

Tunisia: Financial Sector Assessment Program Update—Detailed Assessment of Compliance of the Basel Core Principles for Effective Banking Supervision

This Detailed Assessment of Compliance of the Basel Core Principles for Effective Banking Supervision for Tunisia was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation to the Financial Sector Assessment Program Update with Tunisia. It is based on the information available at the time it was completed in January 2007. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Tunisia or the Executive Board of the IMF.

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE
TUNISIA

**DETAILED ASSESSMENT OF COMPLIANCE
WITH THE BASEL CORE PRINCIPLES FOR
EFFECTIVE BANKING SUPERVISION**
JANUARY 2007

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

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MIDDLE EAST AND NORTH AFRICA VICE-
PRESIDENCY

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GLOSSARY

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BCP	Basel Core Principles
BCT	<i>Banque Centrale de Tunisi</i> (Central Bank of Tunisia)
CAMEL	Capital Adequacy, Asset Quality, Management, Earnings and Liquidity
CGA	<i>Conseil Général des Assurance</i> (General Committee on Insurance)
CMF	<i>Conseil du Marché Financier</i> (Financial Market Board)
CNC	<i>Conseil Nationale de la Comptabilité</i> (National Accounting Board)
DGSB	<i>Direction Générale de Supervision Bancaire</i>
FCC	<i>Fonds Commun de Créances</i> (credit funds)
FCP	<i>Fonds Commun de Placement</i> (investment funds)
FSAP	Financial Sector Assessment Program
IIA	Institute of Internal Auditors
IFRS	International Financial Reporting Accounting Standards
MMR	Money Market Rate
NPLs	Nonperforming Loans
SICAF	<i>Société d'Investissement à Capital Fixe</i> (closed-ended mutual funds)
SICAR	<i>Société d'Investissement à Capital Risque</i> (venture capital funds)
SICAV	<i>Société d'Investissement à Capital Variable</i> (open-ended mutual funds)

I. BASEL COMMITTEE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Background

1. The updating of the 2002 FSAP assessment of compliance with the Basel Committee's 25 Core Principles for Effective Banking Supervision was conducted on during two missions on January 16-31 and March 27-31 by Mr. Jean-Luc Couetoux, Banque de France Inspector, and Mr. Didier Debals, financial sector expert of the World Bank.
2. However, Principle 15 pertaining to anti-money laundering and combating the financing of terrorism has not been assessed by the mission, but by a team of World Bank experts led by Mr. Jean Pesme. This second mission, conducted in January 2006, focused on the assessment of conformity of the Tunisian system with international standards in these two areas, and prepared a separate report. Thus, the assessment of Principle 15 has been carried out by that mission, which has also prepared the comments in Table 2 for this principle.
3. The *Banque Centrale de Tunisie* (BCT) cooperated fully with the assessment and provided extensive clarifications in the form of documents and oral explanations. The assistance of all the staff of the BCT, and in particular of the Directorate General of Banking Supervision is gratefully acknowledged.
4. The first FSAP for Tunisia was conducted in 2001 with two missions ; the first during the period February 20- March 2; the second during May 2-15. As the report was presented to the IMF Executive Board in June 2002, the year 2002 is considered the reference year. It is to be noted that at the time of the two 2001 missions the law 2001-65 concerning credit institutions, which quoted several times in this report and that has been revised in 2006, had not yet been adopted.

B. Information and Methodology Used for the Assessment

5. The review and assessment of Tunisia's application of the Basel Core Principles took the form of interviews and examination of the documents placed at the mission's disposal by the BCT. Numerous interviews were conducted with senior staff at the DGSB performing both off-site and on-site audits. Several meetings also took place with the Director General. In addition, meetings were arranged with several banks, an external auditor working for an international accounting firm commissioned to audit several credit institutions, and representatives of the Financial Markets Board (CMF).
6. The mission carried out a detailed examination of laws passed since the previous assessment, the proposed amendments to the law on the BCT (Law 58-90) and to the "Banking Law" (Law 2001-65), which have been adopted in May 2006, compendia of regulations and accounting rules, and the BCT's circular on internal controls, which was still in a draft form in March 2006. This circular, 2006-19, has been adopted on November 28, 2006, eight months after the mission. However the implementation of these measures will become compulsory only on January 2, 2008, has credit institutions have a one year delay to adopt them. The mission also reviewed standard statements that supervised institutions are

required to submit. Finally, the mission was able to review an inspection report and the complete set of end-2004 documents sent to the BCT by the external auditor of a credit institution.

7. Following the March 2006 mission, the legislation revising Law 58-90 on the establishment and organization of the BCT and Law 2001-65 on the credit institutions has been adopted:

- Law 59-90 has been amended by Law 2006-26 of May 15, 2006; and
- Law 2001-65 has been amended by Law 2006-19 of May 2, 2006.

The basic documents remain Laws 58-90 and 2001-65, which have not been abrogated but only modified by the laws 2006-26 and 2006-19. In the remainder of this report, when one of the two laws is quoted, it is specified whether the relevant provisions have been introduced or modified in 2006. When reference is made to Laws 58-90 or 2001-65 without other specification, this means that the relevant provisions existed before the 2006 revisions, and have not been subject to any revision in 2006.

In the regulatory area, in addition to the above-mentioned circular on internal controls, two other circulars have been adopted after the March 2006 assessment mission;

- Circular 2006-06 of July 24, 2006 on the establishment of a compliance control system; and
- Circular 2006-07 of July 24, 2006 on the executive credit committee.

8. Prior to the January 2006 mission, the BCT had conducted its own assessment of compliance with the Basel Committee principles, although it restricted its evaluation to those principles with which a “noncompliant” assessment had been made in 2001. This document, which the BCT commented on in its discussion with the mission, listed the changes that had taken place in the past five years and indicated the BCT’s overall assessment for each principle considered, in respect of both the essential and the additional criteria.

C. Organization of Banking Supervision

9. Banking supervision is carried out, within the BCT, by the Directorate General of Banking Supervision (DGSB). Since 2001, it handles both off-site and on-site audits, whereas at the time of the 2002 FSAP the Inspectorate of Banks, which was responsible for on-site inspections, had been an autonomous directorate. The staff of the DGSB consists of some 50 officers, 15 of whom are deployed in the Inspectorate, which reports directly to the Director General.

10. To strengthen synergies between these two types of supervision, inspection teams now regularly include the staff member in charge of off-site audits in the institution

concerned. In addition, the six team leaders responsible for conducting investigations have undergone specialized training for different types of credit institution.

11. The BCT monitors closely the supervised institutions. Its monitoring consists of examining prudential reports and the numerous documents that the external auditors of the credit institutions have to submit at the close of each year, extracting information from inspection reports, and holding periodic meetings with the managers of supervised institutions. There are two such meetings each year for the major banks, and one meeting a year for the other institutions.

12. DGSB staff are trained in economics, accounting, and finance. If necessary, the DGSB also draws on specific BCT experts for on-site missions. These are mainly information technology specialists, who are enlisted on the somewhat infrequent occasions when an audit includes a review of the institution's information system or information technology procedures. Sometimes an officer from the Foreign Exchange Directorate or the Credit Directorate may also assist the inspection team.

13. The DGSB has requested a strengthening of its staff (additional three staff per year between 2006 and 2008), as well as some experts in risk management, in order to deal with the changes in the banking system and regulations expected to take place in the next few years, including new regulations on internal control and on combating money laundering and financing of terrorism, as well as the implementation of Basel II.

14. Off-site supervision is organized in the same way as in 2001; the institutions are assigned to different sets of supervisors according to the type of business they perform or statute, (public banks, private banks, former development banks, off-shore banks, leasing and factoring companies, and investment banks).

15. The DGSB's organization chart reflects this work distribution, with two directorates handling off-site audits:

- the Directorate of Banks, which supervises public and private banks; it also includes a modernization and regulations department, which is principally responsible for drafting regulations; and
- the Directorate of Financial Institutions, which supervises leasing and factoring institutions, merchant banks and the former development banks.

16. These two directorates also prepare licensing files and draw up a report on each license application for the Minister of Finance, who makes the decision. The Inspectorate reports directly to the Director General of the DGSB. Over the past three years, the major institutions have had at least one on-site inspection. On the other hand, neither the two factoring companies nor the investment banks have been inspected.

17. There is no methodology manual for off-site supervision, and that covering on-site inspections has not been revised since 2001.

II. GENERAL PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

18. The Basel Committee recognizes that the exercise of effective banking supervision requires sound and sustainable macroeconomic policies, as well as a developed public infrastructure, effective market discipline, and procedures for effective resolution of problems in banks. While these preconditions are beyond the control of the central bank, weaknesses or shortcomings in these areas may impair its ability to implement effectively the Basel Core Principles.

A. Macroeconomic Environment

19. For several years now, Tunisia has been committed to an economic liberalization program, mainly affecting the banking sector. The modernization of that sector forms part of a long-term, so-called upgrading plan, composed of several components. Not least among these is the modernization of information systems.

20. As regards ownership, the preponderance of the public sector has diminished and the ownership of the banks is split into three ways: approximately one-third under majority government ownership, another third owned by private Tunisian investors, and the remaining third owned by foreign private banks. Two public banks have been privatized after being put out to tender, while Banque Franco-tunisienne (BFT) was in the process of being privatized at the time of the mission.

21. With respect to the organizational structure of the banking system, the development bank category was eliminated in 2004; the institutions that used to fall under that category were authorized to engage in all commercial bank activities.

22. In addition, a bank specializing in small and medium-scale enterprises financing (BFPME) started its operations in March 2005. Its function is to provide cofinancing and co-participation to supplement that provided by other banks and financial institutions, including the venture capital investment companies (SICAR).

23. Various steps have been taken to enhance the operational autonomy of the banking sector. Thus, the prior authorization procedure for equity investments in other credit institutions has been eliminated in 2001, and Law 2006-19 modifying the law 2001-65, makes the opening of bank branches in Tunisia conditional to a simple specification by the BCT of terms and conditions, rather than a license.

24. Money market instruments for banks and liquidity management have been modernized, in particular through the introduction of repurchase agreements.

25. Payment systems are also being modernized, with the a new large-value payments system on a gross basis close to enter into operations. These developments also pose new risks for the banks, which need to put in place their own appropriate control procedures. The BCT should examine the effectiveness of those procedures during its on-site inspections.

26. The Tunisian banking sector is characterized by the large share of nonperforming loans (NPLs) in the total stock of loans outstanding. The problems affecting the tourist industry since 2001 have contributed to increase the NPL ratio. While a sharp decline took place in 2005, the ratio remains close to 20 percent.

27. Several measures have been adopted in recent years to deal with the NPLs problem. These include a change in the procedures for realizing real estate collateral, more favorable tax deductibility rules for NPL provisions and write-offs, and the establishment of asset recovery companies. Specifically, procedures for sale of real estate under judicial supervisions have been simplified, the tax-deductible portion of provisions against NPLs has been raised to 85 percent in 2004 and 100 percent in 2005, and the conditions for writing off fully provisioned bad debt have been clarified, although they remain rather strict.

28. Most banks have established asset recovery companies, to which they have transferred their olds NPLs, which, in the most part, were fully provisioned. Up to now the amount recovered on the loans transferred (D 1.3 billion) has been modest.

B. Public Infrastructure: The Legal and Regulatory Framework

29. The legal and regulatory framework governing banking supervision broadly follows the French model, albeit with some marked differences, especially as regards the way the sanctioning and penalties mechanism is structured and the classification and provisioning of NPLs. It is now largely consistent with international rules and has been supplemented in the area of internal controls by the adoption of a circular in July 2006, which was still at the draft level in March 2006..

30. Two laws on the supervision of credit institutions have been promulgated since 2001 :

- Law 2001-65 of July 10, 2001 on credit institutions, which has been revised by Law 2006-19 of May 2, 2006; and
- Law 2005-96 on strengthening the security of financial transactions requires companies raising funds from the public, including credit institutions, to appoint two external auditors to certify their financial statements.

31. With regard to banking regulations, the BCT has strengthened the credit culture by requiring credit institutions to obtain financial statements certified by an external auditor whenever banking exposure to a single enterprise exceed D 5 million, together with a recent rating if exposure reach D 25 million and the company is not listed on the stock exchange.

32. The requirements on internal controls have been significantly strengthened. Thus, Law 2006-19 revising Law 2001-65 requires credit institutions, on the one hand, to establish an Executive Credit Committee, distinct from the Credit Committee, to be chiefly responsible for examining credit activities and submitting proposals regarding the institution's lending policy to the Board, and, on the other, to establish a compliance control system designed to determine and assess the risks of noncompliance with laws and regulations, and with sound

practices. To implement these provisions the BCT has adopted on July 24, 2006 Circular 2006-06 “concerning the implementation of a system of compliance control in credit institutions.”

33. Furthermore, the BCT circular 2006-19 on internal controls, largely inspired by the French regulation 97-02, has been adopted in November 2006.. It establishes a very large number of obligations in this area. While some of these appear to be somewhat ambitious, such as the requirement that each customer be assigned a rating, or that stress tests be carried out to assess capital adequacy in case of shocks that could lead to large losses, these are fully in line with the mechanism of Basel II which represents the international standard in the area of risk monitoring and assessment.

34. Other circulars, mentioned in paragraph 7, were under preparation at the time of the March 2006 mission. They have since been adopted: Circular 2006-06 on outsourcing, and Circular 2006-07 on the executive credit committee. The first circular was adopted at the time of the March 2006 mission.

35. Accounting rules in effect for credit institutions are broadly modeled on internationally recognized standards. Several of them (NC 35 to 39), which are close to the International Financial Reporting Accounting Standards (IFRS), were adopted in 2003 by the National Accounting Council in order to establish the rules for compiling the consolidated accounts that institutions have been required to produce starting with the 2004 financial statements. However, in the area of loan classification and provisioning, the rules established by BCT Circular 91-24 do not envisage the estimation of the present value of annual expected cash flows, either paid by the borrower or recovered in the framework of a restructuring procedure. Since in Tunisia the delays in recovering overdue loans are long, and the amounts recovered under judicial procedures are low, the absence of a present value framework is inconsistent with the provisions of IAS 39, which is the international standard.

