BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION: AN UPDATE AFTER A DECADE OF EXPERIENCE

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Abstract

The Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision (BCPs) are a universally applicable minimum standard for sound prudential regulation and supervision of banks and banking systems. Supervisors use these principles to assess the quality of their regulatory and supervisory frameworks, while the International Monetary Fund (IMF) and the World Bank use them, as part of their Financial Sector Assessment Programme, to assess the efficacy of the banking supervision framework and supervisory approach in each jurisdiction. Since they were first introduced in 1997, the BCPs have undergone two revisions (in 2006 and 2012). In April 2024 the Basel Committee on Banking Supervision published a modification of the standard to account for developments over the last decade, the impact of structural trends in the sector and the lessons learned from previous implementations of the core principles. This article takes a look at the key aspects of this update, the main changes of which refer to new risks, such as climate-related financial risks and the digitalisation of finance, operational resilience, non-banking financial intermediation, financial risk, risk management practices, and systemic risk and macroprudential oversight.

Keywords: Basel Core Principles, prudential regulation, banking supervision, financial sector assessment.

1 Introduction

When the German firm Wirecard was first floated on the Frankfurt Stock Exchange in 2005, there was nothing to indicate that it would go on to take centre stage in a major financial scandal that would years later trigger the downfall of the President of Germany's Federal Financial Supervisory Authority (BaFin). The case laid bare a series of shortcomings, including issues with supervisory reporting on related party transactions, a weakness that had previously been identified by the International Monetary Fund (IMF) in its Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision (known as the Basel Core Principles or "BCPs") (IMF, 2016). Subsequently, the German authorities acknowledged these issues and strengthened BaFin's powers.[1]

The BCPs are a cornerstone of sound banking regulation and supervision within the Basel Committee on Banking Supervision (BCBS) global standards. Unlike the other frameworks issued by the BCBS, which must be implemented in full by all internationally active banks in

1 See BaFin (2021) for further details of these greater supervisory powers.

member jurisdictions, the BCPs are universally applicable, and are therefore applied across all jurisdictions (whether BCBS members or not) and all banks (whether internationally active or not). With this in mind, they cater to a variety of banking systems and a broad spectrum of banks.

The BCPs provide a structure that takes the multi-faceted nature of banking supervision into account. Although this set of minimum standards is not binding, it is expected to be implemented by all jurisdictions, which should help make the global financial system more robust. It is worth noting here that the BCPs do not incorporate the Basel III standards directly, except in the case of internationally active banks (where they are incorporated by cross-referencing the Basel framework).

Prudential authorities use the BCPs as a benchmark for assessing the suitability of their regulatory and supervisory frameworks, and to identify the measures needed to ensure best supervisory practices. They are also used by the IMF and the World Bank to assess the efficacy of countries' banking supervision systems as part of their Financial Sector Assessment Programmes (FSAP).[2] A study of the IMF's assessments of compliance with the BCPs revealed that, despite the progress made in the key regulatory reforms, there is still much to be done before the BCPs are properly implemented in full.[3]

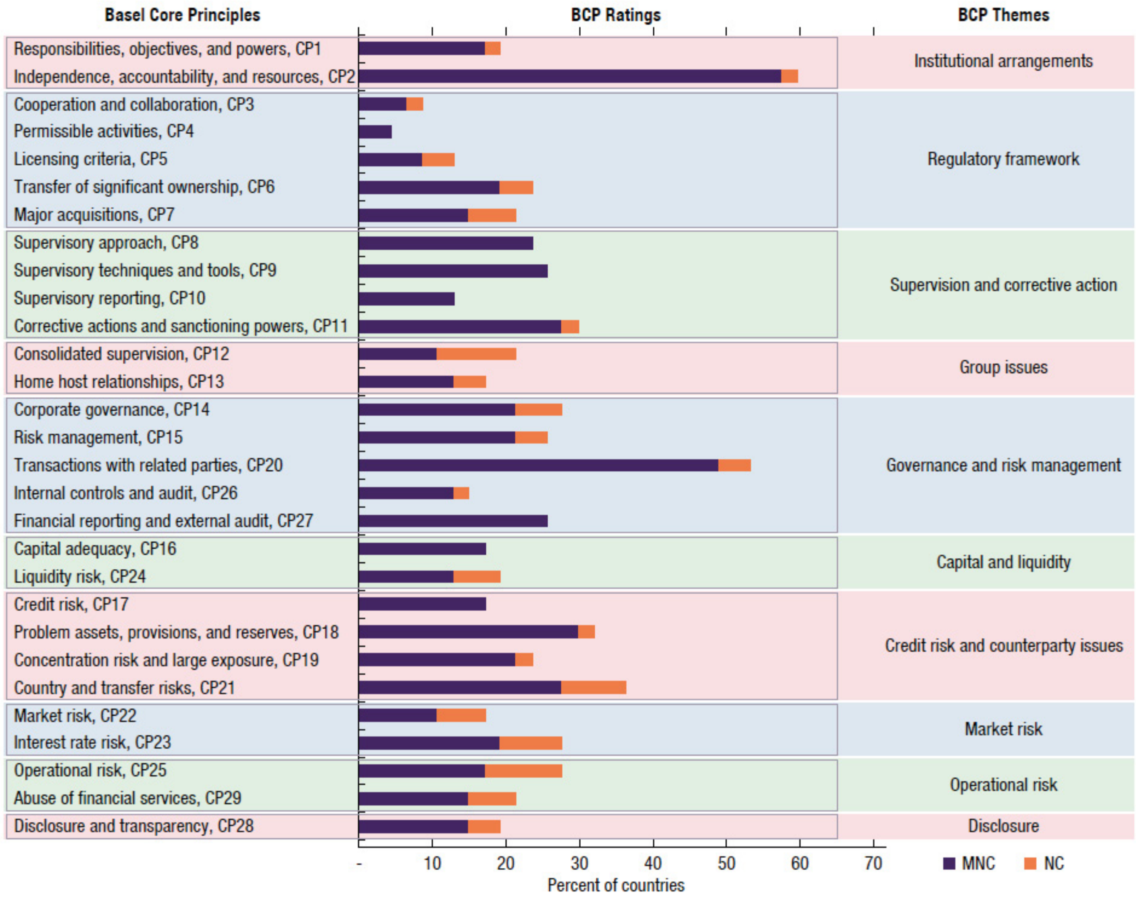
Chart 1 shows the extent of non-compliance with each principle by the group of jurisdictions assessed. Notably, more than half of the jurisdictions failed to satisfactorily comply with the standards of independence, accountability and resources (BCP2) and transactions with related parties (BCP20). Moreover, one-third of the jurisdictions, for instance, lack powers and effective supervisory processes to identify and take timely corrective actions (BCP11), while the framework for the management of problem assets (BCP18) also revealed shortcomings.

