Comparison between the 1999 and 2006 versions of the Core Principles Methodology

1999 Methodology	2006 Draft Methodology
Principle 1 An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place. *Note: Principle 1 is divided into six component parts. Four of the component parts are not repeated elsewhere in the Core Principles. However two parts (3 & 4) are developed in greater detail in one or more of the subsequent Principles. For these two, since the criteria will be developed further elsewhere, this section identifies only the most fundamental and crucial ones.*	**Principle 1: Objectives, independence, powers, transparency and cooperation** An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.[5] Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the overall exercise of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place. *Note: CP 1 is divided into six component parts. Three of the component parts are not repeated elsewhere in the CPs. However, two parts (3 and 4) are developed in greater detail in one or more of the subsequent CPs. For these two, since the criteria will be developed further elsewhere, this section identifies only the most fundamental and crucial ones. Part 6 is enhanced in CPs 18, 24 and 25.* 5. Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification
Principles 1 (1) An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.	**Principle 1(1): Responsibilities and objectives** An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.

1999 Methodology	2006 Draft Methodology
Essential criteria 1. Laws are in place for banking, and for (each of) the agency (agencies) involved in banking supervision. The responsibilities and objectives of each of the agencies are clearly defined.	Essential criteria 1. Laws are in place for banking, and for (each of) the authority (authorities) involved in banking supervision. The responsibilities and objectives of each of the authorities are clearly defined and publicly disclosed.
2. The laws and/or supporting regulations provide a framework of minimum prudential standards that banks must meet.	2. The laws and supporting regulations provide a framework of minimum prudential standards that banks must meet.
4. The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).	
5. Banking laws are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices.	3. Banking laws and regulations are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices.
AC2. The supervisory agency ensures that information on the financial strength and performance of the industry under its jurisdiction is publicly available.	4. The supervisor confirms that information on the financial strength and performance of the industry under its jurisdiction is publicly available.
3. There is a defined mechanism for coordinating actions between agencies responsible for banking supervision, and evidence that it is used in practice.	
No text.	Additional criterion 1. In determining supervisory programmes and allocating resources, supervisors take into account the risks posed by individual banks and banking groups and the different approaches available to mitigate those risks. [6] 6. The concept of risk based supervision has been adopted by some supervisory authorities since the Core Principles were introduced in 1997. As there is no international consensus on the concept of a risk based supervisory approach, the Core Principles do not define nor require authorities to adopt such an approach. Nevertheless the 2006 revision of the core principles recognizes the growing supervisory practice of determining supervisory programmes and allocating resources taking into account the risks posed by individual banks and banking groups.
Principle 1 (2):	**Principle 1(2): Independence, accountability**

1999 Methodology	2006 Draft Methodology
Each such agency should possess operational independence and adequate resources.	**and transparency** Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the overall exercise of its duties.
Essential criteria 1. There is, in practice, no significant evidence of government or industry interference in the operational independence of each agency, and in each agency's ability to obtain and deploy the resources needed to carry out its mandate. AC1. The head of each agency is appointed for a minimum term and can be removed from office during such term only for reasons specified in law. AC2. Where the head of an agency is removed from office, the reasons must be publicly disclosed.	Essential criteria 1. The operational independence, accountability and governance structures of each supervisory authority are prescribed by law and publicly disclosed. There is, in practice, no evidence of government or industry interference which compromises the operational independence of each authority, or in each authority's ability to obtain and deploy the resources needed to carry out its mandate. The head(s) of the supervisory authority can be removed from office during his (their) term only for reasons specified in law. The reason(s) for removal should be publicly disclosed.
AC1, CP1 (1). The supervisory agency sets out objectives, and is subject to regular review of its performance against its responsibilities and objectives through a transparent reporting and assessment process.	2. The supervisor publishes objectives and is accountable through a transparent framework for the exercise of its duties in relation to those objectives. [7] 7. Please refer to CP1 (1), EC1
2. The supervisory agency and its staff have credibility based on their professionalism and integrity.	3. The supervisory authority and its staff have credibility based on their professionalism and integrity.
3. Each agency is financed in a manner that does not undermine its autonomy or independence and permits it to conduct effective supervision and oversight. This includes, inter alia: • salary scales that allow it to attract and retain qualified staff; • the ability to hire outside experts to deal with special situations; • a training budget and program that provides regular training opportunities for staff; • a budget for computers and other equipment sufficient to equip its staff with tools needed to review the banking	4. The supervisor is financed in a manner that does not undermine its autonomy or independence and permits it to conduct effective supervision and oversight. This includes: • a budget that provides for staff in sufficient numbers and with skills commensurate with the size and complexity of the institutions supervised; • salary scales that allow it to attract and retain qualified staff; • the ability to commission outside experts with the necessary professional skills and independence, and subject to

1999 Methodology	2006 Draft Methodology
industry; and • a travel budget that allows appropriate on-site work.	necessary confidentiality restrictions to conduct supervisory tasks; • a training budget and programme that provide regular training opportunities for staff; • a budget for computers and other equipment sufficient to equip its staff with the tools needed to review the banking industry and assess individual banks and banking groups; and a travel budget that allows appropriate on-site work.
Additional criteria 1. The head of each agency is appointed for a minimum term and can be removed from office during such term only for reasons specified in law.	Additional criterion 1. The head(s) of the supervisory authority are appointed for a minimum term.
Principle 1(3) A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision. *Note: This component of Principle 1 is amplified considerably in the Principles dealing with Licensing and Structure (2 to 5), Prudential Regulation and Requirements (6 to 15), Methods of Ongoing Banking Supervision (16 - 20), and Accounting and Disclosure (21).*	**Principle 1(3): Legal framework** A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision.[8] 8. This component of Principle 1 is amplified in the subsequent Principles.
Essential criteria 1. The law identifies the authority (or authorities) responsible for granting and withdrawing banking licences.	Essential criteria 1. The law identifies the authority (or authorities) responsible for granting and withdrawing banking licences.
2. The law empowers the supervisor to set prudential rules administratively (without changing laws).	2. The law empowers the supervisor to set prudential rules (without changing laws). The supervisor consults publicly on proposed changes, as appropriate.
3. The law empowers the supervisor to require information from the banks in the form and frequency it deems necessary.	3. The law or regulations empower the supervisor to require information from the banks and banking groups in the form and frequency it deems necessary.

1999 Methodology	2006 Draft Methodology
Principle 1 (4) A suitable legal framework for banking supervision is also necessary, including … powers to address compliance with laws as well as safety and soundness concerns. Note: This component of Principle 1 is amplified in Principle 22 which addresses Formal Powers of Supervisors.	**Principle 1(4): Legal powers** A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.[9] 9. This component of Principle 1 is amplified in the Principle which addresses "Corrective and remedial powers of supervisors" (23).
Essential criteria 1. The law enables the supervisor to address compliance with laws and the safety and soundness of the banks under its supervision. 2. The law permits the supervisor to apply qualitative judgement in forming this opinion.	Essential criteria 1. The law and regulations enable the supervisor to address compliance with laws and the safety and soundness of the banks under its supervision. The law and regulations permit the supervisor to apply qualitative judgment in safeguarding the safety and soundness of the banks within its jurisdiction.
3. The supervisor has unfettered access to banks' files in order to review compliance with internal rules and limits as well as external laws and regulations.	2. The supervisor has full access to banks' Board, management, staff and files in order to review compliance with internal rules and limits as well as external laws and regulations.
4. When, in a supervisor's judgement, a bank is not complying with laws and regulations, or it is or is likely to be engaged in unsafe or unsound practices, the law empowers the supervisor to: • take (and/or require a bank to take) prompt remedial action; • impose a range of sanctions (including the revocation of the banking licence).	3. When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaged in unsafe or unsound practices, the supervisor has the power to: • take (and/or require a bank to take) prompt remedial action; and impose a range of sanctions (including the revocation of the banking licence).
Principle 1 (5) A suitable legal framework for banking supervision is also necessary, including ... legal protection for supervisors.	**Principle 1(5): Legal protection** A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Essential criteria 1. The law provides legal protection to the supervisory agency and its staff against lawsuits for actions taken while discharging their duties in good faith.	Essential criteria 1. The law provides protection to the supervisory authority and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.

1999 Methodology	2006 Draft Methodology
2. The supervisory agency and its staff are adequately protected against the costs of defending their actions while discharging their duties.	2. The supervisory authority and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Principle 1 (6) Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.	**Principle 1(6): Cooperation** Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.[10] 10. This component of Principle 1 is developed further in the Principles dealing with "Abuse of financial services" (18), "Consolidated supervision" (24) and "Home-host relationships" (25).
Essential criteria 1. There is a system of cooperation and information sharing between all domestic agencies with responsibility for the soundness of the financial system.	Essential criteria 1. Arrangements, formal or informal, are in place for cooperation and information sharing between all domestic authorities with responsibility for the soundness of the financial system, and there is evidence that these arrangements work in practice, where necessary.
2. There is a system of cooperation and information sharing with foreign agencies that have supervisory responsibilities for banking operations of material interest to the domestic supervisor.	2. Arrangements, formal or informal, are in place, where relevant, for cooperation and information sharing with foreign financial sector supervisors of banks and banking groups of material interest to the home or host supervisor, and there is evidence that these arrangements work in practice, where necessary.
3. The supervisor: • may provide confidential information to another financial sector supervisor; • is required to take reasonable steps to ensure that any confidential information released to another supervisor will be treated as confidential by the receiving party; • is required to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes.	3. The supervisor may provide confidential information to another domestic or foreign financial sector supervisor. The supervisor is required to take reasonable steps to ensure that any confidential information released to another supervisor will be used only for supervisory purposes and will be treated as confidential by the receiving party. The supervisor receiving confidential information from other supervisors is also required to take reasonable steps to ensure that the confidential information will be used only for supervisory purposes and will be treated as confidential.
4. The supervisor is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession.	4. The supervisor is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession.

1999 Methodology	2006 Draft Methodology
Principle 2 The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.	**Principle 2: Permissible activities** The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word "bank" in names should be controlled as far as possible.
Essential Criteria 1. The term "bank" is clearly defined in law or regulations.	Essential criteria 1. The term "bank" is clearly defined in laws or regulations.
2. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.	2. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
3. The use of the word "bank" and any derivations such as "banking" in a name are limited to licensed and supervised institutions in all circumstances where the general public otherwise might be misled.	3. The use of the word "bank" and any derivations such as "banking" in a name is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
4. The taking of proper bank deposits[2] from the public is reserved for institutions that are licensed and subject to supervision. 2. An example of "proper" bank deposit is one that is not subject to security law disclosure requirements.	4. The taking of deposits from the public is generally[11] reserved for institutions that are licensed and subject to supervision as banks. 11. The word "generally" allows for the presence in some countries of non-banking financial institutions which may not be supervised in the same manner as banks but do take deposits and provide lending services, given these institutions collectively do not hold a significant proportion of deposits in a financial system. Examples of such institutions are credit unions and microfinance institutions.
No text.	5. The supervisory or licensing authority publishes, and keeps current, a list of licensed banks and branches of foreign banks operating within its jurisdiction.
Principle 3 The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organisation is a foreign bank, the prior consent of its home	**Principle 3: Licensing criteria** The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital

