flows. For a measure to have a bearing on the Code’s obligations, it does not suffice that it have an impact on capital flows or capital mobility; measures which do not target the specific operations covered by the Code – by either prohibiting such operations or creating disincentives for their conclusion - fall outside of the scope of the agreement. On-going discussions in the context of the review of the Code are clarifying that national adaptations of liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements differentiating by currency are not considered capital flow restrictions.

34. The Code does not cover operations among residents and does not provide for better treatment of operations in the country with non-residents than operations among residents. Thus a measure targeting such operations, e.g. a prohibition for established banks to lend in foreign currency to residents, falls outside the scope of the Code. Such internal measures can have an impact on capital flows but have no bearing on Code obligations. In contrast, the IMF’s approach may cover such measures, as they may be tools used to manage capital flows. This is an example of the distinct and complementary approaches of the IMF and OECD, pursuant to their respective mandates.

35. The issue of circumvention of restrictions on foreign exchange lending arises only insofar as residents’ operations abroad are concerned because adherents are expected to allow their residents to transact freely with non-residents in any operations abroad including in foreign exchange, if such operations are free in the country where the operation takes place. An example of such operations is the issue of securities by residents on foreign

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1 These clauses have been used 30 times since 1961.

2 Except to the extent that such internal measures can be shown to frustrate liberalisation commitments, see section 2.2.
organised capital markets. “Voluntary reciprocity”, a European Systemic Risk Board concept, is an avenue to address circumvention and leakages which falls outside of the Code. More generally, international agreements on reciprocal banking regulations, including Basel III jurisdictional reciprocity for the Countercyclical Capital Buffer, have no bearing on rights and obligations under the Code.

36. Some MPMs, including in particular some which are CFMs, would be considered conforming measures from the viewpoint of the Code. These are measures which limit, create impediments or disincentives for the conclusion of a listed operation but that are not covered by liberalisation obligations under lists A and B. These measures are conforming due to carve-outs in text of the Code, or as a result of explicit understandings reached among Adherents, notably measures commonly used by Adherents to address prudential issues. An example of such a carve-out in the text of the Code is the exclusion of financial credits and loans provided by non-residents to residents other than enterprises from the list of operations covered by the Code’s liberalisation obligations. Rules on the net foreign exchange position of banks as well as currency matching requirements for non-bank financial institutions are also not considered capital flow restrictions. Annex II provides an illustration of macroprudential measures that are most commonly used and are not typically under the Code.

37. Finally, some CFMs do fall into the category of restrictive measures that impede or create disincentives for the conclusion of operations covered by liberalisation lists A or B. Such measures may be maintained by members that have limited the scope of their commitments under the agreement by lodging reservations or by invoking derogations. An Adherent may still be in conformity with the Code, provided that the Adherent in question respects the procedural requirements.

38. In sum, commonly used MPMs fall outside the scope of obligations, while many CFMs that are MPMs are conforming measures. Even for those which are not, Adherents which maintain measures constituting restrictions can avail themselves of the reservation and derogation facilities. While reservations and derogations cannot be made with respect to the basic principles of the Code, as set out in its Articles, this is unlikely to impose any constraint on the introduction of prudential regulations.

39. Furthermore, there is scope for narrowing the scope of the Code to accommodate the need to regulate: this has been done through carve-outs in the text of the Code, or by limiting the scope of further understandings among Adherents that are formalised in decisions of the Enlarged Investment Committee. This practice has been used for internationally agreed regulatory standards and provides a mechanism to avoid creating conflicting requirements for countries that have obligations under the Code and are also committed to internationally agreed minimum standards for financial regulation.

3 “Voluntary reciprocity” suggests that a country can decide to apply the same macroprudential measure set by another country to its own institutions, thereby also bringing branches of foreign financial service providers and foreign financial service providers providing cross-border financial services directly within the scope of national macroprudential measures.

