Activities of the Bank

This chapter reviews the activities of the Bank and the international groups it hosts over the past year. These activities focus on the promotion of cooperation among central banks and other financial authorities, and the provision of financial services to central bank customers. The chapter also presents an overview of significant developments in the internal organisation and management of the Bank. The reports mentioned in this chapter, as well as most of the Bank's research output, are available on the BIS website (www.bis.org) or, on request, in hard copy. Details of the activities of the major standing committees hosted by the BIS can also be found on the Bank's website.

1. Promotion of international cooperation: direct contributions of the BIS

Regular consultations on monetary and financial matters

The bimonthly meetings of Governors of BIS member central banks are at the heart of the Bank's contribution to international financial cooperation. During the period under review these meetings continued to provide Governors and senior central bank officials with an opportunity to exchange views on conjunctural developments and issues of topical interest or concern. The November 2002 bimonthly meeting was hosted by the Bank of Mexico in Mexico City.

Several meetings are organised on the occasion of the bimonthly gatherings, each with a different set of participants. The *Global Economy Meeting* brings together the central bank Governors of the main industrial and emerging market economies for a discussion of recent developments and prospects in key economies and financial markets. During the year under review, Governors sought to assess the strength of the global economy within the context of a particularly uncertain environment. The uncertainties to a large extent related to the impact of the protracted decline in equity prices, debt sustainability concerns in a number of major Latin American economies, deflation in several Asian economies, possible strains in a range of financial industries and, as the year progressed, geopolitical tensions centred around Iraq.

During the *meetings of the Governors of the G10 countries*, specific aspects of the cyclical situation were analysed in greater detail, often with a focus on potential policy reactions in the event of a sharp weakening of the global economy. G10 Governors were also briefed on discussions in the committees reporting to them and approved a number of committee documents for public release or consultation (see below). In March 2003, Governors met jointly with the heads of the (non-central bank) supervisory agencies of the G10 countries to review the progress made in drafting the New Basel Capital Accord (see below) and to exchange views on its prospective implementation.

In-depth discussions of a particular topic of interest to central banks take place in a meeting to which all central bank Governors attending the bimonthly gatherings are invited. During the period under review, a broad range of monetary and financial stability themes were debated in these *All Governors' Meetings*, including the implications of demographic changes for the macroeconomy and the financial system; accounting issues in the financial industry; crises of confidence and debt sustainability; dealing with deflation; and central bank approaches to communication with the public.

The Bank continued to organise high-level meetings between central bank Governors and senior representatives of the financial industry. Three such meetings were held during the period under review, producing a fruitful exchange of views on the interaction between developments in the financial industry and the conjunctural situation, and on how to deal with existing or potential weaknesses in the current infrastructure of financial markets.

Outside the framework of the bimonthly gatherings, a series of meetings on issues of special central bank interest were organised throughout the year, in some cases with the participation of a broad range of public and private financial sector specialists.

These meetings included the traditional spring and autumn meetings of central bank economists. The *Spring Economists' Meeting* focused on major issues in the current conjunctural situation and outlook. The *Autumn Meeting of Research Economists* considered new challenges for central banks posed by a world of low and stable inflation, supply side transformations, liberalised financial markets and pronounced cycles in asset prices and credit.

In addition, several ad hoc meetings were organised at the Bank's headquarters as well as at its Asian Office (see below). In September 2002, both the economic and legal aspects of regional currency areas and the use of foreign currencies were discussed among a group of central banks that are either already working under such a regime or aim to establish one. Senior central bank and academic experts explored the link between monetary stability, financial stability and the business cycle in a conference held in March 2003. The BIS also co-organised with Università Bocconi, Milan, as part of the university's centenary celebrations, a conference on risk and stability in the financial system. The conference brought together researchers from central banks and academia and considered the role of markets, corporate managers and regulators in promoting the robustness of the financial system.

A significant number of meetings focused on topics of particular relevance to emerging market economies. As in previous years, working parties on regional monetary policy were held in Asia (Manila, the Philippines, in June 2002), Latin America (Cartagena, Colombia, in October 2002) and Europe (Warsaw, Poland, in February 2003). The annual *Deputy Governors' Meeting* in Basel considered the implications of fiscal policy for central banking in emerging market economies. To celebrate the inauguration of the Bank's Representative Office for the Americas (see below), a roundtable on the choice of exchange rate regimes was organised for Governors from Latin American and other major emerging economies. Finally, in December 2002, Governors from Africa convened in Basel for a two-day discussion of a broad range of issues of relevance to their central banks.

Other areas of central bank cooperation promoted by the BIS

Central bank governance

The objective of the work on central bank governance undertaken by the BIS is to compile, analyse and disseminate information on institutional and organisational matters of interest to central banks. These activities are overseen by the Central Bank Governance Steering Group and are conducted through the Network on Central Bank Governance. The Steering Group comprises eight Governors from a broadly based and representative range of central banks. The Network currently spans about 40 major central banks and monetary authorities around the world.

The Steering Group provides guidance to the Bank on how best to respond to the needs of central banks for governance information, and discusses topical questions of interest to Governors. Following the advice of the Steering Group, the Bank has accorded priority to requests from central banks that are critical for the effective operation of independent and accountable monetary authorities. During the year, demand for governance information spanned a wide range of subjects. The collegial cooperation by the members of the Governance Network in supplying related information for the benefit of the central bank community once again proved a crucial asset for this work. It allowed the Bank to increase its knowledge base on central bank governance matters, which is now electronically available to central banks.

Cooperation on statistics

The BIS continued to work closely with central banks and other international organisations in various statistical areas. Last year, seven new central banks of emerging market countries began to report economic, monetary and financial data on a regular basis, and an additional seven signed up to join the BIS Data Bank. Several initiatives are under way to broaden the topical coverage of the Data Bank, particularly in the area of financial stability.

Central banks from major financial centres continued to share with the BIS comprehensive statistics on the international lending and borrowing activities of banks in their jurisdictions, on a balance of payments basis as well as on a consolidated basis. In response to recommendations by the Committee on the Global Financial System (see below), the BIS and the reporting central banks last year developed new guidelines for improved reporting of banks' consolidated country risk exposures on an ultimate risk basis. This will result in more detailed and comprehensive data on specific types of country risk exposure, including off-balance sheet positions relating to banks' derivatives transactions.

In response to recommendations made by the Markets Committee (see below), an agreement was reached on the methodology to be used for the next Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity, scheduled for 2004. Central banks and the BIS have also been exploring how to enhance or complement reporting arrangements under the existing BIS surveys of derivatives to take account of credit risk transfers.

During the past year, the BIS prepared and published a new version of its *Guide to the international financial statistics*, which covers not only the BIS statistics on international banking and foreign exchange, but also those on securities and derivatives. The new Guide includes an assessment of the quality of the BIS statistics as well as an indication of how the data can be used for analysing capital flows and financial market developments globally. For instance, the BIS banking and securities statistics are an important input to the joint BIS-IMF-OECD-World Bank statistics on external debt, compiled on the basis of creditor data collected by these international organisations. To address the concern that these data sometimes differ noticeably from external debt data reported by the debtor countries themselves, the BIS undertook a study to identify the major gaps between the creditor and debtor data and organised a workshop with emerging market central banks to discuss the issue. A report covering the results of the workshop and the study was published in December 2002.

In August 2002, the BIS hosted the first independent conference of the Irving Fisher Committee on Central-Bank Statistics (IFC), a forum for discussion on statistical issues that are of interest to its more than 60 central bank members. The conference reviewed the challenges to central bank statistical activities with respect to both monetary and financial stability. Attention was also paid to cooperation with national statistical offices and improving the use and usefulness of central bank statistics (see www.ifcommittee.org).

Finally, steps have been taken to strengthen international cooperation on electronic standards for statistical information exchange, in response to an ongoing request from Data Bank participants. Various projects were launched under the auspices of the Statistical Data and Metadata Exchange (SDMX) initiative, in which the BIS works together with the ECB, Eurostat, IMF, OECD and UN. An updated Generic Statistical Message for batch exchange of Time Series – GESMES/TS – has been agreed and will be implemented by all sponsoring organisations. This will result in significant cost savings in central banks, as they will no longer have to submit and receive statistical data in a variety of formats. A demonstration is also being prepared of how new web-based technologies can improve the collection, compilation and web-based dissemination of statistical information. The joint BIS-IMF-OECD-World Bank statistics on external debt are used as a practical case study. A number of central banks contribute to the various projects, which are documented on the SDMX website (www.sdmx.org).

Cooperation with central bank groupings

As well as through the BIS's own activities, central bank cooperation takes place in various parts of the world through existing regional central bank associations. The regional groups provide an effective platform for disseminating information on BIS activities, as well as for establishing relations with central banks that do not otherwise participate in these activities directly. This cooperation, where possible through the Bank's regional offices, takes the form of participation in meetings arranged by these groups and the organisation of ad hoc joint meetings or workshops.

As mentioned below, the BIS Asian Office worked closely on a number of occasions with EMEAP (Executives' Meeting of East Asia-Pacific Central Banks and Monetary Authorities). Various BIS business areas organised joint events with SEACEN (South East Asian Central Banks), which was invited to the meeting of the BIS Data Bank Experts. In addition the BIS provided support to SEANZA (Central Banks of South East Asia, New Zealand and Australia) and has been liaising with the Secretariat of SAARC (South Asian Association for Regional Cooperation) and the central banks of the GCC (Gulf Cooperation Council).

The BIS continued to assist the central banks of the major industrialised countries in coordinating their technical assistance and training for central banks of countries in southeast Europe and the Commonwealth of Independent States (as well as some Asian countries in transition). This takes place through regular consultation meetings, in which the IMF and the ECB also participate, and the maintenance of a database on technical assistance and training to which donor and recipient central banks contribute. The BIS also continued to support the Joint Vienna Institute (JVI), in close cooperation with the Financial Stability Institute (FSI) and the Basel-based groups (see below), by offering a number of seminars for central banks from transition economies on topics relating to monetary and financial stability. Though the BIS will formally cease to participate in the JVI in 2004, the Bank will continue to provide support.

Last year the Governors of the central banks of MEFMI (Macroeconomic and Financial Management Institute of Eastern and Southern Africa) held their annual meeting at the BIS, and a number of BIS experts were made available for MEFMI training events. A joint meeting was also organised with the central banks of SADC (Southern African Development Community). Moreover, in cooperation with the Bank of France, the BIS for the first time helped in capacity building at CESAG (Centre Africain d'Etudes Supérieures en Gestion), within a programme sponsored, amongst others, by the BCEAO (Central Bank of West African States) and BEAC (Bank of the States of Central Africa). Finally, the establishment of the BIS's Americas Office has facilitated active cooperation with CEMLA (Centro de Estudios Monetarios Latinoamericanos). A number of BIS experts have made presentations at CEMLA events, and the BIS Data Bank Experts have supported the CEMLA initiative to establish a regional database on economic and monetary statistics.

Group of Computer Experts

The major goals of the participants in the Group of Computer Experts and its Working Party on Security Issues are to share technical and organisational experiences, to develop and maintain contacts with other central bank IT managers, and to keep abreast of IT developments at central banks.

In the light of the events of 11 September 2001, business continuity planning and provision of alternative IT infrastructure received significant attention from both the main Group and its Working Party during the past year. In this connection, IT security was another important theme. Meetings also focused on how central banks can take advantage in a secure manner of the benefits of the internet, with a number of presentations describing initiatives at central banks to provide secure, high-capability internet infrastructure and applications. Finally, control of the costs of IT has remained a central concern of the Computer Experts. During the past year, participants reported regularly on cost control initiatives and their results.

Internal Audit

Over the past few years, central bank auditors have met regularly to share experiences in their area of expertise, and to explore new and challenging issues. In this context, the Bank of England hosted the 16th Annual Conference of Heads of Internal Audit in May 2002. The main topics for discussion included operational risk, internal auditing standards, the auditing of outsourced activities and corporate governance. In addition, delegates reviewed key business risks faced by their banks, control issues and auditing innovations that had arisen during the previous year. A conference subgroup on IT issues prepared papers on information architecture, internet security, remote access and laptops.

Representative Office for Asia and the Pacific

Benefiting from four years of experience since its opening in 1998, the Representative Office for Asia and the Pacific (the Asian Office) stepped up its efforts to foster central bank cooperation in the region. As part of these efforts, the Office serves as the secretariat for the Asian Consultative Council (ACC), which provides a vehicle for communication between central banks in the region and the Board and Management of the BIS. The ACC has met twice a year since 2001. In addition, the Regional Treasury dealing room, which was opened in late 2000, has enhanced the level and scope of the Office's banking services to the region, not only through daily trading activities but also through assistance provided during visits to reserve managers of central banks.

