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TECHNICAL ASSISTANCE REPORT—BANKING SUPERVISION AND REGULATION

This Technical Assistance report on Myanmar was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on October 2019.

Disclaimer:
This document was prepared before COVID-19 became a global pandemic and resulted in unprecedented economic strains. It, therefore, does not reflect the implications of these developments and related policy priorities. We direct you to the **IMF Covid-19 page** that includes staff recommendations with regard to the COVID-19 global outbreak.

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Monetary and Capital Markets Department

MYANMAR

Banking Supervision and Regulation

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May 2020

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GLOSSARY

CAMEL	Capital, Assets, Management, Earnings, Liquidity
CBM	Central Bank of Myanmar
FIL	Financial Institutions Law
FISD	Financial Institutions Supervision Department
GIZ	Deutsche Gesellschaft fur Internationale Zusammenarbeit GmbH
IFRS	International Financial Reporting Standards
IT	Information Technology
LTX	Long-Term Expert
MCM	Monetary and Capital Markets Department
RBS	Risk-Based Supervision
TA	Technical Assistance

PREFACE

At the request of the Central Bank of Myanmar (CBM), Mr. Ian Tower, IMF short-term expert for the IMF's Monetary and Capital Markets Department (MCM), visited Yangon for a series of missions in 2018 and early 2019 on banking supervision. This report has been prepared following the final mission in the series, from March 25 to April 5, 2019, but summarizes the activities of five separate missions.

The objectives of the work, which followed earlier visits to Myanmar by the expert, were to support the CBM in the development of bank regulation and supervision, in particular its introduction of a more risk-based approach to supervision. The expert met, over the course of the five missions, with Deputy Governor of the CBM, U Bo Bo Nge, the Director-General of the Financial Institutions Supervision Department (FISD), Daw Than Than Swe, the Deputy Director-General of FISD, Directors and many other supervisory staff and worked closely with the IMF Long-Term Experts (LTX) on Banking Supervision, Ms. Carmencita Santos and Mr. Inwon Song.

Mr. Tower expresses his appreciation to the management and staff of the CBM for their engagement in the discussions and for their warm welcome.

The expert also expresses his great sadness at the death during the period of this Technical Assistance (TA) program of Ms. Carmencita Santos, his appreciation of her support and acknowledgment of the outstanding contribution that she made to the development of financial supervision in Myanmar and many other countries.

This report summarizes the work of the missions. It reflects comments from the CBM and relevant departments of the IMF. Extensive outputs from the work have also been provided separately direct to FISD.

This technical assistance was financed by the Japan Administered Account for Selected IMF Activities (JSA).

EXECUTIVE SUMMARY

The CBM requested TA on bank supervision. The expert worked with the management and staff of the FISD over five missions in 2018 and early 2019 to develop a new, more risk-based approach to bank supervision. Two guides were delivered, one on offsite supervision and the other, still in draft form, on risk-based supervision generally, including a risk matrix approach to risk assessment and procedures for examinations. Many pilot applications of the new tools were prepared with FISD staff.

The initial focus of the work was on offsite supervision. The Guide to Offsite Supervision sets out processes for offsite monitoring, including in-depth financial analysis (using key financial ratios, thresholds and benchmarks). Initial procedures were developed for stress-testing (illustrated with a small-scale stress test exercise on three banks) and for use of enforcement powers. Guidelines on using the CBM's established CAMEL (Capital, Assets, Management, Earnings, Liquidity) methodology in a more risk-based way were produced.

Later missions developed a full risk-based supervision framework, including for examinations. The Guide to Risk-Based Supervision sets out approaches to risk assessment and risk mitigation based on international practices. The key risks identified in the Myanmar context include legal, regulatory and reputational risk, strategic risk and group and related parties risk as well as credit, market, operational, and liquidity risks. Initial approaches to measuring impact (based on size) and supervisory risk appetite were developed. Supervisors will apply risk mitigation tools within the context of a supervisory strategy and plan; and will develop examination plans based on the risk assessment and risk mitigation priorities.

