Basel Committee on
Banking Supervision

BCP

Core Principles for effective banking supervision

BCP99

Structure and guidance for assessment reports prepared by the International Monetary Fund and World Bank

This chapter outlines guidance for the preparation of assessment reports by the International Monetary Fund and World Bank.

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BANK FOR INTERNATIONAL SETTLEMENTS

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99.1

This section presents guidance and a format recommended by the IMF and the World Bank for the presentation and organisation of the Basel Core Principles (BCP) assessment reports by assessors in the context of the FSAP and standalone assessments. A self-assessment[1] conducted by the country's authorities prior to IMF-World Bank assessments is an essential element in the process and should also follow this guidance and format.

1 Footnote

1 *Such self-assessment should be made available to assessors well in advance – also considering the possible need for translation – accompanied by the supporting legislation and regulation.*

99.2

The BCP assessment report should be divided into eight parts:

1. a "summary and main findings" section;
2. a general section providing background information and information on the methodology used;
3. an overview of institutional setting and market infrastructure;
4. a review of preconditions for effective banking supervision;
5. detailed principle-by-principle assessments;
6. a compliance table summarising the results of the assessment;
7. recommended actions; and
8. the authorities' response.

The following paragraphs provide a brief description of each of the eight parts.

99.3

A short "summary and main findings section" should provide an overview of the main findings and main recommendations of the report. It should read as an executive summary, with the main findings for several principles aggregated in a few paragraphs under subtitles. For example, assessors may choose to consolidate findings and recommendations under the subtitles of Responsibility, objectives, powers, independence and accountability (principles 1–2), Ownership, licensing and structure (principles 4–7), Methods of ongoing supervision (principles 8–10), Corrective and sanctioning powers of supervisors (principle 11), Cooperation, consolidated, and cross-border banking supervision (principles 3, 12–13), Corporate governance (principle 14), Prudential requirements, regulatory framework, accounting and disclosure (principles 15–29).

99.4

A brief introduction and methodology section which provides background information on the assessment conducted, ie the context in which the assessment is being conducted and the methodology used. This section should:

1. Indicate that the scope of the assessment has been selected with the authorities' agreement, mentioning in particular whether the authorities agreed to be assessed and graded on the basis of only the essential criteria or on the basis of additional criteria too. The names and affiliations of the assessors should be mentioned in this section.

2. Mention the sources used for the assessment such as any self-assessments, questionnaires filled out by the authorities, relevant laws, regulations and instructions, and other documentation, such as reports, studies, public statements, websites, unpublished guidelines, directives, supervisory reports and assessments.
3. Identify counterparty authorities and mention, in a generic way, senior officials[2] with whom interviews were held and meetings with other domestic supervisory authorities, private sector participants, other relevant government authorities or industry associations (such as bankers' associations, auditors and accountants).
4. Mention factors that impeded or facilitated the assessment. In particular, information gaps (such as lack of access to supervisory materials or translated documents) should be mentioned, and an indication should be given of the extent to which these gaps may have affected the assessment.[3]

2 Footnotes

2 *Names are typically avoided, in order to protect individuals and encourage candour.*

3 *If the lack of information adversely impacts the quality and depth of the assessment of a particular Core Principle, assessors should refer to this in the comment section of the assessment template and document the obstacles encountered, in particular where access to in-depth information is crucial in evaluating compliance. Such issues should be brought to the attention of the mission leaders and, where necessary, referred to headquarters staff for guidance.*

99.5

The third section should provide an overview of the supervisory environment for the financial sector, with a brief description of the institutional and legal setting, in particular the mandate and oversight roles of the different supervisory authorities, the existence of unregulated financial intermediaries and the role of self-regulatory organisations. Furthermore, it should provide a general description of the structure of the financial markets and, in particular, the banking sector, mentioning the number of banks, total assets to gross domestic product, a basic review of banking stability, capital adequacy, leverage, asset quality, liquidity, profitability and risk profile of the sector, and information on ownership, ie foreign versus domestic, state-owned versus privately owned, the existence of conglomerates or unregulated affiliates, and similar information. If the assessment is part of an FSAP, this section can be shorter, summarising and cross-referencing other FSAP documents.

