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Implementation of the Basel Core Principles for Effective Banking Supervision - Experience with Assessments and Implications for Future Work

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**Implementation of the Basel Core Principles for Effective Banking Supervision
Experience with Assessments and Implications for Future Work**

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Glossary	3
Executive Summary	4
I. Introduction	6
II. Experience with BCP Assessments.....	7
A. Main Findings of the 2008 Review	8
B. Compliance by Core Principle	8
C. Compliance by Region	14
D. Compliance by Income Level	16
E. Compliance by Assessment Year	18
III. Recent Developments in the BCP	19
A. Revisions to the BCP and the Methodology	19
B. Basel II Implementation and the Revised BCP	20
IV. Implications for Future Work	22
A. Focusing Technical Assistance	22
B. Improving Quality and Consistency of Assessments	23
C. Targeting Assessment Updates	24
Tables	
1. Core Principles with High Degree of Compliance	10
2. Core Principles with Low Compliance	11
3. Leading Areas of Noncompliance by Region	15
4. Compliance Based on Assessment Period	18
5. MCM TA in Banking and Banking Supervision Areas	22
Figures	
1. Global BCP Compliance.....	9
2. Regional BCP Compliance	14
3. BCP Compliance by Income Level.....	16

Boxes

1.	Establishing an Empirical Link Between Compliance with the Basel Core Principles and Financial Stability	6
2.	Main Findings of the 2000 and 2002 Reviews	8
3.	Revisions to the BCP and Methodology and Issues Raised in FSAP Reviews	20
4.	Outreach Meetings with BCP Assessors.....	23

Annexes

1.	Basel Core Principles (1997 version)	25
2.	Compliance with Basel Core Principles by Region	27
3.	Compliance with Basel Core Principles by Income Level	28

GLOSSARY

BCP	Basel Core Principles
BCBS	Basel Committee on Banking Supervision
C/LC	Compliant/Largely Compliant
CP	Core Principles
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
FATF	Financial Action Task Force
IAIS	International Association of Insurance Supervisors
IFIs	International Financial Institutions
ILG	International Liaison Group
IOSCO	International Organization of Securities Commissions
LAC	Latin America and Caribbean
LCFI	Large and Complex Financial Institution
MENA	Middle East and North Africa
MNC/NC	Materially Noncompliant /Noncompliant
OFC	Offshore Financial Center
ROSC	Report on Observance of Standards and Codes
RTAC	Regional Technical Assistance Centers
TA	Technical Assistance
WH	Western Hemisphere

EXECUTIVE SUMMARY

This paper reviews the experience to date in assessing countries' compliance with the Basel Core Principles for Effective Banking Supervision (BCP). This review is based on 136 assessments conducted under the FSAP/OFC programs, using the methodology associated with the 1997 version of the BCP. It follows earlier reviews presented to the Board in 2000, 2002, and 2004. The Fund has developed a strong collaborative relationship with the Basel Committee in promoting financial stability, in particular, in its work through the FSAP program in assessing (together with the World Bank) the quality of countries' supervisory structures. Experience gained from these assessments are also being reported back to the Committee through the Fund's participation in Basel working groups, and staff has also been actively involved in the update of the BCP in 2006, with the objective of maintaining the BCP's relevance as a global standard of good practice.

The findings suggest that while countries have made improvements in strengthening their supervisory frameworks, weaknesses were identified in key areas of prudential regulation and supervision. Overall, there is a relatively high degree of compliance in the principles related to the legal and institutional framework for supervision and the authorization and conduct of banking business. However, more than 40 percent of the assessed countries did not comply with the essential criteria of the principles dealing with risk management, consolidated supervision, and the abuse of financial services. More than a third did not possess the necessary operational independence to perform effective supervision nor have adequate ability to use their formal powers to take corrective action.

The paper also highlights significant differences in compliance both by region and by income level. On average, countries in Western Europe demonstrated a much higher degree of compliance (above 90 percent) with the BCP than their counterparts in other regions. Similarly, the findings suggest that more efforts have to be made to strengthen the supervisory framework in Africa and in countries in the Western Hemisphere. In general, high-income countries reflected a higher degree of compliance than their lower- and middle-income counterparts. Notwithstanding, as evidenced in the ongoing market turbulence, implementation weaknesses in consolidated supervision, risk management, remedial action, and crisis management frameworks also exist in mature markets.

The overall findings suggest that continued efforts are needed to strengthen banking supervision in many jurisdictions. Countries themselves will need to address these areas. Moreover, there may be a need for additional technical cooperation in coordination with other donor countries and institutions. Technical cooperation efforts will need to be directed, in particular, at areas in which compliance is uniformly low and which have proven to be particularly critical in the current crisis for financial stability.

The recent revision of the Core Principles and the implementation of Basel II will place greater demand on countries, on assessments, and technical assistance resources. The revisions of the BCP strengthen the assessment criteria, but also increase their number and scope. Moreover, while Basel II implementation will strengthen the supervisory frameworks, the transition has to be managed carefully to ensure that the supervisory capacity and other preconditions for its effective application are in place. For countries implementing Basel II, assessment of the capital adequacy, supervisory practices, and disclosure frameworks will become more complex. At the same time, there will be renewed interest in assessing the interaction between supervisory frameworks and global financial stability, as evidenced by the crisis in financial markets in industrialized countries.

Going ahead, the coverage of assessments will have to be reviewed in light of the resource constraints imposed by the shrinking budget envelope. Assessments based on the revised BCP standard will place increased demands on both staff and the assessors. In the absence of increasing resources devoted to full assessments, smarter ways will have to be found to maintain assessment quality and develop techniques to monitor progress while continuing to promote greater transparency. This is particularly relevant as most assessments in the future will be in the nature of updates in which ROSCs are typically not produced, as the standard is not assessed in full. Staff is separately developing a proposal for a targeted approach to standards reassessments. This proposal contemplates ROSCs will be produced based on a reassessment of selected principles comprising a given standard. Moving to such a targeted approach poses several significant challenges, and staff will separately present their proposals at a later date on how these challenges can be met.

I. INTRODUCTION

1. **This paper reviews the findings of the Fund/Bank in conducting Basel Core Principles assessments and identifies key issues and challenges facing banking systems in their implementation.** It incorporates findings from 136 assessments conducted under the FSAP/OFC programs and updates earlier reviews to the Board in 2000, 2002, and 2004. In terms of regional coverage, it includes 19 countries each from Asia, Africa, MENA, and Central and Eastern Europe, and 29 countries from Western Europe and 31 from the Western Hemisphere region. The BCP underwent significant revisions in 2006, and although a few assessments using the revised methodology have been completed, these are excluded from the current review.

2. **The Basel Core Principles of Effective Banking Supervision were formulated by the Basel Committee on Banking Supervision in 1997 as a framework of minimum standards for sound practices in banking supervision.** The associated assessment methodology was developed in 1999. Since then, these principles have been used by the IMF and World Bank as the standard against which banking systems of member countries are assessed, and they are a key element of the FSAP and the ROSCs. A strong and effective framework of banking supervision, as reflected in high compliance with these standards, has long been seen by national supervisors as an essential prerequisite for financial stability. Recent empirical studies (Box 1) also support this view.