Given how important the BCPs are for promoting effective supervisory practices, these standards will inevitably evolve over time in response to global financial developments, emerging risks and trends, and changes in the global regulatory landscape. Initially unveiled in 1997, the BCPs were expanded in 1999 with the publication of the methodology to ensure that the degree of compliance by jurisdictions is assessed as objectively and uniformly as possible. They were then revised on two further occasions: in 2006 the principles were reviewed (partly as a result of the major changes entailed by the new Basel II guidelines) and

2 The FSAPs are conducted jointly by the IMF and the World Bank in developing countries and emerging markets, and by the IMF individually in advanced economies. The FSAPs provide a broad, detailed analysis of how resilient a country's financial sector is and include financial institution stress testing, an assessment of the crisis management framework and an evaluation of financial sector supervision and regulation. As far as the latter is concerned, the core sectoral principles issued by the relevant international supervisory bodies are used to assess the efficacy of supervisory and regulatory systems. In addition to the BCBS' BCPs, these include the Insurance Core Principles of the International Association of Insurance Supervisors (IAIS) and the Objectives and Principles of Securities Regulation of the International Organization of Securities Commissions (IOSCO).

3 In 2021 staff from the IMF published a paper setting out the main conclusions drawn from its assessments of BCP implementation, analysing the 47 assessments conducted between 2012 and 2019 to identify the progress made and the areas in which further efforts are needed (Dordevic, Ferreira, Kitonga and Seal, 2021).

Chart 1
BCP compliance by thematic group

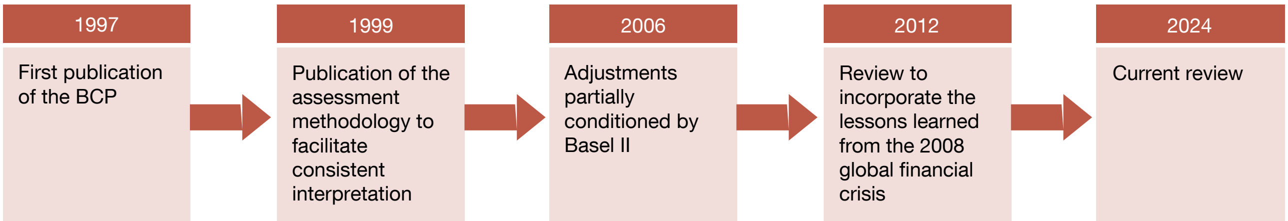


SOURCE: Dordevic, Ferreira, Kitonga and Seal (2021).
NOTE: MNC means "Materially non-compliant"; and NC means "Non-compliant".

the assessment methodology was developed in greater detail. Later, in 2012, further guidance was given to the supervisors, while also improving the minimum banking supervision standards, taking on board the lessons learned from the 2008-2009 global financial crisis (BCBS, 2012). In April 2022, more than one decade on from the previous update, the BCBS agreed to conduct a review to assess the changes needed to the core principles themselves, as well as whether it was necessary to revise the preconditions and the assessment methodology. To this end, it set up a temporary task force comprising representatives from both BCBS and non-BCBS member jurisdictions, as well as the IMF and the World Bank. Figure 1 shows the main milestones in the evolution of the BCPs since they were first conceived.