During the period under review, the Asian Office hosted and supported a series of high-level meetings in Hong Kong SAR and elsewhere in Asia, sometimes jointly with regional central banks and related institutions. The fifth Special Meeting of Asian central bank Governors took place in Sydney in February 2003; participants reviewed the current economic situation and discussed capital flows in East Asia. In September 2002, the Asian Office jointly hosted a seminar on capital account liberalisation with the Chinese State Administration of Foreign Exchange (SAFE) in Beijing, assembling central bankers and economists from four continents. In the same month, a second meeting on monetary policy operating procedures brought together central bank practitioners from within and outside the region to discuss common challenges in this area and potential responses to them. In December 2002, the Office hosted the EMEAP Forum of regional and global officials responsible for the implementation of foreign exchange policy. Finally, in February 2003, a meeting on the experience of deflation in East Asia brought together monetary strategists from central banks within and outside the region. The Office also provided secretariat support to various meetings pertaining to financial stability.

The Asian Office continued to contribute to the Bank's financial and economic research on Asia and the Pacific, and to provide expertise to various meetings organised by regional central banking groups and individual central banks. Topics analysed included the integration of regional bond and banking markets; the investment of dollar foreign exchange reserves; living with flexible exchange rates; the monetary transmission mechanism; foreign currency deposits in domestic banks; and Chinese asset management companies. In the area of banking supervision, the Office has cooperated with regional central banks and bank supervisors in promoting the New Basel Capital Accord through various channels, such as by coordinating and analysing regional participation in the third quantitative impact study.

Representative Office for the Americas

In June 2002, the Host Country Agreement between the BIS and the government of the United Mexican States entered into force. This allowed the Bank to open a Representative Office for the Americas (the Americas Office) in Mexico City. The Americas Office was formally inaugurated in November 2002, in the presence of Governors and representatives of around 50 central banks. The Office will coordinate the activities of the BIS in the Americas, aiming to strengthen further the relations between, and to promote cooperation among, the Bank and the central banks and monetary authorities in the region. In addition, the Office will support BIS banking services provided to institutions based in the region, improve the exchange of information and facilitate the organisation of meetings and seminars.

In pursuing these goals, the Americas Office is cooperating with regional central banking and supervisory organisations, in particular CEMLA. It has contributed to the Bank's financial and economic research on Latin America and the Caribbean, and has provided expertise in support of various events organised by regional central banking groups, individual central banks and the FSI.

Financial Stability Institute

The FSI assists financial sector supervisors globally in implementing sound supervisory standards. Its work is concentrated on banking and insurance sector issues. High-quality, up-to-date information is required for financial sector supervisors to keep pace with innovations in financial markets, the progressive shift to risk-focused supervision systems, and increasingly complex capital requirements. The FSI meets this demand through an intensive programme of disseminating standards and best practices and providing assistance on a wide range of supervisory matters. In particular, the FSI designs and delivers focused and special seminars, as well as regional workshops, for financial sector supervisors around the world. These events also serve the purpose of fostering cross-border supervisory contacts and cooperation.

Over the past year, the FSI organised a total of 49 events, comprising 27 seminars and 22 regional workshops held jointly with regional groups of supervisors. These seminars and workshops covered a variety of topics chosen after consultation with supervisors from a wide range of countries. Topics included the management of credit, market, operational and other risks; risk-focused supervision; corporate governance; consolidated supervision; problem bank resolution; accounting and audit issues; and steps to counter money laundering. The FSI continued to place special emphasis on providing banking supervisors with a better understanding of the proposed changes to the Basel Capital Accord. This effort will continue through the implementation phase for the New Accord. Over 1,600 representatives of central banks and banking and insurance supervisory agencies from all regions of the world participated in FSI events in the past year.

Cooperation with other institutions providing programmes of assistance to supervisors is an important part of the FSI's work. Therefore, it continued to collaborate with such organisations as the World Bank, the IMF, the Toronto International Leadership Centre and regional development banks. The FSI also supported the commitment of the BIS to the JVI. In addition to presentations made at FSI events, FSI staff also spoke on a broad range of topics at various non-FSI conferences and meetings.

In order to provide senior supervisors with information on supervisory developments and key issues affecting financial sector supervision, the FSI publishes a quarterly newsletter, *FSI World*. In 2002 the FSI also presented its first biennial award for research conducted on issues related to banking supervision.

An important new project initiated during the past year has been the FSI's e-learning programme for financial sector supervisors (e-LP). This programme will offer courses over the internet on a wide range of topics of interest to financial sector supervisors. The e-LP will be a valuable tool for all levels of expertise: for the senior-level supervisor, who needs to keep abreast of supervisory issues that are constantly changing; for the technical expert, who needs to be up to date on the state of the art; and for the more junior supervisor, who will have the opportunity to become familiar with the essential elements of sound supervisory practices. The initial courses are expected to be available in the first half of 2004 and will cover various risk management topics, as well as the proposed New Basel Capital Accord. The e-LP is viewed as a strong complement to the FSI's existing activities and will enable the Institute to reach out to a wider audience of financial sector supervisors globally.

2. Promotion of financial stability through the permanent committees

A number of committees have their secretariats at the BIS. These standing committees trace their origin back to requests made by the Governors of the G10 central banks over the course of the past 40 years for study of the basic aspects of the functioning of international financial markets and financial institutions. The committees are chaired by senior officials of member central banks and are composed of central bank experts and, in the case of the Basel Committee on Banking Supervision, members from non-central bank supervisory authorities. Although members are mainly (though not exclusively) from G10 countries, special initiatives are increasingly being undertaken to share experiences with, and invite the views of, those not directly involved in the work of the committees.

Basel Committee on Banking Supervision

Over the past year, the Basel Committee on Banking Supervision has continued its efforts to strengthen the international financial system by promoting prudential supervisory standards and good banking practices for risk management. The development of a new framework for assessing bank capital adequacy has been the Committee's most important and highest-profile initiative during this period. However, the Committee has also been active in the work of the international community to address weaknesses in market foundations, has issued guidance to address key banking risks, and has extended its support for combating the financing of terrorism.

The work of the Basel Committee to develop a new capital adequacy framework for the global banking system made substantial progress during the period under review and is now close to completion. On 29 April 2003, the Committee released its third and final consultative paper on the New Basel Capital Accord for a three-month comment period. It expects to publish the Accord in final form by the end of the year. The New Accord is intended to increase the risk sensitivity of bank capital requirements by aligning them more closely with modern risk management practices. Not only will more risk-sensitive capital requirements lead to more meaningful and informative measures of capital adequacy, but they will also provide benefits through stronger and more accurate incentive structures. These quantitative measures are supported by specific standards designed to strengthen supervisory review and disclosure.

The third consultative paper is a fully specified proposal for the New Accord. It represents the results of a comprehensive and sustained period of consultation with the industry as well as with supervisors not represented on the Committee. A major input into the development and refinement of the new capital framework has come from various "field tests" of the proposed changes to the current Accord. The biggest and most wide-ranging field test (known as the third quantitative impact study) was carried out in the fourth quarter of 2002. Over 300 banks from some 40 countries worldwide took part in the exercise. The field test was undertaken with the goals of ensuring the quality of the Committee's proposals and gathering information helpful to making further modifications prior to the release of the formal consultation paper. A report assessing the results of this field test was released by the Committee in early May 2003.

With the New Accord nearing finalisation, the Accord Implementation Group (AIG), a subgroup of the Basel Committee, has been leading work in the area of implementation. In particular, the AIG has been looking at how to promote greater convergence across jurisdictions in supervisors' approaches to implementation of the New Accord, through information sharing among Committee members about bank and supervisory practices related to the adoption of the new framework. Also, the AIG has been meeting with the Core Principles Liaison Group (consisting of representatives from 15 non-G10 countries, the IMF and the World Bank) to discuss implementation issues, and will continue to do so throughout the implementation process.

Across its range of work, the Basel Committee strives to strengthen prudential supervisory standards throughout the world's banking systems, in both G10 and non-G10 countries. Although the Committee is not an accounting or audit standard setter, at a time when high-profile corporate accounting irregularities have called into question the veracity of accounting practices and the reliability of audits, it has been a priority for the Committee to support the efforts to develop high-quality international standards in these areas. This has been done through active participation in the advisory bodies of the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB), and by closely following the work in both these forums. In this regard, the Committee has commented on important proposals for new international accounting and auditing standards, and has developed guidance for banks and supervisors on policy issues in these and related areas.

As part of its efforts to promote better supervisory standards during the past year, the Basel Committee has continued to provide guidance on the treatment of key banking risks. It has finalised guidance on the management of operational risk and of cross-border electronic banking activities, both of which are significant and growing risks facing the banking sector. The Committee has also undertaken several projects designed to help strengthen the integrity of the global banking system, and has followed up its work on customer due diligence with recommendations for effective customer identification. Customer identification is not only an essential element of a programme of effective customer due diligence, which banks need to put in place to guard against reputational, operational, legal and concentration risks. It is also necessary for compliance with legal requirements to counter money laundering, and as a prerequisite for the identification of bank accounts related to terrorism. Meanwhile, guidance has been issued concerning certain banking structures that can pose significant obstacles to effective banking supervision and which, in some cases, have also been linked to suspicious or illegal banking activity.

One of the strengths of the Basel Committee is that it acts as a forum for central banks and supervisory authorities to discuss and share information on a range of important issues, and promotes working relationships between supervisors at both the senior and staff levels. The Committee is a keen supporter of research on banking and finance, and regularly sponsors events for researchers in central banks and supervisory agencies to exchange views on their latest work. Other events have been aimed at fostering links between researchers in central banks and supervisory agencies and those in the wider academic community. One highly valued forum for promoting discussion and information sharing among senior supervisors on a global basis is the biennial International Conference of Banking Supervisors (ICBS). In September 2002, the 12th ICBS was held in Cape Town, South Africa. The conference, which was attended by over 250 senior banking supervisors from more than 120 countries, was jointly sponsored by the Committee and the South African Reserve Bank. The discussions focused on recent developments concerning the New Basel Capital Accord and on how to foster a stable financial environment in emerging market countries.

In April 2003, William J McDonough stepped down as Chairman of the Basel Committee on Banking Supervision in anticipation of his retirement as President of the Federal Reserve Bank of New York. Jaime Caruana, Governor of the Bank of Spain, was nominated as his successor. Nicholas Le Pan, Canada's Superintendent of Financial Institutions, was appointed Deputy Chairman.

Committee on the Global Financial System

The CGFS pursued its regular monitoring of financial markets in industrialised and emerging economies with the objective of identifying potential risks for financial stability. One issue of recurring interest was how innovative financing techniques, institutional arrangements in the financial industry and macroeconomic policies affect the behaviour and resilience of the financial sector. Another area of focus was adjustment by corporations, households and financial institutions to the changing financial conditions, and the repercussions these adjustments could have on economic activity. In November 2002, the Committee formed a working group on foreign direct investment in the financial sectors of emerging market economies.

During the period under review, the CGFS published two working group reports that reflect its continuing efforts to improve the understanding of the functioning of financial markets. In January 2003, the report entitled *Credit risk transfer* was published. Against the background of a considerable widening of the range of credit risk transfer instruments, the report describes the characteristics of the markets for these instruments, as well as recent developments in these markets. It also examines possible implications of this evolution for the overall functioning of the financial system and discusses some of the concerns that have been expressed about the impact of credit risk transfer on financial stability.

In March 2003, the report entitled *Incentive structures in institutional asset management and their implications for financial markets* was released. The report analyses the agency structures and corresponding incentive schemes in an industry that has grown rapidly since the mid-1990s, and also enquires into ways in which these incentive mechanisms might affect market efficiency and volatility, liquidity and risk management.

The Committee's analyses and assessments have contributed to an informed discussion among G10 Governors and, through the representation of the CGFS in the Financial Stability Forum (FSF), the broader official community. In January 2003, the G10 Governors appointed Roger W Ferguson Jr, Vice Chairman of the Board of Governors of the Federal Reserve System, as the new Chairman of the CGFS. He succeeded Yutaka Yamaguchi, then Deputy Governor of the Bank of Japan.

