

## Measures which are Both Macroprudential and Capital Flow Management Measures: IMF Approach<sup>1</sup>

*The G20 Finance Ministers and Governors, at their February 9-10, 2015 meeting in Istanbul, asked the IMF and OECD, with input from the BIS and FSB, to assess whether further work is needed on their respective approaches to measures which are both macroprudential and capital flow management measures, taking into account their individual mandates. This note summarizes the IMF's approach to assessing such measures, compares the IMF's and OECD's approaches, and suggests ways to move forward on the treatment of such measures.<sup>2</sup>*

**Context.** The global financial crisis underscored the costs of systemic instability at both the national and global levels and highlighted the importance of dedicated macroprudential and capital flow management policies. The IMF has been assisting its members with policy advice as well as developing and making operational their policy frameworks. Multilateral aspects of both policies need to be fully considered, including the interaction with other domestic and international legal frameworks. To the extent that capital flows are the source of systemic financial sector risks, the tools used to address those risks can be seen as both capital flow management measures (CFMs) and macroprudential measures (MPMs).

The Fund may consider the use of measures that are both macroprudential and capital flow management measures as being appropriate in some circumstances. Under the IMF Articles of Agreement member countries are not required to seek the Fund's approval for such measures, except if the measures are inconsistent with members' obligations under Article VIII, Sections 2 and 3. At the same time, if members have obligations to liberalize capital flows under other agreements (including the OECD Codes), they would normally need to comply with the procedures established under those agreements, such as registration, consultation, or approval requirements. A perception could arise that members receive seemingly conflicting signals from different international institutions regarding the appropriateness of such measures. While some tension is inevitable because mandates and obligations differ across legal frameworks and institutions, a question is whether institutions can do more within their existing mandates to address the perceived need for more harmonious signals regarding such measures.

**IMF definitions of CFMs and MPMs.** Under the IMF's institutional view on the liberalization and management of capital flows (the "institutional view"), CFMs refer to measures that are designed to limit capital flows, and encompass both measures that discriminate on the basis of residency and

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<sup>2</sup> This note has benefited from an exchange of views between the IMF and OECD staff and input from the BIS and FSB. The OECD has prepared a separate note on their approach to the assessment of such measures.

those that do not.<sup>3</sup> MPMs refer to measures that are designed to limit systemic financial risks, including risks associated with capital flows.<sup>4</sup>

**IMF's approach to measures that are both CFMs and MPMs.** The IMF has a mandate to promote the economic and financial stability of its members and the effective operation of the international monetary system. The frameworks for capital flow management and macroprudential policies aim at supporting domestic and global stability. The institutional view builds on countries' experiences, analytical research and policy papers, Executive Board discussions, the G20's "Coherent Conclusions for the Management of Capital Flows", and other work. The IMF's institutional view and the paper on "Key Aspects of Macroprudential Policy" provide the basis for assessing measures as CFMs and MPMs as well as their appropriateness, particularly in IMF surveillance and policy advice.

The IMF's frameworks for capital flow management and macroprudential policies overlap. When capital flow volatility contributes to both macroeconomic and systemic financial sector risks, the policy approach draws on both the institutional view and the macroprudential policy framework. For measures that are both CFMs and MPMs, the two frameworks are consistent and the approach is based on a set of common principles, which include to avoid using the measures as a substitute for necessary macroeconomic adjustment; to use the policy instruments that are the most effective, efficient, and direct, and the least distortive, in addressing the policy objective; and to seek to treat residents and nonresidents in an evenhanded manner.

Measures that are both CFMs and MPMs can be appropriate in certain circumstances.<sup>5</sup> When these circumstances abate, the measures should generally be removed. There may be scope, however, to

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<sup>3</sup> See "The Liberalization and Management of Capital Flows—An Institutional View", available at <http://www.imf.org/external/np/pp/eng/2012/111412.pdf>. CFMs comprise *residency-based CFMs*, which encompass a variety of measures (including taxes and regulations) affecting cross-border financial activity that discriminate on the basis of residency; and *other CFMs*, which do not discriminate on the basis of residency, but are nonetheless designed to limit capital flows. These other CFMs typically include measures, such as some prudential measures, that differentiate transactions on the basis of currency as well as other measures that typically are applied to the non-financial sector.

