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This Financial System Stability Assessment paper on **Tunisia** was prepared by a staff team of the International Monetary Fund and the World Bank as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **May 17, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of **Tunisia** or the Executive Board of the IMF.

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TUNISIA

Financial System Stability Assessment

Prepared by the Monetary and Exchange Affairs and Middle Eastern Departments

Approved by Stefan Ingves and Paul Chabrier

May 17, 2002

The Financial System Stability Assessment (FSSA) is based on the work of a joint IMF-World Bank mission that visited Tunisia as part of the Financial Sector Assessment Program (FSAP) in February and May 2001, and on information collected in the context of the 2002 Article IV Consultation. The mission's findings were discussed with the authorities in May 2001. The FSAP team was composed of Dimitri Vittas (World Bank, Team Leader), Bernard Laurens (IMF, Deputy Team Leader), Christine Sampic, Abdourahmane Sarr, Edouard Martin, and Joseph Crowley (all IMF), Cally Jordan, Stephanie Gober, Giovanni Majnoni, Lorenzo Savorelli, Maude Jean-Baptiste, and Liliane Vert (all World Bank), Léon Chaize (Consultant, retired from the *Commission Bancaire*, France), Michel Svetchine (Consultant, *Commission Bancaire*, France), Marie-Noelle Bérubé (Consultant, *Commission des Valeurs Mobilières du Québec*, Canada), and Serge Vachon (Consultant, retired from Central Bank of Canada). Sadok Rouai, Advisor to the IMF Executive Director for Tunisia, attended some of the meetings.

Over the past decade the financial system has been extensively modernized. This has involved several factors: (i) an overhaul of the legal and accounting framework, which today embraces modern concepts; (ii) a strengthening of financial supervision bringing Tunisia's practices closer to best practices; and (iii) a shift to more market-oriented policies. Significant progress has also been achieved toward placing the banking system (which dominates the financial sector) on a sound footing. The analysis shows that, despite the large exposure to credit risk, the banking system appears unlikely to suffer from a generalized crisis, since there is limited exposure to foreign currency risk, most of the weaker banks are under state control, and capital mobility is low. However, weak credit culture and provisioning policies, and high levels of nonperforming loans have placed domestic banks at a disadvantage, as Tunisia is moving toward greater integration with international markets. Furthermore, the high credit exposures to sectors that are subject to cyclical shocks, particularly the tourism sector, are sources of significant vulnerability. It is not yet evident how the events of September 11 will affect banks' tourism portfolios. However, a significant decline in tourism would affect to a greater extent some of the state-owned banks, which are already the weakest banks. In this context, the relatively high profitability of the sector offers a window of opportunity to increase provisioning levels. Securities markets and the insurance sector are small and do not constitute a source of systemic risk. Developing further the government securities market would help reduce the cost of government financing over time and limit the government's exposure in the event of changing international capital market conditions.

The implementation of monetary policy has been significantly strengthened in that credit policy considerations play now a lesser role and the Central Bank of Tunisia has greatly curtailed its readiness to accommodate banks' liquidity needs. Adopting a fully transparent monetary framework, which validates price stability as the primary objective, together with a firmer commitment to market funding of the budget, would help build stronger systemic liquidity arrangements.

This report is divided into two sections. The first section presents the main findings and overall assessment. The second section presents a summary assessment of observance of standards and codes regarding banking supervision, payment and settlement systems, securities markets, and insurance regulation, and transparency in monetary and financial policies. The FSAP report containing detailed institution information and analysis, as well as detailed assessments of the observance of standards and codes, was transmitted to the authorities in December 2001.

The main authors of this report are Bernard Laurens, Abdourahmane Sarr, and Joseph Crowley (all MAE).

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GLOSSARY OF TERMS

AIB	Association of Market Intermediaries
AMC	Asset management company [*Société de recouvrement*]
BCT	Central Bank of Tunisia [*Banque Centrale de Tunisie*]
BDET	*Banque de Développement Économique de Tunisie*
BH	*Banque de l'Habitat*
BNA	*Banque Nationale Agricole*
BNDT	*Banque Nationale de Développement Touristique*
BTS	*Banque Tunisienne de Solidarité*
BVMT	Tunis Stock Exchange [*Bourse des Valeurs Mobilières de Tunis*]
CAN	National Insurance Council
CAR	Capital adequacy ratio
CCA	Consultative Commission on Insurance
CCP	Postal Savings [*Centres de Chèques Postaux*]
CENT	Tunisian National Savings Institution [*Caisse d'Épargne Nationale Tunisienne*]
CMF	Financial Market Board [*Conseil du Marché Financier*]
CNEL	*Caisse Nationale d'Épargne Logement*
CPSS	Committee on Payment and Settlement Systems
DGA	General Directorate of Insurance [*Direction Générale de Assurances*]
EU	European Union
FTUSA	Tunisian Federation of Insurance Companies
IAIS	International Association of Insurance Supervisors
IOSCO	International Organization of Securities Commissions
MoF	Ministry of Finance
NBFI	Nonbank financial institutions
NPLs	Nonperforming loans
OPCVM	Collective Investment Institutions [*Organisme de Placement Collectif en Valeurs Mobilières*]
REV	Express Transfer Settlement [*Règlement Express des Virements*]
ROA	Return on assets
SITBEL	Interbank Teleclearing Corporation [*Société Interbancaire de Télécompensation*]
SICAF	*Société d'Investissement à Capital Fixe*
SICAR	*Société d'Investissement à Capital Risque*
SICAV	*Société d'Investissement à Capital Variable*
STB	*Société Tunisienne de Banque*
STICODEVAM	*Société Tunisienne Interprofessionnelle pour la Compensation et le Dépôt des Valeurs Mobilières*
TAO	*Taux des appels d'offres*
TMM	Money Market Rate

SECTION I. STAFF REPORT ON FINANCIAL SECTOR ISSUES

I. Overall Stability Assessment

1. **Tunisia's financial system is dominated by the banking sector, in which state ownership continues to be extensive.** The state has majority positions in three of the largest commercial banks, a newly created bank specializing in microfinance, the largest insurance company, and two specialized insurance companies. It also operates the social security institutions that dominate the provision of retirement benefits, and has 50 percent participations in the development banks. The other components of the financial system have grown significantly, but remain small compared with the banking sector, and do not constitute a source of systemic risk.

2. **On the whole, while significant and commendable progress has been made during the last decade to strengthen the financial sector, remaining vulnerabilities will need to be addressed before the capital account can be fully liberalized as envisaged by the authorities.** The authorities need to develop a medium-term strategy for the structure of the financial system, including efforts to (i) reduce the extent of state-ownership; (ii) undertake a thorough review of provisioning policies; (iii) encourage banks to take advantage of the current high level of profitability to strengthen provisioning policies; and (iv) allow banks to grow accustomed to the risks of international financial markets.