Various supervisory tools were developed. For offsite supervision, templates were produced for monthly and quarterly reporting of the results of financial analysis and other significant developments. A risk matrix was developed for use in preparing the supervisory plan and for scoping examinations—FISD will run the approach in parallel with CAMEL for the present, using CAMEL only in offsite supervision. Various standard risk mitigation tools have been set out in the Guide to Risk-Based Supervision, including cross-border supervisory cooperation (the guides apply to all banks, including foreign bank branches). Risk-based questionnaires were produced to facilitate the conduct of examinations.

The CBM is implementing the new approach over the period until 2020. While perfecting a complete risk-based approach will take years, the CBM is committed to implementation and is, for example, already undertaking risk assessments using the new risk matrix tool as examinations come due. Recommended priorities are:

- continuing to work with the banks to support their preparation for risk-based supervision, (the overall approach was presented to bank at a seminar in April 2019);
- issuing guidance to banks on expected risk management practices;
- continuing to undertake internal training on the guides;
- introducing electronic reporting and enhanced database capacity, as planned; and

- reviewing the organization, decision-taking processes and resources of FISD to reflect the demands of risk-based supervision such as the need to exercise supervisory judgment.

Table 1. Key Recommendations

Recommendation	Timeframe
The Guide to Risk-Based Supervision should be finalized, with further TA support as required, and once translated, should be adopted by the CBM (the Guide to offsite Supervision has been adopted already).	End 2019
The CBM should, as part of its implementation of risk-based supervision, consider further: • how best to work with the banks to support their preparation for risk-based supervision, which might include issuing a short document describing the approach; • the best way to issue the planned guidance to banks on expected risk management practices; and • whether the demands of risk-based supervision, such as exercising supervisory judgment, require changes in the organization, decision-taking processes and resources of FISD.	September 2019
The CBM should continue to undertake internal training on the processes set out in the guides and the use of supervisory tools.	On-going
To support effective risk-based supervision, the CBM should: • review the need for reporting by the banks of additional data on a regular basis, for example as necessary to support further stress testing by supervisors (which should be supported by IMF TA, if available); • consider whether it needs further development of IT infrastructure in addition to the planned introduction of electronic reporting and enhanced database capacity; and • consider developing a timetable and plan for the implementation of new risk-based regulatory capital and liquidity requirements based on the Basel Committee's Basel II/III framework.	End 2019

I. INTRODUCTION AND APPROACH

1. **The CBM requested TA on the development of banking supervision.** The IMF has been providing TA on bank regulation and supervision to the CBM over several years. The missions covered by this report[1] followed-up missions by the same expert in 2016 and late 2017.[2]

2. **The expert worked mainly with FISD staff.** He met, over the course of the five missions, with Deputy Governor of the CBM, U Bo Bo Nge, who oversees the work of FISD, with Director-General of the FISD, Daw Than Than Swe, the Deputy Director-General of FISD, Directors of FISD, and many other FISD staff.

3. **The work was coordinated with other IMF staff and development partners.** The expert worked closely with the IMF LTX on Banking Supervision in Myanmar, Ms. Carmencita Santos and Mr. Inwon Song. Ms. Katharine Seal, from the Financial Regulation Division of the IMF's Monetary and Capital Markets Department, participated in one mission. The expert also met with Mr. Tony Deary of Deutsche Gesellschaft fur Internationale Zusammenarbeit GmbH (GIZ) to discuss recent developments, including the GIZ-supported banking sector IFRS implementation project; and with World Bank staff.

4. **The expert worked with FISD staff to develop a risk-based approach to bank supervision.** The work focused initially on offsite supervision, building on the initial work of the LTX and FISD staff and moved later to onsite supervision. The expert worked by:

- discussing the CBM's needs with senior and experienced supervisors and relating them to the main elements of international practices in bank supervision;
- developing draft text for guides to supervision, including templates for key outputs such as an examination report and questionnaires for use by examiners;
- presenting and discussing the draft text with a small team of experienced supervisors and revising the text and templates accordingly;
- developing pilot applications of each part of the approach, including a complete set of processes for one large bank and risk assessments for some other banks; and
- presenting key aspects to wider groups of FISD staff and, in the final mission, to representatives of all the banks in Myanmar.