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) continued to promote sound and efficient payment and settlement systems with the aim of strengthening the infrastructure of financial markets. The Committee enhanced its cooperation with other international institutions and groupings, and associated an increasingly wide group of non-G10 central banks with its work.

In November 2002, the CPSS and the Technical Committee of the International Organization of Securities Commissions (IOSCO) published the *Assessment methodology for "Recommendations for Securities Settlement Systems"* (these recommendations were issued in November 2001). The methodology is primarily intended for use in self-assessments by national authorities, or in peer reviews of such self-assessments. It is also meant to provide guidance for the IMF and the World Bank when undertaking their Financial Sector Assessment Program (FSAP) reviews and for other forms of technical assistance. To that end, the IMF and the World Bank took part in developing the assessment methodology. Moreover, the CPSS hopes that the methodology will also prove useful to private market participants conducting their own assessments of the safety and efficiency of securities settlement systems.

Carrying forward its analysis of issues related to retail payments, the Committee published, in March 2003, a report on *Policy issues for central banks in retail payments*. The report focuses on the present involvement of central banks in retail payments and reveals both common policy themes and significant institutional differences across countries. The common themes are expressed in the form of high-level public policy goals, which could also be of relevance for public authorities other than central banks with an interest in the safety and efficiency of retail payments. The report concludes with a number of recommendations regarding minimum actions appropriate for all central banks to further these goals, as well as policy options for some central banks to respond to special circumstances. The Committee has also been studying issues regarding the use of central bank money in payment systems. An analytical report on this subject is likely to be published in the near future.

A key aspect of the Committee's work remains the implementation of its strategy, endorsed by the G10 Governors in 1996, to mitigate foreign exchange settlement risk. To this end, it continued to monitor and encourage market initiatives in this area.

In order to extend its outreach beyond the G10 countries, the CPSS pursued its efforts in the past financial year to strengthen cooperation with non-G10 central banks, particularly those of emerging market economies. The Committee also provided support and expertise to workshops and seminars on payment system issues organised by the BIS in cooperation with regional central banking organisations.

Markets Committee

The bimonthly meetings of the Markets Committee (bringing together senior G10 central bank officials responsible for market operations) focused on shorter-term developments in foreign exchange and related financial markets. On several occasions, the Committee invited representatives from major non-G10 central banks to join the discussion. Topics on the Committee's agenda included the forces behind changes in the external value of the US dollar; volatility in key foreign exchange markets; the impact of economic and political developments in Brazil and commodity price movements on Latin American currencies; and financial risks in the run-up to the war in Iraq. Members were also briefed on specific issues, such as the practice of undisclosed principal trading (when a bank transacts, via a fund manager acting as agent, with a principal whose identity is not disclosed) and recent developments regarding the Continuous Linked Settlement (CLS) Bank. In addition, the Committee initiated a review of the current reporting basis and methodology for the Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity. The proposals of a group of experts were approved by the Committee in January 2003 and now form the basis of preparations for the upcoming survey exercise.

Central Bank Counterfeit Deterrence Group

The Central Bank Counterfeit Deterrence Group (CBCDG) is mandated by the Governors of the G10 central banks to examine the threat to paper currency caused by the increasing use of personal computers and other devices in counterfeiting banknotes. The BIS continued to support the work of the CBCDG by hosting its Secretariat and by acting as its agent in contractual arrangements.

3. BIS contributions to broader international financial cooperation

A number of independent organisations have established their secretariat at the BIS. The Bank provides various secretariat services and logistical support to these groupings and is involved in the discussions taking place within some of them. The agendas, and the approval and public release of documents, are the responsibility of the specific body or organisation to which each of these groupings report.

Group of Ten

The Bank continued to contribute actively to the work of the G10 Finance Ministers and central bank Governors, their Deputies, and the working and contact groups set up under their auspices, both through its participation as an observer institution and through the provision of secretariat support alongside the IMF and the OECD. The G10 reviewed progress in the areas of collective action clauses, codes of good conduct for debt workouts and the sovereign debt restructuring mechanism; examined questions of debt sustainability; and agreed to renew the General Arrangements to Borrow (GAB).

During the period under review, three major documents were released. A report by the G10 Working Group on Contractual Clauses sets out the key features of collective action clauses for sovereign bonds that, if widely adopted, the G10 Ministers and Governors believe would make the resolution of debt crises more orderly. A contact group report entitled *Turbulence in asset markets: the role of micro policies* concluded that appropriately designed taxes, regulations and disclosure policies can help dampen undesirable fluctuations in asset prices. Finally, the report *Insolvency arrangements and contract enforceability* by another contact group demonstrates the importance of having effective means to achieve rapid, efficient and equitable resolution of troubled and insolvent companies that have extensive financial operations.

Financial Stability Forum

The FSF was established in early 1999 to promote international financial stability through enhanced information exchange and cooperation in financial supervision and surveillance. The Forum brings together on a regular basis the national authorities responsible for financial stability – treasuries, central banks and financial supervisors – in key financial centres, as well as senior representatives of the international financial institutions, international supervisory or regulatory standard-setting bodies and central bank expert groupings. The BIS hosts the Forum’s Secretariat, which is composed of staff seconded from FSF member countries and institutions. In May 2003, the G7 Ministers of Finance appointed Roger W Ferguson Jr, Vice Chairman of the Board of Governors of the Federal Reserve System, as Chairman of the FSF in succession to the Forum’s first Chairman, Andrew Crockett. More information on the FSF is available on its website (www.fsforum.org).

Since April 2002, the Forum has met twice, in Toronto and Berlin, and held various teleconferences with its membership. The principal subjects discussed on these occasions were conjunctural and other vulnerabilities in the international financial system and the actions needed to address the weaknesses revealed by recent corporate reporting irregularities. The Forum also held regional meetings to promote wider discussion of financial vulnerabilities and to enable regional representatives to air views on the FSF’s work. Three such regional meetings were held last year – for central and eastern European countries, for Latin American countries, and for the Asia-Pacific region. In addition, the Forum’s Chairman held regular exchanges of views with private sector participants and academics on financial stability issues through the FSF Chairman's Advisory Council.

A central theme of all the FSF meetings in the period under review was the reforms needed nationally and internationally to restore confidence in the financial reporting framework following the spate of corporate reporting and accounting irregularities. The FSF closely monitored the many initiatives being undertaken in this area by market participants, national authorities and international standard setters, and focused attention on gaps and significant divergences in reform efforts. The international dimension of the problems and their remedies has been a preoccupation of the Forum, which has sought to promote international and cross-sectoral coherence whenever this offers opportunities to increase the efficiency, integrity and stability of financial markets. In this context, the FSF arranged in October 2002 a roundtable discussion on the policy implications of recent corporate failures, involving corporate board members, institutional investors, senior bankers, audit firms, rating agencies, governance experts, policy authorities and standard setters. The roundtable recognised that many factors had contributed to the erosion of internal and external discipline that had led to recent corporate governance and reporting failures. Nevertheless, the single most critical element in re-establishing trust in the financial reporting framework was seen to be the restoration of confidence in the quality and integrity of external audits – through public oversight and stronger enforcement mechanisms.

In the past year, the FSF also focused on a number of issues related to the reinsurance industry. This industry plays an indispensable role in the provision of insurance coverage and has become increasingly engaged in the underwriting and distribution of financial risk. While the industry has performed well in the face of recent shocks, the opaqueness of the reinsurance market and of reinsurers' public disclosures makes it difficult to assess the potential impact of problems in the industry, should they arise, on the insurance sector as a whole and on financial stability more generally. Some of these issues are also relevant to other parts of the insurance industry.

The FSF has therefore worked with regulators in the key jurisdictions in which large parts of the global reinsurance industry are based to lead efforts nationally, as well as within the International Association of Insurance Supervisors (IAIS), to produce data and reporting on the global reinsurance market. The Forum has also called for improvements in the frequency, and in the quantitative and qualitative content, of public disclosures by individual reinsurers and insurance companies.

In collaboration with agencies from among its membership, the Forum also carried forward work in other areas, including issues raised by credit risk transfer activities, the availability of information on large and complex financial institutions, and strengthening supervisory standards in offshore financial centres.

Throughout the year, the FSF continued to inform the G7 Finance Ministers and central bank Governors, and the IMF's International Monetary and Financial Committee, on all its activities.

International Association of Insurance Supervisors

The BIS has hosted the Secretariat of the IAIS since the Secretariat's establishment in January 1998. Similar to the Basel Committee on Banking Supervision, but directed at insurance supervision, the IAIS aims at contributing to global financial stability by improving supervision of the insurance industry through the development of standards for insurance supervision, provision of mutual assistance and exchange of information on members' respective experiences. More information on the IAIS is available on its website (www.iaisweb.org).

In collaboration with other international regulatory bodies (in the framework of the Joint Forum of the Basel Committee, IOSCO and the IAIS), the IAIS has also helped develop principles for the supervision of financial conglomerates. Moreover, the IAIS actively participates in the FSF.

The IAIS has issued a wide range of papers setting out supervisory standards in the insurance area. Last year, the IAIS finalised the *Principles on Minimum Requirements for Supervision of Reinsurers* and released an issues paper entitled *Risks to insurers posed by electronic commerce*. In April 2003 the IAIS issued a paper on *Credit risk transfer between insurance, banking and other financial sectors*. Ongoing work includes formulating standards, guidelines or issues papers on insurance liabilities, the use of actuaries, control solvency levels, stress testing, insurance securitisation, disclosure by non-life insurers and reinsurers, supervision of reinsurance companies, risk management for electronic commerce in insurance products and credit risk management. In addition, the Insurance Core Principles and associated Methodology are being revised in order to reinforce their contents. In collaboration with the FSF, the IAIS is developing a framework to enhance the transparency of the global reinsurance market and improve risk-oriented disclosure by individual reinsurance firms. The IAIS coordinates with the IASB in its work on the Insurance Project and other major accounting projects. The IAIS is also working closely with the Financial Action Task Force (FATF) on countering money laundering and combating the financing of terrorism.

Jointly with the FSI and national insurance supervisory authorities, the IAIS organised numerous seminars and training programmes and provided training materials for insurance supervisors in order to help them comply with IAIS supervisory standards. Regional training seminars for insurance supervisors were held in Africa, Asia, central and eastern Europe, Latin America and offshore jurisdictions.

International Association of Deposit Insurers

The IADI was established in May 2002 and opened its Head Office at the BIS in October. The Association provides its members with a forum to contribute to the stability of financial systems by promoting international cooperation in the field of deposit insurance. Forty-four organisations are involved in the activities of the IADI.

The IADI seeks to enhance the understanding and exchange of information on common interests and issues related to deposit insurance. It also sets out guidance to increase the effectiveness of deposit insurance systems taking into account different circumstances, settings and structures.

The Association actively promotes networking and training opportunities for deposit insurers and other authorities concerned with the financial safety net. One of the ways in which this is accomplished is through an annual conference focused on topical deposit insurance issues. The first IADI conference was held at the BIS in May 2002; the next will be held in Seoul, Korea in October 2003.

The Chair of the Executive Council and President of the IADI is Jean Pierre Sabourin, President and CEO of the Canada Deposit Insurance Corporation. Extensive information on the IADI's activities can be found on its website (www.iadi.org).

4. Financial services of the Bank

The BIS's banking operations are exclusively focused on serving the financial needs of central banks and a number of international financial institutions. As of April 2003, some 130 central banks held part of their international reserves at the BIS. In intermediating these funds, the Bank relies on two linked trading rooms in Basel and Hong Kong SAR and offers a range of instruments that are specifically designed for central banks. Security, liquidity and return are the three key features of these products. Other financial services provided by the BIS include asset management, short-term lending to central banks, trustee activities and collateral agent functions. In performing these tasks, special attention is paid to monitoring credit, market and operational risk under the responsibility of an independent risk control unit, reporting directly to the Deputy General Manager, and to supervising the soundness of banking operations as part of the internal audit function.

Operations of the Banking Department

At 31 March 2003 the balance sheet stood at 92.8 billion gold francs,[1] a third successive new record for the end of a financial year, which represented a 5.8% increase over the previous financial year-end figure of 87.7 billion. This year-on-year increase was entirely attributable to the appreciation of other currencies against the US dollar, which inflated the balance sheet total by 6.2 billion gold francs. Indeed, after adjusting for exchange rate effects, the balance sheet actually declined by 1.1 billion gold francs during the financial year.

