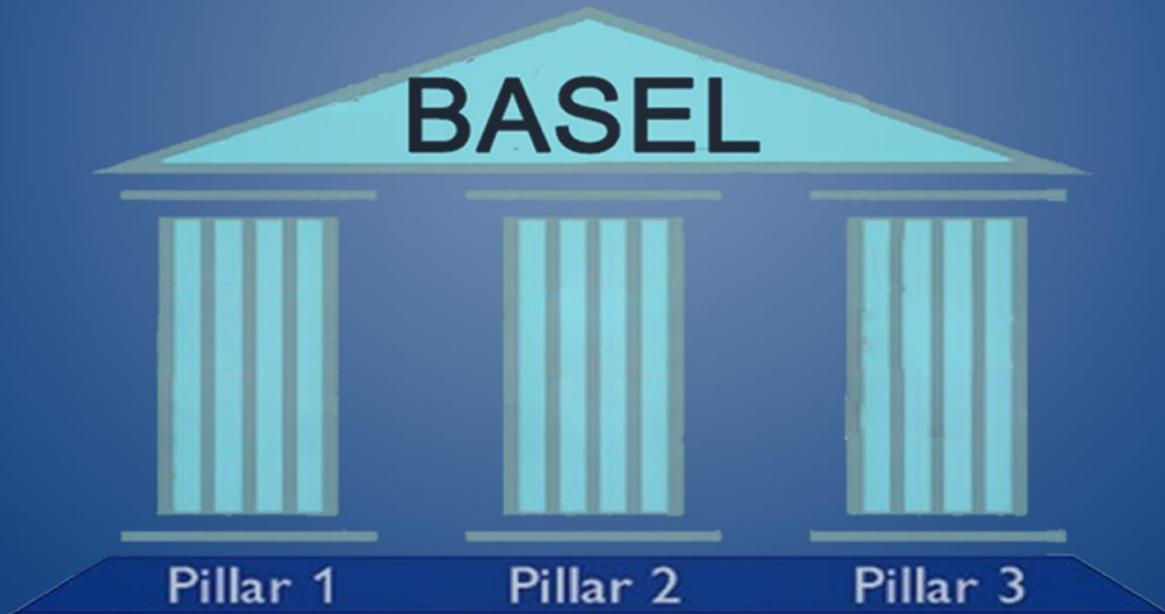




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BASEL MASTER PLAN AND IMPLEMENTATION PLAN FOR  
BANK SUPERVISION DEVELOPMENT TOWARD BASEL STANDARDS



BANK OF THE LAO PDR  
November 2017

**LAO'S PEOPLE DEMOCRATIC REPUBLIC**  
**PEACE INDEPENDENCE DEMOCRACY UNITY PROSPERITY**

**Master Plan and Implementation Plan for  
Bank Supervision Development toward Basel Standards  
from 2017-2025**

**by: Bank of the Lao PDR**

Bank of the Lao PDR  
November 2017

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## Abstract

In accordance to the Strategic Plan for Financial Sector Development of the Lao PDR for 10 Years (2016-2025) and Its Vision until 2030 of the Bank of the Lao PDR in terms of developing and stabilizing the financial sector (Strategic Plan of BOL), Bank of the Lao PDR (BOL) determines its direction to enhance its bank supervision in pursuit of safety, soundness, sustainability and modernization of the financial sector. In doing so, the primary factor to ensure the effective implementation of the strategic plan of BOL is its compliance of Basel Core Principles for Effective Banking Supervision (BCPs) and its implementation of Basel Standards, which set forth the international standards on banking supervision. In addition, the strategic plan of BOL also stipulates that the banking industry should be able to effectively integrate with international specifically under the ASEAN Banking Integration Framework (ABIF), in which the essential factor for this integration is the compliance with BCPs. Due to the perception of such crucial factors, the strategic plan of BOL, hence, requires BOL to prepare the implementation of these international standards since 2016 and aims to implement BCPs and adopt Basel II and partial Basel 3 within 2025. Therefore, in order to achieve the objective of the strategic plan of BOL, it is imperative to issue the Master Plan and Implementation Plan for Bank Supervision Development toward Basel Standards (Master and Implementation Plans) to be a guide for implementing such development in details.

In order to derive this Master and Implementation Plans, BOL has conducted its self-assessment on BCPs (2012) compliance in 2016, to identify gaps on its bank supervision and issues to be prepared and addressed prior to the implementation of these principles. BOL thereby issued this Master Plan and Implementation Plan for Bank Supervision Development toward Basel Standards by determining plans to address some main factors including 1) improvement of legal framework, 2) improvement of supervisory approach, technique, and tools, 3) improvement of IT system of bank supervisors and banks, 4) improvement of risk management frameworks, process and policy of banks, and 5) development of human resource and capacity.

This Master and Implementation Plans consists of 5 Chapters as follow:

- Chapter I Overview of Bank Supervision in Lao PDR
- Chapter II Strategic Plan for Financial Sector Development of the Lao PDR for 10 Years (2016-2025) and Its Vision until 2030 of BOL in respect of Bank Supervision
- Chapter III Rationales for Issuing the Master and Implementation Plans and Previous Missions
- Chapter IV Master Plan
- Chapter V Implementation Plan

This Master and Implementation Plans determines directions, milestones, and processes in order for BOL to implement Basel II. It is highly expected that this Master and Implementation Plans shall be significant the guidance and reference for respective parties to take this into its practice in order to ensure the effective implementation and accomplish the determined deliverables.

On behalf of Bank of the Lao PDR, I would like to express my gratitude to all responsible parties that dedicate themselves to accomplish their assigned duties.

**Governor of the Bank of the Lao PDR**

**Somphao PHAYSITH**

## Interpretation

All terminologies used in this Master Plan and Implementation Plan shall be interpreted as follow:

- 1) **Banks** refers to commercial banks and foreign banks' branches licensed under the law of Lao PDR;
- 2) **BOL** refers to Bank of the Lao PDR;
- 3) **BSD** refers to Bank Supervision Department;
- 4) **AFD** refers to Accounting and Finance Department;
- 5) **ITD** refers to Information and Technology Department;
- 6) **Basel Committee** refers to Basel Steering Committee on Bank Supervision Development toward Basel Standards;
- 7) **Basel Core Principles or BCPs** refers to Basel Core Principles for Effective Banking Supervision (2012 edition);
- 8) **Basel Standards** refers to the banking supervision standards issued by Basel Committee on Banking Supervision (BCBS), including Basel I, Basel II and Basel III;
- 9) **Pillar 1** refers to the first pillar of Basel II on capital requirement;
- 10) **Pillar 2** refers to the second pillar of Basel II on supervisory review processes;
- 11) **Pillar 3** refers to the third pillar of Basel II on market disciplines;
- 12) **ASEAN Banking Integration Framework (ABIF)** refers to the framework on banking integration under ASEAN agreements;
- 13) **Credit Information Bureau (CIB)** refers to the Credit Information Bureau of BOL;
- 14) **Managing Information System (MIS)** refers to Managing Information System used for managing information submitted by commercial banks and facilitating to BOL in collecting, monitor, analyze and exam commercial banks;
- 15) **Standardized Approach (SA)** refers to the standardized approaches based on Basel Standards for each risk;
- 16) **Internal Ratings Based Approach (IRB)** refers to the internal ratings-based approaches for credit risk, which use statistical methodologies and models in the computation;
- 17) **Foundation Internal Ratings Based Approach (FIRB)** refers to the basic methods of internal rating-based approach for credit risk;
- 18) **Advanced Internal Ratings Based Approach (AIRB)** refers to the advanced methods of internal rating-based approach for credit risk;
- 19) **Advance Model Approach (AMA)** refers to the advanced approaches using internal models of commercial banks in order to measure operational risk;
- 20) **Internal Model Approach (IMA)** refers to the advanced approaches using internal models of commercial banks in order to measure market risk;
- 21) **Early Warning System (EWS)** refers to a tool used for monitoring any significant change especially for identifying material gaps or risks, in which to alert the supervisors early enough to closely monitor and conduct early interventions in order to address potential risks. This is a tool for identifying issues likely to occur, which may impact the stability of the system in the future;
- 22) **Internal Capital Adequacy Assessment Process (ICAAP)** refers to the internal processes for capital adequacy assessment under Pillar 2;
- 23) **International Financial Reporting Standard (IFRS)** refers to the international standards on financial reporting issued by IFRS Foundation and International Accounting Standards Board (IASB);

- 24) **Internal Liquidity Adequacy Assessment Process (ILAAP)** refers to the internal processes of banks for liquidity adequacy assessment under Pillar 2;
- 25) **Qualified ASEAN Bank (QAB)** refers to qualified banks that may be established under the ABIF framework;
- 26) **Stress Test** refers to the tests that in the event of an adverse or crisis scenario arises, it may impact on a bank to what extent from related risks, in order to measure risks and effects from such scenarios that may happen and thereby to prepare actions to address the risks.

## **I. Overview of Bank Supervision in Lao PDR**

Since the reform from a mono-banking system to the tiered banking system in 1995 in accordance with new economic mechanism policy by transforming the banking system into business banking in line with the socialist directive, it can be seen that the banking system in the Lao PDR has grown continuously in terms of both quantity and quality, especially after the Ordinance on commercial banks is replaced by Law on Commercial Banks No. 03/NA, dated 26 December 2006.

### **1. Achievements:**

On supervisor, which is BOL, has improved supervisory mechanism and system to, step by step, be along with demands on banking supervision and be able to essentially maintain the stability and soundness of the banking system. This includes that the Bank Supervision Department (BSD) has improved its organizational structure to be more compatible in order to be the secretariat for the leaders of BOL in implementing 4 main duties including drafting prudential regulations for commercial banks; considering to issue banks' license; monitoring and analyzing financial statements of commercial banks; and conducting on-site examination against commercial banks. Through the implementation, it indicates that BOL issued laws, sub-legislations as the reference for the bank supervision aiming to minimize risks and strengthen banks. Moreover, there is also some system in place for off-site supervision, ordinary and ad-hoc on-site supervision in order to monitor the banks' operation and promptly address issues arisen in the bank to result in more prudent supervision, as well as making the banking system sound, stable and developed gradually.

On commercial banks, the Lao banking system continuously grows and stable. It is able to mobilize funds from domestic and overseas and provide funds to productions and businesses, contributing significantly to the implementation of the National Socio-Economic Development Plan to meet its expected milestone. In parallel with the banking system's development, for consumers, which are customers of commercial banks are, day in day out, be more and more confident with the banking system, thereby resulting in the rise in access to banking services nationwide. This includes, as at the end of the year 2016, the number of deposit accounts is 2,611,990 accounts and the number of loan accounts is 140,629 accounts, on average, increasing by 16.71% and 5.25% respectively. This is due to the services are more convenient, supporting the money circulation in the system to be more agile, and in turn, stimulating the national socio-economic development and deriving a better people's living standard gradually.

From the aforementioned achievements, as at the end of 2016, there are in total 41 commercial banks and 1 specialized bank. The banks' service network expands day by day and banks extended 96 branches and 494 service units countrywide and keeps on growing. The banking system has total assets of LAK 113,156 million, continued its increasing trend for 5 years, about 22.25% on average or 87.53% of GDP. The total deposits are LAK 60,993 billion, which increase by 22.43% on average or 47.18% of GDP, and the total credit in the banking system is around LAK 59,745 billion, which rises about 25.94% accounting for 46,21% of GDP. Products and services of banks have also become more varieties, especially electronic banking (E-Banking), salary payments via the banking system, debit and credit card services, payment

services and other utility payments, such as electricity, water, telephone, and other payments. In addition, ATM pooling between commercial banks is also in progress, which bring about more convenient to consumers and reduce the costs of banks.

## 2. Outstanding Issues:

In parallel with the achievements mentioned above, there are also issues to be learned and paid attention to as follow:

After conducting operation previously, although BOL might have regulatory and supervisory mechanism by using Compliance Based Approaches and Basel 1 as the basis for banking supervision, with respect to the growth of banking industries in Laos, the region and the globe, it can be seen that the supervisory approaches including the tools are unable to meet the demand for banking supervision in the new era, in particular, prompt managing and corrective measures against incidences and risks in banking business operations. It is necessary for BOL to develop Risk Based Supervision and Basel II, including the implementation of BCPs as the basis for enhancing and strengthening supervisors on bank supervision to be sound, able to integrate with the regional and international markets.

For banks, the legal awareness of banks is still not as rigid, causing some business operations to not stringently comply with legislation, such as some banks do not strictly implement some regulations. Some banks especially domestic private banks only rely on regulations issued by BOL, specifically issues related to prudential regulations. These banks do not take charge in its own development of banking operation in respect to its risks, in order to improve themselves to compete with the regional and international markets. A number of banks are not fully responsible for their development and strengthening on their own to handle the competition and integration to the regional and global markets.

## 3. Lessons Learned

- 1) It is required to comprehend guidance of the Party and policy of the Government, in order to contribute into the bank supervision and banking business operation, which is deemed to be the determinant for the successful implementation;
- 2) It is required to determine a master plan and implementation plan on transforming toward Risk Based Supervision and Basel II implementation in detail, in order to guide for conducting the banking supervision development in line with Basel aiming at strengthening the supervisors and banks;
- 3) It is required to enhance the drafting and amending processes of legislation to be more comprehensive and compatible with each period, by comparing with international principles. This is to apply to the banking supervision in line with the economic conditions, sectoral growth and in compliance with obligations on regional and international integration. Also, it is to have in place appropriate implementation mechanisms and diverse supervisory tools with the purpose of maintaining the banking system's stability;

- 4) It is required to enhance human resource development in respect of both quantity and quality balancing with the development of Risk-Based Supervision and Basel II Implementation as well as to compete for technical assistance from international organizations to be more effective;
- 5) It is required to improve internal coordination mechanism to be more harmonized;
- 6) It is required to promote the promulgation of financial literacy to the public extensively;
- 7) It is required to have in place budget planning for the development of the human resource, IT system, and other tools in banking supervision.

