

THE DOMESTIC ARCHITECTURE OF FINANCIAL SECTORS IN DEVELOPING COUNTRIES

**An overview through the eyes of a financial sector diagnostic
framework**

Background note to a presentation at the ODI

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1. Introduction

An efficient and robust financial sector is the engine for delivering sustainable economic growth for developing countries. It does so by mobilising and allocating resources to their most productive uses. It lowers the transaction costs of economic activity by providing efficient payments mechanisms, helps pool risk and, through maturity transformation, makes available long-term capital. Financial institutions and markets also play an important corporate governance role over other economic entities. They monitor the use of capital and where necessary, exert external pressure to improve its productivity, or reallocate it to more productive uses. A robust financial sector engenders confidence and facilitates the attraction of private sector capital from abroad. By making funds available for entrepreneurial activity and through its impact on economic efficiency and growth, a well-functioning financial sector also helps alleviate poverty both directly and indirectly.

Frequently however, developing country financial sectors do not perform at their optimum. They tend to suffer from a number of handicaps:

- They are usually *incomplete* – they lack a full range of markets and institutions that meet all the financial needs of the economy. For instance, there is generally a lack of availability of long-term finance for infrastructure and industry, finance for SME development and financial instruments that meet the needs of poor people.
- They are often *fragmented* – lack of information and financial linkages between institutions and markets impairs efficiency in allocating resources. One result is the presence of informal financial organisations.
- They tend to be *distorted* – rather than being market determined, financial sector activities tend to be influenced by the government and other non-commercial factors, for instance in pricing deposits and lending decisions.
- The institutions and markets tend to be *inefficient* – lack of competition, inadequate access to technology and know how and diffused incentives render financial sector activity unduly expensive.
- The financial systems tend to be *fragile* – weaknesses in governance and lack of appropriate regulation and supervision enhance their susceptibility to shocks.

The impact of these shortcomings on wider economic activity is two-fold. They prevent economic potential to be realised. Additionally, financial sectors become susceptible to crises. As the continuing repercussions of the Asian crisis clearly highlight, the financial and human impact of such financial crises can be very severe and prolonged.

So, in developing effective financial sectors:

- how do we identify the gaps in institutions and markets in a country's financial sector that need filling?
- how do we spot the areas of vulnerability in a financial sector that need strengthening before a crisis develops?
- and how do we identify the steps needed to create a more supportive enabling environment for a country's financial sector?

I have recently worked with DFID and the OECD to develop a framework that goes some way toward addressing these issues. This Financial Sector Diagnostic Framework will be the focus of my presentation today.

2. Developing country financial sectors: recent history

We initially prepared the framework in the context of sub-Saharan Africa countries, and this slide sets the scene for it. I think the issues broadly apply to developing countries in other regions as well. Of course, there are risks in the type of generalisation I will attempt to make.

The 1950s and 60s saw the creation of many independent developing countries. At this point in time, the financial sectors in these countries were generally dominated by ex-colonial banks, which often restricted their activities to financing foreign trade, frequently focusing only on serving expatriate companies. Long-term finance was generally unavailable and oligopolistic markets meant that interest rates were often artificially high.

The immediate post-independence period saw governments intervening heavily in the financial sectors. Interest rate ceilings were imposed. In addition, governments engaged in allocating credit to preferred sectors through directed lending. The level of government intervention continued to increase and eventually resulted in major distortions in most of the financial sectors. Problems such as loan losses to SOEs, reduction in savings, capital flight, etc., followed.

The late 1970s and the first half of the '80s saw a wave of liberalisation programs. For various reasons, some of which we will cover in later sessions of this workshop, the record of these and subsequent programs undertaken in developing countries in the 1990s has been indifferent. As a result, liberalisation and reform programmes are still incomplete in most developing country financial sectors.

3. Developing country financial sectors: current position

Looking at the current position, the financial sectors in most African and other developing countries are generally dominated by commercial banks, which can often account for over 80 per cent. of the systems' total assets. Moreover, there is a very high degree of concentration and lack of competition. At the same time, the banks tend to be relatively small by world standards. Lending tends to be focused on the short-term and is predominantly directed to large, often state-owned enterprises and the government. Credit assessment skills at banks often require considerable strengthening.

Non-bank financial institutions and markets are relatively underdeveloped. Institutions and markets are generally missing or are not very liquid.

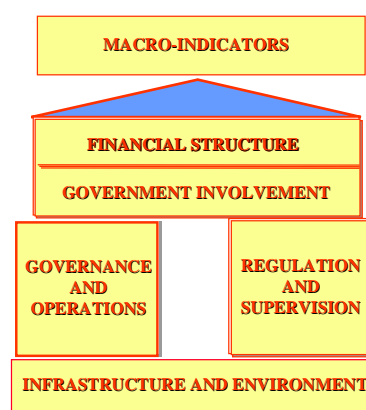
There tends to be weak information and funds flow between institutions and markets in developing country financial sectors. This fragmentation of the financial sector and an active informal and semiformal sector is another important feature.

