

Banking Supervision

Technical Assistance in Fiscal Year 2017

With a view to help promote financial stability in the region, METAC continued to support member countries' efforts to (i) strengthen supervisory institutions, (ii) implement reform strategies to enhance banking supervision practices, and (iii) strengthen supervisors' capacity. revolved around a Results-Based Management (RBM) framework focused on four topical log-frames, with the aim to plan and track the results of TA activities in each country:

- i. **Regulatory and Prudential Framework.** *To achieve strengthened financial sector surveillance by improving the regulatory framework in line with international standards.* Several countries requested TA to improve their regulatory frameworks in response to the IMF's Financial Sector Assessment Programs, in order to further align them to Basel Committee on Banking Supervision (BCBS) standards and guidelines, as the case in **Egypt, Afghanistan, Algeria, Tunisia, Djibouti, Morocco, and Iraq.**
- ii. **Basel II/III Implementation.** *To ensure that banks' capital and liquidity positions adequately cover their risks and contribute to financial stability.* METAC continued its assistance to implement Pillar 2 of Basel II/III, particularly to enhance the supervisory review process in evaluating the adequacy of capital assessed by banks via internal capital adequacy assessment process (ICAAP), akin to **Egypt** and **Morocco.**
- iii. **Risk-Based Supervision and other Supervisory Processes.** *To use supervisory resources effectively and better oversee key risks in the banking system.* METAC continued its assistance to **Lebanon, WBG** to further enhance risk-based supervision:

In Lebanon, by completing the upgrading of the RBS inspection manual of the Banking Control Commission of Lebanon (BCCL)'s and assisting in its implementation by testing it on pilot banks; and in WBG, by assisting the supervisors of the Palestine Monetary Authority (PMA) in assessing banks' risks on a forwardlooking basis. METAC has also started a program with the Central Bank of **Sudan** (CBoS) to upgrade its inspection manual to align it with RBS approach. This program will continue throughout FY18.

- iv. **Stress Testing:** To enhance financial stability through early detection of banking sector vulnerabilities an effective and timely response. In FY17, this has become an area of interest to many countries in the region, including **Afghanistan, Jordan, Egypt,** and **Lebanon.** In **Jordan,** METAC promoted the implementation of more advanced approaches to test the vulnerabilities of banks against stressed conditions, by using next generation solvency and liquidity stress test modules.

Afghanistan:

Banking Regulation and Supervision (August 29-September 1, April 16-20)

To address the weaknesses and poor governance practices in the banking sector, METAC has been supporting the DAB efforts to enhance its regulatory and supervisory frameworks. In this context, METAC undertook two off-site training missions in Amman:

- The first mission trained a team of supervisors on how to deal with weak banks, to enhance their capacity to identify problem banks at an early stage and implement effective measures to manage them. The training focused on the difficulties DAB supervisors encounter while inspecting problematic banks, and the possible measures that could help manage such cases.
- The second mission focused on the techniques of stress testing as an important tool for assessing the resilience of individual banks to adverse economic and financial conditions in a forward-looking perspective. The mission aimed to enhance capacity of DAB supervisors in detecting banks' vulnerabilities under severe but plausible shocks, and accordingly, identifying weak banks at an early stage, and taking corrective actions.

Algeria:

Banking Regulation and Supervision (July 17-21, March 12-16)

Credit risk is a major concern for banks in Algeria. The stress tests performed by the FSAP in 2014 indicated that credit and specifically loan concentration are the main banking sector risks in Algeria. The BA has been working on enhancing and improving the supervision of credit risk in the banking sector and further building the capacity of its supervisors in better monitoring this risk. To support these efforts, METAC organized a national workshop on credit registry, to train a group of 28 staff from various departments of BA. Focusing on the latest developments on credit registry and the experience of other METAC member countries, the workshop emphasized on how to take advantage of the credit registry to monitor credit risk, particularly those arising from large borrowers and credit concentration. Following the training, METAC assisted BA in identifying areas for improving its credit registry to meet international best practices and to strengthen credit reporting by banks.

