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Terms of reference of the review of the OECD Code of Liberalisation of Capital Movements

Report by the Investment Committee

This report has been adopted by the Investment Committee on 17 March 2016 and is now declassified.

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TERMS OF REFERENCE OF THE REVIEW OF THE OECD CODE OF LIBERALISATION OF CAPITAL MOVEMENTS

I. Introduction

1. At its meeting in June 2015, the Investment Committee considered a note prepared by the Secretariat on a possible review¹ of the Code of Liberalisation of Capital Movement [[DAF/INV\(2015\)11](#)], also circulated to Advisory Task Force on the Codes (ATFC) [[DAF/INV/CMF/AS/ATFC\(2015\)3](#)], and requested from the ATFC its expert opinion on a possible review of the OECD Code, the issues that should be addressed in a review, and a proposal for future work without prejudicing the outcome of any such review [[DAF/INV/M\(2015\)4](#)]. The ATFC considered the revised note [[DAF/INV/CMF/AS/ATFC\(2015\)3/REV1](#)] at its October 2015 meeting and provided comments. Further inputs on this note were received during the oral update provided to the Investment Committee at its December 2015 meeting. The report has been revised in light of these comments and additional comments provided by ATFC delegates [[DAF/INV/CMF/AS/ATFC\(2015\)3/REV2](#), [DAF/INV/CMF/AS/ATFC\(2015\)3/REV3](#), [DAF/INV/CMF/AS/ATFC\(2015\)3/REV4](#)]. It has been adopted by ATFC delegates on 14 March 2016 [[DAF/INV/CMF/AS/ATFC\(2015\)3/REV4/FINAL](#)], for its transmission to the Investment Committee. The Investment Committee adopted it at its meeting on 17 March 2016.

2. This note is structured as follows: first, it summarises the terms of reference, setting out the key guiding principles for work on the review as well as the four main areas of work; second, it presents proposals for the implementation plan.

II. Terms of Reference

1. Key guiding principles for work on the review of the Code

3. *Key guiding principles* for the review of the Code have been identified:

a) A review should strengthen the Code

4. The objective of the review is to strengthen the instrument, in particular by making it more relevant. An agreement which emerged from the discussions at the ATFC and the Investment Committee is that the Code's obligations should not be diluted.

b) The outcome of the review process is not to be pre-judged

5. Conducting this review does not pre-judge the outcome of whether to revise the Code or the User's Guide. The discussions around the review of the Code should not be held with a pre-judged outcome in mind. These debates are to be held with an open mind to the global capital flow management challenges, the problems that Adherents and other countries face in the post-crisis macroeconomic environment, and the necessity to have a gradual, coordinated and deliberate approach to progressive liberalisation.

¹ In the context of this document the term "review" is used to mean the process, where issues for discussion are being considered, and the term "revision" is used to mean the outcome, or the confirmation or alteration of understandings as embedded in the User's Guide of the text of the Code, if needed and agreed.

c) Current obligations will continue to apply

6. During this review process, current obligations continue to apply, until agreement is reached among all Adherents on any modification to their Code's obligations, including any new understandings and agreements on their implementation or interpretation.

d) If there are new understandings, they will not give rise to standstill issues

7. If the review process leads to new understandings on the scope and application of the Code, it would not give rise to any standstill issues, as Adherents are entitled to lodge reservations when new or clarified obligations begin to apply.

e) The review, if possible, should not entail a revision of the text of the Code; the review should focus on a review of the User's Guide, where possible²

8. The review, if possible, should not entail a revision of the text of the Code. The review should focus on the User's Guide, which is the Investment Committee's interpretative text of the Code's obligations, prior to considering the necessity of revising the text of the instrument.

2. Key areas of work on the review of the Code

9. The starting point of the discussion on some areas of a potential review was the Investment Committee Bureau's retreat in December 2014, where Bureau delegates considered that a review should (i) reaffirm the role of the Code as an anchor for countries' policies in times of stress, (ii) clarify the treatment of measures taken in the name of "macro-prudential" objectives, (iii) adapt to current requirements for capital flow management, in particular of recipient countries, and (iv) improve governance and strengthen implementation. The discussion by ATFC delegates on 21 October 2015 and further comments made during the meeting of the Investment Committee on 8 December 2015 centred on these areas.

10. Consensus has emerged around the need to provide some *key guiding principles* of such a review, and around *key areas of work*, which will be part of the Terms of Reference for the review.

11. *Key areas of work* to be reflected in the Terms of Reference are:

- Reaffirming the broad scope of the Code by clarifying the treatment of measures equivalent to restrictions and reviewing the treatment of financial innovations;
- Developing understandings on the treatment of measures with stated prudential objectives, including, in particular, new understandings on national adaptations of Basel III type measures differentiating by currency, which should be proportionate to the risks such measures are intended to;
- Considering the merits of rebalancing lists A (standstill) and B (not covered by standstill);

² The substantive issues to be discussed during the review and those that are outlined in the Terms of Reference relate to the areas covered in the Code of Liberalisation of Capital Movement. The issue of governance of the instrument is the one that impacts both the Code of Liberalisation of Capital Movements and the Code of Liberalisation of Current Invisible Operations; however it is an issue of process rather than content and will be treated separately. Hence the text of the Terms of Reference throughout refers to the Code of Liberalisation of Capital Movements.

- Considering ways of strengthening in practice the governance and improving the decision-making process.

12. The main focus of the review is not on FDI policies that may have raised issues in relation to bilateral and regional arrangements. In this context, the review will largely concern itself with capital flow management issues. However, issues around article 9 (non-discrimination, preferential treatment) could be part of the review, if Members agree to address them.

a) *Reaffirm the broad scope of the Code*

13. Work should reaffirm the broad scope of the Code by reviewing (i) whether clarifications are needed regarding the treatment of measures equivalent to restrictions, and (ii) the treatment of new financial instruments.