[1] Until the end of the 2002/03 financial year, the Bank's unit of account was the gold franc. Prior to its amendment (see Section 6), Article 4 of the Statutes defined the gold franc as equivalent to 0.29032258… grams of fine gold. Assets and liabilities were converted to gold francs on the basis of a gold price of US$ 208 per fine ounce (equivalent to 1 gold franc = US$ 1.94149…).

After reaching historically high levels in the early part of the past financial year, the balance sheet eased back in the subsequent months before rising again as from November. This inflow of funds towards the end of 2002 was partially inflated by exchange rate effects, but was also driven by normal year-end factors as well as a "flight to safety" effect arising from mounting geopolitical tensions. In contrast to previous years, this trend continued well into the new year, to the extent that the balance sheet reached successive new highs in the first quarter of 2003, registering an all-time record of 94.3 billion gold francs on 13 March. By the end of the financial year, however, it had declined by 1.5 billion.

Liabilities

On 31 March 2003 borrowed funds in gold and currencies (excluding repurchase agreements) totalled 86.4 billion gold francs, compared with 82.0 billion at the end of the previous financial year. Gold deposits rose by 0.1 billion gold francs to 2.6 billion, representing 3.1% of total borrowed funds (unchanged from a year earlier). Currency deposits, on the other hand, increased by 4.3 billion gold francs (excluding repurchase agreements), reflecting an appreciation of other currencies against the US dollar. But for these currency translation gains, currency deposits would have declined by some 0.6 billion gold francs, as reductions in euro and yen placements were partly offset by inflows of US dollars and sterling.

At 31 March 2003 the US dollar accounted for 67.2% of total borrowed funds in currencies (including repurchase agreements), a modest decline from 69.2% a year earlier.

Currency deposits by central banks and other national monetary authorities rose from 76.2 billion to 80.0 billion gold francs, representing 95.5% of total borrowed funds in currencies (excluding repurchase agreements) at end-March 2003, little changed from the previous year. Funds placed by other depositors (mainly international institutions) amounted to 3.8 billion gold francs. Over the financial year, central bank customers significantly increased their investments in longer-maturity BIS tradable instruments. On the other hand, there was also an expansion in shorter fixed-term deposits, partly reflecting a tendency by certain customers to keep liquid funds at the BIS at a time of heightened geopolitical uncertainty.

Assets

BIS assets for the most part take the form of investments with top-quality commercial banks of international standing and government and quasi-government securities, including reverse repurchase transactions. The BIS also grants short-term credits to central banks, usually on a collateralised basis. The share of sovereign and quasi-sovereign securities increased noticeably during the past financial year to reach almost one third of total assets on 31 March 2003.

The BIS also makes use of various derivative instruments with a view to managing its assets more efficiently (see note 15(a) to the accounts). For the most part, these derivative instruments are of the plain vanilla variety, in particular futures and interest rate swaps.

BIS financial operations, in both Basel and Hong Kong, are carried out within a general policy framework established by the Board. This framework imposes certain general as well as specific limits on the various categories of risk (credit, market and liquidity risk) to which the Bank is inevitably exposed through its market activities. These limits have been set to a stringent standard in order to maintain the outstanding credit quality of the BIS as a counterparty to central banks and commercial institutions.

Investments in currencies stood at 89.4 billion gold francs on 31 March 2003, compared with 83.7 billion at the previous financial year-end. This total included 0.2 billion gold francs in the form of advances to central banks, against 0.1 billion a year earlier. The Bank's assets in gold rose from 3.2 billion gold francs to 3.3 billion over the same period, reflecting a small increase in gold deposits received.

Functions as agent and trustee

Trustee for international government loans

The Bank continued to perform its functions as trustee for the funding bonds 1990–2010 of the Dawes and Young Loans during the year under review (for details on the Bank's functions in this regard see the 63rd *Annual Report* of June 1993). With regard to these funding bonds, the Deutsche Bundesbank as Paying Agent notified the Bank that in 2002 the Bundeswertpapierverwaltung (BWV – German Federal Securities Administration) had arranged for payment of a total amount of approximately €5.5 million in respect of redemption and interest. Redemption values and other details were published by the BWV in the *Bundesanzeiger* (*Federal Gazette*).

The Bank maintained its reservations regarding the application by the BWV of the exchange guarantee clause for the Young Loan (stated in detail in its 50th *Annual Report* of June 1980), which also extend to the funding bonds 1990–2010.

Collateral agent functions

Under a number of agreements, the BIS acts in the capacity of Collateral Agent to hold and invest collateral for the benefit of the holders of certain foreign currency denominated bonds issued by countries under external debt restructuring arrangements. Current Collateral Pledge agreements include those for Brazilian bonds (described in detail in the 64th *Annual Report* of June 1994), Peruvian bonds (see the 67th *Annual Report* of June 1997) and Côte d'Ivoire bonds (see the 68th *Annual Report* of June 1998).

5. Net profits and their distribution

Net profits for the financial year

The accounts for the 73rd financial year ended on 31 March 2003 show a net profit of 362.0 million gold francs, compared with 268.5 million gold francs for the preceding financial year. The rise primarily reflected the increase in net interest and other operating income for the financial year 2002/03, which in turn was related to the reduced level of losses booked on the repayment at market value of the Bank's securitised liabilities (FIXBIS and Medium-Term Instruments). These losses in the borrowed funds book were recognised in accordance with the Bank's accruals accounting principles. This book is managed on a matched basis with limited interest rate, currency and maturity transformation risk, and the market values of the financial instruments on both sides of the borrowed funds balance sheet rise and fall together.

These accruals book losses, which were temporary in nature, were incurred as BIS customers actively managed their portfolios of BIS instruments in an environment where interest rates continued to fall and the market values of their claims on the BIS increased. Under the Bank's accruals accounting methodology these losses were being recovered over time, as the repaid liabilities were soon replaced by borrowings with the same maturities at lower interest rates, while the corresponding assets and derivative instruments remained in place. This year's profit thus benefited from the widening of margins resulting from the recovery of past book losses from early repayment of liabilities. As interest rates fell during the year, borrowed funds accruals profits benefited from book gains from sales of trading investments.

Under the Bank's revised accounting policies, which came into effect on 1 April 2003, such losses will be offset in the profit and loss account by booking the corresponding movements in the market values of the financial instruments on both sides of the balance sheet.

Excluding these factors, underlying profits from the Bank's borrowed funds operations showed mild growth, with the increase in deposits from customers being reinforced by a widening of intermediation margins, which was attributable to developments on the assets side of the balance sheet.

Interest income from investments financed by the Bank's own funds (equity) fell slightly, as the downward impact of lower interest rates outweighed the growth in the volume of the Bank's own funds.

The annual financial accounts show a rise in the costs of administration after depreciation from 76.8 million gold francs in 2001/02 to 98.3 million gold francs in the past year, an increase of 28%. Most of this increase was attributable to the appreciation of the Swiss franc, the currency in which most of the Bank's expenditure is incurred, which was on average 18% higher against the gold franc than in the previous year. In addition, under the Bank's revised accounting policies for provisions and retirement benefit obligations, costs of 48.3 million Swiss francs were booked in the Bank's annual financial accounts to costs of administration, compared with costs of 31.1 million on the same basis in 2001/02. This increase was due to a one-off payment of 33.9 million Swiss francs to restore the coverage ratio of the Staff Pension Fund following its lower than actuarially assumed investment performance. Depreciation costs declined by 7% in Swiss francs, but increased by 8% in terms of gold francs.

The environment of lower interest rates also led to realised capital gains of 108.2 million gold francs on the Bank's own funds investment portfolio. This compares with gains of 85.7 million gold francs under this heading in the previous financial year.

Distribution of the net profit for the year

On the basis of Article 51 of the Statutes, the Board of Directors recommends that the net profit of 362.0 million gold francs be applied by the General Meeting in the following manner:

(i) 68.7 million gold francs in payment of a dividend of 400 Swiss francs per share. It should be noted that the dividend will be paid on 452,073 shares. The number of issued and paid-up shares before the repurchase of shares is 529,125. Of these shares, 77,052 are held in treasury, comprising 74,952 shares repurchased from former private shareholders and central banks, and 2,100 other shares. No dividend will be paid on treasury shares;

(ii) 29.3 million gold francs to be transferred to the general reserve fund;

(iii) 3.0 million gold francs to be transferred to the special dividend reserve fund; and

(iv) 261.0 million gold francs, representing the remainder of the available net profit, to be transferred to the free reserve fund. This fund can be used by the Board of Directors for any purpose that is in conformity with the Statutes.

The Board of Directors has proposed that the above-mentioned dividend be paid on 7 July 2003 to the shareholders whose names are contained in the Bank's share register on 31 March 2003.

Distribution of prior year reserves adjustment

The changes in the Bank's accounting policies adopted in this year's balance sheet and profit and loss account have resulted in a prior year adjustment, which has increased reserves by a total of 1,639.4 million gold francs at 31 March 2002. This is described in detail in note 3 to the annual accounts. On the basis of Article 51 of the Statutes, the Board of Directors recommends that the prior year reserves adjustment of 1,639.4 million gold francs be applied by the General Meeting in the following manner:

(i) 163.9 million gold francs, being 10% of this amount, to be transferred to the general reserve fund; and

(ii) 1,475.5 million gold francs to be transferred to the free reserve fund. This fund can be used by the Board of Directors for any purpose that is in conformity with the Statutes.

Report of the auditors

The Bank's accounts have been duly audited by PricewaterhouseCoopers AG, who have confirmed that the balance sheet and the profit and loss account, including the notes thereto, give a true and fair view of the Bank's financial position at 31 March 2003 and of the results of its operations for the year then ended. Their report is to be found immediately following the accounts.

6. Institutional matters

Amendments to the Bank's Statutes

Change of the Bank's unit of account

An Extraordinary General Meeting (EGM) of the Bank was held on 10 March 2003 and decided, on the recommendation of the Board of Directors, to replace the gold franc by the Special Drawing Right (SDR), as defined by the International Monetary Fund (IMF), as the Bank's unit of account with effect from the beginning of the next financial year, ie from 1 April 2003. Accordingly, the EGM approved an amendment of Article 4 of the Bank's Statutes for the redenomination of the Bank's capital and shares in SDRs. This change involved a reduction of the share capital of the Bank in order to obtain a round amount of SDR 5,000 for the nominal value of each share.

The Bank's use of the gold franc as its unit of account had been regarded as non-transparent and inconsistent with current standards of accounting best practice. For these reasons, and in order to assist in managing the Bank's operations and economic capital more efficiently, it was decided to adopt the SDR as the Bank's new unit of account.

The SDR is the unit of account of the IMF and is also used in private contracts and international treaties and as the unit of account of other international organisations. The SDR's value is based on that of a basket of currencies (currently the US dollar, the euro, the Japanese yen and the pound sterling). The basket is reviewed by the IMF every five years to ensure that the currencies included in it are representative of those used in international transactions and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial system. The valuation basket was last changed in 2001 to take account of the introduction of the euro.

In connection with the replacement of the gold franc by the SDR, the gold franc amounts in which the capital of the Bank had been expressed were converted into SDRs. The EGM decided that the nominal value of the shares should be rounded down from its precise converted amount (SDR 5,696 at 31 March 2003) to SDR 5,000. Following the reduction of 12.2% in the share capital, the excess amount of SDR 92.1 million at 31 March 2003 was transferred from the paid-up capital to the Bank's reserve funds. The change to the SDR had no impact on the Bank's equity.

Other statutory changes

In addition to the amendment of Article 4 of the Statutes of the Bank, the EGM adopted two other amendments. The first of these simplifies the text of Article 5 by removing details of the subscription of the second tranche of the share capital of the BIS, which was completed long ago. The second amendment updates Article 20 of the Statutes, which defines the currencies in which the Bank may carry out operations for its own account. The previous wording, which referred to "the practical requirements of the gold or gold exchange standard", had become obsolete and was therefore replaced by a reference to "currencies deemed suitable by the Board" to reflect the Bank's current practice.

