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International financial system and development

Report of the Secretary-General**

Summary

The present report, submitted pursuant to General Assembly resolution 70/188, summarizes information on recent trends in international official and private capital flows to developing countries and ongoing efforts to strengthen the international financial system for the implementation of the 2030 Agenda for Sustainable Development. It also highlights the progress made on agreements and commitments contained in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development with regard to development finance institutions, financial regulation, international tax cooperation, the global financial safety net, gender impacts of development finance, policy coordination and governance reform of the international financial institutions.

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** The present report was prepared in consultation with staff of the major institutional stakeholders involved in the financing for development process. Responsibility for its contents, however, rests solely with the United Nations.

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I. Introduction

1. In its resolution 70/188, the General Assembly recognized the need to continue to enhance the coherence and consistency of the international monetary, financial and trading systems. It reiterated the importance of ensuring openness, fairness and inclusiveness in the international financial system. It also reiterated the need for the mobilization of resources from a variety of sources and the effective use of financing in order to promote full and productive employment and decent work for all.

2. To achieve the Sustainable Development Goals, both public and private finance need to be aligned with sustainable development. However, as noted in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, to date the international financial system has not adequately allocated resources for long-term sustainable development needs. There has been insufficient investment in critical areas, such as infrastructure, technologies to address climate change, health, education and sanitation services for the world's poor and financial services for all. The financial system and its capital markets do not incorporate the full social and environmental costs of companies.

3. The weak global economy makes implementation of the new agenda more challenging. The Department of Economic and Social Affairs forecasts that world gross product will expand by just 2.4 per cent in 2016, similar to 2015.[1] Downside risks to the global economy remain elevated against the backdrop of weak demand, low investment, constrained public budgets, low commodity prices and volatility in the financial markets.

4. The challenging global environment underscores the importance of ensuring that the global financial system intermediates credit for sustainable development in an effective and stable manner. Ultimately, stability and sustainability are mutually reinforcing. Without a stable financial system, the Sustainable Development Goals risk being derailed by future financial crises and without sustainable investment, there is a risk of sowing the seeds of future environmental catastrophes and economic crises.

II. International financial flows to developing countries

5. International financial flows to developing countries fell in 2015 and are expected to fall further in 2016, reflecting rising global risks and heightened risk aversion. Increased divergence in global interest rates and negative rates in several advanced economies may intensify the volatility of capital flows and the pressure on exchange rates in developing economies. The outcome of the referendum in the United Kingdom of Great Britain and Northern Ireland on its membership of the European Union introduced additional uncertainty in mid-2016, leading financial managers around the world to seek financial safe havens.[2] There is a risk of further market disruption when monetary policies begin to tighten. Greater international policy coordination among monetary authorities can help to mitigate some of the

[1] *World Economic Situation and Prospects 2016: Update as of Mid-2016* (United Nations publication, forthcoming). Available from www.un.org/en/development/desa/policy/wesp/wesp_current/2016wesp_update.pdf.

[2] International Monetary Fund (IMF), "World economic outlook update", July 2016.

negative spillover effects and volatility in the financial markets, while capital account management can help countries manage volatile cross-border capital flows.

A. International public finance

6. As recognized in the Addis Ababa Action Agenda, achieving the Sustainable Development Goals will place significant demands on public budgets and capacities, which will require scaled-up and more effective international support, including both concessional and non-concessional financing.

Official development assistance[3]

7. Preliminary figures for official development assistance (ODA) in 2015 showed an increase to $131.6 billion, representing a rise of 6.9 per cent in real terms over 2014. As a share of gross national income, ODA averaged 0.30 per cent, the same as in 2014 and significantly below the United Nations target of 0.7 per cent. In-donor refugee costs jumped from 4.8 per cent of ODA in 2014 to 9.1 per cent in 2015, reflecting the large numbers of refugees arriving in the countries which are members of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Stripping out funds spent on refugees, aid was up 1.7 per cent in real terms.[4]

8. ODA makes up more than two thirds of external finance for the least developed countries. In the Action Agenda, donors agreed to halt the recent decline in ODA to those countries. Preliminary figures indicate that ODA to the poorest countries increased in 2015 for the first time in several years. Bilateral aid to the least developed countries rose by 4 per cent in real terms in 2015, amounting to $25 billion.[5]

Other international public finance

9. In the Action Agenda, Governments expressed their determination to increase all forms of international public finance and recognized South-South cooperation as increasingly important. The Department for Economic and Social Affairs estimates that concessional South-South cooperation exceeded $20 billion in 2013 and may have further increased in 2014, based on partial data (see E/2016/65).[6] OECD, which also estimates "ODA-like" flows — concessional development finance — from countries that are not members of the Development Assistance Committee, arrived at a comparable figure of $23.5 billion in 2013.[7]

[3] For a more in-depth discussion, see A/71/311.

[4] Organization for Economic Cooperation and Development (OECD), "Development aid rises again in 2015, spending on refugees doubles" (13 April 2016), available from www.oecd.org/newsroom/development-aid-rises-again-in-2015-spending-on-refugees-doubles.htm.

[5] See OECD, "Development aid in 2015 continues to grow despite costs for in-donor refugees", available from: www.oecd.org/dac/stats/ODA-2015-detailed-summary.pdf.

[6] Estimates include concessional loans and grants, as well as debt relief and technical cooperation provided within the South for development purposes.

[7] Estimates of gross flows, including countries that report to the Development Assistance Committee of OECD (such as some Arab and central and eastern European countries) and estimates from published national sources for countries that do not (such as Brazil, China and India). See "Providers of development co-operation beyond the DAC: trends and profiles" in OECD, *Development Cooperation Report 2015, Making Partnerships Effective Coalitions for Action* (Paris, 2015).

