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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/48

10:00 a.m., May 5, 2000

Contents

Executive Board Attendance

E. Aninat, Acting Chairman

Executive Directors	**Alternate Executive Directors**
	A.S. Alosaimi
	D. Ondo Mañe
	Y. Moussa, Temporary
	P.R. Fenton, Temporary
	H. Oyarzábal
	F. Zurbrügg, Temporary
	W.-D. Donecker
A.M. Jul	A.G. Zoccali
	G. Schlitzer, Temporary
K.-T. Hetrakul	C. Harinowo
	A.G. Karunasena
	C. Josz, Temporary
	Å. Törnqvist
	JAM. Abbott, Temporary
	B. Couillault, Temporary
	M. Daïri
	P.A. Akatu, Temporary
	S. Vtyurina, Temporary
	S. Collins
	R. Junguito
	A.F. Al-Faris
G.F. Taylor	
Wei Benhua	
	E. Azoulay, Temporary
	H. Toyama

A.S. Linde, Acting Secretary
M. Schulte, Assistant

Experience with Basel Core Principle Assessments
Staff representatives: Lindgren, MAE; Marston, MAE; Evans, MAE

Also Present
IBRD: G. Ferencz, A. Laurin, Financial Sector Development Department. External Relations Department: M.B. Chatah. Legal Department: R.C. Baban. Middle Eastern Department: P. Chabrier, Director. Monetary and Exchange Affairs Department: S. Das, H. Evans, P.C. Hayward, R.B. Johnston, A.M. Leone, C.-J. Lindgren, D.D. Marston, H. Mehran, J.-W. van der Vossen, L.S. Zacho. Policy Development and Review Department: J. Hicklin, Y.A. Metzgen, M.L. Parkinson, J.E. Ramirez. Secretary's Department: B.A. Sarr. Western Hemisphere Department: R.K. Rennhack, M.R. Zermeno. Office of the Managing Director: A. Bauer. Office of Budget and Planning: E.-A. Conrad, Director; N. Sachdev. Advisors to Executive Directors: O. Himani, N. Jadhav, B. Konan, M.F. Melhem, W. Merz, J.L. Pascual, I.M. Woolford. Assistants to Executive Directors: S. Bonomo, I.- K. Cho, I.C. Ioannou, A. Maciá, M. Yépez.

1. EXPERIENCE WITH BASEL CORE PRINCIPLE ASSESSMENTS

The Executive Directors considered a staff paper on the experience with Basel Core Principle Assessments (SM/00/77, 4/12/00; and Cor. 1, 4/28/00).

Mr. Shaalan and Mr. Himani submitted the following statement:

We welcome today's discussion, and consider areas involving the soundness of the financial system to be an important element of the Fund's work. While it is true, as staff points out, that experience with Basel Core Principle Assessments (CPAs) has been limited, the staff has nevertheless done an excellent job at distilling key issues, and raising important operational matters, to enable us to progress further in this area.

There can be little doubt that the CPAs have proved useful to countries in helping identify weaknesses in banking supervision. It is important to recall, however, that the Basel Core Principles are essentially the outcome of a negotiated compromise reflecting in large part the challenges and priorities of economies with well developed financial systems. Thus, these principles, while being high and demanding standards, are not necessarily the optimal standards. This difference is crucial when considering the degree to which remedial action is needed in economies with less developed financial markets.

Weaknesses in compliance with the standards, where material, are a source of concern for all countries. For countries that have access to international capital markets, or whose banking system is relatively open to international competition, the standards take on added importance. In these instances, we share the view that the Fund could play a useful role in promoting needed reforms, including in particular through the provision of focussed Technical Assistance. In this regard, however, we think it is important for the Board to reflect further on the level of available resources for Technical Assistance. The Fund is getting involved in an increasing number of highly specialized areas where demands for Technical Assistance may be considerably higher than we have budgeted for. We find this disturbing. If we were to ensure the success of our initiatives, we would most likely need to significantly increase the resources available for this purpose. We would certainly not find it an acceptable solution to reduce resources available for assistance in the traditional core areas of Fund activities as a result of an expansion of initiatives.

Assessments of compliance with the Basel Principles are clearly important for all members, but the case of restricting such assessments to the FSAP exercise, rather than through Article IV Consultations, is compelling for a number of reasons. First, this is an area where full-fledged annual discussions are not necessarily needed. Second, the Staff's interlocutors on such issues would generally differ from the monetary and fiscal authorities involved in much of the work of the Article IV consultation. Third, we may well be expanding the focus of Article IV consultations in a way that may detract from having sufficient focus on key nearer-term policy issues.

The CPAs touch on a number of sensitive areas. Thus we have serious reservations on the notion of publication of such assessments. The Basel Committee is right in pointing out that corrective measures to address any weaknesses found through the assessments will take time. The role of the Fund should be centered entirely on way to help countries implement necessary corrective measures in a timely manner, rather than simply attempt to increase pressure on countries by publishing assessments before the relevant authorities have had an adequate opportunity to address the problems. We attached considerable importance to this point. Any perception that these will be published will be counterproductive, and will not help the Fund or the members attain the desired objectives.

Against this background, we are somewhat perplexed by the sentence in paragraph 62 of the paper that "while publication would provide market participants with information which they otherwise could not obtain...any presumption toward publication at this stage could discourage countries in undertaking the assessments." What does "at this stage" mean in this context? Staff comments would be appreciated.

Finally, we see no need to set up a set up additional incentives for countries to participate in CPAs. These incentives are already there in the context of the Financial System Assessment Program. More importantly, we should proceed from the assumption that the authorities in every country would want to ensure that their financial system is more robust. The demonstration effect stemming from the successful completion of CPAs is sufficient.

Mr. Toyama submitted the following statement:

Overview

Banking supervision must be conducted in a rigorous way in the face of the changing condition of the banking system, although in reality it tends to be rather loose. Authorities' responses to banking crises in many countries over the past dozen years have again spotlighted this inherent problem in banking supervision. They have a tendency to expect that any change will be temporary and thus will avoid bank failure, which may have a substantial impact on their country's economy. However, such forbearance policy would eventually cost taxpayers dearly, as well as adversely affect the national economy over a prolonged period.

Accordingly, what is most important for maintaining the soundness of the banking system is to detect a problem early on and fix it quickly before it becomes serious. I hope CPAs will contribute to the featured improved banking supervision with rigorous and quick responses to a detected problem in as many countries as possible.

However, the banking industry is evolving rapidly. The development of information and communication technology has brought about new facets to the industry, including intra- and cross-industry consolidation and provision of new financial services through internet-banking. Deregulation in financial services has reduced barriers among the banking, securities, and insurance industries, which makes CPAs in the areas of securities and insurance essential. Considering the fact that the Core Principles methodology has encouraged wide use of CPs, it would be useful for IOSCO and IAIS to create a methodology in these fields in conjunction with the Fund and the Bank. Such methodologies will contribute to promotion of use of their respective standards.

The framework of CPAs should be continuously reviewed in line with the evolution of the banking industry. In this regard, this chair basically appreciates staff's recommendation to BCPLG shown in Appendix II, but will make some comments.

Regarding an exit process in CP22, we should be mindful that bankruptcy regimes are different among countries and that the banking regulatory and supervisory agencies usually do not have jurisdiction over bankruptcy laws. The study of more explicit principles at the Basle Committee should not reach too far. In addition, rigid operation of the exit process without a proper safety net, including deposit insurance in the midst of a currency crisis, might invite adverse impacts, such as a credit crunch, on the macroeconomic condition.

With respect to arrangements between home and host country supervisors, formality is not necessary to assure the actual exchange of information between supervisors. Therefore, this chair thinks the existing expression is sufficiently appropriate.

It is not appropriate to include appendices on state-owned banks and deposit protection systems in the CPs. They are not necessarily governed by the banking supervision agencies. In particular, it is not appropriate to deal with state-owned banks in the same manner as with private banks. In this regard, this chair would like to point out that the forthcoming report of the Financial Stability Forum's study group on deposit insurance should not be taken as providing "the minimum norm." The study group is supposed to study flexible guidelines rather than the minimum norm.

Specific Issues

Effectiveness of CPAs:

It seems apparent that CPAs can identify any weakness in banking supervision and hence help countries strengthen their financial infrastructure. While self-assessments are still important in terms of country ownership, objective assessments by a third party can avoid less stringent results.

Reforms of Banking Supervision through TA:

It is appropriate to promote reforms of banking supervision through TA targeted at those areas. It is easy to imagine that for developing countries, TA is essential to implement the prescriptions obtained by CPAs. Since CPAs are one of the first priority areas within the Fund used to stabilize the global currency system, this chair believes TA for improved banking supervision is highly recommendable.

Relationships with FSAP/FSSA:

This chair shares the view that CPAs are best undertaken as an integral part of the FSAP/FSSA initiative. This would enable assessments of banking supervision in light of the findings from assessments of the relevant areas such as accounting standards. Such a practice would contribute to more efficient use of Fund resources. Also, this chair would like to point out the effectiveness of CPAs on a stand-alone basis conducted at the time of TA on banking supervision.

Self-assessments/Outsourcing:

Self-assessments are important to ensure country ownership for addressing detected problems. However, they cannot substitute for assessments by external experts who are well aware of situations of other countries. On the other hand, this chair can support assessments by external parties such as large accounting firms, on the conditions that such parties have enough expertise and capability to grasp the current situation of, and detect weakness in, country systems of banking regulation/supervision, that their assessment team contains at least one expert in banking supervision, that confidential information shall remain such, and that there are no conflicts of interest vis-à-vis the assessed country. The Core Principle Methodology refers to consultants in the private sector as one of assessors, along with the Fund, the Bank, and regional development banks. Assessments by foreign supervisors could also be effective. Outsourcing where possible is important for savings resources and the Fund budget.

Publication of CPAs:

Since CPAs check the area of banking supervision, detection of vulnerability in their process would have systemic implication, as in the case of the FSAP/FSSA initiative. However, the purpose of CPAs is not to publicize detected weakness, but to encourage the authorities to make efforts for reforms and thereby make corrections. Hence, this chair can support the BCBS view that countries be given the opportunity to implement reforms before assessments are publicized, and that any decision to publish CPAs in full or summary form should be a national prerogative.

More Participation in CPAs:

The apparent incentive for participating in CPAs should be provided by the very purpose of CPAs that assessments by a third party detect weakness in banking supervision of a country and provide its authorities with a prescription for rectifying that. While it is conceivable to devise additional incentives, such as conditioning use of some facilities or expanded availability of some facilities by achievement of more than a certain level of results from the assessments, this chair is suspicious about the logic of tying CPAs to the use of facilities, since CPAs deal with only that portion of the whole picture where vulnerability of the financial sector can originate. Moreover, if CPAs are basically conducted as an integral part of FSAP, it is all the more important to provide incentives for participating in FSAP rather than solely in CPAs.

Mr. Kelkar and Mr. Karunasena submitted the following statement:

At the outset, we would like to commend the Staff for a precise paper, which not only reviews the experience with Basel Core Principle Assessments (CPAs) initiated in early 1998 but also raises important issues while giving useful suggestions for making further progress and how to incorporate the initiative with the other activities and programs in the Fund. The present review summarizes a number of interesting general findings.

Important role of pre-condition (such as accounting and auditing systems and legal and institutional frameworks) in effective implementation and enforcement of Core Principles (CPs).

Necessity of due attention to strengthen the implementation and enforcement of existing laws and regulations in addition to the improvement in the Core Principles.

Usefulness of co-ordination in financial sector strengthening activities, not only among various international institutions but also among different programs/initiatives within the Fund.

Necessity of due attention for country-specific situations in evaluation of the financial sector compliance and soundness and making recommendations.

Necessity of prioritizing and sequencing of required measures for strengthening the financial sector compliance.

Crucial role Technical Assistance (TA) could play in the improvement and implementation of CPs and addressing weaknesses in required pre-conditions.

It is encouraging that developments in Core Principles and assessment of their implementation have been well received by the international community as well as a number of involving country authorities in the CPA program. CPAs have also provided useful information for strengthening surveillance activities of the Fund and prioritizing of its TA activities. However, much remains to be done to strengthen the financial system in a number of countries through improvements in the implementation and enforcement of PCs as well as improving necessary pre-conditions.

In this context, we underscore the necessity of proper coordination among institutions as well as among different programs/initiatives within the IMF in order to improve the efficiency and minimize potential duplication. Accordingly, we welcome the Staff suggestions to undertake future CPAs as a part of the Financial Sector Assessment Program (FSAP) and the Financial Sector Stability Analysis (FSSA). As financial sector issues are comprehensive and interrelated, a broad approach with deep analysis under FSAP/FSSA is more useful than the stand-alone CPAs to identify the weaknesses in the financial system more accurately and to make necessary recommendations more prudently. However, the preparation of FSAP/FSSA reports requires more resources and time. Hence, it is essential to consider some alternatives to cover more member countries without sacrificing the quality in evaluation of Core Principles.

One alternative approach is to encourage undertaking self-assessments on a voluntary basis, according to a standardized format provided by the Basel Committee on Banking Supervision (BCBS) to cover a large number of countries within a short time period. In 1998 alone there were 124 countries, which made self-assessments, compared with 26 CPAs completed by the Fund and the Bank for the two-year period since February 1998. Similarly, a regular evaluation system of CPs covering a large number of countries on a continuous basis has to be developed as the financial products and Core Principles/Regulations as well as their implementation are changing rapidly. Such a regular assessment system could be more practicable to develop on a more sustainable basis under a self-assessment system rather than under specific programs undertaken by international or regional organizations.