Perhaps the key feature that separates the financial sectors in most developing countries from other parts of the world is the degree and nature of the involvement of the government in the financial sector. Despite attempts at liberalisation and reform, government influence in the sector remains high. These problems are reinforced by weaknesses in regulation and supervision as well as in the underlying legal and accounting framework.

It is in this context that the Financial Sector Diagnostic Framework is intended to operate.

4. The Financial Sector Diagnostic Framework

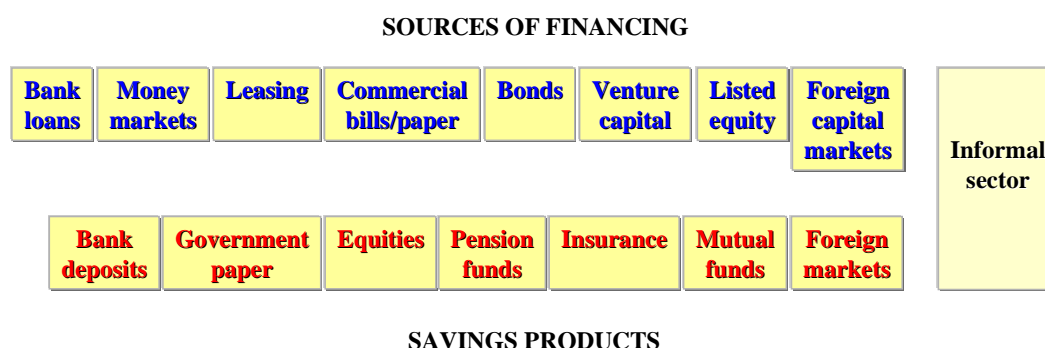
The FSDF sees the financial sector as a sort of a building. At the bottom we have the foundation, which is made up of the financial sector’s supporting infrastructure and its environment. It rests on two pillars - we have called these Governance and operations and Regulation and supervision. The two pillars support what we have called Financial structure and Government involvement. Finally, at the top is the output of the structure - these are various macroeconomic indicators.



These five boxes are the five parameters of the diagnostic framework. To judge the strength and completeness of each of the parameters, the framework provides what we have called factors, which break down each of the parameters to 8-10 components. To judge the robustness of each of the factors we have available a large number of indicators, which can be assessed relatively objectively and compared to benchmarks. An outline of the factors and their indicators is provided at the back of these notes.

I will cover the macro indicators parameter here before going on to financial structure in the next slide. It is made up of factors such as traditional measures of financial depth and savings and investment propensity in the economy. Looked at in isolation, however, these ratios can mislead, as was demonstrated during the Asian crisis.

5. Financial structure and Government involvement



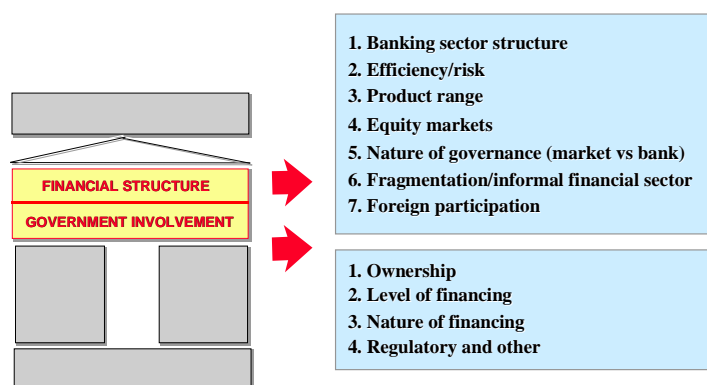
Adapted from Lynch 1996

Before looking at the Financial structure and Government involvement parameter in more detail, I thought it would be worth explaining what I mean by financial structure - basically, it relates to the development and efficiency of the financial sector.

Going from left to right in the chart above, most financial sectors start with the development of a banking sector, taking in short-term deposits and, over time, lending long-term. Then a range of institutions and markets develop to meet longer term and riskier financing needs. Based on this principle, we would expect there to be a continuum of specialist segments in the financial system with linkages between them to allow flow of funds and information between institutions and markets. In the absence of these linkages, the efficiency of the financial sector in allocating resources breaks down.

Many developing countries, however, have relatively underdeveloped banking sectors. At the other end of the spectrum, they may have established stock exchanges, although these are

often illiquid and with very few companies listed in them. Moreover, they tend to have very few institutions and markets in between - the resulting lack of linkages impair the financial sectors' ability to allocate resources to their optimum use.



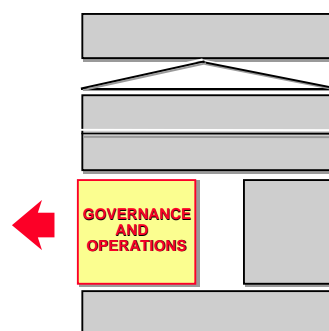
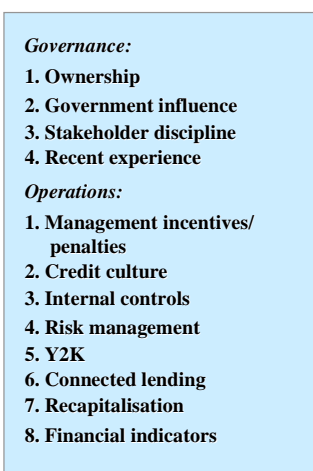
Having a range of institutions and markets with linkages between them does not guarantee optimum allocation of resources. These institutions and markets need to operate efficiently and effectively. This is influenced by various factors, including competition, industry structure, foreign participation in the financial sectors, etc.

