INGIMUNDUR FRIÐRIKSSON[1]

Code of Good Practices on Transparency in Monetary and Financial Policies

This article discusses the Code of Transparency Practices for Monetary and Financial Policies adopted by the International Monetary Fund's Interim Committee in autumn 1999. The member countries are not obliged to adopt the Code although they are encouraged to follow its spirit.

At a meeting in autumn 1999 the International Monetary Fund's Interim Committee adopted a Code of Good Practices on Transparency in Monetary and Financial Policies.[2] Earlier, it had already adopted a similar Code of Good Practices on Fiscal Transparency.[3]

To some extent the background to the Code is the financial crises which have struck various parts of the world in the past few years, most recently in Asia where a chain reaction ensued in Russia and various Latin American countries. In the wake of these crises, systematic efforts followed aimed at strengthening the architecture of the international financial system, with the IMF playing a key role. One of the targets of these efforts was to increase transparency in public administration, which in many places was inadequate. Lack of transparency may have contributed to concealing the reality behind economic developments and policy implementation, for example in the Asian countries which experienced troubles in 1997 and 1998.

In recent years systematic action has been undertaken to increase transparency in economic policies in many parts of the world, in particular in the industrialized countries. Transparency increases understanding of governments' policies and actions and serves to impose restraint on them. In the long term, transparent economic policies may be expected to lead to more focused strategies and facilitate market participants and the public in identifying the economic position and prospects.

The IMF developed its Code of Good Practices on Transparency in Monetary and Financial Policies in cooperation with the Bank for International Settlements and in consultation with central banks, financial agencies and other international and regional organizations and academic experts before their adoption in autumn 1999.

Members of the IMF are not obliged to adhere to the Code, but are encouraged to implement it where possible. Central banks of many industrial countries have already adopted procedures which are consistent with it, others have generally made less progress, and some very little. The following article outlines the section of the Code addressing monetary policies and is largely based on its introductory chapter.

The Code "identifies desirable transparency practices for central banks in their conduct of monetary policy," as the Introduction to it states. The guiding principle behind transparency is to provide the public with understandable, accessible and timely information about its legal, institutional, and economic framework and about central bank accountability.

The transparency principles focus on: (1) clarity of roles, responsibilities and objectives of central banks and financial agencies; (2) the processes for formulating and reporting of monetary policy decisions by the central bank and of financial policies by financial agencies; (3) public availability of informa-

1. The author is Assistant Governor of the Central Bank of Iceland.
2. The Code is published on the IMF website www.imf.org under the section *Standards and Codes*.
3. Also published on the IMF website.

tion on monetary and financial policies; and (4) accountability and assurances of integrity by the central bank and financial agencies.

Highlights of the IMF Code of Transparency Practices:

- The case for transparency of monetary and financial policies is based on two main premises. First, the effectiveness of monetary and financial policies can be strengthened if the goals and instruments of policy are known to the public and if the authorities can make a credible commitment to meeting them. In making available more information about monetary and financial policies, good transparency practices promote the potential efficiency of markets. Second, good governance calls for central banks and financial agencies to be accountable, particularly where the monetary and financial authorities are granted a high degree of autonomy.

- In making the objectives of monetary policy public, the central bank enhances the public's understanding of what it is seeking to achieve, and provides a context for articulating its own policy choices, thereby contributing to the effectiveness of monetary policy. Further, by providing the private sector with a clear description of the considerations guiding monetary policy decisions, transparency about the policy process makes the monetary policy transmission mechanism generally more effective, in part by ensuring that market expectations can be formed more efficiently. By providing the public with adequate information about its activities, the central bank can establish a mechanism for strengthening its credibility by matching its actions to its public statements.

- The benefits for countries adopting good transparency practices in monetary and financial policies have to be weighed against the potential costs. In situations where increased transparency in monetary and financial policies could endanger the effectiveness of policies, or be potentially harmful to market stability or the legitimate interests of supervised and other entities, it may be appropriate to limit the extent of such transparency.

- In the case of monetary policy, the rationale for limiting some types of disclosure arises because it could adversely affect the decision-making process and the effectiveness of policies. Similarly, exchange rate policy considerations, notably, but not exclusively, in countries with fixed exchange rate regimes, may provide justification for limiting certain disclosure practices. For example, extensive disclosure requirements about internal policy discussion on money and exchange market operations might disrupt markets, constrain the free flow of discussion by policymakers, or prevent the adoption of contingency plans. Thus, it might be inappropriate for central banks to disclose internal deliberations and documentation, and there are circumstances in which it would not be appropriate for central banks to disclose their near-term monetary and exchange rate policy implementation tactics and provide detailed information on foreign exchange operations.