As revealed by the comparison given in the present report, self-assessment approach has tended to be much more optimistic about compliance within the CPAs made by the Fund and the Bank. However, it is encouraging that self-assessments made with the help of new methodology specified by the BCBS provided more consistent evaluations. Therefore, we are of the view that it is necessary to give due attention to improve and strengthen the balanced and comparable self-assessment system. We welcome the BCBS's approach to encourage self-assessment on CPs based on the new methodology. We believe that the self-assessment system could play an increasingly important role in future assessment and implementation of Core Principles, if necessary TA and incentives are provided adequately and timely. Staff comments are welcome.

It is also interesting to hear Staff views on the CPAs experience under the 3 different categories mentioned in para 4, i.e. Fund alone, Bank alone and Joint CPAs, as it will be useful for the consideration of division of responsibilities in financial sector strengthening activities between the two institutions.

We are of the view that the Fund could and should play an important role in the strengthening of financial systems in member countries. In this context, the CPA process is only one of the instruments available to the Fund. The following two points are important in deciding the role of the Fund in CPAs.

Implementation and enforcement of the CPs should be the primary responsibility of the national supervisory authorities. We agree with the BCBS's views that IMF could use the Principles in assisting individual countries to strengthen their supervisory arrangements in connection with the work aimed at promoting overall macroeconomic and financial stability.

The primary objective of the CPAs has to be providing necessary assistance for the implementation of CPs rather than judging or rating the adequacy of supervisory systems in member countries.

We have serious reservations on the notion of publication of CPAs as they contain sensitive and institution-wise information. Also, CPAs have been done without any presumption of publication and hence any disclosure could create difficulties for the implementation of corrective measures and necessary reforms. Furthermore, as indicated in the Report, presumption of publication of CPAs could affect the frankness of the countries' discussions on financial sector supervisory weaknesses.

Finally, we believe that the strengthening of financial system, including the improvement in compliance of CPs on a voluntary basis, in any country, has to be a part of the overall economic reform program, as the successful implementation of CPs needs institutional infrastructure and effective enforcement systems.

Mr. Mozhin and Ms. Vtyurina submitted the following statement:

We thank the staff for a useful overview of the integration of the Core Principle Assessments (CPAs) into the overall Fund work on strengthening countries' financial infrastructure. Experience, although limited but very useful, gained from a number of CPAs should further help improve supervisory, prudential and legal systems of member-countries. We would like to limit our comments to the issues for discussion suggested by the staff.

Overall, CPAs have proven to be a useful tool in assisting countries experiencing weaknesses in their banking supervision as well as in identifying flaws that have not been so apparent. We share the staff findings and recommendations presented to the Basle Core Principles Liaison Committee about the improvements that need to be made within the overall framework of CP, such as addressing the limitations in coverage of relevant aspects of the banking system within the CPs and shortcomings in the clarification of assessment criteria under the existing methodology for conducting assessments. However, we are also of the opinion that the criteria for these assessments can never be comprehensive enough. Thus, the assessments should leave room for assessor' judgement and take into account specific domestic circumstances and the voluntary nature of international supervisory and regulatory minimum standards and best practices.

The completed CPAs have revealed that compliance with the majority of individual CPs is far from being satisfactory. This is not surprising since many countries have only recently started to assess their supervisory capacities together with the compliance to the BCP standards. In a variety of countries weaknesses emerged not only because of the flaws in the financial systems, but also because of underlying institutional underdevelopment of legislative and regulatory systems. Work is still in progress and much remains to be done; and the Fund and the countries' authorities should continue their cooperation in improving compliance. In this vein, we agree that the Fund should provide more technical assistance in this area. However, since TA is limited due to resource constraints, it is also important that countries conduct self-assessments to determine the state of compliance and develop their own mechanisms to improve it. In addition, assessments based on agreed methodology by external parties, such as large accounting firms or qualified private experts, are very useful. By conducting these, countries will not only help themselves identify weaknesses but also lay groundwork for the Fund's CPAs.

Continuing with the issue of resource constraint, we see it appropriate to conduct CPAs only in the context of Financial Sector Assessment Programs. Indeed, these CPAs will benefit from a broader perspective of the FSAP while providing assurance that their findings are properly interpreted to take into account the broader institutional and macroeconomic context. However, even when the CPAs are conducted within the FSAP, the shortage of manpower and time creates significant problems in conducting in-depth and comprehensive analyses. In this regard, the Fund needs to exercise greater flexibility when determining the amount of resources to be allocated to specific assessments. As we stated at the FSAP discussion, we believe that more resources and time should be devoted to systemically important countries and to those countries where the financial sector is particularly vulnerable. At the same time, however, we should not forget that in some of those countries compliance with the standards may be very limited due to their weak institutional capacities. Therefore, after all, the bulk of the TA should be targeted towards helping to build these capacities.

As to the issue of a wider disclosure, we believe that the current procedure of incorporating summaries of the CPAs into the FSSAs and ROSCs provides adequate disclosure. As we recall, the Board will return to this topic at our next discussion on publication of the FSSAs and ROSCs. With regard to publishing stand-alone CPAs in full or summary form, it should be left to a country to make this decision. We also do not see a problem in allowing the countries to share the information from CPAs with a limited group of relevant recipients.

As to the last point on providing incentives for countries to participate in CPAs, we are curious as to what the staff have in mind. Obviously, gains from a more robust financial system should be a sufficient enough incentive. However, we are open to other suggestions.

Mrs. Jul and Mr. Zoccali submitted the following statement:

We welcome this opportunity to take stock of the experience with the Basel Core Principles Assessments completed by the Fund and the Bank in 26 countries. This form of feedback to the Basle Committee on Banking Supervision (BCBS) and its Core Principles Liaison Group is deemed very useful. A broader focus for the paper, by incorporating also a description of the status of the proposed modification to the 1988 Capital Accord, which has become the international standard for bank soundness in over 100 countries, would however have been helpful. Universal membership places the Fund in an unique position to disseminate such information widely, effectively broadening the outreach of the specialized groups or fora responsible for advancing the standards for strengthening the soundness of banking systems. By facilitating awareness and identification of concerns before final recommendations are decided, the Fund would be contributing to the general effort to improve the effectiveness of banking supervision. These issues, would seem to be of relevance going forward as staff proposes to convey certain recommendations made in Appendix II of SM/00/77, affecting the methodology and scope of application of CPAs, for example regarding the treatment of risks in CP7 and other CPs, to the Basel Core Principles Liaison Group. We will briefly return to the proposed modifications to the 1988 Capital Accord at the end.

In approaching the role of the Fund in the CPA process, the staff paper exposes the shortcomings of country self-assessments and generalizes in paragraph 34 that they "can rarely be used as a substitute for independent assessments made by the Fund and the Bank". Their benefits, in our view, go beyond improving countries' understandings of CPs and as a tool for facilitating Fund/Bank assessments, by helping to focus discussions on pertinent laws, practices and documentation. We consider self-assessments to be a most useful indicator of the degree of ownership behind countries' efforts to improve their frameworks for prudential and regulatory oversight. Consequently, while agreeing that CPAs can contribute significantly to identifying weakness in banking supervision, the Fund and the Bank should be more proactive in encouraging all countries to do self-assessments, by facilitating agreement and application of consistent methodologies aimed at increasing the reliability of own measures of compliance with CPs. The experience of Western Hemisphere countries with CPAs conducted by a group of preeminent international experts also suggests that there are positive externalities to be gained from working-in other types of independent assessment modalities, based on the agreed methodology, into the overall effort to help countries improve their financial infrastructures. We consider, however, that the greatest value-added from external assessments can be expected from the hands-on involvement of current and former supervisory and regulatory authorities rather than large international accounting firms.

The identification of serious weaknesses in supervision and helping to set priorities are, in our view, strong but insufficient reasons for undertaking CPAs. These exercises must serve both to support reforms in member countries and to level the financial playing field more generally. The information presented in the paper regarding the areas of weak compliance with CPs suggests that technical assistance (TA) needs could be significant. In light of the initial experience with CPAs, staff should provide a realistic estimate of whether additional resource requirements that might be needed to advance the CPA process and make more explicit the trade-offs involved. In any event, we consider it essential that the Fund focus on the provision of the necessary assistance to help countries implement the institutional and other necessary preconditions for more effective supervision and improved observance of CPs. Similarly, it must be able to ensure that future CPAs will be relevant to the state of development of a country's financial market and infrastructure. This is particularly noteworthy in view of the statement on page 10 that "most participants saw the objective of the CPAs as aiding the process of implementation rather than judging the adequacy of supervisory systems". Moreover, the paper adds in this respect that "publication of the results could delay the implementation process."

Regarding the recommendations of CPAs, we agree that priority should specially be given to reforms relating to those CPs which are the most pressing from a macroeconomic and macroprudential perspective, as well as to areas which the authorities view as having potentially significant benefits. Easiness of implementation is not necessarily the best guide, as in many cases substantial revamping of orientation, organization and systems may be called for. What is important is that the capacity of national authorities to bring about change be realistically assessed and supported. In this context, we see a need for flexibility when deciding on the extent of resources to allocate to specific assessments and strongly support stand-alone CPAs, outside the FSAP and FSSA process when the authorities are intent on going forward and particularly during this stage in which the pilot is still ongoing.

The principal aim of CPAs should be to establish objective parameters that allow for consistent and uniform assessments of the framework for banking supervision, to facilitate country and regional comparisons, and identify both weaknesses and progress in addressing them. In this regard, while disclosure of CPAs would be desirable, we concur fully with the view in the supervisory community and the Basel Committee that countries be given needed time, and support, to introduce the recommended reforms and corrective measures before being subjected to assessments that are publicized. We could support the release of summary CPAs when requested by national authorities provided that appropriate safeguards are built-in to ensure that national bank confidentiality laws are respected, particularly regarding sensitive information on individual institutions. We also see strong merit in fostering good relations with supervisors, particularly in countries where the assessed country's banks have foreign branches or affiliates or to regional supervisory organizations. Could staff provide some information regarding the type and extent of existing bilateral information sharing agreements among banking supervisors?

On the issue of incentives for countries to participate in CPAs, it is clear that more robust financial systems are a critical linchpin for macroeconomic stability and sustainable growth. Verification of compliance with CPs entails the risk that CPAs are perceived as a vehicle instrument to expose shortcomings and bring peer and market pressure to bear on the authorities. This is why we consider it essential that they be implemented as part of an integral strategy of the authorities to improve their national regulatory and supervisory capabilities. Credibility, in turn, calls not for specific incentives but for a realistic time frame and with adequate technical support, to take on board not only the relevant aspects of the banking system but also its interlinkages with the broader domestic financial sector.

Finally, we welcome the Basle Committee's preliminary proposals to reinforce bank safety and soundness. The three-pillars approach contained in the Consultative Paper aimed at integrating the traditional minimum capital standards framework with increased emphasis on the supervisory review of capital adequacy and the role of market disciple constitutes an important advance. In this regard, however, a few proposed refinements have the potential to alter the cost of capital and significantly affect financial sector development and growth in emerging market economies. For lack of a better occasion, it is deemed appropriate at least to point now those which, in our view, pose particular concerns: i) the schedule of risk-weights to be applied to claims on sovereigns, is inconveniently steep and asymmetric; ii) the reliance on ratings from private external rating agencies as the basis for determining sovereign risk-weights, as opposed to development of internal rating schemes based on agreed standards and cross-controls; iii) the rule for risk-weighting short-term claims on banks, which disregards "conservative" domestic prudential regulatory policies, i.e. on liquidity, that in some cases may be already be significant; and iv) the risk-weights for corporate debtors, which may provide a perverse incentive to remain unrated when the prospect facing such debtors is obtaining an unfavorable external rating. It is to be hoped that these issues, together with the capital treatment to be given to bank investments in the securities and insurance sectors, will be reviewed by all relevant specialized groups to ensure wide agreement and positive results from their eventual implementation.

Ms. Lissakers and Mr. Abbott submitted the following statement:

It is very useful to have this review of experience with Core Principles Assessments. The paper looks for guidance on a number of procedural and policy points. Before addressing those points, I would like to make a few general observations.

This review demonstrates that the international community was definitely on to something important when, in the late 1990s, it began to focus on the importance of raising the standards and quality of financial supervision. Of course, we always knew that financial fragility and weak regulation posed national and even international systemic risks. But it is only very recently—beginning in 1997 with the Basel Core Principles—that we have developed systematic, internationally-accepted supervisory and regulatory standards that all countries could aspire to and that all could be held accountable for. Subsequently, a major international effort went into explaining the standards and gaining acceptance of the standards. Now, with this staff paper, we have an opportunity to make some informed, albeit still very preliminary, judgements about how well member countries are doing in achieving the banking supervision standards identified in the Basel Core Principles.

The Core Principles, and Basel Committee guidance more generally, are very good examples of how a codes and standards approach can be highly effective in promulgating sound practices and best practices. Recall that the pioneering work of the Basel Committee in establishing minimum standards for capital adequacy was originally formulated as a standard for internationally active banks in BIS countries. Very quickly, however, those capital standards spread beyond the limited BIS universe as countries or even individual banks around the world sought to associate themselves with recognized sound practices. In a similar way, the Core Principles have quickly come to be acknowledged as the standard most supervisors wish to be associated with. This propagation of high standards has taken place without imposition or intrusion.

The staff paper confirms that an enormous amount of work will need to be done to mitigate the economic risks posed by weak financial regulation. The survey findings show that half of the 26 countries reviewed were either materially non-compliant or noncompliant with half of the 25 Basel Core Principles. We can —and I am sure we will—spend a lot of time debating whether these survey results faithfully reflect the true state of banking supervision among member countries. I have no doubt we will learn more as we gain more experience. But these preliminary results are stark. They point to serious lapses in supervision and, consequently, continued vulnerability to seriously damaging economic disruption in many member countries. Certainly the findings confirm that the Fund must energetically press on with the work it has launched in the area of financial sector assessments and in providing encouragement and assistance to member countries working to upgrade their standards of financial regulation. In this regard, it is somewhat anomalous that the Core Principle with the least compliance—that relating to money laundering—is not highlighted for concentrated attention in the staff paper.