3. **The weaker banks are under state control, and their recapitalization needs could represent a significant cost for the budget.** The state-owned banks face the greater exposure to credit risk and to sectors that are subject to cyclical shocks.

4. **The Central Bank of Tunisia (BCT) has developed a full set of indirect monetary instruments. However, markets, including that for government securities, are shallow and credit policy considerations (i.e., encouragement for lending to certain sectors) affect the conduct of monetary policy, though to a much lesser extent than in the past.** Adoption of a fully transparent monetary framework, which validates price stability as the primary objective, together with a firmer commitment to market funding of the budget, would help build stronger systemic liquidity arrangements.

5. **A wide range of alternative sources of funding is available, but bank credit continues to be the predominant source of external finance for Tunisian enterprises.** More balanced financing structures would help strengthen their resilience to increased competition. Improving credit management in the banks would help, as would freeing monetary policy from credit policy considerations.

6. **The detailed assessments of standards confirm that very significant, albeit uneven, progress has been made by Tunisia in introducing frameworks for effective implementation of best practices.** In particular the quality and effectiveness of banking supervision have improved considerably in recent years and Tunisia has established the key pillars for effective banking supervision. However, several weaknesses were identified, mainly in the areas of credit risk management and provisioning policies.

Vulnerability and soundness issues

7. **The banking sector has been strengthened but is not yet on a sound footing.** The financial soundness indicators of commercial banks have clearly improved in recent years, but exposure to credit risk remains significant, particularly in the state-owned banks. The level of NPLs has fallen considerably but it is still high. Loan provisioning has improved, but a remaining weakness is that banks are not required to make provisions for loans secured by real estate collateral, even though collateral is usually recoverable but only after long delays caused by cumbersome judicial procedures. Adequate provisioning is discouraged by tax rules that limit deductible provisions to a percentage of annual profits.

8. **The banking sector is exposed to several potential sources of vulnerability.** Credit exposure to sectors that are subject to cyclical shocks (i.e., construction, tourism) is high, and enterprises will face greater international competition in the context of the Free Trade Agreement with the European Union (EU). While there is no firm evidence yet of any adverse impact on the banking sector of the international situation following September 11 events, the exposure of the banking sector to tourism needs to be closely monitored. If Tunisia was to suffer a significant decline in tourism, the banking sector could be seriously affected, as evidenced by stress tests performed to evaluate bank's exposure to credit risk.

9. **Vulnerability of the banks to a large devaluation of the dinar is limited, as is their direct exposure to interest rate risk.** However, the use of variable lending rates, combined with the high level of indebtedness of the enterprise sector, make borrowers sensitive to interest rate risk, putting the banks themselves at risk indirectly.

10. **Banks face significant exposure to credit risk and stress tests suggest that the level of risk-weighted capital adequacy ratio is sensitive to credit risk shocks.** Requiring higher provisioning for nonperforming loans (NPLs), including ones that are backed by real estate collateral would cause the level of the capital adequacy ratio to decline significantly. Also, most banks would suffer a significant decline in their capital ratios if NPLs were to increase even moderately.

11. **Securities markets have grown considerably but remain small, and nonbank financial institutions do not play an important role in the economy.** The government securities market dominates the securities markets and it poses no systemic risk. Developing the primary market and an active secondary market, both objectives of the authorities, could help reduce the cost of government funding over time. It would also limit the government's vulnerability to changing international capital market conditions, given that one-quarter of Tunisia's external debt is raised in the international capital markets. Significant progress has been made in moving toward market funding of the government, but a clearer commitment, backed by definitive steps, would help.

12. **The financing of housing, SMEs (small- and medium-sized enterprises), and micro activities has improved greatly.** The *Banque de l'Habitat* (BH) and increasingly other banks, offer financial services to homeowners and real estate developers. Leasing and factoring firms and venture capital companies have helped to expand the range of financial

services available to SMEs. In the area of microfinance, the creation of the *Banque Tunisienne de Solidarité* (BTS) has filled a major gap; its operations, however, need to be firmly based on modern principles of microfinance.

Infrastructure supporting the financial system

13. **The legal framework for commercial and financial transactions has been extensively modernized.** The laws governing most financial institutions and markets have been revised, and a new code on commercial companies has been promulgated. New accounting and auditing standards in line with international practices have been adopted. However, despite the creation of asset management companies by some banks, the recovery of claims and the realization of collateral still suffer from delays and judicial obstacles.

14. **Credit policy considerations in the conduct of monetary policy have up till now inhibited money market development.** However, the BCT has recently reduced its consideration of banks' involvement in strategic sectors in managing its weekly repurchase auctions which, together with its recent practice of no longer accommodating all bank refinancing, has stimulated the interbank market.

15. **The national payment system and the securities clearing and settlement system do not pose any systemic risks.** The planned implementation of a large value transfer system will remedy current weaknesses.

16. **The BCT is empowered with the authority to appeal to "market solidarity" or to enlist the support of shareholders in the event of a banking crisis. It also plans to institute a deposit insurance system.** Experience has shown that a "market solidarity" mechanism may be difficult to implement, particularly when there is a large foreign participation in the sector. Instead, the BCT should prepare crisis management scenarios to cope with specific crisis situations in an orderly fashion.

Priority actions

17. **A medium-term strategy for the structure of the financial system needs to be developed for coping with the challenges of the growing regional and global integration.** The further strengthening of the banking system will require the ability to:

- Sharpen the medium-term strategy: reconsider the extent of state-ownership and remove obstacles to the establishment of foreign financial institutions;
- Encourage better provisioning by removing limits on tax deductibility, and place time limits on deducting real estate collateral values from provisioning requirements;
- Strengthen the supervisory frameworks through expanded training, and the promotion of greater functional independence;
- Devise a framework for bank crisis management; and
- Conduct an in-depth study of a deposit insurance mechanism.

18. **Additional measures to strengthen the financial sector include:**

- Accept only government and private commercial papers that satisfy minimum credit worthiness criteria as collateral for BCT refinancing operations;
- Adoption of a fully transparent monetary framework which validates price stability as primary objective;
- Acceptance of a firmer commitment to market funding of the fiscal deficit;
- Rapid completion of the action plan aimed at modernizing the insurance sector;
- Expediting the enforcement of verdicts, realization of collateral and claims; and
- Adoption of a legal framework to combat money laundering.

II. Main Characteristics of the Financial Sector

19. **The commercial banks dominate the financial sector, and the state-controlled banks dominate the banking sector.** The state controls the three largest banks and, together with other state participations (i.e., the largest insurance company and two specialized insurance companies) controls more than half of the banking system's assets (Table 1). Over 90 percent of commercial bank credit is extended to the private sector, and the share of short-term credit in total credit is about 60 percent.