14. The assessment of a specific country measure is guided by its bearing on the obligations set out in the Code's Articles and in the Code's liberalisation lists. Specifically, measures are to be assessed on the basis of Adherents' obligations under the Code, notably the obligation under Article 2 of the Code "*to grant any authorisation required for the conclusion or execution of transactions and for transfers set out in liberalisation lists A and B*".

15. In the context of the 1992 revision of the Codes which expanded the scope of the obligations substantially, Adherents agreed that "equivalent measures" were to be covered. At that time, Adherents "*observed that international capital movements may be affected not only by exchange controls or other explicit restrictions affecting the authorisation of capital transactions or transfers, but also by a range of other measures that might be regarded as having equivalent effects. These measures do not prevent operations entirely, but act as disincentives by raising their costs*" (see [C(89) add1]).

16. The OECD Council agreed in 1992 that the Committee responsible for the Codes will decide on what qualifies as such measures on a case by case basis, having provided definitions of certain measures, such as compulsory deposit requirements and interest rate penalties, which are automatically to be considered as "equivalent measures". It also provided a list of measures that should not automatically be considered to be restrictions, such as minimum reserve requirements established by central banks [C(92)4].³

17. The ATFC and the Investment Committee have looked at a number of recent measures introduced by Adherents, which can be considered "equivalent measures".

18. The assessment of country-specific cases has highlighted the need for clearer guidance on which measures are assessed to be "measures equivalent to restrictions". In this regards, specific criteria going beyond the guidance that is currently provided could help inform future assessment of specific measures.

19. This would help ensure equal treatment in like situations among Adherents and greater certainty on the scope of commitments under the instrument. Such work would also serve to reaffirm the broad scope of commitments already made in the 1992 revision of the Codes.

³ In particular, "*the Committee agreed that "equivalent measures" in the form of compulsory deposit requirements and interest rate penalties, would automatically be regarded as restrictions under the Code while minimum reserve requirements imposed on financial institutions by central banks would not. Queuing arrangements for securities issues would be considered restrictions if they disadvantaged non-residents compared to residents (other than the government). Other non-tax measures would be considered case-by-case*" [Paragraph 55 of C(92)4].

20. In this regard, a review will be useful in raising awareness of the meaning and effects of the Code with respect to “equivalent measures”. Such a process would not only enhance the transparency of the current obligations under the Code for current Adherents, but also improve their clarity for any prospective new Adherents.

21. With regards to the treatment of financial innovations (e.g. Credit Default Swaps), they are covered by the Code, but as a new obligation applies when new instruments are created, Adherents can lodge reservations. It would be helpful to review financial innovations, as well as their characteristics such as maturity – i.e. original versus remaining, introduced recently by Adherents and review whether new reservations are warranted for them.

22. As mentioned in the key guiding principles any new understanding that would clarify and potentially expand the scope of the Code will not give rise to a standstill issue.

b) *Clarify the treatment of measures with stated prudential objectives*

23. Micro- and macro- prudential regulations have been used to limit the risks of foreign exchange mismatches in the balance sheets of domestic corporate sectors. In the absence of a broad prudential carve-out under the Code, the ATFC will review the treatment of measures with a stated prudential objective. This section also covers issues regarding treatment of CFMs which overlap with that of treatment of MPMs.

24. The Code imposes disciplines on all country measures and administrative practices – the sole broad carve-out is for public order and essential security interests. There is no broad prudential carve-out to the Code’s obligations.

25. The vast majority of macro-prudential measures simply fall outside the scope of the Code, even those that may have an incidence on capital flows. 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 the scope of the Code. In other words, for a measure to have a bearing on the Code’s obligations, it is not sufficient that it has an impact on capital flows or capital mobility.

26. Some CFMs, even if taken with a macro-prudential intent, do fall in the category of restrictive measures which impede or create disincentives for the conclusion of operations covered by liberalisation lists A or B. Such measures may be maintained by Adherents if they have limited the scope of their commitments under the Code by lodging reservations or by invoking derogations.

27. The 1992 revision of the Code led to enlarged obligations on the use of foreign currency in denomination and settlement. In this regard, the Code states that “*all operations are to be liberalised regardless of the currency in which they are denominated or settled*”, as reported in Council document [C\(92\)4](#) (Annex 4). To summarise, the Code covers residency-based measures as well as other non-residency-based measures. In particular, the Code also calls for:

- Non-discrimination of non-residents as a key criterion for operations in the country concerned;
- Freedom of residents to conclude operations taking place while abroad under the rules of the foreign jurisdiction;
- Freedom to use foreign currency in denomination and settlement of listed operations, while also protecting countries’ right to regulate the use of currencies in their territory.

28. In light of the surging interest in how to properly regulate the use of foreign currencies for denomination of operations by banks and other parties in the post-crisis environment, the ATFC will review whether there is a need for greater clarity and transparency on how currency-based CFMs measures are treated under the Code.

29. The ATFC and the Investment Committee have already looked at a number of recent measures introduced by Adherents which fall in the category of CFMs with a macro-prudential intent. These cases have raised questions of interpretation and consistency of treatment of Adherents with similar measures.

30. Work in progress in this area also includes the recent IMF and OECD reports to the G20, where the two organisations have provided a selection of CFMs that are also MPMs (Annex 5). There is still a number of unresolved issues in the Code's treatment of certain measures. The work by the ATFC has made evident the limitations of the text of the Users' Guide and the need to resort to the original text of the further understandings reached during the 1992 revision of the Codes. The ATFC will consider whether improvements are needed in the guiding criteria and assessment mechanisms for such measures.