1999 Methodology	2006 Draft Methodology
country supervisor should be obtained.	base. Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.
Essential criteria 11. If the licensing authority and the supervisory authority are not the same, the supervisor has the legal right to have its views considered on each specific application.	Essential criteria 1. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisory authority are not the same, the supervisor has the right to have its views considered on each specific application.
1. The licensing authority has the right to set criteria for licensing banks. These may be based on criteria set in law or regulation.	2. The licensing authority has the power to set criteria for licensing banks. These may be based on criteria set in laws or regulations.
2. The criteria for issuing licences are consistent with those applied in ongoing supervision.	3. The criteria for issuing licences are consistent with those applied in ongoing supervision.
3. The licensing authority has the right to reject applications if the criteria are not fulfilled or if the information provided is inadequate.	4. The licensing authority has the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate.
4. The licensing authority determines that the proposed legal and managerial structures of the bank will not hinder effective supervision.	5. The licensing authority determines that the proposed legal, managerial and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis.[12] 12. Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, 2003).
5. The licensing authority determines the suitability of major shareholders, transparency of ownership structure and source of initial capital.	6. The licensing authority identifies and determines the suitability of major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure and the sources of initial capital.
6. A minimum initial capital amount is stipulated for all banks.	7. A minimum initial capital amount is stipulated for all banks.
7. The licensing authority evaluates proposed directors and senior management as to expertise and integrity (fit and proper test).	8. The licensing authority, at authorisation, evaluates proposed directors and senior management as to expertise and integrity

1999 Methodology	2006 Draft Methodology
The fit and proper criteria include: (1) skills and experience in relevant financial operations commensurate with the intended activities of the bank and (2) no record of criminal activities or adverse regulatory judgements that make a person unfit to uphold important positions in a bank.	(fit and proper test), including the potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank, and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.[13] 13. Please refer to CP 17, EC 4.
8. The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance will be in place. 9. The operational structure is required to include, inter alia, adequate operational policies and procedures, internal control procedures and appropriate oversight of the bank's various activities. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.	9. The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.[14] 14. Please refer to CP 18.
10. The licensing authority reviews pro forma financial statements and projections for the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.	10. The licensing authority reviews pro forma financial statements and projections for the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
12. In the case of foreign banks establishing a branch or subsidiary, prior consent (or a statement of "no objection") of the home country supervisor is obtained.	11. In the case of foreign banks establishing a branch or subsidiary, prior consent (or a statement of "no objection") of the home country supervisor should be obtained.
13. If the licensing, or supervisory, authority determines that the licence was knowingly based on false information, the licence can be revoked.	12. If the licensing, or supervisory, authority determines that the licence was based on false information, the licence can be revoked.
Additional criterion 1. The assessment of the application includes the ability of the shareholders to supply additional financial support, if needed.	Additional criteria 1. The assessment of the application includes the ability of the shareholders to supply additional financial support, if needed.
2. At least one of the directors must have a sound knowledge of each of the types of	2. The Board, collectively, must have a sound knowledge of each of the types of activities the bank intends to pursue and the

1999 Methodology	2006 Draft Methodology
financial activities the bank intends to pursue.	associated risks.
3. The licensing authority has procedures in place to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the licence approval are being met.	3. The licensing or supervisory authority has policies and processes in place to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the licence approval are being met.
Principle 4 Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.	**Principle 4: Transfer of significant ownership** The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties. *(Reference documents:* Parallel-owned banking structures*, January 2003; and* Shell banks and booking offices*, January 2003.)*
Essential criteria 1. Law or regulation contains a clear definition of "significant" ownership.	Essential criteria 1. Laws or regulations contain clear definitions of "significant" ownership and "controlling interest".
2. There are requirements to obtain supervisory approval[3] or provide immediate notification of proposed changes that would result in a change in ownership or the exercise of voting rights over a particular threshold or change in controlling interest. 3. Supervisory approval may consist of either explicit prior approval or non-objection to a prior notification.	2. There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
3. The supervisor has the authority to reject any proposal for a change in significant ownership or controlling interest, or prevent the exercise of voting rights in respect of such investments, if they do not meet criteria comparable to those used for approving new banks.	3. The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments, if they do not meet criteria comparable to those used for approving new banks.
AC1. Supervisors obtain from banks, either through periodic reporting or on-site examinations, the names and holdings of all significant shareholders, including, if possible, the identities of beneficial owners of shares being held by custodians.	4. The supervisor obtains from banks through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles

1999 Methodology	2006 Draft Methodology
	which might be used to disguise ownership.
No text.	5. The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
No text.	Additional criterion 1. Laws or regulations provide, or the supervisor ensures, that banks must notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder.
Principle 5 Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision	**Principle 5: Major acquisitions** The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential Criteria 1. Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need supervisory approval.[4] 4. See footnote 3.	Essential criteria 1. Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval.
2. Laws or regulations provide criteria by which to judge individual proposals.	2. Laws or regulations provide criteria by which to judge individual proposals.
3. Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. (…). CP24 EC2. The supervisor can prohibit banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision.	3. Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor can prohibit banks from making major acquisitions/investments (including from establishing foreign branches or subsidiaries) in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision.
3: (…) The supervisor determines that the bank	4. The supervisor determines that the

1999 Methodology	2006 Draft Methodology
has, from the outset, adequate financial and organisational resources to handle the acquisition/investment.	bank has, from the outset, adequate financial and organisational resources to handle the acquisition/investment.
4. Laws or regulations clearly define for which cases notification after the acquisition or investment is sufficient. Such cases should primarily refer to activities closely related to banking and the investment being small relative to the bank's capital.	5. Laws or regulations clearly define for which cases notification after the acquisition or investment is sufficient. Such cases should primarily refer to activities closely related to banking and the investment being small relative to the bank's capital.
No text.	6. The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks.
No text.	Additional criterion 1. When a bank wishes to acquire a significant holding in a financial institution in another country, the supervisor should take into consideration the quality of supervision in that country.
Principle 6: Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.	**Principle 6: Capital adequacy** Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.[15] *(Reference documents:* International convergence of capital measurement and capital standards*, July 1988; and* International convergence of capital measurement and capital standards: a revised framework*, June 2004.)* 15. The Basel Capital Accord was designed to apply only to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the New Capital Adequacy Framework would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.
Essential criteria	Essential criteria

1999 Methodology	2006 Draft Methodology
1. Laws or regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio. (…) 3. Laws or regulations, or the supervisor, define the components of capital, ensuring that emphasis is given to those elements of capital available to absorb losses.	1. Laws or regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio. Laws, regulations or the supervisor define the components of capital, ensuring that emphasis is given to those elements of capital available to absorb losses.
1. (…) At least for internationally active banks, the definition of capital, method of calculation and the ratio required are not lower than those established in the Basel Capital Accord.	2. At least for internationally active banks, the definition of capital, the method of calculation and the ratio required are not lower than those established in the applicable Basel requirement.
CP12 EC3. The supervisor has the power to impose a specific capital charge and/or specific limits on market risk exposures, including their foreign exchange business. CP13 AC1. The supervisor has the authority to require a bank to hold capital against risks in addition to credit and market risk.	3. The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures.
2. The required capital ratio reflects the risk profile of individual banks, in particular credit risk and market risk. Both on-balance-sheet and off-balance-sheet risks are included.	4. The required capital ratio reflects the risk profile of individual banks. Both on-balance sheet and off-balance sheet risks are included.
AC4. Capital adequacy requirements take into account the conditions under which the banking system operates. Consequently, minimum requirements may be higher than the Basel Accord.	5. Capital adequacy requirements take into account the conditions under which the banking system operates. Consequently, laws and regulations in a particular jurisdiction may set up higher capital adequacy standards than the applicable Basel requirement.
4. Capital adequacy ratios are calculated and applied on a consolidated bank basis. 6. Regular (at least semi-annually) reporting by banks to the supervisor is required on capital ratios and their components.	
5. Laws or regulations clearly give the supervisor authority to take measures should a bank fall below the minimum capital ratio.	6. Laws or regulations clearly give the supervisor authority to take measures should a bank fall below the minimum capital ratio.
No text.	7. Where the supervisor permits banks to use internal assessments of risk as inputs to the

1999 Methodology	2006 Draft Methodology
	calculation of regulatory capital, such assessments must adhere to rigorous qualifying standards and be subject to the approval of the supervisor. If banks do not continue to meet these qualifying standards on an on-going basis, the supervisor may revoke its approval of the internal assessments.
Additional criteria 1. For domestic, as well as internationally active banks, the definition of capital is broadly consistent with the Basel Capital Accord.	Additional criteria 1. For non-internationally active banks, the definition of capital, the method of calculation and the capital required are broadly consistent with the principles of applicable Basel requirements relevant to internationally active banks.
5. Capital adequacy ratios are calculated on both a consolidated and a solo basis for the banking entities within a banking group.	2. For non-internationally active banks and their holding companies, capital adequacy ratios are calculated and applied in a manner generally consistent with the applicable Basel requirement, as set forth in the footnote to the Principle. ..
No text.	3. The supervisor has the power to require banks to adopt a forward-looking approach to capital management and set capital levels in anticipation of possible events or changes in market conditions that could have an adverse effect.
No text.	4. The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.
No text.	5. The supervisor may require an individual bank or banking group to maintain capital above the minimum to ensure that individual banks or banking groups are operating with the appropriate level of capital.
  Principle 13 (this text is given for reference): Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.	**Principle 7: Risk management process** Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board[16] and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the

1999 Methodology	2006 Draft Methodology
	size and complexity of the institution.[17] (Reference documents: *Enhancing corporate governance for banking organisations,* February 2006) 16. The Basel Core Principles refer to a management structure composed of a Board of directors (ie the Board) and senior management. The Committee is aware that there are significant differences in legislative and regulatory frameworks across countries as regards the functions of the Board and senior management. In some countries, the Board has the main, if not exclusive, function of supervising the executive body (senior management, general management) so as to ensure that the latter fulfils its tasks. For this reason, in some cases, it is known as a supervisory Board. This means that the Board has no executive functions. In other countries, by contrast, the Board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of the Board and senior management are used in this paper not to identify legal constructs but rather to label two decision-making functions within a bank.) 17. It should be noted that while, in this and other CPs, the supervisor is required to confirm banks' risk management policies and processes are adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.
  CP13 EC1. The supervisor requires individual banks to have in place comprehensive risk management processes to identify, measure, monitor and control material risks. These processes are adequate for the size and nature of the activities of the bank and are periodically adjusted in light of the changing risk profile of the bank and external market developments. These processes include appropriate board and senior management oversight.	Essential criteria 1. Individual banks and banking groups are required to have in place comprehensive risk management policies and processes to identify, evaluate, monitor and control or mitigate material risks. The supervisor determines that these processes are adequate for the size and nature of the activities of the bank and banking group and are periodically adjusted in the light of the changing risk profile of the bank or banking group and external market developments. If the supervisor determines that the risk management processes are inadequate, it has the power to require a bank or banking group to strengthen them.
No text.	2. The supervisor confirms that banks and banking groups have appropriate risk management strategies that have been approved by the Board. The supervisor also confirms that the Board ensures that policies and processes for risk-taking are developed, appropriate limits are established, and senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies.
CP13, EC5. The supervisor determines that limits and procedures are communicated to the appropriate personnel and primary responsibility for adhering to limits and	3. The supervisor determines that risk management strategies, policies, processes and limits are properly documented, reviewed and updated, communicated within the bank and

1999 Methodology	2006 Draft Methodology
procedures is placed with the relevant business units.	banking group; and adhered to in practice. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of and authorisation by the appropriate level of management and the Board where necessary.
No text. For second-last sentence: CP12 AC1. *Either through on-site work, or through internal or independent external experts, the supervisor determines that senior management understands the market risks inherent in the business lines/products traded and that it regularly reviews and understands the implications (and limitations) of the risk management information that they receive.*	4. The supervisor determines that senior management and the Board understand the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels. The supervisor also determines that senior management ensures that the risk management policies and processes are appropriate in the light of the bank's risk profile and business plan and that they are implemented effectively. This includes a requirement that senior management regularly reviews and understands the implications (and limitations) of the risk management information that it receives. The same requirement applies to the Board in relation to risk management information presented to it in a format suitable for Board oversight.
CP6 AC3. The supervisor determines that banks have an internal process for assessing their overall capital adequacy in relation to their risk profile.	5. The supervisor determines that banks have an internal process for assessing their overall capital adequacy in relation to their risk profile and reviews and evaluates banks' internal capital adequacy assessments and strategies. The nature of the specific methodology used for this assessment will depend on the size, complexity and business strategy of a bank. Non-complex banks may opt for a more qualitative approach to capital planning.
CP12 EC6. The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk.	6. Where banks and banking groups use models to measure components of risk, the supervisor determines that banks perform periodic and independent validation and testing of the models and systems.
No text. For reference. CP7 AC2. The supervisor requires that banks have management information systems that provide essential details on the condition of the loan and investment portfolios.	7. The supervisor determines that banks and banking groups have adequate information systems for measuring, assessing and reporting on the size, composition and quality of exposures. It is satisfied that these reports are provided on a timely basis to the Board or senior management and reflect the bank's risk profile and capital needs.