The factors making up the Financial structure parameter enables a judgement to be developed on these issues.

Assessing the financial structure by itself can be misleading. As I said earlier in my presentation, the involvement of government in the sector can override the predictability of the various factors. It is therefore important to have an understanding of the nature and degree of government influence in the sector through measures such as ownership of institutions, level and nature of government financing and regulatory and other influences such as directed lending or interest rate controls.

6. Governance and operations

The financial sector, and in particular banks, are particularly susceptible to governance-related weaknesses. Basically, because banks' performance is often not very transparent, a combination of various information failure and incentive-related issues lead to the risk of moral hazard - which I could expand on later if you wish.

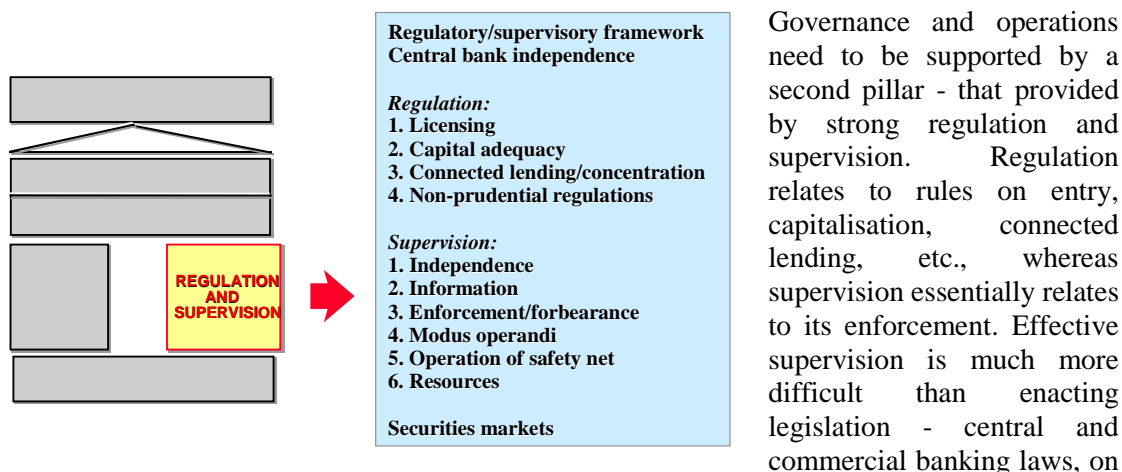


I would like to highlight the need to assess governance-related issues as particularly important in developing a view of financial sector robustness - this is often neglected and instead, the regulatory environment is focused on disproportionately.

For the institutions making up the financial structure to function effectively, therefore, they need to have strong governance and operations. Governance can be assessed by factors such as the nature of ownership - government or industrial companies - carrying with them the risk of directed or insider lending respectively. Also, environmental factors such as transparency of operations that make stakeholder discipline possible need to be assessed. Operational

factors include the financial condition of the institutions, credit culture and quality of staff, etc.

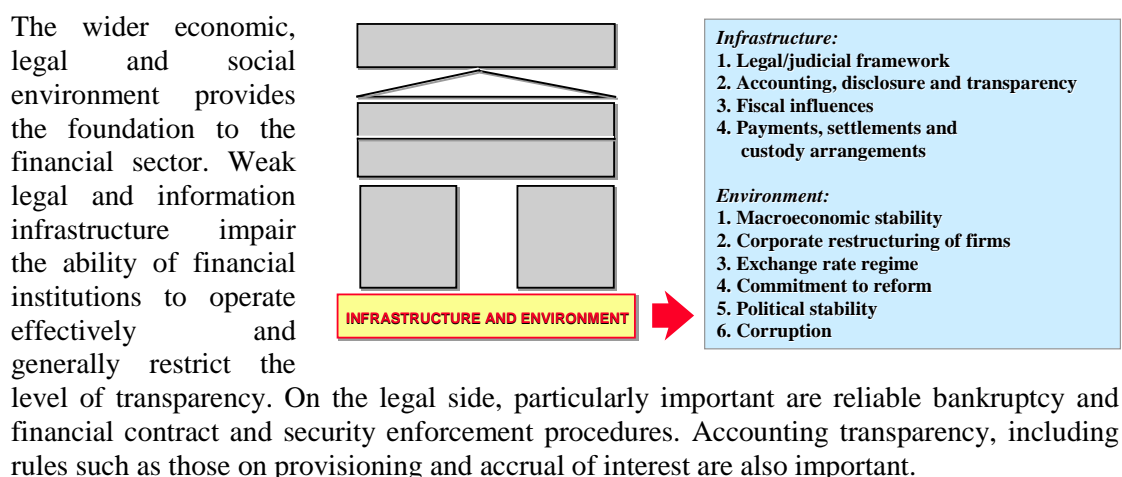
7. Regulation and supervision



Governance and operations need to be supported by a second pillar - that provided by strong regulation and supervision. Regulation relates to rules on entry, capitalisation, connected lending, etc., whereas supervision essentially relates to its enforcement. Effective supervision is much more difficult than enacting legislation - central and commercial banking laws, on

paper, can be misleading as there is often considerable pressure to exercise forbearance or the enforcement agency, usually the central bank, lacks adequate amount or quality of resources to discharge their responsibilities effectively. The factors making up the Regulation and supervision parameter therefore seek to assess both the existence as well as the enforcement of regulation.