36. In the area of guarantees, the Tunisian legislation regarding movable collateral needs to be modernized, in order to be consistent with international standards. There are also delays in real estate and mortgages registration procedures which are considered excessive by banks. Reforms are therefore needed in this area.

37. As regards relations with customers, Laws 2006-26 and 2006-19 modifying Laws 58-90 and 2001-65, introduce numerous provisions designed to enhance the quality of banking services, such as the appointment of an ombudsman and the creation of a banking services monitoring unit in the BCT. The revisions in the laws will be accompanied by implementing circulars.

C. Market Discipline

38. In order to improve the information available to credit institutions for credit risk analysis and to enable the BCT to better monitor it, the Bank has over the past few years embarked on the establishment of various information bureaus that credit institutions can consult. Thus a risk bureau was formed to monitor the indebtedness of enterprises, while a

balance sheet bureau was set up to make companies' financial statements available to banks; the requirement that banks submit to the BCT the annual financial statements of clients with loans above a threshold will gradually enrich this database. Another information bureau is scheduled to come on stream shortly, namely the nonperforming loans bureau, which will provide data on total NPLs by debtor and the classification attributed according to the prudential regulations¹ On the other hand, there is no credit bureau, as such, which would report the score assigned by the various lending institutions to a single counterparty.

39. The role assigned to the external auditors of credit institutions in the supervisory process is significant because every year they have to submit several reports to the BCT, detailing, in particular, any adjustments made to financial statements, internal controls and management, the loan portfolio, and ratios at December 31. In addition, they attend the periodic meetings organized by the BCT with the supervised banks. The four largest international audit firms audit half the institutions, but currently none of them audits public banks.

40. As regards the reporting of financing information, most credit institutions publish their annual financial statements. However, the quality of the information on risk exposure, internal control mechanism, nonperforming loans and their recovery could be improved. The quality of information in the annual report varies widely across banks. With regard to accounts auditing, on the basis of the recent law on financial security, all credit institutions are required to have two external auditors.

41. The BCT devotes several pages in its annual report to banking supervision. Consideration is currently being given to the possibility of producing an annual report specifically dedicated to this area. Indeed it would be advisable to publish every year a BCT report dedicated to banking supervision, which is the practice followed by a large number of bank supervisory authorities. This report should include a description of the banking developments in the previous year in the area of profitability, solvency, risks, and banking organization, as well as a description of the inspections and controls carried out by the BCT. The report should also describe the sanctions adopted, together with an explanation of the reasons for taking such actions.

D. Resolution Framework for Problem Banks

42. The BCT does not currently have a (CAMEL-type) system for identifying those banks which are running into difficulties and providing a basis for taking corrective measures. It would be worth establishing one.

¹ Circular 91-24 of the BCT requires credit institutions to divide their loan portfolios between current and classified loans; the latter include four classes; class 1, assets requiring close monitoring; class 2: uncertain assets; class 3: worrisome assets; class 4: compromised assets. Each of the classes from 2 to 4 involves a provisioning rate, that goes from 20 to 100 percent.

43. Although Article 41 of Law 2001-65 on credit institutions stipulates that all banks must belong to a deposit guarantee scheme, such a mechanism has not yet been put in place. Before introducing such a mechanism the BCT is waiting until the recapitalization of the banks recently privatized has been completed, so as not to start the guarantee scheme before the whole banking system is on a solid basis.

III. MAIN FINDINGS

44. Table 1 contains the for each core principle, but only for the essential criteria, and the assessment given in 2006, compared with that of 2002. In 2006 more than half the principles have been assessed as “compliant” or “largely compliant” and in no case “non-compliant.” The 2006 assessment for the essential and additional criteria is reported in Table 3.

45. A comparison of the 2002 and 2006 assessments with respect to the essential criteria (Table 1) shows that Tunisia has made considerable progress toward full compliance with the Basel Committee principles. Indeed, no principle is marked “noncompliant” and the number of those marked “compliant” has increased. Thus the BCT is now compliant with Principles 1-4, 3, 5, and 21, which were marked “largely compliant” in 2001. The 2006 assessment reflects the promulgation of Law 2001-65 and the entry into force of the accounting standards applicable to consolidated accounts.

46. The principles for which the mission reached a “materially noncompliant” assessment refer to credit and provisioning policy (Principles 7 and 8), consolidated supervision (Principle 20), remedial measures (Principle 22), and supervision of foreign banks (Principle 25). Principle 15 pertaining to anti-money laundering and combating the financing of terrorism has also been assessed as “materially non-compliant.” However, as previously indicated, this assessment has been given not by the BCP team but by the World Bank team which examined this subject.

47. As regards Principles 7 and 8, the legal and regulatory requirements will be observed, once the provisions of the BCT circular on internal controls will have been implemented. In this regard, it should be noted that this circular, adopted on November 26 2006, includes nine articles on the credit risks. However, while credit institutions have to get ready to conform to these norms, these requirements enter into force only on January 2, 2008. The implementation of this circular will make it possible to complete regulatory provisions on credit risk monitoring. However, the terms on which banks extend loans and the insufficient provisioning make it impossible to consider the Tunisian banking system compliant with these two principles. NPLs still made up 20.9 percent of outstanding loans at end-2005. Most bank loans continue to be granted on the basis of collateral, rather than as the result of an in-depth financial analysis aimed at assessing counterparty risk factors, such as the quality of the project and its ability to generate cash-flow. As regards provisioning, a substantial effort is still needed to achieve reasonable coverage of NPLs, given that the collateral taken into account in determining the provisioning requirement is subject to valuation uncertainties. Moreover, the rules governing provisioning do not take into account the time frame for recovering sums owed by debtors, despite generally long, drawn-out legal proceedings.

48. Regarding Principle 15, if some progress has been registered, much remains to be done to bring the anti-money laundering and combating financing of terrorism system in conformity with the Basel Committee criteria.

49. Although the BCT carries out a consolidated analysis of the credit institutions' financial accounts, starting with the accounts for 2004, effective consolidated supervision still has to be implemented. To that end, it is necessary to introduce consolidated ratios and to establish a supervision of the banking groups, in conformity with the provisions of the circular on internal controls, which requires these groups to establish by January 2, 2008 a system of evaluation and surveillance of the risks assumed by the parent company and all the financial subsidiaries, as provided by its article 5.

50. As for remedial measures (Principle 22), the "materially noncompliant" assessment has been maintained, owing to lack of effective enforcement of the penalties system provided in the law.

51. The lack of agreements on information sharing with other supervisors explains why Principle 25 is assessed as "materially noncompliant."

IV. DETAILED ASSESSMENT OF OBSERVANCE OF THE BCPS

A. Principle-by-Principle Assessment

52. Table 2 contains the detailed assessment of compliance with the 25 Basel Committee Principles. The assessment is based on the Core Principle Methodology of the Basel Committee on Banking Supervision, October 1999. The methodology makes a distinction between "essential" and "additional" criteria. Essential criteria should be present in order for supervision to be considered effective. Additional criteria further strengthen supervision and countries should strive to implement as many additional criteria as possible. The assessment takes both the essential and additional criteria into consideration.

53. The 25 Basel Principles have been revised in October 2006, after the BIS issued in April 2006 two consultative documents. This assessment is based on the methodology in effect in March 2006.

54. The rating scale in the current methodology distinguishes five degrees of compliance: compliant, largely compliant, materially noncompliant, noncompliant, and not applicable.

55. A principle will be considered compliant, whenever all essential criteria are generally met without any significant deficiencies. A largely compliant assessment is given whenever only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of the principle concerned. A materially noncompliant assessment is given whenever the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but substantive progress has been made or actions undertaken. A "non-compliant" assessment is given when no substantive progress towards compliance has been achieved or if the information available is

insufficient to determine with certainty whether substantive progress toward compliance has been made. Finally, the term “not applicable” is used if, for any reason, a given principle is deemed to be irrelevant for Tunisia.

Table 1. Tunisia: Results of the Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision

Core Principle	Assessment of Essential Criteria	
	Results of the 2001 Assessment	2006 Assessment 1/
1. Objectives, autonomy, powers and resources		
1.1 Objectives	Compliant	Compliant
1.2 Independence	Compliant	Compliant
1.3 Legal framework	Compliant	Compliant
1.4 Enforcement powers	Largely Compliant	Compliant
1.5 Legal protection	Compliant	Compliant
1.6 Information sharing	Materially Noncompliant	Largely Compliant
2. Permissible activities	Compliant	Compliant
3. Licensing criteria	Largely Compliant	Compliant
4. Ownership	Largely Compliant	Compliant
5. Investment criteria	Largely Compliant	Compliant
6. Capital adequacy	Largely Compliant	Largely Compliant
7. Credit policies	Materially Noncompliant*	Materially Noncompliant
8. Loan evaluation	Materially Noncompliant	Materially Noncompliant
9. Large exposure limits	Compliant	Compliant
10. Connected lending	Largely Compliant	Largely Compliant
11. Country risk	Not Applicable	Not Applicable
12. Market risks	Largely Compliant	Largely Compliant
13. Other risks	Largely Compliant	Largely Compliant
14. Internal control and audit	Largely Compliant	Largely Compliant
15. Money laundering	Noncompliant	Materially Noncompliant
16. On-site and off-site supervision	Compliant	Compliant
17. Bank management	Compliant	Compliant
18. Off-site supervision	Largely Compliant	Largely Compliant
19. Validation of information	Compliant	Compliant
20. Consolidated supervision	Noncompliant	Materially Noncompliant
21. Accounting standards	Largely compliant	Compliant
22. Remedial measures	Materially Noncompliant	Materially Noncompliant
23. Global consolidated supervision	Not Applicable	Not applicable
24. Host country supervision	Materially Noncompliant	Not applicable
25. Sup/foreign establishments	Materially Noncompliant	Materially Noncompliant

1/ The different assessment levels used for the 2006 FSAP Update are based on the Basel Core Principles for Effective Banking Supervision (October 1999 version).

Table 2. Tunisia: Detailed Assessment of Compliance with Basel Core Principles

Principle 1.	Objectives, Autonomy, Powers, and Resources An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1)	An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.
Description	<p>Before being revised in 2006, Article 33 of Law 58-90, creating and organizing the Central Bank of Tunisia (BCT), stated that the BCT is responsible “for ensuring that the banking and financial system is functioning properly.” Law 2006-26, which modifies Law 58-90 replaces this provision with a specific reference to the BCT’s mandate to supervise the banking system, when it states in amended Article 33 that “the BCT supervises credit institutions.” For its part, Article 32 of Law 2001-65 on credit institutions states that the BCT “conducts off-site and on-site inspections of credit institutions.”</p> <p>Banking supervision is conducted, inside the BCT, by the General Directorate of Banking Supervision (DGSB).</p> <p>According to information received from the BCT, the Bank’s internal inspections department – which reports to the General Directorate of Legal and Organizational Services, is entitled to inspect the DGSB. The last inspection of the latter is said to have been carried out in 2001-2002.</p>
Assessment	Compliant with essential and additional criteria
Remarks	<p>Recommendations</p> <ul style="list-style-type: none"> • It might be useful to schedule a mission to inspect the DGSB, especially in order to assess the way it is organized and how it operates; to make suggestions as to how it carries out its functions; and to evaluate the resources needed to optimize its performance. • The BCT should produce and publish a separate annual report on banking supervision and the state of the banking system, in addition to its own annual report.
Principle 1(2)	Each such agency should possess operational independence and adequate resources.
Description	<p>Article 9 of Law 58-90, creating and organizing the BCT, stipulates that the Governor shall be appointed for a term of six years. This term can be renewed one or more times. The Governor may be removed from office only by decree.</p> <p>Law 2006-26 which modifies Law 58-90 does not amend these provisions. However, as the Governor is the highest authority responsible for banking supervision, his mandate should be revocable only for duly justified reasons, which should be mentioned in the Law and published should such a case arise.</p> <p>As regards the resources allocated to the DGSB, there are some 50 staff members (46 at the start of 2006), of whom approximately 30 are engaged in off-site inspection, known as “document control,” and 15 work in the Inspectorate responsible for on-site inspections; this Inspectorate now has ten fewer staff members than it did in 2001, mainly due to retirements, while the off-site inspection staff has increased, thanks to the recruitment of several new staff.</p>

	<p>Currently, the human resources available have been adequate for a reasonable amount of both off-site and on-site inspection. Nevertheless, a request for a three person per year increase in staff was filed in 2006 as part of a three-year plan submitted to the General Directorate of Human Resources of the BCT. The increase would enable the DGSB to facing the regulatory changes expected—internal controls, monitoring of operational and market risks, consolidated inspections, and, in the not too distant future, Basel 2—as well as dealing with the effects on banking supervision of the introduction of procedures for combating money laundering and the financing of terrorism. Moreover, new banking activities and the new regulations in the area of risk monitoring lead to the need to diversify recruitment profiles. New skills are required above all in market risk analysis and advanced statistics.</p> <p>Presently banking supervision teams already benefit from the assistance of BCT colleagues in areas in which they lack the necessary skills or experience. For instance, inspection teams may, if necessary, be supported by the BCT’s information system or foreign exchange market specialists.</p> <p>A special effort is made to train banking supervision personnel. Since almost all on-site inspections take place in Tunis, at the head offices of the credit institutions, there are few travel-related budgetary constraints.</p> <p>Although the integrity of the personnel responsible for banking supervision is at stake, the BCT has no code of conduct. Drafting such a code would reinforce the ethical rules applicable to personnel in the DGSB.</p>
Assessment	<p>Compliant with essential criteria. Noncompliant with the two additional criteria</p>
Remarks	<p>The two additional criteria are not observed. In fact, Law 58-90, also after its 2006 amendment, does not stipulate that the Governor of the BCT may only be removed from office on grounds established by law and that those grounds must be made public.</p> <p>Recommendations</p> <p>It would be useful to establish ethical rules, at least for DGSB personnel. These would, above all, specify:</p> <ul style="list-style-type: none"> • The terms on which staff may acquire securities issued by credit institutions, their subsidiaries, or of any other enterprise on which they could have inside information; • Restrictions regarding invitations and the acceptance of gifts; <p>The terms on which an officer is allowed to leave the BCT to take up a position in a credit institution.</p>
Principle 1(3)	<p>A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.</p>
Description	<p>Article 8 of Law 2001-65, on credit institutions, grants the Ministry of Finance the authority to license credit institutions, based on a report by the BCT. Each application for a license triggers an initial detailed study by the BCT, which leads to a report containing the BCT’s opinion of the planned operation. Law 2006-19, which has amended Law 2001-65 does not amend the provisions in Article 8, but specifies that the license must be issued within four months of receipt of all the required documents.</p> <p>Article 54 of Law 2001-65 stipulates that credit institutions shall be licensed as “banks” or “financial institutions,” whereby the latter include financial leasing and factoring companies and investment banks.</p>