1999 Methodology	2006 Draft Methodology
No text.	8. The supervisor determines that banks have policies and processes in place to ensure that new products and major risk management initiatives are approved by the Board or a specific committee of the Board.
No text.	9. The supervisor determines that banks and banking groups have risk evaluation, monitoring, and control or mitigation functions with duties clearly segregated from risk-taking functions in the bank, and which report on risk exposures directly to senior management and the Board.
CP13 EC3. The supervisor issues standards related to such topics as liquidity risk, interest rate risk, foreign exchange risk and operational risk.	10. The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
No text.	Additional criteria 1. The supervisor requires larger and more complex banks to have a dedicated unit(s) responsible for risk evaluation, monitoring, and control or mitigation for material risk areas. The supervisor confirms that this unit (these units) is (are) subject to periodic review by the internal audit function.
No text.	2. The supervisor requires banks to conduct rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact the bank.
No text.	3. The supervisor requires banks and banking groups to have in place appropriate policies and processes for assessing other material risks not directly addressed in the subsequent CPs, such as reputational and strategic risks.
Principle 7: An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.	**Principle 8: Credit risk** Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of

1999 Methodology	2006 Draft Methodology
	such loans and investments, and the ongoing management of the loan and investment portfolios.[18] *(Reference document:* Principles for the management of credit risk*, September 2000.)* 18. Principle 8 covers the evaluation of assets in greater detail; Principle 9 covers the management of problem assets.
Essential criteria 1. The supervisor requires, and periodically verifies, that prudent credit-granting and investment criteria, policies, practices, and procedures are approved, implemented, and periodically reviewed by bank management and boards of directors.[5] 5. This paper refers to a management structure composed by a board of directors and senior management. The Committee is aware that there are significant differences in legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some countries, the Board has the main, if not exclusive, function of supervising the executive body (senior management, general management) so as to ensure that the latter fulfils its tasks. For this reason, in some cases, it is known as a supervisory board. This means that the board has no executive functions. In other countries, by contrast, the board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of the board of directors and senior management are used in this paper not to identify legal constructs but rather to label two decision-making functions within a bank.	Essential criteria 1. The supervisor determines, and periodically confirms, that a bank's Board approves and periodically reviews, the credit risk management strategy and significant policies and processes for assuming,[19] identifying, measuring, controlling and reporting on credit risk (including counterparty risk). The supervisor also determines, and periodically confirms, that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes. 19. "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.
2. The supervisor requires, and periodically verifies, that such policies, practices and procedures include the establishment of an appropriate and properly controlled credit risk environment, including: • a sound and well-documented credit granting and investment process; • the maintenance of an appropriate credit administration, measurement and ongoing monitoring/reporting process (including asset grading/classification); and • ensuring adequate controls over credit risk.	2. The supervisor requires, and periodically confirms, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: • a well documented strategy and sound policies and processes for assuming credit risk; • well defined criteria and policies and processes for approving new exposures as well as renewing and refinancing existing exposures, identifying the appropriate approval authority for the size and complexity of the exposures; • effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt, monitoring of documentation,

1999 Methodology	2006 Draft Methodology
	legal covenants, contractual requirements and collateral, and a classification system that is consistent with the nature, size and complexity of the bank's activities or, at the least, with the asset grading system prescribed by the supervisor; • comprehensive policies and processes for reporting exposures on an ongoing basis; • comprehensive policies and processes for identifying problem assets; prudent lending controls and limits, including policies and processes for monitoring exposures in relation to limits, approvals and exceptions to limits.
3. The supervisor requires, and periodically verifies, that banks make credit decisions free of conflicting interests, on an arm's-length basis, and free from inappropriate pressure from outside parties.	3. The supervisor requires, and periodically confirms, that banks make credit decisions free of conflicts of interest and on an arm's length basis.
4. The supervisor requires that a bank's credit assessment and granting standards are communicated to, at a minimum, all personnel involved in credit granting activities.	
5. The supervisor has full access to information in the credit and investment portfolios and to the lending officers of the bank.	4. The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Additional criteria 1. The supervisor requires that the credit policy prescribes that major credits or investments, exceeding a certain amount or percentage of the bank's capital, are to be decided at a high managerial level of the bank. The same applies to credits or investments that are especially risky or otherwise not in line with the mainstream of the bank's activities.	Additional criteria 1. The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's senior management . The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
No text.	2. The supervisor determines that banks have in place policies and processes to identify, measure, monitor and control counterparty credit risk exposure, including potential future exposure sufficient to capture the material risks

1999 Methodology	2006 Draft Methodology
	inherent in individual products or transactions. These processes should be commensurate with the size or complexity of the individual bank.
AC3. The supervisor verifies that bank management monitors the total indebtedness of entities to which they extend credit.	3. The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit.
Principle 8: Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.	**Principle 9: Problem assets, provisions and reserves** Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.[20] *(Reference documents:* Sound practices for loan accounting and disclosure*, July 1999; and* Principles for the management of credit risk*, September 2000.)* 20. Principle 8 covers the evaluation of assets in greater detail; Principle 9 covers the management of problem assets.
Essential criteria 1. Either laws or regulations, or the supervisor, sets rules for the periodic review by banks of their individual credits, asset classification and provisioning, or the law/regulations establish a general framework and require banks to formulate specific policies for dealing with problem credits.	Essential criteria 1. Laws, regulations or the supervisor require banks to formulate specific policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require periodic review by banks of their problem assets (at an individual level or at a portfolio level for credits with homogenous characteristics) and asset classification and provisioning.
2. The classification and provisioning policies of a bank and their implementation are regularly reviewed by the supervisor or external auditors.	2. The supervisor confirms the adequacy of the classification and provisioning policies and processes of a bank and their implementation; the reviews supporting this opinion may be conducted by external experts.[21] 21. External experts may be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. Although supervisors may use such external reviews, it is the supervisor who must be satisfied with a bank's classification and provisioning policies and processes.
3. The system for classification and provisioning includes off-balance-sheet exposures.	3. The system for classification and provisioning takes into account off-balance sheet transactions.[22]

1999 Methodology	2006 Draft Methodology
	22. It is recognised that there are two different types of off-balance sheet transactions, those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning) and those that cannot be unilaterally cancelled.
4. The supervisor determines that banks have appropriate policies and procedures to ensure that loan loss provisions and write-offs reflect realistic repayment expectations.	4. The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations.
5. The supervisor determines that banks have appropriate procedures and organisational resources for the ongoing oversight of problem credits and for collecting past due loans.	5. The supervisor determines that banks have appropriate policies and processes, and organisational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.
7. The supervisor is informed on a periodic basis, and in relevant detail, concerning the classification of credits and assets and of provisioning.	6. The supervisor is informed on a periodic basis, and in relevant detail, or has access to information concerning the classification of credits and assets and provisioning.
6. The supervisor has the authority to require a bank to strengthen its lending practices, credit-granting standards, level of provisions and reserves, and overall financial strength if it deems the level of problem assets to be of concern.	7. The supervisor has the power to require a bank to increase its levels of provisions and reserves and/or overall financial strength if it deems the level of problem assets to be of concern.
No text.	8. The supervisor assesses whether the classification of the credits and assets and the provisioning is adequate for prudential purposes. If provisions are deemed to be inadequate, the supervisor has the power to require additional provisions or to impose other remedial measures.
8. The supervisor requires banks to have mechanisms in place for continually assessing the strength of guarantees and appraising the worth of collateral. 10. The valuation of collateral is required to reflect the net realisable value.	9. The supervisor requires banks to have appropriate mechanisms in place for periodically assessing the value of risk mitigants, including guarantees and collateral. The valuation of collateral is required to reflect the net realisable value.
9. Loans are required to be identified as impaired when there is reason to believe that all amounts due (both principal and interest) will not be collected in accordance with the	10. Laws, regulations or the supervisor establishes criteria for assets to be identified as impaired, eg, loans are identified as impaired when there is reason to believe that all amounts

1999 Methodology	2006 Draft Methodology
contractual terms of the loan agreement.	due (including principal and interest) will not be collected in accordance with the contractual terms of the loan agreement.
No text.	11. The supervisor determines that the Board receives timely and appropriate information on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning and major problem assets.
AC2. The supervisor requires that valuation, classification and provisioning for large credits are conducted on an individual item basis.	12. The supervisor requires that valuation, classification and provisioning for large exposures are conducted on an individual item basis.
Additional criterion 1. Loans are required to be classified when payments are contractually a minimum number of days in arrears (e.g., 30, 60, 90 days). Refinancing of loans that would otherwise fall into arrears does not lead to improved classifications for such loans.	Additional criterion 1. Loans are required to be classified when payments are contractually a minimum number of days in arrears (eg 30, 60, 90 days). Refinancing of loans that would otherwise fall into arrears does not lead to improved classification for such loans.
Principle 9: Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.	**Principle 10: Large exposure limits** Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.[23] *(Reference documents:* Measuring and controlling large credit exposures*, January 1991; and* Principles for managing credit risk*, September 2000.)* 23. Connected counterparties may be a group of companies related financially or by common ownership, management or any combination thereof.
Essential criteria 1. A "closely related group" is explicitly defined to reflect actual risk exposure[6]. The supervisor has discretion, which may be prescribed by law, in interpreting this definition on a case-by-case basis. 6. The definition can include not only legally related companies but also financially related companies, e.g., with common ownership. Also physical persons are considered as being parts of	Essential criteria 1. Laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case-by-case basis.

1999 Methodology	2006 Draft Methodology
"closely related groups", e.g. when they have large economic interests at stake in the groups (for instance, when they are large shareholders).	
2. Laws or regulations, or the supervisor, set prudent limits on large exposures to a single borrower or closely related group of borrowers. "Exposures" include all claims and transactions, on-balance sheet as well as off-balance sheet. 4. The supervisor verifies that bank management monitors these limits and that they are not exceeded on a solo and consolidated basis.	2. Laws, regulations or the supervisor set prudent limits on large exposures to a single counterparty or a group of connected counterparties. "Exposures" include all claims and transactions, on-balance sheet as well as off-balance sheet. The supervisor confirms that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
3. The supervisor verifies that banks have management information systems that enable management to identify on a timely basis concentrations (including large individual exposures) within the portfolio on a solo and consolidated basis.	3. The supervisor determines that a bank's management information systems identify and aggregate on a timely basis exposure to individual counterparties and groups of connected counterparties.
No text.	4. The supervisor confirms that a bank's risk management policies and processes establish thresholds for acceptable concentrations of credit and require that all material concentrations be reviewed and reported periodically to the Board.
5. The supervisor regularly obtains information that enables concentrations within a bank's credit portfolio, including sectoral and geographic exposures, to be reviewed.	5. The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed. The supervisor has the power to require banks to take remedial actions in cases where concentrations appear to present significant risks.