This article looks at the scope of the recent BCP review (Section 2), identifying the main changes made (Section 3) and briefly discussing how the BCPs were used in the IMF's latest FSAPs for Spain and the euro area (Section 4), before finishing with some conclusions (Section 5).

Figure 1
BCP Chronology



SOURCE: Devised by authors.

2 Scope of the review

The review was guided by the overarching principle of maintaining the simplicity, flexibility and universal applicability of the BCPs. Similarly, the BCPs continue to be outcome-oriented rather than prescriptive on process, and jurisdictions are therefore free to adopt the processes best suited to complying with a particular principle. For instance, although the BCPs refer to the attributions, functions and powers that a banking supervisor should have, they remain neutral as to each jurisdiction's institutional framework, without prescribing a particular form of organisation. This approach makes sense given that, as already noted, the BCPs are universally applicable, and should therefore be fit for use by a broad range of supervisors operating in very different jurisdictions.

Moreover, it explains the changes made in relation to the proportional application of the BCPs. As in the previous revision of the BCPs, the concept of proportionality underpins all of the assessment criteria, even if it is not always directly referenced. The introductory section of the latest version of the BCPs reinforces these expectations of proportionality, explaining how the concept of proportionality should be understood and applied in practice. This takes on even greater importance since, unlike in other frameworks, there is no gradual phasing in of the implementation of the BCPs. Instead, compliance with the BCPs is assumed at the moment of publication. Moreover, this is of particular relevance considering that this revision includes issues (such as climate-related financial risks) where banks and supervisors' knowledge is still evolving.

The new BCPs include changes to both content and structure, to this end drawing on a variety of inputs, including the impact of recent structural trends (e.g. the digitalisation of finance, climate-related financial risks, changes to the regulatory perimeter, etc.) on the banking system, regulatory and supervisory developments since the BCPs were updated in 2012 (e.g. the creation of new supranational supervisors,[4] additional information on proportionality,

4 The revision was seen as an ideal opportunity to address the issue of shared responsibility between national and supranational systems in key areas of banking supervision. This aspect has been important for the European Union since the Single Supervisory Mechanism (SSM) was set up in 2014.

remote working) and both the lessons learned by jurisdictions during the implementation of the 2012 BCP update and the expertise gleaned from the IMF and World Bank FSAPs since 2012. Meetings were also arranged with supervisors and industry throughout the process to gather feedback from a broad range of stakeholders.

Moreover, the new publication testifies to the efforts made by the BCBS and other financial sector standard-setting bodies, such as the Financial Stability Board (FSB), in revising the different standards issued since 2012, to incorporate the relevant improvements in terms of supervision and regulation and structural trends. Suffice it to say that the new BCPs cite over 30 new reference documents.

In short, post-revision changes have been made to the following thematic areas:

— New and emerging risks, encompassing the digitalisation of finance and the impact of new technologies and climate-related financial risks.

— Operational resilience, including a greater emphasis on cyber risk, business continuity plans and third and fourth-party risk management, as well as on concentration risk.

— Non-bank financial intermediation, such as banks' direct exposures to leveraged funds and the broader implications for financial stability.

— Financial risks, including the reforms to capital, liquidity and funding adequacy; leverage requirements; the prudential treatment of accounting provisions; credit risk (including securitisations); market risk, and derivatives/securities financing transactions.

— Risk management practices, corporate governance, disclosure, risk culture, remuneration policies, data governance and stress testing.

— Systemic risk and macroprudential oversight, including the frameworks for identifying and overseeing systemic risk and the application of macroprudential measures.

In addition to making the content of the standard more robust, the current revision also improves its presentation. Thus, the introductory sections have been amended significantly to make them easier to understand and ensure that the key messages can be identified and clearly grasped. At the same time, a new section explaining some of the terms used repeatedly throughout the BCP has now been included for ease of understanding and to ensure that substantive requirements previously scattered throughout the document are now included in the main body of the text.

Lastly, it is worth noting that the content of the preconditions for effective supervision has not been modified, nor has the assessment methodology, and only minor modifications to these sections are proposed. First, the BCPs retain the six preconditions identified in 2012 that can shape how effective supervision is.[5] These preconditions (which are considered necessary to achieve the supervision goal) generally fall outside the control of supervisors, who should therefore work together with governments and/or the relevant authorities to address any issues identified. Although the BCP assessments conducted by the IMF and the World Bank in the FSAPs are not expected to verify the extent to which such preconditions are met, they should nonetheless include an opinion as to whether the weaknesses in these preconditions hinder effective supervision. Second, the methodology for assessing the extent to which the principles have been observed includes guidelines as to how this should be evaluated and graded.[6] Nonetheless, the primary goal of the evaluation is not to assign a "grade", but rather to identify areas needing attention in each jurisdiction. As noted above, the methodology itself is based on a proportional approach, enabling supervisors to tailor their processes and actions to the size, complexity and risk profile of the supervised institutions.