	<p>The BCT has indicated that in matters of licensing the Ministry of Finance always follows BCT advice. It is the BCT, moreover, that notifies the applicant of the decision taken by the Ministry.</p> <p>For its part, the Financial Markets Board (CMF) has, for several years, been licensing the investment companies it supervises. Formerly, these licenses were also granted by the Ministry of Finance.</p> <p>The revocation of a license falls within the remit of the Ministry of Finance, unless it is imposing a penalty, in which case the decision is taken by the Banking Commission, the organ responsible for imposing penalties on the banking sector. The Commission's membership and functions are described under Principle 22.</p> <p>Article 23 of Law 2001-65 empowers the BCT to establish operational rules and prudential standards. The latter are established by means of BCT circulars or notes to the banks. On the other hand, the minimum capital requirement for credit institutions is established by law; it has recently been revised by the Law 2006-19, which modifies Law 2001-65 (see principle 3). In general, Article 32 of the law authorizes the BCT to request any information it considers necessary, a power that the Bank does in fact exert.</p>
Assessment	<p>Compliant with the essential criteria There are no additional criteria for Principle 1(3).</p>
Remarks	<p>Recommendations</p> <p>International practice with respect to the licensing of credit institutions tends to shift authority for such licensing away from the Ministry of Finance in favor of the central bank or an ad-hoc agency with which the central bank maintains close ties.</p>
Principle 1(4)	<p>A suitable legal framework for banking supervision is also necessary, including ... powers to address compliance with laws as well as safety and soundness concerns.</p>
Description	<p>Law 2006-19 which modifies Law 2001-65 on credit institutions obliges credit institutions, on the basis of article 34 quarter, to establish a system for overseeing compliance, which must be approved by the Board of Directors or Supervisory Board and reviewed annually. To that end, a standing body in charge of compliance, and reporting to that Board, will have to be created. The BCT's implementing regulation, to which the Law refers, at the time of the second mission was to take the form of a Circular, to be drafted by a working group under the aegis of the Governor of the BCT. This circular has been issued on July 24, 2006, as Circular 2006-06, on the establishment of a system of compliance control.</p> <p>Law 2001-65 grants the BCT inspection powers, and Article 32 of that law specifies that supervised institutions must, during such inspections, provide the BCT with "all the documents, information, explanations, and evidence needed to examine their position and to ascertain that they are abiding by the regulations..."</p> <p>Furthermore, in the performance of their legal duties, the external auditors of credit institutions are obliged—as they are for any company whose accounts they audit—to report to the state prosecutor any breaches of the law they detect.</p> <p>The regulations concerning sanctions are described in Principle 22.</p>
Assessment	<p>Compliant with essential criteria. There are no additional criteria for Principle 1(4).</p>
Remarks	<p>Essential Criterion 4 on the supervisory authority's legal power to impose sanctions is established by Law 2001-65. It was therefore considered that this criterion was observed. However, the ways in which the sanctions regime is actually applied remain unsatisfactory (Cf. Principle 22).</p>

Principle 1(5)	A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The BCT regulation n. 445 on the status of the BCT staff stipulates that the BCT protects its staff against any threats and attacks to which they may be exposed in carrying out their functions, and compensate them for any harm that could occur
Assessment	Compliant with essential criteria. There are no additional criteria for Principle 1(5).
Remarks	Essential Criterion 1 indicates that the law must afford legal protection to the supervisory body and its staff against possible prosecution for acts committed in good faith in the performance of their duties. For the BCT this provision is introduced through a regulation. Recommendations As recommended at the time of the 2002 FSAP , it might be useful to specify by internal BCT memorandum the legal status (rights and obligations) of inspectors exercising their on-site inspection duties. This would complement the proposed introduction of a code of conduct (cf. Principle 1-2).
Principle 1(6)	Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	There is still no agreement with the supervisors of the other financial sectors in Tunisia, namely the CMF for investment companies and the Ministry of Finance for insurance companies, venture capital investment companies (SICAR), and asset recovery companies. Nevertheless, these two authorities are frequently in touch with one another. Thus, a director general of the BCT is a member of the CMF and several BCT officers have participated in working groups organized by the CMF or the General Committee on Insurance (CGA), which reports to the Ministry of Finance, which presently is in charge of supervising the insurance sector. Representatives from the BCT are members of the National Commission of Insurance. Moreover, a joint BCT/CMF inspection mission has already been carried out in a closed-end investment company (SICAF), following detection of a case of embezzlement in that company. The new Article 61 bis of the Law 58-90, creating and organizing the BCT, introduced by the Law 2006-26, allows the BCT to cooperate with the regulatory authorities for the financial and insurance sector. Under that Article, the BCT may henceforth reach agreements with them on, in particular: <ul style="list-style-type: none"> • Information sharing; • Experience sharing and training; and • Joint supervisory operations. In anticipation of the implementation of the Law, the BCT plans to prepare a charter, which it would then submit to the CMF and the CGA. It would take the form of a tripartite or bilateral agreement between the BCT and each of the other supervisory authorities. As regards relations with other countries, new Article 61 ter of Law 58-90, introduced by Law 2006-26, allows the BCT to reach bilateral cooperation agreements with foreign supervisors on the exchange of information, especially following the establishment of branches or subsidiaries of credit institutions in the countries concerned. The agreements would specify the ways in which these entities would be supervised. Despite the lack of legal provisions authorizing the BCT to sign agreements with other supervisors, it has already signed an agreement with a number of countries, including Guinea, Palestine, Syria, and Indonesia. However, these agreements do not entail communication of

	<p>confidential data regarding institutions subject to its supervision, as is the case with the usual Memorandums of Understanding between supervisors.</p> <p>They are mainly aimed at facilitating training and the sharing of experiences with various kinds of supervision.</p> <p>As regards the provision of information to judicial authorities, under Article 29 of the Code of Criminal Procedures the BCT must accede to their requests, even with respect to information of a confidential nature.</p>
Assessment	<p>Largely Compliant with essential criteria. There are no additional criteria for Principle 1(6)</p>
Remarks	<p>Since there are still no agreements on sharing confidential information with either the supervisors of the other financial sectors in Tunisia or foreign bank supervisors, and as this was not possible until the revision of the Law 58-90 by the Law 2006-26, the four essential criteria are not observed.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • It would be advisable to sign rapidly an information-sharing agreement with the CMF. It would also an appropriate time to boost cooperation with the Ministry of Finance for certain specialized financial institutions, such as the SICAR and asset recovery companies. With respect to the insurance sector, consideration is currently being given to the institutional position of the agency responsible for supervision. This could delay signature by the BCT of an agreement with the supervisory authority for insurance companies. • Prudential information exchange agreements with foreign supervisors should also be contemplated, especially with those agencies supervising banking groups that are shareholders in Tunisian banks. Furthermore, following implementation of Basel 2, the need for cooperation among supervisory authorities will increase. • Another issue is whether it would not be best to entrust supervision of the SICAR to the CMF and supervision of asset recovery companies to the BCT. Currently, both are subject to Ministry of Finance supervision. As regards asset recovery companies, Article 9 of the Minister of Finance’s decree of December 22, 2001 states that they can be subject to both off-site and on-site inspections by that Ministry. <p>At the least, it would be useful to know what type of inspections are performed by the Ministry of Finance on these two categories of institutions, and for the BCT to obtain the results of those inspections, since they could shed light on the banking groups subject to BCT oversight.</p>
Principle 2.	<p>Permissible Activities The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word “bank” in names should be controlled as far as possible.</p>
Description	<p>Banking activities listed in Article 2 of Law 2001-65 on credit institutions are the followings:</p> <ul style="list-style-type: none"> • taking of deposits from the public; • granting credit, it being specified in Article 4 that leasing and factoring are considered credit operations; • intermediation on the exchange market; and • provision and management of payment instruments. <p>The Law specifies in the same Article that credit institutions may also conduct operations related to their business, such as providing advice and assistance with asset management, financial management, financial engineering, and all services designed to facilitate the establishment, development, and restructuring of enterprises.</p>

	<p>Article 14 of Law 2001-65 prohibits the practice of banking activities on a regular basis by any person or company that has not been licensed as a credit institution. The same law authorizes the BCT to propose that the Ministry of Finance liquidate an enterprise engaging in such activity without a license.</p> <p>This same Article forbids any non-licensed person or company from using the words “bank,” “banker,” “credit institution,” or “financial institution” (as defined under Principle 1.3) in their trade or corporate name, or their advertising, or in any activity they undertake. The Article also prohibits the use of any other term suggesting that the enterprise is a credit institution.</p> <p>Article 14 specifies that, for the purpose of determining whether or not an activity requires a license, the BCT is entitled to demand all the information it needs from the enterprise concerned and to conduct any necessary on-site inspections. Finally, the BCT may, after listening to the representative of the enterprise concerned, propose to the Ministry of Finance that it liquidate any enterprise performing banking operations without a license and that it appoint a receiver.</p> <p>The BCT has indicated that, in order to adhere to these provisions, the Office of the Assistant Director of the information bureau, attached to the General Directorate of Credit and Capital Markets, has been charged with monitoring legal notices and reporting to the DGSB any anomaly it encounters with respect to either illicit use of the term “bank” in companies’ names, or lending and performance of any unlicensed banking activity.</p>
Assessment	Compliant with essential criteria. There are no additional criteria for Principle 2.
Principle 3.	<p>Licensing Criteria</p> <p>The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization’s ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>Title II of Law 2001-65 on credit institutions establishes the terms on which a license is granted and withdrawn. It mentions that the license application is examined by the BCT, which is entitled to request any information it deems necessary. Article 9 of the Law specifies that the license is granted “after taking into account the operating plan of the establishment applying for a license, the technical and financial resources it plans to use, the quality of those putting up the capital, and, if need be, of their guarantors, and the integrity and qualifications of its managers.” For subsidiaries or branches of foreign banks requesting a license, the law does not mention the need to obtain the prior consent of the home country supervisor.</p> <p>As regards capital requirements, until the adoption of the Law 2006-19, Article 13 of Law 2001-65 established the minimum capital for banks at TD 10 million and for financial institutions according to the definition in Principle 1.3, at TD 3 million. Law 2006-19 which revises Law 2001-65 has raised these amounts from TD 10 million to TD 25 million for banks and from TD 3 million to TD 10 million for financial institutions, except for investment banks for which the minimum capital remains TD 3 million. Paragraph 3 of Article 13 of Law 2001-65 stipulates that the minimum capital must be fully paid-up when the credit institution is established. On the other hand, the portion in excess of the minimum may be paid up in accordance with ordinary law.</p>
Assessment	Compliant with essential and additional criteria
Remarks	

Principle 4.	Ownership Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.
Description	<p>Before being revised in 2006, the Law 2001-65 on credit institutions stated, in its Article 10, that any acquisition of equity holdings in a credit institution that would lead to a controlling interest, and, in any case, any operation resulting in the acquisition of a percentage of voting rights equal to or higher than 10 percent, is subject to authorization by the Ministry of Finance, following a report drawn up by the BCT.</p> <p>Law 2006-19 which amends Law 2001-65 clarifies the type of authorization to be requested from the Ministry of Finance, when shares are acquired in a credit institution. New Article 10 of Law 2001-65 establishes that direct or indirect acquisitions that could lead to a controlling interest in a credit institution, as well as any acquisition in excess of established thresholds must be authorized by the Ministry of Finance, which will take a decision based on a report by the BCT. The thresholds set by the Law amending that of 2001 are as follows: one-tenth, one-fifth, one-third, one-half, and two-thirds of the voting rights, with each of these thresholds corresponding to a degree of control.</p> <p>In addition, Law 2006-19 has modified the article 40 of Law 2001-65 introducing the notions of reference shareholder and principal shareholder. A reference shareholder is defined as a shareholder or group of shareholders with ties based on an explicit or tacit agreement that, directly or indirectly, owns a percentage of the institution's capital that gives him or it a majority of voting rights or control over the institution. "Principal shareholder," on the other hand, denotes a shareholder holding 5 percent or more of the capital. The revised law provides that the Governor of the BCT can require, if need be, both reference and principal shareholders and the principal shareholder to provide financial support to the institution in which they hold all or part of the capital.</p>
Assessment	Compliant with essential and additional criteria
Remarks	Law 2001-65 has made several significant changes with respect to shareholdings in credit institutions. Furthermore Law 2006-19, which modifies the previous law, has introduced the concept of "reference shareholder" thus conforming to essential criterion 1, which requires that the law or the regulations give a definition of "major" shareholder. The mission has therefore considered that the BCT is now in conformity with Principle 4., anticipating the effective implementation of these provisions.
Principle 5.	Investment Criteria Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p>Articles 21 and 22 of Law 2001-65 on credit institutions establish the terms on which these institutions may engage in equity investment, introducing two types of restriction:</p> <ul style="list-style-type: none"> • On the one hand, each equity investment, of whatever kind, may not exceed 10 percent of the capital base of the credit institution making the investment (Article 21 of the Law); and • On the other hand, in the case of shares in nonfinancial institutions, the percentage equity holding may not exceed 30 percent. Article 22 of Law 2001-65 distinguishes investments in the equity of financial service companies and others. For shares in companies providing financial services, there is no restriction on the percentage of equity held; thus, a bank may hold 100 percent of the equity of a financial leasing company. For other companies the percentage holding is capped at 30 percent, except when the holding was acquired to allow the credit institution to recover its claims, in which case any excess of the 30 percent threshold must be temporary. <p>These rules, introduced in 2001, have already rendered obsolete previous provisions that</p>