10. The commitments of the World Bank rose in fiscal years 2014 and 2015.[8] Its concessional lending arm, the International Development Association (IDA), which relies on donor contributions to provide highly concessional credits and grants to the world's poorest countries, has grown steadily over the decade in nominal terms, but the last IDA replenishment, agreed in 2013, was broadly flat in real terms.[9] The concessional lending facilities of the regional development banks have remained relatively stable in nominal terms.[10]

11. Annual commitments of non-grant subsidized finance from seven multilateral development banks reached $71.1 billion in 2014-2015, with disbursements of $53 billion and a total exposure of $358.5 billion.[11] National and subregional development banks also exhibited growing levels of commitments and disbursements. Both the New Development Bank and the Asian Infrastructure Investment Bank initiated their first loans and held their first annual meetings in 2016. In the first half of 2016, the New Development Bank approved over $800 million in investments, while the Asian Infrastructure Investment Bank approved over $500 million for four projects.

B. Private capital flows to developing countries

12. In 2015, net capital outflows from developing countries reached $530 billion, outpacing the outflows during the financial crisis. Despite some revival in the first months of 2016, capital outflows are expected to reach $606 billion in 2016.[12] In particular, China witnessed net outflows of $485 billion in 2015 and $123 billion in the first quarter of 2016,[13] in part reflecting corporate efforts to reduce their exposure to dollar-denominated debt.

13. Foreign direct investment (FDI) remains the most stable form of capital flow and, as noted in the Action Agenda, can make an important contribution to sustainable development, particularly when projects are aligned with national and regional sustainable development strategies. Global FDI jumped 36 per cent in 2015 to an estimated $1.76 trillion, its highest level since the global economic and financial crisis of 2008-2009. A strong increase in FDI inflows in developed economies, including a $721 billion surge in cross-border mergers and acquisitions, was the principal factor behind the global rebound, although developing countries also saw their FDI grow, increasing by 5 per cent to a new high of $741 billion.[14]

14. The increased FDI into developing countries was primarily due to increasing inflows to developing Asia, with FDI inflows to India nearly doubling in 2015. FDI to the least developed countries rose by 33 per cent to $35 billion, although the

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[8] World Bank, *Annual Report 2015* (Washington, D.C., 2015).

[9] See ida.worldbank.org/financing/replenishments/ida17-replenishment.

[10] Rebecca M. Nelson, "Multilateral development banks: overview and issues for Congress" (Congressional Research Service, December 2015).

[11] United Nations, *World Economic Situation and Prospects 2016* (New York, 2016).

[12] See IMF, World Economic Outlook database, April 2016.

[13] Data for the first quarter of 2016 from national sources, available from www.safe.gov.cn/wps/wcm/connect/6d920c804c296c90a415af4393d9cc2e/The_time-series_data_of_Balance_of_Payments_of_China.xlsx?MOD=AJPERES&CACHEID=6d920c804c296c90a415af4393d9cc2e.

[14] For foreign direct investment data, see United Nations Conference on Trade and Development, Global Investment *Trends* Monitor, No. 22, 20 January 2016, available from unctad.org/en/PublicationsLibrary/webdiaeia2016d1_en.pdf.

upturn was largely due to inflows into Angola, over three quarters of which were loans provided by foreign parent firms to their Angolan affiliates.[15] Overall, FDI into Africa fell by 31 per cent to $38 billion, with the largest declines in sub-Saharan Africa. FDI generally declined into countries with large natural resources, including Mozambique, Nigeria and South Africa. Nonetheless, FDI into developing countries remains concentrated in countries with natural resources, bypassing some countries where the needs are greatest. FDI into Latin America and the Caribbean also declined, with inflows to Brazil, the region's principal recipient, falling 23 per cent to $56 billion.

15. Weakening aggregate demand and falling commodity prices, accompanied by depreciating national currencies, also weighed on outward investment from many developing and transition economies. Measured by FDI stock, China has become the largest outward investor in the least developed countries.[16] Europe became the world's largest investing region overall.

16. Portfolio flows to developing countries, which tend to be more volatile than FDI, fell from $26 billion inflows in 2014 to $363 billion outflows in 2015, with expectations of outflows of around $255 billion in 2016. The largest capital outflow from developing countries has been in the "other investment" category, which includes currency and deposits, loans, trade credits and other financial sector instruments, and is expected to decline further, by $675 billion, in 2016. Cross-border bank lending to developing countries, generally the largest component of "other investment", contracted by 8 per cent in 2015.[17] The impact of that was greatest in China, where cross-border lending to residents of mainland China dropped $305 billion from its mid-2014 peak, including by 25 per cent in 2015.[18]

17. An additional concern about financial stability in recent years has been the growth in private sector external debt in developing countries and emerging markets.[19] While there is no regular reporting on the aggregate stocks of such debt, research carried out by the International Monetary Fund (IMF) in 2015 estimated that the debt of emerging market non-financial corporations had risen from $4 trillion in 2004 to over $18 trillion in 2014.[20] More recent data for 20 large emerging markets indicates that at year end 2015, total credit to non-financial corporations topped $25 trillion, over 103 per cent of the GDP of those countries.[21]

18. Many developing countries have used international reserves to mitigate the impact on exchange rates and other pressures generated by large capital outflows. Reserves in developing and transition economies increased by only $172 billion in 2014 and then declined by over $511 billion in 2015. In absolute terms, that was in

[15] *World Investment Report 2016: Investor Nationality — Policy Challenges* (United Nations publication, Sales No. E.16.II.D.4).
[16] Ibid.
[17] Based on Bank for International Settlements (BIS) data availability and country classification, available from www.bis.org/statistics/bankstats.htm.
[18] Bank for International Settlements "BIS international banking statistics at end-December 2015", April 2016, available from www.bis.org/statistics/rppb1604.pdf.
[19] See A/71/276 and A/71/311 for reports by the Secretary-General on sovereign external debt.
[20] "Corporate leverage in emerging markets: a concern?" in IMF, *Global Financial Stability Report — Vulnerabilities, Legacies and Policy Challenges: Risks Rotating to Emerging Markets* (Washington, D.C., October 2015).
[21] Bank for International Settlements, statistics on credit to the non-financial sector, accessed on 21 July 2016, available from stats.bis.org/statx/toc/CRE.html.

large part driven by China, where reserves were drawn down by $343 billion in an attempt to stabilize the renminbi, and in Western Asia, as a result of the lower oil prices.[22]

19. Countries typically invest reserves in safe liquid assets, with 64 per cent of official reported reserves being held in United States dollars in the first quarter of 2016, up from 61 per cent in 2014.[23] However, the accumulation of safe low-yielding assets comes with an opportunity cost, since reserves could have been invested in domestic productive capacity and infrastructure at much higher returns and with greater developmental impact.