20. **The development banks (less than 4 percent of total financial assets) have been less efficient in their lending and suffer from higher levels of nonperforming loans.** Around two thirds of their commitments are classified as bad loans, of which around 40 percent are provisioned; these figures worsened steadily during the 1990s. They are however, well capitalized because most of their lending is financed from their equity.

21. **Offshore banks (less than 5 percent of total financial assets) were established to provide financial services to offshore enterprises.** They are subject to all the prudential regulations that apply to domestic banks and there are no banking secrecy arrangements. The benefits granted to offshore banks have been somewhat reduced recently, inasmuch as all banks can now open accounts for offshore enterprises. The differences between offshore and onshore banks are therefore gradually disappearing, and the reasons for offshore banks fade as the liberalization of capital account proceeds, as the reasons for an offshore corporate sector fade with trade liberalization.

22. **The securities markets experienced rapid growth over the past decade or so, but are still small relative to the banking sector, and they do not constitute a source of systemic risk to the extent that securities represent a small portion of financial system's assets.** The number of firms listed on the Tunis Stock Exchange (BVMT) increased from 14 to 44 between 1994 and 2000. However, various constraints have resulted in a low volume of trading. In 2000, market capitalization represented only 14 percent of GDP, and the annual value of trading amounted to 4 percent of GDP.

Table 1. Structure of the Financial System (As of end-2000)

Type of Institution	Assets (In millions of Dinars)	Percent in Total Assets	Number of Institutions	As a Percentage of GDP
Commercial banks	19,612.5	63.6	14	72.8
State-controlled 1/	10,635.2	34.5	6	39.5
Private	8,977.3	29.1	8	33.3
Development banks	1,118.6	3.6	6	4.2
Offshore banks	1,429.6	4.6	8	5.3
CCP	1,000.0	3.2	1	3.7
CENT	800.0	2.6	1	3.0
Leasing companies	860.7	2.8	9	3.2
of which private	780.5	2.5	7	2.9
Factoring companies	29.7	0.1	2	0.1
SICAV	1,398.0	4.5	28	5.2
SICAF	469.0	1.6	85	1.7
SICAR	207.0	0.9	26	0.8
Insurance companies 2/	1,300.0	4.2	16	4.8
Brokerage houses	N/A	N/A	26	N/A
Pension funds 2/	2,500.0	8.1	2	9.3
Total	30,819.1	100.0	366	114.5

Sources: BCT, CMF and DGA.

1/ In 2001, two state-controlled banks have adopted a two-tier board structure, allowing a transfer of management oversight from the line ministry to a corporate supervisory board (*conseil de surveillance*).

2/ Estimates.

23. **The bond market is dominated by government securities, which represent over 85 percent of outstanding bond instruments.** The primary market for government securities has been extensively reformed in recent years, with the introduction of standardized instruments, their systematic auction-based issuance, and the establishment of a group of primary dealers. However, there are persistent shortcomings in the primary market, and the secondary market is in its infancy. As yet, there is no yield curve reflecting the expectations of market participants. The other main bond issuers are banks and leasing companies.

24. **Nonbank financial institutions do not play an important role in the Tunisian economy.** The assets of institutional investors (including insurance companies, pension funds, collective investment institutions and investment companies) correspond to 22 percent of GDP, while the assets of leasing and factoring companies represent 3 percent of GDP.

III. Macroeconomic Factors Affecting the Health of the Financial System

25. **Monetary policy has been prudent, and significant progress has been made in freeing its conduct from credit policy considerations.** The cautious monetary policy, together with manageable fiscal deficits, has resulted in low inflation (Table 2). The BCT had

been giving preferential access to banks with claims on strategic sectors in its weekly repurchase auctions, and this policy may have hindered the dissemination of a modern credit culture and the development of the money market. Recently, however, the BCT has begun to eliminate this policy, and plans to totally eliminate it in the short- to medium-term.

26. **Foreign exchange policy has been aimed at maintaining external competitiveness.** In the face of a weakening euro, the BCT has somewhat expanded its fixed CPI-based real exchange rate rule (which allowed the nominal effective exchange rate of the dinar move as a function of the inflation differential between Tunisia and its main trading partners), permitting a slight depreciation of the real exchange rate. This policy has allowed the main exporting sectors to record good performances, which should contribute to maintaining the good credit quality of banks' exposure to exporting firms. In guiding its exchange rate policy, the BCT has also begun to take into account a broader set of indicators, particularly developments in market shares.

27. **Capital controls are maintained to ensure that domestic savings are used to finance domestic investment, while the liberalization of the external sector has proceeded gradually but steadily.** The initial phase of financial reforms (1987–1993) aimed at a gradual dismantling of the debt economy and culminated with the completion of current account convertibility. Soon afterward, a spot interbank foreign exchange market was introduced (1994), and the regulatory framework for capital account transactions was gradually liberalized in favor of export-oriented activities and corporations, although other capital transactions are still subject to restrictions.

28. **Overall, the prudent and consistent macroeconomic policies have helped improve the image of Tunisia in international markets.** Starting in the mid-1990s, international rating agencies began awarding Tunisia "investment-grade" ratings, allowing the government to borrow on international capital markets at long-term maturities and under relatively favorable conditions. Tunisia's external vulnerability remains low, although there are uncertainties regarding the transition to a fully opened trade regime.

29. In view of the remaining weaknesses in the financial sector, the liberalization of the capital account should proceed with caution. The BCT needs to remain vigilant as international integration presents banks with new opportunities, but also exposes them to new capital market risks. In particular, it will be important to ensure that the pace of liberalization allows banks sufficient time to address current vulnerabilities, develop expertise with international transactions, and further enhance their overall effectiveness and skills in managing flows from international capital markets. A greater presence of foreign banks would facilitate a more rapid transfer of the required expertise.