3 The core principles and the 2024 amendments

These minimum standards are made up of 29 high-level principles divided between what is expected of supervisors and what is expected of banks (see Table 1). Thus, Principles 1 to 13 address supervisory powers, responsibilities and functions, focusing on effective, forward-looking risk-based supervision and the need for early intervention. Principles 14 to 29 cover supervisory expectations of banks, emphasizing the importance of good corporate governance and risk management, as well as compliance with supervisory standards.

Each principle includes certain essential criteria that are needed to satisfy that principle. Some principles also include additional criteria, which include more sophisticated requirements and represent suggested best practices to which countries with more complex banking systems should aspire. With this in mind, these criteria will only be assessed in those jurisdictions that so request. While no new principles have been added in the latest revision, the content of all of the existing ones has been changed to varying degrees. In certain cases, some additional criteria have been upgraded to the category of essential. From now on, such criteria will therefore have to be assessed before a particular principle can be deemed to have been fully complied with. In other cases, this enhancement has taken the form of the addition of new assessment criteria.

5 These six requirements or preconditions are: sound and sustainable macroeconomic policies; a well-established framework for financial stability policy formulation; a well-developed public infrastructure; a clear framework for crisis management, recovery and resolution; an appropriate level of systemic protection (or public safety net); and effective market discipline.

6 Each principle can be graded four ways: i) Compliant: in general, when all essential criteria are met without any significant deficiencies, ii) Largely compliant: only minor shortcomings that do not raise any concerns about the authority's ability and intent to achieve full compliance with the principle within a prescribed period of time; iii) Materially non-compliant: if there are severe shortcomings and evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance; and iv) Non-compliant: if there has been no implementation of the principle, several essential criteria have not been complied with, or supervision is manifestly ineffective.

Table 1
Core Principles for effective banking supervision (2024)

Basel Core Principles	
Supervisory powers, responsibilities and functions	Prudential regulations and requirements
BCP1- Responsibilities, objectives and powers	BCP14- Corporate governance
BCP2- Independence, accountability, resourcing and legal protection for supervisors	BCP15- Risk management process
BCP3- Cooperation and collaboration	BCP16- Capital adequacy
BCP4- Permissible activities	BCP17- Credit risk
BCP5- Licensing criteria	BCP18- Problem exposures, provisions and reserves
BCP6- Transfer of significant ownership	BCP19- Concentration risk and large exposure limits
BCP7- Major acquisitions	BCP20- Transactions with related parties
BCP8- Supervisory approach	BCP21- Country and transfer risks
BCP9- Supervisory techniques and tools	BCP22- Market risk
BCP10- Supervisory reporting	BCP23- Interest rate risk in the banking book
BCP11- Corrective and sanctioning powers of supervisors	BCP24- Liquidity risk
BCP12- Consolidated supervision	BCP25- Operational risk and operational resilience
BCP13- Home-host relationships	BCP26- Internal control and audit
	BCP27- Financial reporting and external audit
	BCP28- Disclosure and transparency
	BCP29 - Abuse of financial services

SOURCE: BCBS (2024).

The main changes introduced are analysed in the following sections (by thematic area), without entering into detail on the content of each principle and its implementing criteria.

3.1 Climate-related financial risks

Climate-related financial risks have been included in the BCPs, recognising their importance, given the impact they can have on the safety and soundness of banks and their additional implications for financial stability. The decision was taken not to include a new principle, but rather to take a cross-cutting approach to include such risks within the existing principles that may be affected, at all times bearing in mind that such modifications should be in line with the principles for the efficient management and supervision of climate-related financial risks (BCBS, 2022).

Particular changes were introduced in the consultative document published in July 2023 to explicitly reference climate-related financial risks and to promote a principles-based approach to improving supervisory practices and banks' risk management. Under the amendments to the principles of supervisory approach and supervisory reporting (BCP8 and BCP10), supervisors are required to consider climate-related financial risks in their methodologies and supervisory processes, and to have the power to require banks to submit information that allows for the assessment of the materiality of climate-related financial risks. The adjustments to the principle on risk management process (BCP15) require, first, that banks have in place comprehensive risk management policies and processes for all material risks (including climate-related financial risks), recognising that such risks may materialise over variable time horizons that go beyond the traditional capital planning horizons, and, second, that suitable measures be applied to manage such risks when they are material. The adjustments to the principle on internal control and audit (BCP26) call on banks to consider climate-related financial risks as part of their internal control framework. At the same time, bank and supervisory practices may consider climate-related financial risks in a flexible manner, given the degree of heterogeneity and evolving practices in this area.

Given the importance of climate-related financial risks, the feedback received during the public consultation revealed widespread support for their inclusion in the BCPs.[7] Nonetheless, views differed as to how to do this. Broadly speaking, banks stressed that it was important to treat such risks as part of the existing categories (credit risk, market risk, operational risk, etc.), rather than as a separate risk. Others noted that, given how new this issue is and the progress still being made in this area from the standpoint of both supervisors and banks, some of the proposals will be hard to apply, particularly for emerging economies and low income countries. Lastly, various climate-related and environmental non-governmental organisations pushed for stricter requirements, asking that they be more prescriptive and even, in some cases, expanding the scope to include concepts such as biodiversity.