- With regard to informing the public about monetary and financial institutions and their policies, an important issue concerns the modalities that these public disclosures should take. In particular with regard to monetary policy, should transparency practices have a legislative basis in a central bank law, or be based in other legislation or regulation, or be adopted through other means? The Code takes a pragmatic approach to this issue and recognizes that a variety of arrangements can lead to good transparency practices. On matters pertaining to the roles, responsibilities, and objectives of central banks (and for principal financial regulatory agencies), it recommends that key features be specified in the authorizing legislation (e.g., a central bank law). Specifying some of these practices in legislation gives them particular prominence and avoids ad hoc and frequent changes to these important aspects of the operations of central banks and relevant financial agencies. Information about other transparency aspects, such as how policy is formulated and implemented and the provision of information, can be presented in a more flexible manner. However, it is important that such information be readily accessible, so that the public can with reasonable effort obtain and assimilate the information.

- While good transparency practices for the formulation and reporting of monetary and financial policies help to contribute to the adoption of sound policies, the Code is not designed to offer judgments on the appropriateness or desirability of specific monetary or financial policies or frameworks that countries should adopt. Transparency is not an end in itself, nor is transparency a substitute for pursuing sound policies; rather, transparency and sound policies are better seen as complements.
- Monetary and financial policies are interrelated and often mutually reinforcing, with the health of the financial system affecting the conduct of monetary policy and vice versa. However, the institutional arrangements for these two types of policies differ considerably [...] To take account of this, the Code is separated into two parts: good transparency practices for monetary policy by central banks; and good transparency practices for financial policies by financial agencies. The basic elements of transparency for both policies are, however, similar.

The Central Bank of Iceland and transparency of monetary policy

In recent years the Central Bank of Iceland has been striving to adopt transparency-orientated procedures which have established themselves in many countries. To this end, the Bank attempts to provide the clearest possible explanations of its monetary policy, monetary policy instruments and assessments of the economic and monetary position and outlook. One main channel for the Bank to present such assessments is its publications, now in particular in its quarterly Monetary Bulletin. This assessment is used as the basis for the Bank's monetary actions. The Bank announces its actions in press releases both in Icelandic and English, in connection with which the Governors are consistently ready to face the media and explain the underlying principles of the actions. Furthermore, the Bank makes a weekly update of the statistical data on its website, thereby facilitating market participants in monitoring economic and monetary developments. Finally, the Bank has sought to use its annual report as a platform to provide more detailed explanations of various aspects of its operations than before.

Several years ago the IMF designed a Special Data Dissemination Standard, SDDS.[4] Members of the Fund were given the opportunity to subscribe to the SDDS formally, whereby they would be obliged to publish detailed statistics in a specific format and according to a preannounced schedule. Iceland undertook the SDDS obligations in 1996 and the Central Bank fulfils them.

The Central Bank's status vis-à-vis the Code on Good Transparency Practices

The provisions of Chapter 1 (on clarity of roles, responsibilities and objectives of central banks for monetary policy) are not entirely fulfilled in Iceland. Although the Bank's ultimate objectives are stated in Art. 3 of the Central Bank Act, these are extensive in character and not entirely self-consistent, besides which it is questionable whether the Central Bank can fulfil them all with the instruments at its disposal, nor does the Bank have full authority to utilize its monetary policy instruments to attain policy objectives. Suffice it to mention in this context that changes to required reserves are subject to ministerial consent. Item 1.2.1 refers to government overdrafts with central banks. Under the current Central Bank Act, the Treasury is authorized to overdraw on its current account with the Bank. An agreement made with the Minister of Finance in 1992 (and twice renewed since) suspended this authorization, as Central Bank publications have frequently pointed out. Issues covered under Item 1.3 (on agency roles on behalf of the government) have also been addressed in the Bank's publications, in particular its annual report.