Table 2. Financial Soundness Indicators

(In percent, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001
Macroeconomic Indicators						
Real GDP growth	7.1	5.4	4.8	6.1	4.7	5.0
Balance of payments						
Current account deficit as a percent of GDP	2.4	3.1	3.4	2.1	4.2	4.2
Official gross reserves in months of goods imports	3.1	3.1	2.6	3.4	2.6	2.5
External debt, total as a percent of GDP	59.9	60.7	56.8	59.7	59.7	60.3
Short-term external debt as a percent of total external debt	13.4	12.9	14.1	12.5	13.8	13.3
Short-term external debt as a percent of reserves	79.1	73.9	84.4	67.1	86.2	79
Nominal effective exchange rate, 12-month growth rate	0.7	-0.8	-0.7	0.3	-0.7	-1.5
Real effective exchange rate, 12-month growth rate	0.7	-0.1	-0.1	1.0	-0.6	-2.5
Public finances						
Balance of central government, excl. grants and privatization	-5.7	-3.7	-3.2	-4.0	-3.2	-3.0
Interest Rates and Inflation						
Consumer price index, 12-month growth rate	3.8	3.7	3.1	2.7	3	1.9
Money market rate	7.8	6.9	6.9	5.9	5.9	6.1
Lending rates 1/	...	...	...	8.7	8.6	8.8
Lending and Asset Prices						
Bank lending to private sector as percent of GDP	46.1	46.7	47.9	48.5	50.1	58.0
Tunis Stock Exchange Index, (BMVT) e.o.p.	571	456	465	810	1,425	996
Other Factors and Indicators						
Standard & Poor's foreign currency debt rating	BBB-	BBB-	BBB-	BBB-	BBB	BBB
Spread of benchmark bonds, e.o.p. (basis points) 2/	...	140-180	470-530	250	130	...
Aggregated microprudential indicators (commercial banks) 3/						
Capital to risk-weighted assets ratio (mean)	...	6.4	9.1	10.5	11.2	11.3
Asset quality						
Foreign currency denominated assets as percentage of total assets	6.9	8.1	8.4	8.1	8.0	7.4
Gross Nonperforming loans as percentage of total assets	25.1	23.0	19.5	18.8	21.6	19.5
Nonperforming loans net of provisions as percentage of net assets	15.2	12.4	8.9	8.8	12.3	12.3
Sensitivity to market risk						
Net open positions in foreign exchange as percentage of capital	...	...	...	1.5	0.1	0.2
Management soundness, Earning/profitability and Liquidity						
Expenses to total income	56.9	57.8	56.4	56.4	56.8	53.6
Return on assets (ROA)	0.9	0.8	1.2	1.2	1.2	1.2
Return on equity (ROE)	...	...	...	12.8	13.7	13.8
Liquidity Assets/ Demand Deposits	257	248	245	249	265	...

Source: BCT; IFS; and Staff estimates.

1/ Money market rate plus average margin applied by commercial banks.

2/ Spreads of the 10 and 30-year Yankee bonds above U.S. Treasury. For 2000, spread over LIBOR of August 2000 Yen Samurai bond.

3/ Preliminary data in 2001.

IV. Robustness of the Financial Sector

A. The Banking Sector[1]

Financial soundness

30. **The implementation of wide-ranging reforms to restructure the corporate sector in the past four years has reduced vulnerabilities that had arisen partly from the directed credit policies of the 1970s and 1980s.** In 1997, the government launched a comprehensive plan to tackle the high levels of NPLs in the banking system. As a step towards the settlement of NPLs to the private sector the government enacted a law governing the creation of private asset management companies (AMCs) charged with the purchase and collection of NPLs. The AMCs are subsidiaries of the respective banks; de facto they play the role of an in-house NPLs recovery structure. Regarding public enterprises, the authorities implemented a plan to restructure the stock of NPLs to public enterprises. The plan included: (i) government guarantee of all NPLs registered at the end of 1997 to banking claims on public enterprises that are to remain publicly-owned and active; and (ii) assumption by the government of the bank's claims on public enterprises that have been or will be liquidated or privatized, in return for non-interest bearing claims on the government with a 25-year repayment period. As a result, official indicators of bank soundness have improved substantially, and the BCT was able to raise the minimum capital adequacy requirement from 5 to 8 percent in 1999. All banks except for one small state-controlled commercial bank now comply with the new minimum requirement.

31. **Despite considerable improvement, commercial banks continue to have a high volume of NPLs and a low level of provisioning.**[2] The ratio of gross NPLs to total gross claims declined from 34 percent in 1993 to 25 percent in 1996 and 19 percent in 1999 (Table 3), but this is still high by international standards. It increased slightly in 2000 to 22 percent as a result of the merger of STB with two development banks (BDET and BNDT), before declining back to 19.5 percent in 2001. Furthermore, the level of provisioning of commercial banks' NPLs that gradually rose from 24 percent in 1992 to about 42 percent in 2000[3] is still low, although most banks are in compliance with current provisioning regulations set by the BCT. However, these regulations do not require loans backed by real estate collateral to be provisioned, even though realizing real estate collateral suffers from long delays in judicial procedures. Therefore, the risk-weighted capital ratio, currently at around 11 percent for all banks, may be overestimated.

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[1] Section II contains the assessment of Tunisia's observance of major international standards and codes relevant for the financial system.

[2] NPLs are higher among development banks, but they report higher levels of capital. Their role has declined following the merger of BDET, BNDT and STB.

[3] Including suspended interest accrual.

Table 3. Nonperforming Loans (Commercial Banks)

(Millions of dinar, unless otherwise indicated)

	1993	1996	1999	2000	2001 2/
Gross NPLs	3505.5	3179.6	3133.8	4243.5	4131.1
Of which State-controlled banks	2874.2	2451.9	1769.4	2880.5	2855.7
In percent of total gross claims	34.0	25.1	18.8	21.6	19.5
In percent of GDP	23.9	16.7	12.6	15.8	14.3
Net NPLs	2647.7	1693.8	1299.6	2155.9	2402.9
Of which State-controlled banks	2247.1	1416.9	738.1	1538.9	1707.8
In percent of total net claims	28.0	15.2	8.8	12.3	12.3
In percent of GDP	18.1	9.0	5.4	8.0	8.3
Of which State-controlled banks	15.3	6.0	3.0	5.7	5.9
Potential Provision Shortfall 1/	...	...	470.1	851.03	1006.0
Of which State-controlled banks	...	...	278.3	608.5	710.0
In percent of total net claims	...	...	3.2	4.9	5.2
In percent of GDP	...	...	1.9	3.2	3.5
Of which State-controlled banks	...	...	1.1	2.3	2.5

1/ Due to reliance on collateral to assess provisions; assuming 50 percent of collateral is not recoverable.
2/ Preliminary data.

32. **Despite large volumes of non-interest bearing assets, commercial banks' profitability is high because of low competition, providing a window of opportunity to strengthen provisioning.** Banks hold non-interest bearing assets that include the non-provisioned NPLs (i.e., about 12 percent of loans) as well as the non-interest bearing claims on the government repayable over a 25-year period. However, commercial banks earn a ROA of 1.2 percent, and even after maintaining a dividend payout ratio of 20 percent, they would on average need less than two years to make up half the current shortfall in provisions (Scenario 2 in Table 4): weak banks, which suffer from a higher shortfall while making smaller profits, would require over three years, while strong banks need less than one year.