5. **Two guides have been developed, covering all aspects of risk-based supervision.** Initially, the objective was to develop one guide for offsite supervision and one for onsite. The expert later decided to recommend that onsite processes be included in a broader guide to risk-

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[1] The missions took place from March 5–16, 2018, June 11–22, 2018, September 17–28, 2018, November 26–December 14, 2018 and March 25-April 5, 2019.

[2] See Report: Myanmar: Banking Regulation and Supervision, June 2016 (DMSDR1S-#5991016) and Report: Myanmar: Banking Regulation and Supervision, November 2017.

based supervision, including the risk assessment methodology that should be used to determine the scope of onsite work.[3]

6. **The CBM has formally adopted the guide to offsite supervision and will adopt the second guide, after translation.** The IMF translator, Ms. Zar Chi Phyoe Wyint, is producing versions of the guides in the Myanmar language, working with FISD staff to ensure the use of appropriate technical language. The translation of the offsite supervision guide is almost complete. The second guide will be translated once finalized.

7. **The approach is based on the CBM's objectives and powers, key risks in the Myanmar banking system and on international practices.**

- It draws on existing CBM tools such as the CAMEL rating system, but introduces international practices in risk-based supervision that are new to Myanmar.
- A risk assessment methodology (using a risk matrix) has been closely based on that of the Monetary Authority of Singapore, which has also provided training to FISD staff.
- The approach has, however, been adapted to meet Myanmar needs, for example adopting a set of key risks that reflects the business, operating environment and ownership structure of Myanmar banks.
- The recommended approach has been based on the objectives and powers of the CBM as set out in the Financial Institutions Law (FIL).

8. **Risk-based supervision will place demands on Myanmar banks.** Risk management practices are likely to require significant improvement to match the expectations underlying risk-based supervision. An initial high-level overview of the CBM's approach was presented to Myanmar banks by the expert and the LTX at a seminar during the March–April 2019 mission.

9. **The expert provided advice on various other issues during the missions, as requested by FISD management.** Key outputs (not covered any further in this report) were:

- a small stress-testing exercise carried out for three banks to illustrate a possible approach: the IMF's standard spreadsheet (Stress Tester 3.0) was used for the work and a presentation made on findings and key lessons;
- advice to FISD on various issues in regulation, including comments on drafts of directives that have since been issued by the CBM;
- advice on the issues in regulation and supervision of residential mortgage lending ahead of a CBM guideline to banks planning to offer home loan products in Myanmar for the first time: a note was provided by the expert;
- advice on the organization of supervision resources, as an input into the Director-General's planning for a new structure of FISD introduced in mid–2018, which divides supervisors into offsite and onsite units; and

[3] In due course, the guides could be integrated: the approach to offsite supervision follows risk-based principles and the guide to risk-based supervision cross-refers to the guide to offsite supervision, where necessary.

- ad hoc staff training: the expert presented to FISD staff on market and liquidity risks (which are less familiar to staff than credit risk).

II. Outputs of the Missions

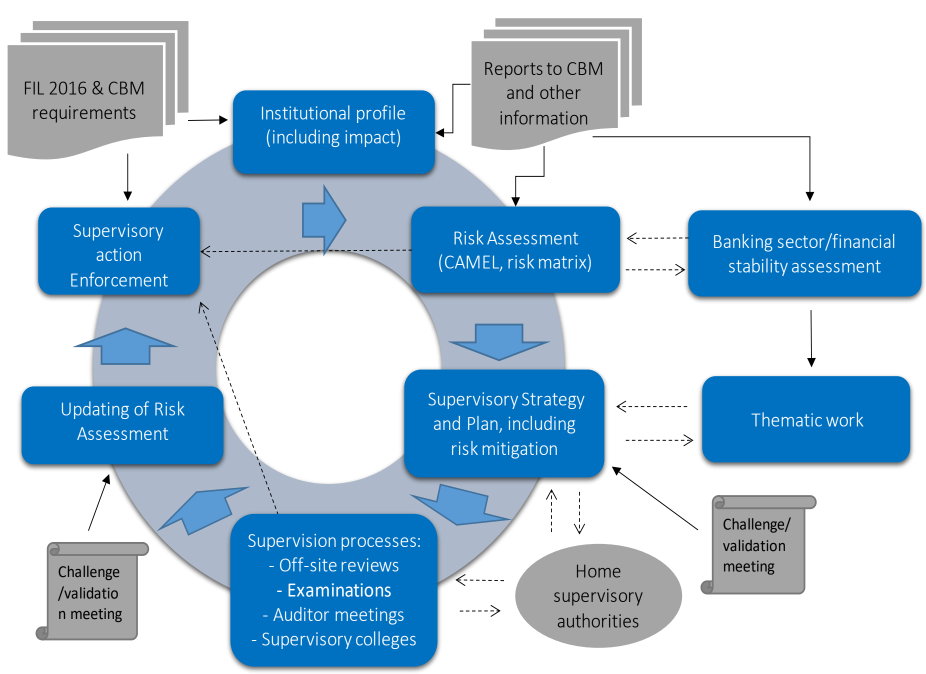
10. **The main outputs of the missions were:**