Box 1. Establishing an Empirical Link Between Compliance with the Basel Core Principles and Financial Stability

In the first such effort, Sundararajan et al. (2001) reviewed the 35 initial BCP assessments conducted by the IMF/World Bank and established an indirect effect of compliance on credit risk and bank soundness through interaction with other macroeconomic and banking sector factors.^{1/} Based on their findings, they argued that interpretation of compliance should therefore be in the context of other macro variables that affect banking risks and soundness. With the benefit of a larger sample of assessments, two recent papers suggest much stronger benefits of compliance. Podpiera (2006) explores the relationship between banking sector performance and the quality of regulation and supervision, as measured by compliance with the BCP for 65 countries, and finds a significant positive impact of compliance on performance, as measured by asset quality and bank efficiency.^{2/} Kunt et al. (2006) study BCP compliance data for 39 developed and emerging market countries from IMF/WB assessments and conclude that there is a positive correlation between bank soundness and an overall index of BCP compliance, with this effect being more pronounced for principles dealing with information requirements and transparency.^{3/}

1/ V. Sundararajan, D. Marston, and R. Basu, 2001, "Financial System Standards and Financial Stability: The Case of Basel Core Principles," IMF Working Paper 01/62.

2/ Richard Podpiera, 2006, "Does Compliance with Basel Core Principles Bring Any Measurable Benefits?," *Staff Papers*, International Monetary Fund, Vol. 53, No. 2.

3/ A. Demirgüç-Kunt, E. Detragiache, and T. Tressel, 2006, "Banking on the Principles: Compliance with Basel Core Principles and Bank Soundness," IMF Working Paper 06/242.

3. **The Fund, together with the Bank, has actively supported the Basel Committee's efforts in developing guidance for bank supervisors worldwide through their participation in its various sub-groups and working groups.** Fund and Bank staff participates in meetings of the International Liaison Group (ILG), its working group on capital, the Research Task Force, and the Accord Implementation Group's Validation sub-group. The Fund has reported to the Committee on the experience gained from the BCP assessments and suggested areas where further guidance could be beneficial. Staff has provided inputs into strengthening the 1997 Core Principles and the associated methodology, and has participated in the drafting and steering groups set up by the Committee to revise the BCP. Staff has also worked with the Committee on developing guidance in areas such as provisioning, dealing with weak banks, and preparing for Basel II implementation. Currently, Fund/Bank are partnering with the ILG in developing a methodology for assessing Basel II implementation in national jurisdictions.

4. **The rest of the paper is organized as follows:** Section II elaborates on the main findings of this review, focusing on those areas in which less progress has been achieved, as reflected in compliance with the related Core Principles. Section III highlights key developments related to the assessment methodology, including the revision of the standard in 2006 and the incorporation of elements of the Basel II framework. Section IV discusses the implications of the main findings and the recent developments on the work of the Fund.

II. EXPERIENCE WITH BCP ASSESSMENTS

5. **The 2004 review¹ identified credit risk management, capital adequacy, consolidated supervision, and AML as areas where compliance was relatively low.** Unlike the earlier reviews in 2000 and 2002 (Box 2), the 2004 review was cross-sectoral in scope and attempted a more integrated view of standard assessments. It covered 90 assessments (including 20 conducted as part of OFC assessments) and considered compliance of all three financial sector standards viz. BCP, IAIS Core Principles, and IOSCO Core Principles. With regard to the BCP, it concluded that notwithstanding better compliance by industrialized countries, relative strengths and weaknesses existed across all country-income groups (industrialized, emerging, and developing). It noted that the broad area of credit risk management had relatively low rates of compliance across all jurisdictions. In addition, it identified the areas of capital adequacy, consolidated supervision, and KYC/AML as being relatively weak from the compliance perspective.

¹ International Monetary Fund, "Financial Sector Regulation: Issues and Gaps," August 2004.

Box 2. Main Findings of the 2000 and 2002 Reviews

The first (2000) review, based on 26 assessments, concluded that countries had much work to do to achieve compliance with many of the Core Principles.^{1/} The review suggested that significant resources, including those from the Fund and Bank, would be required to assist countries to build their capacity in this regard. It identified the drafting of legislation and regulation, and building institution capacity for improved and effective supervision, as key areas of future work. Among individual CPs, it found lowest levels of compliance with those related to credit policies; country, transfer, market and other (liquidity and operational) risk; internal controls; anti-money laundering; consolidated supervision; and remedial measures. It accepted that the sample was too small to draw far-reaching conclusions relating to compliance with macro characteristics (only one industrialized country was included), but did suggest that these findings were spread across all regions. Finally, it suggested that when the CPs were revisited, attention should be paid to incorporating accounting issues, disclosure issues, and exit procedures for banks.

The second (2002) review was based on 60 assessments and identified three key reform themes.^{2/} First, it called for a more explicit assessment of the preconditions of the BCP, and that those related to problem bank resolution and safety nets be incorporated in the BCPs themselves. Second, it called for strengthening of the independence of supervisory agencies and, for this purpose, suggested that guidelines for good governance of the supervisory agencies were needed. Third, it called for guidance on good practices on loan classification and provisioning. It reaffirmed the findings of the first review and also suggested that additional guidelines were advisable in the area of supervision of LCFIs, cross-border cooperation, supervision of state banks, corporate governance of banks, and management of operational risk.

1/ International Monetary Fund, "Experience with Basel Core Principle Assessments," April 2000.

2/ International Monetary Fund and the World Bank, "Implementation of the Basel Core Principles for Effective Banking Supervision, Experiences, Influences, and Perspectives," September 2002.

A. Main Findings of the 2008 Review

6. Overall, this review shows that continued work is needed on strengthening banking supervision in many jurisdictions, particularly in the area of risk management. This (2008) review covers the experience of the full set of BCP assessments conducted in 136 jurisdictions (including OFCs) between 1999 and 2006, before the changeover to the revised methodology. It corroborates many of the findings of the earlier reviews (Box 2) with regard to the main trends in compliance with the BCP and suggests continuing weakness in certain areas. In the following paragraphs, these findings are presented by principle, by region, by country income level, and by year of assessment.

B. Compliance by Core Principle

7. There has been a significant strengthening of the legal and institutional framework for supervision and the authorization and conduct of banking. Figure 1 lays out the global compliance position² by principle and Table 1 highlights those principles with

² Global compliance for each BCP (as, for example, in Figure 1 and Table 1) is computed by taking the percentage of assessed countries which are rated as compliant (fully or largely) for that principle. For this paper, (continued)

which most countries were in compliance [i.e., rated compliant (C) or largely compliant (LC)] at the time of the assessment.³ A complete list of the principles and their relatively ranked compliance position⁴ is provided in Annex 1. As brought out in the table, countries have largely put in place the legal and institutional framework required for supervision as well as the licensing of establishments and carrying out of banking business.