	<p>obliged credit institutions to request authorization if they exceeded a 30 percent holding threshold. They have not been modified by Law 2006-19.</p> <p>As for companies operating within the financial services sector, the Ministry of Finance, which is responsible for supervising the insurance sector, considers that insurance companies are not part of the financial sector. Thus a bank would not be authorized to hold more than 30 percent of the equity of an insurance company, a restriction that could hamper development of banking-insurance (<i>banque-assurance</i>). However, as regards the marketing of insurance products, a Ministry of Finance decree issued on August 8, 2002, implementing the insurance code, authorizes unrestricted marketing by credit institutions of the following products: agricultural risks related insurance, credit and insurance, assurance-assistance and life insurance, and capitalization.</p> <p>Furthermore, Article 10 of Law 2001-65 makes the Ministry's of Finance authorization obligatory for "any act that might lead to the transfer of a significant portion of the assets of a credit institution that could induce a change in its financial structure or in the nature of its activities."</p> <p>Finally, the legislation restricts the extent to which credit institutions can operate outside the banking sector. Indeed, Article 24 of Law 2001-65 stipulates that nonbanking operations must be minor in comparison to an institution's banking activities, and that they may not restrict or distort competition to the detriment of enterprises dedicated to banking on a regular basis. Nevertheless, no specific shares' threshold has been defined, and the percentage of operating income derived from nonbanking activities has not been calculated, because it is deemed to be small.</p>
Assessment	<p>Compliant with essential criteria. There are no additional criteria for Principle 5.</p>
Remarks	<p>In order to be fully compliant with Principle 5, care should be taken to ensure that equity investments of more than 30 percent of the capital of nonfinancial enterprises are not held on a permanent basis.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • While an individual ceiling has been set on each investment holding of credit institutions (10 percent of their capital base (<i>fonds propres</i>)), no such limit has been established for their cumulative investments. It would be advisable to establish such a limit for nonfinancial investments, the standard ceiling being 60 percent of the capital base. • Moreover, when established limits for equity holdings are exceeded, BCT authorization should be systematically required and, in cases in which the BCT agrees to a temporary excess, a BCT waiver should be issued. Thus, equity holdings acquired by a credit institution in order to recover its claims and which exceed 30 percent of capital should be the object of a divestment plan discussed with the BCT, in order to establish a deadline by which the institution has to lower its share in the company concerned to the 30 percent threshold or less. Furthermore, the BCT should envisage deducting from the institutions' capital base that portion of their nonfinancial equity investments exceeding the regulatory ceilings. This is contemplated in the Basel 2 Accord, according to which individual and overall limits on nonfinancial equity participations should not exceed 15 percent and 60 percent of the capital base, respectively. Holdings over and above these thresholds should be deducted from the capital base. • Equity holdings and all claims of that nature held in credit and investment institutions should be deducted from their individually calculated capital bases (Cf. Principle 6).

	Although the capital adequacy ratio applies to the consolidated base, it seems to be coherent to apply the same deduction rules for capital established on individual basis.
Principle 6.	<p>Capital Adequacy Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.</p>
Description	<p>A minimum equity capital requirement for credit institutions was established by Article 13 of Law 2001-65 on credit institutions. As mentioned under Principle 3, the minimal capital requirement has been increased when this law was amended. Equity capital is calculated as defined in Article 5 of BCT Circular 91-24 based on tier 1 and tier 2 capital; the amount of the latter is limited to half of the regulatory capital.</p> <p>Credit institutions must respect two operational ratios: the risk cover ratio (solvency ratio or capital adequacy ratio, which should be equal to 8 percent) and the division of risks. Regulatory capital is placed in the numerator, while the denominator includes all risks incurred, regardless of whether they are assets or off-balance-sheet commitments. The regulation establishes that the cover ratio should be respected on a permanent basis.</p> <p>Credit institutions must report their risk cover ratio to the BCT each quarter, including details of their regulatory capital.</p> <p>Currently, the regulatory capital requirement is calculated only on credit risk, as market risks may be considered slight.</p> <p>Given the lack of consolidated prudential ratios, credit institutions only report their individual capital bases. Furthermore, there is no capital adequacy requirement for risks other than credit risk, such as market risks—which are slight—or operational risks.</p> <p>However, the introduction of consolidated ratios was dependent upon the introduction of accounting standards for consolidated accounts, which are set forth in Principle 20 and only very recently entered into effect. Indeed, credit institutions with subsidiaries or equity holdings had to compile consolidated accounts for the year 2004.</p> <p>The BCT has begun preparing for consolidated supervision; thus, training courses on consolidation were organized in 2005. Moreover, the consolidated accounts transmitted by credit institutions are now being analyzed by off-site inspection staff. In addition, the circular on internal controls adopted after the March 2006 mission (Circular 2006-19 of November 28, 2006) requires banking groups, for the first time, to monitor their consolidated risks.</p> <p>BCT Circular 91-24 also stipulates that the capital base is determined after deduction of any shortfall in provisions that may be detected. Thus, the BCT had to correct the capital bases reported by several credit institutions in 2004, due to a shortfall in provisions. This greatly reduced the solvency margin of one bank, which has since been well below the regulatory threshold of 8 percent. This institution was recently taken over by a foreign group. The BCT is expected to contact the new shareholder to discuss the decisions that need to be taken to regularize the bank's position.</p> <p>The capital requirements can be modified by the divestment of assets, both sound and nonperforming.</p> <p>As regards transfers of nonperforming loans, since 1999 several Tunisian banks have transferred Class 4 claims (doubtful credits which have to be provisioned at 100 percent after</p>

	<p>deducting existing admissible collateral) to asset recovery companies they have established and of which they own 100 percent of the capital. These companies were created by Law 98-4 of February 2, 1998, complemented by a Ministry of Finance decree of December 22, 2001. Outstanding claims with a total nominal value of almost TD 2 billion (TD 1,891 million according to figures provided by the BCT) were transferred by the banking sector between 1999 and 2004. Most of the transfers involved two former development banks and two public banks.</p> <p>According to data obtained from the BCT, the transfers generally involve claims whose face value had been fully provisioned and were carried out with a zero transfer price. However, for one public bank, the selling price of claims transferred between 1999 and 2005 was substantial, in the order of TD 110 million. The transfer of these assets was said to have led to the constitution by the bank of an investment account (<i>compte courant d'associés</i>) in its subsidiary. This was recorded as a "Class 4" loan on the assets side of its balance sheet.</p> <p>In the case of sale of performing claims, some credit institutions plan to resort to transfers to joint claims funds (<i>fonds communs de créances</i>) (FCC). These were established by Law 2001-83 of July 24, 2001, promulgating the code governing collective investment schemes, supplemented by the Ministry of Finance decree of January 31, 2002. Article 25 of the Law states that the sole purpose of the FCC is to acquire performing claims and that resources must be available to address the risk of nonrecovery, including the transfer to the fund of a sum higher than that of the issued shares, the issuance of specific shares covering that risk (but which cannot be acquired by either persons or mutual funds investing in securities), obtaining guarantees from a bank or insurance company, and the existence of guarantees for the claims that were transferred.</p> <p>Concerning the measures to be adopted in case the capital of a credit institution falls below the regulatory limit, Law 2001-65 in its Articles 36 and 37 grants to the BCT various powers, of which some have already been used.</p> <p>Thus Article 36 stipulates that when the circumstances of a credit institution warrants it, the BCT can issue an injunction to the Board of Directors or the Supervisory Board to:</p> <ul style="list-style-type: none"> • increase the capital • prohibit any dividend distribution • constitute provisions <p>The institution must thereafter submit to the Governor of the BCT, within two months from the notification of the injunction, a restructuring plan accompanied by an external audit report specifying the measures taken and those planned, as well as the schedule of implementation.</p> <p>Article 37 stipulates that the Governor, after having heard the representatives of the concerned credit institution, can decide to appoint an interim administrator, when the solvency ratio of the institution is below the minimum required ratio by 25 or 50 percent, and the institution has not responded in a satisfactory manner, within a two month delay, to the injunction to present a restructuring plan.</p>
Assessment	Largely compliant with essential and additional criteria

Remarks	<p>Essential Criterion 4 and Additional Criterion 5 are not observed, because the capital base is not calculated on a consolidated basis. Moreover, in the case of Essential Criterion 5 and Additional Criterion 6, no procedure is established regarding steps to be taken if a credit institution's capital base falls below the required minimum.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • It would be useful to expedite the introduction of consolidated prudential standards for risk diversification and solvency ratios. This would allow to calculate the required capital for banking groups and to ensure that they respect these ratios on a consolidated basis. The BCT circular on internal controls (Circular 2006-19 of November 28, 2006) requires banking groups to implement consolidated risk surveillance. Thus, it seems logical that the supervisor should adopt consolidated management standards for the banking sector. • In the interim, Article 5, on calculation of the capital base, of BCT Circular 91-24 should be amended to oblige banks to deduct from their individually reported capital bases any equity holdings or similar claims they may have in other credit institutions. Indeed, although there are few of them today, the Basel Capital Accord establishes that investments in subsidiaries engaged in banking and financial activities, namely equity and other participations that form part of the capital base of the institutions in which the investment is made, must be deducted from the capital base of the parent institution, when the calculation of the capital base is not performed on a consolidated basis. The reason for this deduction is to avoid multiple use of the same capital base in different financial units of the same banking group (in the parent organization and the affiliate). At the same time, the items deducted from the capital base of the parent institution are not included in its total weighted assets. Basel 2 retains this obligation, while modifying the manner in which the deduction from the capital base must now be made: 50 percent of Tier 1 and 50 percent of additional capital. • It would be advisable that the prudential treatment of each asset transfer operation be discussed, in detail and beforehand, with the BCT, to prevent the institutions from circumventing the regulations even for a short period of time. Indeed, from both an accounting and prudential point of view, transfer of assets by credit institutions are so sensitive that they warrant a detailed analysis of their prudential impact. Here, international practice, especially the IASB (International Accounting Standards Board) Standing Interpretations Committee interpretation SIC-12, is to accept deconsolidation only in cases in which there is effectively no longer any connection between the assignor and the assignee. • Finally, regarding the implementation of measures for dealing with credit institutions with insufficient capital, it would be advisable that the provisions of Law 2001-65 be complemented by a formal outline by the BCT of the actions that it would pursue to respond in a proactive manner to any banking crisis.
Principle 7.	<p>Credit Policies</p> <p>An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.</p>
Description	<p>At the time of the March 2006 mission there still was no regulatory provision specifically addressing credit risk management by credit institutions. Indeed, Standard 22 of the National Accounting Council deals in a general manner with the establishment of internal controls in the banking sector, while Circulars 87-47 and 92-23 address, respectively, the criteria to be</p>

	<p>observed for BCT refinancing of bank claims and the information that external inspectors are required to report to the BCT regarding the loan portfolios of the banks they audit.</p> <p>The circular on internal controls 2006-19 establishes, in Articles 35 to 44, rules to govern credit risk management. They concern, above all, the establishment of procedures and credit files, risk assessment, the introduction of an internal rating system, profitability considerations, and the quarterly review of exposure. Certain credit institutions may find it difficult to comply with these new requirements. Thus, if one considers the obligation to assign each customer a rating on an internal rating scale, it would appear from information gathered by the FSAP mission that few institutions possess such a scale today, with the exception of those that have implemented a scoring system for loans to individuals or leasing, or institutions related to foreign banking groups.</p> <p>The Law 2006-19, which amends Law 2001-65 on credit institutions, introduces in this law an Article 34 ter, which requires each credit institution to establish an Executive Credit Committee. This Committee, chaired by the Chief Executive Officer, or Director General, or Chairman of the Board, will be chiefly responsible for examining financing activities and submitting proposals to the Board of Directors or Supervisory Board (<i>Conseil de Surveillance</i>) regarding the institution's financing policy. The draft Law states that the terms governing implementation of this Article will be established by the BCT.</p> <p>Since 2001, pursuant to Article 7 of the Law 2001-65 credit institutions are subject to the following requirements on required financial information from individuals and companies applying for loans:</p> <ul style="list-style-type: none"> • External auditor's report on their customer, as soon as they have an exposure exceeding 10 percent of their capital base; • Financial statements certified by an external auditor if total banking exposure to a counterparty exceed TD 5 million; and • Recent rating from a credit rating agency for companies that are not listed on the Stock Exchange, if this exposure exceed TD 25 million. <p>The BCT has stated that the provisions regarding the two aforementioned amounts (D 5 million and D 25 million) were observed:</p> <ul style="list-style-type: none"> • In the case of the TD 5 million threshold, by approximately 50 percent of the enterprises, and by two-thirds if contested claims are excluded; and • In the case of the TD 25 million thresholds, by approximately 20 percent of the counterparties, whereby the cost of obtaining a rating may explain why this percentage is so low. <p>The BCT has said that it regularly requests information from its information system (<i>Centrale des risques</i>) to monitor banks' compliance with these provisions.</p> <p>Other obligations of the same kind were introduced by Law 2005-96 on strengthening the security of financial relations. Indeed, pursuant to Article 7 of that Law, which amends the commercial company code, external auditors are required to forward to the BCT a copy of the report they submit to the annual meeting of shareholders, in the case of:</p> <ul style="list-style-type: none"> • Companies raising funds from the public; • Those required to draw up consolidated financial statements; and • Those whose total exposures vis-à-vis credit institutions and bond issues exceed a ceiling established by decree.
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	The decree in question has not yet been issued. Likewise, the BCT has not yet established the precise circumstances in which it will verify whether external auditors have complied with their reporting obligations.
Assessment	Materially noncompliant with essential and additional criteria.
Remarks	<p>Until the adoption of the BCT's circular on internal controls there was no regulation specifying credit institutions' obligations with respect to lending procedures. This gap is now filled by this circular, which contains precise provisions on this subject. Nevertheless, compliance with Principle 7 also requires improved credit risk surveillance by the banks, as well as more robust recovery procedures, both of which are prerequisites for a reduction of the share of nonperforming loans in the banks' portfolios.</p> <p>Recommendations</p> <p>It would be advisable to verify, through off-site and on-site supervision, that the provisions of the BCT's circular on internal controls are effectively implemented by the credit institutions.</p>
Principle 8.	<p>Loan Evaluation and Loan Loss Provisioning</p> <p>Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.</p>
Description	<p>Circular 91-24 to the banks establishes the terms on which claims are downgraded and the different types of provisions required. It has been supplemented by the BCT circular on internal controls 2006-19, which requires banks, under Article 28, to conduct at least quarterly a review of their loan portfolio, above all in order to effect any necessary downgrading.</p> <p>The regulations do not explicitly mention the ways in which the "contagion" (cross-classification) principle is to be applied. This principle may be construed more or less broadly, since it may lead to:</p> <ul style="list-style-type: none"> • Downgrading, within a credit institution, of all its claims on a single debtor as soon as one of them is overdue; • Transferring, within a credit institution, of all loans granted to an economic group to the nonperforming category, as soon as one of the companies in the group defaults, to the extent that default by one of the debtors is such that it may jeopardize the solvency of the group as a whole; • Downgrading, except under special circumstances, of loans granted by an institution to a counterparty if the other local institutions have classified loans to the same debtor in a more highly provisioned nonperforming category. A downgrading of this kind naturally presupposes that credit institutions are aware of the downgrading decision taken by the other banks involved. This information will shortly be available to them on an ongoing basis when the information bureau on nonperforming loans (Centrale des créances classées), run by the BCT, is operational. (For confidentiality reasons, the names of the other credit institutions involved will not be revealed.) <p>In both its off-site and on-site inspections, the BCT applies all three components of the "contagion" principle. The Bank considers that the institutions are familiar with the principle and that its application to groups is established by Article 2 of Circular 91-24, which defines the notion of "single beneficiary."</p> <p>The classification rules described in Article 7 to 10 of Circular 91-24 apply to both assets and off-balance-sheet commitments. The latter should therefore be downgraded as soon the guarantee of the institution concerned risks being called in. The BCT told the mission that off-</p>