- a Guide to offsite Supervision[4] with associated templates and including a guide to CAMEL ratings—see Appendix I for the complete contents; and

- a Guide to Risk-Based Supervision[5] with associated templates and including extensive risk-based examination questionnaires: the expert also produced, in cooperation with FISD staff, a set of pilot completed documents for one bank, including a risk assessment, supervisory strategy and plan, examination scope, examination meetings schedule and a (partially-completed) examination report. See Appendix II for the complete contents (based on the draft left with FISD after the March–April 2019 mission).

11. **The guides together set out a standard cycle of risk-based supervision.** The approach can be represented as in Figure 1.

Figure 1. Risk-Based Supervision—Process Overview



Source: IMF Expert.

[4] See (English language version): Objectives and Tasks of offsite Supervision of Banks: A Guide for Central Bank of Myanmar Bank Supervisors (Version 1, Issued September 2018).

[5] See: Risk-Based Supervision of Banks: A Guide for Central Bank of Myanmar Bank Supervisors, draft April 2019.

- The main supervisory work is focused on the individual bank and is a continuous process: supervisors use information from regular supervisory reporting and other sources to assess risk; supervisory work is then directed at mitigating key risks, on completion of which the risk assessment is updated. Supervisory action (and/or use of enforcement powers) is a key output of the process.

- In addition, the CBM will identify risks that affect multiple banks (or financial stability) for assessment and mitigation using a "thematic" approach.[6] This aspect of the framework has been less fully developed to date and no worked examples have been produced (although the CBM is arguably already using such an approach in practice, in the case of the overdraft review).

A. Guide to Offsite Supervision

12. **The main features of the guide (and related issues discussed during the missions) are:**

- The guide sets out a detailed approach to financial analysis, including ratios and benchmarks designed to guide early supervisory intervention,[7] in particular to mandate certain action in case of adverse developments. The focus is on individual banks. FISD is well equipped for such an approach, having developed an excellent spreadsheet showing balance sheet developments and movements in ratios for each bank and having appointed supervisors in the offsite supervision unit to take the lead in monitoring each bank.

  FISD is currently producing high quality analysis of developments across the banking sector for reporting to senior management and some analysis of individual banks, for example in the context of examinations. It needs to complement this with in-depth reviews of developments in the risk profile of each bank, as set out in the guide.

- The guide sets out processes for monthly and quarterly reporting of developments in the financial condition of the banks, taking advantage of the relatively frequent reporting of financial information; the quarterly process has been designed as the key output of individual bank supervision and a template is included in the guide as well as a worked example. It will be important for supervisors to:

  - identify in their quarterly reviews the significant developments over the period, including developments in the management, business model etc., as well as

[6] Thematic supervisory work involves assessing risk and/or taking risk mitigation actions focused on more than one bank and potentially all the banks. It may involve comparing risks or aspects of risk management across banks (sometimes referred to as horizontal supervision). It may involve mitigating risk by requiring multiple banks to take the same action. The results of thematic work may usefully be published, where not confidential.

[7] For example, the guide sets out levels of Tier 1 and Total Capital ratios (and related conditions) which should prompt action by supervisors.

  movements in key ratios and areas where the bank is an outlier, as identified by peer group comparison;
  - draw out the material supervisory concerns arising from the analysis; and
  - propose appropriate supervisory action, where necessary.