31. A review could examine whether there remains a lack of consensus for excluding certain types of measures, such as currency-based capital flow restrictions, from the scope of the Code, while also improving the guiding criteria and assessment mechanisms for these measures.

32. For example, the ATFC could investigate national applications by currency of Liquidity Coverage and Net Stable Funding Ratio requirements as alternatives to CFMs falling under the Code. The Basel-minimum standards have been adapted to country-specific conditions and thus introduce additional requirements with respect to the Basel III regulation. The ATFC could consider whether clarity or further understandings are needed on these Basel-III plus measures. At the current conjuncture of rising risks around increased external borrowing by non-financial corporations, another useful area for clarification could be prudential measures with a cross-border dimension that are addressed at FX balance sheet mismatches of the non-financial sectors.

c) Consider the merits of rebalancing lists A and B

33. In order to adapt to current requirements for capital flow management, in particular of recipient countries, the ATFC could review the Code's flexibility mechanisms which permit Adherents to introduce measures on a temporary basis to respond to surges in capital inflows, measures introduced to address risks that may arise from foreign currency borrowing, or measures intended as permanent features of the financial regulatory framework in order to reduce systemic risks.

34. With respect to measures that constitute restrictions in the meaning of the Code, Adherents may limit the scope of their Code's obligations by lodging reservations or by invoking derogation as follows:

- Reservations protecting the right of Adherents to reintroduce and maintain measures limiting liberalisation obligations with respect to operations which they are not in the position to liberalise may be lodged when obligations are added, expanded, or begin to apply – typically at the time of adherence;
- Further flexibility exists for measures restricting short-term operations, which can be introduced at any time when needed, even if no reservation had been initially lodged, as these operations are covered by Liberalisation List B, for which there is no standstill commitment;

- For measures for which standstill applies (bearing on List A operations), current Adherents may still limit the scope of their Code obligations, in order to justify imposing new restrictions by invoking the Code's derogation clauses under Article 7.

35. The status regarding flexibility provided by the Code to introduce measures to regulate for financial stability purposes is as follows: i) the vast majority of MPMs are in the category of measures that fall outside the scope of obligations under the Code, while many CFMs that are MPMs are conforming measures;⁴ ii) for restrictive measures, while future Adherents enjoy full flexibility to lodge reservations, current Adherents may do so only for List B operations and must resort to derogation for List A operations.

36. The residual issue relating to flexibility to introduce measures under the Code is the potential need by current Adherents to introduce measures to deal with: i) the introduction of restrictions on a temporary basis to respond to capital surges in a preventive manner; and ii) the introduction of restrictions on a permanent basis to respond to financial stability concerns. The issue is not immaterial, as standstill applies to certain operations that can support short-term or volatile capital flows, in particular for certain inflow operations.⁵

37. For the two cases noted above, Adherents would require a derogation to introduce new measures. The resort to 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,⁶ and there is precedent for long-lasting derogations justified under the “*economic and financial situation*” clause (Article 7(a)) for countries in the process of development. However, the use of Article 7 to introduce preventive measures to deal with capital inflow surges that may 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.⁷ The review could aim at developing new understandings on the conditions for derogation authorisation in case of capital flow surges and in the presence of financial stability concerns.

38. There is a further element of flexibility in the Code in the form of understandings reached among Adherents that help shape the scope and application of obligations. This element is relevant for measures that have become part of agreed international regulatory standards. The OECD Investment Committee is tasked with all questions of interpretation and implementation of the Code and such further understandings are formalised in decisions made by consensus among Adherents taking into account the collective interest, the availability of less restrictive means and other considerations.

⁴ In this latter category, there 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 such a carve-out in the text of the Code is to allow for resident agent rules for transactions and transfers under various Code items. Rules for the net foreign exchange position of banks are carved-out by a specific understanding among Adherents.

⁵ Examples of such List A operations are bank deposits by non-residents and operations in stocks and bonds with an original maturity of one year or more.

⁶ These clauses have been used 30 times since 1961.

⁷ Ongoing work among Adherents, benefiting from the views of non-Adherents, has looked into the issue of the level of flexibility provided by the Code to adopt measures in the context of ongoing use of currency-based CMFs. Results of a survey circulated to OECD and non-OECD Adherents in the second quarter of 2014 show that all respondents except one country expressed the view that the Code has sufficient flexibility regarding the introduction of such measures.

39. Work underway in the ATFC covers a range of measures, mostly intended as permanent features of the financial regulatory framework and broadly falling in the category of inflow operations. In some instances, when measures cover inflow operations broadly, they impinge not only on List B operations but also on certain List A operations. In this context, it should be noted that while the Code's List B covers capital inflows and capital outflows generally in a symmetrical manner, this is not the case for the operation by non-residents of deposit accounts with resident financial institutions which are in List A operations subject to standstill while their capital outflow counterparts are in List B.

40. Adherents will consider the issue of introduction of measures intended as permanent features of the financial regulatory environment having a bearing on operations covered by List A of the Code. The Code's process can help to support a dialogue on how countries can adapt their measures so that they conform with the Code (e.g. a bank levy can be adjusted to apply to maturities of less than one year, rather than more than one year, therefore falling under List B). Adherents will also consider continuing the current practice of assessing each situation on its own merits.

41. Examination of country experiences can help assess whether there are circumstances in which countries should have flexibility to introduce new measures having a bearing on List A operations. Apart from derogation, there may be other solutions that are better adapted to deal with such situations. In particular, Adherents will consider whether specific carve-outs (such as for the FX exposure of banks) could provide the needed extra flexibility or whether the Code's objectives of progressive liberalisation and transparency are best advanced by a rebalancing of List A and List B to attain greater symmetry between inward and outward operations.