C. Long-term investment in sustainable development

20. The Action Agenda emphasizes that the financial system should develop mechanisms to meet long-term financing needs. There has been interest from the international community in the role of investors with long-term liabilities, such as pension funds, life insurance companies and sovereign wealth funds, which between them are estimated to hold assets valued at over $60 trillion. However, those investors are currently a main contributor to portfolio flows, which have a short-term focus and have contributed to the volatility in capital flows noted above. The reallocation of that large pool of resources remains a challenge. Many such investors continue to invest predominantly in liquid assets, with pension funds in the largest pension markets holding 76 per cent of their portfolios in liquid assets.[24] Nonetheless, there has been a shift towards more illiquid assets, including real estate, private equity and infrastructure. In part, that reflects the low interest rate environment, but might also reflect structural shifts (see A/71/311).

21. The Action Agenda also stresses the importance of continuing to better align investors' horizons with the Sustainable Development Goals through a variety of recommendations, instruments, reforms and other policy measures, including measures to strengthen the international financial architecture.

III. Strengthening the international financial architecture in support of the 2030 Agenda for Sustainable Development

22. The Monterrey Consensus of the International Conference on Financing for Development focuses on the importance of a stable international financial architecture. The Addis Ababa Action Agenda reiterates that, while also stressing the role of the financial system in intermediating credit and investment, in particular long-term investment, and placing a greater emphasis on the role of development banks. It also emphasizes the importance of incorporating sustainability factors into the rules that govern the financial system, in order to achieve the Sustainable Development Goals.

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[22] IMF, *World Economic Outlook: Too Slow for Too Long* (Washington, D.C., April 2016).

[23] IMF, currency composition of official foreign exchange reserves database, available from data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4.

[24] Willis Towers Watson, "Global pension assets study, 2016" (February 2016).

A. International public finance institutions

23. The Action Agenda emphasizes that multilateral development banks should make optimal use of their resources and balance sheets, and should update and develop their policies in support of the 2030 Agenda. It also encourages multilateral development finance institutions to establish a process to examine their own role, scale and functioning to enable them to adapt and be fully responsive to the sustainable development agenda.

24. A joint statement from the multilateral financial institutions welcomed the adoption of the 2030 Agenda. The World Bank and IMF outlined their plans for adapting to the 2030 Agenda at their annual meetings in 2015, which were welcomed by a ministerial communiqué.[25] In Asia, while the Asian Development Bank (ADB) will continue to be guided by its Strategy 2020, adopted in 2008, implementation of the 2030 Agenda will be supported by a renewed partnership of the Economic and Social Commission for Asia and the Pacific (ESCAP), ADB and the United Nations Development Programme. Other development banks have indicated that their priorities align with the 2030 Agenda, but have not yet elaborated specific plans for re-examining their role or functioning with regard to it.

25. The World Bank Group last had a capital increase, agreed along with a reform of voting rights, in 2010. In October 2015, the Governors agreed to consider a general capital increase, aiming to reach a decision by the annual meetings in 2017. That coincides with the timetable for further reform of the governance of the Bank (see below). Donors are also considering changes to the way IDA is capitalized. Meetings on the IDA replenishment in the first half of 2016 explored the possibility of leveraging the equity of IDA and making greater use of grants and concessional loans from IDA donors, allowing it to make a higher level of commitments.

26. ADB is working to further optimize its balance sheet. The agreement to merge the lending operations of the Asian Development Fund and the ordinary capital resources of ADB will come into effect in 2017. That will enable it to expand its annual loan and grant approvals from $13 billion in 2014 to more than $20 billion by 2020. At the same time, a number of the Governors of ADB have suggested further capital increases in the medium term. The capital increase of the Inter-American Development Bank, ratified in 2012, should be complete in 2016, resulting in an increase of $70 billion in its ordinary capital resources.

27. At the Group of 20 (G20) Summit, held in Antalya, Turkey, in November 2015, the G20 leaders agreed a five-point action plan to optimize the balance sheets of the multilateral development banks to leverage additional lending out of existing capital resources.[26] In response, the banks have undertaken a number of actions, including setting up a platform to exchange loans to further diversify their portfolios, and prepared a joint response to the G20, which was welcomed at the meeting of G20 Finance Ministers held in July 2016.[27]

28. The Action Agenda also stresses that development banks should establish or maintain social and environmental safeguard systems, including on human rights,

[25] Available from www.imf.org/external/np/cm/2015/101015.htm.
[26] See g20.org.tr/wp-content/uploads/2015/11/Multilateral-Development-Banks-Action-Plan-to-Optimize-Balance-Sheets.pdf.
[27] See www.g20.org/English/Documents/Current/201607/t20160728_3091.html.

gender equality and women's empowerment, that are transparent, effective, efficient and time-sensitive. The World Bank began its safeguards review in 2012. Its Board of Directors discussed a second draft of the new safeguard policies in July 2015 and a consensus emerged on the overall architecture and some of the proposed provisions. The Board opened a third consultation on the draft from August 2015, focused on the feasibility of applying the largely agreed framework in borrowing countries, as well as other open issues that required further attention. The consultations concluded in March 2016.

29. The Asian Infrastructure Investment Bank published a draft safeguard policy in September 2015. After a short consultation and revision period, the final policy was agreed in February 2016, including statements on human rights and gender equality.[28] According to the policy, enforcement of the safeguards will be through both project-level grievance mechanisms and an oversight mechanism, which is still being designed. The New Development Bank has not yet published a safeguard policy, but is recruiting staff related to environmental and social safeguards.