Figure 1. Global BCP Compliance

Source: International Monetary Fund.

each of the six sub-principles of CP 1 are treated as stand-alone principles and weighted equally as the other CPs.

³ The BCP methodology uses a five-part assessment system for each Principle: (i) compliant (C), i.e., all essential criteria are met without any significant deficiencies; (ii) largely compliant (LC), i.e., only minor shortcomings are observed and there are no doubts about the authority's ability to achieve the objectives of the Principle; (iii) materially noncompliant (MNC), i.e., there are sufficient shortcomings to raise doubts about the authority's ability to achieve compliance though substantive progress has been made; (iv) noncompliant (NC), i.e., when no substantive progress toward compliance has been achieved; and (v) not applicable (NA).

⁴ An important caveat while interpreting these results is that this reflects the position at the time the assessment took place, and as has been reflected in some of the updates, the position with regard to some of these principles has improved since the assessment.

8. **There are some significant regional variations. For example, compliance is significantly lower in the MENA region for CP 4 on transfer of ownership, and in Africa and countries in the Western Hemisphere for CP 17 on bank management contact and CP 19 on validation of supervisory information.** These differences may reflect commonly shared legal and institutional characteristics.

Table 1. Core Principles with High Compliance

CP Number/Core Principle Description	Percent of Countries Assessed Compliant/Largely Compliant
CP 2 Permissible activities	96
SP 1.3 Legal framework for authorizing and supervision	89
CP 3 Licensing criteria	82
SP 1.1 Agency objectives/responsibilities	82
SP 1.4 Legal framework for compliance	81
CP 4 Transfer of ownership	81
CP 17 Bank management contact	81
CP 19 Validation of supervisory information	81

Source: International Monetary Fund.

9. **However, less progress has been made on prudential regulation and supervision, with risk management and consolidated supervision emerging as key areas for concern.** Table 2 lists those Core Principles with which countries were least in compliance [i.e., rated as noncompliant (NC) or materially noncompliant (MNC)] at the time of the assessment. Nearly half of the assessed jurisdictions were not in compliance with the principles on supervision and management of risks, mainly market risk, country risk, and “other” risks. The latter category covers liquidity, interest rate, and operational risks. The inability to perform effective consolidated supervision and the abuse of financial services (know-your customer rules and anti-money laundering) follow closely, while more than a third of the jurisdictions were not in compliance with the sub-principle on supervisory independence and resources and the principles on capital adequacy, formal powers of supervisors, and connected lending.

10. **The detailed assessments of the standard bring out the gap between the expectation of the related Core Principles and observed practices in the assessed jurisdictions.** The most commonly cited deficiencies in meeting the CP are summarized in the following paragraphs. It should be reemphasized that these shortcomings do not occur in all jurisdictions judged as not being in compliance. However, these results can be useful inputs for focusing future surveillance and the design of technical assistance.

Table 2. Core Principles with Low Compliance

CP Number/Core Principle Description	Percent of Countries Assessed Materially Noncompliant/ Noncompliant
CP 12 Market Risk	49
CP 11 Country Risk	46
CP 13 Other (Foreign Exchange, Liquidity, Operational, etc) Risks	45
CP 20 Consolidated Supervision	44
CP 15 Abuse of Financial Services	43
SP 1.2 Supervisory Independence/Resources	36
CP 6 Capital Adequacy	34
CP 22 Formal Powers of Supervisors	33
CP 10 Connected Lending	33

Source: International Monetary Fund.

11. **Risk management:** A key lesson from the current crisis referred to in various reports from both the public and private sector is that both firms and their supervisors need to enhance the effectiveness in their risk-management systems. This is underscored by the finding in the assessment that deficiencies in the area of risk management are widespread across all geographical regions. In particular, nearly half the assessed jurisdictions do not meet the standards espoused in the three principles dealing with the supervision of bank risk management for country, market, and “other” risks (e.g., liquidity, foreign exchange, operational, interest rate, and business and legal risks).

- **Supervision of market risk:** The deficiencies most often cited are the absence of a capital charge for market risk and no legal ability to require this. Further, many assessments find that supervisors are not trained in assessing market risk, do not cover it in onsite examinations, and have not issued guidance to banks in this regard.
- **Supervision of country risk:** The assessments show that there are often no requirements for policies and procedures on country risk; no guidance on country risk nor requirements to hold provisions against such risks; no prudential reporting on exposures; and infrequent coverage in on-site examinations. Further, a significant proportion of countries in Africa (26 percent) and Asia (16 percent) were not assessed against this CP on the grounds that their banks had no overseas operations or exposures, though this position may have changed in several of these countries since the assessments.
- **Supervision of “other” risks:** The assessments find that foreign exchange risk and liquidity risk are better covered than operational and interest rate risk. However, in the case of liquidity risks, often no guidance is issued, though it is covered in the examination process. Regulations or guidance on interest rate risk in the banking book are often absent, while additional risks, such as business and legal risks, are not

covered at all. Monitoring systems for operational and liquidity risks are sometimes scarce. Overall, assessors have commented on the lack of supervisory awareness and training, inadequate and dated tools and methodologies to evaluate banks' risk management approaches, no requirements for stress testing, and no authority to require banks to hold capital against such risks.

12. **Weaknesses were also observed in the area of credit risk management.** More than a quarter of the countries did not comply with the credit risk-related principles (CP 7 to CP 9) covering credit policies, loan classification/provisioning, and large exposures; and a third did not comply with CP 10 on connected lending. However, there are significant regional variations with compliance being low at 35 percent in Africa and 55 percent in LAC, and suggest continuing work on strengthening all areas of risk management. As regards connected lending, commonly cited deficiencies were that the definition of connected parties was too narrow. Provisions requiring such lending to be treated on an arm's-length basis were missing and the limits on connected lending were too high. There was no requirement for banks to set up specific policies and procedures for the monitoring and reporting of loans to connected parties. The connected lending aspect was also not looked into during on-site examinations, nor were any sanctions imposed on noncompliance.

13. **Abuse of financial services:** The CPs require supervisors to determine that banks have adequate policies, practices, and procedures in place, including strict "know-your-customer" rules, which promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements. The types of deficiencies cited in the assessments are the absence of (i) legislation or regulation laying out KYC requirements; (ii) information-sharing arrangements with other supervisors; (iii) requirements for reporting suspicious transactions; (iv) supervisory verification of policies and procedures to prevent abuse or identify clients/transactions; and (v) code of ethics for employees. However, it is important to read these observations in the context that, in some of these countries, infrastructure had been recently created and internal procedures were in the process of being defined (sometimes following FATF assessments), and compliance was expected to improve.