The provisions of Chapter 2 (on the open process for formulating and reporting monetary policy decisions) are largely met in Iceland. The monetary policy framework has been explained in the Bank's publications and Governors' speeches. The same applies to monetary policy instruments. Various regulations issued by the Bank, concerning for example its trans-

4. Published on the IMF website www.imf.org and on dsbb.imf.org. The Central Bank of Iceland described the SDDS to the Icelandic public in its annual report for 1999, pp. 38-39.

actions with counterparties, are made public on its website. No formal monetary policy-making committee is active at the Bank. The Central Bank Act assigns monetary authority to the Governors who continually monitor the position and take action when they see reason to do so. Such decisions are not made on preannounced days as is customary in some countries today. Monetary policy decisions are invariably announced without delay, with press releases. Through its extensive publishing activities, the Bank issues periodic public assessments of the economic and monetary conditions and outlook, as well as its progress towards achieving them. Substantial changes in monetary policy are more often than not made in consultation with the relevant parties. An example was the reforms made to the Central Bank's monetary policy instruments early in 1998, when the institutions affected by them were informed of the pending changes and consulted about them. By law the Central Bank is entitled to collect statistical data and a summary of the tasks involved is given in the annual report.

Chapter 3 describes principles for public availability of information on monetary policy, which the Central Bank of Iceland broadly fulfils. Its presentations and releases of central bank data meet standards that are consistent with the International Monetary Fund's data dissemination standards, the Bank publicly discloses its monthly balance sheet, including data on the foreign exchange reserve and associated liabilities, according to a preannounced schedule, and discloses data on its repurchase agreements with credit institutions on a regular basis. The Bank undertakes extensive publishing activities, as described above, and Central Bank officials are consistently ready to explain its objectives and performance to the public. Texts of regulations issued by the Bank are made available to the public on its website.

Broadly speaking, the principles concerning the Central Bank's accountability and integrity are met in Iceland. No rules have been set on the conduct of personal financial affairs of bank officers and other employees. Rules are in effect on the handling of confidential information, among other things to prevent conflicts of interest.

GOOD TRANSPARENCY PRACTICES FOR MONETARY POLICY BY CENTRAL BANKS

I. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES OF CENTRAL BANKS FOR MONETARY POLICY

1.1 The ultimate objective(s) and institutional framework of monetary policy should be clearly defined in relevant legislation or regulation, including, where appropriate, a central bank law.

1.1.1 The ultimate objective(s) of monetary policy should be specified in legislation and publicly disclosed and explained.

1.1.2 The responsibilities of the central bank should be specified in legislation.

1.1.3 The legislation establishing the central bank should specify that the central bank has the authority to utilize monetary policy instruments to attain the policy objective(s).

1.1.4 Institutional responsibility for foreign exchange policy should be publicly disclosed.

1.1.5 The broad modalities of accountability for the conduct of monetary policy and for any other responsibilities assigned to the central bank should be specified in legislation.

1.1.6 If, in exceptional circumstances, the government has the authority to override central bank policy decisions, the conditions under which this authority may be invoked and the manner in which it is publicly disclosed should be specified in legislation.

1.1.7 The procedures for appointment, terms of office, and any general criteria for removal of the heads and members of the governing body of the central bank should be specified in legislation.

1.2 The institutional relationship between monetary and fiscal operations should be clearly defined.[1]

1.2.1 If credits, advances, or overdrafts to the government by the central bank are permitted, the conditions when they are permitted, and any limits thereof, should be publicly disclosed.

1.2.2 The amounts and terms of credits, advances, or overdrafts to the government by the central bank and those of deposits of the government with the central bank should be publicly disclosed.

1.2.3 The procedures for direct central bank participation in the primary markets for government securities, where permitted, and in the secondary markets, should be publicly disclosed.

1.2.4 Central bank involvement in the rest of the economy (e.g., through equity ownership, membership on governing boards, procurement, or provision of services for fee) should be conducted in an open and public manner on the basis of clear principles and procedures.

1.2.5 The manner in which central bank profits are allocated and how capital is maintained should be publicly disclosed.

1.3 Agency roles performed by the central bank on behalf of the government should be clearly defined.

1.3.1 Responsibilities, if any, of the central bank in (i) the management of domestic and external public debt and foreign exchange reserves, (ii) as banker to the government, (iii) as fiscal agent of the government, and (iv) as advisor on economic and financial policies and in the field of international cooperation, should be publicly disclosed.

1.3.2 The allocation of responsibilities among the central bank, the ministry of finance, or a separate public agency, for the primary debt issues, secondary market arrangements, depository facilities, and clearing and settlement arrangements for trade in government securities, should be publicly disclosed.

II. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

2.1 The framework, instruments, and any targets that are used to pursue the objectives of monetary policy should be publicly disclosed and explained.

2.1.1 The procedures and practices governing monetary policy instruments and operations should be publicly disclosed and explained.

2.1.2 The rules and procedures for the central bank's relationships and transactions with counterparties in its monetary operations and in the markets where it operates should be publicly disclosed.

2.2 Where a permanent monetary policy-making body meets to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, information on the composition, structure, and functions of that body should be publicly disclosed.

2.2.1 If the policy-making body has regularly scheduled meetings to assess underlying economic developments, monitor progress toward achieving its monetary policy objective(s), and formulate policy for the period ahead, the advance meeting schedule should be publicly disclosed.

2.3 Changes in the setting of monetary policy instru-

1. The practices in this area should be consistent with the principles of the International Monetary Fund's *Code of Good Practices on Fiscal Transparency*.

ments (other than fine-tuning measures) should be publicly announced and explained in a timely manner.

2.3.1 The central bank should publicly disclose, with a preannounced maximum delay, the main considerations underlying its monetary policy decisions.

2.4 The central bank should issue periodic public statements on progress toward achieving its monetary policy objective(s) as well as prospects for achieving them. The arrangements could differ depending on the monetary policy framework, including the exchange rate regime.

2.4.1 The central bank should periodically present its monetary policy objectives to the public, specifying, inter alia, their rationale, quantitative targets and instruments where applicable, and the key underlying assumptions.

2.4.2 The central bank should present to the public on a specified schedule a report on the evolving macroeconomic situation, and their implications for its monetary policy objective(s).

2.5 For proposed substantive technical changes to the structure of monetary regulations, there should be a presumption in favor of public consultations, within an appropriate period.

2.6 The regulations on data reporting by financial institutions to the central bank for monetary policy purposes should be publicly disclosed.

III. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

3.1 Presentations and releases of central bank data should meet the standards related to coverage, periodicity, timeliness of data and access by the public that are consistent with the International Monetary Fund's data dissemination standards.

3.2 The central bank should publicly disclose its balance sheet on a preannounced schedule and, after a predetermined interval, publicly disclose selected information on its aggregate market transactions.

3.2.1 Summary central bank balance sheets should be publicly disclosed on a frequent and preannounced schedule. Detailed central bank balance sheets prepared according to appropriate and publicly documented accounting standards should be publicly disclosed at least annually by the central bank.

3.2.2 Information on the central bank's monetary operations, including aggregate amounts and terms of refinance or other facilities (subject to the maintenance of commercial confidentiality) should be publicly disclosed on a preannounced schedule.

3.2.3 Consistent with confidentiality and privacy of information on individual firms, aggregate information on emergency financial support by the central bank should be publicly disclosed through an appropriate central bank statement when such disclosure will not be disruptive to financial stability.

3.2.4 Information about the country's foreign exchange reserve assets, liabilities and commitments by the monetary authorities should be publicly disclosed on a preannounced schedule, consistent with the International Monetary Fund's Data Dissemination Standards.

3.3 The central bank should establish and maintain public information services.

3.3.1 The central bank should have a publications program, including an Annual Report.

3.3.2 Senior central bank officials should be ready to explain their institution's objective(s) and performance to the public, and have a presumption in favor of releasing the text of their statements to the public.

3.4 Texts of regulations issued by the central bank should be readily available to the public.

IV. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

4.1 Officials of the central bank should be available to appear before a designated public authority to report on the conduct of monetary policy, explain the policy objective(s) of their institution, describe their performance in achieving their objective(s), and, as appropriate, exchange views on the state of the economy and the financial system.

4.2 The central bank should publicly disclose audited financial statements of its operations on a preannounced schedule.

4.2.1 The financial statements should be audited by an independent auditor. Information on accounting policies and any qualification to the statements should be an integral part of the publicly disclosed financial statements.

4.2.2 Internal governance procedures necessary to ensure the integrity of operations, including internal audit arrangements, should be publicly disclosed.

4.3 Information on the expenses and revenues in operating the central bank should be publicly disclosed annually.

4.4 Standards for the conduct of personal financial affairs of officials and staff of the central bank and rules to prevent exploitation of conflicts of interest, including any general fiduciary obligation, should be publicly disclosed.

4.4.1 Information about legal protections for officials and staff of the central bank in the conduct of their official duties should be publicly disclosed.