Institutional complexity is an unavoidable feature of the work that has evolved on strengthening financial systems. Just in the area of Core Principles assessments, continuous coordination is required among the Fund, the Bank, the Basel Committee, national experts and the countries being reviewed. This can be frustrating but it is being done and, in some cases, done very well. We can point to the development of the Core Principles Methodology Paper as an excellent example of institutional collaboration. Also, there has been a rapid convergence toward a common view of how core principles assessments ought to be conducted.

Problem identification is the first step toward corrective action. We believe that external assessments are an essential component of the whole effort to upgrade standards for financial regulation. The work to date on CPAs confirms this. The gap between the results from self-assessments and third party assessments indicates that many governments are still not fully aware of the extent of reforms needed. External assessments are critical to developing a commitment to reform and to the provision of technical assistance. There is more assessment work to be done than there are resources to do it. Pragmatism should be a hallmark of our work on CPAs. We in the Fund and the other international organizations have a lot of policies and procedures to sort out but we should not let unavoidable bureaucratic requirements deflect our attention from our central objective: raising national standards of financial regulations.

Let me turn now to some of the specific issues raised in the staff paper.

What should be the context for CPAs? Ideally, we would like to see CPAs undertaken in the context of broader FSAPs and accepted by members as a routine expectation under the Fund's Article IV responsibilities. Practically, we do not now have the resources to carry out work of this scope. So, pragmatically, we believe stand-alone CPAs, developed as modules for Reports on the Observance of Standards and Codes, are quite acceptable, particularly since, for many countries, banks still dominate the financial system. Developing CPAs as ROSC modules is a path that, surprisingly, is not pursued in the staff paper.

Requests for Technical Assistance are also an opportunity to undertake CPAs. If TA is requested, it is also an indication of seriousness on the part of the authorities, and this is an important pragmatic consideration in deciding where to devote our limited resources. If CPAs are undertaken as part of a Technical Assistance mission, we believe the assessment results should be incorporated into Article IV reports so that the Board has an opportunity to be aware of developments in this important area. This would also give the Board an opportunity to support an agenda of reform. Given the risk supervisory weakness creates for financial vulnerability, CPAs should be treated as an element of Fund surveillance, even when done in context of TA. This is also an area in which more attention needs to be paid to collaboration with the World Bank

What should be the role of self-assessments? Countries should not be discouraged from undertaking self-assessments. They are useful as an educational and evaluative process and should prove even more effective when conducted pursuant to a common, internationally agreed methodology. Self-assessments are only a starting point, however, and not a substitute for more systematic, independent Fund assessments. The virtue of a Fund assessment—whether carried out as part of an Article IV, FSAP, ROSC or TA mission—is that the Fund can provide a systematic methodology and a credibility that a self-assessment may not. This can be crucial to building a constituency for high standards and for reforms. Likewise, we believe that the

Fund and Bank should be prominent participants in the projects regional organizations are organizing to encourage and review their members' progress in meeting international standards.

There should be a presumption in favor of disclosure of assessments. We understand all the arguments presented in opposition to disclosure. It is understandable that early in the process countries may prefer to obtain an outside professional evaluation to help them sort out the problems and develop a work program. This is the standard rational for keeping technical assistance discussions private. However, this can only be an argument for temporizing on disclosure, not for non-disclosure. Ultimately public disclosure is likely to help mobilize opinion in favor of reforms and can help foster stronger market discipline where supervisory weaknesses are not corrected. This should be seen as supporting the underlying objectives of technical assistance. In any case, disclosure to the Board should be given a high priority given the importance of sound regulation to financial stability. (As an aside, we note that in this paper we are told that the Fund has participated in 26 CPAs but we are provided the identities of only five of the countries reviewed.)

We have argued in many venues the need to develop incentives to implement standards and believe that disclosure is a critical incentive, particularly to ensure that market mechanisms work effectively. This is as true for banking supervision as it is for other economic and financial policy standards. Unfortunately, the benefits of implementing high quality, internationally-accepted standards are often obscured by the perceived short-term costs, so the gains—domestically as well as internationally—from ensuring a robust financial system may not always spark sufficient motivation. We look forward to further work in this area being pursued in the Financial Stability Forum.

A significant "incentive" the international community can provide is technical assistance. Technical assistance should be focused on those countries that show the most glaring weaknesses and which demonstrate the strongest commitment to reforms. I doubt if much is gained by the Board trying to micromanage specific core principles that should be priorities for TA. Circumstances in individual countries vary considerably and MAE has sufficient knowledge of country practices to make informed judgements about where the individual country priorities ought to be. In any case, it is hard for the Board to do too much micromanagement since the Board is largely kept in the dark about staff TA discussions with member countries. As I indicated above, this could be corrected if, as we believe, CPAs were incorporated into Article IV reviews, even if they were originally done under the auspices of technical assistance. In any case, technical assistance should be closely coordinated with the World Bank and the regional banks. This point was not sufficiently emphasized in the staff report.

A few detailed points should also be noted:

We would recast the reference to accounting standards in ¶ 52. We think the aim should be: "a convergence towards high quality, internationally acceptable accounting principles, standards and practices" rather than to harmonize or elaborate international accounting principles and standards per se.

In Appendix II, the staff recommends some changes in the Core Principles. We believe changes should be made cautiously. It will be useful to share the experience with the CPAs with the Basel Committee but the initiative for amending the Core Principles ought to be left to the Basel Committee. Rather than launching extended negotiations of new or modified core principles, it may be just as effective and more efficient to just cite evolving guidance from the Basel Committee. The papers on managing credit risk and loan accounting that were issued last year by the Basel Committee are examples of such material that could be referenced.

Mr. Morais submitted the following statement:

We thank staff for a concise paper on the experience with the core principle assessments (CPAs) launched just over two years ago. Going by the feedback from the member countries that have participated in the assessments so far, there is reason to believe that CPAs could play an important role in helping to strengthen national banking sectors and contribute to stability of the international financial system. At this stage, the evidence on compliance with CPs—from the sample of countries, all but one of which are developing countries—underscores the view that emphasis of CPAs should be on providing support for implementation of needed improvements rather than on judging the adequacy of supervisory systems. In this context, we share staff's view that in many countries, the task of setting up the appropriate regulatory environment, including building the institutional capacity to enable improved and effective supervision, will require significant resources at both national and international levels including assistance from the Fund and the Bank.

The central objective of CPAs, which is to determine whether supervisors have the capability of, and are effectively supervising and monitoring all the important risks taken by banks, goes to the heart of the effort to strengthen the international financial system. The issue therefore, is not whether CPAs play a useful role, but how best to make them serve their intended purpose. The limited evidence suggests that members have found them useful in helping to focus the necessary attention on areas of weaknesses and providing the appropriate context for implementing reforms to address them. In this regard, we note that the assessments have found significant deficiencies in key areas which include risk management and monitoring systems, implementation of consolidated supervision and, mechanisms for corrective action in problem situations. Even more important, staff point to general weaknesses in the implementation and enforcement of existing laws and regulations. In many countries, significant deficiencies were also found in the regulatory framework for supervision themselves. While not surprising, the findings serve to underscore the importance of this kind of assessment and the substantial technical assistance effort that is needed in order to put national supervisory systems on sound footing. The situation also suggests the need to consider expanding the scale of CPAs to enable as many countries as possible, to define an appropriate reform agenda. I will return to this point.

The CPA process is a promising instrument for effectively strengthening financial system surveillance in the context of Article IV consultations, and, from this point of view, is best carried out in the framework of the FSAP and FSSAs. However, the resource intensity of FSAP limits the number of countries that could be covered to well below the potential number that is likely to require CPA for the purpose of developing the supervisory system. Even the five-year cycle for FSAP suggested by staff in the context of the recent discussion is unlikely to be adequate. In this connection, therefore, we see strong merit for emphasizing, as regards developing countries, stand-alone CPAs for the purpose of helping to define reform priorities and technical assistance needs. Perhaps, there is also room for a wider use of self-assessments as a stop-gap even though we recognize its limitations. In this regard, it is noteworthy that, with the use of the "core principles methodology", the self-assessment recently undertaken by some countries have proved to be more comparable to those of the Fund and the Bank. This development seems to enhance the prospects for the success of the regional supervisory arrangements referred to in the paper. We would be interested in further staff comments on the issue of self-assessments.

The issue of publication was discussed extensively during the recent Board review of the FSAP and some tentative compromise was reached. However, as regards CPAs, the case against publication at this stage, is somewhat more obvious, and we would go along with the prevailing view in the supervisory community and the Basel Committee, that the countries assessed need time to implement recommended reforms and corrective measures before being subjected to assessments that are publicized. Moreover, while it may be argued that publication would provide an incentive for some members to participate in CPAs, given that it will take time for most members to be covered, publication may give an unfair advantage to countries with strong compliance standards that are covered early in the process. The lack of harmony in international accounting principles and standards and the difficulty that this creates for consistency and comparability of national prudential standards is another reason for caution at this stage. Also, as noted by staff, the criteria governing CPs may be too sophisticated relative to the state of development of the country's financial markets and infrastructure, as is certain to be the case in many developing countries. Meeting the CPs for these countries in a material way, could therefore, be a process that takes years. I would appreciate staff comments.

Staff touched upon a number of shortcomings of the CPs as they currently stand. Among these, the supervisory community has stressed the need for regulators to harmonize differences in national accounting standards which present difficulties for loan valuation in particular. Staff have also suggested the need for clear rules to be applied for exit cases which is appealing, in view of the fact that the exit process is often drawn out, resulting in increased losses to banks and the government budget. We wonder whether there can be much progress in this area as each situation is likely to present a different set of challenges for the authorities. A final point on the issue of prioritizing resource allocation: staff observes that CPAs may not be sufficiently in-depth in some cases to identify all underlying weakness for reasons of resource constraints. They suggest for this reason, that more resources and time would better be spent on a country of systemic importance or one with a more complex banking and financial system. In general, a country with a complex financial structure is likely to require more resources, as seemed apparent from the recent paper on the review of the FSAP. However, this should not imply that the quality of the assessment should differ among countries. Presumably, a less complex financial system should require relatively less resources and time to assess effectively than a more complex one.

Finally, we look forward to further progress on these various issues in the forthcoming workshop of the Basel Committee and Core Principles Liaison Committee.

Mr. Bernes submitted the following statement:

I would like to express my appreciation to staff for a comprehensive and informative report. Given the importance of the banking sector in the intermediation process, particularly in emerging markets, Core Principles Assessments (CPAs) have an important role to play in helping countries to strengthen their financial infrastructure.

The serious weaknesses identified in the 26 CPAs completed to date are a cause for concern. I strongly agree with staff that considerable attention needs to be given to recommended supervisory and regulation reforms in the context of surveillance, particularly in FSAP diagnoses and Fund programs. There also should be a process for following up on recommended reforms. One approach would be, as staff suggest, to target TA more heavily to these areas. But it may also be necessary to follow up on such items in subsequent Article IV consultations.

I agree that CPAs are best undertaken as an integral part of the FSAP and FSSA process. Indeed, as I said in the discussion of the progress report on the FSAP pilot exercise, for most such missions the primary focus should be standards assessment. Placing CPAs in the broader context of the financial system by undertaking them within a FSAP will make them more valuable. In particular, it will make it possible to prioritize follow-up TA and legislative action within the needs for the financial sector as a whole.

This being said, I do not think that CPAs should be undertaken exclusively within a FSAP. There may be instances where, owing to the state of development of its financial system, or for other reasons, a country may want to do a CPA but not a full FSAP. Countries should continue to have this option.

While we generally prefer peer reviews, I agree that self-assessments of core principles are to be welcomed, particularly in light of the resource constraints faced by the Fund and the considerable period of time that will elapse before most of the membership will have the opportunity to participate in a FSAP. In this regard, I note that more recent self-assessments based on the new methodology paper appear to have yielded results that are more comparable to the Fund and Bank CPAs. As well, the use of international accounting firms to conduct CPAs could be feasible under the right circumstances. It is particularly important that the firms have the specialized personnel required to assess core principles 1 and 2. One way that this could be achieved is by their employing people who have experience with a well-respected national regulatory authority.

On the issue of publication, I prefer to use existing policies rather than create an additional policy. CPAs undertaken as part of a FSAP should be subject to the publication policy decided by the Board at the time of the final review of the pilot exercise later this year. A CPA undertaken on a standalone basis, if a country so chooses, can be converted to an ROSC and released. I understand the concerns that a country might have about publishing an assessment that identifies serious deficiencies in its regulatory regime, especially as it can take a considerable period of time to enact the legislation and establish the institutions needed to meet the core principles. In these cases, I think that it would be appropriate to permit countries to delay publication for a period and, if they choose, to accompany the release of the assessment with a plan outlining how they intend to address any problems identified in the assessment.

Finally, I think that it is too early to say with certainty whether countries need more incentives to participate in CPAs, FSAP etc. I would hope that the benefits from having a more robust financial system would be a sufficient incentive, but if further down the road we conclude that this is not the case, we should revisit the question of incentives.

Mr. Törnqvist and Mr. Sigurgeirsson submitted the following statement:

We welcome this well-written report on a very important subject. Identifying weaknesses in financial systems before serious problems arise has proven crucial in times of increased volatility and an increasingly complex financial environment. To assist members in this respect has become an important part of the Fund's surveillance. Since this is a new area to the Fund, it needs new tools to perform this function. The Basel Core Principles are such tools. Furthermore, this well-defined set of principles will provide a good guide for countries that engage in financial sector reform and for those in the process of developing financial markets. In this regard, it would be desirable if the general guidelines of CPs could be extended to other areas of the financial sector.