30. Member States have repeatedly emphasized the importance of women's rights and gender equality, including in the financing for development outcomes, and have encouraged the multilateral development banks to include gender equality in their investment decisions. The World Bank Group adopted a new gender strategy in December 2015, which runs from 2016 to 2023 and builds on the conceptual framework developed in the 2012 World Development Report on gender.[29] Its country-driven approach aims to maximize the impacts of efforts to close gender gaps in key development outcomes by steering activities and their monitoring towards measurable and meaningful results. The Bank monitors the gender components of its lending in its corporate reporting. According to its October 2015 scorecard, 64 per cent of projects were gender-informed in the three dimensions of analysis, action and monitoring; 70 per cent of projects were reporting on gender results during implementation; and all country strategies had incorporated gender. The International Finance Corporation (IFC) has been collecting indicators disaggregated by gender through its Development Outcome Tracking System since 2009. In line with the new gender strategy of the World Bank Group, IFC will develop a revised results framework that better reflects gender outcomes in its work. That will include working with its clients on increasing their collection and use of data disaggregated by gender. The African Development Bank Group has strengthened the focus of its results measurement framework on gender and is now seeking to track data, disaggregated by gender, on the beneficiaries of its operations wherever possible. In 2014, 89 per cent of its new projects had a gender-informed design, with 78 per cent having satisfactory gender-equality outcomes.[30]

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[28] Asian Infrastructure Investment Bank, "Environmental and social framework" (February 2016).

[29] World Bank Group gender strategy 2016-2023, "Gender equality, poverty reduction, and inclusive growth" (2015), available from documents.worldbank.org/curated/en/2015/12/25691813/world-bank-group-gender-strategy-fy16-23-gender-equality-poverty-reduction-inclusive-growth.

[30] African Development Bank Group, "Annual development effectiveness review 2015: driving development through innovation" (2015).

B. International financial regulation

31. Since the financial crisis, the international community has worked to strengthen the resilience of the financial sector through regulatory reform, aimed primarily at ensuring the safety and soundness of the financial system. Reforms have focused on the banking and insurance sectors and on derivatives markets and shadow banks.

32. The ultimate goal of the financial system is to facilitate the flow of funds from savers to borrowers and effectively allocate funds throughout the economy. The safety and soundness of both individual institutions and the system more broadly is crucial to supporting lending and investment. At the same time, the financial system should provide access to credit if it is to contribute effectively to sustainable development. Reducing risks, particularly systemic risks, while promoting access to credit and financial services for all, presents a complex challenge for policymakers, since there can be trade-offs between the two. The regulatory and policy framework thus needs to strike the appropriate balance.[31]

33. Meanwhile, the Action Agenda notes that financing flows need to be aligned with sustainable development. That can be done through various policy mixes, including pricing externalities, blended finance and guarantees, and leveraging private investment through public intermediaries, such as development banks. It can also be included in the financial governance architecture. For example, the United Nations Environment Programme Inquiry into the design of a sustainable financial system cites several examples, including the focus of the Central Bank of Brazil on socio-environmental risk management flows as part of its core functions as a prudential bank regulator; the argument of the Bangladesh Bank that its support for rural enterprises and green finance contributes to financial and monetary stability; and the prudential review of climate risks to the insurance sector in the United Kingdom undertaken by the Bank of England, based on a connection between its core prudential duties and the United Kingdom Climate Change Act.

Banking regulation

34. International standards for banking regulation are established by the Basel Committee on Banking Supervision, with guidance from the Financial Stability Board, and then adopted into national regulations. The Basel III framework for banking regulation raised the capital adequacy standards for banks, meaning that regulated institutions must hold more core capital relative to assets. At the end of October 2015, the risk-based capital framework had been implemented in all 24 jurisdictions of the Board. The six European Union jurisdictions have included carve-outs that allow lower risk weighting for exposure to sovereign debt and loans to small and medium enterprises, in an attempt to ensure sufficient access to credit in those areas, although this has led to them being judged materially non-compliant with the Basel III standard in peer reviews.[32] Liquidity coverage ratio regulation

[31] See Ratna Sahay and others, “Financial inclusion: can it meet multiple macroeconomic goals?” IMF staff discussion note (September 2015), available from www.imf.org/external/pubs/ft/sdn/2015/sdn1517.pdf.

[32] Financial Stability Board, “Implementation and effects of the G20 financial regulatory reforms: report of the Financial Stability Board to G20 Leaders” (9 November 2015).

was completed in all jurisdictions and disclosure requirements are in draft form in seven jurisdictions.[33]

35. The Committee finalized or issued for consultation a number of global standards for banks during 2015, including margin requirements for non-centrally cleared derivatives; interest rate risk in the banking book; net stable funding ratio disclosure standards; review of the credit valuation adjustment risk framework; criteria for identifying simple, transparent and comparable securitizations; haircut floors for non-centrally cleared securities financing transactions; revisions to the standardized approach to credit risk; and minimum capital requirements for market risk.[34] It has also started work on a review of the regulatory treatment of sovereign risk, which may have an effect on the cost of borrowing for countries considered risky.

36. The use of internal risk models has been criticized since the adoption of Basel II, because the models are highly complex, may allow regulatory arbitrage and may not appropriately handle tail-end risks. Some have argued that they favour larger, more complex financial institutions, which have the capacity to run such models. In addition, there was a concern that the implementation of Basel II advanced approaches which allowed banks to use internal risk models, was uneven and allowed large variations of risk weighting across institutions and jurisdictions. The 2016 work programme of the Committee on Banking Supervision addresses the excessive variability in risk-weighted assets. The Committee plans to look at the rules for and the application of the internal risk models of banks and may impose capital floors, based on standardized approaches. The Committee aims to complete the review by the end of 2016.