33. **The non-interest bearing assets increase the cost of bank intermediation** and place affected banks at a competitive disadvantage against new banks and existing banks that do not have to carry this burden. Assuming a risk-free rate of interest of 7 percent, the impact of unproductive assets on bank margins could be between 100 and 200 basis points.

34. **Commercial banks also suffer from a rapidly growing exposure to sectors that are vulnerable to a cyclical downturn, to a European recession, or a global decline in tourism in the aftermath of the September 11 events.** In particular, lending to sectors related to construction, property development and tourism represent 38 percent of total commercial bank credit. Loans to construction and public works grew by 34 percent between 1998 and 2000 and lending to property development by 45 percent during the same period. Four months after the September 11 events, the authorities indicated that data available did not evidence an adverse impact on banks' balance sheets from the consequences on the international environment of the events of September 11. However, the large share of loans granted to sectors related to the tourism industry suggests that if Tunisia were to face a significant decline in this sector, banks' balance sheets would be severely

affected. Therefore, the exposure of the banking sector to tourism needs to be monitored closely.[4] In this regard, it should be noted that about 40 percent of the tourism portfolio is already nonperforming. This problem is more acute in the state-owned banks, particularly those which merge with development banks that have been more exposed to the tourism sector.[5] Also, banks may have to cope with increases in NPLs to industries that are likely to suffer from greater international competition as a result of trade liberalization, at least during a transitional period. These vulnerabilities heighten the need for making precautionary provisions against future NPLs, while at the same time covering those inherited from the past.

Table 4. Bank Profitability and Provisioning

(End of 2000 data)	Provisions Shortfall 1/	Pre-provisions Income	Years to Build Full Provisions	
	(In thousands of dinars)		Scenario 1 (recovery ratio = 0)	Scenario 2 (recovery ratio = 50%)
Strong banks 2/	50,900	109,700	0.8	0.4
Medium strength banks 2/	274,900	152,000	1.9	0.9
Weak banks 2/	1,360,400	207,600	6.8	3.4
Total	1,686,200	469,300	3.5	1.8

1/ The value of provisions shortfall is estimated to be the difference between required provisions and the value of NPLs. This estimate is based on the assumption that the recovery ratio on collateral is equal to 0 (Scenario 1) or 50 percent (Scenario 2). The number of years is the simple average of the years required for each bank and therefore may differ from the ratios of the aggregate provisions shortfall and pre-provision income.

2/ The classification of banks in three groups reflects performances under the stress test exercise.

Credit risk and stress tests

35. **Stress tests applied on commercial banks show very limited exposure to foreign currency, liquidity, and direct interest rate risks.** Foreign exchange risk is limited because banks hold very small open foreign exchange positions. A stress test based on an open position of 20 percent, the maximum allowed by current regulations, shows that a 50 percent devaluation of the dinar would cause the banks' ratio of equity to total assets to fall only by approximately 1 percentage point. Tunisian banks also show a low sensitivity to interest rate fluctuations because most credits and interest-bearing deposits are indexed to the money

[4] The tourism sector represents about 14 percent of commercial bank's credits and 30 percent of credit to the services sector, which itself receives about 55 percent of total bank credit. Moreover, given the interlinkages that may exist between the tourism sector and other services sectors (e.g. transport) the banking sector may face a greater exposure to the tourism sector.

[5] Before the merger of BDET, BNDT and STB, 85 percent of NPLs of the development banks were concentrated in the tourism sector.

market rate (TMM). Increasing interest rates by about 500 basis points would cause a fall in the banks' risk-weighted capital ratio from 11 to around 8 percent. Nevertheless, while the direct impact of these changes would have little impact on banks' portfolios, the indirect effects of an increase in interest rates could be severe, as it could lead to a deterioration in the quality of floating-rate loans extended to enterprises.

36. **The rule that banks do not need to provision for NPLs that are backed by real estate collateral may imply an overstatement of risk-weighted bank capital.** To estimate the extent of this vulnerability, two stress tests were applied. The first assumed that collateral was unrecoverable and resulted in a reduction of the overall risk-weighted capital from 11 to 0.5 percent. The impact was much greater for state-controlled than private banks. A second test assumed that 50 percent of collateral was unrecoverable and resulted in a reduction of the overall risk-weighted capital ratio to around 6 percent, while the capital ratio of weak banks fell to 3.4 percent.

37. **Commercial banks also have a significant exposure to credit risk** (Table 5). The following stress tests were performed (all of them with the assumption that 50 percent of collateral would be unrecoverable): (i) a 20 and 30 percent increase in NPLs (implying an increase in NPLs ratio from 19.5 percent to 22 percent and 25 percent respectively) all in the loss category; (ii) 50 percent of claims classified in category 1 (claims requiring special monitoring but having no arrears in excess of 90 days) would migrate to the loss category; (iii) 20 percent of claims classified in category 1 would migrate to the loss category; (iv) 25 percent of current claims on industrial companies would migrate to the loss category; and (v) 25 percent of current claims on the tourism sector would migrate to the loss category.

38. **The stress tests show a highly differential impact across individual banks.** Strong banks (which are also the most profitable) are not seriously affected even under the most adverse assumptions, and retain a solvency ratio of 8 percent or higher in almost all cases. Conversely, medium strength or weak banks always slip below the 8 percent threshold, and sometimes have a ratio that is low or even negative for the weak banks. Weak banks report a higher risk-weighted capital ratio than medium strength banks, but they suffer a greater deterioration in their capital ratios under all the stress tests. Furthermore, some state-controlled banks accounting for about 40 percent of banking system assets become insolvent under several credit risk stress tests.

39. **For state-controlled banks, state intervention to compensate for the amount of their provisioning shortfall under the scenario in which 50 percent of collateral is unrecoverable and maintaining the capital adequacy ratio at 8 percent would require about 1.3 percent of 2001 GDP.** If such a government capital injection were concentrated in one year it would amount to a 50 percent increase in the fiscal deficit. Maintaining the present capitalization of state-controlled banks at its current level (11.7 percent) would require about 2.4 percent of GDP.