8. Infrastructure and environment



The wider economic, legal and social environment provides the foundation to the financial sector. Weak legal and information infrastructure impair the ability of financial institutions to operate effectively and generally restrict the level of transparency.

On the legal side, particularly important are reliable bankruptcy and financial contract and security enforcement procedures. Accounting transparency, including rules such as those on provisioning and accrual of interest are also important.

There is a two-way interaction between the financial sector and the real economy and weaknesses in the latter can damage the financial sector, although a deep and stable financial system is better able to withstand environmental shocks. Finally, issues within the wider social climate (for instance, the level of corruption) and political stability can also influence the functioning of the financial sector. Various factors, once again, are available to assess the relative strengths of these components.

9. Interlinkages and sequencing

The financial sector therefore acts as a system of inter-linked institutions, markets and supporting infrastructure, drawing on its enabling environment for strength. Financial institutions and markets must operate efficiently themselves. They must additionally fulfil effectively their function as components of the country's financial system. To be successful, measures to develop new institutions and markets, or strengthen existing ones, must take into account these systemic interdependencies.

Before completing the overview of the framework, therefore, I think it is important to highlight three further issues that follow:

Firstly, the framework's constituent factors and indicators cannot be looked at on their own, in isolation. There is considerable interlinkage between the parameters - for instance, weaknesses in the foundation - infrastructure and environment - leads to fragility in the other parameters of the financial sector.

Secondly, there is a need to have some understanding of the order in which to expect the parameters and factors should develop - sequencing, in other words. For instance, drafting of regulation and strengthening of supervisory capacity would be expected to come relatively early in the reform process, and privatisation of financial institutions later.

10. Implications for financial sector strategy

Financial sector projects need to be undertaken as part of a comprehensive development and reform strategy. The inter-linkages between the various components of the financial sector and the systemic nature of its functioning warrant this approach. Moreover, a strategic approach also enables host country stakeholders and donors to work together proactively to achieve development goals, rather than react to specific problems.

A comprehensive financial sector strategy has the advantage of co-ordinating and implementing programs in their proper sequence. If financial sector liberalisation and reform is improperly sequenced, the sector becomes vulnerable to expensive crises. The process needs to be implemented as a co-ordinated package of initiatives, many moving in parallel, but with due consideration to progress in other related areas. For example, there is considerable risk in liberalising entry into the financial sector without putting adequate safeguards, in the form of regulation and supervision, in place. Certain exogenous factors, such as macro-economic and fiscal stability, are also important inputs in the sequencing decision.

The starting point for developing a comprehensive financial sector strategy is an understanding of the strengths, weaknesses and reform needs of a country's financial sector. The key diagnostic areas were highlighted earlier in the paper, by using the FSDF as a tool. The output of financial sector assessment exercises would then be used to formulate strategic objectives. This interim stage between diagnosis and implementation is important as strategic objectives can be achieved through activity in a number of areas. For instance, competition can be enhanced through privatisation, encouraging new institutions and markets and appropriate market entry regulation.

Having reviewed the diagnostic and objective-setting stages with the aid of the FSDF, possible areas where recipient countries and donors can work together to meet strategic objectives are now highlighted in the context of the Framework. The Chart at the end of this Section summarises these.

Financial structure and government involvement

Strategic objectives for this parameter are achieved through broadly two groups of often-interdependent activities:

- Financial liberalisation.
- Developing new financial institutions, markets and products.

Financial liberalisation strategy-related activities centre around developing policies on interest rate liberalisation, withdrawal of lending directives as well as moving to more indirect monetary policy instruments and market-oriented fiscal management. Privatisation of existing financial institutions can also be loosely grouped into this category as it entails removal of direct government influence. Liberalisation of the financial sector to facilitate entry of new institutions, including appropriately qualified ones from more developed economies, is a further issue.

The building of new financial institutions, markets and products, both in the formal and informal financial sectors, is one of the key development assistance needs in recipient countries. As already highlighted, the need is for a range of institutions and markets serving different segments of the financial system. In addition to deepening the financial sector, this has the advantage of facilitating financial liberalisation by widening options for government financial activities. At the same time, a move to more market-based central and local government financing policies stimulates the development of these institutions and markets. New institutions and markets needed in developing countries often include money markets, debt and equity capital markets (including stock exchanges) and institutions such as pension and insurance funds. Additionally, the development of intermediaries such as securities brokers require support.