The text ultimately approved has struck a reasonable balance between the different viewpoints: climate-related financial risks have been included explicitly, while also bearing in mind the current state of play in a still developing field. The specific changes made following the public consultation notably include: first, the term “climate-related financial risk” has been defined with a view to making the concept easier to understand. Moreover, although the language proposed in the consultation has been maintained for most of the principles, some particularly significant modifications have been made concerning the requirements relating to the risk management process (BCP15).[8] Thus, although the need for scenario analysis and stress testing to reflect climate-related financial risks remains an essential criterion of BCP15, the language has now been made more flexible to allow for a more proportionate application of the requirements, thereby recognising the differing degrees of progress and complexity in these areas.

3.2 Operational resilience and digitalisation

Innovation driven by technology and the digitalisation of finance is changing both customer behaviour and the way in which banking services are provided. New products, new participants and the use of new technologies entail both opportunities and risks for supervisors, banks

7 The feedback received on the BCP consultative document can be found at the following link on the Bank for International Settlements website (BCBS, 2023b).

8 BCBS (2023a).

and the banking system. Meanwhile, banks are increasingly dependent on third parties for the provision of technological services, thus creating additional points of cyber risk, as well as possible concentrations across the entire system. As information and communication technologies evolve, the banking sector, as one of the most highly digitalised sectors, is continually faced with challenges of cyber risk.

Operational resilience seeks to ensure that banks are better equipped to be able to withstand, adapt to and recover from serious operational risks, such as those stemming from cyber incidents or technological failures, but also those deriving from pandemics or caused by natural disasters. As a result, the far-reaching modifications and additions to BCP25 primarily concern what is referred to as "operational resilience", as opposed to the 2012 version, which was limited to "operational risk". Despite forming part of the same principle, a distinction is drawn in the BCPs between the concept of operational resilience, which refers to the planning and continuity of critical business activities, and the concept of operational risk management, which seeks to minimise the economic impact resulting from inadequate (or failed) processes, persons or internal systems, as well as from external events. This second definition includes legal risk, but excludes strategic and reputational risk.

Besides, in terms of how the consequences of digitalisation can be incorporated within risk management for banks and supervisors, BCP15 on risk management process was already broad enough to cover the digitalisation-related risks to banks. However, modifications have been made to emphasise the dependence on third-party technology service providers. Indeed, access to information is one of the key aspects for ensuring effective supervision. With this in mind, together with the new BCP25 on operational resilience, the revision of BCP1 (referring to supervisory responsibilities and powers) grants supervisors access to the necessary information, including records that are held by relevant service providers and that can be accessed either directly or through the supervised bank.

3.3 Non-bank financial institutions

Financial intermediation has changed significantly since the last review of the BCPs, driven by rapid advances in FinTech and the proliferation of non-bank financial intermediaries (NBFIs). NBFIs complement banks in providing financial services, but their activities may also affect the stability of the financial system through their interconnections with banks.

During the consultation process, some participants called for explicit regulation of NBFIs. The BCPs were not amended to that effect, as they were designed to apply to institutions designated as banks. However, in response to the growing importance of NBFIs, there is a more explicit recognition in BCP8 (supervisory approach) that supervisors should remain vigilant to the risks arising from the activities of NBFIs and their potential impact on the banking system. In addition, some perhaps less substantive amendments have been introduced in BCP4 (permissible activities), mainly aimed at strengthening supervisory expectations in monitoring the risk that transactions with different NBFIs may pose to banks. The group-wide supervisory approach has also been strengthened by explicitly stating in BCP10 that the supervisor has the power to request certain information, including information related to transactions with NBFIs. Expectations have likewise been strengthened for banks. BCP15 (risk management process) now states that banks must have adequate risk management policies and processes for, among others, step-in risk.[9] Furthermore, BCP17 (credit risk) explicitly recognises that transactions with NBFIs may give rise to counterparty risk. In short, the reviewed BCPs continue to focus on banks and supervision, while simultaneously strengthening expectations about them to take into account the growing importance of NBFIs and the risks they may entail for the banking sector.

3.4 Financial risks

The main trends and developments of the last decade have played an important role in this review. However, particular attention was also paid to some of the reforms undertaken by the BCBS to address the weaknesses that came to light during the 2008-2009 crisis, but which had not been included in the 2012 review, or at least not fully, as more experience was needed with their application. A case in point is the need for a non-risk-based measure. The aim of this measure is to complement risk-based approaches, restricting leverage in banks and, by extension, in the banking system. To cover this aspect, BCP16 (capital adequacy) now includes among its essential criteria that supervisors should have the power to impose this type of non-risk-based measure. However, this requirement has been introduced in a flexible manner. Consequently, the measure as defined in Basel III is not required (except for internationally active banks). Instead, the principles are flexible and allow for a wide range of leverage indicators and controls. It should be noted that many jurisdictions, despite not yet having adopted Basel III, already have a long track record of using leverage measurement tools. In short, the principle raises awareness of the importance of leverage and requires that it be monitored in all jurisdictions, offering the measure designed by the BCBS merely by way of example.