37. Governments have also committed to addressing the risk of "too-big-to-fail" financial institutions and the cross-border elements in effective resolution of troubled systemically important financial institutions. To address the issue of "too-big-to-fail", the Financial Stability Board has suggested that designated global systemically important banks should have a total loss-absorbing capacity beyond the general standards of Basel III, comprising the capital and long-term debt of the institution. In November 2015, the Board published a term sheet with a quantitative determination of total loss-absorbing capacity. The implementation of new rules for domestic systemically important banks to have a higher loss-absorbing capacity, which were approved by the Committee on Banking Supervision in 2012 and were to be phased in from January 2016, is nearly complete, although four jurisdictions are still in the process of final adoption.[35] Structural reforms to global systemically important banks, meant to separate core banking activities from market-based activities, have yet to be accepted in many countries and are still being debated.

38. The Action Agenda notes that national policy decisions in relation to financial regulation can have systemic and far-ranging effects well beyond national borders,

[33] Basel III introduced two required liquidity ratios. The "liquidity coverage ratio" requires a bank to hold sufficient high-quality liquid assets to cover its total net cash outflows over 30 days; the "net stable funding ratio" requires the available amount of stable funding to exceed the required amount of stable funding over a one-year period of extended stress. See, for example, www.bis.org/bcbs/publ/d366.htm.

[34] See Bank for International Settlements, *86th Annual Report* (Basel, Switzerland, June 2016).

[35] Basel Committee on Banking Supervision, "Tenth progress report on adoption of the Basel regulatory framework" (April 2016). The standard has also been considered as not applicable to the United States.

including in developing countries. The report of the Financial Stability Board on implementation, dated November 2015, marks the first year that the report has attempted to assess the impact of the implementation of the new financial regulatory reforms. The report found that no major "unintended consequences" in emerging market and developing countries had yet been identified, but acknowledged that evidence was largely qualitative. It noted that some countries had been affected by spillover from the implementation of reforms in the home jurisdictions of global financial institutions. It also noted that it was empirically difficult to single out the effects of reforms, either positive or negative, which was particularly the case for long-term reforms that were still being implemented.

39. In April 2015, the G20 asked the Board to consider risks related to climate change. In November, the Board proposed the creation of an industry-led task force to develop recommendations on climate-related financial disclosures. Appropriate disclosures are not only a prerequisite for financial firms to manage and price climate risks accordingly, but also to allow them to take lending, investment or insurance underwriting decisions based on their view of transition scenarios. In December 2015, the Board launched the industry-led Task Force on Climate-related Financial Disclosures. The Task Force will develop a set of recommendations for consistent, comparable, reliable, clear and efficient climate-related disclosures by companies. It has concluded that its recommendations will apply broadly to financial and non-financial firms.

40. On a country level, there has also been an increase in environmental, social and governance reporting and disclosure. A recent study found that there had been a substantial increase in reporting instruments over the past several years, with almost 400 sustainability reporting instruments in existence in 64 countries.[36] Disclosure for financial services companies represents 37 per cent of sector-specific instruments, up from 24 per cent in 2013. Nonetheless, reporting is not standardized and it is unclear to what extent it has changed behaviour.

Shadow banking, derivatives, financial inclusion and correspondent banking

41. Given the impetus for tightening regulation on the banking system, there is a concern that financial activity will shift to shadow banking.[37] The Financial Stability Board estimates two different measures of shadow banking: the narrow measure, which focuses on non-bank financial entities that pose financial stability risks, rose to $36 trillion in 2014. A broader measure, which includes all "other financial institutions", saw an increase to $80 trillion. An even broader measure, which includes pension funds and insurance companies, grew by 9 per cent to $137 trillion.[38] A number of policies were recently finalized in this area (e.g. money market funds, risk alignment of securitization), so implementation is generally at an early stage. A peer review by the Board in May 2016 indicated that more work needed to be done and that "only a few FSB jurisdictions currently have a systematic process involving all relevant domestic authorities … to ensure that [the

[36] Wim Bartels and others, "Carrots and sticks: global trends in sustainability reporting regulation and policy" (KPMG and others, 2016).

[37] The term "shadow banking" is sometimes used to refer to unregulated financial intermediation that facilitates the creation of credit; however, the Financial Stability Board defines shadow banking as credit intermediation involving entities and activities outside the regular banking system.

[38] Financial Stability Board, "Global shadow banking monitoring report 2015" (November 2015).

regulatory perimeter] encompasses non-bank financial entities and activities that could pose financial stability risks”.[39]

42. The 2008 crisis also exposed risks associated with unregulated derivatives, particularly over-the-counter derivatives, which dramatically increase leverage in the financial system. The reforms agreed at the Financial Stability Board, which included the need for trade reporting, central clearing, platform trading and margin posting, were due to be phased in at the end of 2012. By November 2015, half of the Board jurisdictions had implemented central clearing arrangements and one third had fully implemented the platform trading requirements. In many jurisdictions, there are still legal impediments to the effective use and sharing of information derived from trading platforms and central clearing parties. The rules on margin requirements for non-centrally cleared derivatives are to be phased in between September 2016 and 2019.

43. One of the risks of tightening the rules on shadow banking is that unregulated financial institutions often play an important role in financial inclusion, particularly in developing countries. The Action Agenda thus emphasizes the importance of a robust risk-based regulatory framework for all financial intermediation that considers their impact on inclusion (see A/71/311). Member States have committed to considering including financial inclusion as a policy objective in financial regulation, in accordance with national priorities and legislation. They have also agreed to work to ensure that the policy and regulatory environment supports stability in the financial markets and promotes financial inclusion in a balanced manner and with appropriate consumer protection.

44. Correspondent banking relationships, agreements between two banks in different countries to handle transactions on behalf of each other, are an important part of the international financial system. They enable the provision of domestic and cross-border payments and are critical for facilitating the transfer of remittances from migrant workers. The Action Agenda stresses the need for adequate financial services and the facilitation and reduction in cost of remittance transfers, but many correspondent banking relationships have been terminated in the wake of the financial crisis. In July 2016, IMF staff wrote that “in recent years, several countries have reported a reduction in CBRs by global banks. Pressure on CBRs has been associated with restricted access to financial services by certain categories of customers, business lines, jurisdictions or regions”.[40]

45. Evidence of the decline of correspondent banking relationships comes from surveys, such as those conducted by the World Bank and published in November 2015, and IMF discussions with country authorities. The Financial Stability Board has also published a report on the decline in such relationships and prepared an action plan that was endorsed by the G20 in November 2015. The action plan included (a) further examining the dimensions and implications of the decline; (b) clarifying regulatory expectations, including more guidance from the Financial Action Task Force; (c) domestic capacity-building in affected jurisdictions; and

[39] Financial Stability Board, “Thematic review on the implementation of the Financial Stability Board policy framework for shadow banking entities” (May 2016).