The process of improving the implementation of the Core Principles, following a review, is likely to be time-consuming in many cases. Lack of resources and slow political decision making are factors that may cause delays. Therefore, it may still be too early to determine the extent to which CPAs have helped countries strengthen their banking systems. Nevertheless, we believe that CPAs have already proven to be a valuable tool for identifying potential weaknesses in banking supervision, and that they will do so even more in the future.

As can be seen by the very interesting results that are put forward in the paper, the CPAs have already contributed to identifying problem areas. We note with concern that there are widespread weaknesses with respect to a number of principles, several of which are among the most important ones. We understand that these weaknesses relate to both regulation and application. These are important findings that should assist countries in prioritizing areas for reform. It is obvious that a lot remains to be done. But we must keep in mind that the sample of countries is not representative of the IMF membership as a whole.

While it is desirable to conduct CPAs in a broad institutional and macroeconomic context of financial sector assessment programs (FSAPs), stand-alone CPAs associated with technical assistance should also be conducted. They can certainly play a role in promoting good practices. Getting involved in an exercise based on this well-defined set of principles will be helpful in generating a broader understanding of the key issues of bank supervision at various levels of Government.

Likewise we believe that that the usefulness of self-assessments should not be underestimated, despite their shortcomings. Making such assessments will improve the relevant authorities' understanding of the overall state of their country's financial system and banking supervision, and it will make them aware of important principles that they may not have paid attention to before. It is encouraging to note that self-assessments made under the new methodology appear to be more consistent than the early ones. But the ultimate need to conduct the assessments in a uniform fashion, according to the "Core Principles Methodology," is obvious; the comparability of the results across countries is essential. It is therefore important that work continues on improving the methodology by further developing and refining the criteria.

CPAs constitute an activity where close cooperation with the World bank is essential. It is encouraging that, according to our information from various sources, this cooperation works quite well, not least in the field.

With respect to publicity, the paper takes a very cautious approach. This may be warranted to some extent. We understand that countries may want time to allow for corrections of major weaknesses before publication. But, we would, in general, encourage countries to publish results as soon as possible. The status of the supervisory system and standards of a country is of great public interest. Important principles of transparency are involved. Therefore, countries that wish to publish their CPAs should be allowed to do so at any time. It can be noted that the current publication practice in this area is confusing; ROSCs can be published on a voluntary basis while FSSAs have not been published so far; yet CPAs can be part of both FSSAs and ROSCs. As a consequence, summaries of CPAs have in fact already been published.

Finally, it would be interesting to hear from staff how they look at the study mentioned in the paper, where a group of external experts have been contracted to do CPAs in countries in the Western Hemisphere. Should it be seen as alternative or complementary to Fund work in this field, and will the Fund be involved in this exercise at all?

Mrs. Hetrakul and Mr. Harinowo submitted the following statement:

I join other directors in thanking the staff for a useful paper on the experience with the Basel Core Principles Assessments completed by the Fund and the Bank in 26 countries. This is certainly a valuable contribution by the two institutions in further strengthening the financial system of the member countries, especially in the area of banking supervisory capacity, prudential regulations as well as the member countries' legal system. At the same time, this exercise also showed the effective coordination of various institutions—Basel Committee, the Fund and the World Bank, and the member countries' authorities.

The staff note that the CPAs have proven to be useful in assisting countries in identifying serious weaknesses in their banking supervision. Therefore, the exercise has a certain value added compared to the self assessments made by the member countries themselves. I tend to share this argument, since there is always a tendency for a self assessment to be less rigorous than assessment made by external parties. However, looking at recent various initiatives launched almost at the same time by the Fund, we have to recognize the hard facts of resource constraints. The recent experience indicated that the Fund was only able to complete 26 CPAs in the two year period compared with 124 self assessments in one year time. Therefore, while recognizing the quality of CPAs by the Fund and the Bank, we should not substitute the self assessments made by the member countries, but make it complementary. Self assessments can be made regularly by the members and periodically the Fund and the Bank will make CPAs in these countries. The result of the CPAs will fill the gap the countries have made through their self assessments.

Like Mr. Kelkar and Mr. Karunasena, countries need to be encouraged to undertake self assessments on a voluntary basis. The standardized format by the Basel Committee will provide comparable basis for the exercise. Since self assessments will realistically be the core vehicle of the exercise, due to the said resource constraints, we need to devote greater efforts of improving the methodology and format of the self assessments, so as to meet the standard set by the CPAs. With this approach, the gap between self-assessment and less frequent CPAs will not be too wide so that necessary corrections can be made more easily.

Given the resource constraints, my authorities also share the Staff's view of the need to incorporate the CPAs with the FSAP/FSSA initiative. This will save staff's time and at the same time will ensure a more comprehensive analysis. Indeed, this is an area where incorporating this exercise will not overburden the FSAP/FSSA and, in fact, will further strengthen the quality and coverage of the FSAP/FSSA exercise. I believe that this suggestion will receive a broad consensus from the Board.

On the issue of the parties to implement CPAs, my authorities have a strong preference on the assessments done by multinational organizations such as the World Bank, IMF or BIS for their independence, expertise and thorough understanding of the methodologies of CPAs. Second alternative would be to have self assessments by member countries themselves. Third alternative would be to have peer review within the regional grouping of bank supervisors. Assessments by external parties such as large accounting firms can be useful, but are less preferable.

Many Directors stress the need for technical assistance in this exercise, especially if the CPAs reveal a serious weakness in the members' supervisory function. I could not agree more, and also share the view of Mr. Kelkar and Mr. Karunasena which I quote "that the primary objective of the CPAs has to be providing necessary assistance for the implementation of CPAs rather than judging or rating the adequacy of the supervisory system in member countries". Since many of the recent discussions suggest an increasing need for technical assistance, I am just wondering whether we can make such complementary efforts through teleconferences, internet or other long distance learning methods. This method, combined with less frequent visits of the technical assistance team, may stretch the Fund's limited resources to benefit a larger number of countries and a broader audience. I would appreciate staff's comment on this issue.

Mr. Portugal and Mr. Junguito submitted the following statement:

Staff has presented us a detailed paper on the experience with the Basel Core Principle Assessments. To that end, it reminds us that the Core Principles Assessments, CPAs, have the objective of judging the adequacy of the risks for banking supervision, and the supervisors' ability to monitor and limit major risks borne by banks. Based on the results from a set of 26 CPAs completed, it sets up a number of questions seeking the guidance from the Board.

We believe that the CPAs have proven useful to countries concerned in identifying weaknesses in banking supervision. We found important Table 1 of the staff paper which summarizes the percentage share for compliance with the Basel Core Principles derived from the sample of 26 CPAs completed to date. With the caveat that it is a small sample and that its findings have to be taken cautiously, its results demonstrate, as staff indicates, that compliance with the majority of individual CPs is far from satisfactory and that there are serious weaknesses in banking supervision in many countries.

We are supportive of the Fund increasing its focus on promoting reforms through technical assistance targeted to areas where compliance is weak. We agree with Mr. Shaalan and Mr. Himani that the Board should reflect on the level of available resources for technical assistance, and with Ms. Jul and Mr. Zoccali that staff should provide an estimate of additional resource requirements for that purpose. Wide availability of technical assistance would, by itself, be an incentive to undertake CPA's. Nevertheless, as we have indicated in the Board, we firmly consider that the adoption of standards and the provision of technical assistance should be undertaken on a voluntary basis. Beyond all, we have argued against including the adoption of standards as an element of conditionality in Fund programs.

Staff also asks whether the assessments of compliance with the Core Principles as an input in Fund surveillance are best undertaken as part of the FSAP and FSSA process. The staff paper, based on the experience with CPAs both carried out as part of FSAPs and on stand-alone basis, clearly argues in favor of those CPAs undertaken as part of FSAPs, and we have no strong arguments against such conclusion. In fact, the overview of financial sector supervision is an integral part of FSAPs. Our main point is that FSAPs are most useful when they are tailor made for the particular member's needs and that, in some cases, attention should be centered more on financial sector restructuring than on supervision. Besides, stand-alone CPAs should continue to be undertaken, especially in the context of technical assistance as discussed above.

We agree that self-assessments or assessments by external parties such as large accounting firms may also be useful and, as Mr. Kelkar and Mr. Karunasena, we welcome the BCBS's approach to encourage self-assessments based on the new methodology. The adoption of the agreed methodology will facilitate a greater understanding of the purpose behind the relevant CP and the criteria for judging compliance. The staff finding that self-assessments tend to be less strict when compared to CPAs done by the IMF may not be a case against them. Self-assessments often reflect valid perceptions by the local authorities in regard to the nature and enforcement of their supervisory activities and not always a misunderstanding of the purpose behind the Core Principles.

We share the staff's view that CPAs often contain information and judgement that are sensitive, and that they raise issues of disclosure similar to those in FSAPs and related Fund surveillance documents. We consider that the CPAs contained in the FSAPs should continue to be made available only to the authorities in the country concerned. It is a fact that countries assessed need time to introduce the recommended reforms and that untimely disclosure of assessments could become an obstacle to such reforms. As with other matters regarding the publication of FSAP and FSSA reports, we think that the decision to release the CPA results should wait until the discussion of the FSAP pilot project is finalized.

Finally, we share Ms. Jul and Mr. Zoccali's view that a broader focus of the paper incorporating the status of the proposed modification of the Basel Capital Accord would have been useful. In that regard, staff have provided us with a separate and earlier paper indicating their comments on the proposals for a New Capital Adequacy Framework, whose general spirit we share, but that, unfortunately, has not been set as a topic of our analysis.

In terms of today's discussion, we would be particularly interested to know how would the actual CPA methodology be affected if the New Capital Adequacy Framework is adopted. Staff comments on the subject would be very welcome.

Mr. Oyarzábal submitted the following statement:

We would like to commend the staff for the comprehensive paper that reviews the experience with Basel Core Principle Assessments (CPAs). It raises issues that should be addressed in dealing with this subject in the future, with a view to improve the supervisory, prudential, and legal systems of the financial sector of member countries.

As stated in the paper, the two main objectives of CPAs are to assess the adequacy of the legislative and regulatory framework, and to determine whether the supervisors are capable of, and in fact are, effectively supervising and monitoring all the risks taken by banks. On one hand, the identification of the important role of preconditions necessary to implement and apply core principles such as accounting and auditing systems, as well as the legal and institutional frameworks, is a substantive contribution to the usefulness of CPAs. Assessments have contributed to create awareness of the need to strengthen existing laws and regulations. At the same time, they have highlighted the benefits of coordination between international institutions, as well as supervisory agencies. Another useful lesson has been the need to pay attention to countries' specific situation when evaluating financial sector compliance and soundness at the time of making recommendations, coupled with the need to prioritize measures to address financial sector compliance. Last, but definitely not least, has been the identification of the significant role that technical assistance must play in the improvement and implementation of CPs in addressing weaknesses and vulnerabilities in the financial sector.

In general, one of the conclusions that has been brought out through the completed CPAs is that compliance with the majority of the individual CPs is still unsatisfactory. This fact is highlighted by assessments which pointed out at weaknesses present not only in the financial system per se, but also in the legislative and regulatory systems, which tend to act in a self-reinforcing way. This situation stresses the need for further work to be carried out in promoting and improving compliance with CPs. The need to strengthen institutional capacity is certainly of the essence in the efforts to break this vicious cycle. To this end, technical assistance is of the utmost importance. However, the current resource constraints within the organization prevent a timely response to address these needs.

We consider that self-assessment can be a crucial element in the development of ownership and sustainability in the application of this prudential framework to the financial sector. Here again, the issues of weak institutional capacity, as well as technical assistance, must be brought out. The emphasis on the development of sound accounting and auditing systems, as well as the framework of legal and institutional nature, coupled to the dissemination of the methodology would be germane in creating the basic elements to motivate self-assessment. While these issues are being addressed, and until self-assessment can be evaluated as meeting international standards, the participation in the process of strengthening the banking sector can be supported by Fund-Bank initiatives, as well as other institutions that have been actively playing a role in CPAs.

It is important to recognize that countries must be given time and support to create adequate capacity to implement reforms and correct measures in dealing with Basel Core Principles. In this respect, we feel that stand-alone CPAs would be most appropriate in the initial stages of this process of change. At a later stage, the assessments could be incorporated into the process of the FSAPs and the FSSAs. These assessments (CPAs) provide for a thorough analysis of the vulnerabilities and risks related to the financial sector and are also undertaken with a frequency more in line with the structural characteristics that must be considered in the implementation of the principles. At this stage, it would not seem appropriate that the assessment of compliance with the principles be incorporated as part of Article IV consultations.

It is also important to review the framework of CPAs to consider the characteristics of the depth of financial markets in emerging market economies. It should be taken into account how these markets evolve, as well as the changes constantly being introduced into the banking industry. In this respect, the role of new financial instruments such as derivatives and the need to recognize the increasing financial or quasi-banking activity of other institutions such as the securities and insurance industries should become an intrinsic part of these assessments. Consolidation in an ample framework can address non-banking activities as well as off-shore institutions and transactions.

The issue of wider disclosure for CPAs is very difficult to support other than what can be incorporated into the FSSAs. We believe that emerging country's financial markets have little depth and are in general very sensitive to issues arising from financial sector vulnerabilities. At the same time, until self-assessment is firmly in place, the frank discussion necessary between countries' banking supervisory authorities and other institutions like the Fund should not be negatively affected by the implications put forward by publication. Pressure to promote wider disclosure in an untimely manner could create difficulties in implementing corrective measures and/or necessary reforms.

The implementation of CPs and the participation in CPAs, as a means to foster a stronger financial system, should be an important incentive in itself for their embrace by country authorities. If and when "these incentives" are perceived to be an imposition, they can be either rejected or very probably work against the sustainability of reforms in the medium and long term. It would be useful to identify incentives that can promote ownership in dealing with this subject and would welcome staff's comments in this respect.