- The guide sets out an approach to determining CAMEL ratings based on qualitative as well as quantitative criteria.

  - Supervisors are expected, as part of the quarterly review process, to review and revise, as necessary, the CAMEL ratings.
  - An annex to the guide sets out issues to consider on each CAMEL item and for each of the one to five ratings, for example (for Capital) focusing on capital quality, access to new capital and the adequacy of capital management as well as the level of capital ratios.
    This is a significant change from FISD's previous mainly quantitative approach.

- The Guide makes clear that stress-testing by the CBM will be a part of the supervision process, starting with an annual exercise undertaken using supervisory information; but detailed procedures for carrying out stress tests in practice will need to be developed in the future, drawing on further TA, if available.

- The Guide includes guidelines for supervisors on when to consider the use of the CBM's enforcement powers, where appropriate.

  - It will be important for FISD to be ready to use formal powers to require corrective actions or impose administrative penalties, as necessary, including where requests to banks to take action have not led to the required results.
  - There appears to be a need to establish internal procedures, including appropriate decision-taking arrangements, to govern the use of powers in practice. This is an area where further TA support could be provided.

- The guide includes material on the application of offsite supervisory processes to the groups of which many banks are a part and foreign bank branches.

  - The guide classifies the different types of group in Myanmar. Mainstream banking or financial groups are limited at present, but many banks are part of wider nonfinancial groups or share ownership with nonfinancial entities.
  - The approach to foreign bank branches is broadly the same as for domestic banks but includes monitoring of parent bank developments and coordination with the home supervisory authority.

13. **While the guide is fit for immediate implementation, the effectiveness of offsite supervision would be increased by:**

- the development of an Information Technology (IT) infrastructure, including electronic reporting by banks and a database and analytical capacity: the expert understands that the CBM has been discussing a comprehensive approach with suppliers; for the present, the paper-based approach exposes the process to high risks of error and inaccuracy, while also being inefficient to operate in practice;

- action to fill gaps in the confidential supervisory data reported to the CBM: these include full details of off-balance sheet business, more detailed information on nonperforming loans (including the economic sectors of borrowers) and data that would support fuller analysis of liquidity such as maturity gap information, sources of deposits (by sector etc.,) and analysis of large deposits.

14. **The approach will also benefit from improvements in accounting and auditing in Myanmar.** While many banks are working towards implementation of International Financial Reporting Standards, they are not required to do so until 2023. The supervision process is exposed to shortcomings in the underlying accounting information. The CBM does, however, maintain an active dialogue with auditors of banks. A process for reviewing audited annual financial statements and meeting with auditors is included in the Guide to offsite Supervision.

B. Guide to Risk-Based Supervision

15. **The main features of the guide (and issues discussed during the missions) are:**

- The guide sets out a risk matrix approach to risk assessment.

    - This has been based on the framework of the Monetary Authority of Singapore, adapted to Myanmar circumstances.
    - As explained in the guide, the risks to be assessed by supervisors include legal, regulatory and reputational risk, strategic risk, and group and related parties risk in addition to standard financial risks.
    - There was extensive discussion of the choice of group and related parties risk, which is not included in risk assessment methodologies in all countries but which reflects the significance of wider groups to Myanmar banks and the experience there of related party lending.
    - The impact of the bank also needs to be assessed—in the guide, impact is derived simply from size, which is appropriate to the nature of the simple banking business model at present. Three peer groups have been created for the private domestic banks, large, medium, and small. The state-owned banks and foreign bank branches form peer groups of their own.

- The approach to risk assessment requires supervisors to identify inherent risks and to assess the adequacy of risk management in relation to those risks, using judgment.

  - It was decided after discussion of two different options for the risk matrix, to focus the assessment on the inherent risk and adequacy of controls in each significant activity of the bank (in line with the Monetary Authority of Singapore's approach): however, only a small number of such activities should be identified for each bank.
  - It will be important to deepen supervisors' understanding of inherent risk (for example, for credit risk, it requires evaluation of the different risks in corporate, SME, and retail lending rather than just reference to overall levels of nonperforming loans).
  - Default ratings for certain inherent risks could be developed (examples are being provided to FISD).
  - Guidance has also been provided on how combinations of inherent risk ratings and ratings of the quality of risk management can be combined to derive net risk; however, the ratings are all ultimately a judgment for supervisors to make (subject to challenge from management and by reference to peer group comparison, it is recommended).
  - Overall governance, capital and earnings are to be assessed for the bank and a judgment made as to whether they mitigate or amplify risks assessed at the level of significant activities.