1999 Methodology	2006 Draft Methodology
Additional criterion 1. Banks are required to adhere to the following definitions: • 10 percent or more of a bank's capital is defined as a large exposure; • 25 percent of a bank's capital is the limit for an individual large exposure to a private sector non-bank borrower or a closely related group of borrowers. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialised banks.	Additional criterion 1. Banks are required to adhere to the following definitions: • ten per cent or more of a bank's capital is defined as a large exposure; and • twenty-five per cent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialised banks.
Principle 10: In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.	**Principle 11: Exposures to related parties** In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties[24] and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes. *(Reference document:* Principles for the management of credit risk*, September 2000.)* 24. Related parties can include the bank's subsidiaries and affiliates, and any party that the bank exerts control over or that exerts control over the bank. It also may include the bank's major shareholders, directors, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.
Essential criteria 1. A comprehensive definition of "connected or related parties" exists in law and/or regulation. (…) AC1. The definition of "connected or related parties" established in law and/or regulation is broad and, generally, includes affiliated companies, significant shareholders, board members, senior management, key staff as well as close family members, corresponding persons in affiliated companies, and companies controlled by insiders and shareholders.	Essential criteria 1. Laws or regulations explicitly provide, or the supervisor has the power to provide, a comprehensive definition of "related parties". This should consider the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case-by-case basis.

1999 Methodology	2006 Draft Methodology
2. Laws and regulations exist that exposures to connected or related parties may not be extended on more favourable terms (i.e., for credit assessment, tenor, interest rates, amortisation schedules, requirement for collateral) than corresponding loans to non-related counterparties.[7] 7. An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., employees receive credit at favourable rates.)	2. Laws, regulations or the supervisor require that exposures to related parties may not be granted on more favourable terms (ie for credit assessment, tenor, interest rates, amortisation schedules, requirement for collateral) than corresponding exposures to non-related counterparties. [25] 25. An exception may be appropriate for beneficial terms that are part of overall remuneration packages (eg staff receiving credit at favourable rates).
3. The supervisor requires that transactions with connected or related parties exceeding specified amounts or otherwise posing special risks are subject to approval by the bank's board.	3. The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process.
4. The supervisor requires that banks have procedures in place to prevent persons benefiting from the loan being part of the preparation of the loan assessment or of the decision itself.	4. The supervisor requires that banks have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure.
5. Laws or regulations set, or the supervisor has the mandate to set on a general or case-by-case basis, limits for loans to connected and related parties, to deduct such lending from capital when assessing capital adequacy or to require collateralisation of such loans.	5. Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such lending from capital when assessing capital adequacy or to require collateralisation of such exposures.
6. The supervisor requires banks to have information systems to identify individual loans to connected and related parties as well as the total amount of such loans, and to monitor them through an independent credit administration process.	6. The supervisor requires banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures, and to monitor and report on them through an independent credit review process. The supervisor confirms that exceptions to policies, processes and limits are reported to the appropriate level of senior management and, if necessary, to the Board, for timely action. The supervisor also confirms that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
7. The supervisor obtains and reviews information on aggregate lending to connected	7. The supervisor obtains and reviews information on aggregate exposures to related

1999 Methodology	2006 Draft Methodology
and related parties.	parties.
AC2. There are limits on aggregate exposures to connected and related parties that are at least as strict as those for single borrowers, groups or related borrowers.	8. Laws, regulations or the supervisor establish limits on aggregate exposures to related parties that are at least as strict as those for single counterparties, or groups of connected counterparties.
Principle 11: Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.	**Principle 12: Country and transfer risks** Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks. *(Reference document:* Management of banks' international lending*, March 1982.)*
Essential criteria 1. The supervisor determines that a bank's policies and procedures give due regard to the identification, monitoring and control of country risk and transfer risk. Exposures are identified and monitored on an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.	Essential criteria 1. The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, monitoring and control of country risk and transfer risk. Exposures are identified and monitored on an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
2. The supervisor verifies that banks have information systems, risk management systems and internal control systems to comply with those policies.	2. The supervisor confirms that banks have information systems, risk management systems and internal control systems that accurately monitor and report country exposures and ensure adherence to established country exposure limits.
3. There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices which are all acceptable as long as they lead to reasonable, risk-related, results. These include, inter alia: • The supervisor (or some other official authority) decides on appropriate minimum provisioning by setting fixed percentages for exposures to each	3. There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices which are all acceptable as long as they lead to risk-based results. These include: • The supervisor (or some other official authority) decides on appropriate minimum provisioning by setting fixed percentages for exposures to each

1999 Methodology	2006 Draft Methodology
country.	country.
• The supervisor (or some other official authority) sets percentage intervals for each country and the banks may decide, within these intervals, which provisioning to apply for the individual exposures.	• The supervisor (or some other official authority) sets percentage intervals for each country, and the banks may decide, within these intervals, which provisioning to apply for the individual exposures.
• The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The provisioning will then be judged by the external auditor and/or by the supervisor.	The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The provisioning will then be judged by the external auditor and/or by the supervisor.
4. The supervisor obtains and reviews sufficient information on a timely basis on the country risk/transfer risk of individual banks.	4. The supervisor obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of individual banks.
Principle 12: Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and /or a specific capital charge on market risk exposures, if warranted.	**Principle 13: Market risk** Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted. *(Reference document:* Amendment to the Capital Accord to incorporate market risks*, January 1996)*
Essential criteria 1. The supervisor determines that a bank has suitable policies and procedures related to the identification, measuring, monitoring and control of market risk.	Essential criteria 1 The supervisor determines that a bank has suitable policies and processes that clearly articulate roles and responsibilities related to the identification, measuring, monitoring and control of market risk. The supervisor is satisfied that policies and processes are adhered to in practice and are subject to appropriate Board and senior management oversight.
2. The supervisor determines that the bank has set appropriate limits for various market risks, including their foreign exchange business. 4. The supervisor verifies that banks have information systems, risk management systems and internal control systems to comply with those policies, and verifies that any limits (either internal or imposed by the supervisor) are	2. The supervisor determines that the bank has set market risk limits that are commensurate with the institution's size and complexity and that reflect all material market risks. Limits should be approved by the Board or senior management. The supervisor confirms that any limits (either internal or imposed by the supervisor) are adhered to.

1999 Methodology	2006 Draft Methodology
adhered to.	
5. The supervisor satisfies itself that there are systems and controls in place to ensure that all transactions are captured on a timely basis, and that the banks' positions are revalued frequently, using reliable and prudent market data.	3. The supervisor is satisfied that there are systems and controls in place to ensure that all transactions are captured on a timely basis, and that the banks' marked to market positions are revalued frequently, using reliable and prudent market data (or, in the absence of market prices, internal or industry-accepted models). The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments/reserves for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
6. The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk.	4. The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk. The supervisor confirms that the approaches are integrated into risk management policies and processes, and results are taken into account in the bank's risk-taking strategy.
3. The supervisor has the power to impose a specific capital charge and/or specific limits on market risk exposures, including their foreign exchange business. 7. The supervisor has the expertise needed to monitor the actual level of complexity in the market activities of banks.	
Additional criteria No text.	Additional criterion 1. The supervisor requires that market data used to value trading book positions are verified by a function independent of the lines of business. To the extent that the bank relies on modelling for the purposes of valuation, the bank is required to ensure that the model is independently tested.

1999 Methodology	2006 Draft Methodology
1. Either through on-site wok, or through internal or independent external experts, the supervisor determines that senior management understands the market risks inherent the business lines/products traded and that it regularly reviews and understands the implications (and limitations) of the risk management information that they receive. 2. The supervisor reviews the quality of management information and forms an opinion on whether the management information is sufficient to reflect properly the banks' position and exposure to market risk. In particular, the supervisor reviews the assumptions management has used in their stress testing scenarios, and the banks' contingency plans for dealing with such conditions. 3. The supervisor who does not have access to the adequate skills and capacity does not allow banks to determine their regulatory capital requirements based on sophisticated models, such as VaR.	
No text	**Principle 14: Liquidity risk** Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems. *(Reference document:* Sound practices for managing liquidity in banking organisations*, February 2000.)*
Essential Criteria CP13 EC4. The supervisor sets liquidity guidelines for banks, which include allowing only truly liquid assets to be treated as such, and takes into consideration undrawn commitments and other off-balance- sheet liabilities, as well as existing on-balance-sheet liabilities.	Essential criteria 1. The supervisor sets liquidity guidelines for banks and these take into consideration undrawn commitments and other off-balance sheet liabilities, as well as existing on-balance sheet liabilities.
No text.	2. The supervisor confirms that banks have a liquidity management strategy, as well as policies and processes for managing liquidity risk, which have been approved by the Board.

1999 Methodology	2006 Draft Methodology
	The supervisor also confirms that the Board has an oversight role in ensuring that policies and processes for risk-taking are developed to monitor, control and limit liquidity risk, and that management effectively implements such policies and processes.
No text.	3. The supervisor determines that a bank's senior management has defined (or established) appropriate policies and processes to monitor, control and limit liquidity risk; implements effectively such policies and processes; and understands the nature and level of liquidity risk being taken by the bank.
No text.	4. The supervisor requires banks to establish policies and processes for the ongoing measurement and monitoring of net funding requirements. The policies and processes include considering how other risks (eg credit, market and operational risk) may impact the bank's overall liquidity strategy, and require an analysis of funding requirements under alternative scenarios, diversification of funding sources, a review of concentration limits, stress testing, and a frequent review of underlying assumptions to determine that they continue to be valid.
CP13 AC3. Supervisors obtain sufficient information to enable them to identify those institutions carrying out significant foreign currency liquidity transformation.	5. The supervisor obtains sufficient information to identify those institutions carrying out significant foreign currency liquidity transformation. Where a bank or banking group's foreign currency business, either directly, or indirectly through lending in foreign exchange to domestic borrowers, is significant, or where a particular currency in which the bank has material exposure is experiencing problems, the supervisor requires the bank to undertake separate analysis of its strategy for each currency individually and, where appropriate, set and regularly review limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant individual currency.
No text.	6. The supervisor determines that banks have contingency plans in place for handling liquidity problems, including informing the supervisor..