Donors can also support local partners in developing new financial products. This includes new debt and equity instruments as well as specialist credit products in, for example, longer-term finance (including infrastructure-related), SME finance, trade and agricultural finance. Products such as leasing are particularly suited to the underdeveloped legal infrastructure in developing countries. In addition to technical expertise, financial assistance through participation in equity funds, credit guarantee funds and credit lines can stimulate these activities and can be beneficial provided they are designed to achieve long-term self-sustainability and minimise market distortions.

Microfinance is of considerable importance as it can, appropriately designed and implemented, directly alleviate poverty by increasing income and investment. Focus should be on strengthening indigenous organisations and products, extending reach and encouraging the adoption of best practice from other parts of the world tailored to the local environment. The development of semi-formal organisations, including those that are NGO-led, and their evolution into more formal institutions where appropriate also requires support. Informal finance should be seen as an integral component of the financial sector to ensure linkages are developed between formal, semi-formal and informal financial institutions that enable funds to flow into microfinance activities.

Governance and operations

Many of the governance-related objectives can be met through activities in other areas, for example: by developing a range of institutions and markets and tailoring licensing requirements to stimulate competition; and improving legal and information infrastructures as well as designing appropriate deposit protection systems to enhance stakeholder discipline.

Much of the potential work in this area relates to improving the operations of state owned commercial banks and development finance institutions. The key objective is to identify viable institutions and restructure them, whilst finding a politically acceptable solution for those that are unlikely to be sustainable in a market-based system. As highlighted earlier, given banks often account for over 80 percent. of financial sector assets in less advanced developing countries, this is a crucial area of assistance from donors. Institution building support through transfer of technology and know how may be required by local partners especially in areas such as credit analysis and management information systems, often for considerable periods. Where large incidences of non-performing loans exist, assistance in resolving them is also a critical need.

Technical and financial support may be required to recapitalise banks that are being restructured. Additionally, support to privatise banks is often an important need, although particular care must be taken to ensure appropriate checks and balances exist for the institutions to operate effectively after privatisation. In cases where immediate privatisation is not possible, appropriate commercially-oriented governance structures can be established as an interim measure.

Regulation and supervision

The most immediate need in this area is usually in the drafting or strengthening of legislation for the regulation and functioning of central banking, commercial banking and non-banking institutions and markets such as those affecting insurance companies, pension funds, mutual funds and insider dealing. International standards such as the Basle Core Principles for banking supervision and International Organisation of Securities Commissions (IOSCO) principles and frameworks should be aimed at as the ultimate goal, but also with due consideration to the stage of development of the local institutions and markets and their capacity to absorb regulation. The challenge is to draft regulations that are market-friendly and encourage competition, including from foreign institutions, whilst enhancing transparency, protecting depositors, investors and other participants and preventing crises.

In terms of resource commitment, however, the more enduring need in developing countries is for assistance in building institutions that can effectively supervise financial sector institutions and markets and enforce regulations. This requires transfer of know how on supervisory practices as well as access to technology to develop appropriate systems and procedures to discharge monitoring-related responsibilities. Additionally, central bankers and finance ministry officials may need donor co-operation in developing capacity to discharge their monetary, fiscal and external finance related responsibilities.

Infrastructure and environment

Assistance with drafting and enacting bankruptcy-related legislation is often needed, along with support for capacity-building in the judiciary to enforce these and other laws. In addition, frequently, enabling legislation needs to be enacted, or existing laws amended, to ensure that new products such as leasing, housing finance and new financial instruments can be introduced. Accounting regulations for banking and other financial institutions generally need strengthening, as does the auditing profession and its practices. New financial instruments and new practices such as mergers and acquisitions can also require new

accounting standards and amendments to corporate legislation. Existing tax laws often conflict with the efficient operation of the developing financial sector and need to be addressed. In a wider context, support for developing more market-friendly commercial and labour laws and general accounting principles is also necessary, for example to enable corporate restructuring. Rating agencies and credit bureaux providing information on loans and pledges also require setting up.

A reliable payments system is critical for the efficient functioning of the financial system and the wider economy and transfer of know how and technology can help many developing countries 'leap frog' in areas such as use of payment cards and, assuming the necessary infrastructure exists, e-commerce. Efficient settlements and custody systems are another prerequisite for developing confidence in and encouraging domestic and foreign participation in financial markets.

From a broader perspective, there may be a general need to educate legislators and civil servants to facilitate change.