The staff representative from the Monetary and Exchange Affairs Department, responding to questions raised in preliminary statements, noted that the staff report had above all been a progress report on the work of the Basel Committee on Banking Supervision (BCBS) in which the Fund was involved. The Core Principles had been the result of a process initiated by the Managing Director in 1996, when he had called for the development of international banking guidelines and envisaged a role for the Fund in that context. There had been some sensitivity on the part of the BCBS toward that project, because the Basel Committee felt that the Fund was encroaching on their territory. Once the Basel Core Principles (CPs) had been developed, the Fund had been invited to comment and, together with the World Bank, to participate in the Core Principles Liaison Group (CPLG), which comprised a wider membership than the BCBS and reviewed developments relating to the Core Principles.

Once Fund staff begun assessments of countries' compliance with the Core Principles, the need for a methodology had become apparent and a joint effort had been made to produce a methodology that could make assessments of the Core Principles more practical, operational and uniform, the staff representative recalled. The Fund's contribution to that effort—providing the BCBS with information on the experience with CPAs—was taking place within the CPLG. The Basel Committee had formally approved the methodology that had been developed. It was reassuring that other organizations, such as the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), were adopting a similar methodologies, and that attempts were being made at harmonizing these methodologies by taking account of the various experiences gained.

The Fund's working relationship with the Basel Committee and its subgroups was excellent, the staff representative remarked, and the Fund was being regarded as a partner in the effort to bring about the adoption of new banking standards. The staff report would also be submitted as one contribution to the first workshop that the Basel Committee would hold on the matter during the following week. The staff report would thus become an important input for the ongoing debate. The aim was to take stock of the experience with the Core Principles themselves, and also with the methodology. It was not envisaged that there would be any major adjustments at the current stage.

The results of the current discussions of the new capital adequacy framework could eventually require changes in the Core Principles, the staff representative considered. The Board had reviewed information on the original proposal in mid-1999, while the staff had provided comments in February, which also had been shared with the Board. The commenting period had ended on March 31, 2000. On the basis of the comments received, a new version of the proposals would be drafted, which would again be circulated for comments by end 2000. The Basel Committee intended to complete the new framework next year. The implementation of the new framework could be expected to be fully implemented within five years.

The comments made by the Fund staff on the Consultative Paper from June 1999 had been welcomed by the relevant BCB working groups, and the issues raised by Mrs. Jul and Mr. Zoccali in their preliminary statement were currently under consideration, the staff representative informed. Once the next round of talks were completed, the staff would share any new information on those discussions with the Board.

Mr. Donecker made the following statement:

> Let me first thank staff for a short and concise paper on our topic today.
>
> We strongly support the implementation of "Core Principle Assessments" (CPAs). CPAs can provide a very important contribution for strengthening the financial system and for crisis prevention by tackling institutional, structural and microeconomic roots of possible crises. The observance of "Core Principles" affects an important area of structural issues with a significant macroeconomic impact. These principles should therefore also play an important role in the context of the surveillance activity of the Fund.
>
> We agree with staff that CPAs have proved useful to countries concerned in identifying weaknesses in banking supervision. The IMF should also increase its focus on promoting reforms to address such weaknesses in close collaboration with the respective member state. In this regard, a targeted Technical Assistance by the Fund and the Bank will be useful.
>
> We also share staff's view that assessments of compliance with the Core Principles are best undertaken as an integral part of the FSAP and FSSA process. Such a process guarantees that the World Bank and the IMF are involved, with their respective comparative advantage and expertise. However, we should avoid overloading the FSAP/FSSA-process, which calls for a strict application of the "modular approach". Under certain circumstances a "stand-alone" CPA could also be considered.
>
> Self-Assessments or assessments by external parties based on the agreed methodology can be useful, but their results should not be overvalued. As elaborated by staff, self-assessors had in the past an incentive and tendency to show the extent of implementation in the best possible light. They often did not take the need for comprehensive implementation, both by the supervisory authority and by the banks, fully into account. Against this background, the main job has to be done by the World Bank and the IMF in the context of a CPA. Self-assessments should only be seen as a second pillar. In this context, we would prefer self-assessments by external parties based on the "methodology paper", since this will guarantee a certain objectivity and will facilitate the comparison of the results of different CPAs.
>
> We are in favor of encouraging the wider disclosure of CPAs, or of summaries or extracts from them and thus for a presumption for publication, but we have to respect that any decision to publish CPAs in full or summary

form should remain a national prerogative. If the respective country decides not to authorize a publication, such a decision should be made public. Staff should examine on a case-by-case basis how to strike the right balance between the legitimate interest of confidentiality of the involved national authorities and financial institutions on the one hand and the interest of the international community in increased crisis prevention promoted by using market discipline and peer pressure on the other hand. We support the view of the Basel Committee on Banking Supervision that countries should be given the opportunity to implement reforms or announce their envisaged reform measures before assessments are published. We also support staff's considerations to integrate CPAs in Fund programs in an appropriate way.

Finally, we feel that there is no need to provide more incentives for countries to participate in CPAs. The basic incentive is already in place, i.e. the respective country will benefit from a published CPA with positive results via increased investor confidence resulting in greater stability of its financial sector and balance of payments as well as via more favorable access to the international capital markets.

Mr. Daïri, responding to Mr. Donecker's statement, considered that benefits would not exclusively be brought about by published CPAs. A country would also benefit from a CPA conducted as part of a reform process performed to strengthen its supervisory capacity even without subsequent publication. Therefore, for a CPA to be useful to a country, the link to the publication of the results was not required, while the country could opt for publication once compliance had been established.

Mr. Donecker stated that he agreed with that interpretation and considered that a country would benefit from undertaking a CPA in any event.

Mr. Abbott considered that a country would benefit directly from the publication of CPA results, because their publication would strengthen those forces supporting reform within the country. While, as a consequence of publication, banks might have to make higher risk provisions and companies' access to lending from affiliated banks might become more difficult, it was important not to underestimate the positive role that disclosure could play in advancing reform processes. The CPA was not just a matter for consultation between the Fund and the supervisor, but it was also a matter of interest for a public constituency, and the Fund had a role in advancing reforms in that area, which could be helped by giving due consideration to the benefits of disclosure.

Mr. Collins made the following statement:

I welcome this opportunity to discuss the Basel core principle assessments. I strongly endorse the observations of Ms. Lissakers and Mr. Abbott that this propagation of high standards has taken place without imposition or intrusion. The paper shows the benefits which the process has brought about in identifying a large number of areas in which the countries examined are far below the standards incorporated in the core principles.

The effectiveness of the assessments has undoubtedly been strengthened by the availability of the methodology. None of the specific weaknesses identified comes as a surprise, in particular, weaknesses in risk management, corrective action, and, above all, consolidated supervision. Similarly, the identified shortcomings with regard to the preconditions have also been expected. However, the value-added of this exercise is that the individual countries examined know specifically where to target their efforts at improvement.

The core principles and the methodology will have to be revisited in light of the experience gained, but there must be no weakening in specific criteria. As Mr. Lindgren said, there will be a Core Principles Liaison Group workshop in Basel on May 10 to embark on this process. The Basel Committee is the standard-setter with the competence to decide how and when changes should be made. It is not appropriate for the Board to address in detail the changes to the core principles proposed by the staff. However, the staff's input, as well as that of the World Bank, will be an important ingredient in the Liaison Group's considerations.

As regards the modality for conducting CPAs, they should form part of the FSAP process, and every FSAP should include a CPA. That does not mean that there should not be stand-alone CPAs, and there is no reason why they should not be part of the ROSC process, where appropriate. If confined to either the FSAP or to technical assistance, some important industrial countries, which may be of low priority in the context of FSAP and do not need external technical assistance, night not conduct a CPA for many years. There might also be a possibility whereby a quick assessment could be made as part of an Article IV consultation to identify key vulnerabilities and weaknesses in regulatory structures, particularly in the area of preconditions.

As regards self-assessments and assessments by external parties, it is important to distinguish their contribution. Self-assessments have been shown to be relatively deficient and, therefore, cannot be relied upon exclusively. Nonetheless, they can be useful as preparation for external assessments and subsequently for monitoring progress with the recommendations made by external assessors. It is important that assessment capacity is developed in countries not only to improve the quality of self-assessments but also to encourage the commitment to tackling weaknesses identified in CPAs.

External private sector assessors, such as international accountancy and auditing firms, which currently carry out work on behalf of regulators and, as a result, will have experience with the effectiveness of the supervisory regimes, can be a useful addition to a scarce resource. They have contributed significantly to the design and implementation of risk-based frameworks in some countries, including my own.

The question of disclosure is a difficult one. Ultimately, we should be aiming for publication of CPA results. A clearer appreciation of the strengths and weaknesses of regulatory systems is an important contribution to better-informed markets and so to more effective market discipline and stability. I think it might be sensible to distinguish three types of disclosure. There could be private disclosure to other supervisors. Most supervisors' understanding of and confidence in the home country's supervisory system and standards would undoubtedly be boosted by access to the results of CPAs made available on a confidential basis by the home supervisor. Dialogue between home and host would thereby be better informed and made more efficient. Also, one could envisage a Fund announcement that a country had undergone a CPA irrespective of any decision to publish its findings more widely. That in itself would introduce useful discipline. Then, there is the question of more general publication. Ultimately, countries should retain discretion on whether or not to publish. It is understandable that they would be reluctant to publish adverse findings, at least until they have had an opportunity to formulate a strategy for addressing significant weaknesses that have been identified. That seems reasonable as long as the required improvements are not unduly delayed. More generally, I support Mr. Bernes's approach, which is to use existing publication policies for whichever CPA modality is adopted, rather than to seek to design an additional publication policy for CPAs alone.

Finally, on the question of incentives, I do not think there is an urgent need, at present, for more incentives to participate in CPAs. However, the process of technical assistance may be a useful carrot in some cases. More generally, the benefits of improving supervision should be self-evident.

Mr. Daïri, referring to an issue raised by Mr. Collins with regard to industrial countries' involvement in CPAs, considered that it was important to ensure that the G-7 countries set a good example by accepting CPAs that were conducted by the Fund or by other experts and by accepting, from the beginning, that the results of the assessments would be published. The staff report appeared to imply that the majority of existing problems concerned developing and transition economies. However, there had been severe problems of supervision in a number of large industrialized countries, and there might still be more problems that needed to be addressed. Therefore, it was important to be evenhanded with regard to CPAs and to ensure that systemic risks were addressed as a matter of priority.

Mr. Collins replied that industrialized countries should have the same rights and obligations as all other members of the Fund, and considered that it would be an inefficient use of resources to require industrialized countries to have CPAs in the FSAP context. It was preferable to have stand-alone CPAs in the case of industrialized countries, as they could be done faster and more efficiently. The question of publication would arise in the same way for industrialized and developing countries. If industrialized countries wished to set an example, they should do so, but they should retain the right not to publish the CPA results, if weaknesses were identified that they would like to correct first. If CPAs were conducted within the ROSC process, the existing rules for publication under that process should also apply to the CPA.

The Acting Chairman noted that Mr. Daïri agreed with Mr. Collins's statement.

Mr. Couillault made the following statement:

I would like to express our support for the principle of CPAs and our appreciation of their usefulness for identifying weaknesses in banking supervision. There is no doubt that a sound banking sector and effective banking supervision are key elements in the prevention of crises. Therefore, we believe that CPAs should help strengthen the Fund's surveillance.

We believe that the Fund should promote and encourage reforms in the areas where weaknesses have been detected. I share Mr. Bernes's concerns on the number of weaknesses remaining, keeping in mind that we have before us a limited sample of countries. We believe that technical assistance should buttress the financial sector where that is needed as a matter of priority. That being said, it should not mean limiting technical assistance to those countries which have undertaken a CPA.

On the issue of the adequate framework for CPAs, we would like to reiterate the views we expressed during the previous discussion on the FSAP. We believe that CPAs should be an integral part of FSAPs, but we also believe that this should not be the only framework within which to undertake a CPA. It had been recalled during our Board meeting on FSAPs that CPAs undertaken in the context of an ROSC could, for example, be a useful instrument as a first step toward an FSAP.

Self-evaluation of standards conducted in the context of a ROSC has, in our view, two major advantages. It creates a participatory process and eventually strengthens the ownership of the outcome. Also, that first analysis would help prepare an FSAP mission by identifying the main weaknesses. That is the only possibility for a country to have the results of CPAs published in this context.

Against this background, we would not support an overly rigid approach that ruled out CPAs under ROSC and technical assistance missions. We fully support the principle of self-assessments, provided that an evaluation by the staff of self-assessments protects the exercise against any risk of a positive bias. We have some concerns with regard to the suggestion to use private companies to make assessments on the quality of the banking sector and of the supervisory framework. We believe that banking supervision is a public good and, therefore, we should avoid confusing peer reviews with market pressure. Also, we consider that involving private companies in this activity is a potential source of confidentiality problems and of conflicts of interest.

On the issue of transparency and wider disclosure, our position is close to that of Mr. Bernes. If the IMF is not involved in a CPA, it is the right of the country to decide on disclosure. In a case like that there is no need for any discussion. If the IMF is involved, and if CPAs are undertaken under the umbrella of specific IMF policies, such as technical assistance, ROSC, and FSAP, the situation is different. In those cases the disclosure policy that has already been decided—or will be decided later for FSAPs—should be applied. Therefore, there is no need to reopen the discussion of this question, which has been very controversial in the past.

Mr. Azoulay made the following statement:

I welcome the opportunity to discuss the Fund's experience with the core principles assessments. We consider of high importance the set of global standards for prudential regulation and banking supervision. However, we recognize that even a detailed and comprehensive set of standards by itself is not a sufficient condition for strengthening the banking system worldwide. We believe the process of implementation is more important. Assessment is not the ultimate objective but is a means leading to the implementation of sound practices. In this regard, the Fund and the World Bank are playing an important role by conducting assessments within member countries as a first step toward full compliance.