## **II. Strategic Plan for Financial Sector Development of the Lao PDR for 10 Years (2016-2025) and Its Vision until 2030 of BOL in respect of Bank Supervision**

In reference with the Strategic Plan for Financial Sector Development of the Lao PDR for 10 Years (2016-2025) and Its Vision until 2030 that is approved by the Prime Minister of the Lao PDR in the Decree No. 316/GOV, dated 19 August 2016 and by the Governor of BOL in the Decision No. 833/BOL, dated 28 September 2016, it is reflected lessons learned from the aforementioned outstanding issues, vision and milestones on banking supervision as follow:

### **1. Visions on Development**

The visions for bank supervision development are as follow:

1. To create a safe, sound, sustainable, modernized banking industry and be able to integrate with international markets;
2. To create conditions preferable for banks to have more diverse ownership and business activities in which appropriate with economic infrastructure development determined by the Government; to provide various products and services via advanced tools to customers throughout the country; to be able to mobilize deposits efficiently in order to responsibly finance the socio-economic development; to operate its businesses effectively, soundly and integratably with the region and international markets.

The achievement of the said vision, especially the improvement toward the integration with the region and international markets will create significant opportunity as follow:

- (1) Banks incorporated in the Lao PDR will be able to access wider financial markets with better capabilities to expand their service networks throughout the ASEAN region;
- (2) The inflow of funds into the country will increase, making firms be able to better access financing, increasing accessibility to finance, and in turn enhance their productivity and services resulting in the growth in demand for employment;

- (3) Nondiscrimination treatments will increase more competition, which will thereby bring about the improvement of service quality, deter the public sector from monopoly perception;
- (4) The competition may result in improving quality and modernization, and eventually benefiting the consumers.

From the opportunities mentioned above, it will support the socio-economic development in general, which will double the demand for financial and banking services as well as the demand for funds for development. However, the competition for such opportunities will also bring about several challenges, such as:

- (1) The banking industry in the country is mainly occupied with small and traditional banks. The readiness preparation of BOL and banks for the regional and international integration, especially the ASEAN Integration Framework and World Trade Organization (WTO), including the strategy on bank supervision development toward Basel II, are all extremely demanding and required to have good strategic planning.
- (2) The improvement and development of the supervisory system to adopt Basel II require a lot of funds to invest in IT system and human resource development, in which insufficient investment may cause the impediment to implementing, specifically to banks.

## 2. Milestones

In accordance with the Strategic Plan of BOL, the milestones for bank supervision development for 2020 and 2025 are as follow:

### **a. Milestones for 2020:**

- (1) To amend Law on Commercial Banks;
- (2) To consider, draft and amend prudential regulations for banks;
- (3) To continue to encourage the registered capital injection of banks;
- (4) To restructure banks to be safe and sound, starting with the state-owned banks;
- (5) To introduce Financial Soundness Indicators (FSIs), Stress Test Model and Early Warning System;
- (6) To study the feasibility and alternative strategies for conducting the Financial Sector Assessment Program (FSAP);
- (7) To be able to apply BCPs in banking supervision with Basel II as the foundation;
- (8) To prepare strategies supporting ASEAN Banking Integration in order to be able to negotiate for establishing a Qualified ASEAN Bank in the Lao PDR (QAB);
- (9) To prepare readiness for complying the obligations to open the service sector under the WTO framework.

### **b. Milestones for 2025:**

1. To consider rating categories of banks according to international standards;
2. To improve the bank supervision toward Basel 3;
3. To promote establishing QAB of the Lao PDR in an ASEAN country at least 1 bank.

### **III. Rationales for Issuing the Master and Implementation Plans and Previous Missions**

With regards to the Strategic Plan of BOL mentioned above as well as the external factors in the international integration especially in the integration under ABIF, there are crucial factors stated in both materials on the necessity to implement BCPs and bank supervision in compliance with Basel. Hence, in order to materialize the Strategic Plan of BOL and the ASEAN financial Integration framework, it is imperative to create a master plan for bank supervision development toward Basel standards as guidance for implementation of such development in detail.

In conformable with the Strategic Plan of BOL in general, in specific, it is a strengthening plan for banking supervision by enhancing the bank supervision toward Basel II adoption. This includes studying relevant principles (Basic Knowledge on Basel II attached) and exchange lessons from foreign countries related to the tasks from time to time.

From the previous operation, the Basel Steering Committee has been adjusted 3 times in 2014, 2015 and the latest in 2016, according to the Decision on Assigning Bank Supervision Development toward Basel Standards No. 1095/BOL, dated 12 December 2016, which have conducted the primary tasks as follow:

#### **1. Studying Basel Principles:**

The committee has accomplished the in-depth study in BCPs and each Pillar of Basel II based on relevant documents of the principles of the committee that introduced Basel principles, which is Basel Committee for Banking Supervision (BCBS) and other documents from seminars related to Basel II. The purpose of the study is to comprehend the principles of each BCPs' criteria and Pillars, implementation procedures, lessons from other countries and technical viewpoints on the direction for implementation in the Lao PDR. The committee has presented the information from the studies to the BOL's leader meetings and to banks from time to time.

#### **2. Collaboration with Lao Bankers' Association:**

Basel Steering Committee consisted of the Chair of Lao Bankers' Association (LBA) as a member, for the purpose of being a connecting point to collaborate with banks as well as being a promoter to banks in the development of Basel Standard implementation. LBA has paid attention to working with banks in order to encourage banks about the need to prepare and invest in their system development or to hire experts on technical assistance to get ready for implementing Basel II. LBA has organized meetings to discuss the preparation for Basel II implementation including directions for hiring experts and selecting pilot banks. Basel Steering Committee has also been invited to the meeting and informed the meeting on the Strategic Plan of BOL on the banking system development, which aims for the capability to implement Basel II within 2020. For banks in general, it is necessary to study about Basel II in detail. Therefore, a technical working group was established between technical teams from each Pillar of Basel Steering Committee and Basel teams from each bank for the purpose of creating an understanding of Basel II and directions for adopting Basel II for a particular level. Furthermore, the Chair of LBA also conducts initiatives to bring the bank under his responsibilities to be a pilot for the gap assessment and volunteers to be one of the pilot banks for implementing Basel II for the group of state-owned banks in the future.