42. Adherents will also consider whether a rebalancing of List A and B operations to provide for added flexibility in dealing with surges in capital inflow would serve best the Code's objectives of progressive liberalisation and transparency.

43. It should be noted that the review will not be carried out on the presumption that solutions to these issues will be reflected in changes to the instrument.

d) Improve governance and strengthen implementation

44. Improved governance and strengthened implementation of both the Code and the CLCIO could be achieved along two lines: by improving the effectiveness on the assessment of measures and strengthening the decision-making rules, and by improving transparency and review mechanisms.⁸

45. The current rules on decision-making are set in accordance with the Decision of the Council on the Governance of the Codes of Liberalisation, (Annex I to [C\(2012\)88/REV2](#)) any decision i) to invite a non-Member to adhere to either or both of the Codes, or ii) to make any change in the text of either Code, other than amendments to country-specific reservations in Annex B of either Code or to country-specific entries in Annex E of the Code, shall require consensus both in Council and in the Investment Committee meeting in a session enlarged to non-Members that have adhered to the Codes of Liberalisation (Enlarged Investment Committee). In the same Decision, the Council agreed to delegate to the Enlarged Investment Committee all other decisions concerning the Codes of Liberalisation.

46. Taking into account the relevance of the consensus rule at the OECD, the finding that a specific country measure is non-conforming or that measures of a certain type should be treated as measures

⁸ While the note refers mainly to the Code of Liberalisation of Capital Movements, this point on improving governance and strengthening implementation applies to both the Code of Liberalisation of Capital Movements and to the Code of Liberalisation of Current Invisible Operations.

“equivalent to a restriction” requires a Committee decision by consensus. Reports by the ATFC to the Investment Committee to advise on such matters also require consensus. However, in the current setting, a country under review is both a “party” and a “judge” in such assessment, and the ability to reach agreements on country-specific assessments and recommendations depends entirely on the will of Adherents.

47. The review will consider whether there should be a more effective process to assess measures and their implications under the Code, including the process of reviewing measures and decision-making. The experiences of the Working Group on Bribery (consensus minus one), the Global Forum on Tax Transparency and Exchange of Information (consensus minus one) and of the Committee on Capital Movements and Invisible Transactions (CMIT), a technical expert committee predecessor of the Investment Committee, where decision-making on technical assessments was by majority, are valuable precedents.

48. “Decisions” within the meaning of the OECD Convention should remain subject to consensus as they are legally binding (these apply to changes in the scope of the Code’s obligations and lists of reservations). For other purposes, such as the general and special tasks by the Investment Committee under Articles 18 and 19 or for issues related to the interpretation, consensus minus one could be considered.

49. In terms of transparency and monitoring mechanism the Code’s process relies on peer pressure for enforcement, which requires that Adherents provide justification for measures maintained or introduced. It is the basis of a process for learning from each other to develop best practices by learning how best to deal with legitimate policy concerns in a less restrictive manner.

50. Article 11 of the Codes sets out the procedure for notification of measures by Adherents to the Organisation. However, in the current setting, again we rely on Adherents to behave as “good Codes citizens”, to notify their measures and have an open peer discussion on them.

51. Also, the publication of Investment Committee reports and recommendations on Adherents’ positions under the Codes has been on a case by case basis.

52. For the process to be effective, its governing bodies need to have effective mechanisms for review and for decision-making that best fit present day needs. To improve transparency of decision-making and strengthen implementation, publication of Investment Committee reports and recommendations on Adherents’ positions under the Code could become the rule. In addition, the current review mechanisms could be strengthened, for example by conducting regular horizontal reviews. Finally, to improve monitoring, the notification procedure could be clarified, for instance providing details on the delay of time in which Adherents are expected to notify their measures to the Organisation.

III. The implementation of a review

1. Organisation and timeline

53. After the approval of the Terms of Reference by the Investment Committee, the ATFC at its meeting in April 2016 will discuss the organisation, roadmap and timeline of the review. In particular (Figure 1):

- The work will be organised in a **Phase One (or "Diagnostic Phase")**, which is diagnostic and fact-finding in nature to identify and discuss the technical issues. This first phase will take place within the ATFC, which is a body with the necessary expertise for this technical discussion. A subsequent **Phase Two (or "Decision-Making Phase")** will deal with drafting recommendations

of options and final decision-making. This second phase will take place within the ATFC in closed session where the relevant recommendations will be drafted, and then within the Investment Committee, also meeting in closed session.⁹

- During Phase One or “Diagnostic Phase” technical notes will be prepared by the Secretariat with inputs from ATFC Bureau delegates, other interested ATFC delegates and experts from international organisations (IMF, BIS, etc.). Each note will deal with one of the issues from 5a) to 5d). These notes will then be discussed in the ATFC Plenary session. As mentioned above, **the outcome of this “Diagnostic Phase” is to have a sound analytical assessment and technical discussion** (Figure 2).
- Phase Two or “Decision-Making Phase” will include any decisions to revise either the User’s Guide or the text of the Code. The ATFC meeting in closed session will be in charge of drafting recommendations to be ultimately approved by the enlarged **Investment Committee, composed of Codes’ Adherents** (Figure 2).