14. **Consolidated supervision:** The CP requires supervisors to have the ability to supervise the banking group on a consolidated basis, whereby all risks run by a banking group are taken into account, wherever they are booked. Although 44 percent of the assessed countries are rated noncompliant, the figure could be greater as another 20 percent were either not assessed on this principle or this was deemed to be "not applicable" to their financial systems on the grounds that formal group structures were not present. Commonly-cited deficiencies were the lack of reliable consolidated information and legal powers to examine and supervise some financial activities, including those of offshore banks; inability to have direct access to nonconsolidated subsidiaries and to the holding company; no capital allocation to cover risks on a consolidated basis; no framework to evaluate risks presented by nonbank entities within a group; no provisions or arrangement to share information with

other supervisors (domestic or foreign) of group entities; no legal requirements to consolidate the operations of all subsidiaries and report the accounts and exposures on a consolidated basis; and no requirement to report prudential requirements on a consolidated basis.

15. **Supervisory independence/resources:** The lack of experienced supervisors, training budgets, inability to retain qualified staff due to low salary scales, and competition from industry are cited in the assessments on the resources issue. On operational independence, while there is rarely any explicit recognition of interference in the assessments, there is often reference to key elements of the structure of supervision that point to the potential of such interference. For example, some assessments have pointed to the absence of requirements for a fixed term for head of agency or no specified reasons for dismissal or requirement to make public reasons for dismissal. Other assessments point to the lack of credibility in supervisory actions, because powers are not used, or that there is a prominent role for ministers in supervisory decisions either due to legal requirements or established practice; no budgetary independence because activities are funded out of a central budget; lack of protection of supervisors from industry and government interference; presence of supervised financial sector participants on agency boards; and, in some jurisdictions, the practice of supervisory agencies owning supervised financial institutions.

16. **Capital Adequacy:** While most jurisdictions applied a risk-weighting framework along the lines of Basel I for credit risk, the commonly observed shortcomings were that the capital adequacy requirements were not applied on a consolidated basis and that the market risk charge had yet to be incorporated into the capital calculation. Other observations point to application of lower risk weights in some categories and note the lack of authority, or clear policy, to deal with banks breaching the minimum ratio.

17. **Formal Powers of Supervisors:** In the case of CP 22, supervisors in most jurisdictions judged as not fully compliant had the authority to impose sanctions on banks, though sometimes for a very limited range of events. In general, assessors observed a lack of clarity as to the means by which the sanction is matched to the severity of the infringement. This results in the powers not being applied consistently, regulatory forbearance, and supervisory actions not being seen as credible. There were also a few instances where the powers were very narrow, which could lead to extreme actions, such as liquidation for situations for which intermediate steps are commonly available in other jurisdictions. In addition, in several cases, there were formal or informal requirements for all sanctions and penalties to be approved by the minister, which eroded the credibility of the supervisory agency.

18. **In addition, a review of the preconditions to the assessments suggests other key areas where efforts are needed.** Assessors are required to form a view on whether key preconditions, the performance of which is outside the control of the supervisors, but which need to be in place for banking supervision to be effective, are met. Among these are “a sufficient and flexible range of procedures” for efficient bank resolution and an appropriate

public safety net. In addition, the FSSA also reviews the adequacy of crisis-management arrangements. While several key elements of both bank resolution and crisis management are included in various Core Principles, the BCP in themselves do not assess these arrangements. However, a reading of the FSSA and preconditions text suggests that these need strengthening in many jurisdictions and should be a key priority for both surveillance and technical assistance in coming years.

Figure 2. Regional BCP Compliance

Source: International Monetary Fund.

C. Compliance by Region

19. **The countries of Western Europe lead in compliance with the Core Principles.** Coverage of these assessments by region is driven by the FSAP schedule and is partly skewed—while Europe has been covered in full, as has nearly all of Latin America and the Caribbean (91 percent), the MENA region and Asia have been covered to the extent of 60 percent, and less than half of the African membership (43 percent). As brought out in Figure 2, compliance⁵ varies significantly across regions—it is more than 90 percent in Western Europe, several countries in which are members of the Basel Committee, around

⁵ This is computed as the average of the compliance position (i.e., percentage of the BCPs, which are rated as fully or largely compliant) of all countries in the region.

70 percent in Central and Eastern Europe, (which includes several EU accession countries), and is lower at around 55 percent in Africa and Western Hemisphere countries. However, this regional data masks individual country compliance. In terms of principles with least compliance, there are some regional variations (Table 3) with KYC/AML issues being relatively more prominent in Asia and Africa, legal protection for supervisors in Central and Eastern Europe, and internal audit and control in LAC.

Table 3. Leading Areas of Low Compliance by Region

Core Principles	Countries Not in Compliance (In percent)	Core Principles	Countries Not in Compliance (In percent)
Asia (19)		Africa (19)	
Abuse of Financial Services	63	Abuse of Financial Services	79
Country Risk	53	Market Risk	79
Other Risks	53	Other Risks	74
On and Off-site Supervision	53	Country Risk	68
Credit Policies	47	Formal Powers of Supervisors	68
Western Hemisphere (31)		MENA (19)	
Market Risk	65	Market Risk	58
Capital Adequacy	61	Other Risks	58
Consolidated Supervision	61	Consolidated Supervision	58
Other Risks	58	Country Risk	47
Internal Controls and Audit	55	Abuse of Financial Services	47
Eastern Europe (19)		Western Europe (29)	
Consolidated Supervision	63	Formal Supervisory Powers	14
Country Risk	58	Country Risk	10
Market Risk	58	On/Off Site Supervision	10
Legal Protection for Supervisors	47	Loan Classification/ Provisioning	10
Independence/Resources Other Risks, Abuse of Financial Services, Cross-border	37	Acquisitions and Investments	10
		Independence/Resources	10

Source: International Monetary Fund.

D. Compliance by Income Level

20. While the assessments indicate both strengths and weaknesses across all income groups, high-income countries do better on compliance than their lower-income peers. High-income countries reflect a much higher degree of compliance (89 percent) than the low (52 percent), low-middle (54 percent), and upper-middle income (64 percent) countries. This suggests that there will be a continued strong demand for technical assistance in strengthening banking supervision for developing and emerging countries for the next few years.

Figure 3. BCP Compliance by Income Level

Source: International Monetary Fund.

21. Shortcomings in the supervisory framework in the mature economies have contributed to the recent turmoil in the mature financial markets resulting from the sub-prime crisis. The causes of the turmoil have been investigated in several forums and inadequate supervision has been accorded some share of the blame in the chain of events. The report of the Financial Stability Forum (FSF),⁶ for example, points to poor underwriting standards; shortcomings in firms' risk-management practices; poor investor due-diligence; poor performance by the credit-rating agencies; incentive distortions, including in the Basel I framework; and weaknesses in disclosure and liquidity risk management as key contributory factors, which were fed by an environment of an exceptional credit boom and low interest rates.

⁶ Financial Stability Forum, "Report on Enhancing Market and Institutional Resilience," 2008.