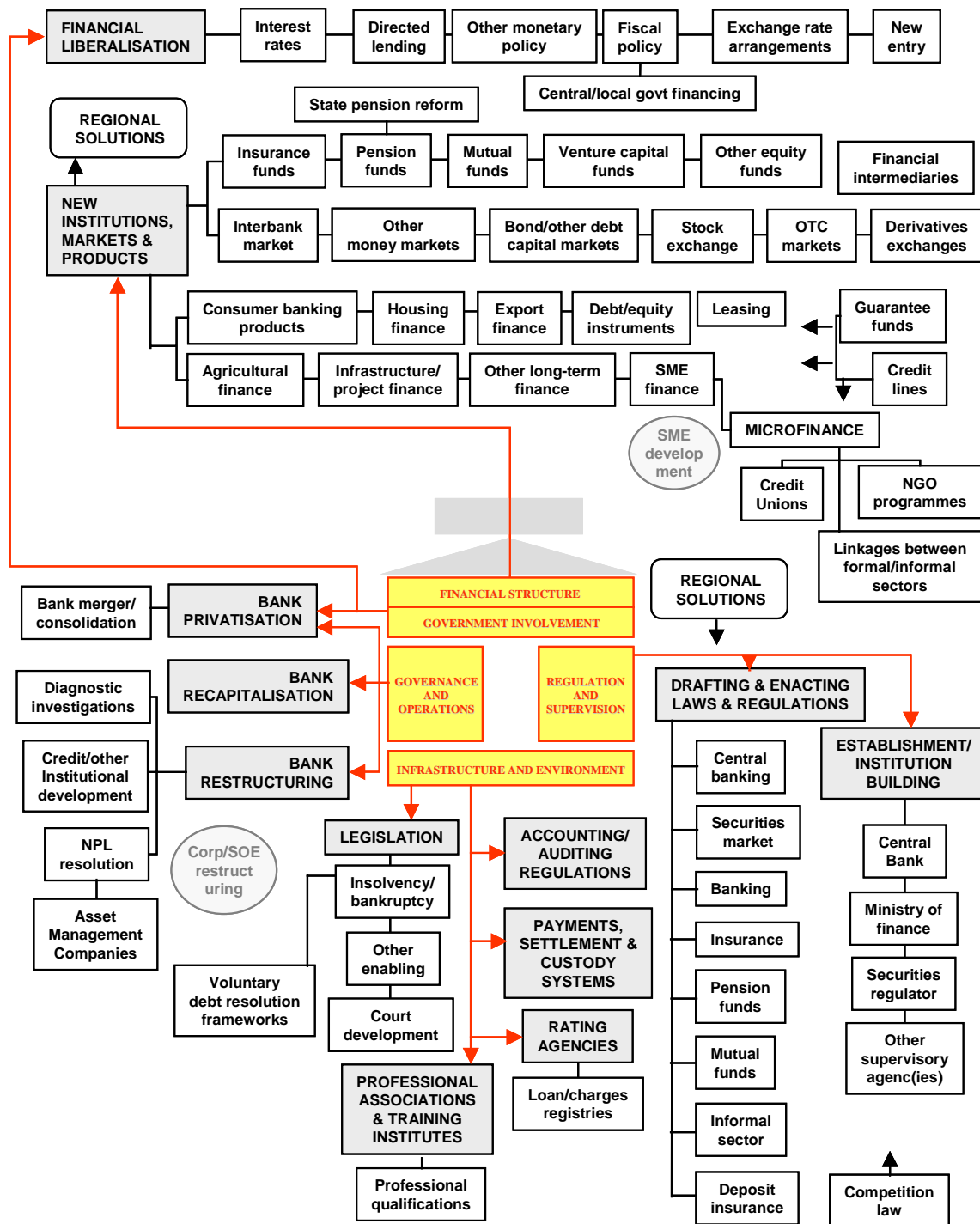
Regional solutions

The entire financial sector of many developing countries is smaller than the largest banks in more advanced industrialised countries. It is doubtful if they can be sustainable, or at best, function optimally, on a stand-alone basis. The political and economic feasibility of regional institutions and markets, such as stock exchanges, central banks, insurance markets and credit rating agencies needs to be explored where they provide a superior solution.