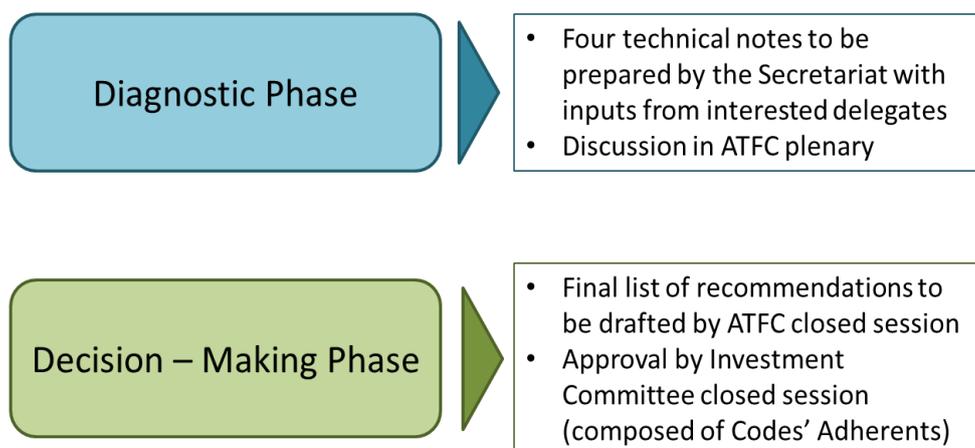
54. The ATFC will begin the review in April 2016 and will seek to complete its work within 18 months, with a list of final recommendations planned to be drafted by October 2017. Final recommendations by the ATFC in closed session are planned to be drafted at the ATFC meeting of October 2017, and planned to be approved by the Investment Committee at its meeting in March 2018.

55. Adherents commented positively on the possibility of organising a high-level seminar with a wide attendance of experts and agreed that such event would be appropriately timed if organised during the autumn of 2016. Such a seminar would serve as a platform for a broader discussion on capital flow management issues and EMEs experiences with capital flows and prudential regulation. Participation from all G20 countries, as well as other international organisations, and relevant stakeholders is envisaged.

Figure 1. Planned timeline for the review



⁹ As mentioned in paragraph 45, according to Council document [C\(2012\)88/REV2](#), Annex I “Decision-Making Phase” needs to be approved in both by the Investment Committee and the Council.

Figure 2. Diagnostic Phase and Decision-Making Phase¹⁰

2. Resources

56. Such an exercise will require a full-time Policy Analyst/Economist dedicated only to the review. Additional funds will have to be raised to cover work of the Head of Division and Senior Economists leading the team and supervising the work as well as the support by the OECD Legal Directorate, which will be involved as with the review of any OECD legal instrument.

57. Resources for the review are to be allocated from the working budget of the unit responsible for the instrument or from potential voluntary contributions.

3. Engagement with non-adherent countries and expert organisations

58. The Codes have been open for adherence by non-OECD countries since June 2012. Therefore, the review process could also be an interesting opportunity to engage non-adherent countries in the OECD work on capital account liberalisation.

59. While participation in the decision-making process is restricted to Adherents to the Code, non-adhering countries should be invited to participate in the discussions on the review with a non-decision-making status. The IMF, BIS and FSB should be included in an advisory role in the Code review sessions, to ensure that the outcome of the Code review is consistent with developments in these other bodies, including in the key area of currency-based restrictions. In addition, the Secretariat should conduct consultations on the review, including with Business and Industry Advisory Committee to the OECD (BIAC), the Trade Union Advisory Committee of the OECD (TUAC), and other relevant stakeholders.

IV. Conclusion

60. The Investment Committee at its meeting on 17 March 2016 adopted the following conclusions:

- Delegates agree with and confirm the key guiding principles as set out in section 2 of this document;

¹⁰ As mentioned in paragraph 45, according to Council document [C\(2012\)88/REV2](#) Annex I “Decision-Making Phase” needs to be approved in both in Investment Committee and Council.

- Delegates agree on the key areas of work as set out in section 2 of this document;
- Delegates agree on the implementation plan of the review as set out in section 3 of this document.

ANNEX 1: THE CONTRIBUTION OF THE CODE OVER TIME

The Code is the only multilateral agreement on capital flow measure management and progressive liberalisation...

1. The Code was established in 1961 at a time when many OECD Members were in the process of economic recovery and development and when the international movement of capital faced many barriers. The Code was also the first instrument created by the OECD when it was founded. For over 50 years, the Code has provided a balanced framework for countries to progressively remove unnecessary barriers to the movement of capital, while providing flexibility to cope with situations of economic and financial instability.

2. The Code is the only multilateral agreement among State parties dedicated to co-operation on capital flow measure management and progressive liberalisation. Since its inception in 1961, the Code has contributed to:

- entrenching the capital account opening process as undertakings by Adherents;
- pushing the opening process forward and consolidating it on a broad multilateral and non-discriminatory basis;
- guiding the 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 as 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.

...and a living instrument which has been adapted to different settings, since 1961

3. The Code is a living instrument, which has undergone a process of review and adaptation over time. The review process has brought about a gradual but continual expansion of the scope of obligations and a lifting of liberalisation standards:

- Collective investment securities were introduced as part of the CLMC's obligations under List A, since 1973;
- The right of establishment under item I/A of the Code was introduced in 1984;
- Short-term capital movements are covered since 1992, at the time of the last major revision;
- The understanding regarding "measures equivalent to restrictions" also dates back to 1992;
- Restrictions applying to portfolio investment abroad by certain institutional investors, namely insurance companies and pension funds, were brought within the purview of the Code in 2002;
- In 2011 the Code was opened to non-OECD members;
- In 2012 new governance arrangements were established, which granted non-OECD members the same rights and obligations as members. This major step was taken as a result of the renewed interest in cross-border capital movements and financial services after the 2008 financial crisis.

ANNEX 2: RECENT RESEARCH RELATED TO THE REVIEW PROCESS AND ITS INTERNATIONAL PERSPECTIVE

The case for a review

The policy context

1. Important momentum has built up for a review of the Code. 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 spill overs from national capital management policies. Capital controls data suggests traditional residency-based capital controls are back in use. It is of note that measures restricting banks' operations in foreign currency are rising. This lingering legacy is set against a fundamental principle supporting globalisation – that economic development sooner or later requires that a country allows capital to move across borders.