- The risk assessment should be informed by the nature of the bank's business, its organization and management, its regulatory history etc—details of which are to be set out in the bank's Institutional Profile, together with other background information. The risk assessment results are then also recorded in the Institutional Profile, making it the complete reference document for each bank. It will be important to ensure that Institutional Profiles are updated regularly.

- The risk assessment should then be used as a basis for:

  - the choice of supervisory actions required to mitigate the assessed risks: a standard list of actions is set out in the guide, including reliance on banks' control functions such as internal audit, and coordination with home supervisors, in the case of foreign bank branches; and
  - scoping the examination of the bank.

- The guide suggests that supervisors record their choice of risk mitigation action in a supervisory strategy and plan, to be developed annually for each bank.

  - The strategy would take account of judgments such as the scope for reliance on the board and senior management to mitigate risk.
  - The plan would include all planned work on the bank such as meetings with auditors and involvement in supervisory colleges, for foreign bank branches, where applicable.

- The approach to risk mitigation and development of the supervisory strategy and plan should be informed by the CBM's supervisory risk appetite.

    - For the present, it is suggested in the guide that supervisors should aim to mitigate all significant activities or risks rated High or Medium High (net of controls) and any Medium Low risk where the direction of risk is assessed to be increasing.
    - Risk assessment and, especially, risk mitigation should take into account the impact of the bank (a large bank should be supervised more intensively than a small bank with the same risk assessment—the CBM's appetite for problems and, especially, failure at larger banks is relatively low.
    - Risk appetite needs to be kept under review, given the high demands on FISD resources from dealing with weaker banks and the relatively large number of high risks that have emerged from the initial applications of the risk matrix.

- The examination remains a key supervisory activity under risk-based supervision, although it needs to be tailored to the risk assessment and impact (peer group) of the bank.

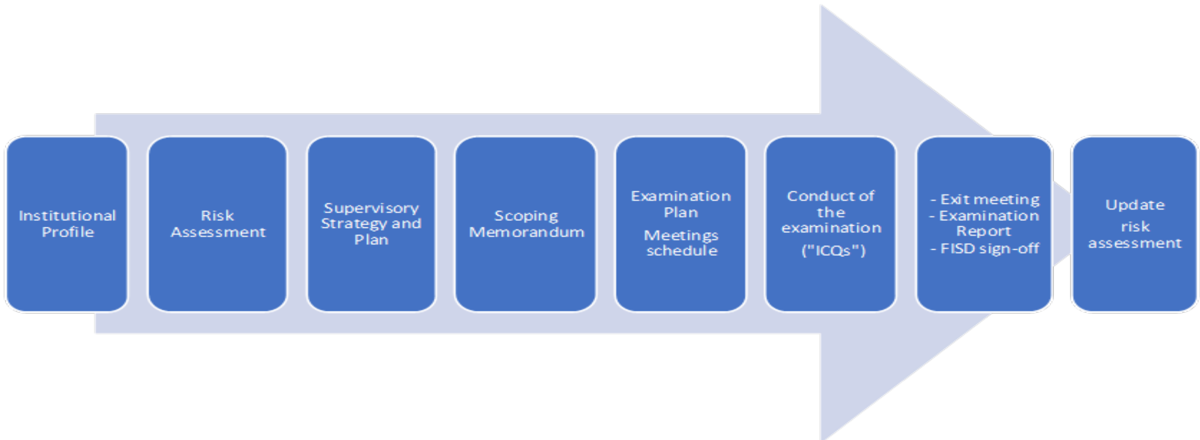
    - The frequency as well as the scope of examinations (and the supervisory resources used) can be expected to vary much more than in the past, at least once the approach to risk-based supervision is fully implemented.
    - Nonetheless, in discussion, it was agreed that FISD would aim for the present to undertake at least one examination for each bank in each year.