1999 Methodology	2006 Draft Methodology
Additional Criteria CP13 AC4. The supervisor determines that, where a bank conducts its business in multiple currencies, management understands and addresses the particular issues this involves. Foreign currency liquidity strategy is separately stress-tested and the results of such tests are a factor in determining the appropriateness of mismatches.	Additional criteria 1. The supervisor determines that, where a bank conducts its business in multiple currencies, foreign currency liquidity strategy is separately stress-tested, and the results of such tests are a factor in determining the appropriateness of mismatches.
No text.	2. The supervisor confirms that banks periodically review their efforts to establish and maintain relationships with liability holders, maintain the diversification of liabilities, and aim to ensure their capacity to sell assets.
Principle 13: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.	**Principle 15: Operational risk** Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and mitigate operational risk.[26] These policies and processes are commensurate with the size and complexity of the bank. *(Reference documents:* Sound practices for the management and supervision of operational risk, February 2003; and Outsourcing in financial services, Joint Forum, February 2005.) 26. The Basel Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.
Essential criteria CP13 EC1. The supervisor requires individual banks to have in place comprehensive risk management processes to identify, measure, monitor and control material risks. These processes are adequate for the size and nature of the activities of the bank and are periodically adjusted in light of the changing risk profile of the bank and external market developments. These processes include appropriate board and senior management oversight.	Essential criteria 1. The supervisor requires individual banks to have in place risk management policies and processes to identify, assess, monitor and mitigate operational risk. These policies and processes are adequate for the size and complexity of the bank's operations, and the supervisor confirms that they are periodically adjusted in the light of the bank's changing risk profile and external market developments.
No text.	2. The supervisor requires that banks' strategies, policies and processes for the management of operational risk have been approved and are periodically reviewed by the Board. The supervisor also requires that the

1999 Methodology	2006 Draft Methodology
	Board oversees management in ensuring that these policies and processes are implemented effectively.
No text.	3. The supervisor is satisfied that the approved strategy and significant policies and processes for operational risk are implemented effectively by management.
No text.	4. The supervisor reviews the quality and comprehensiveness of the bank's business resumption and contingency plans to satisfy itself that the bank is able to operate as a going concern and minimise losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
No text.	5. The supervisor determines that banks have established appropriate information technology policies and processes that address areas such as information security, system development, and have made investments in information technology commensurate with the size and complexity of operations.
No text.	6. The supervisor requires that appropriate reporting mechanisms are in place to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
No text.	7. The supervisor confirms that legal risk is incorporated into the operational risk management processes of the bank.
No text.	8. The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management programme should cover: • conducting appropriate due diligence for selecting potential service providers; • structuring the outsourcing arrangement; • managing and monitoring the risks associated with the outsourcing arrangement;

1999 Methodology	2006 Draft Methodology
	• ensuring an effective control environment; and • establishing viable contingency planning. Outsourcing policies and processes should require the institution to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.
CP13 AC2. The supervisor encourages banks to include a statement on their risk management policies and procedures in their publicly available accounts.	
	Additional criterion
CP13 EC2. The supervisor determines that the risk management processes address liquidity risk, interest rate risk, and operational risk as well as all other risks, including those risks covered in other Principles (e.g., credit and market risk). These would include: • Liquidity: good management information systems, central liquidity control, analysis of net funding requirements under alternative scenarios, diversification of funding sources, stress testing and contingency planning. Liquidity management should separately address domestic and foreign currencies. • Interest rate risk: good management information systems and stress testing. • Operational risk: internal audit, procedures to counter fraud, sound business resumption plans, procedures covering major system modifications and preparation for significant changes in the business environment.	1. The supervisor determines that the risk management policies and processes address the major aspects of operational risk, including an appropriate operational risk framework that is applied on a group-wide basis. The policies and processes should include additional risks prevalent in certain operationally intensive businesses, such as custody and correspondent banking, and should cover periods when operational risk could increase.
No text.	**Principle 16: Interest rate risk** Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to their size and

1999 Methodology	2006 Draft Methodology
	complexity. *(Reference document:* Principles for the management and supervision of interest rate risk*, July 2004.)*
Essential criteria CP 12, EC 1. The supervisor determines that a bank has suitable policies and procedures related to the identification, measuring, monitoring and control of market risk.	Essential criteria 1. The supervisor determines that a bank's Board approves, and periodically reviews, the interest rate risk strategy and policies and processes for the identification, measuring, monitoring and control of interest rate risk. The supervisor also determines that management both implements the interest rate risk strategy and ensures that the above policies and processes are developed.
CP 13, EC 5. The supervisor determines that limits and procedures are communicated to the appropriate personnel and primary responsibility for adhering to limits and procedures is placed with the relevant business units.	2. The supervisor determines that banks have in place comprehensive and appropriate interest rate risk measurement systems and that any models and assumptions are validated on a regular basis. It confirms that banks' limits reflect the risk strategy of the institution and are understood by and regularly communicated to relevant staff. The supervisor also confirms that exceptions to established policies, processes and limits should receive the prompt attention of senior management, and the Board where necessary.
CP 12, EC 6. The supervisor determines that banks perform scenario analysis, stress testing and contingency planning, as appropriate, and periodic validation or testing of the systems used to measure market risk.	3. The supervisor requires that banks periodically perform appropriate stress tests to measure their vulnerability to loss under adverse interest rate movements.
No text.	Additional criteria 1. The supervisor has the power to obtain from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardised interest rate shock on the banking book.
No text.	2. The supervisor assesses whether the internal capital measurement systems of banks adequately capture the interest rate risk in the banking book.

1999 Methodology	2006 Draft Methodology
No text.	3. The supervisor requires stress tests to be based on reasonable worst case scenarios and capture all material sources of risk, including a breakdown of critical assumptions. Senior management is required to consider these results when establishing and reviewing a bank's policies, processes and limits for interest rate risk.
No text.	4. The supervisor requires banks to assign responsibility for interest rate risk management to individuals independent of and with reporting lines separate from those responsible for trading and/or other risk-taking activities. In the absence of an independent risk management function that covers interest rate risk, the supervisor requires the bank to ensure that there is a mechanism in place to mitigate a possible conflict of interest for managers with both risk management and risk-taking responsibilities.
Principle 14: Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.	**Principle 17: Internal control and audit** Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations. *(Reference documents:* Framework for internal control systems in banking organisations*, September 1998;* Internal audit in banks and the supervisor's relationship with auditors*, August 2001; and* Compliance and the compliance function in banks*, April 2005.)*
Essential criteria 1. Corporate or banking laws identify the responsibilities of the board of directors with respect to corporate governance principles to ensure that there is effective control over every aspect of risk management.	Essential criteria 1. Laws, regulations or the supervisor establish the responsibilities of the Board and senior management with respect to corporate governance to ensure that there is effective control over a bank's entire business.

1999 Methodology	2006 Draft Methodology
2. The supervisor determines that banks have in place internal controls that are adequate for the nature and scale of their business. These controls are the responsibility of the board of directors and deal with organisational structure, accounting procedures, checks and balances and the safeguarding of assets and investments. More specifically, these address: • Organisational structure: definitions of duties and responsibilities including clear delegation of authority (for example, clear loan approval limits), decision-making procedures, separation of critical functions (for example, business origination, payments, reconciliation, risk management, accounting, audit and compliance). • Accounting procedures: reconciliation of accounts, control lists, information for management. • Checks and balances (or "four eyes principles"): segregation of duties, cross-checking, dual control of assets, double signatures. • Safeguarding assets and investments: including physical control.	2. The supervisor determines that banks have in place internal controls that are adequate for the nature and scale of their business. These controls are the responsibility of the Board and/or senior management and deal with organisational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments. More specifically, these controls address: • Organisational structure: definitions of duties and responsibilities, including clear delegation of authority (for example, clear loan approval limits), decision-making policies and processes, separation of critical functions (for example, business origination, payments, reconciliation, risk management, accounting, audit and compliance). • Accounting policies and processes: reconciliation of accounts, control lists, information for management. • Checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures. Safeguarding assets and investments: including physical control.
3. To achieve a strong control environment, the supervisor requires that the board of directors and senior management of a bank understand the underlying risks in their business and are both committed to, and legally responsible for, the control environment. (…)	3. Laws, regulations or the supervisor place the responsibility for the control environment on the Board and senior management of the bank. The supervisor requires that the Board and senior management understand the underlying risks in their business and are committed to a strong control environment.
3. (…) Consequently, the supervisor evaluates the composition of the board of directors and senior management to determine that they have the necessary skills for the size and nature of the activities of the bank and can address the changing risk profile of the bank and external market developments. The supervisor has the legal authority to require changes in the composition of the board and management in order to satisfy these criteria.	4. The supervisor has the power to require changes in the composition of the Board and senior management to address any prudential concerns related to the satisfaction of these criteria.
4. The supervisor determines that there is an appropriate balance in the skills and	5. The supervisor determines that there is an appropriate balance in the skills and

1999 Methodology	2006 Draft Methodology
resources of the back office and control functions relative to the front office/business origination.	resources of the back office and control functions relative to the front office/business origination.
No text. For reference: CP15 EC4. The supervisor determines that banks appoint a senior officer with explicit responsibility for ensuring that the bank's policies and procedures are, at a minimum, in accordance with local statutory and regulatory anti-money laundering requirements.	6. The supervisor determines that banks have a permanent compliance function[27] that assists senior management in managing effectively the compliance risks faced by the bank. The compliance function must be independent of the business activities of the bank. The supervisor determines that the Board exercises oversight of the management of the compliance function. 27. The term “compliance function” does not necessarily denote an organisational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance.
5. The supervisor determines that banks have an appropriate audit function charged with (a) ensuring that policies and procedures are complied with and (b) reviewing whether the existing policies, practises and controls remain sufficient and appropriate for the bank’s business. (…)	7. The supervisor determines that banks have an independent, permanent and effective internal audit function charged with (i) ensuring that policies and processes are complied with and (ii) reviewing whether the existing policies, processes and controls remain sufficient and appropriate for the bank’s business. [28] 28. The term “internal audit function” does not necessarily denote an organisational unit. Some countries allow small banks to implement a system of independent reviews, eg conducted by external experts, of key internal controls as an alternative.
5. (…) The supervisor determines that the audit function: • has unfettered access to all the bank’s business lines and support departments; • has appropriate independence, including reporting lines to the board of directors and status within the bank to ensure that senior management reacts to and acts upon its recommendations; • has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; • employs a methodology that identifies the key risks run by the bank and allocates its resources accordingly.	8. The supervisor determines that the internal audit function: • has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; • has appropriate independence, including reporting lines to the Board and status within the bank to ensure that senior management reacts to and acts upon its recommendations; • has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; • employs a methodology that identifies the material risks run by the bank; • prepares an audit plan based on its

1999 Methodology	2006 Draft Methodology
	own risk assessment and allocates its resources accordingly; has the authority to assess any outsourced functions.
6. The supervisor has access to the reports of the audit function.	
Additional criteria 1. In those countries with a unicameral board structure (as opposed to a bicameral structure with a supervisory board and a management board), the supervisor requires the board of directors to include a number of experienced non-executive directors.	Additional criteria 1. In those countries with a unicameral Board structure (as opposed to a bicameral structure with a Supervisory Board and a Management Board), the supervisor requires the Board to include a number of experienced non-executive directors.
2. The supervisor requires the internal audit function to report to an Audit Committee.	2. The supervisor requires the internal audit function to report to an audit committee, or an equivalent structure.
3. In those countries with a unicameral board structure, the supervisor requires the Audit Committee to include experienced non-executive directors.	3. In those countries with a unicameral Board structure, the supervisor requires the audit committee to include experienced non-executive directors.
No text.	4. Laws or regulations provide, or the supervisor ensures, that banks must notify the supervisor as soon as they become aware of any material information which may negatively affect the fitness and propriety of a Board member or a member of the senior management.
Principle 15: Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.	**Principle 18: Abuse of financial services** Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. [29] *(Reference documents:* Prevention of criminal use of the banking system for the purpose of money-laundering*, December 1988;* Customer due diligence for banks*, October 2001;* Shell banks and booking offices, *January 2003*; Consolidated KYC risk management*, October 2004;* FATF 40 + IX*, 2003* and *FATF AML/CFT*