2. 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 opening up their capital accounts in order to fully participate in the global economy. In Latin America, Colombia and Costa Rica are following the path of their OECD neighbors – Chile and Mexico, and have made credible commitments to progressive liberalisation. South Africa is modernising its capital markets and foreign exchange regime as a general drive to financial liberalisation, while India is looking at allowing fuller capital account convertibility in the next few years.

3. Furthering the process of opening up capital movements will go a long way in addressing some of the structural imbalances that created frictions in the global economy prior to the 2008 crisis. Restrictions on the capital account often go hand in hand with foreign exchange interventions to perpetuate undervalued exchange rates and export-driven growth models. And 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 macro-prudential policies that guard against key currency mismatches in crisis situations. The latter policies work in the opposite direction to improved global liquidity.

4. To reignite global growth, investment and foreign exchange need to flow seamlessly across borders in order to fund investment, improve global liquidity and to foster productivity growth via competition in the market for corporate control. Capital flow liberalisation must not be undermined as countries seek to shore up their financial systems and strengthen financial regulation. Progressive, sequenced liberalisation, mindful of vulnerabilities stemming from large and high financial flow volatility is called for, underpinned by a clear benchmark. The Code review process will provide a timely and important opportunity to advance consensus on the desirable features of a multilateral regime for cross-border capital movements.

5. 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, good governance features of CFMs include: transparency of the measure, its proportionality relative to the objective pursued, no discrimination 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.

6. For example, measures going beyond Basel III-minimum standards, as well as the treatment of CFMs with a macro-prudential intent under the Code, have raised new issues, and existing agreements and understandings on the application of the Code may provide insufficient guidance on their treatment under the Code.

7. As an agreement of multilateral co-operation, the Code is about finding the right balance between an Adherent's individual interest and the collective interest in an open, functioning global financial system. While there are *fora* to discuss matters such as spill-over effects of unconventional monetary policies in advanced economies, there is no *forum* to discuss emerging and other economies' responses and cooperation in term of capital flow management other than the dialogue provided by the OECD's Code.¹

What could a review of the Code achieve in the current policy context?

8. The current environment for international capital movements is at a turning point given pressures from unconventional monetary policy unwinding and heightened exchange rate volatility in the short term. A review of the Code provides an important opportunity to expand knowledge of the instrument and share experiences with orderly financial liberalization more broadly, benefit from the perspectives of non-adhering countries and foster dialogue and commitment on continued openness, transparency and multilateral co-operation.²

9. If the review should conclude there is a need for revisions to the User's Guide of the text of the Code, such revisions should reiterate the Code's approach of not preventing Adherents from taking measures that they feel necessary for financial stability and indeed may be fully justified from a national standpoint, but rather of encouraging them to follow due process when they introduce these measures, in the collective interest of transparency and accountability. Keeping measures with a bearing on the Code transparent enables an assessment of the proportionality of measures taken in light of their stated objectives and could help find alternative, less burdensome measures.

10. A review can help frame the way in which specific measures are addressed. Such framing of issues would assist in the implementation of the 1992 agreement to extend Code's obligations to cover equivalent measures under the Code [C(89)57; C(89)57/ADD1; [C\(92\)4](#)] by developing further guidance to ensure proportionality and fairness in the assessment and treatment of various types of specific country measures.

11. In the current changing policy environment, there are recurring issues to do with the treatment of measures with macro-prudential intent. There is an apparent lack of clarity over the broad understanding

¹ *Fora* dedicated to financial sector reform, such as the Financial Stability Board (FSB), the Basel Committee and IOSCO, are playing a key role in providing an international platform to review financial regulations. However, none of these *fora* have an explicit mandate to look at the implications for openness and integration of the system or consistency with the international legal obligations of individual countries adopting the proposed new rules. While WTO's GATS obligations do overlap with Codes obligations, particularly in the area of financial services, their scope regarding capital movements is limited and the WTO *forum* does not provide for a platform for dialogue among countries regarding capital flow management issues. The IMF supports its membership in developing policies towards capital flow management issues, but has a smaller involvement in the assessment of the consistency of individual country measures with countries' international obligations.

² Annex 1 provides a brief description of earlier reviews and their outcomes.

achieved in the 1992 revision of the Codes to cover equivalent measures, including currency-based measures. One purpose of the review will be to provide clarity and transparency, and to bring to light existing understandings for the benefit of current Adherents and any potential new Adherents.

12. The review takes place at a time when Key Partner countries and other Emerging Market Economies (EMEs), which account for a growing share of global financial markets, are moving towards a path of gradual liberalisation and are looking at the OECD Code as an international benchmark to assess their degree of openness and progress.

13. The Code was opened for adherence by non-OECD members in 2012. This created an opportunity for the Code to play a greater role in international economic co-operation in the field of cross border capital flows and trade in services. To foster this development, a strong message is needed about the value of the Code as an instrument of co-operation. The Code itself needs to be clear, transparent, and firm in responding to the needs of potential requests for adherence from a range of countries at different levels of economic development.

14. The instrument needs to balance the rights and obligations among all adhering countries. The review process can serve to look into whether the flexibility of the Code provides sufficient policy space for Adherents and whether there is a need to revise the balance between List A and List B, the scope for invocation of derogation, and/or the development of further understandings on the treatment of certain classes of measures in order to protect Adherents' policy space while maintaining measures subject to transparency and peer review when relevant.

ANNEX 3: MEASURES CONSTITUTING RESTRICTIONS AND EQUIVALENT MEASURES

[Extract from the User's Guide]

Measures constituting restrictions

Any **law, decree, regulation, policy and practice** taken by the authorities, which may restrict the conclusion or execution of operations covered by the Codes constitutes a restriction. Measures such as screening procedures or registration requirements are not considered restrictions, if they do not affect the effective carrying out of the operation.