### 3. Competition for Assistance from International Organizations:

Previously, Basel Steering Committee as well as Bank Supervision Department has strived to obtain technical assistance from international organizations consistently and comprehensively, such as the seminar on lesson of Vietnam on Basel II preparation by E&Y, Basel II lessons of the financial and banking institutions from National Bank of Cambodia, lessons on assessment of banks' readiness of Bank of Thailand specifically on Basel II implementation planning, self-assessment of banks on Basel II implementation and readiness preparation including regulation issuance plan for Basel II implementation, exchanging lessons on Basel from Kasikorn Bank and Standard Chartered Bank specified on Basel Standards and implementation methods of Basel principles. Moreover, there is also assistance from the World Bank (WB) on the development of Financial Soundness Indicators (FSI), regulation amendment toward BCPs compliance including the amendment of Law on Commercial Banks. International Monetary Fund (IMF) also provides seminars on banking supervision and Risk-Based Supervision, and technical assistance on Risk-Based Supervision Manual, which has cooperated on the work from time to time between IMF and the delegated team from BSD. Furthermore, BOL has consistently delegated its employees to join seminars overseas such as seminars from the SEACEN Centre and Bank Nagara Malaysia under BOL's budget, SEACEN and Asian Development Bank (ADB).

### 4. Assessment of Bank Supervision in the Lao PDR in Comparison with International Standards

For the purpose of materializing the Strategic Plan of BOL mentioned above, BOL has employed E&Y to assess the bank supervision in the Lao PDR in 2016 compared with international standards, especially the Basel Standards on both perspectives – for Supervisors (compliance with BCPs) and for banks (compliance with Basel II), which can compare as follow:

#### 4.1 In Comparison with BCPs

The outcome from the assessment of BCPs compliance – 29 principles, reveals that there is one principle that is fully compliant (licensing criteria); 6 principles are largely compliant (roles, responsibilities, power, and functions of supervisors); 19 principles are materially non-compliant (governance mechanism and risk management); 2 principles are Non-compliant (supervisory tools and techniques, and related party transactions); and a principle is not applicable (oversea investment of banks).

In addition, the assessment also indicates that there are weaknesses in the banking supervision of BOL categorized into 5 groups as follow:

- 1) **Preconditions:** the Lao PDR has yet not had in place the ready infrastructure both on financial and legislation perspectives such as legislation on bank supervision is still insufficiently comprehensive – provision of regulations are not clear and prudent enough; authorities that have important role in supporting the supervisors are either not yet modernized or lacking, such as credit information companies, credit rating companies, credit guarantee companies, and asset appraisal firms
- 2) **Supervisory approach, technique, and tools:** the supervisors lack a detailed manual and in compliance with the international best practice on approach and technique on bank supervision and examination as well as lacking tools to monitor risks of banks in a timely manner. For instance, there is no early warning system and stress testing. Additionally,

the systems used are not yet modernized especially IT system to support the application of approach, technique, and tools for bank supervision.

- 3) **Corporate Governance (CG):** supervisors have not determined the corporate governance framework for banks. It should clearly determine the relationship between each body of banks, such as shareholders, board of directors, managing directors, for the purpose of ensuring the stability and continuity of each bank, which is a fundamental factor to the stability of banking system in general.
- 4) **Risk management:** supervisors have yet not issued a risk management framework for banks in order to reduce risks that each bank faces in its business operation, including credit risk, operational risk, and market risk.
- 5) **Human resources and capacity:** the existing human resources are not sufficient and lack skill sets in conducting bank supervision, lack assessment and plans for capacity development comprehensively and effectively.

#### 4.2 In comparison with Basel II

- Pillar 1: Capital Requirements

Pillar 1 is a principle for managing capital adequacy to support business operation of banks. In general, it is deemed that BOL has implemented and complied largely with such principle from Basel 1, which the current risk management is only for credit risk. In order to move toward to Basel II, hence, BOL shall include operational and market risks, by concentrating on improving legal framework, capacity building and IT system of BOL as well as banks, to support the implementation of such principles into its supervision. In doing this, BOL shall have in place its Master Plan and Implementation Plan for the supervision on capital requirements to be suitable to the economic condition and the growth of banks and banking sector.

- Pillar 2: Supervisory Review Process:

Pillar 2 is the reviewing processes of the supervisor which is BOL in assessing banks' capital adequacy to cushion existing risks and assessing its risk management other than what has mentioned in Pillar 1, including strategic risk, liquidity risk, credit concentration risk, interest rate risk in the banking book, and corporate governance. BOL itself shall improve its approaches and tools for risk-based supervision, for the purpose of examination and assessment of risk management and capital adequacy of banks to ascertain that banks have sufficient capital in the normal time and in crisis, which should be higher than determined in Pillar 1. For banks, it shall have in place rules, policy and methods to assess its internal capital adequacy assessment process (ICAAP) and assess other inherent risks in its businesses. Also, the assessment of capital and risk profile shall be inspected and approved by the Board of Directors and senior management of the banks.

- Pillar 3: Market Discipline:

Pillar 3 is the application of market mechanism in banking supervision or market discipline, which is the principle to require banks to disclose its information on capital adequacy, risk level, and risk management system that shall ensure its transparency of information. Currently, the legislative framework of BOL requires banks to publish its financial statement that has been audited by a qualified external auditor. The publishing of the

financial statement only focuses on disclosure of quantitative information and applies the same criteria of disclosed information to all banks (according to the Notice on External Audit and Publish of Financial Statement No. 338/BOL, dated 13 Sept 2012). However, such regulation and reporting templates issued by BOL still have no requirements on disclosure of banks' strategy and implementation plan on risk management, risk profile, exposures to related parties, related party transactions, banking group structures and no requirements for banks to submit its ad hoc reports to BOL in the event that the banks found critical issues. Additionally, there are no specific requirements to disclose the risk profile and systematic importance of banks.

BOL disclose its economic reports and statistic reports on its website on a quarterly and annually basis, which the publication will help the public to understand the banking system. In present, the report only provides general information, such as the economic growth of the Lao PDR and a brief report on the monetary sector (including monetary policy, financial statement, money supply, exchange rate, interest rate, banking supervision, deposits, credit, and stock exchange information). However, BOL does not disclose information of financial soundness indicators and banks' financial statement in its annual economic report that can reflect core factors of the business operation of banks (including balance sheets, capital adequacy ratio, profitability, and risk conditions).