	<p>balance-sheet exposure accounted for DT 174 million out of D 5.2 billion in NPLs at end-2004.</p> <p>Six banks were under-provisioned in 2004, some of them registering significant shortfalls. One of them now has a solvency ratio markedly below the regulatory threshold of 8 percent, because the BCT has deducted from its capital base the additional provisions to be constituted, thereby reducing its capital base in the same amount (cf. Description under Principle 6). In addition, the Governor of the BCT asked two public banks not to distribute dividends in 2004 in order to consolidate their capital base. Neither bank made a substantial profit that year.</p> <p>Since 1999, the banks have established asset recovery companies, which have bought nonperforming loans classified in class 4 (more than one year overdue) in several batches. Initially they had to be licensed by the Ministry of Finance, but now they can be established on the basis of a simple specification of their terms and conditions. These companies, referred to above in the Description under Principles 1-6 and 6, have enabled several banks to reduce the nominal value of their outstanding nonperforming loans. The BCT is authorized under Article 32 of Law 2001-65 to supervise these entities, inasmuch as they are subsidiaries of banks, but it has not yet done so.</p> <p>Two Tunisian banks, which are subsidiaries of large French banking groups quoted on the stock exchange, are now required to prepare a consolidation file under International Accounting Standards/International Financial Reporting Accounting Standards (IAS/IFRS), with a view to compiling the financial statements of their group. They therefore apply IAS 39 with respect to depreciation of claims, which requires estimating discounted collection flows for the future years, with the provision to be constituted based on the application of the depreciation principle known as “impairment”, equal to the difference between the nominal value of the claim and the sum of the estimated and discounted collection flows, which take into account possible guarantees.</p>
Assessment	<p>Materially noncompliant with essential criteria. Compliant with the two additional criteria.</p>
Remarks	<p>Some essential criteria are not currently observed. They include Criterion 1, because the obligation to periodically review exposures has been introduced by Article 28 of the BCT’s Circular on internal controls, which will enter in effect only in 2008. As for Criterion 5, there appears to be no evidence that the institutions have appropriate procedures and resources in place for “ongoing surveillance of doubtful loans and recovery of loan arrears.” The new circular on internal controls includes various provisions designed to improve the monitoring of credit risk, and its implementation by the credit institutions will be assessed by the BCT through its on site and off-site inspections.</p> <p>Finally, in relation to Criterion 6, regarding the possibility of the supervisory agency to demand to a credit institution to tighten its lending terms, it appears that this possibility was never exercised. However, it would at least be useful to define under what conditions it could be applied</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Even if, according to the BCT, credit institutions are familiar with “contagion” principle rules, it might be useful to mention them explicitly in the regulations. Indeed, the regulations constitute the legal benchmark allowing the BCT to impose penalties on an institution. It could at the same time be pointed out that discounted bills or drafts that has not yet fallen due need not be included in nonperforming loans, provided that there is no risk of the liability not being paid by the main debtor.

	<ul style="list-style-type: none"> The provisioning system currently in effect does not take into account actual recovery prospects for Class 4 claims. However, according to a BCT study on Class 4 claims at end-2003, 39 percent of them were more than five years old, taking into account the length of judicial proceedings. Consequently, the amounts the bank is likely to recover will probably only be collected several years after the transfer to Class 4. Internationally recognized accounting standards now take the time factor into account by <i>discounting the collection flows estimated for each year</i>.
Principle 9.	<p>Large Exposure Limits Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.</p>
Description	<p>With respect to exposure, risk division limits are established by BCT circular 91-24 on the diversification and hedging of risks and monitoring of exposures. They are:</p> <ul style="list-style-type: none"> Total exposure to borrowers for whom, in each case, the exposure incurred is equal to or exceeds 5 percent of regulatory capital (fonds propres nets) must not exceed 5 times the regulatory capital; Total exposure to borrowers for whom, in each case, the exposure incurred is equal to or exceeds 15 percent of regulatory capital must not exceed twice the regulatory capital. <p>These limits are established by BCT Circular 2001-12, which has amended Circular 91-24 with respect to the diversification and scope of risks and the monitoring of exposures. Henceforth, other than these two limits and those referring to equity holdings (cf. the Description under Principle 5) credit institutions must observe a risk concentration ratio that limits exposure to a single beneficiary to 25 percent of their capital. The notion of “single beneficiary” is defined in Article 2 of BCT Circular 91-24. It applies to artificial persons related to one another through shared management or as a result of economic or financial interdependence.</p>
Assessment	Compliant with essential and additional criteria.
Remarks	<p>The 2002 assessment “compliant with the Principle” has been maintained. However, it is worth noting that Essential Criterion 4 on exposure to a single borrower or group of related borrowers on a consolidated basis is not currently observed for lack of a consolidated ratio; this problem will be addressed with the implementation by the banks of the BCT’s internal controls circular 2006-19 which envisages for bank conglomerates the establishment of risk surveillance systems on a consolidated basis and the introduction of ratios on a consolidated basis (see Principle 20).</p> <p>Recommendations</p> <p>It would be advisable to encourage banks to establish internal limits systems, distinct from those established in the regulations, for both counterparty and sector risk, as contemplated in the BCT’s internal controls circular 2006-19 (Articles 18 and 23).</p>
Principle 10.	<p>Connected Lending In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm’s-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.</p>
Description	<p>Article 23, second paragraph, of Law 2001-65 on credit institutions defines connected parties as “persons with connections to the credit institution.” They comprise:</p> <ul style="list-style-type: none"> Any shareholder whose holding directly or indirectly, including that of his spouse, ascendants, and descendants, exceeds more than 5 percent of the credit institution’s capital;

	<ul style="list-style-type: none"> • The chief executive officer of the credit institution, the chairman of the board of directors, the director general, the deputy directors general, members of the board of directors or supervisory board, and the external auditors, as well as the spouses of the above and their ascendants and descendants; • Any enterprise in which one of the above-mentioned persons is either an owner, or partner, or acting representative, a director, member of the board of directors, or its supervisory board; • Any subsidiary or enterprise in which the credit institution has an equity holding large enough to control it or exercise a predominant influence over its activities. <p>Credit institutions must declare to BCT every year, in a specified form, their connected loans, as specified above.</p> <p>Credit institutions are obliged to submit an annual report to the BCT in the form of a regulatory statement on connected lending, as defined above.</p> <p>Loans to connected parties are deemed to be special agreements. As such they must be reviewed by the external auditors, who then draw up a special report to be submitted to the shareholders’ general assembly. Pursuant to the second paragraph of Article 29 of Law 2001-65, they must obtain prior approval by the board of directors or supervisory board, before being approved by the general assembly. This article specifies that when a loan agreement is subject to prior approval by the board of directors or supervisory board and by the shareholders’ general assembly, the interested party may not take part in the vote.</p> <p>Article 3 of Circular 91-24 also refers to connected persons, but defines them more restrictively: managers and shareholders with an equity holding of more than 10 percent. In addition, Note 93-23, giving terms of reference for account inspections, indicates in Point 6 of the scope and forms of audit that the external auditor’s evaluation must encompass “all credit extended to shareholders holding more than 5 percent of the bank’s capital, and to the bank’s administrators and managers.” They are required to provide information on such loans in the report they submit to the BCT prior to the annual shareholders’ meeting. Moreover, Article 7 of that Note mention, under the pieces of information to be submitted by the external auditor to the BCT, those pertaining to the identification and quantification of large exposures, and it refers to connectedness that “implies the ability to exert control or to influence the bank’s policies and decisions.”</p>
Assessment	Largely compliant with essential and additional criteria.
Remarks	<p>Law 2001-65 does indeed include a definition of connected parties. Nevertheless, certain criteria contained in Principle 10 are not observed.</p> <p>This is the case for several essential criteria regarding the existence of legal or regulatory provisions governing the granting of loans and the ceilings on the amounts involved:</p> <ul style="list-style-type: none"> • Criterion 2: these loans cannot be granted on more favorable terms than those for loans of comparable risk; • Criterion 4 : existence of internal procedures to exclude loan beneficiaries from participating in the decisions to evaluate and extend the loans; • Criterion 5: establishment of a ceiling on the loan, deduction from the capital base, or collateral requirement; • Criterion 6: a system for identifying connected loans. <p>With respect to the two additional criteria, the definition of connected parties (Criterion 1) contained in Law 2001-65 and those given in the regulations are not consistent with one another. Moreover, the ceilings set for such loans are markedly higher than those established</p>

	<p>for other groups of borrowers (Criterion 2).</p> <p>The “largely compliant” assessment was nevertheless made taking into account that the BCT was committed to revise shortly its regulations in order to comply with most of the criteria. Following the mission, the BCT’s circular on internal controls 2006-19 has introduced the principal recommendations put forward below, under its articles 23-d, 27 (2), 29 and 52-g.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • It would be advisable to bring the definitions of connected parties contained in Circulars 91-24 and 93-23 into line with that provided in Article 23 of Law 2001-65, especially since the ceiling established in the regulations on these loans—three times the amount of capital—is applicable to the definition of connected parties in Circular 91-24, and not to that retained in Law 2001-65. • It would also be advisable that the regulations specify that : <ul style="list-style-type: none"> ○ Operations in favor of persons with connections to the credit institution should not be conducted, at equivalent levels of risk, on more favorable terms than those applied to customers; ○ Credit institutions must be able to identify in their information system all connected lending, and must have internal procedures that prevent a person with connections to the credit institution from having any role in the extension of credit or any other service for which that person would be the beneficiary. • Article 3 of Circular 91-24 limits the total exposure to managers and stockholders whose equity holding exceeds 10 percent to three times the bank’s net capital. It is however also specified that the 25 percent limit of capital for a same beneficiary applies also to this type of lending. Moreover the BCT has indicated to the mission that in practice the size of such loans is much lower than this ceiling, It remains however to be noted that an overall ceiling equal three times capital is high. It would be advisable that the regulations lower this limit.. • Finally, it would be advisable to mention in the regulations that loans to connected parties must either be collateralized or deducted from the capital base.
Principle 11.	<p>Country Risk Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.</p>
Description	<p>Except in exceptional cases (import/export trade credits, generally covered by deposits or by the value of the merchandise in question), bank portfolios do not contain cross border bank and nonbank credit. They are therefore not exposed to country risk.</p>
Assessment	Not applicable
Principle 12.	<p>Market Risks Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.</p>
Description	<p>There appear to be only limited market risks. First, interest risk is currently modest. Indeed, the credit institutions’ securities portfolio mainly consists of Treasury bills. Moreover, the lending rate is indexed to the money market rate (MMR), while banks’ resources are either demand deposits or deposits with a remuneration linked to the MMR. The residual interest rate risk is related to the refinancing of the Treasury bills purchased by the banks. Exchange rate risks also remain modest and are addressed through prudential limits.</p>

	The BCT circular 2006-19 on internal controls comprises specific provisions on market risk in its Articles 31 to 34, which cover the totality of such risks.
Assessment	Largely Compliant with the essential and additional criteria. (Essential Criterion 6 and Additional Criterion 3 Not Applicable).
Remarks	<p>In practice, market risks do not cause significant risks to banks, and the circular on internal controls 2006-19 has introduced controls in this area.</p> <p>In assessing compliance with this Principle, consideration must be given to the limited scope of market operations. Thus, Essential Criterion 6 and Additional Criterion 3 on simulations of crisis scenarios may be considered inapplicable. However, Article 34 of the BCT's circular on internal controls includes this obligation, anticipating an increase in market operations and related increased volatility of operating income.</p> <p>Recommendations</p> <p>It would be advisable to monitor closely developments in the market risks, as they could increase with the liberalization and modernization of the financial sector.</p>
Principle 13.	<p>Other Risks</p> <p>Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.</p>
Description	<p>Until recently, the main instrument governing credit institutions' general obligations with respect to internal controls was Standard 22 of the National Accounting Board, which supplemented the standard applicable to all enterprises.</p> <p>Law 2006-19, which has amended Law 2001-65, has introduced a new article 34 providing for the establishment of an appropriate internal audit system, the creation of an executive credit committee, and of a permanent body for compliance control. Following the assessment mission, these have been the object of two circulars of 24 July 2006, Circular 2006-07 on the executive credit committee, and Circular 2006-06 on compliance controls. In addition, the BCT's circular on internal controls 2006-19 refers explicitly to the different classes of risks associated with banking activity: credit risks (articles 22 to 30), market risks (Articles 31 to 34), global interest rate risks (Articles 35 to 37), payment risks (Articles 42 to 44), and operational risks (Articles 45 to 47).</p> <p>As regards liquidity risk, circular 91-24 established a prudential standard. Credit institutions are required to report to the BCT, each month, their liquidity ratio, which has to be permanently maintained at or above 100 percent. Any adjustments to the accounts made by the BCT must be taken into account in the liquidity ratio calculation.</p> <p>There is also an exchange risk standard: open positions, as a whole, must not exceed 20 percent of regulatory capital.</p> <p>With regard to information systems, credit institutions, and especially banks, have been overhauling them in the past years as part of the banking system modernization plan. In fact, this component is a priority within that plan. It is monitored periodically by a working group, the steering committee of which is chaired by the Governor of the BCT, with members representing the banking profession and the Ministry of Technology.</p> <p>The BCT inspectors whom the FSAP mission met pointed out that credit institutions had greatly improved their information systems. They noted that they now it is much easier than in</p>