99.6

The fourth section should provide an overview of the preconditions for effective banking supervision, as described in this BCP standard. Experience has shown that insufficient implementation of the preconditions can seriously undermine the quality and effectiveness of banking supervision. Assessors should aim to give a factual review of preconditions so that the reader of the report is able to clearly understand the environment in which the banking system and the supervisory framework are operating. This will provide the perspective for a better appreciation of the assessment and grading of individual principles. The review normally should take up no more than one or two paragraphs for each type of precondition and should follow the headings indicated below.

1. Sound and sustainable macroeconomic policies: the review should describe those

aspects that could affect the structure and performance of the banking system and should not express an opinion on the adequacy of policies in these areas. It may make reference to analyses and recommendations in existing IMF and World Bank documents, such as Article IV and other Bank and Fund programme-related reports.

2. A well established framework for financial stability policy formulation: the review should indicate the existence or otherwise of a clear framework for macroprudential surveillance and stability policy formulation. It should cover clarity of roles and mandates of the relevant agencies; the mechanisms for effective inter-agency cooperation and coordination; and communication of macroprudential analyses, risks and policies, and their outcomes. Assessors may rely on independent assessments of the adequacy and effectiveness of the framework, where available.
3. A well developed public infrastructure: a factual review of the public infrastructure should focus on elements relevant to the banking system and, where appropriate, it should be prepared in coordination with other specialists on the mission and the IMF-World Bank country teams. This part of the review of the preconditions could cover issues such as the presence of a good credit culture, a system of business laws, including corporate, bankruptcy, contract, consumer protection and private property laws, that is consistently enforced and provides a mechanism for the fair resolution of disputes; the presence of well trained and reliable accounting, auditing and legal professions; an effective and reliable judiciary; an adequate financial sector regulation; and efficient payment, clearing and settlement systems.
4. A clear framework for crisis management, recovery and resolution: the review should cover the availability of a sound institutional framework for crisis management and resolution of banks, and the clarity of the roles and mandates of the relevant agencies. While evidence of effectiveness may be observed in the actual management and resolution of past crises, it may be also available from documentation of the outcomes of crisis simulation exercises conducted in the jurisdiction. Assessors may rely on independent assessments of the adequacy and effectiveness of the framework, where available.
5. An appropriate level of systemic protection (or public safety net): an overview of the safety nets or systemic protection could, for instance, include the following elements: an analysis of the functions of the various entities involved, such as supervisory authorities, the deposit insurer and the central bank. This would be followed by a review of the existence of a well defined process for dealing with crisis situations, such as the resolution of a failed financial institution. This would be combined with a description of the coordination of the roles of the various entities involved in this process. Additionally, in connection with the use of public funds (including central bank funds), a review of whether sufficient measures are in place to minimise moral hazard would be conducted. Moreover, the mechanisms to meet banks' temporary short-term liquidity needs, primarily through the interbank market, but also from other sources, would need to be described.
6. Effective market discipline: a review of market discipline could, for instance, cover issues such as the presence of rules on corporate governance, transparency and audited financial disclosure; appropriate incentive structures for the hiring and removal of managers and board members; protection of shareholders' rights; adequate availability of market and consumer information; disclosure of government influence in banks; tools for the exercise of market discipline, such as the mobility of deposits and other assets held in banks; adequate periodicity of interest rate and other price quotes; an effective framework for mergers, takeovers and acquisitions of equity interests, the possibility of foreign entry into the markets, and foreign-financed takeovers.