- A process for examinations is set out in the guide and is illustrated (in the context of the risk assessment and supervisory plan) in Figure 2 below. Compared with current practice, this will involve:

    - more work on scoping the examination work and on advance planning of the meetings to be held onsite;
    - a documentation request to be sent to the bank in advance of the work; and
    - more time spent in the course of the examination with senior management and members of the board (such as the chair of the Audit/Risk Committee of the board) as well as with risk managers and heads of control functions such as risk management and internal audit.

It was noted that this approach will need to be implemented gradually to fit the limited available resources for risk-based examinations.

Figure 2. Risk-Based Examination Process



Source: IMF Expert.

- After discussion, it was decided that for the conduct of examinations, questionnaires (also known as internal control questionnaires or "ICQs" after the current FISD examination tool) would be developed for each of the seven assessed risks.

    - These are described in the guide and are attached to it as appendices (there is one on each risk and an additional questionnaire on overall risk governance).
    - The questionnaires include up to around 20 main questions with bullet point follow-ups and suggested associated examination procedures and space to record observations relevant to the assessment of inherent risk and quality of risk management.
    - As they are focused on risks, they need to be adapted in practice to the assessment of significant activities.

- The examination report should follow the risk-based scoping of the examination and should focus on reporting key findings and the actions required of banks.

    - The reports are likely to be shorter than current reports, depending on the findings at the bank—typically around 20 pages—with the focus on communicating required actions.
    - The final examination report should reflect the revised risk assessment and development (or revision) of the supervisory plan, communicating an overall supervisory view of the bank as well as comments on individual risks etc.
    - The report should be shared with banks, as currently, and should communicate the overall risk assessment (composite risk rating) and the main reasons for the rating.
    - There may be a need for a purely internal FISD report setting out the proposed changes in the risk assessment and other confidential findings and analysis that would not be communicated to banks.

- While some supervisors communicate details of the risk assessment to banks, the guide suggests that only key findings, required actions, and the composite risk rating be shared with bank management. Communicating the details of the risk assessment would risk distraction from key messages on the required actions. Over time, the CBM should consider communicating not just the bank's own composite risk rating but also the average rating for the peer group. This can be helpful in incentivising action by the bank where its relative rating is below its expectations.

16. **The guide also sets out in a final section what has been discussed with FISD about roles and responsibilities for carrying out the elements of risk-based supervision.**

- offsite supervisors will lead on most of the key processes, including risk assessment, the supervisory strategy, and plan and scoping of the examination (in cooperation with the examiners—they may also be involved in conducting examinations). This will require changes from the current division of responsibilities, but is necessary to ensure that one supervisor has the overview of each bank.
- Examiners will focus on each examination as it comes due, with responsibilities also for cooperating with offsite supervisors on the scoping and reporting of examinations and in revising the risk assessment after the examination to take account of their findings.
- The guide also proposes defined responsibilities for FISD senior management in relation to the process of risk-based supervision such as to make decisions on FISD's supervisory risk appetite and priorities for the use of its resources and to provide challenge and support to supervisors on the exercise of supervisory judgment.

III. NEXT STEPS

17. **The CBM is already implementing parts of the recommended approach.** For example, the CAMEL rating guide is being used, and risk assessments are being developed using the new risk matrix tool as examinations come due. A small number of examinations have been conducted using the proposed approach to planning and the risk-based examination questionnaires. Initial indications are that supervisors are adjusting to the new focus on risk and risk management at the same time as they continue to focus on the high levels of non-compliance in the sector. There is of course further to go in familiarizing all supervisors with the methodology and applying it to all banks.

18. **The CBM plans to roll out the approach over the period until 2020, although full implementation will clearly take much longer.** 2020 is an appropriate target for adopting the risk-based methodology across all banks and all supervisory processes. It has been communicated by FISD management to the banks, putting them on notice of the CBM's change in expectations of the supervisory relationship. Perfecting the risk-based approach is likely to take many more years. Most supervisors find that two or more complete supervisory cycles for each bank are required to build confidence in supervisory judgments and to establish the required level of expertise amongst supervisory staff. The CBM's timetable will also be affected by the high priority necessarily being given to issues in the weak banks.