Withdrawal of privately held shares

Following the decision taken by the Extraordinary General Meeting held on 8 January 2001 to withdraw all privately held shares of the BIS (described in detail in the 71st *Annual Report* of June 2001, pages 172–3), the Bank paid registered former private shareholders compensation in the amount of 16,000 Swiss francs per share. Certain former private shareholders contested this amount (see also the 72nd *Annual Report* of July 2002, pages 172–3) by initiating claims before the Arbitral Tribunal provided for by the Hague Agreement, which, pursuant to Article 54 of the Bank's Statutes, has sole jurisdiction to hear disputes between the Bank and its former private shareholders arising from the withdrawal. The Arbitral Tribunal issued a Partial Award on 22 November 2002 confirming the legality of the mandatory repurchase, but nevertheless concluding that the compensation should be increased. It ruled that the former private shareholders are entitled to receive a proportionate share of the net asset value of the Bank, subject, however, to a 30% discount. This formula is equivalent to that which has been applied by the BIS to new central bank subscriptions of shares. The precise amount of additional compensation will be determined by the Arbitral Tribunal after further proceedings to be held in the course of 2003. The Bank has confirmed its past declaration that it will voluntarily apply to all registered former private shareholders the decision of the Arbitral Tribunal in final settlement of all claims. Once that decision is issued, these former shareholders will be contacted in writing to arrange for payment of the additional compensation.

In a proceeding brought by a separate group of former private shareholders, the Commercial Court in Paris made a preliminary determination (without addressing the substance of the matter) in March 2003 that it has jurisdiction over their claims seeking to increase the amount of compensation. The BIS has requested review of this procedural decision by the Paris Court of Appeals, arguing that the Arbitral Tribunal in The Hague has exclusive jurisdiction over the matter.

Changes in accounting policies

Financial year 2002/03

Following a review of its accounting policies, the Bank has decided to amend its policies for recognising profit on the sales of own funds securities, and for accounting for provisions and retirement benefit obligations. These changes are described in note 2 to the accounts. The comparative figures in the balance sheet, profit and loss account and notes to the accounts for the financial year 2001/02 have accordingly been restated. The impact of these restatements on the reserves and net profit for that year is shown in note 3 to the accounts. The accounts set out in comparative form the financial results for the years 2001/02, as restated, and 2002/03.

Financial year 2003/04

The introduction of the SDR as the Bank's unit of account (see above) has facilitated a number of further changes to the Bank's accounting policies, which have been put into effect as from 1 April 2003. These changes provide a better picture of the Bank's financial position and performance.

An unaudited reconciliation to a pro forma balance sheet in SDRs as at 31 March 2003 and to a profit and loss account in that currency for the year then ended, incorporating the new accounting policies, is presented on pages 201–5 of the attached balance sheet and profit and loss account.

Budget policy

The process of formulating the Bank's budget for the next financial year starts about six months in advance with the setting by Management of the broad business orientation and of staffing and funding envelopes. Within the context of this general budgetary framework, business areas subsequently specify their plans and corresponding resource requirements. The process of reconciling the detailed business plans and overall resource availability culminates in the determination of a draft financial budget. This must be approved by the Board before the start of the financial year.

In drawing up the budget, a distinction is made between administrative and capital expenditures. Staff remuneration represents about half of the administrative costs. Other major expenditure categories, normally accounting for a further 25% of administrative spending, are IT and telecommunications expenditures, and charges under the Bank's Pensions System. Because of the nature of the expenditures, capital spending tends to vary significantly from year to year. Most of the Bank's administrative and capital expenditure is incurred in Swiss francs.

Costs of administration before depreciation during the financial year 2002/03 amounted to 199.2 million Swiss francs, 5.3% below the budget of 210.3 million Swiss francs.[2] The budget was drawn up assuming that the Bank would quickly replace those members of staff who had taken advantage of an early retirement offer in the previous financial year. This proved difficult to accomplish, with the resulting saving constituting the primary cause of the underspending of the administrative budget. Capital expenditure, at 16.1 million Swiss francs, was 11.9 million below budget: expenditure on some IT projects was postponed as the completion of the Bank's new IT infrastructure was delayed.

The Board approved an increase in the administrative budget for the financial year 2003/04 of 2.3% to 215.1 million Swiss francs. The capital budget

[2] The Bank's budgetary accounting excludes the impact of the amended accounting policies for provisions and retirement benefit obligations, which are reflected in the financial accounts and discussed in Section 5.

foresees an increase of 2.7 million Swiss francs to 30.7 million. In addition to a 2% increase in staff salary ranges, the budgets incorporate the continuation of the e-learning initiative for bank supervisors, the costs of moving to new offices in Hong Kong, and enhanced IT and financial control support for banking activities.

BIS remuneration policies

General BIS salary policy

The jobs performed by BIS staff members are assessed on the basis of a number of objective criteria, including requisite qualifications, experience and responsibilities, and are classified into distinct job grades. Regular salary surveys are conducted in which BIS salaries are compared with salaries paid in comparable institutions or market segments. These comparisons take into account differences in the taxation of salaries of the staff of the surveyed institutions. When applying the market data to BIS salaries, the BIS focuses on the upper half of market salaries in order to attract highly qualified staff.

The job grades are associated with salary ranges that are adjusted annually for the rate of inflation in Switzerland and the average increase of real salaries in the business sector of major industrial countries. Movements of salaries of individual staff members within each salary range are based on merit subject to a regular evaluation of performance. The BIS does not apply a bonus scheme.

Non-Swiss and non-locally hired staff (including senior management) are entitled to an expatriation allowance, which currently ranges between 14 and 18% of annual salary depending on family status. In addition, the BIS offers health insurance and a defined benefit contributory pension plan.

Remuneration of senior management

The salaries of Heads of Department are adjusted annually, normally in line with the increase in the staff salary ranges. The salaries of the General Manager and the Deputy General Manager are reviewed periodically by the Board. As of 1 July 2002, the remuneration of senior managers was as follows (number of function holders in parentheses):

- General Manager (1) 617,050 Swiss francs
- Deputy General Manager (1) 566,500 Swiss francs
- Heads of Department (3) 526,070 Swiss francs

Remuneration of the Board of Directors

The Annual General Meeting approves the remuneration of members of the Board of Directors. Adjustments take place every three years. Since 1 July 2002, the overall fixed annual remuneration paid to the Board of Directors has amounted to 844,800 Swiss francs. In addition, all Board members receive an attendance fee for each Board meeting in which they participate. Assuming the full Board is represented in all Board meetings, the annual total of these attendance fees amounts to 777,240 Swiss francs.

Changes in the Board of Directors and the Bank's Management

In September 2002, Antonio Fazio, Governor of the Bank of Italy, reappointed Vincenzo Desario as a member of the Board of Directors for another period of three years, expiring on 7 November 2005. Ernst Welteke, President of the Deutsche Bundesbank, renewed the appointment of Hans Tietmeyer as a member of the Board of Directors in November 2002 for a further term of three years, expiring on 31 December 2005. In March 2003, Guy Quaden, Governor of the National Bank of Belgium, reappointed Vicomte Verplaetse as a member of the Board of Directors for another three-year period, expiring on 28 February 2006.

At the end of December 2002, Urban Bäckström resigned from his position as Governor of Sveriges Riksbank and vacated his seat on the Board. From 1 January 2003, the Board elected Lars Heikensten, the successor to Mr Bäckström at Sveriges Riksbank, as a member of the Board for the unexpired period of Mr Bäckström's term of office, ie until end-March 2005.

On 19 March 2003, Masaru Hayami retired from his position as Governor of the Bank of Japan and vacated his seat on the Board. In May 2003, the Board elected his successor at the Bank of Japan, Toshihiko Fukui, as a member of the Board for the unexpired period of Mr Hayami's term of office, ie until 12 September 2003. Upon his retirement as President of the Federal Reserve Bank of New York on 10 June 2003, William J McDonough relinquished his appointment as member of the Board.

As regards the Management of the Bank, Andrew Crockett relinquished his position as General Manager at the end of March 2003. He was succeeded by Malcolm Knight on 1 April 2003.

Lists of Board members, senior officials of the Bank and member central banks are provided at the end of this chapter.

Balance sheet and profit and loss account

at 31 March 2003

Balance sheet at 31 March 2003

(in millions of gold francs – see note 2(a) to the accounts)

2002	Assets	2003
	Gold	
1 910.3	Held in bars	*1 990.0*
1 299.6	Time deposits and advances	*1 309.6*
3 209.9		3 299.6
3 292.3	Cash on hand and on sight account with banks	3 041.5
9 588.1	Treasury bills	14 027.3
	Time deposits and advances in currencies	
28 435.1	Not exceeding 3 months	*22 725.5*
17 102.9	Over 3 months	*17 483.6*
45 538.0		40 209.1
	Securities purchased under resale agreements	
1 660.7	Not exceeding 3 months	5 302.2
	Government and other securities at term	
3 753.3	Not exceeding 3 months	*4 625.1*
19 857.6	Over 3 months	*22 165.9*
23 610.9		26 791.0
115.4	Land, buildings and equipment	138.9
699.1	Miscellaneous assets	21.7
87 714.4		92 831.3

After allocation of the year's net profit			Before	After
Before allocation of prior year reserves adjustment	After allocation of prior year reserves adjustment		allocation of the year's net profit and prior year reserves adjustment	allocation of the year's net profit and prior year reserves adjustment
2002 as originally stated	2002 as restated	Liabilities	2003	2003
330.7	330.7	Capital	330.7	330.7
3 307.8	4 947.2	Reserves	3 307.8	5 240.5
		Prior year reserves adjustment	1 639.4	
		Profit and loss account	362.0	
(384.0)	(384.0)	Shares held in treasury	(522.7)	(522.7)
25.5	24.1	Valuation difference account	303.9	303.9
3 280.0	4 918.0	Equity	5 421.1	5 352.4
		Deposits (gold)		
1 909.8	*1 909.8*	Sight	*1 989.3*	*1 989.3*
266.4	*266.4*	Not exceeding 3 months	*245.8*	*245.8*
355.2	*355.2*	Over 3 months	*403.3*	*403.3*
2 531.4	2 531.4		2 638.4	2 638.4
		Deposits (currencies)		
2 510.3	*2 510.3*	Sight	*2 410.7*	*2 410.7*
36 369.5	*36 369.5*	Not exceeding 3 months	*32 970.2*	*32 970.2*
40 606.6	*40 606.6*	Over 3 months	*48 378.5*	*48 378.5*
79 486.4	79 486.4		83 759.4	83 759.4
		Securities sold under repurchase agreements		
660.0	660.0	Not exceeding 3 months	51.8	51.8
1 704.0	66.0	Miscellaneous liabilities	960.6	960.6
52.6	52.6	Dividend		68.7
87 714.4	87 714.4		92 831.3	92 831.3

Profit and loss account

for the financial year ended 31 March 2003
(in millions of gold francs)

	2002 as restated	2003
Interest and discount, and other operating income	6 015.7	4 999.6
Less: interest and discount expense	5 410.1	4 358.9
loss on repayment of liabilities at market value	346.0	288.6
Net interest and other operating income	259.6	352.1
Less: costs of administration		
Board of Directors	*0.9*	*1.2*
Management and staff	*47.2*	*65.6*
Office and other expenses	*19.9*	*22.0*
Costs of administration before depreciation	68.0	88.8
Depreciation	*8.8*	*9.5*
	76.8	98.3
Operating profit	182.8	253.8
Profit on sales of investment securities	85.7	108.2
Net profit for the financial year	268.5	362.0

The Board of Directors recommends to the Annual General Meeting that the net profit for the year ended 31 March 2003 be allocated in accordance with Article 51 of the Statutes as follows:

	2002 as restated	2003
Dividend: 380 Swiss francs per share on 452 073 shares	*52.6*	
400 Swiss francs per share on 452 073 shares		*68.7*
	52.6	68.7
	215.9	293.3
Transfer to general reserve fund	31.2	29.3
	184.7	264.0
Transfer to special dividend reserve fund	3.0	3.0
	181.7	261.0
Transfer to free reserve fund	181.7	261.0
	–	–

Movements in the Bank's capital and reserves

during the financial year ended 31 March 2003
(in millions of gold francs)

I. Capital

	Number of shares	Gold francs (millions)
Shares of 2 500 gold francs, of which 25% has been paid up:		
Balance at 31 March 2002 as per balance sheet	529 125	330.7
Balance at 31 March 2003 as per balance sheet	529 125	330.7

Further information is given in note 9 to the accounts.