1999 Methodology	2006 Draft Methodology
	Methodology, 2004, as updated.*)* 29. The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering, and terrorist financing. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in essential criteria 6, 7 and 9. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this CP.
Essential criteria No text.	Essential criteria 1. Laws or regulations clarify the duties, responsibilities and powers of the banking supervisor and other competent authorities , if any, related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
1. The supervisor determines that banks have in place adequate policies, practices and procedures that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, by criminal elements. This includes the prevention and detection of criminal activity or fraud, and reporting of such suspected activities to the appropriate authorities.	2. The supervisor must be satisfied that banks have in place adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
7. In addition to reporting to the appropriate criminal authorities, banks report to the supervisor suspicious activities and incidents of fraud material to the safety, soundness or reputation of the bank.	3. In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when they are material to the safety, soundness or reputation of the bank[30]. 30. Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and terrorist financing to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities, that serves as an FIU.
No text. For reference: 2. The supervisor determines that banks have documented and enforced policies for identification of customers and those acting on their behalf as part of their anti-money-laundering program. There are clear rules on what records must be kept on customer identification and individual transactions and the retention period.	4. The supervisor is satisfied that banks establish "know-your-customer" (KYC) policies and processes which are well-documented and communicated to all relevant staff. Such policies and processes must also be integrated into the bank's overall risk management. The KYC management programme, on a group-wide basis, has as its essential elements • a customer acceptance policy that identifies business relationships that

1999 Methodology	2006 Draft Methodology
	the bank will not accept, • a customer identification, verification and due diligence programme; this encompasses verification of beneficial ownership and includes risk-based reviews to ensure that records are updated and relevant, • policies and processes to monitor and recognise unusual or potentially suspicious transactions, particularly of high-risk accounts, • escalation to the senior management level of decisions on entering into business relationships with high-risk accounts, such as those for politically exposed persons, or maintaining such relationships when an existing relationship becomes high-risk, and clear rules on what records must be kept on consumer identification and individual transactions and their retention period. Such records should have at least a five year retention period.
No text.	5. The supervisor is satisfied that banks have enhanced due diligence policies and processes regarding correspondent banking. Such policies and processes encompass: • gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised, and not establishing or continuing correspondent relationships with foreign banks that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
9. The supervisor periodically checks that banks' money laundering controls and their systems for preventing, identifying and reporting fraud are sufficient. The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its anti-money laundering obligations.	6. The supervisor periodically confirms that banks have sufficient controls and systems in place for preventing, identifying and reporting potential abuses of financial services, including money laundering. 7. The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its obligations related to

1999 Methodology	2006 Draft Methodology
	criminal activities.
No text. For reference: 2. The supervisor determines that bank staff is adequately trained on money laundering detection and prevention.	8. The supervisor must be satisfied that banks have • requirements for internal audit and/or external experts[31] to independently evaluate the relevant risk management policies, processes and controls. The supervisor must have access to their reports, • established policies and processes to designate compliance officers at the management level, and appointed a relevant dedicated officer to whom potential abuses of the bank's financial services (including suspicious transactions) shall be reported; • adequate screening policies and processes to ensure high ethical and professional standards when hiring staff, and • ongoing training programmes for their staff on KYC and methods to detect criminal and suspicious activities. 31. May be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.
5. The supervisor determines that banks have clear procedures, communicated to all personnel, for staff to report suspicious transactions to the dedicated senior officer responsible for anti-money laundering compliance. 6. The supervisor determines that banks have established lines of communication both to management and to an internal security (guardian) function for reporting problems.	9 The supervisor determines that banks have clear policies and processes, for staff to report any problems related to the abuse of the financial services either or both to local management and the relevant dedicated officer. The supervisor also confirms that banks have adequate management information systems to provide managers and the dedicated officers with timely information on such activities.
8. Laws, regulations and/or banks' policies ensure that a member of staff who reports suspicious transactions in good faith to the dedicated senior officer, internal security function, or directly to the relevant authority cannot be held liable.	10. Laws and regulations ensure that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
AC3. The supervisor has the legal obligation to inform the relevant criminal authorities of any suspicious transactions.	11. The supervisor is able to inform the financial intelligence unit and, if applicable, other designated authority of any suspicious transactions. In addition, it is able, directly or

1999 Methodology	2006 Draft Methodology
AC4. The supervisor is able, directly or indirectly, to share with relevant judicial authorities information related to suspected or actual criminal activities.	indirectly, to share with relevant judicial authorities information related to suspected or actual criminal activities
10. The supervisor is able, directly or indirectly, to share with domestic and foreign financial sector supervisory authorities information related to suspected or actual criminal activities.	12. The supervisor is able, directly or indirectly, to cooperate with the relevant domestic and foreign financial sector supervisory authorities or share with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
11. The supervisor determines that banks have a policy statement on ethics and professional behaviour that is clearly communicated to all staff.	
5. If not performed by another agency, the supervisor has in-house resources with specialist expertise on financial fraud and anti-money laundering obligations.	Additional criterion 1. If not performed by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities.
EC3. The supervisor determines that banks have formal procedures to recognise potentially suspicious transactions. These might include additional authorisation for large cash (or similar) deposits or withdrawals and special procedures for unusual transactions. AC1. The laws and/or regulations embody international sound practices, such as compliance with the relevant forty Financial Action Task Force Recommendations issued in 1990 (revised 1996).	
Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision. (Note: this Principle should be considered in conjunction with Principles 17 through 20.)	**Principle 19: Supervisory approach** An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.

1999 Methodology	2006 Draft Methodology
Essential criteria	Essential criteria
1. Banking supervision requires an in-depth understanding, periodic analysis and evaluation of individual banks, focussing on safety and soundness, based on meetings with management and a combination of both on-site and off-site supervision. (…)	1. The supervisor has policies and processes in place to develop and maintain a thorough understanding of the risk profile of individual banks and banking groups.
2. And (2) uses off-site work as a primary tool to: … • monitor trends and developments for the banking sector as a whole.	2. The supervisor monitors and assesses trends, developments and risks for the banking system as a whole. The supervisor also takes into account developments in non-bank financial institutions through frequent contact with their regulators.
AC3. The supervisor has a methodology for determining and assessing the nature, importance and scope of the risks to which individual banks are exposed, including the business focus, the risk profile and the internal control environment. Off-site and on-site work is prioritised based on the results of that assessment.	3. The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, importance and scope of the risks to which individual banks or banking groups are exposed. The methodology should cover, inter alia, the business focus, the risk profile and the internal control environment, and should permit relevant comparisons between banks. Supervisory work is prioritised based on the results of these assessments. [32] 32. Please refer to the footnote to CP 1(1), AC 1.
3. The supervisor checks for compliance with prudential regulations and other legal requirements through on-site and off-site work.	4. The supervisor confirms banks and banking groups' compliance with prudential regulations and other legal requirements.
CP17 EC3. The supervisor requires banks to notify it of any substantive changes in their activities or any material adverse developments, including breach of legal and prudential requirements.	5. The supervisor requires banks to notify it of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
CP18 EC6. The supervisor has an analytical framework that uses the statistical and prudential information for the ongoing monitoring of the condition and performance of individual banks. The results are also used as a component of on-site supervision planning. This requires that the supervisor has an adequate information system.	6. The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.

1999 Methodology	2006 Draft Methodology
Additional criteria No text.	Additional criterion 1. The supervisor employs a well defined methodology designed to establish a forward-looking view on the risk profile of banks, positioning the supervisor better to address proactively any serious threat to the stability of the banking system from any current or emerging risks.
2. The supervisor has the right to access copies of reports submitted to the board by both internal and external auditors. 4. The supervisor is legally required to treat as confidential information received as part of the supervisory process. However, the supervisor is given powers under the law to disclose information in certain defined circumstances. The law prevents disclosure of confidential information unless the supervisor is satisfied that it will be held confidential by the recipient, or unless disclosure is otherwise required by law.	
Principle 17: Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.	**Principle 20: Supervisory techniques** An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Essential criteria CP16 EC4. The appropriate mix of on-site and off-site supervision is determined by the particular conditions and circumstances of the country. In any event, the framework integrates the two functions so as to maximise the synergy and avoid supervisory gaps. CP16 AC1. The supervisor has procedures in place to assess the effectiveness of on-site and off-site functions, and to address any weaknesses that are identified.	Essential criteria 1. The supervisor employs an appropriate mix of on-site and off-site supervision to evaluate the condition of banks, their inherent risks, and the corrective measures necessary to address supervisory concerns. The specific mix may be determined by the particular conditions and circumstances of the country. The supervisor has policies and processes in place to assess the quality, effectiveness and integration of on-site and off-site functions, and to address any weaknesses that are identified.
CP19 EC1. The supervisor has in place a coherent process for planning and executing on-site visits, using either in-house examiners, or making use of the work of external auditors, as appropriate. There are policies and procedures in place to ensure that examinations are conducted on a thorough and consistent basis with clear responsibilities, objectives and	2. The supervisor has in place a coherent process for planning and executing on-site and off-site activities. There are policies and processes in place to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and

1999 Methodology	2006 Draft Methodology
outputs. The supervisor holds meetings with banks and their auditors to discuss the results of work by the external auditors and to agree on the responsibilities for corrective work.	off-site functions.
CP16 EC1. (…) The supervisor has a framework that (1) uses on-site work (conducted either by own staff or through the work of external auditors) as a primary tool to: • provide independent verification that adequate corporate governance (including risk management and internal control systems) exists at individual banks; • determine that information provided by banks is reliable; • obtain additional information needed to assess the condition of the bank.	3. On-site work, conducted either by the supervisor's own staff or through the work of external experts,[33] is used as a tool to: • provide independent verification that adequate corporate governance (including risk management and internal control systems) exists at individual banks; • determine that information provided by banks is reliable;[34] • obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, the evaluation of material risks, and the identification of necessary remedial actions and supervisory actions, including enhanced off-site monitoring; and • monitor the bank's follow-up on supervisory concerns. 33. May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. 34. Please refer to CP 21.
CP16 EC2. And (2) uses off-site work as a primary tool to: • review and analyse the financial condition of individual banks using prudential reports, statistical returns and other appropriate information, including publicly available information; • (…)	4. Off-site work is used as a tool to: • regularly review and analyse the financial condition of individual banks using prudential reports, statistical returns and other appropriate information, including publicly available information; • follow up on matters requiring further attention, evaluate developing risks and help identify priorities and scope of further work; and help determine priorities and scope of on-site work.
1. Based on the risk profile of individual banks, the supervisor has a programme of regular meetings with senior and middle management (including the board, non-executive directors and heads of individual	5. Based on the risk profile of individual banks, the supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive directors, Audit Committee and senior and middle management

1999 Methodology	2006 Draft Methodology
units) to discuss operational matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems etc.	(including, heads of individual business units and control functions) to develop an understanding of and assess such matters as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality and risk management systems.
4. As part of the licensing process, and on an on-going basis during routine supervision, the supervisor considers the quality of management.	6. On an ongoing basis during on-site and off-site supervisory activities, the supervisor considers the quality of the Board and management.
CP16 AC5. The supervisor is able to reasonably place reliance on internal audit work that has been competently and independently performed.	7. The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
No text.	8. The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses by means of written reports or through discussions or meetings with management.
2. The supervisor has a thorough understanding of the activities of its banks. This is accomplished through a combination of off-site surveillance, on-site reviews and regular meetings.	
Additional criterion CP19 AC1. The supervisor meets with management and the board of directors each year to discuss the results of the supervisory examination or the external audit. Such visits should allow for the supervisor to meet separately with the independent board members.	Additional criterion 1. The supervisor meets periodically with senior management and the Board to discuss the results of supervisory examinations and the external audit. The supervisor should also meet separately with the independent Board members, as necessary.
Principle 18: Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis[8]. 8. This CP refers to accounting consolidation which should be applied by one means or another to the whole bank, i.e. not only to the figures of a bank's branches but also to those subsidiaries in which the bank has a significant controlling interest.	**Principle 21: Supervisory reporting** Supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.[35] 35. In the context of this CP, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this CP, and the latter are

1999 Methodology	2006 Draft Methodology
Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.	addressed in CP 22.
Essential criteria CP18 EC1. The supervisor has the legal authority to require banking organisations to submit information, on both a solo and consolidated basis, on their financial condition and performance, at regular intervals. These reports provide data on matters such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, loan loss provisioning, market risk and deposit sources.	Essential criteria 1. The supervisor has the power[36] to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, at regular intervals. These reports provide information on such matters as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, asset concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk and market risk. 36. Please refer to CP 1(3).
CP21 EC5. The supervisor provides report instructions that clearly establish the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that command wide international acceptance and are aimed specifically at banking institutions.	2. The supervisor provides report instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
CP21 EC6. The supervisor requires banks to utilise valuation rules that are consistent, realistic and prudent, taking account of current values where relevant, and that profits are net of appropriate provisions.	3. The supervisor requires banks to utilise valuation rules that are consistent, realistic and prudent, taking account of current values where relevant.
CP18, EC8. The supervisor collects data from banks at a frequency (e.g., monthly, quarterly and annually) commensurate with the nature of the information requested, and the size, activities and risk profile of the individual bank.	4. The supervisor collects and analyses information from banks at a frequency (eg monthly, quarterly and annually) commensurate with the nature of the information requested, and the size, activities and risk profile of the individual bank.
CP18, EC7. In order to make meaningful comparisons between banking organisations, the supervisor collects data from all banks and all other relevant entities within a banking organisation on a comparable basis and related to the same dates (stock data) and periods (flow data).	5. In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).