[40] Michaela Erbenová and others, “The withdrawal of correspondent banking relationships: a case for policy action”, IMF staff discussion note (June 2016).

(d) strengthening the tools used for due diligence, including the use of the legal entity identifier in correspondent banking.[41]

Credit rating agencies

46. In 2012, the Financial Stability Board set out a road map to reduce mechanistic reliance on credit rating agency ratings in standards, laws and regulations. The 2014 peer review of implementation by national authorities of the 2010 "Principles for reducing reliance on CRA ratings" found that more could be done to address gaps in individual action plans. As one example, a European Union report from October 2015 found that references to credit ratings were still present in national and European Union legislation, as well as within the collateral frameworks of some central banks.

47. In the United States of America, financial regulators have replaced the mandatory use of credit ratings with alternative approaches that include the use of definitions, regulatory models and evaluation by third parties, but credit rating agency ratings are still allowed to be used by banks in their internal risk models.[42] Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the United States Securities and Exchange Commission annually assesses credit rating agencies, with the most recent report, published in December 2015, covering their activities in 2014.[43] It found that one larger agency and some smaller ones did not have adequate policies, procedures and controls to manage issuer-paid conflict or to prevent the access of analytical personnel to fee or market share information. It also found that at one of the larger credit rating agencies, policies and procedures were not sufficient to prevent prohibited unfair, coercive or abusive practices and that the decision of the agency in question to issue an unsolicited rating of an issuer was motivated at least in part by market share considerations.

C. Multilateral reform

Safety nets and macroeconomic surveillance

48. An adequate global financial safety net can provide liquidity in times of systemic crisis, reducing the incentive for countries to accumulate excess reserves as a form of self-insurance against adverse shocks.[44] The IMF aimed to strengthen the global financial safety net after the global financial crisis by quadrupling its lending resources and introducing several new financing instruments, with the objective of reducing the perceived stigma of borrowing from the Fund and encouraging countries to ask for assistance before they faced a full-blown crisis. The Action Agenda recognizes the need to strengthen the permanent international financial safety net with a strong and quota-based Fund.

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[41] Financial Stability Board, "Report to the G20 on actions taken to assess and address the decline in correspondent banking" (November 2015).

[42] John Soroushian, "Credit ratings in financial regulation: what's changed since the Dodd-Frank Act", Office of Financial Research (April 2016).

[43] United States, Securities and Exchange Commission "2015 Summary report of Commission staff's examinations of each nationally recognized statistical rating organization" (December 2015).

[44] The global financial safety net is generally considered to comprise international reserves, the resources of the IMF, central bank bilateral swap arrangements and regional financing arrangements. Some analysts include market-based instruments as well.

49. In advance of the Third International Conference on Financing for Development, the Fund reformed its lending architecture to expand access to its concessional resources and provide the poorest countries with a wider safety net to handle unanticipated shocks.[45] Key measures include raising access limits by 50 per cent for all concessional facilities, rebalancing the funding mix of concessional to non-concessional financing under blended arrangements and setting the interest rate at zero for rapid credit facility loans to low-income countries with urgent balance of payments needs.

50. In November 2015, the Board of the IMF decided to include the renminbi as the fifth currency that makes up the basket of special drawing rights (SDRs). Because of the substantial increase in the international use and trading of the renminbi, it will form 10.92 per cent of the SDR basket, starting in October 2016. The Fund will also separately identify the renminbi in its official foreign exchange reserves database from that date.

51. A paper by IMF staff in March 2016 noted the growth and reforms of the global financial safety net, while also laying out the case for further reforms.[46] In it they argued that, while the safety net had grown significantly since the global financial crisis, important gaps remained in the architecture. As noted in the paper, the safety net is now more fragmented, has uneven coverage and remains too costly, unreliable and conducive to moral hazard. IMF staff are currently working on a deeper assessment as the basis for considering whether broader reforms to the Fund toolkit would be helpful in addressing the gaps.

52. In the Action Agenda, Member States called for strengthened cooperation between the IMF and regional financial arrangements, while safeguarding their respective independence. The importance of this was underscored in the case of the loans made to Greece in the last several years, with challenges emerging in the cooperation with the emergency financing arrangements of the European Union, owing to different approaches to the lending framework and sequencing of required policy reforms.[47] In May 2016, the Association of Southeast Asian Nations agreed to strengthen cooperation with the IMF by conducting a joint test run of their regional financial arrangement, the Chiang Mai Initiative Multilateralization.

53. In the Action Agenda, Member States recognized that a stable global macroeconomic environment would facilitate the implementation of policies that contribute to sustainable development. Given the current state of the global economy, the IMF intends to conduct intensified monitoring through its external sector report, which gives an update of global imbalances and presents an integrated and multilaterally consistent assessment of the external sector positions and policies of large economies. In 2016, G20 countries also recommitted to conducting financial sector stability assessments at least every five years.

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[45] See IMF, "Financing for development: enhancing the financial safety net for developing countries" (July 2015).

[46] IMF, "Adequacy of the global financial safety net" (March 2015).

[47] Independent Evaluation Office of the IMF, "The IMF and the crises in Greece, Ireland, and Portugal: an independent evaluation by the Independent Evaluation Office" (July 2016).