Table 5. Stress Tests (Credit Risk, 2001 Data)
(Millions of dinar, unless otherwise indicated)

	RP	AP	CLTRL	C	RWA	RWA%	ROA	CAR	CAR [1]	CAR [2]	CAR [3]	CAR [4]	CAR [5]	CAR [6]	CAR [7]	CAR [8]
Commercial Banks	1727.5	1728.2	2013.0	2070.6	18294.0	100.0	1.16	11.3	0.4	6.2	3.8	2.6	-0.5	3.6	3.7	5.1
State-controlled	1157.3	1147.9	1419.9	1108.7	9497.4	51.9	0.95	11.7	-3.9	4.5	1.3	-0.4	-3.6	1.5	2.8	3.5
Private	570.2	580.3	593.1	961.9	8796.6	48.1	1.39	10.9	4.5	7.8	6.4	5.7	2.6	5.8	4.7	6.8
Commercial Banks																
Strong	281.3	281.3	73.5	427.1	3558.3	19.5	1.52	12.0	10.1	11.1	10.1	9.6	5.2	8.8	7.8	10.2
Medium strength	276.3	285.1	405.0	544.1	5355.3	29.3	1.27	10.2	2.8	6.6	5.2	4.4	1.9	4.8	4.4	5.7
Weak	1162.6	1154.5	1503.2	1039.2	9262.7	50.6	0.92	11.2	-6.0	3.4	0.0	-1.8	-5.0	0.2	1.1	2.2

RP = Required Provisions
AP = Actual Provisions
C = Capital (Tier I net and Tier II)
CAR = Capital Adequacy Ratio
CLTRL = Potential under provisioning due to the fact that collateral security is considered in calculations of required provisions
RWA = Risk Weighted Assets
ROA = Return on assets

[1] Assume that 0 percent of collateral are realizable : CAR 1 = (Equity - Underprovisioning)/(RWA - Underprovisioning) .
[2] Assume that 50 percent of collateral are realizable.
[3] Same as in [2] and assume a 20 percent increase in non performing assets (to a ratio of 22 percent from 19.5 percent) all in the loss category of which 50 percent are recoverable.
[4] Same as in [2] and assume a 30 percent increase in non performing assets (to a ratio of 25 percent from 19.5 percent) all in the loss category of which 50 percent are recoverable.
[5] Same as in [2] and assume that 50 percent of claims in the special mention category (class 1) move to the loss category, of which 50 percent are recoverable.
[6] Same as in [2] and assume that 20 percent of claims in the special mention category (class 1) move to the loss category, of which 50 percent are recoverable.
[7] Same as in [2] and assume that 25 percent of industrial sector current claims move to the loss category, of which 50 percent are recoverable.
[8] Same as in [2] and assume that 25 percent of tourism sector current claims move to the loss category, of which 50 percent are recoverable.

Credit policies and enterprise finance

40. **Despite measures to encourage financing from the securities markets and alternative source of funding, bank credit continues to be the predominant source of external finance for Tunisian enterprises.** NPLs were reduced in half compared to their 1992 level, but their continuing high level suggests the need for further improvements in banks' credit policies. There appears to be significant room for improving credit policies by adopting modern methods of credit appraisal, relying on realistic cash flow projections rather than the availability of collateral security, and avoiding situations of excessive leverage. Cognizant of these problems, the BCT recently required all large borrowers to obtain a credit rating or to be listed on the stock exchange (which in turns makes the corporations subject to disclosure requirements). Firmer actions such as these would considerably improve the amount and quality of financial information available on large business groups. Banks have created special committees to monitor the standing of large delinquent borrowers and to seek the recovery of debts. Adoption of the new draft laws on business groups and consolidated accounts would also enhance the transparency and quality of information on Tunisian enterprises.

41. **Requiring greater provisioning of NPLs by banks to account for difficulties in recovering collateral (as indicated above) would make a major contribution to modernizing credit policies.** This could be achieved by placing time limits on deducting real estate collateral values from provisioning requirements. Banks would be forced to be more careful in selecting their borrowers, and to charge higher spreads to their more risky customers. Wider bank margins could induce stronger companies to seek cheaper financing from securities markets. Limiting the amount of bank leverage would also force companies to strengthen their balance sheets by obtaining more diverse financing from equity markets or other sources.

42. **The benefits of more diversified financing structures would be particularly great in the case of tourist projects, which tend to be financed with excessive recourse to banks.** Delays in completion and cost overruns cause a significant increase in the financing burden of such projects, partly explaining the presence of a large volume of NPLs in a sector that has otherwise been booming. Development banks have taken the lead in such financing, and their generally weak project monitoring has allowed projects to become excessively leveraged and to suffer from long delays in completion and even longer delays in repayment. If banks refused to finance excessively leveraged tourist projects, their promoters would be forced to seek financing from equity markets and other sources that might be more vigilant in ensuring that their resources are used productively.

43. **Transferring NPLs to AMCs could result in a substantial loan recovery, provided they acquire expertise in their specialized function and increase recovery efforts.** Encouraging banks to transfer their fully provisioned NPLs to AMCs would avoid problems with the preparation of consolidated accounts for the bank groups. Such a transfer would also allow banks to seek for their AMC subsidiaries local and foreign partners

specializing in debt recovery and enterprise restructuring. Moreover, the AMCs could expedite the realization of collateral.[6]

B. Vulnerabilities of the Corporate Sector

44. **The level of private sector indebtedness has recently declined but is still very high.** The volume of credit extended to the productive sector equals 65 percent of GDP, comparable to levels observed in the more advanced emerging economies. This high level is explained by easy access to bank credit by pledging real estate collateral, which is not easily recoverable. But in turn, banks do not need to provision for NPLs that are backed by real estate collateral.[7] In a sample of 1500 enterprises, the average debt-asset ratio exceeds 65 percent, and it reaches 80 percent in the construction sector.

45. **An additional source of fragility stems from sizable short-term indebtedness, which the lack of consolidated accounts does not allow to fully assess.** Short-term credit represents over two thirds of total indebtedness and reaches 90 percent in the commerce sector because of heavy reliance on trade credit; meanwhile the majority of long-term credits are at variable rates that are indexed to short term money market rates. Consequently, enterprises are vulnerable to increases in interest rates. In the absence of consolidated accounting, the common practice of cross-participation between groups of firms may have allowed an artificial increase in equity recorded by firms.

46. **The observed improvement in profitability is not yet sufficient to remedy the imbalances in the financial structure of enterprises.** Profitability, as measured by ROA, increased from 1.9 to 3.9 percent between 1996 and 1999, and rose generally in all sectors of industry and services, except agriculture and the extractive industries, where it declined. The tourism sector recorded losses throughout the period 1996–1999, but these losses have declined steadily. On the basis of a sample of 40 major enterprises for which precise data is available, an interest rate increase of 4 percentage points would cause an operating loss for about 20 percent of the firms in the sample.

47. In order to prepare enterprises for increased competition the authorities are implementing a "*mise à niveau*" program to facilitate enterprise restructuring. The program has targeted 2,000 firms and has placed special emphasis on improving management practices. Participating firms represent 40 percent of the total employment of enterprises with more than 20 employees, 64 percent of total sales, and 39 percent of exports. Participation by SMEs (firms with less than 100 employees) increased from 24 percent of the number of firms

[6] To facilitate loan recovery through transfers of NPLs to AMCs, the authorities have allowed the transfer of partially rather than fully provisioned loans and have reduced from four to two years the minimum time NPLs can remain on the books before being written-off.