99.7

BCP assessors should not assess preconditions themselves, as this is beyond the scope of the individual standard assessments. Assessors should rely to the greatest extent possible on official IMF and World Bank documents and seek to ensure that the brief description and comments are consistent. Where relevant, assessors should attempt to include in their analysis the linkages between these factors and the effectiveness of supervision. As described in the next section, the assessment of compliance with individual Core Principles should mention clearly how it is likely to be primarily affected by preconditions that are considered to be weak. If shortcomings in preconditions are material to the effectiveness of supervision, they may affect the grading of the affected Core Principles. Any suggestions aimed at addressing deficiencies in preconditions are not part of the recommendations of the assessment but can be made into general FSAP recommendations within the scope of the FSAP exercise.

99.8

The fifth section contains a detailed principle-by-principle assessment, providing a "description" of the system with regard to each criterion within a principle; a grading or "assessment"; and "comments". The template for the detailed assessment is structured as follows.

Principle (x) (repeating verbatim the text of the Principle)	
Essential criteria (EC)	
Description and findings regarding EC1	
Description and findings regarding EC2	
Description and findings regarding EC3	
Additional criteria (AC) (only if the authorities choose to be assessed and graded against these too)	
Description and findings regarding AC1	
Description and findings regarding ACn	
Assessment of Principle (x)	Compliant / Largely compliant / Materially non-compliant / Non-compliant / Not applicable
Comments	

99.9

The "description and findings" section of each criterion should provide information on the practice as observed in the country being assessed. It should cite and summarise the main elements of the relevant laws and regulations. This should be done in such a way that the relevant law or regulation can be easily located, for instance by reference to URLs, official gazettes and similar sources. Insofar as possible and relevant, the description should be structured as follows:

1. banking laws and supporting regulations;
2. prudential regulations, including prudential reports and public disclosure;
3. supervisory tools and instruments;
4. the institutional capacity of the supervisory authority; and
5. evidence of implementation and/or enforcement or the lack of it.

99.10

Evidence of implementation and/or enforcement is essential: without the effective use of the powers vested in the supervisor and implementation of rules and regulations, even a well designed supervisory system will not be effective. Examples of practical implementation should be provided by the authorities, reviewed by the assessors and mentioned in the report.[4]

1 Footnote

[4] *For instance: how many times over the past years have the authorities applied corrective action? How frequently have banks been inspected on-site? How many licensing applications have been received, and how many have been accepted/turned down? Have asset quality reports been prepared by the inspectors, and how have the conclusions been communicated to senior bank and banking supervision management?*

99.11

The "assessment" section of the template should contain only one line, stating whether the system is "compliant", "largely compliant", "materially non-compliant", "non-compliant" or "not applicable" as described in BCP20.9 and BCP20.10. There are three assessment options:

1. Unless the country explicitly selects another option, compliance with the Core Principles will be assessed and graded only with reference to the essential criteria.
2. A country may voluntarily choose to be assessed against the additional criteria, in order to identify areas in which it could enhance its regulation and supervision further and benefit from assessors' comments on how this could be achieved. However, compliance with the Core Principles will still be graded only with reference to the essential criteria.
3. To accommodate countries that seek to attain best supervisory practices, a country may voluntarily choose to be assessed and graded against both the essential and the additional criteria. It is anticipated that this will provide incentives to jurisdictions, particularly those that are important financial centres, to lead the way in the adoption of the highest supervisory standards.

99.12

The essential criteria set out minimum baseline requirements for sound supervisory practices and are universally applicable in all countries. An assessment of a jurisdiction against the essential criteria must, however, recognise that its supervisory practices should be commensurate with the risk profile and systemic importance of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. As with the essential criteria, any assessment against additional criteria should also adopt the principle of proportionality. This principle should underpin assessment of all criteria even if it is not always explicitly referred to in the criteria. For example, a jurisdiction with many systemically important banks or banks that are part of complex mixed conglomerates will naturally have a higher hurdle to clear to obtain a "compliant" grading as compared to a jurisdiction which only has small and non-complex banks that are primarily engaged in deposit-taking and extending loans.