However, international transactions may be affected by certain measures which have effects equivalent to a restriction, although they do not prevent operations. This is the case where such measures raise the effective cost of operations. **Equivalent measures** in the field of capital movements might take the form of compulsory deposit requirements, interest rate penalties or queuing arrangements for security issues. The Codes treat these equivalent measures like restrictions subject to progressive liberalisation.

A similar question has arisen with respect to particularly burdensome **licensing requirements and other domestic regulations** and **internal arrangements**, such as “golden shares” keeping special decision power to governments not proportionate to their shareholding in privatised enterprises, which may affect operations both under the Capital Movements Code and the Current Invisibles Code. The Committee has considered, however, in most cases, that despite their possible economic impact, such measures do not constitute restrictions under Article 1 of the Codes, as long as they are applied in a non-discriminatory manner. They may however, on a case-by case basis, give rise to an action under Article 16 of the Codes (see below), if their impact is such that they effectively frustrate operations covered by the Codes.

Taxes on financial and capital transactions – for example stamp duties, taxes on the issue, transfer, purchase and sale of securities, banking taxes, taxes on cheques and taxes levied on transactions such as validation of contracts and sale of real estate – may constitute restrictions, if they penalise specifically international transactions between residents and non-residents. Taxes of a general nature, such as income taxes and capital gains taxes are not concerned, since in general they are not intended to discourage international capital movement operations as such. Equally, apparently discriminatory taxes levied in accordance with widely accepted principles of international tax law are not considered as equivalent to a restriction under the Codes.

Under the Capital Movements Code, **currency rules** – i.e. the obligation to use a particular currency – for denomination and settlement, imposed by a country on operations by its residents abroad, would be considered restrictions. On the other hand, Member countries are of course free to determine which currencies may be used on their domestic markets by residents and non-residents alike.

The obligation to use **special payments channels**, e.g. different exchange markets for different kinds of operations, constitutes a restriction under the Capital Movements Code, if any exchange rate differential with the official market were to exceed 2 per cent continuously over several months.

ANNEX 4: OBLIGATIONS FOR OPERATIONS IN FOREIGN CURRENCY AND USE OF FOREIGN CURRENCY

[Extract from the OECD Report to G20 “The OECD’s Approach to Capital Flow Management Measures used with a Macro-Prudential Intent”]

The Code covers only operations between residents and non-residents. A key test is non-discrimination, but the Code also includes other specific liberalisation commitments.

Under Article 2 “[W]henver 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 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 revision of the Codes 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}

35. 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.

36. 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.

37. 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.

38. 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”.

ANNEX 5: JOINT IMF-OECD TABLE ON A SELECTION OF CAPITAL FLOW MANAGEMENT MEASURES (CFMS) THAT ARE ALSO MACROPRUDENTIAL MEASURES (MPMS)

Table 1. Selection of Capital Flow Management Measures (CFMs) that are also Macroprudential Measures (MPMs)¹

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
1	Limit	<p>Limit on banks' foreign exchange derivative contracts set as a percentage of bank capital.</p> <p>The measure increases the cost of derivative transactions, thereby limiting banks' reliance on short-term external funding.</p> <p>Measure introduced in the context of capital flow volatility and limits the systemic impact of large movements in capital flows. The measure mitigates systemic liquidity risks associated with banks' reliance on FX funding and volatile capital inflows.</p>	<p>The measure is an MPM because it limits banks' reliance on short-term external funding and the exposure of the financial sector to systemic liquidity risks associated with a sudden stop in capital flows. Although the measure does not discriminate on the basis of residency, given the circumstances, including the announced objective, it is nonetheless designed to limit capital flows. Therefore, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>The measure has a bearing on Code obligations only to the extent that it extends to operations carried-out abroad by resident banks, in which case it has a bearing on obligations established under Liberalisation List B, item XII. Operations in foreign exchange. B. Abroad by residents.</p> <p>Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.</p> <p>See OECD's Background Note, section 5: "Illustrative examples", for further details on this measure.</p>

Notes to the Table:

1. This table is an illustrative list of possible measures that can be considered as both CFMs and MPMs, and is not a recommended or exhaustive list. The description and purpose of the measures provided under column II focuses on their use as CFMs/MPMs.
2. The IMF approach for assessing whether a particular measure is a CFM and an MPM is based on "[The Liberalization and Management of Capital Flows: An Institutional View](#)" and "[Key Aspects of Macroprudential Policy](#)" and the associated staff guidance notes, including the "[Staff Guidance Note on Macroprudential Policy—Detailed Guidance on Instruments](#)." A measure is considered as both a CFM and an MPM when it is designed to limit capital flows in order to reduce systemic financial risk stemming from such flows. In practice, the IMF assessment of such measures has been guided by the provisions noted in the table, and also depends on country-specific circumstances, including the overall context in which the measure was implemented. Such measures can have a role in supporting macroeconomic policy adjustment and safeguarding financial system stability in certain circumstances, such as in response to capital inflows: (i) when the room for adjusting macroeconomic policies is limited; (ii) when the needed policy steps require time, or when the macroeconomic adjustments require time to take effect; (iii) when an inflow surge raises risk of financial system instability; or (iv) when there is heightened uncertainty about the underlying economic stance due to the surge.
3. The assessment of a specific country measure is guided by its bearing on the operations covered by the Code. Specifically, measures are to be assessed in a meeting of the Investment Committee on the basis of adherents' obligations under the Code, notably under Article 2 of the [Code of Liberalisation of Capital Movements](#) to grant any authorisation required for the conclusion and execution of transactions and for transfers set out in liberalisation lists A and B. The further understanding among members on measures equivalent to restrictions extends liberalisation commitments to include measures which constitute disincentives for the conclusion of operations covered by the Code (see [Users' Guide](#): Measures constituting restrictions).