22. **Although BCP assessments overall reflect a high degree of compliance in these economies, they do flag some of the fault lines that have been revealed in the wake of the current crisis.** The United States, where the sub-prime crisis originated, has not yet been assessed. However, examples from the BCP assessments of the United Kingdom and Germany (which are published) are illustrative. Even though both countries demonstrated a very high degree of compliance, the assessors had observed the need for further strengthening of some key areas. For instance, the United Kingdom report points out that no special statutory insolvency procedures existed for banks and the FSA had a limited role in statutory insolvency procedures. It cautioned that under the system, the treatment of depositors like other creditors could delay repayment of depositors by several weeks. In addition, it has made recommendations on increasing staffing capacity for supervising the trading of highly complex products, developing an approach to liquidity management, and identifying off-site monitoring triggers. In Germany's case, the BCP assessment points out the need for issuance of guidance on "other" risks (liquidity, operational, and interest rate risk) appropriate to the operations of different banks and also calls for instituting proactive measures for identification and treatment of weaknesses in institutions, as well as the introduction of explicit rules to take action in specified timeframes.

23. **The experience of the industrialized countries that have been affected by the recent financial turmoil suggests that while compliance with the BCP is an important indicator of the strength of the banking supervision it cannot rule out problems in the banking system.** Assessments are important in identifying weaknesses that may contribute to or exacerbate banking sector problems. Compliance at a point in time cannot, however, rule out problems developing subsequently in individual banks or groups of institutions, nor can it foreshadow the implications of changes in the regulatory environment. It must be supplemented with effective bank resolution frameworks, safety net mechanisms, and crisis-management arrangements.

24. **Drawing lessons from the turbulence, several actions have been proposed to strengthen supervisory frameworks.** In its recent report,⁷ the FSF has called for firms to strengthen their risk-management practices and for supervisors to strengthen prudential oversight of capital, liquidity, and risk management, and to enhance the supervisory assessment of banks' valuation processes to strengthen disclosures. It has also called for authorities to strengthen their responsiveness to risk through better cooperation and exchange of information, including the assessment of financial stability risks and coordinated action for large global banks. The Basel Committee is expected to announce upgraded guidance relating to some of these areas later this year.

⁷ Ibid, p.16.

25. **The Fund and Bank will contribute to these efforts through their membership of the various groups of the standard-setting bodies.** In addition, developing more systematic means of following up on the findings of the FSAP and BCP assessments and monitoring progress through the regular surveillance process, as well as in scheduling FSAP updates and programming technical assistance, would be an effective response.

E. Compliance by Assessment Year

26. **Overall, compliance has improved over time.** The table shows how overall compliance has improved by year of assessment, with the rate of noncompliance (obtained by averaging over assessments covered in a period) going from 36 percent in 1999–2001 to 17 percent in the assessments concluded in 2005–2006. This may be driven by a host of factors, including the scheduling of the assessments, with the proportion of low- and middle-income countries in the sample trending downwards over this period, and increased occurrence of substantive updates in later years. However, assessors also point to the role of the increased awareness and absorption of the standards with time, greater integration, and information sharing among jurisdictions. National authorities, with encouragement from the IFIs, have also made a significant effort to adopt the Core Principles.

Table 4. Compliance Based on Assessment Period

	Composition of BCP Assessments 1999–2006 (In percent)			
	1999–2000	2001–2002	2003–2004	2005–2006
Average noncompliance rate	36	25	24	17
Number of assessments	23	58	37	18
High Income	4	20	14	8
Middle Income	12	31	15	8
Low Income	7	7	8	2

Source: International Monetary Fund.

27. **Nonetheless, this picture of compliance is a static one, prevailing at the time of the assessment, and does not reflect improvements made subsequently.** While the factual updates of the assessment conducted in the context of FSAP updates and occasional coverage in the Article IV often suggest significant improvements in compliance with principles earlier identified as noncompliant, these are not currently captured in a systematic manner to enable comparison. A sample of 16 assessments where substantive updates have been conducted using the same (1997) methodology enables a better comparison, showing that compliance rates increased from 72 percent to 84 percent for the countries covered. This suggests that the assessments may have an important role in identifying and conveying key weaknesses and that national authorities have been receptive to this advice.

III. RECENT DEVELOPMENTS IN THE BCP

A. Revisions to the BCP and the Methodology

28. **Experience gained from BCP assessments were a key input for the revision of the Core Principles and assessment methodology in 2006.** Following an extensive consultation, the Basel Committee issued a revised version of the principles in October 2006 at the ICBS, where they were endorsed by the supervisory community. The revision was intended to ensure the continued relevance of the BCP as the standard for banking supervision in the face of changes in banking practices and supervisory focus. The concerns arising from the BCP assessment experience were also fed into the revision process through Fund/Bank participation in the drafting and steering groups set up by the Basel Committee's Core Principles Liaison Group. The IMF Board was informed⁸ of the changes introduced by the revised principles and the methodology and endorsed the use of the revised principles as the standard under which future assessments would be undertaken and ROSCs prepared.

29. **The revisions have further clarified and strengthened some of the areas in which compliance was already weak, as identified by the earlier reviews.** These include risk management, consolidated supervision, and abuse of financial services. This raises the bar, and therefore, assessments conducted under the new methodology may still find continuing low compliance (Box 3). The revisions have been kept to a minimum and the number of principles left unchanged at 25, which should contribute to ensuring continuity and comparability with the 1997 original BCP. The revisions have been made in both the original principles and the associated methodology by (i) introducing new stand-alone principles to focus on areas now considered important, e.g., comprehensive risk management, operational risk, and liquidity risk; (ii) consolidating earlier principles to address issues of overlap; and (iii) introducing new “essential” and “additional criteria” in existing principles.

⁸ International Monetary Fund and the World Bank, “Note to the Executive Boards of the IMF and the World Bank on Revised Basel Core Principles for Effective Banking Supervision”, April, 2007.

Box 3. Revisions to the BCP and Methodology and Issues Raised in FSAP Reviews

The revisions to the BCP and the methodology considerably strengthen the focus on the principles which this and earlier reviews of the BCP assessment have found to be low. The Methodology provides more guidance to assessors on how they should address the “**preconditions**” for effective banking supervision, (i.e., sound macroeconomic policies, developed public infrastructure, effective market discipline, and public safety nets), which are usually outside the control of bank supervisors. More emphasis has been placed on governance, transparency and accountability of supervisory agencies, and reaffirming **supervisory independence and adequacy of resources** and legal protections in SP 1.6.

Stand-alone principles have been created for an **integrated approach to risk management, liquidity risk, interest rate risk, and operational risk**, which were earlier all considered together as CP 13 (Other Risks). The effect of this will be to allow for more focused assessment of these key risk areas. The earlier CP 15 (**abuse of financial services**) has been expanded to better capture issues pertaining to banks’ supervisors from the revised FATF standards. KYC rules are also required to be integrated into banks’ overall risk-management processes. The roles and responsibilities of bank supervisors and the financial intelligence unit in combating criminal abuse of banks have been further clarified and closer cooperation sought. Finally, there is greater focus on the actual exercise of **consolidated supervision** rather than the legal authority alone and the need for supervisors to have a working knowledge of the structure of large banking groups, domestically as well as those abroad, is reinforced.

