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Partnerships with USAID/PARE

*On the Road to Banking Supervision
Reforms in BiH*

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Partnership for Advancing Reforms in the Economy (PARE)



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE

- USAID Partnership for Advancing Reforms in the Economy (PARE) is a two to four year activity with the purpose of providing technical assistance in the financial services sector in BiH
- Demand-driven approach by actively seeking partnerships with public and private stakeholders in BiH



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Overall Objective

- Advance reforms in the financial services sector
- Build institutional capacity and assist BiH in:
 - *(i) meeting requirements on its path towards joining the EU, and*
 - *(ii) implementing EU and other international standards*
- Contribute to creation of a single economic space in BiH through convergence of the institutional regulations
- Enable effective financial intermediation and private sector investment and growth



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Project Structure

- The Project is designed to:
 - **Strengthen regulatory system for financial services sector (Component 1)**
 - Improve financial administration of public resources (Component 2)
 - Improve enabling environment for private sector investment and growth (Component 3)



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Component 1

- PARE works to **strengthen regulatory system for the financial services sector in BiH.**
- The overall goal is to improve regulatory framework, supervisory performance, and introduce EU principles, standards, and best practices
- The project works with counterparts in the following sectors:
 - **Banking Supervision**
 - **Central Banking**
 - **Insurance Supervision**
 - **Capital Markets**
 - **Factoring**
 - **Leasing**
 - **Private Pension Funds**



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Components 2 & 3

- Component 2
 - PARE works to **improve financial administration of public resources.**
- The overall goal is to improve parliamentary oversight of public sector audit, increase communications capacity of Audit Offices, and establish internal audit units within public enterprises and government offices
- Component 3
 - PARE works on **enabling environment for private sector investment & growth.**
- The overall goal is to establish and/or strengthen professional associations in the financial services sector and increase their capacity to advocate for improved business environment, improve consistency of standards and professional certifications.



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Expected Results

- Modern, sound, and effective financial services sector consistent with EU and other international standards
- Financial services sector complement with other economic sectors in BiH
- Financial services sector in BiH attractive for domestic and foreign investors



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Financial Services Sector

- **Financial Services Sector**
 - **Central Bank of BiH (CBBH)**
 - **Banking Supervision (Agencies; BSA)**
 - Deposit Insurance Agency
 - Insurance Supervision
 - Capital Markets
 - Leasing & Factoring (Supervision, Regulatory Framework)
 - Private Pension Funds (Supervision, Regulatory Framework)



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Banking Supervision Reform

- Scope of the reform:
 - **Basel II Framework for BiH**
 - Other Technical Aspects:
 - International Accounting Standards (IFRS)
 - Harmonized Chart of Account
 - International Valuation Standards (IVS)
 - Group-wide Supervision
 - Appropriate Regulatory & Legal Framework
 - Appropriate Institutional Framework



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Partnership for Advancing Reforms in the Economy (PARE)

Banking Supervision Reform - Basel II Framework

- Considerations:
 - FSAP in 2006 – Basel Core Principles (Basel I)
 - CARDS/ECB recommendations
 - Activities in BiH re: FSAP Recommendations
 - Stabilization and Association Agreement (SAA)
 - Financial Stability Forum and Basel Committee guidance
 - Financial Stability Indicators
 - Recent global financial developments
 - Prominence of foreign-owned banks in BiH



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Partnership for Advancing Reforms in the Economy (PARE)

Banking Supervision Reform - Basel II Framework

- **Pillar I** – Credit, Market, Operational Risk
- **Pillar II** – Supervisory Capacity & Financial Stability
- **Pillar III** – Market Scrutiny, Transparency