<sup>4</sup> Input provided by the BIS refers to the October 2011 joint FSB-IMF-BIS report to the G20 on Macroprudential Policy Tools and Frameworks. The BIS recommends that macroprudential tools be classified operationally in terms of both their objective of limiting systemic risk and their governance. In particular, it suggests classifying a measure as macroprudential if and only if the measure was intended primarily to contain systemic financial risks *and* it was taken by the agency mandated to be in charge of macroprudential policy. The BIS regards these criteria as important for clarity of purpose and greater accountability, and in particular to avoid certain measures that may not be macroprudential from being characterized as such. The IMF's 2013 paper "Key Aspects of Macroprudential Policy" (<http://www.imf.org/external/np/pp/eng/2013/061013b.pdf>) defines macroprudential policy as the use of primarily prudential tools to limit systemic risk, and it recognizes the importance of strong governance arrangements to help ensure the appropriate design and use of macroprudential tools. It states the institutional framework for macroprudential policy needs to assure willingness and ability to act to limit such risk, with the establishment of clear institutional mandates for systemic stability being a desirable part of the macroprudential policy framework. As the paper notes, in practice countries have adopted different institutional models to achieve their systemic financial stability objectives.

<sup>5</sup> Measures that are both CFMs and MPMs can have a role in supporting macroeconomic policy adjustment and safeguarding financial system stability in certain circumstances, such as in response to a surge of capital inflows: (i) when the room for adjusting macroeconomic policies is limited; (ii) when the needed policy steps require time,  
(continued)

maintain certain measures over the longer term for managing systemic financial risks, although their usefulness relative to their costs would need to be evaluated on an ongoing basis, and consideration given to whether there is an alternative way to address the prudential concern that is not designed to limit capital flows.

***Application of the IMF's approach to measures that are both CFMs and MPMs.*** When a measure is designed to limit capital inflows in order to address systemic financial risk stemming from such flows, it would be considered as both a CFM and an MPM. In practice, the assessment of whether a particular measure is a CFM and an MPM requires an analysis of the design of the measure and country-specific circumstances, including the context in which the measure was introduced. The accompanying table provides an illustration of measures that are both macroprudential and capital flow management measures, and how they may be assessed under the IMF and OECD approaches.

***IMF and OECD approaches to measures that are both macroprudential and capital flow management measures: selected aspects***

- *Rights and obligations.* The IMF's Articles of Agreement do not impose an obligation on member countries to liberalize 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 institutional view does not alter members' rights and obligations under the Articles or under other international agreements.<sup>6</sup> Rather, the Fund would take into account the institutional view in assessing capital account policies where relevant, particularly in its surveillance and policy advice. In contrast, the OECD has an international agreement, the Code of Liberalisation of Capital Movements that sets an objective of progressive liberalization among its adherents taking into account country-specific circumstances and requires adherents to notify and be available for consultations with their peers regarding capital flow restrictions between residents and nonresidents that are introduced or re-imposed.
- *Definition.* The IMF approach considers an MPM to be also a CFM if the measure is designed to limit capital flows. The OECD Code's framework covers measures which are restrictions under the Code: that is, measures that specifically target and limit capital flow operations included in the operations' lists of the Code, irrespective of their declared intent.
- *Coverage.* The IMF's coverage of measures that are both CFMs and MPMs is guided primarily by surveillance considerations. Accordingly, these measures are discussed in staff reports when

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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.

<sup>6</sup> Conformity with obligations under other agreements would continue to be determined solely by the existing provisions of those agreements.

they have implications for a member's domestic stability or for global stability. The OECD Code sets a transparency requirement that requires the reporting of all measures that fall within the scope of the Code. An implication of the IMF's focus on surveillance considerations in its coverage of measures that are both CFMs and MPMs is the IMF does not formally assess each measure the OECD would cover.