Observations based on six assessments (five national and one regional supervisory agency) conducted in 2007, using the revised methodology are illustrative. Although the sample is too small to draw any definitive conclusions, key issues identified using the earlier methodology are carried over. The overall compliance rate drops to 61 percent for this group from the 78 percent for the preceding year, though both the enhanced criteria and sample selection may account for this. All six jurisdictions have been assessed noncompliant with the revised CP 1.2 on independence and accountability and CP 24 on consolidated supervision. Four of the six jurisdictions do not comply with new CP 7 on risk management processes; revised CP 23 on corrective and remedial powers; and new CP 16 on interest rate risk in the banking book, while three of six jurisdictions do not comply with revised CP 1.6 on cooperation; CP 4 on transfer of significant ownership; CP 5 on major acquisitions; and CP 13 on market risk. These early indications suggest that the bar has been raised with the new methodology. With existing guidance on capital, liquidity, and risk management set to be revisited by the Basel Committee, more work will need to be done by national authorities to strengthen their supervisory systems.

B. Basel II Implementation and the Revised BCP

30. **The revised capital adequacy framework (Basel II) is poised to become the new global standard for capital adequacy, which is a key anchor of bank regulation and supervision.** The Basel Committee on Banking Supervision released the new capital adequacy framework (Basel II) in June 2004. The position of the Committee on its implementation has been that “moving towards Basel II may not be a first priority for all supervisory authorities in terms of what is needed to strengthen their supervision.” The view that Basel II should be implemented by countries based on schedules driven by their own national circumstances is also shared by the World Bank and the IMF. The Core Principles do not require countries to explicitly comply with Basel I or Basel II, though they expect

internationally active banks to be subject to capital requirements, which are not less than the applicable Basel requirement. However, surveys by the FSI suggest that more than 100 countries around the world intend to implement Basel II in one of its forms to replace Basel I as the new capital standard.

31. Several elements of the Basel II framework have been integrated into the revised Core Principles. CP 6 of the BCP, which covers capital adequacy, did not require implementation of Basel I, but did suggest that the framework applied should not be less conservative than this for internationally active banks. The revised CP 6, too, does not require explicit implementation of Basel II, although many elements of this, which are related to Pillar 1, have been captured in the additional criteria. At the same time, existing principles have been upgraded to reflect new understandings in risk management, which have arisen from the discussions on Basel II. Foremost among these is the addition of a new principle on the comprehensive risk-management process, which reflects Pillar II, and an additional principle on disclosure, which reflects the spirit of Pillar III. Operational risk is also treated in a stand-alone principle to reflect the improvements in the understanding and management of this risk.

32. Countries that choose to adopt Basel II would now be assessed against the revised standard in the course of BCP assessments. In an earlier note to the Board⁹ staff had stated that “for countries that are implementing Basel II, preparing assessments of their supervisory and regulatory systems will become more complex.” In particular, for those countries with banks adopting the internal ratings-based approaches, judging the quality and effectiveness of the supervision of these banks will require assessors with a good understanding of underlying implications of implementation of Basel II. The note also recognizes that countries are likely to request assistance in Basel II-related areas and that, in responding to such requests, the Bank and Fund will need to coordinate carefully with Basel II-related technical assistance activities of other agencies and donors.

33. Proper implementation of Basel II is important for the framework to be effective. Basel II creates an appropriate incentive framework for bank management, supervisors, and markets to monitor banks’ risk management systems. Greater supervisory attention to managing the transition to Basel II is warranted to assess the impact on capital, and supervisors need to be aware of the risks associated with selectively implementing elements of the Basel II framework, as partial or incomplete implementation will not deliver the benefits of the framework.

⁹ International Monetary Fund and the World Bank, “Implementation of Basel II—Implications for the World Bank and the IMF”, July, 2005.

34. **The Fund and the Bank have developed a methodology to assess Basel II implementation.** Working together with a consultative group of supervisory authorities represented on the Basel Committee's International Liaison Group, staff has developed a methodology for the assessment of implementation, which can be used for both surveillance and for a diagnostic review to identify technical assistance needs. This methodology has been field-tested in four volunteer jurisdictions. Based on the experience of these pilots, this methodology has been reviewed and approved by the consultative group and by the Basel Committee, and will be available later this year for BCP and stand-alone assessments.

IV. IMPLICATIONS FOR FUTURE WORK

A. Focusing Technical Assistance

35. **This review identifies those areas in which compliance is generally weak, and in which the Fund and the Bank may be called upon to provide technical assistance in the future.** These are consolidated supervision, supervisory identification of risks in general and the supervision of market, liquidity, and operational risks in particular; as well as the implementation of Basel II. In addition, as reviews of the preconditions to the BCP suggest, strengthening operational independence and frameworks for supervisory action and instituting well-designed bank-resolution frameworks, safety nets, and crisis-management systems remain key priorities in many jurisdictions.

Table 5. MCM TA in Banking and Banking Supervision Areas

TA Topic	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07
	Field Time 1/ (In years)								
Bank Restructuring	6.5	3.1	4.6	4.3	5.4	3.7	2.9	3.4	3.3
Special Fin. Issues	0.6	0.0	0.6	0.1	0.3	1.0	3.1	3.4	6.8
Bank Supervision and Regulation	32.8	26.8	21.1	26.9	28.9	26.6	25.2	22.3	19.7
Deposit Insurance	0.0	0.3	0.1	0.0	0.2	0.1	0.1	0.0	0.1
Multi-topic TA Advisory Missions 2/	7.2	6.3	6.5	8.2	6.7	11.7	16.4	9.4	7.4

Source: International Monetary Fund, MCM.

1/ Includes HQ-based staff and field experts—short- and long-term—and all TA delivered via the Regional Technical Assistance Centers (RTACs) and covers both Fund-financed and externally- financed TA, but does not include staff time spent at HQ on TA-related activities.

2/ Some banking supervision-related TA may be captured under multi-topic missions.

36. **The Fund has been a leading provider of technical assistance in the area of banking supervision and regulation, though the resources deployed have been trending downward in recent years.** In field years, MCM TA on banking supervision has declined from 32.8 years in 1999 to 19.7 years in 2007. While, on average, compliance is weaker in low- and middle-income countries, the recent turmoil has brought out the need for

strengthening these areas in some mature economies as well. Hence, this demand will have to be reviewed in the context of current technical assistance priorities.

B. Improving Quality and Consistency of Assessments

37. **Maintaining the quality and consistency of assessments is critical to the credibility of the assessment process.** The increased complexity introduced in the assessment process by revisions of the standards and introduction of new guidance in the context of a shrinking budget envelope will add to the challenge of quality assurance. Staff is studying several proposals, that were made in this regard in the course of a recent outreach meeting (Box 4) with a group of experienced BCP assessors. Among these are (i) identifying experienced assessors and creating a group of core assessors; (ii) fostering greater exchange among assessors through a shared intranet link and periodic meetings; (iii) streamlining the review process and working with a dedicated group of off-site reviewers; and (iv) updating guidance and toolkits for assessors.