Given the changing objective of strengthening banking supervision worldwide and its contribution to the Fund's work on surveillance, multilateral institutions should continue carrying out such assessments. After an assessment is conducted, the follow-up is important. The IMF and World Bank should closely follow measures taken to counter deficiencies and assess the extent of implementation and enforcement.

The coordination of technical assistance to help countries in their implementation process is also important. In light of the large number of experts required, we share the view expressed by other Directors that these assessments should be combined with the FSAP. The conduct of these assessments under the FSAP will broaden the examination to include other aspects that could strengthen a country's financial infrastructure. Assessments made by external parties, such as large accounting firms, would help alleviate resource constraints.

We believe that, in addition to identifying a country's compliance with CPAs and determining the need for technical assistance, the Fund's experience with assessments should also serve as feedback to the BIS to help identify areas of the Core Principles where there is a need for adjustment. I have noticed that after the CPs were issued in 1997, the experience of Fund and Bank assessors helped create the CP methodology in 1999, which included a more explicit list of criteria derived from the original 25 CPs. As the staff mentioned, that experience will be used to evaluate the appropriateness of the CPs themselves for the assessed country.

In this respect, the recent experience gained by examining the causes of the turbulence in global financial markets should serve to update the CPs and help improve global standards. Additionally, following the problems of LTCM, the BIS issued its sound practices for banks' interaction with highly leveraged institutions last year. The question is whether these new practices have been included in the Fund's country assessments. There was an interesting document issued by the BIS in 1998 setting a framework for international control systems in banking organizations. I wonder in which context, this framework has been assessed and whether the Fund could also consider assessing more closely countries internal control systems.

The process of assessment can be improved by conducting assessments limited to a subgroup of CPs. For example, assessing only Principles 16 to 20 which relate to the quality of a country's own supervision and which could shed light on its ability to reliably conduct a self-assessment. An examination of this subgroup could serve as an objective tool for selecting the list of countries where an in-depth review will be needed, and those countries which could conduct self-assessments with a relative amount of confidence regarding the reliability of their results within the international community. An initial examination of this subgroup should be relatively easy and quick, and should not require a large number of experts. Countries with a lower supervision capability should be the first to be assessed comprehensively. I urge the staff to consider this approach.

We believe that the primary objective of an assessment remains the identification of the nature and the extent of weaknesses in the banking system. The results of such assessments should not be used to grade or rank a supervisory system, but rather to develop an action plan that prioritizes the improvements needed to achieve full compliance with the CPs. Disclosure is not our main priority, since we believe countries should be given the opportunity to implement reforms before the assessment. The main incentive for countries to participate in CPAs is based on gains and advantages that will result in a more robust financial system.

Although there will be a follow-up on the report on the implementation of standards of the FSF subgroup to look more closely at other incentives for the implementation of standards, the odds do not seem favorable. For instance, the BCBS has decided after thorough consideration not to use the implementation of standards as a factor in lower risk weight in the determination of capital requirements.

Mr. Josz made the following statement:

It is appropriate that the Fund has been very active in evaluating countries' compliance with the Core Principles for Effective Banking Supervision issued by the Basel Committee in September 1997. Since then, there have been 26 such assessments, 18 of them conducted by Fund teams and four by joint Fund/Bank teams. Monitoring the quality of bank supervision is closely related to the Fund's mission of reinforcing the stability of the international monetary and financial system.

Countries' compliance with the Core Principles is also essential element of the Financial Sector Assessment Program (FSAP), whose aim is to detect financial sector vulnerabilities. For this reason it is preferable to conduct Core Principle Assessments (CPAs), when possible, as a part of FSAPs.

In practice, however, stand-alone CPAs cannot be ruled out. It is expected that it will take five years before every member country has been covered by an FSAP, and restricting CPAs to that schedule would unduly delay them for many countries. The Fund should therefore continue to make CPAs for individual countries as needed for establishing priorities in surveillance, technical assistance, and programs.

But now that a Core Principles Assessment methodology is available, countries, especially Offshore Financial Centers, need not wait for the Fund to conduct an assessment. With this methodology the reliability of self-assessment is likely to increase, and such exercises will be very useful as a guide for the efforts of monetary and financial authorities to increase the effectiveness of their banking supervision. The results of such self-assessments will also greatly assist the Fund in conducting CPAs at a later date.

The Fund policy on publishing the results of Fund-conducted CPAs should be decided when the FSAP pilot project is reviewed at the end of the year. In the meantime, Fund-conducted CPAs—like FSAPs—should not be published. The main purpose of CPAs should be to improve supervision by identifying problems and eliminating them. It is by no means clear how publication will serve this goal. The threat that a poor assessment might be publicized could be a powerful incentive to improve policies. But it is likely that many countries will score poorly in the beginning, since the Core Principles are demanding. This fact, combined with the threat that the poor result will be publicized, could be an equally powerful incentive to avoid both FSAPs or stand-alone CPAs altogether.

Like Ms. Lissakers and Mr. Abbott, I think the results of CPAs should be communicated to the Board by reason of the important role that strong prudential supervision plays in the preservation of economic and financial stability.

Engaging large accounting firms to perform CPAs could create problems. To be effective, the assessors should have extensive practical experience in financial supervision, a qualification which the Fund has so far succeeded in finding in the supervisory community. In addition, conducting a CPA could require access to confidential information about individual financial institutions of kinds that supervisory authorities may have but are forbidden to reveal to outside accounting firms.

Finally, I support Ms. Jul's and Mr. Zoccali's request for a Board discussion of the proposals for new capital adequacy rules that the Basel Committee has circulated for comments. I am glad that the staff has already provided some comments, but I think the Board should also examine these proposals in order that all countries may also have an opportunity to comment.

Mr. Wei made the following statement:

We welcome today's discussion and thank staff for providing a concise and informative paper. As staff mentioned, CPAs are initially launched on the volunteer principle and conducted in the context of the Fund's technical assistance in banking supervision, to set priorities for technical assistance as well as structural benchmarks for Fund-supported adjustment programs. Therefore, we believe that the voluntary principle should be maintained in future CPAs whether they will be conducted in the process of FSAP or FSSA, or in a stand alone format.

That being said, let me now turn to the issues for discussion.

On the first issue, we are of the view that all countries should be involved in the decision making process for international standards and rules, especially the developing countries and the emerging markets. I understand that representatives of developing and emerging economies have been invited to participate in the design process of the core principles. We welcome the gesture from the Basle Committee of Banking Supervision and encourage them to continue to invite participation from developing and emerging countries in the process of establishing rules and regulations. The will and interests of the developing countries and emerging markets should be appropriately reflected and respected in the process. Accordingly, the voluntary nature of member countries' participation in the CPAs should be guaranteed; in addition, a certain flexibility in the assessment design is needed. Also, we note that among the 26 completed CPAs, only a few industrial countries have participated. We thus encourage the staff to include more developed countries in future CPAs, and to pay particular attention to the highly-leveraged activities of the banking sectors, since we all know that those activities can lead to sharp market volatility when financial crises occur.

On the second issue, like many others, we believe at the current stage that the CPAs should still be fundamentally TA-targeted. Many countries are currently not able to meet the core principle requirements due to their weak institutional capacities. TA is the most effective approach in helping these countries enhance their institutional building.

On the third issue, first, like Mr. Shaalan, we hesitate to include CPAs in the Article IV process because they may detract from having sufficient focus on key near-term policy issues. From a cost/effect perspective, consideration could be given to integrating future CPAs into the FSAP and FSSA process. However, as some Directors have expressed concern for such arrangements, I wish to listen to staff's responses. We can also see some value in stand-alone assessments, because we believe that countries could have a better understanding of the core principles and their impact could be expanded. But we would emphasize that they should be initiated by the country authorities themselves and a consistent methodology should be further developed.

On the issue of using external firms or individual experts, due to the sensitivity of this matter, it would be difficult to get external parties, such as large accounting firms involved in the process.

On the fifth issue, we have reservations about the disclosure of CPAs. As pointed out by many Directors, due to their confidential nature, it should be up to the country to decide whether it agrees to the publications of CPAs. We understand that the recommended reforms and corrective measures need time; and the presumption of publication may hamper the candid atmosphere between the authorities concerned and the staff, and thus weaken the Fund's role as a macroeconomic adviser for its members.

On the last issue, in our opinion, in order to encourage more countries to participate in CPAs, the staff should make further efforts to guarantee that the CPAs are mainly TA-targeted and that the principle of confidentiality is strictly applied. Without these two principles in place, it would be difficult to win the trust of member countries in conducting CPAs.

Mr. Zurbrügg made the following statement:

Let me start by warmly welcoming Mr. Lindgren's initial comments regarding the improved working relationship between the Basel Committee and the Fund and the World Bank. This Chair attributes great importance to a good cooperation between the various institutions. Given the division of labor between standard setting and monitoring in the area of Basel Core Principles, good cooperation is particularly important in this case.

The Basle Committee's Core Principles have provided countries with a good framework to assess and eventually strengthen the reliability of banking supervision. The overall success in strengthening banking supervision will, of course, hinge on the degree of compliance with the Core Principles in individual countries. In this regard, the assessments performed both by the Fund and the World Bank are important. Although the assessment and implementation of the Core Principles is still in an early stage, in a number of countries the assessments performed to date have helped the authorities identify weaknesses and take measures to strengthen the financial infrastructure.

While the CPAs by the Fund and the World Bank are crucial in providing a more objective and consistent assessment across the membership, self-assessments can play an important role. Self-assessment allows the use of confidential information available only to the country's authorities. Furthermore, the process itself is conducive to deeper and more serious thinking about the benefits and requisites of banking supervision. Contrary to Mr. Donecker, I would say that self-assessments are the first and not the second pillar of the CPA. It is important for most countries to have the chance to self-assess their compliance with the Core Principles before being assessed by a third party.

As regards the use of external parties such as large accounting firms, I think this could be helpful in the area of self-assessments. Self-assessments are more useful, if the authorities know that an external assessment will also take place. Given the resource constraints of the Fund and the World Bank, it could take a while until CPAs are performed. To still have the disciplining effect of an external assessment, the use of large accounting firms in self-assessments could be useful.

Given that compliance with the Core Principles alone is only a necessary but not a sufficient condition for a robust financial infrastructure, I share the staff's view that ideally we should aim at CPAs being an integral part of the FSAP and FSSA process. In this context, CPAs would provide the largest value added with respect to assessing overall vulnerability of the financial system. However, we should not unduly constrain stand-alone CPAs by aiming for the ideal solution. In view of the limited number of FSAPs and their large resource costs, stand-alone CPAs can play an important role in countries, in which weaknesses in banking supervision are considered essential. In our discussion on ROSCs we recognized the advantages of a modular approach. I am somewhat puzzled by staff's statement stating that "there will not be enough resources available to do all such assessments, at least in FY2001."

Resource constraints should also guide the use of targeted TA to promote reforms in areas of weak compliance of core principles. While such TA is undoubtedly useful to increase compliance, its utility should be carefully weighed against that of providing TA in other areas of macroeconomic policies.

As regards the wider disclosure of CPAs we are faced with well-known trade-off between the benefits of increased transparency for strengthening market discipline and the risk of creating incentives to withhold unfavorable information. Given the early stage of the CPA process in many countries, we agree with staff that a presumption of publication would be counterproductive. At this stage our aim must be to create conditions to allow countries to make a frank assessment and take the necessary measures as soon as possible.

Notwithstanding this cautious approach, staff should encourage countries to publish CPAs and certainly not object to their dissemination if a country wishes to do so.

Finally, we do not think that further incentives are necessary to promote participation in CPAs. Compliance with the Core Principles has already gained high prestige in financial markets. In our view, market pressures for conducting CPAs is sufficiently strong.

Mr. Schlitzer made the following statement:

We are grateful to the staff for preparing this paper that summarizes very well the experience obtained so far with CPAs. Given the increased importance of the domestic financial sector in Fund surveillance, CPAs represent a key instrument in our toolkit. If I may draw a comparison with the discussion we had two days ago on reserve management practices, two differences emerge: first, it is much less controversial that this is a Fund core area, and second, the findings obtained from the CPAs conducted so far do indicate that there are important problems in a number of countries. Hence, this is an area where the Fund staff will be engaged quite considerably in the coming years.

In this connection, we are glad to note that, of the 26 CPAs completed so far, the majority have been conducted by the IMF staff. Indeed, the application of Basel Core Principles is inherent to the stability-growth nexus, which strictly falls within the Fund's domain. In any event, it is crucial that the assessments carried out by the Fund and the Bank be performed in the same manner and not lead to distorted conclusions, depending on the main mandate of the assessor institution. Fortunately this risk is now reduced, albeit perhaps not eliminated, with the core principles methodology.

As recognized by the staff, the 26 CPAs conducted so far are not enough to allow us to claim that the findings are statistically significant. Moreover, only less than half of them have been carried out using the core principles methodology. These caveats notwithstanding, we believe that the results provide useful indications on where the weaknesses in the application of the core principles are most likely to be found.

Concerning the findings per se, it seems that compliance is especially weak for 8 of the 25 core principles. Most of these critical areas are of crucial importance for the Fund, as they have a direct impact on financial stability, the only exception being perhaps the one on money laundering. Among these critical areas I would highlight in particular that of consolidated supervision, which is becoming more and more important given the globalization of finance. This is an issue that has emerged vividly during last week's consultative meeting on OFCs and that is of relevance for industrial countries also.

The areas where compliance appears particularly weak are also those where the Fund should mostly concentrate its activity, especially through TA, although there is also an evident need to target Fund's assistance to the special needs of each member. Perhaps we should wait until we have gained enough experience before concluding where to concentrate our work.