19. **It is recommended that the CBM develop priorities for the further work needed to implement risk-based supervision most effectively.** Recommended areas on which the CBM could focus are:

- continuing to work with the banks to support their preparation for risk-based supervision, building on the initial communication to banks in the April 2019 seminar; this might include issuing a short document describing the risk-based approach in more detail;
- issuing guidance to banks on expected risk management practices: this is a high priority and would complement the recent communication to banks as well as equipping supervisors to highlight specific deficiencies in the risk management practices of banks by reference to the guidance and to enforce corrective actions (further thoughts on a possible guideline is being provided by the expert);
- continuing to undertake training; seminars for supervisory staff, not all of whom have been involved in the development of the methodology, are being provided by the LTX, starting with the Guide to offsite Supervision; they could be extended soon to cover the Guide to Risk-Based Supervision (the risk assessment approach has been tested in practice mainly by members of the onsite supervision unit so far);
- identifying and taking action to fill gaps in the confidential supervisory data reported by banks, as mentioned in paragraph 13 above: and
- introducing electronic reporting and database capacity, as planned; this is another high priority for the reasons already discussed: FISD needs electronic reporting and enhanced database and analytical capacity to make risk-based supervision work efficiently and effectively; they may also prefer other IT approaches to managing risk-based supervision tools (the risk matrix relies at present on spreadsheets).

20. **The CBM could also develop a plan for regulatory change to support risk-based supervision.** In due course, it will be helpful for the CBM to have implemented more risk-based approaches to capital adequacy and liquidity of banks. The Basel Committee's Basel II/III framework complements risk-based supervision by aligning capital requirements to risk (Basel I covers only credit risk) and providing for a process of assessing individual banks' capital adequacy in relation to risk (the "Pilar 2" framework). The liquidity requirements of Basel III would require careful consideration but could provide a much more risk-focused approach than the current liquid assets ratio.

21. **It is also important that the CBM review the organization, decision-taking processes and resources of FISD**. Risk-based supervision imposes new demands on limited numbers of expert supervisory staff at the same time as they are stretched by the issues in weak banks. It is recommended that FISD review staff numbers and skills needs, taking account of the demands of the risk-based approach such as the need for supervisory judgment.

22. **In relation to organization and decision-taking, the CBM could consider:**

- the further development of roles and responsibilities of offsite and onsite supervisors, including the potential for integration in the future;
- the approach to decision taking on risk assessments and supervisory plans, including the risk mitigation actions required of banks: as discussed during the missions, there would be value in holding "challenge/validation panels" at key stages in the process to pool knowledge and expertise on each bank and to challenge proposed judgments before they are communicated to banks;
- the potential value in the medium term of a dedicated person or team, separate from offsite supervisors and examiners, responsible for managing and developing the risk-based supervision framework and to be responsible for evaluating, and reporting to FISD management on its implementation in line with the guides; resource limitations are likely to make this hard to achieve in the near term; and
- procedures for the exercise of formal powers such as the imposition of administrative penalties under Chapter XXIV of the FIL: in due course the wider use of these powers will call for carefully-designed processes to demonstrate that powers have been exercised with due process, reducing the risk of successful challenge by banks.

23. **In addition, there are parts of the methodology that, as discussed in this aide-memoire, have not been as fully discussed or developed as others.** These include:

- the supervisory strategy and plan: it is recommended that more pilots are carried out to identify how best to implement this part of the process and in particular to develop good practices in planning strategically for supervisory work;

- the thematic supervision process, which, as mentioned, has not been piloted yet: again, this may be a regarded as a medium term objective;

- the approach to stress-testing (including the expectations of banks in relation to their use of stress tests for risk management);

- the approach to using formal powers, including enforcement tools (corrective action powers and imposition of administrative penalties).

24. **As highlighted in this Aide-Memoire, further TA could support much of this work.** Specific topics mentioned in this report are stress-testing and the issues in internal organization in addition to support for the implementation of the guides. It is recognized that there are other high priority TA demands related to the issues with weak banks and crisis management.

Appendix I. Guide to Offsite Supervision—Contents

Appendix II. Guide to Risk-Based Supervision—Contents