Box 4. Outreach Meetings with BCP Assessors

The IMF and World Bank have organized three outreach meetings with BCP assessors since FSAPs were introduced. The first meeting took place in 2001 in Paris, and was attended by invited assessors from banking, securities, and insurance sectors. The second meeting was held in Basel in 2004, in which BCP assessors participated together with national supervisors represented in the International Liaison Group (ILG) of BCBS. The key outcomes of the 2004 meeting were (i) it called for a revision of BCP and methodology and proposed inputs for the revision, based on assessment experience; (ii) it suggested how Basel II framework, when agreed, could be incorporated into the BCP Assessments; and (iii) it suggested that work be done to examine the issue of consistency across assessments.

The third outreach meeting was held in Washington, D.C. in January 2008. The primary focus was to share experience on the revised BCP methodology and to continue the work on improving quality and consistency. In addition, the meeting also discussed (i) the role of self-assessments; (ii) risk-based or targeted updates; and (iii) the relationship between BCP assessments and the proposed Basel II implementation assessments. The assessors concluded that moving to a risk-based assessment, where updates were conducted on selected principles reflecting a carefully constructed risk-profile, was the most efficient and effective way forward in a resource-constrained environment, though some concerns were expressed as to how such a system may work in practice. Further, coordinating Basel II implementation assessments alongside BCP assessments could lead to better allocation of resources.

38. **A regional approach to delivering technical assistance for conducting self-assessments could help streamline delivery and also improve assessment quality.** A well-conducted and objective self-assessment enables authorities to take ownership of the assessment process. It is also a key input for any external assessments, as it allows assessors to better focus their attention on identifying gaps and assessing implementation, which improves both quality and consistency of the process. The Fund has received requests for assistance in self-assessments under the new methodology, and MCM has already undertaken regional workshops in Central America to deliver this to a wider constituency.

C. Targeting Assessment Updates

39. **Going ahead, the coverage of assessments will have to be reviewed in the light of the resource constraints imposed by the shrinking budget envelope.** At the same time, there will be a renewed interest in assessing the role of supervisory frameworks in global financial stability, as evidenced by the crisis in financial markets in industrialized countries. Assessments based on the revised standard and those carried out in the context of Basel II implementation will also place increased demands on both staff and the assessors, and will have to be carefully managed. The new methodology increases the number of assessment criteria by 20 percent and sub-criteria by 60 percent, although the time and number of experts for the assessment remains the same.

40. **In the absence of increasing resources devoted to full assessments, smarter ways will have to be found to maintain assessment quality and develop techniques to monitor progress while continuing to promote greater transparency.** With FSAPs having been undertaken for over two-thirds of the membership, more missions will be in the form of FSAP updates, where more targeted assessments may be possible.¹⁰ In an update, to which fewer resources are allocated, factual updates are usually carried out instead of reassessments or substantive updates. These factual updates are not published as ROSCs nor does their format permit a systematic monitoring of progress made in compliance with the standard.

41. **To address the issues of resources, better monitoring, and enhanced transparency, staff is separately developing a proposal for a targeted approach to standards reassessments.** This contemplates ROSCs to be produced based on a reassessment of selected principles comprising a given standard. The principles to be reassessed would be selected and justified in advance of the mission—based on clearly outlined criteria—including weaknesses identified in previous assessments and key emerging risks and vulnerabilities. Moving to such a targeted approach poses several significant challenges and staff will present their proposals at a later date on how these challenges can be met in the context of the ongoing organizational restructuring.

¹⁰ Standards are not typically reassessed in the course of an update, unless requested by the authorities in view of a significant change in either the preconditions, the supervisory framework, compliance positions, or the standard itself.

Annex 1. Basel Core Principles (1997 version)

Topic	CP # and Subject	Core Principle
Preconditions for Effective Banking Supervision	SP11 Objectives & Responsibilities	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banking organizations.
	SP12 Independence & Resources	Each such agency should possess operational independence and adequate resources
	SP13 Legal Framework for Authorizing & Supervising	A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking organizations and their ongoing supervision.
	SP14 Legal Framework for Compliance and Soundness	A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns
	SP15 Legal Protection	A suitable legal framework for banking supervision is also necessary, including and legal protection for supervisors
	SP16 Information Exchange	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Licensing and Structure	CP2 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.
	CP3 Licensing Criteria	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 organization'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 organization is a foreign bank, the prior consent of its home country supervisor should be obtained.
	CP4 Significant Ownership	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.
	CP5 Major Acquisitions	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.
Prudential Regulations and Requirements	CP6 Capital Adequacy	Banking supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks. Such requirements should reflect the risks that the banks undertake, and must define the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the Basle Capital Accord and its amendments.
	CP7 Credit Policies	An essential part of any supervisory system is the 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.
	CP8 Loan Evaluation and Loss Provisioning	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 loan loss reserves.
	CP9 Large Exposure	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.
	CP10 Connected Lending	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.
	CP11 Country Risk	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.

Topic	CP # and Subject	Core Principle
	CP12 Market Risk	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.
	CP13 Other Risks	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.
	CP14 Internal Controls/Audit	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.
	CP15 Abuse of Financial Services	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.
Methods of Ongoing Banking Supervision	CP16 On and Off Site Supervision	An effective banking supervisory system should consist of some form of both on-site and off-site supervision.
	CP17 Bank Management Contact	Banking supervisors must have regular contact with bank management and thorough understanding of the institution's operations.
	CP18 Information Requirements	Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.
	CP19 Validation of Supervisory Information	Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.
	CP20 Consolidated Supervision	An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.
Information Requirements	CP21 Accounting Standards	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 reflect its condition.
Formal Powers of Supervisors	CP22 Formal Powers of Supervisors	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.
Cross-border Banking	CP23 Global Consolidated Supervision	Banking supervisors must practice global consolidated supervision over their internationally-active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.
	CP24 Contact & Information Exchange	A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.
	CP25 Supervision over Foreign Banks	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.