We agree with the staff that CPAs should best be performed within the context of FSAPs and FSSAs, because there can be synergies and economies of scale and also because one can get a better overall picture of a country's financial sector vulnerabilities. Yet, as pointed put in a number of preliminary statements, we would not dismiss the use of stand-alone CPAs, which could be done as ROSC. The use of TA is also of critical importance.

On the issue of transparency, the approach followed by the staff, which allows countries to implement the necessary reforms and publish the assessment only thereafter, seems sensible. Yet, we should not downplay the effect on incentives that publication can have. This said, we should be careful not to create a new set of rules for CPAs. When CPAs are performed under the FSAP/FSSA framework, the solution for publication of CPAs should be consistent with the publication rules for FSAPs and FSSAs.

Mr. Moussa made the following statement:

We welcome this comprehensive and candid assessment of the main criteria governing the supervision of banks. However, the limited extent of the experiment- it covered only 26 countries- does not allow to reach general conclusions on the nature, scope and likelihood of risks in the banking sector. Although the exercise is at an early stage, the identification by the staff of areas for future improvement in risk management is particularly useful.

Before addressing what we see as the main challenges on the road to a better supervision of banks, we will make a few general comments:

At the outset, we see as of paramount importance, the role of internal control of banks in managing risks. The existence of early warning mechanisms, red flags, and corrective measures to address malfunctions, is an indication of the reliability of the control system. Consequently, the work of supervisory bodies should rely on effective internal procedures.

Moreover, we would like to place a special stress on the so-called "general pre-conditions", which shape the environment in which banks and supervisors alike operate. We deem crucial the legal system and the institutional capacity to carry out supervision. In effect, in many developing countries, the lack of enforcement capabilities and poor supervision often hamper an effective control of banks. This points to the need for more technical assistance to be provided to such countries, in the related areas of weakness.

Furthermore, as rightly underscored by the staff, the understanding of both the criteria and the goals of supervision by the supervisory bodies has a bearing on the measurement of risks, as evidenced by the mixed results of self-assessments by countries. The very relevance of lengthy Core Principles also needs to be checked. Accordingly, we wonder if a balance cannot be struck between an in-depth analysis of risks and a limitation of the number of criteria to some key Principles. Besides, like the staff, we wonder whether more emphasis should not be put on countries of systemic importance or with a fragile banking structure. This exploration of some sort of trade-off is justified by the resource-intensive nature of the assessments.

On the issue of dissemination and publication, we recommend that the national prerogative to release CPA be maintained.

We now turn to what we consider as some of the challenges facing the CPA exercise, namely, the very definition of bank activity, the over-reliance on auditing and rating firms, the determination of adequate capital, and the issue of international supervision of banks:

First of all, the definition of banks itself is becoming blurred, as many non-bank institutions have bank-like activities. For instance, auto makers and retail companies have developed a substantial lending activity; incidentally, it is worth noting that banks are facing unfair competition from other credit providers with less stringent supervision. Conversely, some banks are being more and more involved in such activities as real estate and insurance, while others have corporate affiliates. This raises the issue of what activity is permissible to banks and how a full consolidation of risks can be undertaken.

Moreover, it is our view that, although a good supervision of banks reduces the risks, this condition alone does not suffice to guarantee the health of the banking sector. In effect, recent highly publicized cases of bankruptcy in America, Europe, or Asia, caught the supervisory authorities by surprise. Moreover, neither the auditing firms, nor the credit rating agencies had been able to foresee the danger. In light of that experience, it should be remembered that even audited financial statements do not guarantee a true and fair view of the reviewed entities. In addition, the provisioning policy can give rise to some form of "creative accounting", as the perception of risk entails an element of subjectivity. This complicates further the issue of the transparency of banks' account, even in industrialized countries. Likewise, we caution against an over-reliance on the predictive power of rating agencies. As a result, in assessing the soundness of the banking system, the judgement of the supervisors is as valuable as the formal information and evaluation systems.

Furthermore, a misunderstanding seems to exist about the meaning of "adequate capital". Indeed, "adequate capital", as described by the Principles, is destined to cover expected loss on assets, not to prevent a bank from failure. In reality, owing to off-balance sheet items and to the increasing sophistication of financial instruments, the real risk of a bank may be higher than the one inferred from its financial statements. Besides, on the specific question of the quality of bank assets, the weighting of risks associated with different types of assets is far from perfect. In effect, there is a bias against assets related to non-OECD countries and to countries without a formal sovereign rating. Clearly, the estimated probability of default of the latter category of countries is generally higher, thus raising the cost of borrowing for such countries.

Finally, from the international financial stability standpoint, the risk chiefly rests with entities with subsidiaries in many countries, or with systemically important countries. Here, we should not let ourselves be misled by the legal issue of corporate nationality, namely, the discussion on whether the nationality of a corporation is determined by residence, headquarters, location of main operations, or capital control. The fact remains that many so-called national banks in countries with poor supervision infrastructure are offshoots of large foreign banks of countries whose supervision systems are supposedly efficient. How the parent companies consolidate their global risks is then a key issue. This problem is compounded by the issue of consolidated supervision by authorities, with the underlying questions of legal cooperation and information sharing among countries. In this connection, offshore financial centers are a good illustration.

Mr. Daïri made the following statement:

Like other Directors, we would like to express our appreciation to the staff for an extremely useful report. We share the staff's and other Directors' views that CPAs have proved to be useful in identifying weaknesses in banking supervision, and we agree on the need for the Fund to increase its efforts in helping countries identify and address those weaknesses mainly through technical assistance.

As suggested by the staff, assessments of compliance with the core principles are best conducted under the FSAP/FSSA process. This would help bring more clarity in Bank-Fund involvement in the financial sector area, reduce overlaps, and improve efficient use of scarce resources. However, stand-alone CPAs should not be ruled out as an element of ROSCs. This being said, we believe that countries should continue to be encouraged to make self-assessments, in view of their significant contribution and build-up of expertise. While it would be useful to base such self-assessments on the methodology, it is important that member countries' conditions and capabilities be fully recognized and technical assistance be provided in an appropriate manner.

Like other Directors, we have reservations regarding the involvement of private firms in CPAs by virtue of the confidentiality issues involved and the need to tailor the CPAs to the concerned country's circumstances. Private firms may take the agreed methodology as a check list against which they would rate the country's practices rather than a framework that would be used to promote appropriate supervision. We are of the view that premature publication of assessments in many cases could hinder the reform process and create unwarranted uncertainties. Therefore, publication of assessments in any form should remain the sole responsibility of member countries. We agree with Mrs. Jul and Mr. Zoccali that the paper could have gained from a presentation of the issues related to the new capital adequacy framework.

We consider that the gains from robust financial sectors are a sufficient incentive for countries to participate in CPAs. However, like Mr. Oyarzábal, we welcome the staff's suggestions of additional incentives provided they contribute to the strengthening of ownership and they do not result in the imposition of constraints or undue pressure on the membership.

Mr. Alosaimi made the following statement:

I thank the staff for a useful report on the experience with Basel Core Principles Assessments. I shall refer to the assessments as BCPAs, not as CPAs.

The 26 BCPAs provide an adequate basis for the Fund to take stock of the likely benefits and costs of this important initiative. The report provides strong evidence that these assessments have been helpful and should be continued. That being said, I would like to add a few remarks.

The Basel Core Principles have made an important contribution to the strengthening of banking assessments. Progress in implementing these principles is encouraging and should be stepped up. In that context, one also needs to keep in mind the differences in levels of development of countries. Accordingly, care should be taken in interpreting cross-country comparisons as in compliance with Basel Core Principles as shown in table 1 of the staff report.

As the staff report makes clear, in footnote 12 on page 17, full scale BCPAs are highly resource-intensive. Since resource availability on such a grand scale appears unlikely, the danger ahead is that BCPAs may lead to an attrition of routine Fund activities. In that regard, I am concerned about the adverse impact on the Fund's technical assistance in the crucial macroeconomic and structural policy areas. In setting priorities, the focus should be not only on country coverage, but should also involve the ranking of the Basel Core Principles by degree of relevance to the Fund's core mandate.

As the staff stresses in paragraph 6 of the staff report, further banking system reforms are needed in the context of weaknesses perceived as threatening domestic or international financial stability. A wide focus initially makes sense to acquire knowledge. BCPAs should, as a rule, be highly selective in coverage of countries on a the basis of need. Similarly, while all of the 25 Basel Core Principles in Box 1 are more or less relevant to the Fund, the macroprudential regulations have no greater immediate consequence than, for instance, the details of a country's bank licensing process.

While it is clear from paragraph 27 of the staff report that many countries are still far from complying with the Basel Core Principles, this could, in part, reflect their diverse stages of development. This also highlights the difficulty of approaching the assessment of country practices as a phenomenon independent of the overall economic development process. In this regard, the staff has rightly stressed that the assessor must have sufficient room for judgment to take a specific country's circumstances into account. It is clear that, while avoiding a mechanical application of Basel Core Principles, it is crucial for the Fund to continue promoting country compliance of relevant banking standards. This is best done as part of the FSAP exercise or as a stand-alone effort on a basis of need. Self-assessments with appropriate safeguards are also a useful option.

On the issue of publication, it is crucial not to lose sight of the basic purpose of the Fund's BCPAs, which is to assist member countries. Indeed, as staff acknowledges in paragraph 62 on page 23 of the staff report, the prospect of public dissemination may not only discourage participation, but also undermine members' trust in the confidential, and advisory role of the Fund. Therefore, I join other Directors in the view that the decision to publish BCPAs should be a national prerogative.

Mr. Woolford made the following statement:

We have an important issue before us, and the consensual nature of this discussion underlines its importance. The well written staff report has helped in this regard, and I would like to thank the staff for that.

We think that CPAs have proved useful for member countries. On the issue of technical assistance, I have some sympathy for the concern raised by Mrs. Jul. Technical assistance will obviously be needed for a number of countries, but one should not lose sight of the resource implications of that. In the last two discussions, there have already been a number of claims for additional technical assistance. We are fully supportive of this, but we need to keep an eye on resource implications for the budget.

On FSAPs, I would like to associate myself with the views expressed by Mr. Collins and other Directors. In many cases it seems sensible to conduct them within an FSAP, but there will be occasions, when one would prefer to use other vehicles, either because of the need for a rapid assessment or it needs to cover the broader financial system and might bring up additional issues. One of the countries of my constituency, for example, has an unusual financial system, and a CPA needs to be undertaken in this context. Therefore, I would like to associate myself with Mr. Collins's position in that regard. On the self-assessments, I would like to associate myself with Mr. Zurbrügg's view. They are indeed extremely important, especially when augmented by third party or external assessments.

On the issue of publication, I agree with the proposition that the staff according to which some countries will need the opportunity to implement improvements before the publication of the results. That appears sensible, and I would agree with that position with one qualification: There should be a presumption for publication, implying that, after some period of time, perhaps a number of years, publication should be seriously considered.

In thinking about publication it is important to distinguish what precisely is being published. Countries may be more open to publishing a brief summary paper that, for example, identifies problems but also states that the country had in place a number initiatives to counter them within a certain time frame. The type of publication is something that must be carefully considered.

Mr. Abbott recalled that several speakers had emphasized the close link between CPAs and the Fund's responsibility for Article IV surveillance as well as the close linkage of issues raised in CPAs with financial stability. The staff report had identified a number of weaknesses that were of concern to the Board with regard to financial stability. That issue should be carried forward with regard to the question of how disclosure should be handled. A number of policies on disclosure were already in place, and there was no need to add new policies. However, some of those policies overlapped and there remained some confusion, as there were different disclosure policies for the FSAP reports, for the ROSCs, Article IV reports, and for technical assistance reports. The disclosure policy on technical assistance reports was not satisfactory, given that the Board tended to receive relatively little feedback on the assessments conducted in that context.

To the extent that those assessments yielded information that was directly relevant to the Fund's role in Article IV surveillance, Mr. Abbott considered that there should be a presumption that the results of the assessments would not remain a matter for discussion exclusively between the staff and the authorities, but that they would be incorporated and presented to the Board as part of Directors' responsibility for surveillance. The entire CPA exercise had been envisaged as part of the Fund's universal role to ensure financial stability and perform Article IV reviews. Therefore, there should be more clarity that the Board would be a participant in that process to a greater extent than appeared to have been the practice in the past.

With regard to the question of disclosure, there were already standards for that within the context of Article IV consultations, and there was thus no need to invent new procedures, Mr. Abbott reiterated. The emphasis on providing technical assistance and encouragement for reform and other highly desirable procedures to help countries advance should not be used as a vehicle for effectively suppressing disclosure.

The staff representative from the Monetary and Exchange Affairs Department, responding to comments on the issue of self-assessments, recalled that, initially, when the Core Principles had been issued, self-assessments had been widely encouraged. Given that the format of those assessments had remained relatively ill-defined, the outcome had tended to show that practically all participants had at least a broadly satisfactory degree of compliance in all areas covered by the Core Principles. That result had demonstrated that there was a need to put in place a methodology in order to increase the consistency and quality of the assessments. A number of countries had also used third party assessors to perform staff-assessments. With the new methodology in place, the self-assessment process was becoming more robust than in the past. The methodology called for the assessments to be conducted by at least two experienced supervisors coming from different supervisory traditions. That was required to ensure the professionalism of the assessors and safeguard against any country bias. The Basel Committee strongly encouraged self-assessments and the Fund supported that approach, as it provided the Fund's work on assessments with a useful starting point.

The available evidence suggested that more recent self-assessments were much more rigorous and consistent than earlier ones, the staff representative observed. As ownership was extremely important in that context, countries themselves needed to identify what needed to be done. That approach was strongly favored by the supervisory community and by Fund staff. In some cases where countries expressed a wish to conduct self-assessments, the Fund had provided technical assistance.