99.13

The "comments" section of the template should be used to explain why a particular grading was given. In case of a grading below "compliant", this section should be used to highlight the materiality of the observed shortcomings and indicate which measures would be needed to achieve full compliance or a higher level of compliance. This should also be included in the table on "recommended actions" (see below). This reasoning could be structured as follows:

1. the state of the laws and regulations and their implementation;
2. the state of the supervisory tools and instruments, for instance reporting formats, early warning systems and inspection manuals;
3. the quality of practical implementation;
4. the state of the institutional capacity of the supervisory authority; and
5. enforcement practices.

99.14

The "comments" should explain the cases where, despite the existence of laws, regulations and policies, weaknesses in implementation contributed to the principle being graded as less than "compliant". Conversely, when a "compliant" grading was given, but observance was demonstrated by the country through different mechanisms, this should be explained. The "comments" section should also highlight when and why compliance with a particular criterion could not be adequately reviewed, such as where certain information was not provided or where key individuals were unavailable to discuss important issues. Requests for information or meetings should be documented in the "comments" section to clearly demonstrate the assessor's attempts to adequately assess a principle.

99.15

Assessors may also include "comments" where they find particularly good practices or rules in some field that might serve as examples and best practice to other countries. Planned initiatives aimed at amending existing or adopting new regulations and practices but which are not yet in effect can receive favourable mentions in this section. Recent legislative, regulatory or supervisory initiatives for which implementation could not be verified should be mentioned in this section as well.

99.16

The assessment and accompanying grades should solely be based on the regulatory framework and supervisory practices in place at the time of the assessment and should not reflect planned initiatives aimed at amending existing regulations and practices or adopting new ones. This would be applicable in the case where actions are in process that would result in a higher compliance rating but have not yet been effected or implemented.

99.17

When linkages between particular principles are evident, or between preconditions and principles, this section should be used to caution the reader that, although the regulation and practices in principle (x) seem compliant, a "compliant" grading cannot be given because of material deficiencies in the implementation of principle (y) or precondition (z).[5] While recognising that there could be common deficiencies which are both relevant and material enough to affect the rating of more than one principle, assessors should avoid double-counting as far as possible. If the deficiencies found in linked principles or preconditions are not material enough to warrant a downgrade, this should still be brought out in this section of the template.

1 Footnote

5 *For example, the regulation and supervision of capital adequacy may seem compliant, but if material deficiencies are found in another principle, such as provisioning, that will mean capital may be overstated and ratios unreliable.*

99.18

Grading should be given to a principle regardless of the level of development of a country. If certain criteria are not applicable given the size, nature of operations and complexity of a country's banking system, grading of the principle should be based on the level of compliance with the applicable criteria only. This must be clearly explained in the relevant section of the report so that a future review can reconsider the grading if the situation changes. The same applies to a "not applicable" grading of a principle.

99.19

The sixth section of the report comprises a compliance table, summarising the assessments, principle by principle. This table has two versions: the one that does not include explicit grading (Table 2) is to be used in reports on the observance of standards and codes (or ROSCs; see BCP99.22,[6] the version with grading (Table 1) is to be used in the detailed assessment only. This table should convey a clear sense of the degree of compliance, providing a brief description of the main strengths and, especially, weaknesses with respect to each principle. The template is as follows:

Summary compliance with the Core Principles – Detailed Assessment Report (DAR) Table 1

Core principle	Grade (column not used in ROSCs)	Comments
1. Responsibilities, objectives and powers		
2. Independence, accountability, resourcing and legal protection for supervisors		
3. Cooperation and collaboration		
4. Permissible activities		
5. Licensing criteria		
6. Transfer of significant ownership		
7. Major acquisitions		