In a second mission to Algeria, METAC trained BA supervisors on the ICAAP, covering the objectives of ICAAP, its framework and design, stress testing as an essential element in assessing capital needs under stressful conditions, material risks to be assessed, and the methodology and techniques to quantify risks and risk appetite. The mission also assisted the authorities in clarifying the concept of related parties, as recommended by the 2013 FSAP, and provided specific suggestions to amend the BA regulation related to this topic.

Djibouti:

Banking Regulation and Supervision (October 16-27, February 5-16)

METAC's first mission to Djibouti assessed the CDs needs of "Banque Centrale de Djibouti" (BCD). Following the 2008 FSAP, the BCD enhanced the banking regulatory and supervisory frameworks with IMF assistance. Nevertheless, banking regulation needs further strengthening, the capital adequacy, assets classification and

provisioning, exposures of related parties, internal control, corporate governance, risk management, and anti- money laundering and fighting terrorism. Banking supervision also needs to be strengthened, by focusing on risks and internal control, developing enforcement framework, conducting penalty procedures, and enhancing the existing resolution framework. METAC identified areas where it can provide assistance in the regulatory and supervisory frameworks, and agreed with the authorities on a medium-term CD agenda.

A subsequent mission assisted the BCD in improving their prudential regulations on the equity components of the capital adequacy ratio, loan classification and provisioning, and related parties. Accordingly, the mission proposed three instructions, which should help to strengthen banks' financial soundness and prompt the BCD to adopt an effective regulatory framework. The mission also trained the banking supervision staff on the implementation of these regulations.

Iraq:

Banking Regulation and Supervision (November 20-28, March 5-12, April 22-25)

Strengthening banking supervision is critical to monitor and contain the damage caused by the crisis in Iraq on the banking system. Accordingly, as part of the IMF Stand-By Arrangement, the Central Bank of Iraq (CBI) committed to prepare regulatory changes to strengthen prudential standards and bank supervision, with the support of METAC and other external consultants. In this context, METAC has developed a two-year TA program to upgrade the regulatory framework:

- The first mission of the program focused on aligning regulations on capital adequacy ratio and liquidity measurement with the requirements of Basel II/III. The regulation on capital adequacy ratio focused on the common equity Tier 1 capital, capital conservation buffer, and leverage ratio. The regulation on liquidity aligned the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) with Basel III, and set a minimum floor in local currency, in each major currency, taking into consideration the particularity of the Iraqi banking system. The regulation on liquidity also defined additional metrics to measure and manage liquidity risk that include: contractual maturity mismatch; concentration of funding; and market-related monitoring tools, and emphasizing on liquidity governance.
- The second mission completed the drafting of regulations on (i) risk management framework, (ii) loan classification and provisioning, (iii) credit risk management to provide a comprehensive bank-wide view of credit exposures consistent with a bank's risk appetite, (iv) measuring and managing concentration risk, (v) large exposures measured on solo and on a consolidated basis, and (vi) related parties' exposures, in line with BCBS guidelines, and after considering the Iraqi context. These regulations set out certain detailed requirements and reporting obligations for banks.
- The third mission aimed at discussing with a group of the CBI officials the regulations drafted with METAC assistance in November 2016 and March 2017. The mission trained the CBI officials on the implementation of these regulations,

and prepared them to oversee the implementation and train other CBI supervisors and officials.

Jordan:

Banking Regulation and Supervision (August 14-18)

The Central Bank of Jordan (CBJ) has undertaken significant reforms to enhance and its capacity to monitor the banking system in Jordan, including the development of an early warning system, the establishment of the Financial Stability Department, and the adoption of the Next Generation Balance Sheet to test the vulnerability of the banking sector. As part of METAC's support to these reforms, a mission provided training the CBJ supervisors on stress-testing as an essential tool to assess the resilience of banks to adverse economic and financial shocks. The mission discussed how to analyze and report on multi-period sensitivity and scenario solvency testing and how to integrate them in banking supervision. It also covered liquidity stress-testing and its interaction with solvency stress-testing and interest rate risk, and how to design stress test scenarios. These will help supervisors identify vulnerable banks at an early stage and contribute to enhancing financial stability.