#### **IV. Master Plan**

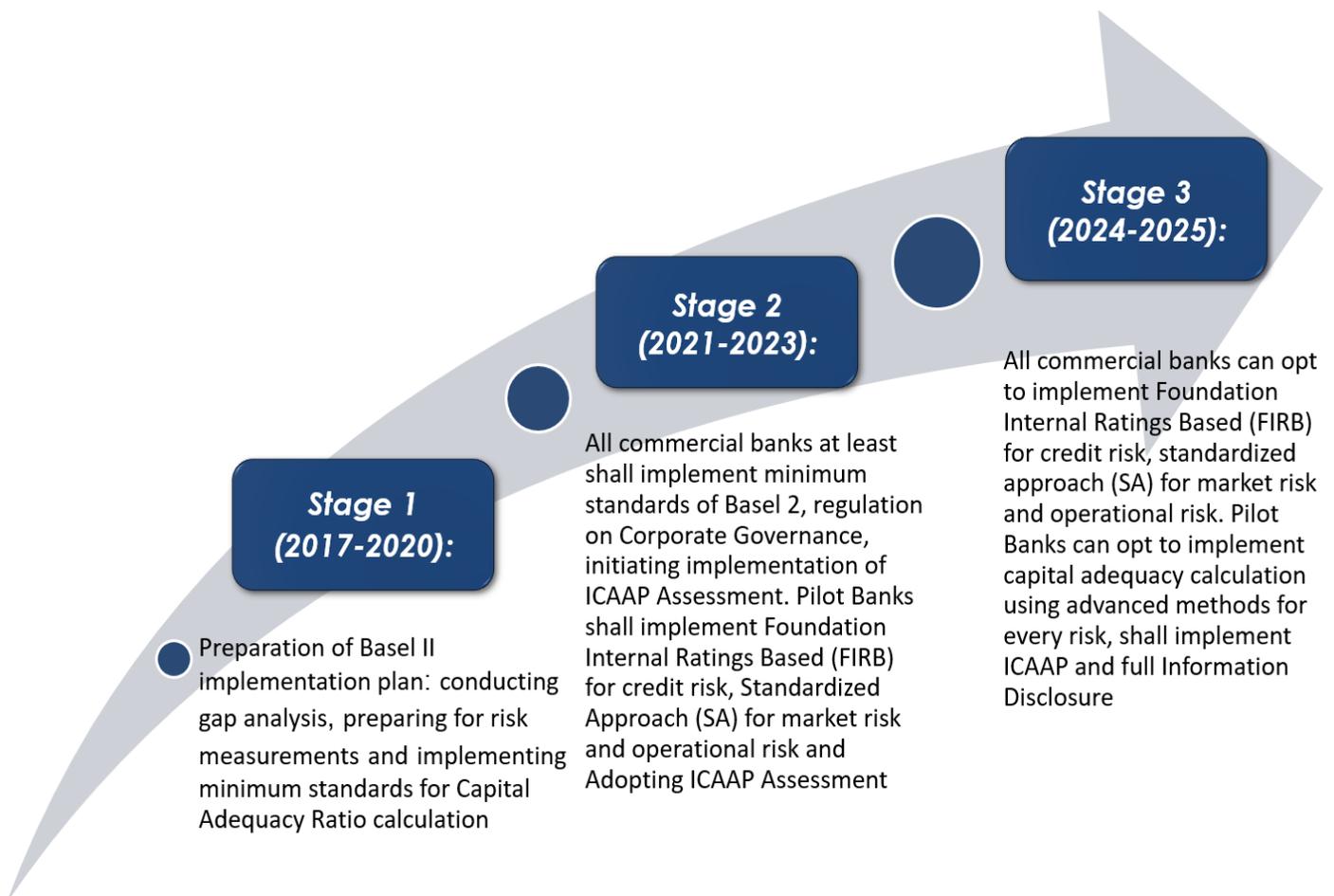
As the studies of the Basel Committee as well as the lesson learned from other countries and the assessment results, BOL determines its Master Plan into 5 groups as follow:

- 1) Improvement of current Legal Framework: creating the necessary legal framework to support the implementation of Basel Standards, which determines the scope of application, criteria and regulatory implementation plan;
- 2) Improvement of supervisory approach, technique and tools: creating and improve banking supervision manual which is the off-site and on-site examination manual to move toward risk-based supervision, aiming at forward-looking analysis and examination and be able to detect issues and employ early intervention;
- 3) Improvement of IT system of supervisor and banks: improvement of MIS and IT system in general in order to reinforce off-site and on-site examination, aiming at abilities to analyze and examine banks' information in a timely manner;
- 4) Improvement of structure, processes, and policy of banks' risk management: improvement of corporate governance, processes and policy of banks on risk management for the purpose of the segregation of duties on risk management within the banks accurately and have in place the prudent risk governance policy;
- 5) Improvement of Capacity Building: creating curricula for training, plans to enhance capacity and human resource development of the relevant departments as well as BOL, in order to improve their knowledge and ability on banking supervision based on Basel Standards and other internationally recognized standards.

From the abovementioned 5 task groups, it can be separated into 50 detailed tasks and within 3 phases for the 3 pillars, including Phase 1 from 2017-2020, Phase 2 from 2021-2023 and Phase 3 from 2024-2025, which can be summarized a follow:

- Phase 1 (2017-2020): this stage is the preparation to move toward Basel II implementation, specifically conducting gap analysis of banks, determination of supervision methods of BOL and legal framework on risk management, including issuing regulations on implementation of minimum standards of Basel II for banks, determination of pilot banks that have been selected by BOL to trial the implementation of minimum standards on capital requirements.
- Phase 2 (2021-2023): in this phase, all banks shall at least implement minimum standards of Basel II, regulation on corporate governance shall be issued, ICAAP assessment and disclosure based on Pillar 1 and 2 shall be initiated. In addition, BOL shall employ risk-based supervision manual and conduct workshops with banks consistently. Pilot banks may implement foundation internal rating-based approach for capital measurement for credit risk, standardized approach for market risk and operational risk, and implement corporate governance requirements to be ready for implementing ICAAP.
- Phase 3 (2024-2025): at this stage, BOL shall issue regulation for banks to be able to implement capital measurement based on more advanced approaches, as well as improve legal framework and reassessment of BCPs compliance. Pilot banks may implement capital measurement based on the advanced internal ratings-based approach for all risks, shall conduct ICAAP and disclose all required information.

❖ Graph 1: Phases of Bank Supervision Development



The following are tasks of each pillar in brief:

**1). Pillar 1**: consists of a total of 31 tasks. These include specific tasks for Pillar 1 5 tasks, joined tasks with Pillar 2 at 7 tasks, joined tasks with Pillar 3 at 1 task, and joined tasks with all Pillar at 18 tasks. These tasks are comprised of 14 tasks for BSD, 3 tasks for Basel Committee, 7 tasks for AFD, 6 tasks for ITD, 1 task for the committee for law on commercial bank amendment and 3 tasks for FSI committee, as well as 2 tasks related to banks. These tasks are related to task group 1) improvement of current legal framework, task group 2) improvement of supervisory approach, technique, and tools, task group 3) improvement of accounting and IT system, task group 4) improvement of risk management framework as well as communication between BOL and banks, and task group 5) improvement of capacity building, as follow:

Task group (1): improvement of regulations is a foundation for other tasks, which BOL has to enhance framework, processes, and policy on supervision of credit, operational and market risks, by creating and issuing detailed guidelines on capital adequacy assessment for each risk with an appropriate approach for each period. For the improvement of legislation under the assessment, BOL may determine the objectives by reviewing capital adequacy ratio, capital definition and approaches for risk assessments in conformation with Basel II, in particular, the risk weights for each risk.

Task group (2): Improvement of supervisory approach, technique and tools is the crucial task due to the fact that BOL has to move from rule-based supervision to risk-based supervision, in which accounting and MIS system of BOL also the supervisors shall be able to support supervisory processes specifically analysis and inspection of banks mainly based on risks.