With respect to credit risk, the reviewed BCP17 places greater emphasis on risks related to securitisation transactions and counterparty credit risk. Since the 2012 review, the BCBS has published many recommendations and documents on the risks involved in these transactions and the treatment they should be afforded.[10] For this reason, the review focuses more explicitly on the appropriate treatment of risk arising from certain securitisation structures and requires banks to have a comprehensive and ongoing understanding of the characteristics and potential risks of their securitisation transactions. It is also clarified that the concept of securitisation includes not only traditional securitisations, but also synthetic securitisations. The definition of counterparty credit risk has also been fine-tuned, bringing it into line with BCBS standards.

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9 The risk that a bank will provide financial support to an unconsolidated entity in distress, in the absence of or above and beyond any contractual obligation to provide such support.

10 For example, some aspects of their treatment were reviewed and some definitions clarified in BCBS (2014b).

Furthermore, as established in BCP18 (problem assets, provisions and reserves), banks must have adequate policies and processes for the early identification and management of problem assets and the maintenance of adequate provisions and reserves. This stems from the new role assigned to expected credit loss (ECL) provisions. In the aftermath of the global financial crisis, G20 leaders, regulators and prudential authorities urged accounting standard setters to improve standards and practices relating to provisioning and the calculation of financial asset impairments. A more forward-looking approach was taken at the international level. The accounting model for loan loss provisioning, in the standards of both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board, is now based on expected credit losses rather than on incurred losses. Thus, BCP18 has been amended to incorporate specific aspects relating to expected credit losses, such as the definition of credit loss or a wide range of indicators to detect a significant increase in credit risk. These changes take into account the idiosyncrasies of national accounting systems and are consistent with the BCBS Guidance on credit risk and accounting for expected credit losses published in December 2015 (BCBS, 2015).

In BCP19 the treatment of concentration risk and large exposure limits has been adjusted to align it with the large exposure framework that the BCBS designed in 2014[11] and the definition of connected counterparties in particular. The extent of concentration risk has also been clarified. The identification of connected counterparties posing a shared risk is the most significant and complex change to this principle. Properly understanding and applying the concept of group of connected counterparties (in particular the situation of economic interdependence between borrowers) is a major challenge for both institutions and supervisors. This is by no means easy, due to the combination of objective and subjective situations and to the scarcity of available information. Moreover, the additional criterion relating to the calculation of large exposure limits – which is a requirement on which the different jurisdictions may opt to be assessed in the FSAPs – has been made more stringent. In particular, this calculation is now based on Tier 1 capital (instead of total equity, as stipulated in the 2012 BCPs).

In the other principles dealing with financial risks (BCP21, BCP22, BCP23 and BCP24) only minor editorial changes have been introduced for the most part. In the case of liquidity and interest rate risk in the banking book, the changes are not conceptual but seek to make the 2012 proposals more stringent and universal, by turning additional criteria into essential criteria (for example, the disclosure requirement for encumbered assets).

3.5 Corporate governance and risk management practices

A new BCP14 on corporate governance was introduced in the 2012 review, as it became clear during the global financial crisis that weaknesses in banks' corporate governance could pose significant risks to banks and to the banking system as a whole. Indeed, good corporate governance underpins effective risk management and public confidence in individual banks

11 BCBS (2014a).

and the banking system. The 2024 review leaves BCP14 largely unchanged, although it introduces some changes to underline the importance of good corporate governance. For example, it includes the idea that corporate governance policies and processes should cover corporate culture and values and fit and proper processes. It also emphasises that the composition of banks' boards of directors should take into account diversity considerations, experience and skills, and that their independence and regular renewal should be promoted.

Moreover, a new essential criterion has been introduced into BCP15 (risk management process), focusing on data aggregation. One key lesson from the great financial crisis was that banks' IT systems and data architecture were inadequate to support financial risk management. To address this, the expectation has been introduced that a bank should have the ability to aggregate data and conduct reporting commensurate with its risk profile and systemic importance.

3.6 Business model sustainability

Changing macroeconomic conditions and structural developments that may affect the banking sector make it crucial for banks to adapt their business models so that they remain sustainable over the medium and long term. Potential adverse structural trends (e.g. digital innovation and demographic change) highlight the importance of assessing the soundness of banks' business models. The BCPs have been revised to give greater prominence to the concept of sustainability of banks' business models, understood as their ability to design and implement sound, forward-looking strategies to generate sustainable returns over time. This concept has now been explicitly included, while maintaining a generic approach ensuring universal application. Similarly, targeted reviews have been introduced to more explicitly recognise the supervisory implications of new business models (BCP8), including for banks' risk management (BCP15). While the ultimate responsibility for designing and implementing sustainable business strategies lies with a bank's board of directors, supervisors also play an important role, since assessing the soundness of banks' business models is a key component of effective supervision.