II. Development of the reserve funds

	Legal reserve fund	General reserve fund	Special dividend reserve fund	Free reserve fund	Total of reserve funds
Balances at 31 March 2002 after allocation of net profit for the financial year 2001/02 – as previously stated	33.1	1 330.6	74.5	1 869.6	3 307.8
The Board of Directors recommends to the Annual General Meeting that the transfer to reserve funds resulting from the changes in accounting policies described in notes 2 and 3 be allocated in accordance with Article 51 of the Statutes as follows:		163.9		1 475.5	1 639.4
Balances at 31 March 2002 – as restated	33.1	1 494.5	74.5	3 345.1	4 947.2
Add: allocation of net profit for the financial year 2002/03	–	29.3	3.0	261.0	293.3
Balances at 31 March 2003 as per balance sheet	33.1	1 523.8	77.5	3 606.1	5 240.5

III. Capital and reserve funds at 31 March 2003 (after allocation) were represented by:

	Capital	Reserve funds	Total of capital and reserves
Net assets in			
Gold	330.7	330.5	661.2
Currencies	–	4 910.0	4 910.0
Balances at 31 March 2003 as per balance sheet	330.7	5 240.5	5 571.2

Notes to the accounts

for the financial year ended 31 March 2003
(in millions of gold francs)

1. Introduction

The Bank for International Settlements (BIS) is an international financial institution which was established pursuant to the Hague Agreements of 20 January 1930. The headquarters of the Bank are in Basel, Switzerland. The objects of the BIS, as laid down in Article 3 of its Statutes, are to promote the cooperation of central banks, to provide additional facilities for international financial operations and to act as trustee or agent for international financial settlements. Fifty central banks are currently members of the Bank and exercise the rights of representation and voting at General Meetings in proportion to the number of BIS shares issued in their respective countries. The Board of Directors of the Bank is composed of the Governors of the central banks of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States of America, as well as appointed directors from six of those countries.

The accounts for the financial year 2002/03 are presented in a form approved by the Board of Directors pursuant to Article 49 of the Bank's Statutes.

2. Significant accounting policies

Following a review of its accounting policies, the Bank has decided to amend its policies for recognising profit on the sales of own funds securities, and for accounting for provisions and retirement benefit obligations. These changes are described in detail in the relevant paragraphs under this heading below. The comparative figures in the balance sheet, profit and loss account and notes to the accounts for the financial year 2001/02 have accordingly been restated. The impact of these restatements on the reserves and net profit for that year is shown in note 3 to the accounts.

With effect from 1 April 2003, the Bank's unit of account is the Special Drawing Right (SDR) as defined by the International Monetary Fund. An unaudited reconciliation to a pro forma balance sheet in SDRs as at 31 March 2003 and a profit and loss account in that currency for the year then ended is presented on pages 201–5.

(a) Unit of account and currency translation

The unit of account used in these accounts is the gold franc, which is equivalent to US$ 1.94149… . Article 4 of the Bank's Statutes, prior to its amendment on 10 March 2003, defined the gold franc (abbreviated to GF) as representing 0.29032258... grams of fine gold. Items representing claims on gold are translated into gold francs on the basis of their fine weight. Items denominated in US dollars are translated into gold francs on the basis of a gold price of US$ 208 per ounce of fine gold (this price was established by the Bank's Board of Directors in 1979, resulting in the conversion factor of GF 1 = US$ 1.94149…). Items denominated in other currencies are translated into US dollars at the spot market rates of exchange prevailing at the balance sheet date, with the resulting US dollar balances converted into gold francs accordingly.

Exchange differences arising on the translation of currency assets and liabilities denominated in currencies other than the US dollar are taken to the valuation difference account.

The net balance resulting from exchange differences on the translation of forward currency contracts and swaps is included under miscellaneous assets or liabilities.

(b) Basis of valuation and determination of profit

Except as otherwise stated, the accounts of the Bank are drawn up on the historical cost basis and income and expense items are recorded on the accruals basis. Profits and losses are determined on a monthly basis, translated into US dollars at the spot market rate of exchange prevailing at each month-end and translated into gold francs as set forth above; the monthly profits thus calculated are accumulated for the year.

Profits and losses arising on the sale of investment securities designated by the Bank as belonging to its own funds are taken to the profit and loss account. Previously, such profits and losses were credited to the securities equalisation account, which was included under the heading "Miscellaneous liabilities" in the balance sheet, and amortised to the profit and loss account over a period corresponding to the average term to maturity of the Bank's investment portfolio. The impact of this change in accounting policy on reserves and net profit for the previous financial year is shown in note 3.

(c) Gold

Gold assets and liabilities are stated on the basis of their fine weight.

(d) Treasury bills; government and other securities at term

Treasury bills and government and other securities at term are stated at cost, plus accrued interest where applicable, adjusted for the amortisation of premiums or discounts over the period to maturity; interest and discount income includes such amortisation.

(e) Time deposits and advances in currencies

Time deposits and advances are stated at their principal value plus accrued interest.

(f) Securities purchased under resale agreements

Securities acquired in connection with purchase and resale agreements are stated at the amount advanced to the counterparty plus accrued interest.

(g) Land, buildings and equipment

The cost of the Bank's land, buildings and equipment is capitalised. The cost is depreciated on a straight line basis over the estimated useful lives of the assets concerned, as follows:

Land – not depreciated.
Buildings – 50 years.
Building installations and machinery – 15 years.
Information technology equipment – 4 years.
Other equipment – 4 to 10 years.

(h) Valuation difference account

The valuation difference account records the effect of exchange differences as described in item (a) above; these valuation changes relate essentially to that portion of the Bank's own funds held in currencies other than the US dollar.

(i) Deposits

Deposits are book claims on the Bank and are stated at their principal value plus accrued interest. Certain claims are issued at a discount to the value payable on the maturity of the deposit; in such cases the accounting treatment is analogous to that applied to dated securities held by the Bank (see item (d) above).

Gains and losses on the repayment of the transferable book entry claims described in note 12(c) at their market values are incorporated in the profit and loss account under the heading "Loss on repayment of liabilities at market value".

(j) Securities sold under repurchase agreements

Securities sold in connection with sale and repurchase agreements are stated at the amount received from the counterparty plus accrued interest.

(k) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events and it is probable that resources will be required to settle the obligation, provided that the amount of the obligation can be reasonably estimated.

In previous years, the Board of Directors reviewed the level of, and if necessary set aside an amount to, a provision for banking risks and other eventualities, which was included under the heading "Miscellaneous liabilities" on the balance sheet. As a result of this change in accounting policy, the Board of Directors recommends to the Annual General Meeting that the balances on this and other provisions be credited to the reserve funds. The impact of this change on reserves and profits for the previous financial year is shown in note 3.

(l) *Retirement benefit obligations*

The Bank operates defined benefit pension and health and accident schemes. The liability in respect of these defined benefit schemes is based on the present value of the defined benefit obligation at the balance sheet date, less the market value of the scheme assets (if the scheme is funded) at the balance sheet date, together with adjustments for unrecognised actuarial gains and losses and past service cost. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by the estimated future cash outflows using discount interest rates of highly rated corporate debt securities which have terms to maturity approximating the terms of the related liability. The impact of this change in accounting policy on reserves and net profit for the previous financial year is shown in note 3.

The amount charged to the profit and loss account represents the sum of the current service cost of the benefits accruing for the year under the scheme, and interest at the discount rate on the defined benefit obligation. In addition, actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to the schemes are charged to the profit and loss account over the service period of the staff concerned. The resulting assets or liabilities are included under the headings “Miscellaneous assets” or “Miscellaneous liabilities” in the balance sheet.

3. Restatements of reserves and net profit

Following the changes in accounting policy described in note 2 and in accordance with the recommendations made by the Board of Directors to the Annual General Meeting concerning allocations to the reserve funds, the Bank's reserves and net profit for the financial year 2001/02 have been restated as follows:

	Reserves	Net profit
As previously published	3 307.8	225.7
Changes in accounting policy:		
Sales of own funds investment securities – *note 2(b)*		
Transfer of the balance on the securities equalisation account	101.1	
Reversal of amortisation of accumulated profits on sales of investment securities		(33.5)
Profits on sales of own funds investment securities		85.7
Provisions		
Transfer of general provision for banking risks and other eventualities – *note 2(k)*	1 582.1	(1.2)
Other provisions – *note 2(k)*	9.5	(0.8)
Retirement benefit obligations – *note 2(l)*	(53.3)	(7.4)
Increase due to changes in accounting policies	1 639.4	42.8
As restated	4 947.2	268.5

The net increase in reserves from the change in accounting policy was offset by a corresponding reduction in "Miscellaneous liabilities". The proposed allocations are shown in Table II of "Movements in the Bank's capital and reserves".

4. Gold holdings

The following table shows the composition of the Bank's total gold holdings:

Assets	*2002*	2003
Gold bars held at central banks	*1 910.3*	1 990.0
Gold time deposits:		
Not exceeding 3 months	*328.4*	283.7
Over 3 months	*971.2*	1 025.9
	3 209.9	3 299.6

The Bank's own gold holdings at 31 March 2003 amounted to GF 661.2 million, equivalent to 192 tonnes of fine gold (2002: GF 661.4 million; 192 tonnes).

5. Treasury bills

The Bank's holdings were as follows:

	2002	2003
Book value	*9 588.1*	14 027.3
Market value	*9 587.0*	14 027.6

6. Government and other securities at term

The Bank's holdings were as follows:

	2002	2003
Book value	*23 610.9*	26 791.0
Market value	*23 649.6*	27 312.6

7. Land, buildings and equipment

	Land & buildings	IT & other equipment	Total
Cost:			
Opening balance at 1 April 2002	129.1	40.8	169.9
Capital expenditure		5.8	5.8
Disposals and retirements		(0.5)	(0.5)
Exchange adjustments	30.9	10.1	41.0
Cost at 31 March 2003	160.0	56.2	216.2
Depreciation:			
Accumulated depreciation at 1 April 2002	32.6	21.9	54.5
Depreciation charge for the current year	2.7	6.8	9.5
Disposals and retirements		(0.5)	(0.5)
Exchange adjustments	7.9	5.9	13.8
Accumulated depreciation at 31 March 2003	43.2	34.1	77.3
Net book value at 31 March 2003	116.8	22.1	138.9

The cost of the Bank's land at 31 March 2003 was GF 29.2 million (2002: GF 23.5 million).

8. Miscellaneous assets

These comprised:

	2002	2003
Net balances on forward operations and swaps	*691.6*	–
Other amounts recoverable	*7.5*	21.7
	699.1	21.7

9. Capital

The Bank's share capital consisted of:

	2002	2003
Authorised capital:		
600 000 shares,		
each of 2 500 gold francs	*1 500.0*	1 500.0
Issued capital: 529 125 shares		
(2002: 529 125)	*1 322.8*	1 322.8
of which 25% paid up	*330.7*	330.7

(a) The Extraordinary General Meeting on 8 January 2001 amended the Bank's Statutes to restrict the right to hold shares in the BIS exclusively to central banks, thereby effecting a mandatory repurchase of 72 648 shares from the American, Belgian and French issues held by private (ie non-central bank) shareholders against compensation of 16 000 Swiss francs per share. The Bank also repurchased at the same price 2 304 shares of these three issues held by other central banks. The Board will, in due course, redistribute these shares to the Bank's existing central bank shareholders in a manner which it considers appropriate. The voting rights attached to these shares remain unaffected; they continue to be exercisable by the American, Belgian and French central banks, respectively.

(b) Following the decision of the Arbitral Tribunal in The Hague in November 2002 the cost of repurchasing the total of 74 952 shares above, excluding interest thereon, is estimated to amount to GF 522.7 million (2002: GF 384.0 million). This amount is shown as a negative liability under the caption "Shares held in treasury" in the Bank's balance sheet.

(c) The number of outstanding shares on which the dividend for the financial year 2002/03 is payable is as follows:

Issued capital as at 31 March 2003	529 125
Less: shares held in treasury	
From private shareholders and central banks	74 952
Others	2 100
Total outstanding shares eligible for dividend	452 073

(d) The Extraordinary General Meeting on 10 March 2003 amended the Bank's Statutes to redenominate in SDRs the Bank's share capital and the nominal value of each share with effect from 1 April 2003. In order to obtain a round sum amount for the nominal value of each share (SDR 5 000, of which 25% is paid up), the total share capital was reduced. The resulting excess of SDR 92.1 million (GF 65.1 million) was transferred from paid-up capital to the free reserve fund at that date.