[7] Regarding bankruptcy procedures, some provisions of the legal framework for corporate restructuring, currently under review, have, at time, been used by enterprises to delay repayment of bank credit.

in 1996 to 64 percent in 2000. Early results show that participating firms experienced accelerated rapid sales growth. There has also been increased strategic orientation towardexporting, outsourcing support operations, seeking foreign partners, and opening company ownership to external investors.

48. **Measures to strengthen the corporate sector would need to give greater priority to improving the financial structure of Tunisian enterprises.** There is a risk that focusing on short-term goals such as the level of activity and on factor accumulation in a context of a poor credit culture, capital accumulation may reach diminishing returns. That would imply that credit is not allocated to the sectors with the best returns. In such a context, high leverage ratios would make Tunisian corporations vulnerable to shocks.

C. Securities Markets

Government securities

49. **The government securities market has many positive attributes (Box 1). Encouraging the orderly development of the primary market and of an active secondary market would limit the government's vulnerability to changing international capital market conditions; it would also bring about a gradual reduction in funding costs over time.** About one-third of the government domestic debt is from captive sources. A firmer commitment, backed by definitive steps, to market funding of the budget would help develop the market. Other areas for improvement should also be considered including formalizing and publicizing the debt management strategy; developing a more professional approach and creating an appropriate institutional structure; adhering to the issues timetable; introducing repurchase operations; and boosting transparency efforts on the framework for public debt management.

Private securities

50. **The landmark 1994 Law provided for a modern and robust regulatory framework for the securities markets.** It created the Financial Market Board (CMF) as the new regulatory agency, converted the stock exchange into a business corporation owned by its members, and set up a new securities depository and clearing agency. Trading and market surveillance are highly automated, and clearing and settlement facilities are paperless and on a delivery versus payment basis.

51. **Yet, lax enforcement of the regulations and weak sanctions risk undermining public confidence in both market transparency and integrity.** Lax enforcement has been motivated by concern that strict supervision could stifle nascent markets, but there is a clear need for an action plan to increase the severity of sanctions, particularly for repeat offenders, and instill greater public confidence in market integrity.

52. **In this context, the underdevelopment of the securities market largely stems from the absence of companies that are able and willing to make public offerings of securities.** The continuing presence of large state-owned companies, especially in the public

utilities sector, deprives the securities markets of large and viable issuers. The high cost of transparency as well as reluctance to dilute controlling positions deter many family-owned groups from listing. On the demand side, market development is hampered by the weakness of institutional investors (especially pension funds) and the absence of independent operators and foreign investment banks.

Box 1. Government Securities Market

About two-third of domestic debt is in marketable form; instruments are standardized, and in book entry form; transactions are tax-neutral; and investors may subscribe through their bank or mutual fund. The risks associated with debt management were limited by financing approximately 40 percent on the domestic market, keeping the short-term portion of the debt under one-third of the negotiable debt, spreading out maturities over 10 years, and avoiding variable-rate instruments. In addition, the government has taken advantage of Tunisia "investment-grade" ratings to raise funds on the international capital market; about 25 percent of Tunisia's foreign debt is now market-based.

Against these important advantages, the government securities market presents several weaknesses: the debt management strategy is not formalized and lacks transparency; there is no firm commitment to market funding (captive funding increased to 25 percent of total domestic debt in 2000 from 20 percent in 1999, and 16 percent during the period 1996-98); and there is no formal analysis of exchange rate, interest rate and refinancing risks.

This has resulted in a limited success of the auctions. Participation of the primary dealers has shrunk and at times auction sessions were canceled, or issued amounts were substantially lower than those announced. Several reasons can be suggested to explain these difficulties: (i) interest rates do not reflect market conditions; (ii) competition from other money market instruments has been growing; and (iii) the spread between short and long rates is low because of the reluctance of the Treasury to accept high rates for long maturities.

The secondary market is inactive. This can be explained by limited supply of securities on the capital markets, leading holders of government securities to keep them until maturity. This tendency may be accentuated by the fact that the securities are recorded at their historical value, making investors not interest-rate sensitive, which, in turn deters active management.

D. Nonbank Financial Intermediaries

53. **Over the last decade, the growth of the insurance sector has been in line with the overall growth of the economy, although it still faces persistent structural problems.** In particular, state-owned and mutual companies are under-capitalized and under-reserved. By contrast, the large private companies are well run, strongly capitalized, and adequately reserved. The Insurance Code is relatively modern, but it should be updated with regard to prudential rules, rules on corporate governance, internal control systems, conflicts of interest, and reinsurance. Also, the nonrigorous and unequal application of current prudential rules has allowed two companies to operate for a long period with negative equity, and independent audits have shown that several companies lacked adequate technical provisions.

54. **The authorities should continue their efforts to reform and modernize the insurance sector.** A detailed action plan has already been prepared and is being implementation. It aims to upgrade regulation and supervision, restructure and strengthen under-capitalized and under-reserved insurance companies, amend the insurance code, and revamp the automobile insurance branch. These actions should be implemented without delay.

55. **Collective investment institutions grew rapidly in response to strong demand for investment instruments offering diversification and professional management at affordable cost.** Tax treatment (that is lower than the marginal rates for wealthy investors) has also been a key factor. The regulatory framework was recently strenghtnened with the adoption of a new law with regard to licensing criteria, the segregation of customer assets, valuation of assets at fair prices, and enhanced transparency of financial conditions and fees. It will be important to curtail the tendency that mutual funds have to invest in bonds issued by leasing companies and other entities belonging to the same business group.

56. **Venture capital companies enjoy significant tax advantages and offer alternative sources of external funding.** However, a large part of their resources has been channeled into the enterprise restructuring program and the construction sector, rather than toward small businesses that have limited access to other sources of financing.

57. **Pension funds account for only a small part of financial system.** Their accumulated assets amount to less than 10 percent of GDP and are primarily invested in government securities, with some investments in equities, housing loans, and bank deposits. At the time of the FSAP mission, the two social security institutions have large unfunded actuarial liabilities and are experiencing difficulties as a result of the authorities' failure to settle obligations associated with the campaign to encourage employees to take early retirement. The authorities have launched an in-depth study with assistance from the World Bank the conclusions and recommendations of which are expected by the end of the year 2002. Pending comprehensive reform, a number of intermediate measures have been taken to ensure the financial equilibrium of the National Retirement and Social Security Fund (CNRPS) until 2005.