	<p>the past to obtain the data they need from those systems.</p> <p>Certain on-site inspections include IT tasks, when this dimension has been incorporated into the mission plan. Whenever this is the case, an IT specialist from the BCT's General Directorate of Information Systems is asked to examine the security and quality of the bank's information system, under the authority of the team leader.</p> <p>The BCT's circular on internal controls 2006-19 introduces specific obligations in the I.T. area, such as the establishment of a business continuity plan.</p>
Assessment	Largely compliant with essential and additional criteria
Remarks	<p>As regards the essential criteria, until the adoption, following the FSAP mission, of the BCT's circular on internal controls there was no regulatory instrument specifying the obligations of credit institutions with respect to the various risks to which they are exposed.</p> <p>As for Additional Criterion 2, it would be worth encouraging credit institutions to deepen the risk management section of their annual report.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • There are apparently not many on-site missions conducting a critical review of the computerized data system, due to the projects under way that are designed to upgrade these systems. <p>However, it would be useful to increase the frequency of IT audits in the missions, in order to:</p> <ul style="list-style-type: none"> ○ Monitor observance of the deadlines set for execution of information system modernization projects; ○ Gauge the quality of IT procedures and highlight the areas that need to be improved; ○ Verify, , that credit institutions meet their IT security obligations listed by the BCT's circular on internal controls (Articles 14 and 15) <ul style="list-style-type: none"> • The introduction in the Tunisian banking system of the Basel II Accord is envisaged for 2008-09. This could contribute to strengthening the risk analysis culture within the banks, but should take place with caution, since other measures as the recovery of nonperforming loans remain the priority.
Principle 14.	<p>Internal Control and Audit</p> <p>Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and exposures; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p>Law 2001-65, building on older provisions, requires credit institutions, under the Article 34, to have an internal controls mechanism and to establish a standing internal audit committee responsible above all for ensuring that the institution has in place internal control procedures commensurate with its risks.</p> <p>Accounting Standard 22 of the National Accounting Board (Conseil Nationale de la Comptabilité, CNC) is still the principal regulatory frame of reference for internal controls. It is supplemented by several BCT circulars, which establish the limits for risk diversification, liquidity, and the solvency ratio.</p>

	<p>Standard 22 assigns to banks' senior management the task of "determining the appropriate procedures and means for attaining internal control objectives." In addition, since 2001, credit institutions have been required to have an audit committee.</p> <p>Law 2006-19 which amends Law 2001-65 introduces several new provisions on internal controls. They concern, in particular, the requirement that credit institutions (i) introduce "an appropriate system of internal controls" (Article 34 bis) ; (ii) establish an Executive Credit Committee, responsible for examining lending operations and submitting proposals to the Board of Directors and the Supervisory Board regarding the institution's lending policy (Article 34 ter), and (iii) establish a compliance control system designed to determine and assess the risks of noncompliance with laws and regulations, with the rules of good performance of the banking profession, and with sound practices (Article 34 quater). The BCT is responsible for establishing the regulations needed to implement these provisions. This task has been entrusted to a working group, under the aegis of the Governor of the BCT.</p> <p>In the regulatory area,, the BCT's circular on internal controls , adopted in November 2006, reviews the principal risks facing banks and establishes their obligations with respect to each. It establishes the powers and composition of the standing audit committee and requires the institutions to appoint an officer responsible for internal audits. It also requires the institutions to submit two annual reports to the BCT: one on risks (article 53), the other on the internal audit environment (Article 52).</p> <p>As regards the issue of to whom the credit institutions' internal audit departments report to, it would appear that they now all, without exception, answer directly to the Office of the Director General, as recommended by the Institute of Internal Auditors (IIA). On the other hand, neither the selection nor the frequency of audits would appear to be systematically based on a detailed analysis of risks and their magnitude. The external auditor met by the FSAP mission said that he did not rely on the work of the internal auditors of the institutions he audits, because their work is not based on a genuine map of the risks and it does not really cover the requirements of the internal control mechanism.</p> <p>As regards the financial information published by credit institutions, judging by some annual reports for 2004, the section on risks and internal controls is not well developed, as is the analysis of nonperforming loans (which could be ordered according to age, collection rate, etc.). By contrast, the financial statements of international banks now devote considerable space to these items, as they describe the main risks they are exposed to, as well as the organization of the lending departments and of other risk taking departments, as well as that of the internal audit.</p> <p>On the other hand, the annual accounts of the credit institutions are generally published in the media, along with the external auditor's opinion.</p>
Assessment	Largely compliant with essential and additional criteria.
Remarks	<p>Internal control obligations have been supplemented with the adoption of Law 2006-19 amending Law 2001-65 and the BCT's Circular on internal controls. It will then be a matter of having all credit institutions apply the new provisions. Currently, their internal control system appears to be less than fully satisfactory, particularly if one considers that audits are not based on an accurate assessment of risks and that the annual audit schedule is not always followed.</p> <p>As for Additional Criterion 2, the draft BCT Circular on internal controls submitted to the mission provided for the "officer in charge of internal audits to report to management and, where applicable, to the standing audit committee." The final text, constituted by Circular 2006-19, indicates in the Article 9, second paragraph, that "these officers [in charge of</p>

	<p>permanent controls and periodic controls, ie audits] report on the results of their mission to the management body”. It also specifies that “when the latter [the management body], or the board of directors, or the supervisory board, consider it necessary, they report also directly to the board of directors or the supervisory board, and when applicable to the permanent audit committee.” For this criterion to be fully observed, the words “where applicable” should be deleted.</p> <p>Recommendations</p> <p>It would be advisable, during on-site inspections, to strengthen the analysis of risks and of the quality of the internal controls mechanism, including a review of the means by which banking groups ensure that their systems cover all their financial activities, as required under Article 5 of the BCT Circular on internal controls 2006-19.</p>
Principle 15.	<p>Money Laundering</p> <p>Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict “know-your-customer” rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.</p>
Description	<p>Law 2003-75 of December 12, 2003, which is the main element of the system for anti-money laundering and combating financing of terrorism imposes on credit institutions:</p> <ul style="list-style-type: none"> • to identify their customers, be they physical or moral entities, including when they act on behalf of third parties, but the notion of beneficiary is defined more restrictively than recommended by the FATF in 2003; • to declare to the Tunisian Commission of Financial Analysis (CTAF) the suspicious or unusual transactions (Art. 86 and following), the physical persons having carried out a declaration in good faith not being subject to prosecution (Article 98); • to conserve for 10 years the information regarding the identification of their clients and the transactions they have carried out (Article 75). <p>The conditions for implementing the obligations of this law have been further specified by the CTAF Directive 2006/02 of April 20, 2006, which requires from credit institutions:</p> <ul style="list-style-type: none"> • to put in place “adequate systems for risk management in relation to accounts with high risk”(Article 6), without however defining the notion of “accounts with high risks”; • the communication to the relevant staff of the procedures pertaining to the identification of customers and suspicious transactions (Articles 10 and 11); • the appointment of a correspondent of the CTAF, having at the minimum rank of director, in charge to declare to this institution the suspicious transactions (Article 12). <p>It is envisaged that a circular of the BCT will specify the implementation details of this directive, in particular regarding the supervision mechanism that the credit institutions have to establish (Article 13 of the directive).</p> <p>In its supervisory role, the BCT has to monitor the observance by credit institutions of their obligations pertaining to AML/CFT. No specific inspection has taken place till now. Furthermore, in the context of the review of the licensing applications for which the BCT has to provide an advice to the Ministry of Finance, the BCT has to ensure that the shareholders and the officers of the credit institution meet the conditions of fit and proper.</p>

	<p>With regards to sanctions, while the BCT has a general power covering the violations identified in the area of AML/CFT (see principle 22), when it decides to impose a penalty to an institution, it can impose only a sanction commensurate to the identified violation. This limitation would not allow the BCT to impose pecuniary sanctions to credit institutions that have violated AML/CFT norms, as the infraction does not relate to a specific amount.</p> <p>The BCT can communicate confidential information to the CTAF and to judicial authorities; but it is not required to inform the latter of all suspicious transactions that it identifies during its inspections, while it must make a suspicious transaction declaration to the CTAF, if the credit institutions have not done so. Furthermore, with the adoption of Law 2006-26 of May 15, 2006, which modifies the law 58-90 on the organization of the BCT, the latter can exchange confidential information with foreign supervisory agencies and other Tunisian supervisors.</p> <p>Finally, no legal or regulatory provision has been adopted to require from a credit institution, whose financial situation, solidity, or reputation has been compromised, to inform of this the BCT.</p>
Assessment	Materially non compliant with essential and additional criteria
Remarks	<p>During the assessment carried out by the World Bank team on the conformity of the AML/CFT to the FATF recommendations, the implementation by credit institutions of the provisions of the law 2003-73 was still at the initial stage:</p> <ul style="list-style-type: none"> • only five suspicious transactions declarations had been received by the CTAF; • the specific elements for implementing the surveillance mechanism necessary to the observance by the credit institutions of their obligations had not been defined; • the modalities of control by the BCT remained to be defined. <p>However, the regulatory framework has been strengthened in 2006 with the adoption of Directive 2006/02 of CTAF and of Law 2006/26. Furthermore, certain credit institutions have established a control mechanism, in particular the subsidiaries of international banks; finally, the BCT has started training its staff in the area of AML/CFT.</p> <p>The priority must now be given to the effective implementation of the existing regulatory and legal mechanism. To that end, the BCT will have to pursue the actions that it has initiated, in order to be able to supervise effectively the observance by credit institutions of their obligations in this area. In addition, the BCT powers of financial sanctions could be enlarged. Finally, the BCT should issue rapidly a circular, so as to implement the provisions of Law 2003-73 and Directive 2006-02.</p> <p>Furthermore, specific provisions should be adopted to require any credit institution which detects a case of money laundering or fraud, that can affect its financial solidity, its soundness or its reputation, to inform of this the BCT.</p>
Principle 16.	<p>On-Site and Off-Site Supervision An effective banking supervisory system should consist of some form of both on-site and off-site supervision.</p>
Description	<p>The BCT conducts both off-site inspection, organized as reported under Principle 18, and on-site inspections. To strengthen synergies between these two types of supervision, inspection teams now regularly include the staff member in charge of off-site inspections in the institution.</p>

	<p>The six team leaders responsible for conducting inspections have undergone specialized training for different types of institution, so as to enhance their professional expertise. They are assisted by Inspectorate staff and can count, if need be, on help from BCT specialists, especially IT experts, when their missions include evaluation of the institution's information system or an examination of its IT security procedures. An office from the BCT's Exchange or Credit Directorates may also, at times, assist the inspection team with regard to specific aspects of its mission.</p> <p>All on-site inspectors generate a report and a letter, known as a "notification," listing the principal anomalies detected, signed by the Governor of the BCT. Only this written communication is delivered to the President of the inspected institution, who is responsible for forwarding it to the member of the board of directors and for replying with a list of the corrective measures he or she envisages adopting to remedy the anomalies detected. The findings of the mission are only presented orally by the team leader to the institution's managers at the end of the supervisory inspection.</p> <p>The mission report is drafted by the team leader. It includes a long section devoted to a review of exposures, but also includes comments on organizational and procedural arrangements. It is completed with a series of Annexes and a separate executive summary.</p>
Assessment	Compliant with essential criteria and largely compliant with the additional criteria.
Remarks	<p>As regards the Additional Criteria, there are no procedures for evaluating supervisory functions (Criterion 1). Furthermore, the BCT has no methodology for its choice of on-site inspections (Criterion 3). At the same time, the quality of the banks' internal inspections is not yet such that the BCT can rely on their findings (Criterion 5).</p> <p>Recommendations</p> <ul style="list-style-type: none"> • Although Article 33 of Law 2001-65 simply mentions that "the results of the (on-site) inspection are communicated" to the President of the institution, it is to be recommended that he or she receive the full mission report. Indeed, this would strengthen application of the principle of transparency and underscore the joint nature of the exchanges between the BCT and the inspected institution, as it is always possible for an on-site mission to initiate disciplinary proceedings in cases where the regulations are breached. Transmission of the report would allow the President of the inspected institution to be informed in detail of the shortcomings described by the inspector and to convey any of his observations. • It would be advisable for each on-site mission to prepare a more formally structured file, indexed according to subjects covered in the inspection. • It would also be advisable to compile a methodology manual for off-site inspections and to update the existing manual for on-site inspections. • It would also be appropriate to study a warning and grading system, based on evaluation of the individual situation of each credit institution or the analysis of the data available on the banking sector, possibly enriched by the compilation of vulnerability indicators. <p>As for evaluating the effectiveness of off-site and on-site inspection functions, it might be useful, as recommended in connection with Principle 1-1, to re-audit the DGSB.</p>
Principle 17.	<p>Bank Management Contact Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.</p>
Description	Periodic meetings are arranged with the representatives of all credit institutions (except for the recently created factoring companies) to take stock of developments in their activities, their