10. Reserves

The Bank's reserves, after the allocations proposed by the Board of Directors and the restatement of reserves for the financial year 2001/02 resulting from the changes in accounting policies (see note 3), consisted of:

	2002 as restated	2003
Legal reserve fund	*33.1*	33.1
General reserve fund	*1 494.5*	1 523.8
Special dividend reserve fund	*74.5*	77.5
Free reserve fund	*3 345.1*	3 606.1
	4 947.2	5 240.5

The yearly allocations to the various reserve funds are governed by Article 51 of the Bank's Statutes. The proposed allocations are shown in Table II of "Movements in the Bank's capital and reserves".

11. Valuation difference account

The movements on this account during the year were as follows:

	2002	2003
Opening balance	*56.0*	24.1
Currency translation gain/(loss)	*(31.9)*	279.8
Closing balance	*24.1*	303.9

12. Deposits

(a) Gold

Gold deposits placed with the Bank originate entirely from central banks.

(b) By maturity

The maturity breakdown of currency deposits placed with the Bank was as follows:

	2002	2003
Central banks		
Sight	*2 214.2*	2 035.2
Not exceeding 3 months	*34 372.8*	30 618.3
Over 3 months	*39 641.0*	47 309.5
Other depositors		
Sight	*296.1*	375.5
Not exceeding 3 months	*1 996.7*	2 351.9
Over 3 months	*965.6*	1 069.0
	79 486.4	83 759.4

(c) By instrument

The breakdown of currency deposits by type of instrument was as follows:

	2002	2003
Sight and Notice Accounts	*9 227.8*	8 461.7
Fixed-Term Deposits	*19 601.6*	21 239.4
Transferable book entry claims		
Floating rate (FRIBIS)	*3 200.1*	4 155.5
Fixed rate		
Issued at par (Coupon FIXBIS)	*14 227.1*	13 956.8
Issued at a discount (Discount FIXBIS)	*11 478.8*	7 491.3
Medium-Term Instruments	*21 751.0*	28 454.7
	79 486.4	83 759.4

Transferable book entry claims on the BIS are registered in the name of the subscriber. FRIBIS, Coupon FIXBIS and Discount FIXBIS mature within one year of issue. Medium-Term Instruments have fixed maturities, which are in principle not less than one year and not more than 10 years from the date of original issue of the claim. The Bank is required to repurchase at the prevailing market value these claims, in whole or in part, upon request by the subscribing counterparty of at least one business day's notice. The resulting gains and losses are incorporated in the profit and loss account under the heading "Loss on repayment of liabilities at market value".

13. Miscellaneous liabilities

These comprised:

	2002 as restated	2003
Net balances on forward operations and swaps	–	537.1
Administrative and banking payables	*7.4*	203.4
Retirement benefit obligations – *note 14*		
Directors' pensions	*2.3*	2.8
Health and accident benefits	*52.4*	68.7
Payable to former shareholders	*3.9*	148.6
	66.0	960.6

14. Retirement benefit obligations

(a) Directors' pensions

The Bank operates an unfunded defined benefit arrangement for its directors, whose entitlement is based on a minimum service period of four years. The movement in the accounts during the year was as follows:

	2002	2003
Opening liability	*2.2*	2.3
Exchange differences	*0.1*	0.5
Charged to the profit and loss account	*0.2*	0.2
Contributions paid	*(0.2)*	(0.2)
Closing liability	*2.3*	2.8

(b) Staff pensions

The Bank operates a final salary defined benefit Pensions System for its staff. The Pensions System is based on a fund which is similar in nature to a trust fund, having no separate legal personality. Its assets are administered by the Bank for the sole benefit of current and former members of staff who participate in the scheme. The scheme is valued annually by independent actuaries. The latest actuarial valuation was carried out at 30 September 2002.

	2002	2003
Present value of funded obligations	*258.6*	361.6
Fair value of scheme assets	*257.2*	340.1
	1.4	21.5
Unrecognised actuarial losses	*(1.4)*	(21.5)
Liability in the balance sheet	*–*	–

The movement in the accounts during the year was as follows:

	2002	2003
Opening (asset)/liability	*–*	–
Charged to the profit and loss account	*7.9*	21.6
Contributions paid	*(7.9)*	(21.6)
Closing (asset)/liability	*–*	–

The principal actuarial assumptions used in the calculations above were as follows:

	2002	2003
Discount rate – market rate of highly-rated corporate bond	*4.0%*	3.5%
Expected return on scheme assets	*5.0%*	5.0%
Future salary increases	*4.1%*	4.1%
Future pension increases	*4.1%*	4.1%

(c) *Health and accident benefits*

The Bank also provides unfunded post-retirement healthcare and accident benefits, based on a minimum service period of 10 years. The methodology used for the determination of the costs and obligations arising from this scheme and the actuarial assumptions used in calculating these benefits are identical to those for the Pensions System, except that there is an additional assumption for long-term medical inflation of 5.0% per annum.

The movement in the accounts during the year was as follows:

	2002	2003
Opening liability	*48.2*	52.4
Exchange differences	*1.3*	12.5
Charged to the profit and loss account	*5.2*	6.3
Contributions paid	*(2.3)*	(2.5)
Closing liability	*52.4*	68.7
Unrecognised actuarial loss	*–*	16.2
Present value of obligation	*52.4*	84.9

(d) *Savings Scheme*

Until 31 March 2003 the Bank operated a Savings Scheme for its staff. This was a separate fund similar in nature to the Pension Fund. The Bank's contributions to the scheme were charged to the profit and loss account and the liabilities under the scheme were off-balance sheet. On 1 April 2003 the scheme was wound up, and its outstanding obligations were settled on that date.

15. Off-balance sheet items

(a) Derivatives

In the normal course of business, the Bank engages in transactions involving derivative financial instruments, including forward exchange contracts, currency and interest rate swaps, forward rate agreements, futures and options, which are used to manage the Bank's interest rate and currency exposure on assets and liabilities. The Bank applies the same credit criteria in considering off-balance sheet commitments as it does for all other investments.

Notional principal amounts

	2002	2003
Exchange rate contracts:		
Foreign exchange swaps and forwards	*4 704.2*	17 859.6
Currency swaps	*5 438.0*	7 083.1
Options	*207.9*	462.8
Interest rate contracts:		
Interest rate swaps	*69 767.5*	85 813.8
Forward rate agreements and futures	*29 837.1*	36 554.4
Options	–	397.7

The notional or contracted principal amounts of the various derivatives reflect the degree to which the Bank is active in the respective markets but give no indication of the credit or market risk on the Bank's activities. The gross replacement cost of all contracts showing a profit at prevailing market prices on 31 March 2003 was GF 2 838.1 million (2002: GF 1 601.3 million).

(b) Fiduciary transactions

Fiduciary transactions are not included in the balance sheet, since they are effected on behalf of and at the risk of the Bank's customers, albeit in its own name.

	2002	2003
Nominal value of securities held under:		
safe custody arrangements	*4 351.0*	5 876.5
collateral pledge agreements	*2 555.0*	2 515.1
portfolio management mandates	*1 235.0*	1 526.8
	8 141.0	9 918.4
Gold held under earmark (in tonnes)	*170*	168

The financial instruments held under the above arrangements are deposited with external custodians, either central banks or commercial institutions.

16. Contingent liabilities

Certain former private shareholders have expressed their dissatisfaction with the amount of compensation paid to them by the Bank in connection with the mandatory repurchase of the shares not held by central banks (see note 9(a)).

In proceedings initiated by former shareholders before the Arbitral Tribunal in The Hague, that Tribunal issued a Partial Award on 22 November 2002 confirming the legality of the mandatory repurchase, but nevertheless concluding that the compensation should be increased. It ruled that the former private shareholders are entitled to receive a proportionate share of the net asset value of the Bank, subject, however, to a 30% discount. This formula is equivalent to that which the BIS has applied to new central bank subscriptions of shares. The Bank has confirmed its past declaration that it will voluntarily apply the decision of the Arbitral Tribunal to all registered former private shareholders in final settlement of all claims. The precise amount of additional compensation will be determined by the Arbitral Tribunal after further proceedings to be held in the course of 2003. The BIS estimates the additional compensation due at 4 868 Swiss francs per share, equivalent to a total of GF 138.7 million for the 74 952 repurchased shares, such total amount being reflected in the increased amount shown on the balance sheet under the heading "Shares held in treasury". The claimants contest the amount per share, arguing that the Tribunal should award additional compensation which in total would range up to approximately GF 100 million beyond the Bank's estimate.

In a proceeding brought by a separate group of former private shareholders, the Commercial Court in Paris made a preliminary determination (without addressing the substance of the matter) in March 2003 that it has jurisdiction over their claims seeking to increase the amount of compensation. The Bank has requested review of this procedural decision by the Paris Court of Appeals, arguing that the Arbitral Tribunal in The Hague has exclusive jurisdiction over the matter. Accordingly, the Bank has not made separate provisions for these claims.

Report of the auditors

Report of the auditors
to the Board of Directors and to the General Meeting
of the Bank for International Settlements, Basel

We have audited the accompanying balance sheet and profit and loss account, including the notes thereto, of the Bank for International Settlements. The balance sheet and profit and loss account have been prepared by the Management of the Bank in accordance with the Statutes and with the principles of valuation described under significant accounting policies in the notes. Our responsibility under the Statutes of the Bank is to form an independent opinion on the balance sheet and profit and loss account based on our audit and to report our opinion to you.

Our audit included examining, on a test basis, evidence supporting the amounts in the balance sheet and profit and loss account and related disclosures. We have received all the information and explanations which we have required to obtain assurance that the balance sheet and profit and loss account are free of material misstatement, and believe that our audit provides a reasonable basis for our opinion.

In our opinion, the balance sheet and profit and loss account, including the notes thereto, have been properly drawn up and give a true and fair view of the financial position of the Bank for International Settlements at 31 March 2003 and the results of its operations for the year then ended so as to comply with the Statutes of the Bank.

PricewaterhouseCoopers AG

Ralph R Reinertsen | Anthony W Travis

Basel, 12 May 2003

Pro forma accounts (unaudited)

Introduction

At the Extraordinary General Meeting (EGM) of the Bank held on 10 March 2003, it was decided that the gold franc would be replaced as the Bank's unit of account by the Special Drawing Right (SDR) as defined by the International Monetary Fund with effect from 1 April 2003. This change has been made to assist in managing the Bank's operations and economic capital more efficiently and to enhance the transparency of its accounts.

Consequences of the change to the SDR

The replacement of the gold franc by the SDR[1] requires a conversion into SDRs of the gold franc amounts in which the capital of the Bank has been expressed. The EGM decided that the nominal value of the shares should be rounded down from its precise converted amount (SDR 5 696 at 31 March 2003) to SDR 5 000. Following the reduction of 12.2% in the share capital, the excess amount of SDR 92.1 million at 31 March 2003 has been transferred from the paid-up capital to the Bank's reserve funds. There is no impact on the Bank's equity from this change.

Changes in accounting policies

The Bank has taken the opportunity to review its accounting policies and align them more closely with its business operations. Certain accounting policy changes have been made in the audited gold franc accounts. The introduction of the SDR as the Bank's unit of account has facilitated a number of further changes which have been put into effect as from 1 April 2003. These changes better reflect the Bank's financial position and performance, and are described below.

In order to reflect the increasingly market-related nature of the Bank's operations, financial instruments and gold will be shown on the balance sheet on a trade date basis at their market or fair values, instead of at amortised historical cost on a value date basis. Derivative financial instruments will be reflected on both sides of the balance sheet at their gross fair values. Profits and losses on the Bank's trading operations will be recorded in the profit and loss account based on market values. The currency composition of the assets designated as being financed by the Bank's equity (own funds) has been

[1] One SDR is equivalent to the sum of US$ 0.577, €0.426, ¥21.0 and £0.0984 according to Rule O–1 as adopted by the Executive Board of the International Monetary Fund on 29 December 2000 and effective 1 January 2001; this decision is subject to revision every five years.

realigned since 31 March 2003 to approximate the composition of the SDR currency basket. Currency translation differences will be recorded in the profit and loss account. The resulting profits will provide a better picture of the economic performance of the banking book, which is managed with limited interest rate, currency and maturity transformation risk. In addition, reserves will be created to reflect the unrealised profits of the Bank's investment securities portfolio and its own gold.