3.7 Systemic risk and macroprudential oversight

The last decade has reaffirmed the importance of applying a system-wide macro perspective to the supervision of banks, to help identify and analyse systemic risks and take preventive action to address them. Adopting this broader perspective of the financial system was already part of many of the 2012 principles, and this has now been strengthened. To this end, it has been decided not to incorporate a specific principle on macroprudential issues, but rather to strengthen existing requirements by harnessing the experience of jurisdictions in macroprudential policy and oversight. The approach followed has carefully avoided prescribing one type of institutional organisation to the detriment of another, since, as explained above, the application of the BCPs should be universal and should therefore be possible under the different institutional frameworks in place in the different jurisdictions.

In particular, this review has strengthened aspects relating to cooperation in BCP3 and to the relationship between home and host supervisors in BCP13. The importance of close cooperation, both at the national and international level, between the various authorities responsible for banking/financial supervision and for macroprudential policy and financial stability, is thus emphasised.

In addition, amendments have been incorporated to clarify the role of the supervisor in the risk identification and mitigation process in the financial system (in particular the BCP8 supervisory approach and the BCP9 supervisory techniques and tools). The supervisor is required to have a process in place to assess whether banks are systemically important in a national context and to identify, monitor and assess typical bank behaviour that may adversely affect stability.

In addition, in BCP16 on capital adequacy an additional criterion has been added, enabling supervisors (or the relevant authority) to require banks to hold additional capital that can be released in the event of systemic shocks and thus have sufficient resources to be able to weather adverse economic conditions. This buffer could include sectoral capital requirements, in line with the principles issued by the BCBS in 2019 for the operationalisation of the sectoral countercyclical capital buffer.[12]

3.8 Related parties

The principle governing related party transactions (BCP20) has been significantly strengthened, mainly through the enhanced definition of related party. The assessments conducted by the IMF and the World Bank found compliance with this principle to be weak. Indeed, it is the second least observed principle (see Chart 1), with significant shortcomings due to overly restrictive definitions of related party. Poor supervision of exposures to related parties can lead to both financial deterioration and outright abuses by banks (for example, concealing the final beneficiary of the transaction) (Chatain, Caruso, Dohotaru, Krause and Ortiz, 2023).

Despite the lack of relevant BCBS standards or guidelines, the definition of related parties, the approval process for granting and managing related party transactions and the associated reporting requirements have all been strengthened. As the introduction of a broad definition of related parties will substantially reinforce this principle, flexibility is included to exempt certain transactions within the banking group from requirements that prevent such transactions from being carried out on more favourable terms than with unrelated counterparties, and from the obligation to apply limits, deductions or guarantees, where the supervisor considers that this is consistent with sound risk management across the group.

12 BCBS (2019).

3.9 The institutional framework and the supervisory approach

In the 2012 review of the BCPs, the principles relating to the institutional framework (BCP1 and BCP2) were changed to ensure that the supervisor was equipped with appropriate capacities and powers, as well as to ensure that its governance, means and functioning encouraged it to use them. The latest review introduced clarifications and some improvements, showing that these principles remain broadly valid.

First, BCP1 now includes a general reference to those countries that have transferred supervisory tasks from a national supervisor to a supranational one, such as the SSM led by the ECB. The SSM did not exist at the time of the previous review of BCPs and the assessment methodology only envisaged national supervisory systems. The new text points out the importance of a clear distribution of roles and responsibilities between supervisors, which should be enshrined in the law and made available to the public.

In addition, supervisors' accountability has been strengthened through increased transparency. To this end, legislation (BCP1), supervisory priorities (BCP2) and the summary of the process for the identification of systemically important institutions (BCP8) need to be published in a timely manner. Some issues directly related to the supervisor's work that have been addressed in BCBS documents in recent years, such as the measurement of supervisory impact, have not been included in the BCPs.

Moreover, a clearer distinction is now drawn between the existence of supervisory powers and their timely exercise through the use of appropriate tools. Corrective measures are a clear example of this: BCP1 provides for the power of the supervisor to take corrective action, while BCP11 clarifies that it should take such measures pre-emptively when necessary.

Minor changes have also been introduced in BCP2 with the aim of improving the exercise of the supervisor's tasks: for example, establishing a clear internal distribution of competences and delegation of functions, or considering risks and emerging practices in the planning of staffing needs.

Finally, with regard to techniques and supervisory tools (BCP9), the supervisory approach must be regularly reviewed to ensure that it remains fit for purpose. Regarding the implementation of corrective measures, the supervisor is required to be able to simultaneously implement corrective measures and sanctions, and to have a policy on their publication (BCP11).

3.10 Licenses

As regards licensing criteria (BCP5), the fit and proper assessment of members of the governing bodies and senior management must now also verify that they have sufficient availability and time to perform their functions. In addition, the supervisor must reassess their suitability if a significant event occurs (such as a change of control) or information comes to light that affects such suitability.

4 The IMF's assessment of the BCPs in Spain and the euro area

As is well known, in 2014 the institutional architecture of financial supervision changed substantially in Spain and in the other countries of the banking union,[13] as it ceased to be exercised exclusively by the national competent authorities (NCAs) in each country and became the responsibility of the SSM, under the responsibility of the ECB.[14] Since then, the IMF's assessments of the efficiency of the banking supervision system under the FSAP have had to adjust to this new institutional reality, which further complicates the analysis. The scope of the work (i.e. which institution is being assessed, the ECB or the NCA) and the type of institutions whose supervision is under review (significant institutions (SIs), less significant institutions (LSIs) or both) have become particularly relevant.