### *Proposed steps going forward*

The IMF has a consistent approach for assessing measures that are both CFMs and MPMs. The institutional view takes into account macroeconomic and financial stability considerations when assessing the appropriate policies related to capital flows. It could be used to foster a global dialogue on the management of capital flows to promote macroeconomic and financial system stability and, given the IMF's near universal membership, facilitate consistent policy advice across countries. IMF policy advice for member countries based on the institutional view can help promote a more consistent approach toward the treatment of capital flow management measures. It can also help inform assessments of measures under international agreements, including the OECD Code. The institutional view is intended to be flexible and seeks to incorporate new experience, analysis, and empirical evidence going forward. In this context, we will strive to further contribute to global understanding about the appropriate use of measures that are both CFMs and MPMs.

IMF staff will continue exchanges with the OECD Secretariat regarding policies related to capital flows, including in cases where the Fund may support measures that can require derogations or reservations by adherents to the OECD Code. The staff's participation in the Advisory Task Force on the Codes of Liberalisation (ATFC) remains a welcome and useful avenue for exchanging views on capital flow issues.

## Selection of Capital Flow Management Measures (CFMs) that are also Macroprudential Measures (MPMs)<sup>7</sup>

I. Type of Measure	II. Description and Purpose of Measure	III. IMF Assessment <sup>8</sup>	IV. OECD Assessment <sup>9</sup>
<b>1</b>	<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>

<sup>7</sup> 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.

<sup>8</sup> 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.

<sup>9</sup> 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](#)).

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2	<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"> <li>• Liberalisation List A: <ul style="list-style-type: none"> <li>- Item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions.</li> </ul> </li> </ul> <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"> <li>• Liberalisation List B: <ul style="list-style-type: none"> <li>- Item V. Operations on money markets. D. Operations abroad by residents.</li> <li>- Item VI. Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents.</li> <li>- Item IX. Financial credits and loans. A. Credits and loans granted by non-residents to residents.</li> </ul> </li> </ul> <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>

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<b>3</b>	<p>Tax</p> <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 nonresidents' 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 or purchase.</p> <p>Adherents may introduce such measures, covered by List B, at any time by lodging a reservation.</p>
<b>4</b>	<p>Tax</p> <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 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"> <li>• Liberalisation List B: <ul style="list-style-type: none"> <li>- Item V, Operations on money markets. D. Operations abroad by residents.</li> <li>- Item VI, Other operations in negotiable instruments and non-securitized claims. D. Operations abroad by residents.</li> <li>- Item IX, Financial credits and loans. A. Credits and loans granted by non-residents to residents.</li> </ul> </li> </ul> <p>Adherents may introduce such measures, covered by List B, at any time by lodging a</p>

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			<p>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	<p style="text-align: center;">Reserve requirement</p> <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 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"> <li>• Liberalisation List B: <ul style="list-style-type: none"> <li>- item XII Operations in foreign exchange. B. Abroad by residents.</li> <li>- 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.</li> <li>- 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.</li> </ul> </li> </ul> <p>Adherents may limit the scope of their Code obligations under List B at any time by lodging a reservation.</p>
6	<p style="text-align: center;">Reserve requirement</p> <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 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</p>	<p>The measure has a bearing on Code obligations under:</p> <ul style="list-style-type: none"> <li>• Liberalisation List A: <ul style="list-style-type: none"> <li>- Item IV, Operations in securities on</li> </ul> </li> </ul>

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	<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>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>capital markets. D. Operations abroad by residents.</p> <ul style="list-style-type: none"> <li>- Item XI. Operation of deposit accounts. A. Operation by non-residents of accounts with resident institutions.</li> </ul> <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"> <li>• Liberalisation List B:             <ul style="list-style-type: none"> <li>- Item V, Operations on money markets. D. Operations abroad by residents.</li> <li>- Item VI, Other operations in negotiable instruments and non-securitised claims. D. Operations abroad by residents.</li> <li>- Item IX, Financial credits and loans. A. Credits and loans granted by non-residents to residents.</li> </ul> </li> </ul> <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>