Pro forma accounts reconciliations

These reconciliations link the figures in the audited gold franc balance sheet and profit and loss account with the values in the SDR accounts described above by:

(i) disclosing the gold franc equivalent figures translated into SDRs at the exchange rate of 31 March 2003 (SDR 1 = GF 0.7072146 or US$ 1.3730456);

(ii) making revaluation adjustments incorporating the change in the valuation of the Bank's assets and liabilities resulting from the accounting policy changes described above;

(iii) effecting transfers:

  (a) between share capital and the reserve funds resulting from the downward adjustment of the nominal value of the Bank's shares to SDR 5 000;

  (b) of the balance on the valuation difference account to reserves resulting from the change of accounting policy on currency translation differences referred to above; and

  (c) from reserves to the gold revaluation account to reflect the excess of the market value of the Bank's gold (US$ 335.18 per ounce) over its previous value, US$ 208 per ounce;

(iv) making other adjustments to reflect the change to accounting for the Bank's assets and liabilities on a trade date basis, instead of the value date basis previously used in the Bank's accounts, and to show the Bank's derivative instrument balances on a gross basis instead of net.

Pro forma balance sheet reconciliation (unaudited)

at 31 March 2003
(in millions of Special Drawing Rights)

	Balance sheet (GF)	Translated into SDRs	Revaluations	Reclassi-fications	Trade date adjustments	Balance sheet (SDRs)
Column/notes	1	2	3	4	5	6
Assets						
Gold	3 299.6	4 665.6	2 876.4	–	–	7 542.0
Cash on hand and on sight account with banks	3 041.5	4 300.7	–	–	–	4 300.7
Treasury bills	14 027.3	19 834.6	0.6	–	889.4	20 724.6
Time deposits and advances in currencies	40 209.1	56 855.6	48.3	–	1 824.2	58 728.1
Securities purchased under resale agreements	5 302.2	7 497.3	–	–	4 757.7	12 255.0
Government and other securities at term	26 791.0	37 882.4	737.5	–	112.7	38 732.6
Derivative financial instruments	–	–	3 966.1	–	–	3 966.1
Land, buildings and equipment	138.9	196.4	–	–	–	196.4
Miscellaneous assets	21.7	30.7	–	–	3 143.2	3 173.9
Total assets	92 831.3	131 263.3	7 628.9	–	10 727.2	149 619.4
Liabilities						
Paid-up capital	330.7	467.6	285.9	(92.1)	–	661.4
Reserves (after allocation of the net profit)	5 240.5	7 410.1	623.4	(49.8)	(2.5)	7 981.2
Shares held in treasury	(522.7)	(739.1)	–	–	–	(739.1)
Securities revaluation account	–	–	357.0	–	–	357.0
Gold revaluation account	–	–	–	571.6	–	571.6
Valuation difference account	303.9	429.7	–	(429.7)	–	–
Equity	5 352.4	7 568.3	1 266.3	–	(2.5)	8 832.1
Deposits						
Gold	*2 638.4*	*3 730.7*	*2 291.9*	–	–	*6 022.6*
Currencies	*83 759.4*	*118 435.6*	*1 595.8*	–	*2 487.4*	*122 518.8*
	86 397.8	122 166.3	3 887.7	–	2 487.4	128 541.4
Securities sold under repurchase agreements	51.8	73.2	–	–	–	73.2
Derivative financial instruments	–	–	3 234.4	–		3 234.4
Miscellaneous liabilities	960.6	1 358.4	(759.5)	–	8 242.3	8 841.2
Dividend	68.7	97.1	–	–	–	97.1
Total liabilities	92 831.3	131 263.3	7 628.9	–	10 727.2	149 619.4

Notes to the pro forma balance sheet reconciliation

1. The figures in this column contain the audited balance sheet figures in gold francs at 31 March 2003, and assume that the recommendations made by the Board concerning transfers to the reserve funds are adopted.

2. The figures in this column are translated from the gold franc figures in column 1 to SDRs at the exchange rate of the balance sheet date, SDR 1 = GF 0.7072146 (SDR 1 = US$ 1.3730456).

3. The adjustments in this column principally relate to the following revaluations:
   (a) gold from the equivalent of US$ 208 per ounce of gold to its market value of SDR 244.11 (US$ 335.18) at 31 March 2003.
   (b) financial instruments in currencies from amortised historical cost to market value, based on mid-market prices. The balance on the securities revaluation account represents the unrealised revaluation surplus of investment securities.
   (c) derivative financial instruments to fair value. From 1 April 2003, derivative assets and liabilities (principally on currency and interest rate contracts) are reflected separately at fair value on each side of the balance sheet. Under the Bank's accounting policy until 31 March 2003, they were netted off and their net value included either in miscellaneous assets or in miscellaneous liabilities.

4. The amounts in this column comprise:
   (a) the rounding down of the paid-up portion of the shares to SDR 1 250 per share resulting from the downward adjustment of the nominal value of the Bank's shares to SDR 5 000 per share, and the transfer of the resulting excess of SDR 92.1 million from share capital to reserves. The Bank's capital and reserves in total are not affected by this adjustment.
   (b) the transfer of the balance on the valuation difference account to reserves. From 1 April 2003, exchange differences on currency translation will be reflected in the profit and loss account.
   (c) the transfer from reserves to the gold revaluation account of the excess of the market value of the Bank's own gold over its previous value in the gold franc accounts, based on US$ 208 per ounce.

5. The figures in this column relate to the adjustment to reflect the Bank's assets and liabilities on a trade date basis instead of the previous value date basis.

6. The figures in this column are the final SDR pro forma balance sheet figures and are equal to the sum of the figures in columns 2 to 5.

Pro forma profit reconciliation (unaudited)

for the financial year ended 31 March 2003
(in millions of Special Drawing Rights)

	Profit and loss account (GF)	Translated into SDRs	Revaluations	Transfers	Trade date adjustments	Profit and loss account (SDRs)
Column/notes	1	2	3	4	5	6
Net interest and other operating income	352.1	497.9	66.0	–	(2.5)	561.4
Less: costs of administration	(98.3)	(139.1)	–	–		(139.1)
Operating profit	253.8	358.8	66.0	–	(2.5)	422.3
Profits on sales of investment securities	108.2	153.0	–	–	–	153.0
Net profit for the financial year	362.0	511.8	66.0	–	(2.5)	575.3
Dividend	(68.7)	(97.2)	–	–		(97.2)
Profit transferred to reserves	293.3	414.6	66.0	–	(2.5)	478.1

Notes to the pro forma profit reconciliation

1. The figures in this column are extracted from the audited profit and loss account in gold francs for the year ended 31 March 2003.

2. The SDR equivalent figures are translated from the gold franc figures in column 1 at the exchange rate of the balance sheet date, SDR 1 = GF 0.7072146 (SDR 1 = US$ 1.3730456).

3. The adjustment in this column represents the change in the net unrealised profits of the assets, liabilities and derivatives in the Bank's trading book. From 1 April 2003, changes in the market values of the Bank's trading assets, liabilities and derivatives will be reflected in the profit and loss account.

4. There are no transfers between profit and loss account items.

5. This represents the profit impact from the introduction of trade date accounting and the revaluation of assets purchased to their mid-market values.

6. The figures in this column are the final SDR pro forma profit and loss account figures and are equal to the sum of the figures in columns 2 to 5.

Five-year summary of the balance sheet

(in millions of gold francs)

Financial year ended 31 March	1999	2000	2001	2002	2003
Gold	3 878.7	3 505.8	3 521.1	3 209.9	3 299.6
Cash on hand and on sight account with banks	8.3	11.4	20.3	3 292.3	3 041.5
Treasury bills	7 314.0	7 853.9	4 597.8	9 588.1	14 027.3
Time deposits and advances in currencies	32 423.0	41 853.9	44 796.4	45 538.0	40 209.1
Securities purchased under resale agreements	276.0	1 268.1	3 882.0	1 660.7	5 302.2
Government and other securities at term	22 167.9	20 139.9	18 339.5	23 610.9	26 791.0
Land, buildings and equipment	124.7	120.7	113.2	115.4	138.9
Miscellaneous assets	44.5	82.0	783.7	699.1	21.7
Total assets	66 237.1	74 835.7	76 054.0	87 714.4	92 831.3
Paid-up capital	323.2	330.7	330.7	330.7	330.7
Reserves (after allocation of the net profit for the year)	4 305.0	4 526.6	4 731.3	4 947.2	5 240.5
Shares held in treasury	–	–	(384.0)	(384.0)	(522.7)
Valuation difference account	268.0	198.4	56.2	24.1	303.9
Equity	4 896.2	5 055.7	4 734.2	4 918.0	5 352.4
Deposits					
Gold	*3 192.6*	*2 820.2*	*2 842.3*	*2 531.4*	*2 638.4*
Currencies	*57 705.8*	*65 903.7*	*67 274.8*	*79 486.4*	*83 759.4*
	60 898.4	68 723.9	70 117.1	82 017.8	86 397.8
Securities sold under repurchase agreements	121.5	103.0	990.6	660.0	51.8
Miscellaneous liabilities	263.6	898.4	163.5	66.0	960.6
Dividend	57.4	54.7	48.6	52.6	68.7
Total liabilities	66 237.1	74 835.7	76 054.0	87 714.4	92 831.3

The figures for prior financial years have been restated to reflect the changes in accounting policies for sales of own funds investments, provisions and retirement benefit obligations.

Five-year summary of the profit and loss account

(in millions of gold francs)

Financial year ended 31 March	1999	2000	2001	2002	2003
Net interest and other operating income	365.2	380.6	322.4	259.6	352.1
Less: costs of administration					
Board of Directors	*1.3*	*1.2*	*1.1*	*0.9*	*1.2*
Management and staff	*46.0*	*47.4*	*40.4*	*47.2*	*65.6*
Office and other expenses	*18.6*	*19.4*	*21.6*	*19.9*	*22.0*
Costs of administration before depreciation	65.9	68.0	63.1	68.0	88.8
Depreciation	*6.0*	*7.6*	*8.1*	*8.8*	*9.5*
	71.9	75.6	71.2	76.8	98.3
Operating profit	293.3	305.0	251.2	182.8	253.8
Profit on sales of own funds investment securities	124.1	(81.4)	2.1	85.7	108.2
Net profit for the financial year	417.4	223.6	253.3	268.5	362.0
Dividend	57.4	54.7	48.6	52.6	68.7
Profit transferred to reserves	360.0	168.9	204.7	215.9	293.3

The figures for prior financial years have been restated to reflect the changes in accounting policies for sales of own funds investments, provisions and retirement benefit obligations.

Board of Directors

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President of the Bank

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David Dodge, Ottawa
Antonio Fazio, Rome
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Peter Praet or Jan Smets, Brussels
Jürgen Stark or Stefan Schönberg, Frankfurt am Main
Marc-Olivier Strauss-Kahn or Michel Cardona, Paris
Paul Tucker or Paul Fisher, London

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Consultative Committee
Audit Committee

both chaired by Lord Kingsdown

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André Icard	Deputy General Manager
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Robert D Sleeper	Head of Banking Department
Renato Filosa	Manager, Monetary and Economic Department
Mario Giovanoli	General Counsel, Manager
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Peter Dittus	Deputy Secretary General
Josef Tošovský	Chairman, Financial Stability Institute

BIS member central banks

Central Bank of the Argentine Republic
Reserve Bank of Australia
Austrian National Bank
National Bank of Belgium
Central Bank of Bosnia and Herzegovina
Central Bank of Brazil
Bulgarian National Bank
Bank of Canada
The People's Bank of China
Croatian National Bank
Czech National Bank
National Bank of Denmark
Bank of Estonia
European Central Bank
Bank of Finland
Bank of France
Deutsche Bundesbank
Bank of Greece
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National Bank of Hungary
Central Bank of Iceland
Reserve Bank of India
Central Bank and Financial Services Authority of Ireland
Bank of Italy
Bank of Japan
The Bank of Korea
Bank of Latvia
The Bank of Lithuania
National Bank of the Republic of Macedonia
Central Bank of Malaysia
Bank of Mexico
Netherlands Bank
Central Bank of Norway
National Bank of Poland
Bank of Portugal
National Bank of Romania
Central Bank of the Russian Federation
Saudi Arabian Monetary Agency
Monetary Authority of Singapore
National Bank of Slovakia
Bank of Slovenia
South African Reserve Bank
Bank of Spain
Sveriges Riksbank
Swiss National Bank
Bank of Thailand
Central Bank of the Republic of Turkey
Bank of England
Board of Governors of the Federal Reserve System
National Bank of Yugoslavia[1]

[1] Following the constitutional changes in February 2003 which transformed the Federal Republic of Yugoslavia into the State Union of Serbia and Montenegro, with two separate central banks, the legal status of the Yugoslav issue of the capital of the BIS is currently under review.

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