1999 Methodology	2006 Draft Methodology
CP18, EC5. The supervisor has the authority to request and receive any relevant information from banks, as well as any of their related companies, irrespective of their activities, where the supervisor believes that it is material to the financial situation of the bank or the assessment of the risks of the bank.	6. The supervisor has the power to request and receive any relevant information from banks, as well as any of their related companies, irrespective of their activities, where the supervisor believes that it is material to the financial situation of the bank or banking group, or to the assessment of the risks of the bank or banking group. This includes internal management information.
CP19, EC4. The supervisor has the legal right of full access to all bank records for the furtherance of supervisory work. The supervisor also has similar access to the board, senior management and staff, when required.	7. The supervisor has the power of full access[37] to all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required. 37. Please refer to CP 1(4).
CP18, EC3. The supervisor has a means of enforcing compliance with the requirements that the information be submitted on a timely and accurate basis. The supervisor determines that the appropriate level of senior management is responsible for the accuracy of supervisory returns, can impose penalties for deliberate mis-reporting and persistent errors, and can require that inaccurate information be amended.	8. The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines that the appropriate level of senior management is responsible for the accuracy of supervisory returns, can impose penalties for misreporting and persistent errors, and can require that inaccurate information be amended.
CP21 EC3. The supervisor ensures that information from bank records is verified periodically through on-site examinations and/or external audits. CP19, EC5. The supervisor has a programme for the periodic examination of supervisory returns by examiners or through the work of external auditors. There is a requirement that certain key supervisory returns such as that for capital adequacy be examined at least annually by the auditors and a report submitted to the supervisor.	9. The supervisor utilises policies and processes to confirm the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. [38] 38. May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.
CP19, EC3. The supervisor can also make use of external auditors to examine specific aspects of banks' operations, provided there is a well developed, professionally independent auditing and accounting profession with skills to undertake the work required. The respective roles and responsibilities for the supervisor and the auditors in these circumstances are clearly defined by the supervisor.	10. The supervisor clearly defines and documents the roles and responsibilities of external experts, [39] including the scope of the work, when they are appointed to conduct supervisory tasks and monitors the quality of the work. External experts may be utilised for routine validation or to examine specific aspects of banks' operations. 39. May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may

1999 Methodology	2006 Draft Methodology
	conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be comfortable with the results of the reviews conducted by such external experts.
No text.	11. The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
CP18, EC2. Laws and regulations establish, or the supervisor has the authority to establish, the principles and norms regarding the consolidation of accounts as well as the accounting techniques to be used. CP18, EC4. The information that is required to be submitted includes standardised prudential and statistical reports, and detailed balance sheets and income statements, as well as supporting schedules that provide details concerning on and off balance sheet activities and on reserves included in capital. Inclusion of data on loan classification and provisioning is also required. CP19, EC2. The supervisor has the authority to monitor the quality of work done by external auditors for supervisory purposes. The supervisor has the authority to directly appoint external auditors for conducting supervisory tasks or oppose the appointment of an external auditor that is deemed to have inappropriate expertise and/or independence. CP21 EC11. Where supervisors rely primarily on the work of external auditors (rather than on their own examination staff), banks are required to appoint auditors who are recognised by the supervisor as having the necessary professional skills and independence to perform the work	
Principle 21: Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly	**Principle 22: Accounting and disclosure** Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability. (Reference document: Enhancing bank transparency, September 1998)

1999 Methodology	2006 Draft Methodology
reflect its condition.	
Essential criteria	Essential criteria
1. The supervisor has the authority to hold management responsible for ensuring that financial record keeping systems and the data they produce are reliable, and that supervisor-required reports are submitted on a timely and accurate basis.	1. The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that financial record-keeping systems and the data they produce are reliable.
2. The supervisor has the authority to hold management responsible for ensuring that the management report and financial statements issued annually to the public receive proper external verification and bear an external auditor's opinion.	2. The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that the financial statements issued annually to the public receive proper external verification and bear an external auditor's opinion.
6. The supervisor requires banks to utilise valuation rules that are consistent, realistic and prudent, taking account of current values where relevant, and that profits are net of appropriate provisions.	3. The supervisor requires banks to utilise valuation rules that are consistent, realistic and prudent, taking account of current values where relevant, and that profits are net of appropriate provisions..
7. Laws or regulations set, or the supervisor has the authority, in appropriate circumstances, to establish, the scope and standards to be achieved in external audits of individual banks, and to make public issuance of individual bank financial statements subject to its prior approval.	4. Laws or regulations set, or the supervisor has the power, in appropriate circumstances, to establish, the scope of external audits of individual banks and to set the standards to be followed in such audits.
AC2. The supervisor has guidelines covering the scope and conduct of audit programmes that ensure that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitisations, and the adequacy of internal controls over financial reporting.	5. Supervisory guidelines or local auditing standards determine that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitisations, and the adequacy of internal controls over financial reporting.
10. The supervisor has the right to revoke the appointment of a bank's auditors.	6. The supervisor has the power to reject the appointment of an external auditor that is deemed to have inadequate expertise or independence, or found not to be subject to or to follow established professional standards.
9. The supervisor requires banks to produce annual audited financial statements based on accounting principles and rules that command wide international acceptance and	7. The supervisor requires banks to produce annual audited financial statements based on accounting principles and rules that are widely accepted internationally and have

1999 Methodology	2006 Draft Methodology
have been audited in accordance with internationally accepted auditing practices and standards.	been audited in accordance with internationally accepted auditing practices and standards.
AC1. The supervisor promotes periodic public disclosures of information that are timely, accurate, and sufficiently comprehensive to provide a basis for effective market discipline.	8. Laws, regulations, or the supervisor[40] require periodic public disclosures of information by banks that adequately reflect the bank's true financial condition. The requirements imposed should promote the comparability, relevance, reliability and timeliness of the information disclosed. 40. For purposes of this EC, the disclosure requirement may be found in applicable accounting, Stock Exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.
No text.	9. The required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and basic business, management and governance. The scope and content of information provided and the level of disaggregation and detail should be commensurate with the size and complexity of a bank's operations.
No text.	10. Laws, regulations, or the supervisor provide effective review and enforcement mechanisms designed to confirm compliance with disclosure standards.
No text.	11. The supervisor or other relevant bodies publish aggregate information on the banking system to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
4. The supervisor ensures that there are open communication lines with the external auditors. 8. The supervisor has the ability to treat as confidential certain types of sensitive information.	

1999 Methodology	2006 Draft Methodology
Additional criteria CP19 AC2. The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.	Additional criteria 1. The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
3. Auditors have the legal duty to report to the supervisor matters of material significance, for example, failure to maintain the licensing criteria, or breaches of banking or other laws. The law protects auditors from breach of confidentiality when information is communicated in good faith. 4. Auditors also have the legal duty to report matters to the supervisor, in situations where they become aware of matters which, in the context of the available information, they believe is likely to be of material significance to the functions of the supervisor.	2. External auditors, whether or not utilised by the supervisor for supervisory purposes, have the duty to report to the supervisor matters of material significance, for example failure to maintain the licensing criteria or breaches of banking or other laws, or other matters which they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations ensure that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
No text.	3. Laws, regulations, or the supervisor require banks to rotate their external auditors (either the firm or individuals within the firm) from time to time.
No text.	4. The supervisor requires banks to have a formal disclosure policy.
No text.	5. The supervisor has the power to access external auditors' working papers, where necessary.
Principle 22: Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.	**Principle 23: Corrective and remedial powers of supervisors** Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking licence or to recommend its revocation.

1999 Methodology	2006 Draft Methodology
Essential criteria 3. The supervisor ensures that remedial actions are taken in a timely manner. AC2. The supervisor addresses all significant remedial actions in a written document to the board of directors and requires that progress reports are submitted in writing as well.	Essential criteria 1. The supervisor raises supervisory concerns with management or, where appropriate, the Board, at an early stage, and requires that these concerns are addressed in a timely manner. Where the supervisor requires the bank to take significant remedial actions, these are addressed in a written document to the Board. The supervisor requires the bank to submit regular written progress reports and checks that remedial actions are completed satisfactorily.
4. The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).	2. The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
1. The supervisor has the authority, backed by legal sanctions, to take an appropriate range of remedial actions against, and impose penalties upon, banks, depending on the severity of a situation. These remedial actions are used to address such problems as failure to meet prudential requirements and violations of regulations. They range from informal oral or written communication with bank management to actions that involve the revocation of the banking license.	3. The supervisor has available[41] an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations, or supervisory decisions, or is engaged in unsafe or unsound practices, or where the interests of depositors are otherwise threatened. These tools include the ability to require a bank to take prompt remedial action and to impose penalties, In practice, the range of tools is applied in accordance with the gravity of a situation. 41. Please refer to CP 1(4).
2. The range of possible actions available is broad, including, in addition to the others mentioned, restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or restricting the powers of managers, directors, or controlling owners, arranging a take-over by or merger with a healthier institution, and imposing conservatorship.	4. The supervisor has available a broad range of possible measures to address such scenarios as described in EC 3 above and provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or restricting the powers of managers, Board directors or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking

1999 Methodology	2006 Draft Methodology
	licence.
No text.	5. The supervisor has the power to take measures should a bank fall below the minimum capital ratio, and seeks to intervene at an early stage to prevent capital from falling below the minimum. The supervisor has a range of options to address such scenarios.
4. The supervisor applies penalties and sanctions not only to the bank, but, when and if necessary, also to management and/or the board of directors.	6. The supervisor applies penalties and sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Additional criteria 1. Laws and/or regulations mitigate against the supervisor unduly delaying appropriate corrective actions.	Additional criteria 1. Laws or regulations mitigate against the supervisor unduly delaying appropriate corrective actions.
CP20 AC1, 2nd bullet. the supervisor has the authority to take remedial actions, including ring-fencing, regarding parent companies and non-bank affiliates concerning matters that could impact the safety and soundness of the bank.	2. The supervisor has the power to take remedial actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries and other related companies in matters that could impair the safety and soundness of the bank.
No text.	3. When taking formal remedial action in relation to a bank, the supervisor ensures that the regulators of non-bank related financial entities are aware of its actions and, where appropriate, coordinates its actions with them.
Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.[9] 9. Supervision of the banking group on a consolidated basis goes beyond accounting consolidation. It implies that there is a group-wide approach to supervision whereby all risks run by a banking group are taken into account, wherever they are booked. It is important to note that both accounting consolidation and consolidated supervision are key aspects of the supervision of banking groups. **Principle 23:** Banking supervisors must practise global consolidated supervision over their internationally active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business	**Principle 24: Consolidated supervision** An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.[42] *(Reference documents:* Consolidated supervision of banks' international activities*, March 1979;* Principles for the supervision of banks' foreign establishments*, May 1983;* Minimum standards for the supervision of international banking groups and their cross-border establishments*, July 1992; and* The supervision of cross-border banking*, October 1996.)*