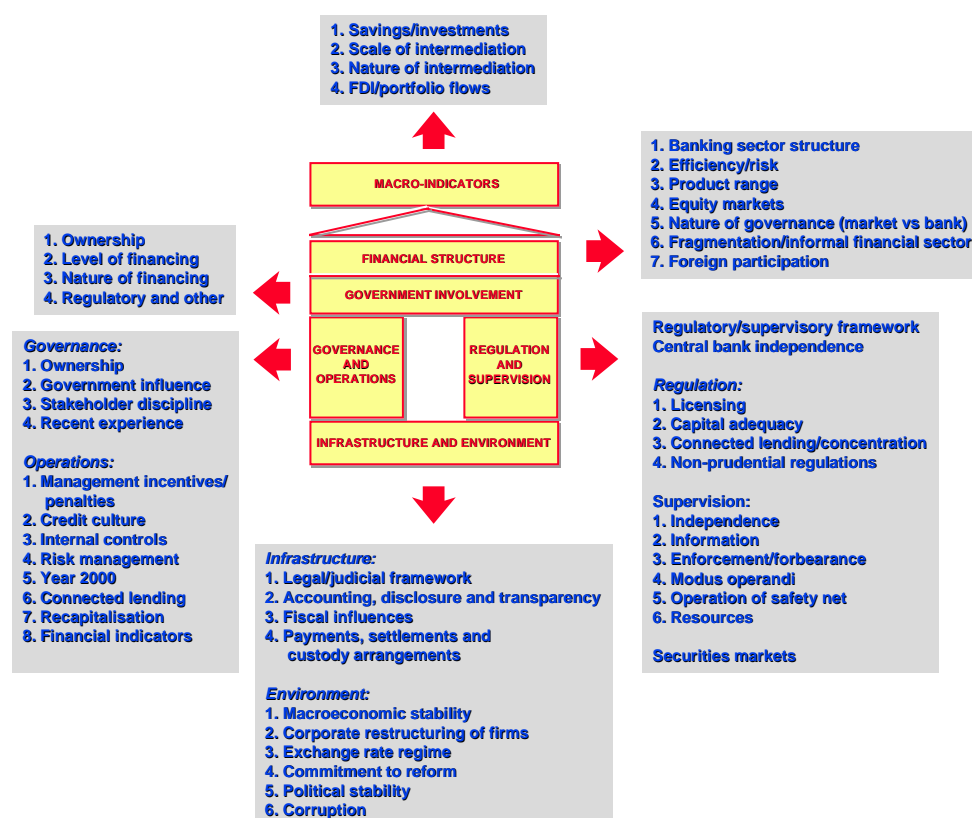
Time

Institutional building needs considerable training. More importantly, it needs changes in attitude and corporate and business cultures. This takes many years and it is critical that a realistic time-scale is adopted for implementation of any financial reform strategy, whilst recognising the need to maintain momentum and move as quickly as possible.

FINANCIAL SECTORS IN DEVELOPING COUNTRIES: TYPICAL STRUCTURES & DEVELOPMENT AND REFORM NEEDS



OUTLINE OF THE FACTORS AND INDICATORS OF THE FSDF



I MACRO-INDICATORS

1. Savings/investments

- Gross domestic savings/GDP
- Gross domestic investments/GDP

2. Scale of intermediation

- M2/GDP
- M2/M0
- Total loans/GDP
- Total financial assets/GDP

3. Nature of intermediation

- Long-term vs short term liabilities/total liabilities
- Security market outstandings/M2
- Deposits vs lending by banks
- Sectoral distribution of credit (vs share of GDP)

4. FDI/portfolio flows

- FDI/GDP
- Portfolio investments/GDP

II FINANCIAL STRUCTURE AND GOVERNMENT INVOLVEMENT

Financial structure

1. Banking sector structure/competition

- Concentration
- Spreads
- Common ownership
- Barriers to entry
- Branching
- Restrictions on activities

2. Efficiency/risk

- Spread
- Central bank credit to banks/GDP
- Real deposit rates
- History of financial/banking crises

3. Product range

Key

- 1= readily available, subject to normal market criteria
 2= existence of a small market; unrestricted, but has not yet developed
 3= moderately restricted availability; the market exists but participation is restricted
 4= highly restricted availability; access to the market is very tightly controlled
 5= not available, or theoretically available, but not actively traded

Sources of financing

Bank loans	Money markets	Leasing	Commercial Bills	Commercial Paper	Bonds	Venture capital	Listed equity	Foreign capital markets
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Money markets

- 2= secondary market in Treasury bills developed, introduction of some other institutions
 3= primary Treasury bills market. Very limited/thin secondary market
 5= no formal market, only informal dealings between banks

Bonds

- 3= secondary market of government bonds developing. Some limited issues of private sector bonds
 4= Primary market in government, government guaranteed and parastatal bonds. Very limited/thin secondary market

Equity

- 2= moderate capitalisation/turnover relative to GDP
 4= formally organised stock exchange, but few placements/low capitalisation
 5= only OTC market

Savings products

Bank deposits			Government paper		Equities	Mutual funds	Pension	Insurance	Foreign markets
Sm -all	Large	Current	Short	Long					

Also consider corporate bonds/paper.

Risk management products

Foreign exchange				Interest rate				Equity	
<i>Spot</i>	<i>For-ward</i>	<i>Swaps</i>	<i>Fut-ures</i>	<i>FRAs</i>	<i>Fut-ures</i>	<i>Swaps</i>	<i>Options</i>	<i>Fut-ures</i>	<i>Options</i>

4. Equity markets

- Date of establishment of stock exchange
- Market capitalisation: \$m/% of GDP
- Turnover ratio (turnover/capitalisation)
- Number of listed domestic companies

5. Corporate governance

- Banks vs non-bank holding of shares in corporates

6. Fragmentation/informal financial sector

- Size of informal sector/GDP
- Interest rate differential between formal and informal sectors
- Total assets of informal vs formal financial sector
- Level of lending from formal to informal institutions
- Level of formal institutions' deposits from and credits to, rural areas/total deposits or credits
- Rural branches of formal institutions/total branches
- Nature and extent of semi-formal initiatives

7. Foreign participation

- Number of banks owned or controlled by foreign banks/total number of banks
- Assets owned by foreign owned or controlled banks/total assets
- Assets owned by banks with significant minority foreign participation/total assets
- Level of foreign ownership of NBFIs

B Government involvement

1. Ownership

- Number of banks owned or controlled by the government/total number of banks
- Assets owned by government owned or controlled banks/total assets
- Assets owned by banks with significant minority government participation/total assets
- Appointment of bank directors
- Level of government ownership of NBFIs