**Annex 2. Compliance with Basel Core Principles by Region 1/
(Percent of assessed countries)**

	Global			Africa			Asia & Pacific			E. Europe			W. Europe			Middle East			Western Hem		
Core Principle	C	NC	NA	C	NC	NA	C	NC	NA	C	NC	NA	C	NC	NA	C	NC	NA	C	NC	NA
SP11 Objectives & Responsibilities	82	9	9	89	5	5	89	11	-	95	-	5	83	-	17	74	16	11	71	19	10
SP12 Independence & Resources	64	36	-	42	58	-	63	37	-	63	37	-	90	10	-	79	21	-	45	52	-
SP13 Legal Framework for Authorizing & Supervising	89	11	-	95	5	-	89	11	-	95	5	-	100	-	-	95	5	-	65	32	-
SP14 Legal Framework for Compliance and Soundness	81	18	1	79	16	5	79	21	-	79	21	-	93	7	-	89	11	-	68	29	-
SP15 Legal Protection	70	30	-	74	26	-	79	21	-	53	47	-	93	7	-	58	42	-	55	42	-
SP16 Information Exchange	71	29	-	42	58	-	63	37	-	84	16	-	97	3	-	63	37	-	65	32	-
CP2 Permissible Activities	96	4	-	89	11	-	100	-	-	95	5	-	100	-	-	95	5	-	94	3	-
CP3 Licensing Criteria	82	18	-	74	26	-	74	26	-	89	11	-	100	-	-	74	26	-	74	23	-
CP4 Significant Ownership	81		-	74	26	-	79	21	-	84	16	-	100	-	-	58	42	-	77	19	-
CP5 Major Acquisitions	73	27	-	74	26	-	74	26	-	74	26	-	90	10	-	84	16	-	48	48	-
CP6 Capital Adequacy	67	33	-	58	42	-	63	37	-	74	26	-	97	3	-	74	26	-	35	61	-
CP7 Credit Policies	71	29	-	63	37	-	53	47	-	79	21	-	93	7	-	79	21	-	55	42	-
CP8 Loan Evaluation and Loss Provisioning	73	27	-	74	26	-	63	37	-	79	21	-	90	10	-	79	21	-	52	45	-
CP9 Large Exposure	74	26	-	68	32	-	63	37	-	79	21	-	100	-	-	79	21	-	52	45	-
CP10 Connected Lending	66	34	-	53	47	-	63	37	-	68	32	-	93	7	-	58	42	-	52	45	-
CP11 Country Risk	47	46	7	5	68	26	32	53	16	42	58	-	90	10	-	47	47	5	42	52	6
CP12 Market Risk	47	49	4	21	79	-	47	37	16	42	58	-	93	7	-	32	58	11	32	65	-
CP13 Other Risks	55	45	-	26	74	-	47	53	-	63	37	-	97	3	-	42	58	-	39	58	-
CP14 Internal Controls/Audit	69	31	-	53	47	-	63	37	-	89	11	-	100	-	-	63	37	-	42	55	-
CP15 Abuse of Financial Services	54	43	3	21	79	-	37	63	-	58	37	5	97	3	-	42	47	11	48	45	6
CP16 On and Off Site Supervision	76	24	-	79	21	-	47	53	-	89	11	-	90	10	-	89	11	-	61	35	-
CP17 Bank Management Contact	81		-	84	16	-	68	32	-	84	16	-	100	-	-	84	16	-	65	32	-
CP18 Information Requirements	76	24	-	68	32	-	68	32	-	79	21	-	100	-	-	84	16	-	52	45	-
CP19 Validation of Supervisory Information	81		-	79	21	-	68	32	-	84	16	-	100	-	-	95	5	-	58	39	-
CP20 Consolidated Supervision	43	44	13	11	53	37	42	37	21	26	63	11	97	-	3	37	58	5	26	61	13
CP21 Accounting Standards	75	25	-	58	42	-	68	32	-	68	32	-	100	-	-	79	21	-	65	32	-
CP22 Formal Powers of Supervisors	67	33	-	32	68	-	79	21	-	84	16	-	86	14	-	63	37	-	55	42	-
CP23 Global Consolidated Supervision	50	22	28	21	16	63	42	32	26	42	37	21	86	3	10	58	21	21	35	29	35
CP24 Contact & Information Exchange	62	17	21	26	16	58	53	32	16	74	11	16	93	3	3	68	21	11	48	23	29
CP25 Supervision over Foreign Banks	77		3	53	42	5	89	11	-	74	26	-	97	3	-	79	16	5	65	26	10

1/ C = Compliant/Largely Compliant; NC = Materially or Noncompliant; NA = Not Applicable.

**Annex 3. Compliance with Basel Core Principles by Income Level 1/
(Percent of assessed countries)**

Core Principles	Global			Low			Low Middle			Upper Middle			High Income		
	C	NC	NA	C	NC	NC	C	NC	NA	C	NC	NA	C	NC	NA
SP11 Objectives & Responsibilities	82	9	9	92	4	4	68	19	14	83	14	3	89	-	11
SP12 Independence & Resources	64	36	-	50	50	-	54	46	-	48	52	-	91	9	-
SP13 Legal Framework for Authorizing & Supervising	89	11	-	92	8	-	81	19	-	79	21	-	100	-	-
SP14 Legal Framework for Compliance and Soundness	81	18	1	75	25	-	70	27	3	76	24	-	98	2	-
SP15 Legal Protection	70	30	-	54	46	-	57	43	-	66	34	-	91	9	-
SP16 Information Exchange	71	29	-	37	63	-	76	24	-	69	31	-	87	13	-
CP2 Permissible Activities	96	4	-	92	8	-	100	-	-	93	7	-	98	2	-
CP3 Licensing Criteria	82	18	-	58	42	-	73	27	-	90	10	-	98	2	-
CP4 Significant Ownership	81	19	-	63	37	-	70	30	-	90	10	-	93	7	-
CP5 Major Acquisitions	73	27	-	75	25	-	68	32	-	59	41	-	87	13	-
CP6 Capital Adequacy	67	33	-	50	50	-	59	41	-	52	48	-	91	9	-
CP7 Credit Policies	71	29	-	63	37	-	57	43	-	66	34	-	91	9	-
CP8 Loan Evaluation and Loss Provisioning	73	27	-	75	25	-	54	46	-	69	31	-	89	11	-
CP9 Large Exposure	74	26	-	63	37	-	59	41	-	72	28	-	93	7	-
CP10 Connected Lending	66	34	-	46	54	-	54	46	-	62	38	-	89	11	-
CP11 Country Risk	47	46	7	4	79	17	30	56	14	38	59	3	89	11	-
CP12 Market Risk	47	49	4	21	79	-	30	59	11	38	59	3	82	18	-
CP13 Other Risks	55	45	-	25	75	-	35	65	-	52	48	-	89	11	-
CP14 Internal Controls/Audit	69	31	-	46	54	-	49	51	-	76	24	-	93	7	-
CP15 Abuse of Financial Services	54	43	3	13	75	13	32	68	-	66	31	3	87	13	-
CP16 On and Off Site Supervision	76	24	-	79	21	-	68	32	-	69	31	-	87	13	-
CP17 Bank Management Contact	81	19	-	75	25	-	68	32	-	83	17	-	96	4	-
CP18 Information Requirements	76	24	-	63	38	-	62	38	-	79	21	-	91	9	-
CP19 Validation of Supervisory Information	81	19	-	79	21	-	68	32	-	72	28	-	98	2	-
CP20 Consolidated Supervision	43	44	13	4	67	29	19	73	8	34	45	21	89	7	4
CP21 Accounting Standards	75	25	-	54	56	-	62	38	-	72	28	-	98	2	-
CP22 Formal Powers or Supervisors	67	33	-	33	67	-	59	41	-	69	31	-	91	9	-
CP23 Global Consolidated Supervision	50	22	28	21	25	54	30	41	30	45	28	28	84	2	13
CP24 Contact & Information Exchange	62	17	21	42	21	38	49	27	24	52	21	28	91	4	4
CP25 Supervision over Foreign Banks	77	20	3	67	33	-	68	27	5	72	24	3	93	4	2

1/ C = Compliant/Largely Compliant; NC = Materially or Noncompliant; NA = Not Applicable.