4 For example, a measure is non-conforming under the Code if it violates the MFN principle under Article 9 of the Code; this discipline of the Code is unlikely to be an impediment to the implementation of needed financial regulations. The obligation under Art 2(d) to allow loans between residents of two adhering countries to be “expressed or guaranteed” in the currency of either country, where such loans are allowed, can be seen to be in the nature of a commitment to avoid conflicting requirements that would frustrate a liberalisation measures, rather than a commitment to liberalisation in itself.
5. **CONSISTENCY WITH OTHER INTERNATIONAL OBLIGATIONS, G20 AND IMF APPROACHES**

40. The EU Treaty provisions have much in common with the Code but the membership is regional. They require free capital movements among EU countries and between EU countries and third countries. Many investment chapters of regional free trade agreements (FTAs) and bilateral investment treaties (BITs) use a broad definition of inward international investment. However, unlike the Code, they do not cover capital outflows by residents. In addition, while the Code provides for liberalisation of entry of new investments, most BITs protect only existing investments. The GATS includes some elements of capital movement liberalisation, but only insofar as a capital movement is needed for the effective delivery of a service. If, for instance, a foreign services provider wants to deliver a service by means of a commercial presence in a country, it should have the ability to move capital to establish a subsidiary or a branch in this country. But, unlike the OECD Code, the General Agreement on Trades in Services (GATS) is not a code of conduct for capital movements.

41. The Code has been designed to ensure consistency with other international obligations of adhering countries, including the IMF’s Articles of Agreement. The IMF’s Articles do not impose an obligation on member countries to liberalise their capital account policies, while recognizing that members have the right (albeit not unlimited) to “exercise such controls as are necessary to regulate international capital movements.” The IMF’s institutional view on the liberalisation and management of capital flows does not alter members’ rights and obligations under the Articles or under other international agreements. The IMF has explained that rather, the IMF would take into account the institutional view in its policy advice and where relevant, in assessing members’ capital account policies, particularly in its surveillance, and that the institutional view also serves to facilitate consistency and evenhandedness in IMF staff advice on the appropriateness of such policies, taking into account country circumstances and macroeconomic and financial stability considerations.

42. The Code and the IMF’s Institutional View do not create conflicting requirements. Rather, as stated in the joint note of February 2016 by the IMF and the OECD to the G20 International Financial Architecture Working Group,5 “both [IMF and OECD] approaches assist countries in ensuring that measures are not more restrictive or maintained longer than necessary. The economic usefulness of maintaining CFMs over the longer term for managing systemic financial risks needs to be evaluated against their costs on an ongoing basis, and due consideration given to alternative ways that may be available to address the prudential concern that are not designed to limit capital flows. While the appropriateness of CFMs including those used with a macro-prudential intent depends on specific country circumstances that vary over time, features of CFMs recommended by the two institutions include: no substitute for warranted macroeconomic adjustment, transparency and temporary use of the measure, its proportionality relative to the objective pursued, and no discrimination between residents and non-residents to the extent possible and among countries in its application, being mindful of the rights and obligations of the country under international agreements it may have entered into, including the IMF’s Articles of Agreement and the OECD Code”.

43. The Code echoes and supports implementation of the G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences (2011) that calls for CFMs to be “transparent, properly communicated, and be targeted to specific risks identified” and includes CFMs among the category of policies that

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5 See Co-operation on approaches to macro-prudential and capital flow management measures: Update by the IMF and the OECD, *IMF/OECD update to G20, 16 February 2016*
“should be the object of regular, credible and even-handed multilateral surveillance to assess both their individual impact and aggregate spillover effects.”

6. ONGOING REVIEW OF THE CODE

44. Important momentum has built up for a review of the Code to verify and ensure its continued relevance. The current policy environment around capital flows has moved multilateral co-operation, openness and transparency to the top of the policy agenda. The global financial and economic crisis of 2008 left the international monetary system with vulnerabilities caused by volatile capital flows and the spill-over effects from diverging national policies. Three European Economic Area (EEA) countries returned to traditional capital controls that restrict operations on the basis of residency. In parallel, OECD data suggest that CFMs that take the new form of Currency-Based Measures (CBMs) applied to banks’ operations with non-residents have become more prevalent, including among OECD countries. Signs of a reversal in the trend towards greater financial openness following the 2008 crisis are visible from an increase in saving-investment correlations in OECD and BRICS countries; while this reversal may reflect cyclical factors and subsequent retrenchment of banks’ international operations, the increased recourse to these measures also plays a role.

45. At the same time, the bulwark against restrictive tendencies for the most part held up during the crisis in the vast majority of OECD countries. What is more, major non-OECD emerging economies, in particular the world’s second largest economy China, are progressively opening up their capital accounts as a long term objective in order to fully participate in the global economy. India has been reported to be looking at allowing fuller current account convertibility in years to come, while South Africa is pursuing efforts to modernise its foreign exchange regime. In Latin America, Colombia, Costa Rica and Peru are following the path of their OECD neighbours (Chile and Mexico), and have made credible commitments to progressive liberalisation, having applied for adherence to the Code.