Lebanon:

Banking Regulation and Supervision (September 19-30, February 20- 24, April 25-28)

Over the last ten years, the BCCL has been implementing a risk-based supervision (RBS) program. In this context, a METAC mission assisted the BCCL on the implementation of the risk-based supervision (RBS) manual that was developed earlier with METAC assistance. The mission worked with a task force team of BCCL supervisors on a pilot bank to identify difficulties and challenges in the implementation process. The mission assisted in developing a template for RBS report, which would help to assess how a bank manages risks and to signal the areas that could threaten the soundness and safety of the bank. A follow-up on mission on RBS will take place in FY18.

Morocco:

Banking Regulation and Supervision (October 17-27, March 6-17)

METAC joined an MCM mission to review the preparation of Bank Al-Maghrib's (BAM) supervision department for the move to a more flexible exchange rate arrangement. It assessed the implications of this move on foreign exchange, interest rate, and liquidity risks, and advised on the ongoing supervisory efforts in the run up to the transition, as well as on market risk and asset and liabilities management issues that would be raised with the gradual dis-anchoring from the current currency composite reference. Together with the authorities, METAC also prepared a two-year road map for banking supervision of market risks, to continue to assist the BAM in this area.

A follow-up METAC mission assisted BAM on supervising market risk from a riskbased perspective and mapping market risk. The mission identified the regulatory texts and

supervisory procedures that would require adjustments in order to enhance further supervision of market risk. Follow-up missions are planned throughout the Fiscal Year 2018.

Sudan:

Banking Regulation and Supervision (December 4-8, March 12-16)

METAC continued its support to the Credit Information and Scoring Agency (CIASA), which is owned by the CBoS, to help them improve the credit registry system and develop a credit scoring system, and strengthen the authorities' capacity to monitor credit risk concentration and to detect non-performing loans at an early stage. The mission followed up on progress made in implementing METAC's earlier recommendations (February and March 2016). It also determined the status of installation and effectiveness of the CIASA credit scoring system, and advised on some key technical components related to credit scoring.

A second METAC mission marked the start of a series of TA missions to help the CBoS implement its reform strategy to strengthen banking supervision. The mission reviewed the current inspection manual and provided recommendations to align it with risk-based supervision. This assistance is expected to continue throughout FY18, with a view to establish a risk-based supervision framework in Sudan.

Tunisia:

Banking Regulation and Supervision (January 16-20)

METAC undertook its first CD mission to the Central Bank of Tunisia (CBT), to support the authorities' banking regulatory and supervisory reforms in the context of the IMF Stand-By Arrangement (SBA). The mission provided training on market risk to 15 supervisors: It conducted peer analyses of similar countries on market risk, and offered practical examples to illustrate the calculation of capital charges, covering interest rate, equity, and foreign exchange risks under the standardized approach of Basel II. The mission also helped the CBT in drafting a framework on market risk, to help them curb excessive risk-taking and meet one of the structural benchmarks of the SBA. In this context, it discussed with the authorities various options, advised them to keep the regulation straightforward (i.e., without going into complex techniques such as securitization, CDS, etc.), emphasized the need for a precise definition of the trading portfolio, drawing on recent work undertaken by the Basel Committee to limit regulatory arbitrage between the banking trading books, and prepared a detailed outline of a regulation covering capital charges for market risk.

West Bank and Gaza:

Banking Regulation and Supervision (September 25-October 6)

Banks in WBG face several risks, including high exposure to the Palestinian Authority, as well as an unstable political and operating environment. The PMA has undertaken several reforms to enhance the soundness of the banking sector. In this context, METAC has completed a series of peripatetic missions since October 2012, which have

resulted in the preparation of an inspection manual covering key aspects of risk-based supervision (RBS). In FY17, a METAC mission assisted the PMA in the implementation of the RBS manual. The mission worked with the PMA supervisors to assess, in a forward-looking perspective, the risk profiles of four domestic banks, of which two systematically important. The supervisors have gained a sound understanding of the business model, management and major issues of the supervised banks. METAC will continue to provide TA on the implementation of the RBS manual, including by training analysts to prepare risk assessments, and by field-testing the manual.