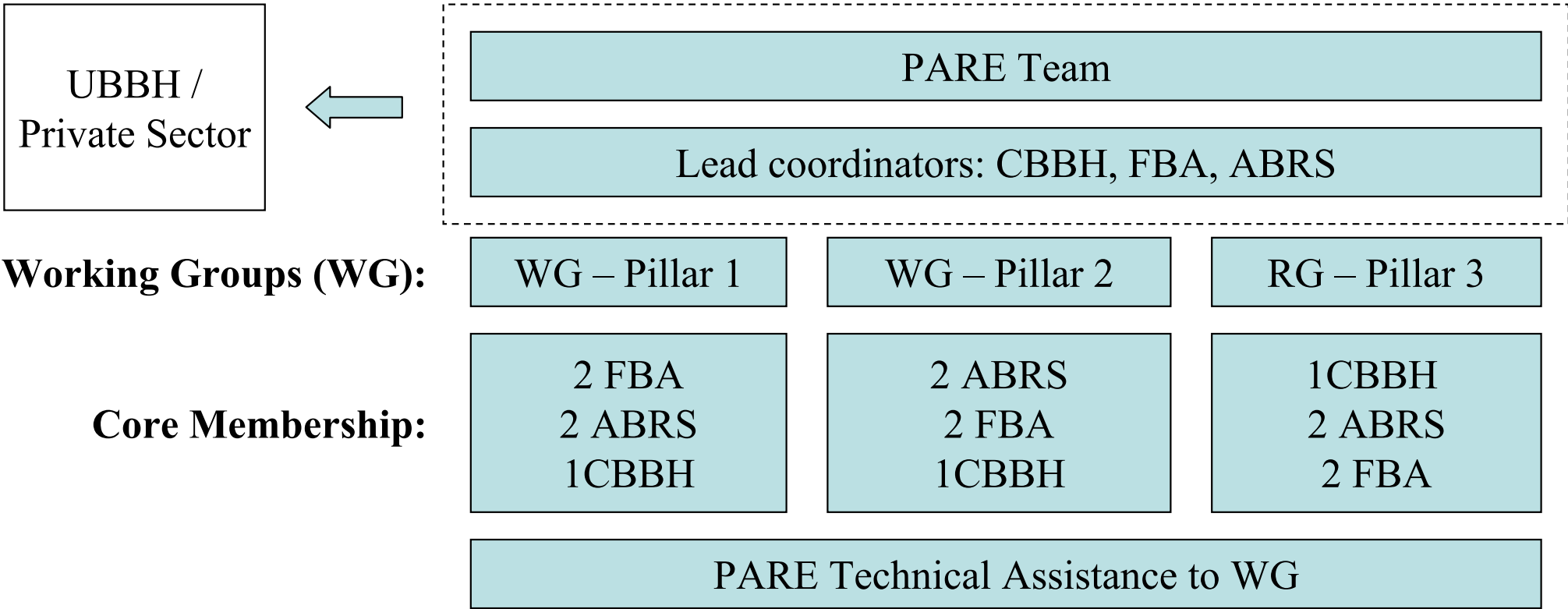


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Partnership for Advancing Reforms in the Economy (PARE)

Basel II Framework for BiH – Implementation Framework



- Legend:**
- FBA** – Banking Supervision Agency of FBiH
 - ABRS** – Banking Supervision Agency of RS
 - CBBH** – Central Bank of BiH
 - UBBH** – Banking Association of BiH



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Partnership for Advancing Reforms in the Economy (PARE)

Basel II Framework for BiH

- Strategic framework design (November 2008)
 - Developed by PARE
 - Accepted by BSAs, CBBH, and other key stakeholders
- BSAs have adopted harmonized strategies for Basel II Framework implementation following PARE recommendations. CBBH to adopt one shortly.
- Basel II working groups (WG) established (Feb 2009):
 - PARE's design was accepted by BSAs, CBBH, and other key stakeholders
 - Focus on WGs' action plans for implementation of Basel II Framework based on strategic framework design



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Partnership for Advancing Reforms in the Economy (PARE)

Basel II Framework for BiH - Implementation

- Start with the most fundamental approaches for achievement under Basel II
 - Compliance with Basel I Core Principles (FSAP 2006)
 - Gradual build-up to full compliance with Basel II following Basel II three-pillar structure
- Gradual and evolutionary process that requires time and resources for banks and the BSAs
 - Requires building supervisory capacities and structural competencies



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Partnership for Advancing Reforms in the Economy (PARE)

Basel II Framework for BiH - Timeline

- Three phases
 - Phase 1 = four to five years
 - Phase 2 = two to three years
 - Phase 3 = two to three years
- Complete implementation of Basel II to span about 10 years



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Partnership for Advancing Reforms in the Economy (PARE)

Basel II Framework for BiH – First 2-3 Years

- Recommended initial approaches to achieve system-wide within the first two to three years (by end 2011) include:
 - Standardized Approach for credit risk, with potential modification of risk weights.
 - Standardized Measurement Approach for market risk, with potential modification of risk weights.
 - Basic Indicators Approach for operational risk.



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Summary of Activities

- Banking Supervision Reforms:
 - ✓ Apr-May 2008 – Partnership to pursue reforms - Planning phase and assigning top level priority to banking supervision reforms
 - ✓ June 2008 – Assessment - Banking Supervision & Implementation of Basel Core Principles in BiH
 - ✓ Nov 2008 – Development of the Basel II Framework for BiH
 - ✓ Dec 08/ Jan 2009 – Adoption of the Strategy for Implementation of the Basel II Framework for BiH
 - ✓ Feb 2009 – Design of the Basel II Implementation Structure / establishment of working groups



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Partnership for Advancing Reforms in the Economy (PARE)

USAID PARE – Summary of Activities

- **Banking Supervision Reforms:**

- o Mar 2009 – Development and adoption of WGs’ action plans
- o Maj/June 2009 – WGs Joint Meeting – Start of working groups’ activities and adoption of action plans
- o *Jul/Aug 2009* – Study trip – visit to ‘home’ banking supervisor in EU member country
- o *Oct 2009* – WGs Joint Meeting – review dynamics of WGs action plans’ implementation
- o Oct 2009 – Bank and Non-Bank Supervision Conference
- o *Jan 2010* - WGs Joint Meeting – summary of achievements and action plans’ implementation