Task group (3): Accounting and MIS are yet developed. Prior to the development, there shall be an assessment of the existing accounting and MIS system of BOL and banks' information by considering the core banking system of banks, designing and improving MIS system of BOL. It should be able to handle reporting, public disclosure, data gathering and analysis of BOL. This has to be created as a detailed action plan for banks, for the purpose of the gap analysis for building their own master plan and following up the implementation. In doing so, BOL shall issue guidance to banks to design, implement risk management framework and risk-based financial plan, which the time frame is in phase 1 (2017-2019), expected to complete the assessment in 2018, designs and MIS development for supporting capital calculation by 2019 and in phase 2 (2021-2023) is to design and develop MIS for advanced approach for capital calculation.

Task group (4): Risk management framework shall be actively enhanced. BOL shall have necessary regulations in place for dealing with the risk management framework development. In doing so, a series of communication between BOL and banks is essential to complete the implementation, which discussion between BOL and banks shall be conducted on an on-going basis. This is to assess the readiness in parallel with strengthening capacity building for banks on applying calculation methods and procedures as well as conducting compliance assessment of new regulations with Basel II.

Task group (5): human resource is the pivotal factor to the success of the whole project. In order to contribute to the achievement, it is necessary to have a knowledgeable and capable workforce at a certain level. BOL has to create curricula and training programs

related to the management of each risk, in particular, credit risk management (FIRB, AIRB), market risk management (SA, IMA) and operational risk management (SA, AMA). These tasks are on-going tasks, conducting from 2017-2023.

**2). Pillar 2:** is comprised of 39 main tasks. These include specific tasks for Pillar 2, 12 tasks, joined tasks with Pillar 1 at 7 tasks, joined tasks with Pillar 3 at 2 tasks, and joined tasks with all Pillar at 18 tasks. These tasks consist of 23 tasks for BSD, 3 tasks for Basel Committee, 5 tasks for AFD, 5 tasks for ITD, and 2 tasks required BSD to cooperate with other relevant departments and Government authorities, and 3 tasks related to banks. These tasks are associated with task group 1) improvement of the current legal framework, task group 2) improvement of supervisory approach, technique and tools, and task group 5) improvement of capacity building, as follow:

Task group (1): for improvement of legal framework, BOL has currently appointed committees for amending and drafting regulations to support tasks related to Pillar 2, including (1) risk manual on monitoring and assessment for off-site and on-site supervision; (2) regulation on safeguards of supervisors of BOL and banks' examination, as a reference for the supervision of BOL; (3) regulation on corporate governance as a guidance for banks' internal governance; (4) regulation on cash reserve ratio, which related to liquidity of banks; (5) internal capital adequacy assessment of banks including stress testing, early warning system (regarding to the Decision on Appointment of Committee for Planning on Issuance and Amendment of Regulations for Bank Supervision from 2016-2020, No. 276/BSD, dated 14 Mar 2017 and based on Plan Issuance and Amendment of Regulations for Bank Supervision No. 153/BSD, dated 02 Sep 2016); and (6) other relevant regulations. The amendment and issuance of regulations are the fundamental tool for BOL to supervise banks based on risks;

Coordination and cooperation with other parties on improvement of regulations and tools for supervision: tasks of Pillar 2 will not be able to complete if there is no cooperation from other relevant parties, in particular, credit information (CIB, managing, and financial analyzing system), accounting especially IFRS, monetary policy (macroeconomic, interest rate and exchange rate policy) and other tasks;

Task group (2): For improvement of supervisory approach, technique and tools, Pillar 2 also has to prepare a plan for informing banks on the risk language for the purpose of moving toward risk-based supervision and a plan for ICAAP assessment for banks that never employ Basel standards, which is another task for Pillar 2 to conduct in the first phase.

Task group (5): capacity building related to Pillar 2 is to focus on creating a new mindset on risks, risk awareness, risk governance, and supervision manual.

**3). Pillar 3:** consists of 24 tasks. These include specific tasks for Pillar 3 at 6 tasks, joined task with Pillar 1 at 1 task, joined tasks with Pillar 2 at 2 tasks, and joined tasks with all Pillar at 18 tasks. These tasks consist of 14 tasks for BSD, 3 tasks for Basel Committee, 4 tasks for AFD, 3 tasks for ITD, 1 task for LSCO, 1 task for MPD and 2 tasks for banks. These tasks are associated with task group 1) improvement of the current legal framework, task group 2) improvement of supervisory approach, technique and tools, and task group 5) improvement of capacity building, as follow:

Task group (1): main tasks for Pillar 3 is to develop a regulation on reporting and information disclosure of banks based on Pillar 1 and Pillar 2, both qualitative and quantitative information, such as requirements on banks to provide additional transaction information of banks' operation including strategies and risk management, exposures to related parties, major acquisition and others. Sufficiently disclosed information is an important additional contribution and effective to banking supervision as a reinforcement for banks to have in place programs and methods to conduct a sound risk management, which BOL shall require banks to disclose in a timely manner, accurate and sufficient for each period, in order to provide basic information to utilize market discipline for effective banking supervision.

Task group (2): The Pillar has to cooperate and discuss with other relevant departments for the purpose of determining templates, forms of reporting in compliance with IFRS and Basel II, including reporting system development.

Task group (5): Another task for Pillar 3 is to conduct training and seminars to supervisors and banks to have a level understanding and consistency in respect of the information reporting and disclosure based on Basel II.

Detailed tasks, duration, and responsible parties are addressed in the attached tables.

## **V. Basel Implementation Plan**

With regards to the above 5 group tasks, BOL decides the implementation plan in details, divided by each Pillar, which can be summarized as follow:

- Improvement of the current legal framework overall is to introduce a regulatory basis for the purpose of reinforcing bank supervision development based on Basel standards. This includes the law on commercial banks that increases compliance with BCPs, improvement of the decision on capital adequacy requirements to be in line with Basel II, issuance of regulation on risk management, ICAAP and information disclosure according to Basel II.

- Improvement of supervisory approach, technique and tools is the task to enhance methods and technique on banking supervision from compliance-based supervision and examination based on quantitative information toward risk-based supervision and add examination based on qualitative information, as well as drafting manual on financial analysis and examination of banks as the primary tool for bank supervision.

- Improvement of IT system of supervisors and banks aims at the improvement of the management of information system, data centralization, and development of IT system capabilities, in order to support desired tasks on bank financial analysis and examination replacing manual analysis and examination, and to be able to enhance the efficiency of off-site and on-site examination.