46. Currency convertibility, among other factors, is an important contributor to efficient allocation of global resources and growth. A deepening of global foreign exchange liquidity engineered by a broad openness agenda will reduce the perceived need for CFMs as macro-prudential policies that guard against key currency mismatches in crisis situations. Permanent capital flow restrictions can work in the opposite direction to improved global liquidity.

47. Recent experience with use of CFMs has prompted renewed debate on their effectiveness to address financial sector vulnerabilities and their implications for longer-term prosperity. Persevering with open capital accounts mindful of the necessary safeguards against vulnerabilities stemming from large and volatile financial flows is called for, underpinned by a clear benchmark. The Code review process provides a timely and important

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6 See also OECD’s approach to capital flow management measures used with a macro-prudential intent, Report to G20 Finance Ministers, April 2015.

7 CBMs directed at banks are defined as regulations on banks’ operations discriminating on the basis of the currency of an operation—in other words, measures that apply a less favourable treatment to operations by banks in a particular currency, typically foreign currencies. CBMs encompass a broad category of measures: regulations imposing a different treatment between domestic and FX-denominated operations by banks. CBMs may be addressed at operations amongst residents, or at operations also with non-residents. Within this latter broad category, CBMs may have the character of capital flow restrictions as they extend to operations abroad with non-residents. Also, among currency-based CFMs, those measures that apply to operations with non-residents only are traditionally defined as capital controls.


9 Econometric evidence on the growth benefits of capital flow restrictions, or the impact of currency-based CFMs, on decoupling the economy from global credit cycles is mixed or remains subject to different interpretations, with results being sensitive to updates in data, expansion in country samples, or model specifications. See OECD staff research papers at: www.oecd.org/investment/codes
opportunity to advance consensus on the desirable features of a multilateral regime for cross-border capital movements.

48. On 17 March 2016, Adherents adopted terms of reference for the update of the Code. The purpose of the review is to strengthen the Code and to ensure its continued relevance. The review of the Code will also improve clarity and predictability in the implementation of the instrument, as well as the transparency of specific measures introduced by Adherents. Ultimately, the work on the review will be a contribution to shaping the desirable features of the open, transparent and resilient economy which we want.

49. Key areas of on-going consideration among participants in the review include:

   a. Reaffirming the broad scope of the Code. This includes considerations of the extent to which levels of reserve requirements, which are higher when applied to operations with non-residents may amount to restrictions to capital movements in the meaning of the Code. On innovative financial instruments that have been generated by markets since the last review of the Code in 1992, there is an inclination to agree that the list of the Code operations is comprehensive enough to include them.

   b. Developing understandings on the treatment of measures with stated prudential objectives. The vast majority of macro-prudential measures fall outside the scope of the Code. Preliminary discussions suggest that national adaptations of liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements differentiating by currency should not be considered as capital flow restrictions. That is already the case for the regulation of net external positions of banks and currency matching requirements for non-bank financial institutions.

   c. Considering the merits of rebalancing the list of operations subject to standstill (i.e. derogation is needed to introduce new restrictions) and the list of operations that is not subject to standstill (i.e. new reservations can be lodged to reflect new restrictions). The Terms of Reference for the review have noted non-residents’ deposit accounts with domestic financial institutions as a possible candidate to be moved from the former to the latter category.

   d. Considering ways of strengthening in practice the governance and improving the decision-making process. Serious consideration is being given to formalising in the Code’s procedural articles the possibility to elicit inputs from relevant International Organisations to assist adherents in their deliberations on invocations of derogations, other reserved measures under review, on generic emerging issues, and informing their decisions.

50. The first two issues were reviewed in the October meeting 2016. In April 2017, work will continue on these two issues.
ANNEX I. ADHERENCE TO THE CODE: WHAT IS THE PROCESS?

Core principles of adherence are:

- **Non-discrimination**: Grant the benefit of their liberalisation measures to all other adherents and apply remaining restrictions in a non-discriminatory (MFN) fashion.
- **Transparency**: Report up-to-date information on barriers to capital movements which might affect the Code's obligations and the interests of other adherents.
- **Standstill**: Avoid taking new restrictive measures or introducing more restrictive measures except in accordance with the Code's derogation provisions and other safeguards, or with established understandings regarding their application.