	<p>organizational changes, and their profitability, and to review their principal commitments. In the case of banks, these meetings take place twice a year, chaired by the Director General of the DGSB. The one held at the beginning of the year takes place before the shareholders' annual general meeting: it is devoted to activities of the institution, profitability, strategy, and the review of exposures. The mid-year meeting is chiefly devoted to examining exposures. These meetings also take stock of progress made in implementing the remedial measures that the institutions undertook to adopt to correct the anomalies detected during off-site and on-site inspections.</p> <p>These meetings are attended by the BCT's on-site inspector and the inspector in charge of the most recent on-site mission, the principal representatives of the institutions, and their external auditors.</p> <p>Prior to the meetings, which follow a very precise agenda, the BCT asks the institutions to provide a considerable amount of information on all aspects of their activities.</p> <p>Nonperforming loans are examined in detail during the discussions, largely on the basis of an analysis of comparative tables prepared by the BCT: the list of debtors whose loans have been placed in a more favorable category since the last meeting, the statement of loans listed for a single counterparty by other institutions but recorded by them in more highly provisioned classes, and trends in the value of guarantees put up for nonperforming loans.</p> <p>At the end of these meetings, if necessary, a letter is addressed to the President of the institution, to inform him or her of the anomalies to be corrected. The corrective measures specified in his written reply are monitored by the off-site audit staff.</p> <p>The BCT gauges the quality of the banks' management when it reviews the licensing procedures and examines, in particular, whether the executives' experience is sufficient to enable them to discharge their responsibilities, and again during on-site inspections of the banks' organizational structure.</p>
Assessment	Compliant with essential criteria. There are no additional criteria.
Remarks	<p>Recommendations</p> <p>It would be useful to structure more formally the monitoring of the action plans that the institutions embark upon in order to remedy shortcomings pointed out by the BCT as a result of its off-site and on-site inspections, possibly incorporating into them the actions plans designed to correct weaknesses identified by the external auditors.</p>
Principle 18.	<p>Off-Site Supervision</p> <p>Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.</p>
Description	<p>As in 2001, off-site supervision is divided between two directorates: one supervising the banks, the other, financial institutions. The Modernization and Regulatory Department, which reports to the Directorate of Banks, is chiefly responsible for preparing regulations, in close cooperation with the off-site audit units.</p> <p>As indicated under Principle 1.2, young graduates have been hired since 2003 to strengthen the human resources engaged in off-site inspection.</p> <p>Off-site inspection, known as "document control," includes examining applications for licenses and ongoing supervision of credit institutions. The latter task is performed by analyzing the numerous periodic statements that the credit institutions are required to transmit to the BCT, as well as financial statements and reports that the external auditors have to prepare for the BCT at the end of each financial year.</p>

	<p>There are frequent exchanges of information and any anomalies noted by those responsible for monitoring the prudential statements are quickly reported to management. Significant changes on prudential statements sent to the BCT from one end-of-period to another are analyzed and the institutions are contacted for explanations. For credit risk surveillance, the supervisors have at their disposal a large database that allows them to compare the risk assessments made by the institutions in respect of borrowers indebted to several banks. Furthermore, they maintain regular contact with their colleagues in the General Directorate of Credit, which manages the BCT's information systems and keeps track of bank exposure and payment incidents. Finally, periodic meetings with the banks enable supervisors to take stock of the main problem loan files, of the corrective measures requested from the institutions, especially following on-site inspections, and to monitor developments in the institution's financial conditions. On the other hand, the BCT prepares relatively few cross-cutting reports on areas such as NPL trends, the transfer of claims to asset recovery companies, and so on.</p> <p>As regards cooperation with other supervisory bodies, the BCT is a member of the Francophone Supervisors Group and Group of Supervisors of Arab countries, under the aegis of the Arab Monetary Fund, which enables it to keep up to date on developments in supervision methods and to make its own contributions to the implementation of better practices. Furthermore, the governors of the central banks of Maghreb countries have decided, during a meeting in Tunis on June 9, 2005, to create for the region a group of banking supervisors, with the aim to cooperate in the area of banking regulation and supervision.</p>
Assessment	Largely compliant with essential criteria. There are no additional criteria for Principle 18.
Remarks	<p>With respect to Essential Criterion 1, there is still no consolidated ratio. On the other hand, starting with the 2003 accounts, banking groups are required to compile consolidated accounts and to report them to the BCT.</p> <p>Furthermore, although the BCT has extensive data on credit institutions, collected in the form of prudential data, there is no analytical framework to evaluate the totality of risks, so as to establish priorities for on-site inspections, nor are comparative evaluation of credit institutions made on a regular basis. Under these conditions, the Principle is not compliant with Essential Criteria 6 and 7, even if the BCT has extensive information on the risk exposure of credit institutions.</p>
Principle 19.	Validation of Supervisory Information Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external inspectors.
Description	The main purpose of on-site missions is to verify the reliability of the data transmitted to the BCT. They are carried out by the Inspectorate, which for the past few years has been attached to the DGSB, whereas it used to be an autonomous general directorate. The team leaders, who are responsible for conducting the investigations, report directly to the Director General of the DGSB.
Assessment	Compliant with essential and additional criteria.
Remarks	With respect to Essential Criterion 2, it is worth noting that, although it is deemed compliant with Principle 19, the BCT could not, from a strictly legal point of view, oppose the appointment of an external auditor in a credit institution or issue an opinion opposing his or her appointment, for lack of specific legal or regulatory provisions. On the other hand, under Article 46 of Law 2001-65, the BCT is authorized to remove an external auditor appointed to a credit institution, in accordance with Essential Criterion 10 of Principle 21.

Principle 20.	<p>Consolidated Supervision An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.</p>
Description	<p>Article 32 of Law 2001-65 mentions that BCT supervision—off-site and on-site—concerns credit institutions, but also their subsidiaries and the entities they control directly or indirectly and their subsidiaries.</p> <p>Tunisian credit institutions have limited holdings in other credit institutions. All the banks have a leasing subsidiary, except one. The other equity holdings in the financial sector involve insurance companies, open-ended mutual funds (SICAV), closed-ended mutual funds (SICAF), or venture capital funds (SICAR); in the case of these companies, most of the capital is held by the controlling bank.</p> <p>As mentioned in relation to Principle 6, the prudential ratios provided by credit institutions are based solely on the individual institution’s data. No circular has yet been prepared that would require supervised institutions to provide consolidated ratios. However, the establishment of consolidated standards was dependent upon the preparation of accounting standards for consolidation, which were only recently adopted.</p> <p>Indeed, the National Accounting Board (CNC) has adopted several standards, promulgated by Ministry of Finance decree of December 1, 2003, to govern the compilation of consolidated annual accounts and the treatment to be accorded to credit institutions’ equity holdings. The instruments concerned are:</p> <ul style="list-style-type: none"> • Standard NC 35 on consolidated financial statements • Standard NC36 on investments in associates • Standard NC37 on equity participation in joint ventures • Standard NC 38 on business combinations • Standard NC 39 on information on connected parties. <p>These standards are inspired by their IFRS equivalents (IAS 22 for business groups, IAS 24 for connected parties, IAS 27 for subsidiaries, and IAS 28 for investments in associated parties). They have been applied since the closing of the accounts for 2003, which led to the first publication of consolidated accounts by credit institutions. For 2003, the global integration method was used for exclusively controlled financial subsidiaries, while the equivalence method was used for nonfinancial subsidiaries, regardless of the degree of control. As of 2004, the global method must be used for all financial or nonfinancial subsidiaries that meet the exclusive control criteria.</p> <p>As regards external audits, Law 2005-96 on strengthening the security of financial relations requires companies compiling consolidated accounts to appoint two external auditors, when their balance sheet total exceeds a threshold established by decree. This same rule applies to credit institutions publicly soliciting public savings (Articles 13 ter of Law 2005-96 and Article 35 of the draft revised text of Law 2001-65 on credit institutions).</p>
Assessment	<p>Materially Noncompliant with essential criteria Compliant with the additional criteria</p>

Remarks	<p>Although the BCT closely scrutinizes the consolidated accounts that credit institutions have been required to publish since the 2003 decree, it does not yet possess all the resources needed for surveillance on a consolidated basis, in the absence of consolidated ratios and information sharing agreements concluded with other financial sector supervisors (Cf. Essential Criteria 6 and 7).</p> <p>Recommendations Cf. recommendations with respect to Principle 6.</p>
Principle 21.	<p>Accounting Standard Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.</p>
Description	<p>The accounting rules applicable to credit institutions are established by standards set by the National Accounting Board (CNC), known as “NCT” (Tunisian Accounting Standards); five are specific to banks, the rest apply to all companies.</p> <p>Standard NC 22, on internal controls and the structure of accounts in banking institutions, establishes the rules that credit institutions must follow in recording their operations and compiling their accounts.</p> <p>A recent study by a local audit firm, which is a member of the international PWC network, compares the NCT with their American (USGAAP) and IFRS equivalents, and shows that Tunisia’s accounting standards are largely inspired by international norms.</p> <p>The provisions on periodic accounting statements and documents are established by BCT Circular 93-08. They specify a number of accounting and classification requirements.</p> <p>The financial statements of credit institutions have to be certified by at least one external auditor, while two auditors are required for credit institutions raising funds from the public. As indicated under Principle 22, the Banking Commission may terminate the mandate of a credit institution's external auditor. The BCT maintains close links with the external auditors, who take part in the meeting with the banks at the end of the fiscal year.</p> <p>Finally, the BCT does not make recourse to outside auditors for conducting on-site inspections, which are carried out exclusively by the BCT inspectorate.</p>
Assessment	Compliant with essential and additional criteria.
Remarks	<p>With regard to provisioning against credit risk, the Tunisian standards do not provide for estimating the present value of the cash flows that the bank considers could be recovered in the event of a default. Nevertheless, in the case of NPLs, the recovery period is often lengthy. Under such circumstances, in order to determine the amount of the provision, it would appear advisable either to estimate the present value of the sums that the bank anticipates recovering each year or to introduce simple rules that take into account the duration of the recovery procedure, especially by writing down the guarantees used in calculating the provision according to the age of the claims.</p>
Principle 22.	<p>Remedial Measures Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.</p>
Description	The Law 2006-19 which has amended Law 2001-65 on credit institutions has not revised the

	<p>provisions pertaining to the list of penalties that may be imposed on credit institutions supervised by the BCT and their representatives; or the respective powers of the Governor of the BCT and the Banking Commission to impose penalties.</p> <p>Article 42, paragraph 1 of Law 2001-65 on credit institutions authorize the Governor of the BCT to initiate proceedings in the event of breaches of the law or banking regulations. In this case, credit institutions are subject to one of the following seven penalties, listed in the aforementioned Article according to increasing seriousness:</p> <ol style="list-style-type: none"> 1. Warning 2. Reprimand 3. Fine 4. Suspension of all BCT refinancing 5. Prohibition to perform certain operations and any other restrictions on business activities 6. Withdrawal of licensed intermediary status 7. Revocation of license. <p>The first four penalties are within the remit of the Governor of the BCT, while the remaining three are within the sphere of competence of a special commission, known as the Banking Commission.</p> <p>The Banking Commission comprises four members:</p> <ul style="list-style-type: none"> • A magistrate serving at least as President of a chamber of a Court of Appeals, who chairs the Commission; • A representative of the Ministry of Finance, with at least Director General rank; • A representative of the BCT with at least Director General rank; • The Director General of the Tunisian Association of Banks and Financial Institutions. <p>Penalties applicable to the representatives of credit institutions—members of the board of directors or oversight board, directors, managers, and legal representatives—are all subject to a decision by the Banking Commission. The penalties applicable to them are established in Article 45 of Law 2001-65:</p> <ul style="list-style-type: none"> • Temporary suspension of one or more representatives of the credit institution, with or without the appointment of an interim administrator; • Suspension of one or more representatives of the credit institution, with or without the appointment of an interim administrator; • A fine of up to five times the amount of the offense. <p>Article 48 of Law 2001-65 imposes a fine on credit institutions committing one of the following three violations: setting lending or deposit rates above the limits established by the BCT; charging fees not contemplated in BCT circulars; and collection of fees at rates higher than those reported to the BCT. Article 49 of Law 2001-65 stipulates that the hiding of information or reporting of knowingly inaccurate information is punishable by a fine. In addition, the Ministry of Finance may, pursuant to Article 15 of Law 2001-65, decide, on the basis of a report of the BCT, to revoke a credit institution's license if it provided false information to obtain it. Furthermore, any delay in disclosing documents requested by the BCT may give rise to a fine for each day of delay. However, an institution may be liable to a one-off or daily fine without prejudice to other penalties that may be applicable as a result of further violations it may have committed.</p> <p>As regards preventive measures, Article 36 of Law 2001-65 authorizes the BCT to serve a</p>
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	<p>formal notice on credit institutions if they fail to observe rules of good conduct and, in particular, to issue an injunction to them to increase their capital, to prohibit the distribution of any dividend, and to constitute provisions. No injunction has been issued since this Law entered into force. Article 37 of Law 2001-65 also allows the Governor of the BCT to appoint an interim administrator for a credit institution.</p> <p>Since Law 2001-65 entered into force—with the exception of certain fines, some of which did not, moreover, stem from violations of prudential regulations, no officially sanctioned disciplinary measure has been applied to a credit institution or any of its managers.</p> <p>The Banking Commission has never been installed because it has never had to pronounce on the adoption of any of the three penalties within its sphere of competence. Although only one of its four members is expressly appointed by law—namely the Director General of the Tunisian Association of Banks and Financial Institutions—the BCT has pointed out that the other three (a magistrate serving at least as President of a chamber of a Court of Appeals, a representative of the Ministry of Finance, with at least Director General rank; and a representative of the BCT with at least Director General rank) could be appointed rapidly—within a week if need be—even though the law does not specify how they are to be appointed.</p> <p>As for penalties that may be imposed on external auditors, Law 2001-65 provides for the possibility of the BCT prohibiting an external auditor of a credit institution from practicing his profession either for a period of up to three years, or permanently. The law refers to an appeals procedure only in the case of a permanent prohibition, in which case the Banking Commission rules on the appeal. Since Law 2001-65 entered into force, no penalty has been imposed on an external auditor. However, there was one case in which the Governor wrote an external auditor a letter, after shortcomings were detected.</p> <p>Law 2001-65 does not mention possibilities of appeal in cases other than that mentioned above. The BCT has pointed out that the appeal procedures applicable to disciplinary measures imposed on both credit institutions and their managers are those found in ordinary law and that there is therefore no need to mention them in Law 2001-65.</p>
Assessment	Materially Noncompliant with essential and additional criteria.
Remarks	<p>Law 2001-65 provides for penalties under the terms established by Essential Criteria 1, 2, and 4. On the other hand, these penalties have never been imposed, even though some institutions may have breached the regulations. That being so, Essential Criterion 3 and Additional Criterion 1, which require sanctions to be imposed without delay, are not observed, which shows that the sanctions mechanism is not effectively applied. In these circumstances, the 2002 assessment has been maintained</p> <p>Recommendations</p> <ul style="list-style-type: none"> • It would be appropriate to review the system of penalties applicable to credit institutions. Indeed, it seems to be difficult to determine a priori and systematically the level of penalty to be imposed on an institution. De facto, it is the Governor who takes the initiative to convene the Banking Commission, since it will only be constituted when he deems that one of the three most severe penalties is called for. <p>One option might be to devolve all authority for imposing penalties to the Banking Commission. This option would conform to sound practices recommending a separation between supervisory and punitive functions. The Banking Commission should in that case be installed on a permanent basis, in which case it would be preferable to make mention in the law of the ways in which its members are to be appointed and the duration of their term.</p>