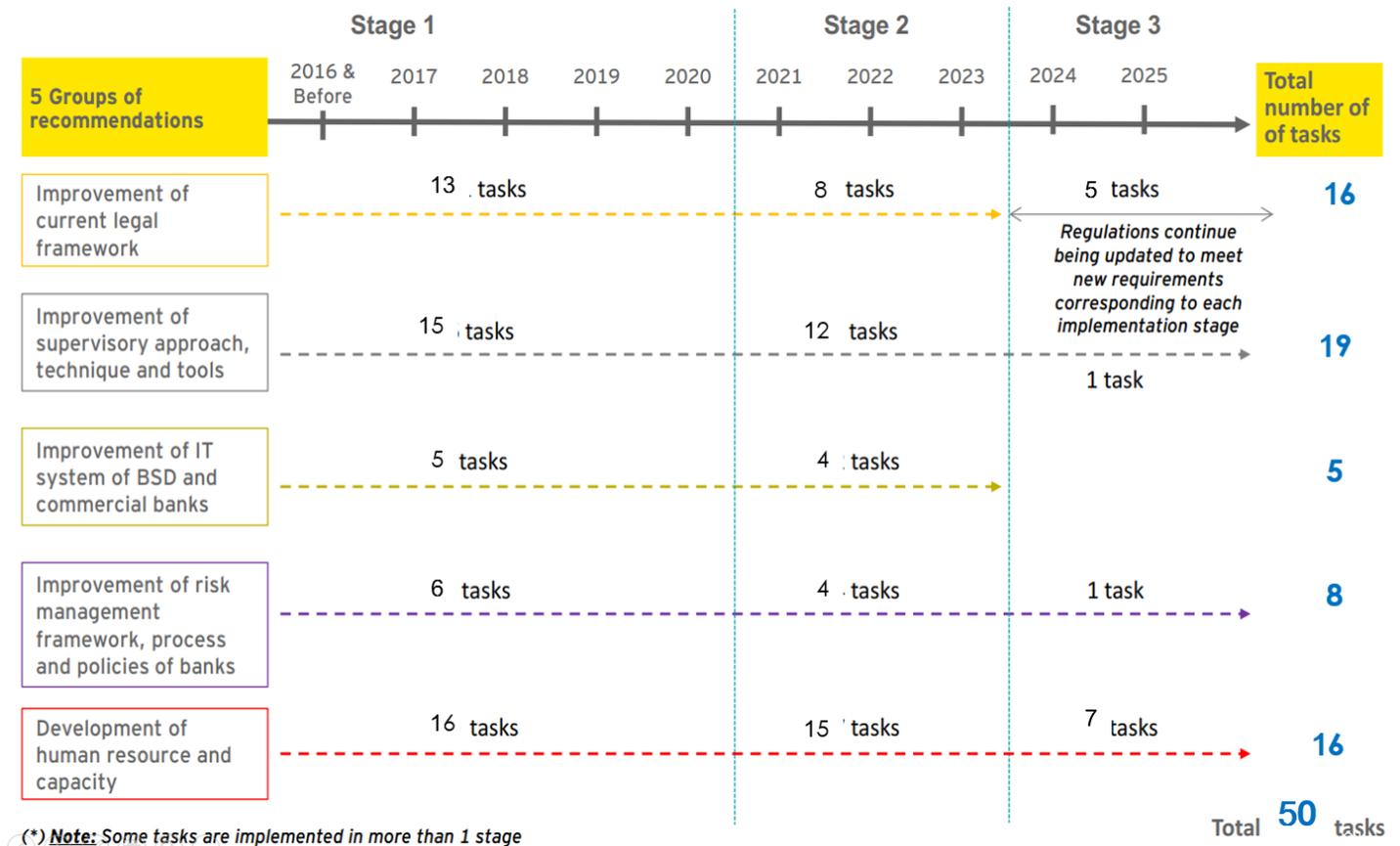
- Improvement of structure, processes, and policies on risk management of banks aims at issuing regulation determining risk management tasks, which direct banks to create risk management environment, risk management strategies, risk appetite, as well as processes and policies on risk management of banks. In addition, it is required for the improvement of banks' corporate governance of each bank to be closed to international practices, for the purpose of increasing management quality and applying to develop a foundation for Basel II adoption.

- Capacity building and human resource overall is to create curricula and organize a series of training to BOL officials, divided into 3 levels, including beginning level for new

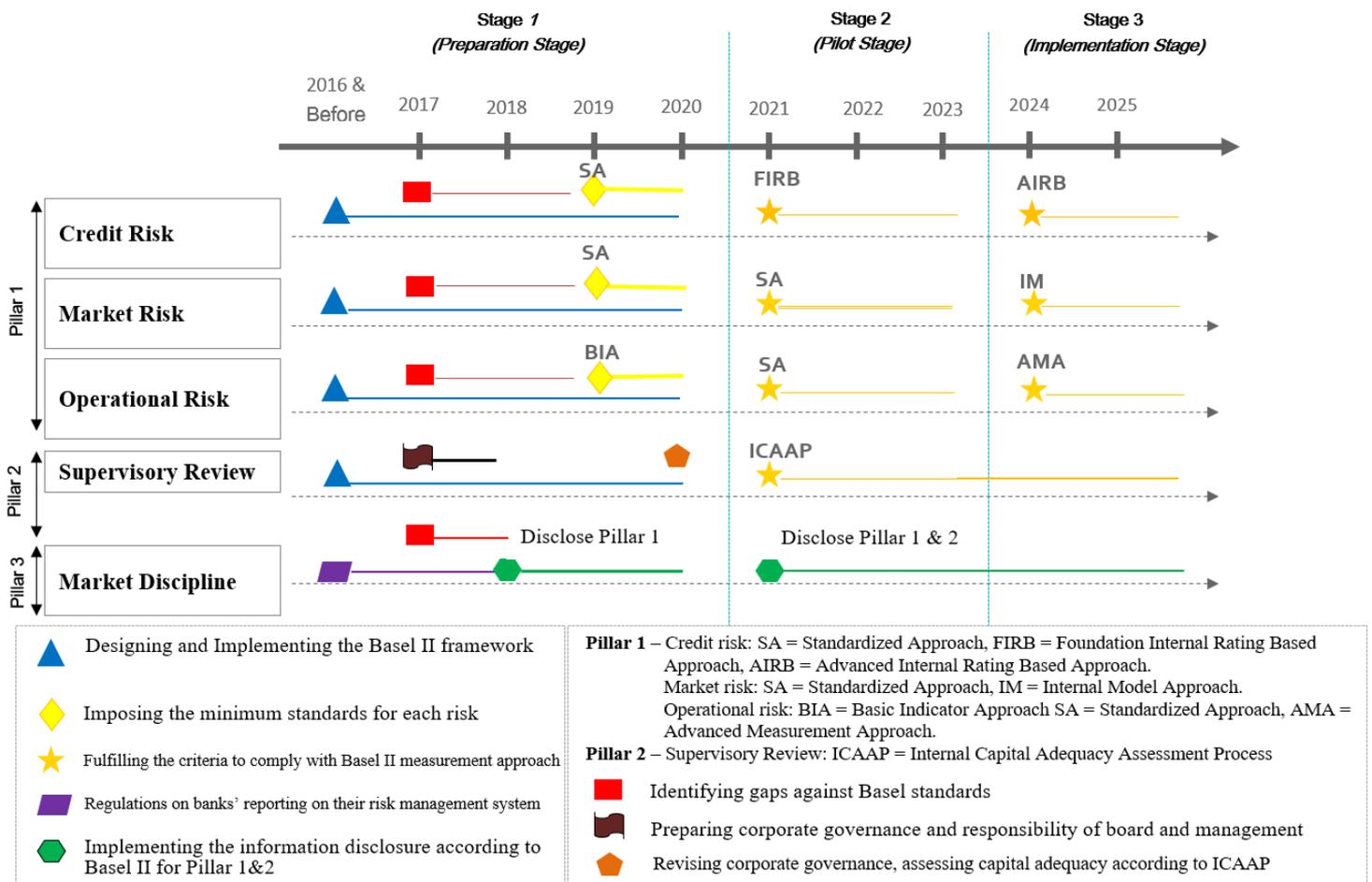
employees, intermediate level for senior, highly experienced officials and management level of BOL. Moreover, BSD has a plan on capacity building to its employees which may be organized regarding with supports from other organizations. These supporters of BSD consist of ADB, SEACEN, IMF, WB and other organizations. Training plan of BSD is comprised of workshops/training, appointments for employees to upgrade to master and Ph.D. degree, both in Laos and overseas.