Prospective adherents are expected to:

- Avoid the lodging of 'precautionary' reservations under the Code (reservations reflect existing operative restrictions);
- Maintain an open and transparent regime for FDI;
- Liberalise other long-term capital movements, including equity investment and debt instruments of maturity of one year or more;
- Indicate a non-binding timetable or expected conditions for relaxing remaining controls on short-term capital movements;
- Avoid restriction on payments or transfers in connection with international current account transactions; comply with IMF Article VIII requirements.

**Adherence procedure:**

- **Interest**
  - The interested country writes to the OECD Secretary General explaining the motivation for its interest.
  - Upon recommendation by the Enlarged Investment Committee (i.e. including non-member adherents), the country may be invited to undertake a comprehensive review of its proposed position under the Code.

- **Review**
  - The Secretariat prepares a report on the country's position, based on information provided by the applicant country and through staff missions.
  - The Enlarged Investment Committee examines the applicant's position under the Code, taking into account the circumstance of the applicant, including its level of economic and financial development.
  - The review process may take 12-18 months or longer if legislative changes are required. The country concerned is responsible for financing the review process.

- **Invitation**
  - An invitation to adhere to the Code is made on the basis of the Enlarged Investment Committee assessment of the applicant country's position and by a concurrent decision of both the Enlarged Investment Committee and the OECD Council.

- **Adherence**
  - The adherence process concludes with an exchange of letters between the Secretary General and the country's government setting out the rights and obligations of the country as an adherent to the Code, including its list of agreed reservations.
### ANNEX II. EXAMPLES OF MACROPRUDENTIAL MEASURES THAT DO NOT FALL UNDER THE CODE

<table>
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<th>Financial system component</th>
<th>Bank or deposit-taker</th>
<th>Lending contract</th>
<th>Non-bank investor</th>
<th>Securities market</th>
<th>Financial infrastructure</th>
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<td>Balance sheet</td>
<td>Lending contract</td>
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<tr>
<td>Leverage</td>
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<td>Liquidity or market risk</td>
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<td>Interconnectedness</td>
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- **Vulnerability**: Leverage
- **Bank or deposit-taker**: Balance sheet, Lending contract
- **Non-bank investor**: LTC cap, Debt service / income cap, Maturity cap
- **Securities market**: Margin / Haircut limit
- **Financial infrastructure**: Margin / Haircut limit

- **Leverage**: Capital ratio, Risk weights, Provisioning, Profit distribution restrictions, Credit growth cap
- **Liquidity or market risk**: Liquidity / reserve requirements, FX lending restriction, Currency mismatch limit, Open FX position limit
- **Interconnectedness**: Concentration limits, Systemic capital surcharge, Subsidiarisation

**OECD Note**: On FX lending restrictions, see Section 4 of the present report

ANNEX III. RULES CONCERNING CURRENCY OPERATIONS

Under Article 2 “[W]henever existing regulation or international agreements permit loans between different Members [...] the repayment obligation may be expressed or guaranteed in the currency of either of the two Members concerned”.

Furthermore, under item XII of Liberalisation List B, members —subject to reservation (see section 3.1) which they may have lodged— commit to permit their residents to freely buy and sell domestic currency for foreign currency and to exchange currencies, by means of spot or derivative transaction, when the operation takes place abroad.

The 1992 review of the Code’s obligations led to enlarged obligations on use of foreign currency in denomination and settlement. At that time, members agreed on the following, as reported in Council document C(92)4:

“(3. Use of foreign currency in denomination and settlement)

One of the innovations of the Revised Code is to provide that all the operations are to be liberalised regardless of the currency in which they are denominated or settled. This includes currency composite units of account such as the ECU and the SDR.

In the sense of the Codes, the Committee took this to imply that non-residents in dealing with residents on the territory of residents should have access to the same facilities and can use the same foreign currencies that residents are permitted to use for domestic operations.

Similarly, residents should be permitted to use, in respect of operations abroad in another OECD Member country, any currency that may be used in the Member country concerned for the transactions in question.

Where operations have no natural domestic counterpart (e.g. Sections VIII to XII of the Revised Code), Members should be able to use any foreign currency for the denomination or settlement of those operations”.

As mentioned above, internal arrangements do not normally have a bearing on Code’s obligations. Such internal arrangements include for example domestic regulations concerning only residents or local licensing requirements applying to residents and non-residents in a non-discriminatory manner.

However, under Article 16 “If a Member considers that the measures of liberalisation taken or maintained by another Member, in accordance with Article 2(a), are frustrated by internal arrangements likely to restrict the possibility of effecting transactions or transfers, and if it considers itself prejudiced by such arrangements, for instance because of their discriminatory effect, it may refer to the Organisation”.

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