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Partnership for Advancing Reforms in the Economy (PARE)

List of Counterparts

- Central Bank of BiH
- Banking Supervision Agencies of FBiH and RS
- Ministries of Finance of BiH, FBiH, and RS
- Deposit Insurance Agency of BiH
- Insurance Agencies of BiH, FBiH, and RS
- Securities Commission of FBiH and RS
- Sarajevo and Banja Luka Stock Exchanges

- Parliament of BiH - Committee for Budget and Finance
- Parliamentary Audit Committees of FBiH and RS
- (Supreme) Audit Offices of BiH, FBiH, and RS

- Banking Association of BiH
- Association of Accountants and Auditors of BiH, FBiH and RS
- Association of Leasing Companies of BiH



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Partnership for Advancing Reforms in the Economy (PARE)

Detailed Basel II Framework Timeline



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Phase 1-2008 to 2013

- Design of a strategy and related action plans (2008-09).
- Adaptation of current legal and regulatory framework to requirements for Basel II, subject to regulatory discretion re suitability of specific risk weights (2009-10).
- Investment in needed training and technologies (2009 on).
- Strengthening of coordination mechanisms within BiH and on a cross-border basis, accounting for the full range of risks that can impact bank capital (2009 on).
- Development of bank-by-bank capital assessment plans (2009 on).



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 1-2008 to 2013

- Development of supervisory capacity to certify/validate that more complex systems can qualify banks for capital relief, based on close coordination and cooperation with EU regulators and international organizations (2009 on).
- Adoption of new laws and regulations as needed, for effective implementation (2009 on).
- Enactment of reforms to strengthen institutional capacity to ensure better information is available on risk-related items (e.g., valuation standards as they apply to assets and capital calculations) (2009 on).



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 1-2008 to 2013

- Strengthening of banks' monitoring of exposures to related-party entities (2009 on).
- Strengthening of banks' monitoring of counter-party risk exposures where off-balance sheet items are in effect (2009).
- Gradual introduction of banking exposures to securities markets in BiH and abroad (2011 on).
- Gradual movement towards use of CRA ratings on specified exposures to link to capital calculations (2011 on).



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 2-2014 to 2016

- Adjustments to risk weights from original Basel Capital Accord to converge more closely with Basel II.
- Continued investment in needed training and technologies.
- Customization of capital measurement requirements on a bank-by-bank basis relative to the level of risk management capacity developed by the banks re credit, market and operational risk.
- Graduation of some banks to “medium”-level systems for capital measurement, such as foundation IRB for credit risk, internal modeling of market risk, and SMA on operational risk issues.



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 2-2014 to 2016

- Continued development of supervisory capacity to certify/validate that more complex systems can qualify banks for capital relief, based on close coordination and cooperation with EU regulators and international organizations.
- Adoption of new laws and regulations as needed, for effective implementation.
- Effective monitoring of banks' exposures to related-party entities.
- Effective monitoring of counter-party risk exposures where off-balance sheet items are in effect.



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 2-2014 to 2016

- Adequate systems to assess the risk of banking exposures to securities markets in BiH and abroad, with bank exposures to securities accounting for 10-20 percent of total assets (or more, if deemed satisfactory by the BSAs from a risk management perspective).
- Increased use of CRA ratings on specified exposures to link to capital calculations.
- Initial use of CRAs on corporate bond and/or equity issues by banks in BiH marketplace.
- Adherence to IOSCO standards in all securities-related activities and exposures.



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 3-2017 to 2018

- Final adjustments to risk weights to be fully harmonized with EU directives and Basel II requirements.
- Continued investment in training and technologies.
- Customization of capital measurement requirements on a bank-by-bank basis relative to the level of risk management capacity developed by the banks re credit, market and ops risk, & predicated on high levels of supervisory capacity to validate approaches.
- Graduation of some banks to “advanced”-level systems for capital measurement, such as advanced IRB for credit risk, internal modeling of market risk, and AMA on operational risk issues.



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 3-2017 to 2018

- Continued development of supervisory capacity to certify/validate that more complex systems can qualify banks for capital relief, based on close coordination and cooperation with EU regulators and international organizations.
- Refinement of legislation and regulations as needed, for effective and sustained implementation.
- Effective monitoring of banks' exposures to related-party entities.
- Effective monitoring of counter-party risk exposures where off-balance sheet items are in effect.



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Partnership for Advancing Reforms in the Economy (PARE)

Phase 3-2017 to 2018

- Adequate systems to assess the risk of banking exposures to securities markets in BiH and abroad, with bank exposures to securities accounting for up to 35 percent of total assets (or more, if deemed satisfactory by the BSAs from a risk management perspective).
- Widespread use of CRA ratings on specified exposures to link to capital calculations.
- Widespread use of CRAs on corporate bond and/or equity issues by banks in BiH marketplace.
- Adherence to IOSCO standards in all securities-related activities and exposures.