Third-party assessments were an effective way of strengthening the self-assessment process, the staff representative considered, given that it was a country's prerogative to use an outsider to perform the assessment. With regard to questions on the initiative taken in Latin America, heads of state there had asked all countries to do CPAs, and the regional organization of supervisors was currently in the process of planning their implementation, because, if they were to be done quickly, outside resources needed to be tapped. As the process gained credibility, the Fund could increasingly make use of self-assessments. In that regard, it was also important to intensify cooperation on that between the Fund, the Bank, the Inter-American Development Bank, the regional association of supervisors and national supervisors to achieve results that enhanced credibility. It was hoped that those results could be used directly for the Fund's FSAP, and there were indications that other regions might initiate similar projects in the future.

On the issue of CPAs as part of the FSAP or as a stand-alone exercise, the staff representative said that the preference of the staff and the CPLG would be to do CPAs an integral part of an FSAP. However, the majority of the CPAs conducted so far had been stand-alone exercises performed as part of technical assistance. It was true that only a few industrialized countries had been participants in the first sample of CPAs that had been analyzed in the staff report, due to the fact that most CPAs had been conducted in the context of technical assistance. Only five CPAs had been done in the context of the FSAP so far. However, that balance would change in the future.

Mr. Collins wondered whether the staff could address the issue raised by many Directors that stand-alone CPAs would remain necessary. The staff had stated that they should all be done as part of the FSAP process in future, while, in the past, they had been done under technical assistance. That position did not seem to reflect accurately the views expressed by Directors.

The staff representative from the Monetary and Exchange Affairs Department responded that the staff intended to conduct CPAs as part of the FSAP process. However, as in the past, there would be room within technical assistance for stand-alone CPAs. In that context, there remained the concern as to how much additional technical assistance resources that required. At the current juncture, about 35 to 40 percent of technical assistance resources in the MAE Department were used for financial sector issues, mainly for banking supervision. Within that total, it seemed possible that most of what needed to be done could be carried out. Therefore, a number of those assessments would be done as technical assistance priorities. The Fund was not the only provider of technical assistance in that context; the World Bank, regional development banks, and a number of bilateral donors were also involved. Therefore, it was necessary to take stock of developments so far and to assess likely future demand on Fund resources in that area, given that other institutions were also involved.

Mr. Collins wondered whether the staff could elaborate on the issue of stand-alone CPAs in the context of technical assistance and those conducted under the FSAP. Given that some countries would not be involved in an FSAP for a considerable period of time and might not see a need for technical assistance either, how would the staff propose to ensure that those countries would still conduct a credible CPA? Was it possible that the United Kingdom, for example, would not have a CPA for more than five years, given that it would not be part of the FSAP for that period of time?

The staff representative from the Monetary and Exchange Affairs Department responded that the United Kingdom was expected to participate in the FSAP within the next two years, as all G-20 countries had committed to setting an example in that context. There were no explicit budget provisions for stand-alone CPAs outside the technical assistance process. However, there was always some room at the margin to perform a number of stand-alone CPAs.

Mr. Couillault wondered whether it was a correct interpretation of the staff's position that industrialized countries were excluded from having CPAs?

Mr. Woolford supported the view expressed by Mr. Collins, and considered that, while those assessments might not have been budgeted, the Board had been giving a clear indication as to the modalities under which they might be conducted.

The staff representative from the Policy Development and Review Department responded that, while there was a preference for incorporating CPAs into the framework of the FSAP and the FSSA process, there had been scope for stand-alone assessments in the past, and there would also be scope for them in the future. Comments on the broader issue concerning the specific modalities of the FSAP and the timing of the CPAs would be welcome at the current stage, although the matter would best be discussed in full as part of the FSAP review at the end of 2000.

The staff representative from the Monetary and Exchange Affairs Department added that the staff was aware of the Board's views on that matter and that, if a country wanted a CPA and felt there was a need for the Fund or the Bank to conduct it, the staff would attempt to accommodate such requests. Normally the Fund would follow the modular approach and do various standards assessments that would feed into the FSAP process at the following stage. That was done on a case-by-case basis.

Mr. Abbott asked the staff to provide additional information about stand-alone CPAs and about the circumstances under which they took place. It seemed to have been desirable, in the past, to provide technical assistance to all those who declared their intention to participate. Could the staff clarify as to how volunteering for participation in a CPA was encouraged in the context of Article IV surveillance? Would the staff prompt a member country to request technical assistance when weaknesses in supervision were discovered, or would the staff encourage a CPA in cases where a country appeared somewhat reluctant to have such a review? That process should be part of Fund surveillance and therefore, it should be proposed to member countries in a more vigorous manner than it appeared to be done at present. The current practice appeared to respond to those countries who displayed an interest in receiving Fund assistance.

Mr. Couillault said that his chair strongly supported the FSAP, but also would like CPAs included in the Fund's surveillance process. However, participation in the FSAP was voluntary. Therefore, countries needed to be encouraged to be part of an FSAP mission and could not be forced to participate. That had been the basis of the pilot project, and it was encouraging to see that there were no difficulties in finding candidates for the FSAP in 2000. If and when vulnerabilities were detected, it was imperative for the Fund to find ways to address the problems and help solve them. However, the basic approach for a pilot project had to remain voluntary participation.

The staff representative from the Monetary and Exchange Affairs Department, responding to questions on the linkage of CPAs to Fund surveillance and the issue of the publication of their results, noted that it had not been intended, at the current stage, to discuss the entire array of issues nor to set new policies. Currently, there was a variety of discussions underway following from the FSAP progress report, and further reviews would occur later in 2000, including the discussions on transparency to be held in the summer and the discussions on standards and codes for which an interim set of policies was already in place. All comments provided so far, including the views expressed in the current Board meeting, would be included in policy formulation at a later stage.

The concluding remarks of the most recent Board discussion on the FSAP had captured the variety of views that had again been expressed during the current meeting, the staff representative recalled. Those comprised Mr. Abbott's position that assistance for financial sector supervision should be an integral part of Fund surveillance. There appeared to be broad agreement on that point, but, while there was widespread support for the FSAP process, there was not full agreement on the question of its precise modalities. The discussion on those modalities would be held in the course of the FSAP review later in 2000.

In cases where the Fund provided technical assistance on Basel Core Principles assessments, their results had, in the past, been reflected in the policy discussions of the respective Article IV consultation, the staff representative observed. However, there had been changes in recent years with regard to the modalities and the roles of technical assistance and surveillance. Those changes were still ongoing, would figure prominently in the FSAP review later in 2000.

CPAs as part of technical assistance had so far been conducted on a confidential basis. However, their conclusions had always been taken into account in the broader work of the Fund on those matters, and, partly as a consequence of that, more recent Article IV consultations had tended to focus more than before on financial sector issues. The experience gained from CPAs in the context of technical assistance would thus provide valuable feedback for the wider framework without establishing a formal process.

The staff representative from the Policy Development and Review Department, responding to comments and questions relating to the issue of publication of CPA results, noted that there was no intention on the part of the staff to propose a new policy. Clear interim guidelines for handling the question of publication in the context of the FSAP/FSSA and the ROSC process were already in place. There appeared to be a consensus on the view expressed on that issue in Mr. Bernes's preliminary statement that CPAs undertaken as part of the FSAP should be subject to the publication policy that would be decided later in 2000 as part of the final FSAP review. However, as had been pointed out by Mr. Woolford, it was necessary to differentiate as to what precisely would be published—a summary or a more comprehensive presentation of the results. With regard to summary assessments, there was already an agreed process in place allowing their publication and their discussion in the Board on a voluntary basis. At the current stage, there was no proposal on the part of the staff to change that. With regard to a possible delay of any CPA publication, that would also have to be addressed later in 2000 in the context of the upcoming review.

The staff representative from the Monetary and Exchange Affairs Department, responding to a question raised by Mr. Junguito, Ms. Jul, and Mr. Zoccali on the new capital adequacy framework and potential reforms of the Core Principles, reiterated that the entire discussion related to work in progress. The staff had provided comments on the BCBS's consultative paper, which had been distributed to the Board in February. A new consultative paper would be produced at a later stage. It might be convenient for the Board to discuss the matter, once that paper had been circulated.

The discussion of the capital adequacy framework currently under way included most of the major emerging market countries as members of a group whose composition broadly resembled that of the G-20, the staff representative concluded. A major revision of the Core Principles was bound to come about once the reform of the capital adequacy framework would be completed. While the Basel Committee was already aware of some areas that needed revisions, the intention was to address those revisions all at one time, when the new capital adequacy framework was in place, rather than reviewing individual sections of the Core Principles at the current stage and others later. The aim was to limit the disruption to the stability of both the Core Principles and the methodology to a single and comprehensive review process.

Ms. Jul expressed the wish that Directors may have the opportunity to comment on the reform of the capital adequacy framework before the staff's comments would be sent to the Basel Committee, so that Directors could add their concerns and questions to those comments.

The Acting Chairman replied that Fund staff and management had taken note of the concerns expressed on that subject and recalled that it was an ongoing process in which more time would be needed.

The Acting Chairman made the following concluding remarks:

Executive Directors welcomed the opportunity to review the experience to date with 26 Basel Core Principles Assessments (CPAs), conducted by the Fund and the World Bank. Given the key role of banks in the financial sectors of most countries, Directors considered CPAs to be a crucial element of the broader Financial Sector Assessment Program (FSAP). Directors representing countries which had undergone CPAs noted that the results of CPAs had proved useful for strengthening systems of banking regulation and supervision. While recognizing the preliminary nature of this survey, Directors, nevertheless, stressed the importance for the Fund to pursue vigorously its work in the area of financial sector assessment so as to provide its diverse membership with the assistance they will need to further strengthen their financial systems.

Directors welcomed the development of a methodology for assessment, and noted the significant improvements that this methodology had brought to the assessments. They also welcomed the Fund's increasingly active collaboration and dialogue with the Basel Committee, and encouraged staff to continue to contribute to the efforts of the Basel Committee to further improve the Core Principles and their implementation. Directors were encouraged by the cooperation between Fund and Bank staff and the national authorities in the preparation of CPAs. They considered that the Fund's universal membership put it in a unique position to identify concerns that countries may have and to disseminate more widely the work on raising standards in the financial sector.

Most Directors agreed that CPAs are best undertaken within the broader framework of the FSAP, in order to address financial vulnerabilities more fully and provide better linkages to the overall macroeconomic conditions and other preconditions for such assessments, such as effective accounting as well as legal and institutional frameworks. At the same time, there will continue to be a role for stand-alone assessments as part of a technical assistance program, or in the course of drawing up a reform agenda, or as modules for Reports on the Observance of Standard and Codes (ROSCs).

Directors observed that the 26 assessments showed serious weaknesses in banking supervision in many countries, noting, in particular, weaknesses in the implementation and enforcement of regulations and law in systems for managing and monitoring bank risks, in undertaking prompt action to correct incipient weaknesses, in consolidated supervision, and in establishing many of the preconditions for effective supervision, such as accounting and legal systems. They urged the authorities in these countries to take necessary corrective actions expeditiously. Directors considered that technical assistance, without neglecting other key areas, should focus on addressing these weaknesses, and resources for this purpose should continue to be carefully reviewed and increased as needed.

While self-assessments have tended to be more optimistic than CPAs conducted by the Bank and the Fund, Directors noted that self-assessments, which could be done with the help of outside experts, are valuable if prepared on the basis of the new methodology and if followed by an independent assessment by the Fund or the Bank. Directors pointed to the usefulness of self-assessments, in particular as an indicator of the degree of the country's ownership of the reform effort and also to lay the groundwork for the external assessment and thus help address the resource constraint.

Directors stressed the importance of assessing compliance, not only through having in place the appropriate rules but also by ensuring that the rules are fully complied with in practice. In this context, they agreed that CPAs would need to identify and help prioritize corrective actions. Directors saw the need for a supportive role of technical assistance from the Fund and the Bank to help improve implementation. They also noted the importance of keeping the Basel Core Principles and the accompanying methodology up to date, making use of experience gained so far from the assessments.

The Board will consider the broad issue of publication of CPAs conducted as part of FSAP in the context of the review of the pilot project later this year. As already agreed, summaries of the CPAs will be published on a voluntary basis as part of the ROSCs.

Directors generally considered that the prospect of improving national regulatory and supervisory capabilities was providing adequate incentives for countries to participate in CPAs.

In conclusion, Directors agreed that a further review of experiences with CPAs could be highlighted as part of the next review of the FSAP later this year.

The Acting Chairman noted that the Board approved the publication, with some delay, of the concluding remarks and the staff report, in view of the upcoming meeting of the Liaison Group in Basel.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/47 (5/3/00) and EBM/00/48 (5/5/00).

2. POLICY ON CONTINGENT CREDIT LINES—EXTENSION OF DEADLINE FOR REVIEW

Paragraph 20 of Decision No. 11627-(97/123)SRF, as amended, shall be amended by deleting "May 5, 2000" and replacing it with "August 31, 2000". (EBS/00/81, 4/28/00)

Decision No. 12197–(00/48) SRF, adopted
May 4, 2000

3. PAKISTAN—CONSULTATION WITH WORLD TRADE ORGANIZATION ON BALANCE OF PAYMENTS RESTRICTIONS

The Executive Board approves the recommendation to consult with the World Trade Organization (WTO) in connection with the forthcoming consultation of the WTO Committee on Balance of Payments Restrictions with Pakistan as set out in EBD/00/37 (5/1/00).

Decision No. 12198–(00/48), adopted
May 3, 2000

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, and an Advisors to Executive Director as set out in EBAM/00/62 (5/2/00) is approved.

APPROVAL: March 15, 2001

SHAILENDRA J. ANJARIA
Secretary