Capital account management

54. The Action Agenda recognized that when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported by macro-prudential and, as appropriate, capital flow management measures. A forthcoming stocktaking exercise by the IMF of country experiences in dealing with capital flows will draw lessons and examine emerging issues, including reviewing the experience with the framework on the liberalization and management of capital flows articulated by the institutional view of the IMF. In addition, OECD is reviewing its members' experience, with its requirement to liberalize all capital flows. The United Nations system also continues to do work on capital account management, including publishing a compendium of capital account management measures used globally.[48]

Women's participation in the economy

55. In the Action Agenda, Member States committed to ensuring women's equal access to and opportunities for participation and leadership in the economy. Using data from regular enterprise surveys, covering 169 countries, the World Bank estimates that across all countries more than 35 per cent of firms have female participation in ownership. However, only 18.5 per cent of firms have females as a top manager and only 13.3 per cent have majority female ownership.[49] A private sector database of holders of seats on corporate boards globally showed that in 2015 only 15 per cent were women, which drops to 8.4 per cent if only major corporations in emerging markets are considered.[50] Similarly, data from the International Labour Organization on the gender composition of occupations published in 2016 shows that women hold 43.1 per cent of managerial, technical and professional roles globally, but only 41.3 per cent of such roles in developing countries.[51]

Global economic governance

56. The Action Agenda recommits to broadening and strengthening the voice and participation of developing countries in international economic decision-making and norm-setting and global economic governance. Countries also reiterated their commitment to further reform of governance at both the IMF and the World Bank to adapt to changes in the global economy.

57. The quota and governance reforms agreed at the IMF in 2010 became effective in January 2016. The reforms doubled the quota resources of the IMF and realigned quota shares, increasing the aggregate voting rights of developing and emerging market countries and improving their representation on the Board. The aggregate quota share of emerging market and developing countries increased by 2.8 per cent to 42.4 per cent. All board members will henceforth be elected, eliminating the right

[48] See, for example, José Antonio Ocampo and Stephany Griffith-Jones, "A counter-cyclical framework for a development-friendly international financial architecture", Department for Economic and Social Affairs working paper No. 39 (June 2007).

[49] See World Bank Group enterprise surveys, available from www.enterprisesurveys.org/data/exploretopics/gender.

[50] Linda-Eling Lee and others, "Women on boards: global trends in gender diversity on corporate boards", MSCI (November 2015).

[51] ILO "Women in work: trends 2016" (2016).

to appoint an executive director that had been enjoyed by the five largest shareholders.[52] Consents to the quota changes are required and, as of July 2016, all but nine countries had lodged their formal consents with the IMF. The fifteenth General Review of Quotas, including a new quota formula, was originally to be completed by January 2014, but the Governors have now agreed that the work should be completed in time for the annual meetings in 2017.

58. The World Bank shareholding review, agreed in 2010, is still being phased in, as countries have until March 2017 to subscribe for their new shares in the institution and pay in additional capital. In 2010, the Governors agreed to conduct periodic shareholding reviews of the Bank and IFC every five years, beginning in 2015. The review in 2015 covered the weighting of members in the world economy, their contributions to the development mission of the World Bank Group and progress towards equitable voting power. At the spring meeting in 2016, the Development Committee welcomed the interim report on the dynamic formula and stressed the need for the further work planned, aiming to reach an agreement by the 2017 annual meetings, in line with the shareholding review principles and the road map agreed in Lima in 2015.[53]

59. In the Action Agenda, Member States, as the shareholders in the main international financial institutions, committed to an open, transparent, gender-balanced and merit-based selection of the heads of the main international financial institutions. In January 2016, the IMF Executive Board opened a process for selection of its Managing Director, as the first term of the incumbent, Christine Lagarde, was due to expire in July 2016. The board invited nominations during a three-week window. Only one nomination, for Ms. Lagarde, was received. In mid-February, the IMF Executive Board thus reappointed Ms. Lagarde for a second term. The five-year term of World Bank President, Jim Yong Kim, is due to expire in July 2017. As yet, the World Bank Executive Board has not announced any timeline for the presidential selection in 2017.

Role of the United Nations in promoting policy coherence

60. The Action Agenda recognizes that institutional "silos" need to be broken down through cross-fertilization of ideas and more effective coordination of actions, as well as the importance of addressing inconsistencies in the system. In the Agenda, Member States committed to taking better advantage of relevant United Nations forums for promoting universal and holistic coherence and international commitments to sustainable development. The 2030 Agenda and financing for development processes have already served to increase cooperation between United Nations agencies, the World Bank Group and the IMF and among development banks. The Inter-agency Task Force on Financing for Development, which includes the five major institutional stakeholders and over 50 United Nations agencies, international organizations and other relevant actors, such as the Financial Stability Board and OECD, can serve to further increase collaboration between international institutions. Members of the Task Force already plan to use it as a platform for advancing cross-institutional work on specific topics.

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[52] For full details of the reforms, including the results for individual countries and groups, see "IMF quota and governance reform: elements of an agreement" (October 2010).

[53] IMF and World Bank Development Committee, "2015 shareholding review: report to the Governors" (September 2015).

61. At the fourteenth session of the United Nations Conference on Trade and Development (UNCTAD), held in Nairobi in July 2016, at which the Nairobi consensus (the Maafikiano) was adopted, Member States directed the UNCTAD secretariat to support developing countries, upon their request, in the formulation and implementation of national trade policy and regulatory frameworks and their integration into national development strategies and macroeconomic policies. UNCTAD will also continue working on investment policy frameworks, international investment agreements and the links between gender equality, women's and girls' empowerment and trade and development.

62. The Economic and Social Council has a key role to play in addressing issues of coherence, coordination and cooperation. As a result of the Action Agenda, the annual special high-level meeting of the Council with the Bretton Woods institutions, the World Trade Organization and UNCTAD was incorporated into an annual Council forum on financing for development follow-up. The forum provides an important platform for strengthening international cooperation and its outcomes should guide all Member States and relevant organizations.