1999 Methodology	2006 Draft Methodology
conducted by these banking organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.	42. For the purposes of consolidated supervision according to CP 24, a banking group includes the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Other entities, for example parent companies and non-bank (including non-financial) group entities, may also be relevant. This group-wide approach to supervision, whereby all risks run by a banking group are taken into account, wherever they are booked, may go beyond accounting consolidation.
Essential criteria CP20 EC1. The supervisor is aware of the overall structure of banking organisations (i.e., the bank and its subsidiaries) or groups and has an understanding of the activities of all material parts of these groups, including those that are supervised directly by other agencies.	Essential criteria 1. The supervisor is familiar with the overall structure of banking groups and has an understanding of the activities of all material parts of these groups, domestic and cross-border.
CP20 EC3. The supervisor has the legal authority to review the overall activities of a bank, whether the activities are conducted directly (including those conducted at overseas offices), or indirectly, through subsidiaries and affiliates of the bank. CP23 EC1. The supervisor has the authority to supervise the overseas activities of locally incorporated banks. CP20 EC4. There are no impediments to the direct or indirect supervision of all affiliates and subsidiaries of a banking organisation.	2. The supervisor has the power to review the overall activities of a banking group, both domestic and cross-border. The supervisor has the power to supervise the foreign activities of locally incorporated banks.
CP20 EC2. The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group.	3. The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group.
CP20 EC5. Laws or regulations establish, or the supervisor has the authority to impose, prudential standards on a consolidated basis for the banking organisation. The supervisor uses its authority to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures and lending limits. CP20 EC6. The supervisor collects consolidated financial information for each banking organisation.	4. The supervisor has the power to impose prudential standards on a consolidated basis for the banking group. The supervisor uses its power to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures and lending limits. The supervisor collects consolidated financial information for each banking group.
CP20 EC7. The supervisor has arrangements with functional regulators of individual business vehicles within the banking	5. The supervisor has arrangements with other relevant supervisors, domestic and cross-border, to receive information on the financial

1999 Methodology	2006 Draft Methodology
organisation group, if material, to receive information on the financial condition and adequacy of risk management and controls of such business vehicles.	condition and adequacy of risk management and controls of the different entities of the banking group.
CP20 EC8. The supervisor has the authority to limit or circumscribe the range of activities the consolidated banking group may conduct and the overseas locations in which activities can be conducted; the supervisor uses this authority to determine that the activities are properly supervised and that the safety and soundness of the banking organisation is not compromised.	6. The supervisor has the power to limit the range of activities the consolidated group may conduct and the locations in which activities can be conducted; the supervisor uses this power to determine that the activities are properly supervised and that the safety and soundness of the bank are not compromised.
CP23 EC2. The supervisor satisfies itself that management is maintaining proper oversight of the bank's foreign branches, joint ventures, and subsidiaries. It also satisfies itself that the local management of any overseas offices has the necessary expertise to manage those operations in a safe and sound manner.	7. The supervisor determines that management is maintaining proper oversight of the bank's foreign operations, including branches, joint ventures and subsidiaries. The supervisor also determines that banks' policies and processes ensure that the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements.
CP23 EC3. The supervisor determines that bank management's oversight includes: a) information reporting on its overseas operations that is adequate in scope and frequency and is periodically verified; b) assessing in an appropriate manner compliance with internal controls; and c) ensuring effective local oversight of foreign operations.	8. The supervisor determines that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) includes: (i) information reporting on its foreign operations that is adequate in scope and frequency to manage their overall risk profile and is periodically verified; (ii) assessing in an appropriate manner compliance with internal controls; and (iii) ensuring effective local oversight of foreign operations. For the purposes of consolidated risk management and supervision, there should be no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. Transmission of such information is on the understanding that the parent bank itself undertakes to maintain the confidentiality of the data submitted and to make them available only to the parent supervisory authority.
CP23 EC4. The home country supervisor has the authority to require closing of overseas	9. The home supervisor has the power to require the closing of foreign offices, or to

1999 Methodology	2006 Draft Methodology
offices, or imposing limitations on their activities, if it determines that the supervision of a local operation by the bank and/or by the host country supervisor is not adequate relative to the risks the office presents.	impose limitations on their activities, if: • it determines that oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents; and/or it cannot gain access to the information required for the exercise of supervision on a consolidated basis.
CP23 AC2. The supervisor ensures that management's local oversight of foreign operations is particularly close when the foreign activities have a higher risk profile and/or when they differ fundamentally from those conducted in the home country, or are conducted at locations that are especially remote from the principal locations at which the bank conducts comparable activities.	10. The supervisor confirms that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is particularly close when the foreign activities have a higher risk profile or when the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank's home country.
Additional criteria CP20 AC1. For those countries that allow corporate ownership of banking companies: • the supervisor has the authority to review the activities of parent companies and of companies affiliated with the parent companies, and utilises the authority in practice to determine the safety and soundness of the bank; • the supervisor has the authority to take remedial actions, including ring-fencing, regarding parent companies and non-bank affiliates concerning matters that could impact the safety and soundness of the bank; and • the supervisor has the authority to establish and enforce fit and proper standards for owners and senior management of parent companies.	Additional criteria 1. For those countries that allow corporate ownership of banking companies: • the supervisor has the power to review the activities of parent companies and of companies affiliated with the parent companies, and uses the power in practice to determine the safety and soundness of the bank; the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
CP23 AC4. The home country supervisor assesses the quality of supervision conducted in the countries in which its banks have material operations.	2. The home supervisor assesses the quality of supervision conducted in the countries in which its banks have material operations.
CP23 AC3. The supervisor arranges to visit the offshore locations periodically, the frequency determined by the size and risk profile of the overseas operation. The supervisor meets the local supervisors during	3. The supervisor arranges to visit the foreign locations periodically, the frequency being determined by the size and risk profile of the foreign operation. The supervisor meets the host supervisors during these visits. The

1999 Methodology	2006 Draft Methodology
these visits. CP23 AC1. The supervisor has a policy for assessing whether it needs to conduct on-site examinations or require additional reporting, and it has the legal authority and resources to take those steps as and when appropriate.	supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations , or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Principle 24: A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities. **Principle 25:** Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.	**Principle 25: Home-host relationships** Cross-border consolidated supervision requires cooperation and information exchange[43] between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards required of domestic institutions. *(Reference documents:* Principles for the supervision of banks' foreign establishments (Concordat), *May 1983; Report on Cross-Border Banking Supervision*, June 1996; Shell banks and booking offices*, January 2003;* and The high-level principles for the cross-border implementation of the New Accord*, August 2003.)* 43. Information exchange is covered in more detail in CP1 (6), which underpins the standards set out in this CP.
Essential criteria No text.	Essential criteria 1. Information to be exchanged by home and host supervisors should be adequate for their respective roles and responsibilities.
CP24 EC1. For significant overseas operations of its banks, the home country supervisor establishes informal or formal arrangements (such as memoranda of understanding) with host country supervisors for appropriate information-sharing on the financial condition and performance of such operations in the host country. (…) CP25 EC4. The host country supervisor can share with home country supervisors information about the local operations of foreign banks provided its confidentiality is protected.	2. For material cross-border operations of its banks, the supervisor identifies all other relevant supervisors and establishes informal or formal arrangements (such as memoranda of understanding) for appropriate information sharing, on a confidential basis, on the financial condition and performance of such operations in the home or host country. Where formal cooperation arrangements are agreed, their existence should be communicated to the banks and banking groups affected.

1999 Methodology	2006 Draft Methodology
CP24 EC3. The home supervisor provides information to host country supervisors concerning the specific offices in the host country, concerning the overall framework of supervision in which the banking group operates, and, to the extent appropriate, concerning significant problems arising in the head office or in the group as a whole.	3. The home supervisor provides information to host supervisors, on a timely basis, concerning: • the specific operations in the host country; • the overall framework of supervision in which the banking group operates; • the bank or banking group, to allow a proper perspective of the activities conducted within the host country's borders; and • where possible and appropriate, significant problems arising in the head office or the banking group as a whole, where they may have a material effect on the foreign subsidiary or branch. A minimum level of information on the bank or banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.
CP24 EC1. (…) Information sharing arrangements with host country supervisors include being advised of adverse assessments of such qualitative aspects of a bank's operations as the quality of risk management and controls at the offices in the host country. CP25 EC6. The host country supervisor advises home country supervisors on a timely basis of any material remedial action it takes regarding the operations of a bank from that country. CP25 AC1. The host country supervisor obtains from home country supervisors sufficient information on the banking group to allow it to put into proper perspective the activities conducted within its borders.	4. The host supervisor provides information to home supervisors, on a timely basis, concerning: • material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a bank's operations in the host country; • adverse or potentially adverse developments in the local operations of a bank or banking group regulated by the home supervisor; • adverse assessments of such qualitative aspects of a bank's operations as risk management and controls at the offices in the host country; and • any material remedial action it takes regarding the operations of a bank regulated by the home supervisor. A minimum level of information on the bank or

1999 Methodology	2006 Draft Methodology
	banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of the cross-border operations to the bank or banking group and financial sector of the home country. In this context, the home supervisor will inform the host supervisor when the cross-border operation is material to the bank or banking group and financial sector of the home country.
CP25 EC1. Local branches and subsidiaries of foreign banks are subject to similar prudential, inspection, and regulatory reporting requirements as domestic banks.	5. A host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to similar prudential, inspection and regulatory reporting requirements as domestic banks.
CP25 EC3. The host supervisor, before issuing a licence, determines that approval (or no objection) from the home supervisor has been received. CP25 EC2. For purposes of the licensing process as well as ongoing supervision, the host country supervisor assesses whether the home country supervisor practices consolidated global supervision.	6. Before issuing a licence, the host supervisor establishes that no objection from the home supervisor has been received. For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practises global consolidated supervision.
CP25 EC5. Home country supervisors are given on-site access to local offices and subsidiaries for safety and soundness purposes.	7. Home country supervisors are given on-site access to local offices and subsidiaries of a banking group in order to facilitate its assessment of the group's safety and soundness and compliance with KYC requirements. Home supervisors should inform host supervisors of intended visits to local offices and subsidiaries of banking groups.
No text.	8. The host supervisor supervises shell banks,[44] where they still exist, and booking offices in a manner consistent with internationally agreed standards. 44. Reference document: *BCBS paper on shell banks*; 2003. See also footnote on CP3 EC5.
CP24 AC1. A supervisor who takes consequential action on the basis of information received from another supervisor, consults with that supervisor, to the extent possible, beforehand.	9. A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.

1999 Methodology	2006 Draft Methodology
Additional criteria No text.	Additional criterion 1. Where necessary, the home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy should reflect the size and complexity of the cross-border operations of the bank or banking group.
2. Even for less than significant overseas operations of its banks, the home country supervisor exchanges appropriate information with host country supervisors.	