Thus, in the context of Spain's 2017 FSAP, the IMF published a technical note on the supervision of Spanish banks, for which it used, among other inputs, a self-assessment of the BCPs provided by the authorities (IMF, 2017). Although this technical note covered aspects relating to both SIs and LSIs, it focused on the Banco de España's remit, powers and functions and placed greater emphasis on the supervision of LSIs. In this note, the IMF issued a number of recommendations, but it did not publish a detailed qualitative assessment of the BCPs or assess each principle individually.

Subsequently, in 2018, the IMF completed the first assessment of the implementation of the BCPs in the euro area. A detailed compliance report (IMF, 2018) was published, grading each principle[15] against the revised criteria and methodology issued in 2012. It should be noted that the ECB chose to be assessed and rated against both the essential criteria and the additional criteria. The IMF's assessment focused exclusively on the ECB, as it is the body ultimately responsible and is in charge of the functioning of the SSM. In addition, the review only covered SIs, although it was noted that, to the extent that regulation and practices were harmonised across SSM countries, the assessment of the supervisory environment for SIs may provide a useful picture of the regulation and supervision of LSIs, indirectly supervised by the ECB. In this jurisdiction, each principle is graded for the euro area as a whole, and no country-specific grades are provided. However, the accompanying detailed qualitative assessments include comments on relevant country specificities.

Broadly speaking, the 2018 report recognised the merits of the ECB's supervisory system, with a clear mandate, independence from both the national governments of member countries

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13 It currently comprises the 20 euro area countries and Bulgaria.

14 For the SSM to carry out its tasks, a distinction was drawn between significant institutions, directly supervised by the ECB, and less significant institutions, supervised by the NCAs under the oversight of the ECB.

15 BCP29 on abuse of financial services, which includes money laundering and terrorist financing, was not assessed, as these matters are not within the SSM's remit.

and industry, well-defined processes and methodologies, and committed staff, laying the foundations for forward-looking, pre-emptive and evenhanded supervision. However, areas for improvement were also identified and some principles were graded as “materially non-compliant”.[16] Given the time that has elapsed since then, some of the issues identified in the report have already been addressed and proposals have been put forward for others that, if adopted, would address or mitigate the weaknesses identified. For example, some internal processes have been revised and streamlined, and supervisory transparency has increased; an amendment to the European Capital Requirements Directive has also been agreed allowing the supervisor to oppose the acquisition by an institution of a significant holding in an undertaking before it takes place.

Finally, it should be noted that in 2024 the IMF has been working on two new FSAPs, one for Spain and one for the euro area as a whole, in which the BCPs will be used to analyse the quality of banking supervision and regulation (although a detailed BCP assessment will be conducted only in the latter case). Each of these FSAPs is at a different stage. In the case of Spain, work started at the beginning of 2023 and was close to finalisation at the time of writing. Here, the assessment of specific aspects of LSI supervision is based on the 2012 version of the BCPs. In the case of the euro area, work started in 2024 and, therefore, the assessment will be based on the 2024 version of the BCPs.

5 Concluding remarks

The BCPs constitute a set of internationally agreed measures to improve the quality of regulatory and supervisory frameworks in all types of jurisdictions and all types of banks worldwide. The 2024 revision seeks to ensure that the balance between simplicity, flexibility and universal application is preserved. The principles can be considered de facto minimum standards covering a wide range of areas, including, inter alia, supervisory responsibilities, powers and resources, risk management procedures and capital adequacy. However, the BCPs enable supervisors to tailor their processes and actions to the size, complexity and risk profile of the supervised institutions.

As outlined in the previous sections, the principles are regularly reviewed and updated to ensure they maintain their quality and effectiveness. At the same time, a degree of stability is needed to avoid uncertainty in their application. The latest review has shown that the BCPs are a “living” standard that stands the test of time. However, it also reflects the structural changes and lessons learnt in their implementation and evaluation since their last update, which justify the adjustments made. Indeed, compared with previous reviews, which significantly changed the content of the BCPs, the 2024 review mainly updated them, taking

16 The principles on major acquisitions (BCP7), corrective and sanctioning powers of supervisors (BCP11), capital adequacy (BCP16), transactions with related parties (BCP20), country and transfer risks (BCP21) and liquidity risk (BCP24) were graded as materially non-compliant.

into account new developments and vulnerabilities in the financial system and regulatory and supervisory developments.

In short, the update of BCPs has struck a reasonable balance between maintaining their universal applicability and increasing the demands on supervisors and banks in certain areas. This is very important, as a general application of the principles, while not an absolute guarantee that banking crises will not occur, contributes to strengthening the supervisory framework and the resilience of institutions and, ultimately, to enhancing financial stability at the national and global level. In this respect, an important incentive for the proper and effective implementation of the BCPs is the regular assessment of countries' compliance by the IMF and the World Bank.

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