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
2	Limit	<p>Limit on the daily balance of banks' short-term (up to one year) liabilities to nonresidents set as a percentage of bank capital.</p> <p>The measure increases the cost of banks' use of short-term funding from non-residents beyond a set limit.</p> <p>The measure contains systemic liquidity risk by reducing banks' reliance on short-term external funding and indirectly dampens excessive credit growth funded by capital inflows.</p>	<p>The measure is an MPM because it increases the cost of banks' reliance on short-term external funding, thereby limiting excessive credit growth and the exposure of the financial sector to systemic liquidity risks associated with a sudden stop in capital flows. Since the measure discriminates between resident and nonresident lenders, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>The measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List A <ul style="list-style-type: none"> - item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions. <p>Adherents may limit the scope of their Code obligations under List A by lodging a reservation only when obligations are added, extended or begin to apply. Adherents may invoke a derogation to suspend their obligations, subject to additional review and reporting requirements (see OECD's Background Note).</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>
3	Tax	<p>Additional buyer's stamp duty on purchases of certain categories of residential property levied at a higher rate for nonresidents than residents.</p> <p>The measure mitigates the build-up of systemic risk stemming from capital flows to an overheating property market. By increasing the costs of purchase of residential property particularly for nonresidents, the measure reduces non-residents' housing demand.</p>	<p>The measure is an MPM because by limiting the inflow of foreign capital into the domestic property market, it reduces the systemic risk associated with property price corrections when these inflows recede. Since the measure discriminates between residents and nonresidents, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the sections on household sector tools (para 71) and corporate sector tools (para 90) of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>The measure affects non-residents' purchase of real estate in the country introducing the measure and as such has a bearing on Code obligations under List B, item III. Operations in real estate. A. Operations in the country concerned by non-residents. 1. Building of purchase.</p> <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
4	Tax	<p>Bank levy on non-deposit FX liabilities with maturities shorter than one year.</p> <p>The measure increases the cost of short-term non-core FX funding.</p> <p>Measure was introduced in the context of capital flow volatility and limits the systemic impact of large movements in capital flows. The measure mitigates systemic liquidity risk associated with banks' excessive reliance on short-term non-core FX funding and volatile capital flows.</p>	<p>The measure is an MPM because it limits banks' reliance on short-term external funding and the exposure of the financial sector to systemic liquidity risk associated with a sudden stop in capital flows. Although the measure does not discriminate on the basis of residency, given the circumstances, including the announced objective, it is nonetheless designed to limit capital flows. Therefore, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>To the extent that the measure limits the freedom for residents to freely decide on the use of currency for denomination and settlement of operations with non-residents, the measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p> <p>Specific measures may also have a bearing on operations covered by Item X, Sureties, guarantees and financial back-up facilities of the General List, with items falling under both liberalisation lists.</p>
5	Reserve requirement	<p>A reserve requirement on domestic banks' foreign currency swap and forward transactions with nonresidents.</p> <p>The measure increases the cost to domestic banks of foreign currency swap and forward transactions with nonresidents.</p> <p>The reserve requirement mitigates systemic liquidity risk related to increasing currency and maturity mismatches on banks' balance sheets driven by short-term capital inflows.</p>	<p>The measure is an MPM because it limits systemic liquidity risks related to increasing currency and maturity mismatches on banks' balance sheets caused by short term capital inflows. Since the measure discriminates between residents and nonresidents, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the section on liquidity tools, para 135 of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>The measure has a bearing on Code obligations only to the extent that it extends to operations carried-out abroad by resident banks, in which case it has a bearing on obligations established under:</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item XII. Operations in foreign exchange. B. Abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims D. Operations abroad by residents. To the extent that swaps contain also an interest rate element. - item VI. Other operations in negotiable instruments and non-securitised claims C. Operations in the country concerned by non-residents. To the extent that swaps contain also an interest rate element and that residents are allowed to carry-out such operations. <p>Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.</p>

	I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment ²	IV. OECD Assessment ³
6	Reserve requirement	<p>A reserve requirement on banks' credit lines and other external obligations with nonresidents of three years or less in maturities.</p> <p>The measure increases the cost of banks' reliance on external funding.</p> <p>The reserve requirement prevents the build-up of systemic risk associated with FX lending in the context of a highly dollarized economy and strong capital inflows.</p>	<p>The measure is an MPM because it increases the cost of banks' reliance on external funding and the exposure of the financial sector to systemic risks associated with currency mismatches on banks' balance sheets and a sudden stop in capital flows. Since the measure discriminates between resident and nonresident lenders, it is also considered a CFM.</p> <p>Assessment is based on Annex II, page 40 and Box 2, page 21 of the institutional view; and the sections on tools that target foreign exchange loans (para 109) and liquidity tools (para 135) of the detailed staff guidance note on macroprudential policy instruments.</p>	<p>The measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> • Liberalisation List A <ul style="list-style-type: none"> - item IV. Operations in securities on capital markets. D. Operations abroad by residents. - item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions. <p>Adherents may limit the scope of their Code obligations under List A by lodging a reservation only when obligations are added, extended or begin to apply. Adherents may invoke a derogation to suspend their obligations, subject to additional review and reporting requirements (see OECD's Background Note).</p> <ul style="list-style-type: none"> • Liberalisation List B <ul style="list-style-type: none"> - item V. Operations on money markets. D. Operations abroad by residents. - item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents. - item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents. <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p> <p>Specific measures may also have a bearing on operations covered by Item X, Sureties, guarantees and financial back-up facilities of the General List, with items falling under both liberalisation lists.</p>