2. Level and nature of financing

- Level of credit to or guaranteed by government/ total credit
- Level of government credit from and holding of government securities by central bank/GDP
- Holding of government securities and loans to government by banks/total assets
- Credit to SOEs/total credit
- Credit to and holding of government and SOE securities/ total assets
- Direct/indirect financing by government

3. Regulatory and other indirect influences

- Directed lending
- Implicit or explicit guarantees
- Interest rate ceilings
- Bail out/weak exit policies and political pressure for forbearance
- Overgenerous lender of last resort/deposit protection
- Supervisory responsibilities at MoF

III GOVERNANCE AND OPERATIONS

A Governance

1. Ownership

- Government
- Private sector
- Capital requirements high/commensurate with risk
- Industrial holding companies
- Ownership by strong/foreign financial institutions
- Dispersed ownership

2. Government influence

- Directed lending
- Implicit or explicit guarantees
- Bail out
- Weak exit policy
- Overgenerous lending of last resort and deposit protection
- Connections with political parties/politicians

3. Stakeholder discipline

- Disclosure/transparency
- Good interbank markets
- Foreign/major financial institutions as shareholders
- Market for corporate control
- Exit/bankruptcy provisions
- Competition

4. Recent experience

- Track record in governance

B Operations

1. Management incentives/penalties

- Replacement of management for poor performance
- Enforceable legal liability of managers
- Appointment/removal authority with independent Board

2. Credit culture

- Credit evaluation procedures
- Training, experience and competence of staff

3. Internal controls

- Segregation of responsibilities and reconciliation procedures
- Operating policies and standards
- Comprehensiveness and internal consistency of record-keeping systems
- Organisational independence of internal audit and management control functions and access to authority

4. Risk management

- Presence and use of risk management systems

5. Connected lending

- Government directed lending
- State-owned bank exposure to state-owned enterprises
- Exposure to companies in which financial institution also has shareholding
- Lending to related companies, eg, common shareholder
- Existence of and compliance with maximum credit concentration rules

6. Recapitalisation

- Conditions attached

7. Financial indicators

Stock measures	Flow measures
Non performing loans/loans	Operating expenses/assets
Provisions/loans	Interest income/assets
Capital/assets	Net profits/assets

IV REGULATION AND SUPERVISION**A Regulatory/supervisory framework**

- Acknowledgement of/adherence to Basle Core Principles
- Explicit prudential norms/standards
- Definition of responsibilities/ authority
- Co-ordination and exchange of information among authorities, including host country ones

B Central bank independence

- Impact on responsibilities

C Regulation**1. Licensing**

- Explicit criteria
- Appropriate 'fit and proper' standards
- Appropriate capital requirements
- Encouragement of strong financial institutions, including foreign

2. Capital adequacy

- Basle ratio minimum floor
- Based on risk

3. Connected lending/concentration

- Limits on lending to single (groups of) customers
- Arms length dealing with related parties
- Enforcement

4. Non-prudential regulations/other

- Directed lending
- Restrictions on maturities/interest
- Restrictions on branching/expansion
- 'Speed brakes'
- Money laundering/other

D Supervision

1. Independence

- Location
- Direct/indirect government influence
- Autonomy and authority

2. Information

- Comprehensiveness
- Consistency and reliability
- Timeliness
- Independent verification

3. Enforcement/forbearance

- Government influence
- Regulatory capture
- Legal protection of supervisors
- Track record

4. Modus operandi

- Contact with management
- Independent verification of information
- Supervision on a consolidated basis
- Focus on bank risk management
- Policies to take corrective action and orderly exit policies

5. Operation of safety net

- Avoidance of moral hazard
- Private sector devices
- Equitable share of losses
- Basis of lender of last resort support
- Basis of providing public funds

6. Resources

- Financial
- Human

E Securities markets

G-10 Working Party's recommendations

V INFRASTRUCTURE AND ENVIRONMENT

A Infrastructure

1. Legal/judicial framework

- Market friendliness of legal framework
- Property rights and contract law
- Practical enforceability of market contracts
- Ability to pledge and seize collateral
- Bankruptcy code
- Well defined fiduciary responsibilities and liabilities of financial agents, stakeholders managers of financial institutions

2. Accounting, disclosure and transparency

- Internationally consistent generally accepted accounting standards
- Strong regulatory body
- Appropriate rules on recognising, classifying and providing against doubtful an lost exposures for banks
- Effective/regular auditing
- Timeliness and accuracy of publication of relevant aggregate financial data (macroeconomic indicators, reserves, banking sector statistics, etc.)
- Availability of independent credit-rating or credit information facilities

3. Fiscal influences

- Interest rate ceilings
- Non-deductibility of loan loss provisions
- Taxes on accrued interest
- Other.

4. Payments, settlements and custody arrangements

- Development/reliability

B Environment

1. Macroeconomic stability

- GDP trend/volatility
- Inflation trend

2. Corporate restructuring of firms

- Co-ordination with bank restructuring

3. Exchange rate regime

- Open/closed – vulnerability of financial sector

4. Commitment to reform

- Political/social

5. Political stability

- Recent events
- World Bank Political Instability Index

6. Corruption

- Recent evidence
- Anti-corruption programmes
- Transparency International Index