	<ul style="list-style-type: none"> • Although it is recognized that both parties must be present when disciplinary proceedings are started, regardless of whether they are initiated by the Governor or the Banking Commission, the manner in which the principle is to be applied is only specified for cases in which the Banking Commission is entitled to impose a penalty. It would seem to be logical, by extension, that these provisions should also apply when this authority is exercised by the Governor of the BCT. • It would also appear to be advisable to mention avenues of appeal in Law 2001-65, even if they are the same as those available under ordinary law. • Since the authority to impose penalties would remain split between the Governor of the BCT and the Banking Commission, it would be useful to specify whether the latter is entitled to impose a penalty of less severity than those for which it is competent and whether the Governor of the BCT may impose one of the penalties in his remit, should the Banking Commission have decided not to punish an institution.
Principle 23.	<p>Globally Consolidated Supervision Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.</p>
Description	No Tunisian banking group currently conducts significant business abroad. That being so, Principle 23 may be considered “not applicable.”
Assessment	Not applicable
Remarks	
Principle 24.	<p>Host Country Supervision A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.</p>
Description	<p>Currently, Principle 24 only applies to Magreb Leasing Arabe (AML), whose reference shareholder is Amen Bank, which is supervised by the BCT.</p> <p>Two other institutions abroad in which Tunisian shareholders hold equity are: UTB (Union Tunisienne de Banques), with head office in Paris, and Banque Sénégal-Tunisienne (BST), in Dakar. The BCT and STB are the principal shareholders in UTB.</p> <p>These institutions are supervised by the respective authorities in the countries concerned.</p> <p>No Tunisian credit institutions currently have branches abroad. It should be noted that the manner in which Tunisian credit institutions may open or close offices abroad is governed by Law 2001-65, Article 11, which specifies that they require authorization by the Ministry of Finance and the BCT.</p>
Assessment	Not applicable
Remarks	Inasmuch as so far there is only one institution abroad, Principle 24 may be considered “not applicable.” Nevertheless, given the possibility of Tunisian credit institutions being established abroad, it would be advisable to consider signing agreements with the countries in which such institutions are most likely to be established.
Principle 25.	<p>Supervision Over Foreign Banks' Establishments Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.</p>

Description	<p>In several local banks the principal shareholder is a European banking group: UIB (Société Générale), UBCI (BNP Paribas), Banque du Sud (Banco Santander of Spain together with Attijariwafabank of Morocco), and Banque de Tunisie (Crédit Mutuel of France). These institutions are subject to Tunisian prudential standards in respect of activities carried out on Tunisian soil and to the standards of their Group in their reports to their head office, which is subject to consolidated supervision in the country of origin. Being subject to BCT supervision, these institutions are required to deliver periodic statements to the BCT and are subject to on-site inspections by the BCT's Inspectorate. They may also be audited by inspectors from their own Group, in addition to the local inspections.</p> <p>Article 12, paragraph 2, of Law 2001-65 stipulates that any credit institution whose head office is located abroad or any branch of a foreign bank must be established as a business corporation (<i>société anonyme</i>) or as approved when its license was issued with the agreement of the home country supervisory authority.</p> <p>It also requires (Article 27) that one of the institutional representatives of foreign credit institutions (the President, Director General, and the Chairman of the Supervisory Board or Chairman of the Board of Directors) be of Tunisian nationality.</p> <p>Some foreign banks also have a representation office in Tunisia.</p> <p>Nonresident activity is mostly conducted by off-shore banks, which are also subject to BCT supervision, but governed by special legal and regulatory provisions (Law 85-108 and Circular 86-13).</p> <p>For lack of agreement with the home country supervisory authorities of the principal foreign banking groups present in Tunisia, there is no sharing of confidential information among supervisory authorities.</p>
Assessment	Materially Noncompliant with Essential Criteria and the Additional Criterion.
Remarks	<p>For lack of an agreement with home country banking supervisors, most of the Essential Criteria and the Additional Criterion are not observed.</p> <p>Recommendations Cf. recommendations in connection with Principle 1-6.</p>

B. Authorities Response to the Assessment

56. The review of compliance with the Basel Committee's Core Principles for Effective Banking Supervision was carried out in January and March 2006, during the updating of the 2002 FSAP. It was discussed in depth with representatives of the DGSB. An initial version of that document, without assessments, was sent to the BCT for comments in mid-February 2006, and these comments were incorporated in the final version. The updated assessment for each principle, supplemented, where appropriate, with comments and recommendations, was transmitted to the BCT for comments in mid-March 2006, and discussed with the BCT during the second FSAP Update mission in the last week of March 2006. To the extent that the mission was informed, before the finalization of the report, of the legislation prepared which amends the Laws 58-90 and 2001-65, and of the draft BCT circular on internal controls, these have been mentioned. However, the implementation of their provisions by credit institutions remains to be achieved.

57. The BCT broadly agreed with the assessments and recommendations, and expressed their appreciation for the work carried out by the assessment team. It has transmitted some comments on the last version prepared by the mission which took into account the adoption of the circular on internal controls; these comments have been for the most part incorporated in the final draft.

58. The BCT noted that on Credit Policy (CP 7) the implementation of the circular on internal controls, which was still in draft form in March 2006, will cover current regulatory gaps in credit decisions. This circular, adopted on November 28, 2006 as circular 2006-19, includes a number of provisions on credit risk. The BCT also noted that they are taking measures to strengthen consolidated supervision (CP20), and that the law 2006-26 amending the law 58-90, which was not yet adopted at the time of the mission will authorize the central bank to enter into information sharing agreements with other domestic and foreign financial supervisors. This will also permit compliance with CP 25 (supervision of foreign banks establishments) as soon as these agreements are fully operational. With regard to Principle 22, the BCT did not agree with the recommendations regarding the reorganization of the sanctions system, namely (i) the transformation of the Banking Commission in a permanent body, noting that it can be convened rapidly when needed, and (ii) the devolution to this commissions of all sanctioning powers, currently split under the banking law between the Governor and the Commission, which they consider appropriate.

C. Recommended Action Plan

59. The key actions that must be implemented in order to achieving full compliance with the Basel Committee Principles are indicated below.

Improve lending policy and monitoring portfolio's quality

60. It is essential to put in place a lending policy based on analysis and monitoring of counterparty risk. All the banks now have a credit evaluation section separate from the commercial section, as well as a credit committee. However, the decentralization of functions could be improved to ensure that the level of delegation of authority is tailored to the risk incurred, since excessive centralization could run counter to the objective of improving the analysis of counterparty risk.

61. Credit institutions must assess the profitability of the loans they grant, regularly monitor the quality of their loan portfolio, and have at their disposal adequate instruments to recover nonperforming loans.

Strengthen provisioning of NPLs and reduce their share in total loans

62. Increasing the NPL provisioning ratio must be a key priority for the banking sector. The authorities' objective of achieving a 70 percent provisioning ratio by 2009 must be considered a minimum, and any effort over this target should be encouraged. This objective should be accompanied by a substantial reduction of the NPL ratio.

Strengthen risk control and internal control mechanisms in credit institutions

63. The liberalization of the Tunisian banking sector and measures adopted by the BCT in recent years have heightened credit institutions' awareness of risks and of the need to boost their internal control mechanisms. It would be advisable to reinforce this trend by ensuring that credit institutions implement the provisions of the BCT circular on internal controls, and by focusing more sharply during on-site supervisory work on the organization of internal controls and the identification of possible shortcomings.

64. In the credit institutions, the internal audit department will now report directly to the Office of the General Manager, as is advisable. However, internal audits are not systematically based on an assessment of risks, without a clear mapping of such risk. Risk assessment requires that credit institutions build adequate capacity to monitor and control them, which in turn the BCT will have to assess.

65. With respect to on-site inspections, evaluation of internal control mechanisms should place greater emphasis on any flaws encountered in the definition of responsibilities, separation of functions, and the quality of permanent and periodic controls. It would also be advisable to conduct more frequent audits of I.T. systems.

66. The quality of information systems varies markedly from one credit institution to another. Not all of them—especially the banks, which have the highest exposure to credit risk—are equipped to monitor risks on an ongoing basis. Thus, with respect to credit risk there is no reasonable assurance that the authorizations granted—or the ceilings on exposures for economic groups and branches of economic activity—are respected. In addition, the institutions need automatic reconciliation tools to be able to handle suspense account items, which not all of them have. Steady modernization of data processing and information systems is a priority for the banking system, both to achieve productivity gains by reducing the volume of manual operations, and to improve operations monitoring and control

Establish consolidated supervision

67. Establishing consolidated supervision is an important objective for both banks with equity holdings and the BCT.

68. The BCT's circular on internal controls imposes new obligations on bank groups, which from now on will be required to monitor their risks on a consolidated basis and to establish consistent internal control mechanisms in their financial subsidiaries.

69. For its part, the BCT should introduce consolidated ratios, so that existing supervisory rules apply to banking groups. While at present banking groups are limited in numbers and do not control many subsidiaries, these may generate additional risks. For instance the SICARs (private venture capital firms) may take exposures on a client already heavily indebted to the bank controlling SICAR. Furthermore, sales of claims on which the bank retains a risk must not lead to a lower minimum capital requirement than that originally set.

70. As for equity holdings in financial institutions, it would be advisable—even before publication of regulations on the establishment of consolidated ratios—to deduct equity investments of banks in other financial institutions from the separately calculated capital base of each institution, in order to avoid double counting the capital base.

Adapt the BCT inspections to the new provisions established by the circular on internal controls on connected lending, and limit the ceiling of such lending

71. The BCT circular 2006-19 on internal controls prescribes that the credit institutions identify connected lending in their information system, and specifies particular norms for extending such credit. It would be advisable that the BCT incorporates these provisions in its inspections. Moreover, it would be advisable to make use of a revision of the Circular 91-24 of the BCT to modify its Article 3, so as to lower the ceiling applicable to this type of lending, currently set at three times capital, which appears high.

Implement the system of sanctions

72. Full implementation of the sanctions mechanism is essential, because it is key to the credibility of the supervisory authority. Until now, the BCT has not applied formal sanctions, nor injunctions, toward any credit institutions which has been in breach of the regulations. These breaches are mostly related to excess credit concentration and equity participation in non financial companies. With the modernization of the banking system, the entry into effect of the circular on internal controls, and the adoption of other envisaged regulations, it is recommended that identified breaches, including those pertaining to the organization of the internal control system, be monitored rigorously by the BCT. Any violations of the regulations should be promptly corrected, or should be the object of a waiver in duly justified cases. In the case of persistent violations, sanctions should be adopted.

73. Concerning the organization of the sanctions system, the mission recommends to conferring sanctioning powers exclusively on the Banking Commission, while the Governor of the BCT should have the power to issue injunctions.

Establish information exchange agreements with other supervisors

74. To enable the BCT to carry out consolidated supervision, it has to be able to exchange information with the country's other oversight bodies: the Financial Markets Board (CMF) for the mutual fund institutions (SICAV, SICAF and FC); the Ministry of Finance for insurance companies, the SICAR, and the asset recovery companies, which under present conditions constitute an extension of banking activities.

75. Agreements with foreign supervisors should also be established, especially with those agencies supervising banking groups that hold shares in recently privatized Tunisian banks. Furthermore, the need for cooperation among supervisory authorities will increase following implementation of the Basel II agreement.

Strengthen the independence of the Governor of the BCT

76. The grounds on which the Governor may be removed from office should be specified in the Law and subject to publication. This would achieve compliance with the additional criteria of Principle 1-2.

Table 3. Tunisia: Summary Compliance of the Basel Committee Principles (Essential and Additional Criteria)

Core Principle	Essential Criteria					Additional Criteria				
	C	LC	MNC	NC	NA	C	LC	MNC	NC	NA
1. Objectives, autonomy, powers and resources										
1.1 Objectives	X					X				
1.2 Independence	X								X	
1.3 Legal framework	X									
1.4 Enforcement powers	X									
1.5 Legal protection	X									
1.6 Information sharing		X								
2. Permissible activities	X									
3. Licensing criteria	X					X				
4. Ownership	X					X				
5. Investment criteria	X									
6. Capital adequacy		X					X			
7. Credit policies			X					X		
8. Loan evaluation			X			X				
9. Large exposure limits	X					X				
10. Connected lending		X					X			
11. Country risk					X					
12. Market risks		X					X			
13. Other risks		X					X			
14. Internal control and audit		X					X			
15. Money laundering			X					X		
16. On-site and off-site supervision	X						X			
17. Bank management	X									
18. Off-site supervision		X								
19. Validation of information	X					X				
20. Consolidated supervision			X			X				
21. Accounting standards	X					X				
22. Remedial measures			X					X		
23. Global consolidated supervision					X					X
24. Host country supervision					X					X
25. Sup/foreign establishments			X					X		

* C = Compliant; LC = Largely Compliant; MNC = Materially Noncompliant; NC = Noncompliant; NA = Not Applicable.

Shading indicates that there are no additional criteria for that principle.

The vertical strikethrough indicates that compliance with Principle 15 was not assessed.