For the overall plan and detailed plan for each task are attached.

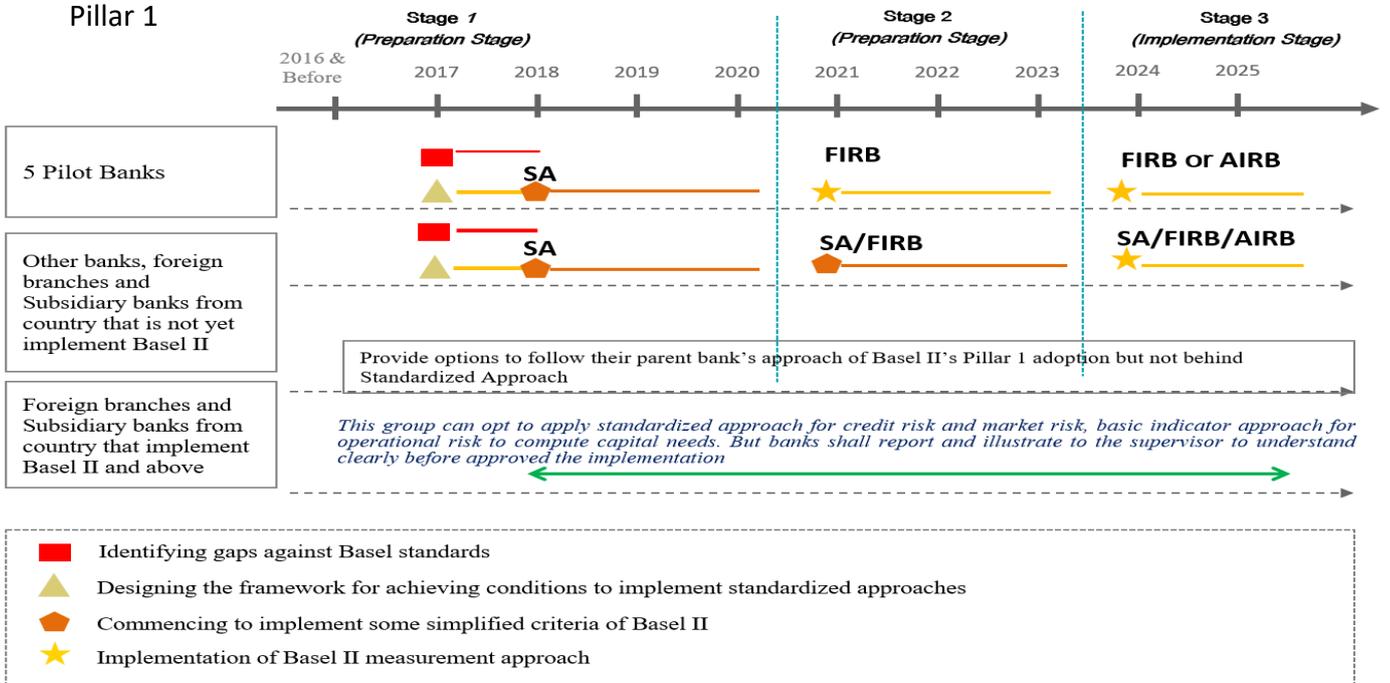
❖ **Table 1: Detailed Tasks and 5 Group Tasks**



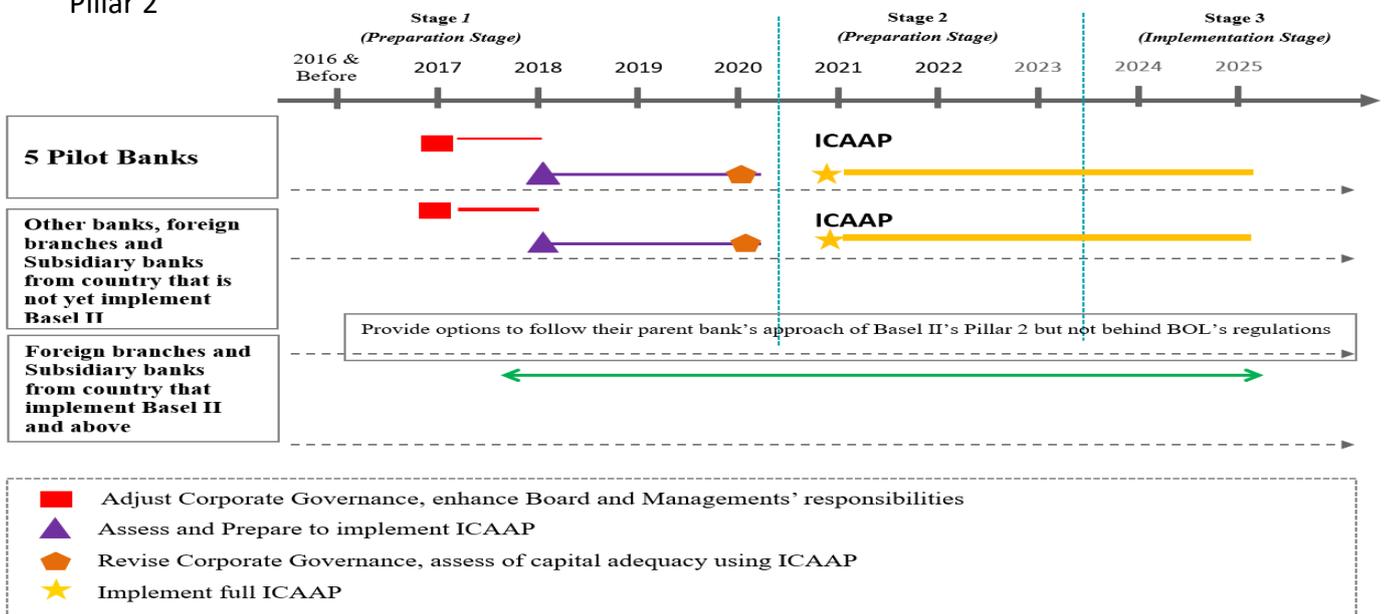
❖ **Graph 2: Implementation Plan by Each Phase**



## Pillar 1



## Pillar 2



## Pillar 3