8. Supervisory approach		
9. Supervisory techniques and tools		
10. Supervisory reporting		
11. Corrective and sanctioning powers of supervisors		
12. Consolidated supervision		
14. Home-host relationships		
15. Risk management process		
16. Capital adequacy		
17. Credit risk		
18. Problem exposures, provisions and reserves		
19. Concentration risk and large exposure limits		
20. Transactions with related parties		
21. Country and transfer risks		
22. Market risk		
23. Interest rate risk in the banking book		
24. Liquidity risk		
25. Operational risk and operational resilience		
26. Internal control and audit		
27. Financial reporting and external audit		
28. Disclosure and transparency		
29. Abuse of financial services		

Summary compliance with the Core Principles – ROSC	Table 2
Core principle	Comments
1. Responsibilities, objectives and powers	

2. Independence, accountability, resourcing and legal protection for supervisors	
3. Cooperation and collaboration	
4. Permissible activities	
5. Licensing criteria	
6. Transfer of significant ownership	
7. Major acquisitions	
8. Supervisory approach	
9. Supervisory techniques and tools	
10. Supervisory reporting	
11. Corrective and sanctioning powers of supervisors	
12. Consolidated supervision	
14. Home-host relationships	
15. Risk management process	
16. Capital adequacy	
17. Credit risk	
18. Problem exposures, provisions and reserves	
19. Concentration risk and large exposure limits	
20. Transactions with related parties	
21. Country and transfer risks	
22. Market risk	
23. Interest rate risk in the banking book	
24. Liquidity risk	
25. Operational risk and operational resilience	
26. Internal control and audit	
27. Financial reporting and external audit	

28. Disclosure and transparency	
29. Abuse of financial services	

1 Footnote

[6] The ROSC does not include the grading in the table because the grades cannot be fully understood without the description and detailed comments (which are available only in the DAR).

99.20

The seventh section comprises a "recommended actions" table providing principle-by-principle recommendations for actions and measures to improve the regulatory and supervisory framework and practices. This section should list the suggested steps for improving the compliance and overall effectiveness of the supervisory framework. Recommendations should be proposed on a prioritised basis in each case where deficiencies are identified. The recommended actions should be specific in nature. An explanation could also be provided as to how the recommended action would assist in improving the level of compliance and strengthening the supervisory framework. The institutional responsibility for each suggested action should also be clearly indicated to prevent overlaps or confusion. Recommendations can also be made regarding deficiencies in compliance with the additional criteria and to principles which are fully compliant but where supervisory practice can still be improved. The table should indicate only those principles for which specific recommendations are being made. The template for the recommended actions is as follows.

Recommended actions to improve compliance with the Core Principles and the effectiveness of regulatory and supervisory frameworks	
Reference principle	Recommended action
Principle (x)	Example: suggested introduction of regulation (a), supervisory practice (b)
Principle (y)	Example: suggested introduction of regulation (c), supervisory practice (d)

99.21

The eighth section describes the authorities' response to the assessment.[7] The assessor should provide the supervisory authority or authorities being assessed with an opportunity to respond to the assessment findings, which would include providing the authorities with a full written draft of the assessment. Any differences of opinion on the assessment results should be clearly identified and included in the report. The assessment should allow for greater dialogue, and therefore the assessment team should have had a number of discussions with the supervisors during the assessment process so that the assessment should also reflect the comments, concerns and factual corrections of the supervisors. The authority or authorities should also be requested to prepare a concise written response to the findings ("right of reply"). The assessment should not, however, become the object of negotiations, and assessors and authorities should be willing "to agree to disagree", provided the authorities' views are represented fairly and accurately.

1 Footnote

[7] *If no such response is provided within a reasonable time frame, the assessors should note this explicitly and provide a brief summary of the initial response provided by the authorities during their discussion with the assessors at the end of the assessment mission (“wrap-up meeting”).*

99.22

The presentation of assessment results in ROSCs is different from the presentation of the outcome of the DAR described above. The ROSC should comprise all of Section 1 and summaries of Sections 2, 3, 4, 7 and 8. There should be no Section 5 (detailed assessment), and the summary table in Section 6 should be amended to remove the "grades" column. All sections should remove references to the grades. An ROSC is a mandatory attachment to the FSAP reports if a full DAR is not published.