IV. Illicit financial flows and international tax cooperation

63. Tackling tax evasion and avoidance and other illicit financial flows remains one of the biggest challenges in mobilizing domestic revenues for developing countries. In October 2015, OECD published a conservative estimate of the value of base erosion and profit shifting, estimating that between 4 and 10 per cent of corporate income tax, or $100 billion and $240 billion annually, is evaded. The report "confirm[ed] that profit shifting is occurring, is significant in scale and likely to be increasing, and creates adverse economic distortions".[54]

64. In a globalized world, there are limits to what countries can do to combat illicit financial flows on their own. The Action Agenda thus called for international tax cooperation to be strengthened and decided to work to further enhance the resources of the Committee of Experts on International Cooperation in Tax Matters. It was agreed that the frequency of Committee meetings would be increased from a total of five days per year in one session to eight days per year in two sessions. The Committee met in October 2015 and considered proposed upcoming guidance on issues such as profit shifting, taxation of service transactions, the extractive industries and tax treaties. It adopted an extensive programme of work, including the creation of two new subcommittees on royalties and on dispute avoidance and resolution. However, the Economic and Social Council has yet to decide on the dates and venue of the future sessions of the Committee.

65. In the Action Agenda, Governments committed to making sure that all companies, including multinationals, pay taxes to the Governments of the countries where economic activity occurs and value is created, in accordance with national and international laws and policies. As one set of actions to address this, a series of reports that comprise an action plan on base erosion and profit shifting, including 15 action items, was published by OECD in October 2015 and endorsed by the G20 leaders at their summit in November 2015. The action plan includes guidance in 11 substantive areas, including on how multinational enterprises may allocate

[54] OECD, *Measuring and Monitoring BEPS, Action 11-2015 Final Report* (Paris, 2015).

profits derived from intellectual property, on the use of management fees and on other intra-group service provision charges, which have been used to shift profits to shell companies in low- or no-tax jurisdictions. OECD has launched an inclusive framework for implementation of the action plan, which, by July 2016, included 85 jurisdictions.[55] The framework seeks to ensure implementation of the four minimum standards arising from the action plan on harmful tax practices, tax treaty abuse, country-by-country reporting and dispute resolution mechanisms, which will be subject to a peer review process.

66. OECD endorsed an implementation package for country-by-country reporting of multinational enterprises in May 2015, whereby the ultimate parent entity of a multinational group with consolidated group revenue of more than 750 million euros would file a country-by-country financial report in its jurisdiction of residence. There are template agreements to facilitate the exchange of such reports, but no central registry. Furthermore, the exchange of information will be subject to the existence of bilateral tax agreements and information technology, which may not be in place for all authorities, especially in developing countries. There is no provision for public transparency on the number of such reports filed or the number exchanged between tax authorities.

67. To properly audit the activities of multinational enterprises, tax authorities will require access to the country-by-country reports. The inability of developing countries to access such reports effectively, because of their less extensive network of tax treaties, may further widen the gap between the taxation capacity of developed and developing countries. Under their domestic legal systems, some countries are likely to seek reports from domestic entities that are part of multinational enterprises, even without tax treaties in place, raising issues about confidentiality. Based on the Convention on Mutual Administrative Assistance in Tax Matters (see below), OECD has now also prepared a Multilateral Competent Authority Agreement on the Exchange of Country by Country Reports. As at the end of June 2016, 44 countries had signed the Agreement. However, some developed countries that host a significant number of multinational enterprises have not signed the agreement and few developing countries have so far signed.

68. The Action Agenda also highlighted the need for access to information on beneficial ownership for the competent authorities. Access to such information can improve the ability of tax authorities to detect tax avoidance and evasion practices by both individuals and enterprises. The most widely used standard is derived from the standard of the Financial Action Task Force and forms part of the standard on exchange of information of the Global Forum on Transparency and Exchange of Information for Tax Purposes. Access to information on the beneficial ownership of an entity in another jurisdiction will generally require a bilateral agreement of some type, such as a double tax treaty or a tax information exchange agreement. Some countries are proceeding unilaterally to public registries. The United Kingdom has legislated to implement a centralized public registry, which became operational in June 2016; Norway and Denmark have also committed to operating public registries; and in May 2015, the European Union promulgated rules that all member States must have centralized registries available to country authorities, although it did not require them to be public. In April 2016, the United Kingdom, Germany, France, Italy and Spain announced an agreement for piloting the automatic

[55] See www.oecd.org/ctp/beps-about.htm.

exchange of beneficial ownership information. Finance ministers from those countries have co-written a letter to their G20 counterparts to urge a global standard for such an exchange, which they suggest OECD and the Financial Action Task Force could take the lead in creating.[56]

69. Information exchange between jurisdictions on financial accounts and tax matters is typically based on either a bilateral agreement, such as a double tax treaty or a tax information exchange agreement or, for parties to it, the multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Multilateral Competent Authority Agreement on the Common Reporting Standards, which now has 84 signatories, is based on article 6 of the Convention. OECD now expects that the first exchange relationships under the Agreement will become effective in late 2016 or early 2017. In relation to the automatic exchange of information, more countries and jurisdictions have joined the Global Forum on Transparency and Exchange of Information for Tax Purposes, which now has 134 members. After 2017, OECD plans to facilitate an in-depth peer review of each jurisdiction that has signed up to the standard on automatic exchange of information to assess compliance.

70. An important issue for international tax cooperation remains that of ensuring that developing countries, including the least developed countries, receive the benefit of information exchange on tax matters in terms of support for the information technology needed for automatic exchange, capacity-building on seeking exchanges and responding to requests, and on data analysis and risk assessment. It is also important that the administrative burdens on such countries are minimized and that confidentiality issues, while very important, are not used to improperly deny information flows to such countries.

71. The IMF, OECD, United Nations and World Bank Group have formed a platform for collaboration on tax to better support Governments through strengthening links between capacity-building and standard-setting, and systematic sharing of information on activities.

V. Conclusion

72. As emphasized in the chapters of the Action Agenda and highlighted in the present report, ensuring a stable, effective and inclusive international financial system will remain critical to achieving the 2030 Agenda for Sustainable Development, including the Sustainable Development Goals, and leaving no one behind.

[56] See www.gov.uk/government/publications/g5-letter-to-g20-counterparts-regarding-action-on-beneficial-ownership.