58. **Leasing companies are one of the most successful innovations in the financial system.** They are primarily directed toward small- and medium-scale enterprises. Forty percent of leasing companies' resources derive from bond issues and 30 percent from bank loans. Most of the bond issues of leasing companies are subscribed by mutual funds, often belonging to the same business group, a practice that is undesirable and should be curtailed.

59. **Factoring services are offered by two newly-established factoring companies.** In common with leasing and venture capital companies, these are ideal vehicles for financing small emerging and expanding firms. They offer clear advantages over traditional banking institutions thanks to their more efficient use of collateral security and recovery of loans.

E. Sectoral Policies: Housing, SMEs, and Microfinance

60. **Following the establishment of the *Banque de l'Habitat* (BH), the provision of housing loans to individuals has been expanded considerably. Recent years have also seen commercial banks participate more intensively in the financing of housing.** The BH claims a very good repayment record. Its nonperforming housing loans amount to less than 2 percent, and its total losses are negligible. The BH also grants short-and long-term loans to developers and to commercial and industrial firms, an activity that it intends to expand in order to reduce its exposure to housing sector risks.

61. **All banks (including the BH) finance their housing loans through short-term resources.** While the interest rate risk is limited by the prevalence of variable rate loans, banks face a larger credit risk from borrowers who may be unable to shoulder higher mortgage rates. Therefore, it would be desirable to develop a mortgage securitization market that would achieve a better matching of assets and liabilities and would make possible for banks to offer fixed-rate mortgage loans.

62. **In recent years, the range of credit and financing facilities available to small- and medium-sized enterprises (SMEs) has broadened considerably.** Venture capital, leasing, and factoring companies have been established and are building up their operations at a rapid pace. Export financing and insurance mechanisms have also been directed at small firms. Lending terms and conditions would also appear to have improved of late, although commercial banks continue to require real estate guarantees and the cost of credit appears to be high. In contrast, leasing and factoring companies have devised ways to work within the existing legal framework and avoid the procedural complications associated with the realization of real estate collateral. In addition, the authorities established the BTS to promote self-employment by facilitating access to microcredit; its operations, however, need to be strengthened to be in line with modern principles of microfinance.[8]

V. Infrastructure Supporting the Financial System

A. Legal and Accounting Framework

63. **Tunisia has a well-established legal system but, like many other countries, it suffers from long court delays with respect to debt recovery and the recovery of collateral.** Generally speaking, legislation is well drafted and resembles mainstream continental European law. Most laws governing the financial system have been revised in the last decade and have been expanded to embrace modern concepts and practices. The proposed amendments to the Code of Civil and Commercial Procedures that is currently being reviewed by parliament, would expedite court decisions, but the problems entailed in executing court judgments remain unresolved, and a comprehensive modernization of the Code of Civil and Criminal Procedures is essential in order to update and accelerate obsolete procedures. The authorities are aware of these difficulties and collaboration between the BCT, the Banking Association, and the Ministry of Justice have recently been improved to identify measures to increase the rate with which the judicial process treats loan recovery cases. The use of arbitration and pretrial mediation should also be encouraged. Further improvements in the registration of land tenure titles would make the use of real estate for mortgage purposes more efficient.

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[8] The BTS lends at heavily subsidized interest rates, and relies on financial backing from the State. Typically, microfinance institutions have a loan recovery rate exceeding 95 percent; the BTS already has a rather high rate of arrears (22 percent on microprojects and 19 percent on microcredits).

64. **The legal framework for the collection of bad debts has been greatly improved by the enactment of legislation for AMCs.** However, their success would depend on progress in strengthening the debt collection legal and judicial framework. In addition, the AMCs should be fully consolidated in the financial accounts of their parent bank.

65. **The promulgation of the new Code on Commercial Companies in 2000 marked a major legislative breakthrough.** The code emphasizes transparency, collegiality, accountability of managers, and greater shareholder rights. The new management structure of business corporations holds out the possibility of transferring responsibility for the supervision of state-controlled banks from the line ministry to the bank's own supervisory board, which should enhance the operational efficiency of state-controlled banks and reduce political influence. The draft law on business groups and holding companies should promote improved corporate governance, in particular, by limiting cross-participations in group companies and mandating public disclosure of holding company structures.

66. **Considerable efforts have been made since the mid-1990s to modernize accounting rules and to bring them more closely into line with international principles.** New accounting standards and charts of accounts have been published for commercial companies and financial institutions, and draft accounting standards were recently published on the preparation of consolidated accounts and the treatment of business groups and holding companies. At the same time, international auditing standards have been adopted. Enforcement of these standards will improve the transparency, accuracy, and reliability of the financial information for commercial and financial institutions.

B. Liquidity Management and Interbank Market

67. **The BCT has developed a comprehensive set of indirect policy instruments to manage banking system liquidity.** The weekly credit auctions (*appel d'offres*) are the main discretionary instrument. They are supplemented by standing facilities which allow banks, at their own initiative, to obtain or place liquidity at the official (but penalty rates compared to market conditions) intervention rates, and by the non-remunerated reserve requirements set at 2 percent of sight and term deposits. The combination of the weekly liquidity auctions with the standing facilities creates a corridor for money market rates.

68. **Recent changes in the implementation of monetary policy are expected to stimulate the development of the money market, and to provide incentives for banks to upgrade their liquidity management skills.** Since early 2001, the BCT no longer systematically meets banks' requests under its standing facilities, and it has curtailed reliance on end-of-day settlement operations [*opérations ponctuelles*] allowing market rates to fluctuate within the corridor. These measures have led to increased interbank market activity.

69. **The role of government securities in the BCT's monetary operations could be further expanded.** The limit on the BCT holdings of government securities[9] (together with

[9] The BCT can hold government securities up to 10 percent of government revenues.

the associated reliance on claims on priority sectors) and the absence of efficient repurchase facilities are obstacles for full reliance on open market operations. The BCT should be allowed to carry out monetary operations with negotiable government securities, such as treasury bills, in any necessary quantity, as required for monetary policy considerations. Furthermore, reliance on claims on strategic sectors in the weekly repurchase auctions should be discontinued and the BCT should only accept government securities and private paper which satisfies minimum credit worthiness criteria as collateral for its refinancing operations.[10] Indeed, the case can be made that discontinuing the reference to priority sectors in the conduct of monetary policy would signal the BCT's determination to move away from credit policy considerations in the conduct of monetary policy, thus providing an incentive for banks to enhance their credit culture.

C. Payment System

70. **The national system for the clearing and settlement of checks and other instruments is of systemic importance.** The BCT plays a key role in the system's operations and regulations and the institutional and legal framework is comprehensive and generally up-to-date. The planned implementation of a large value transfer system (REV) will enhance the efficiency of the system by ensuring the real-time gross settlement of large value payments as well as finality in settlement on the value date.

71. **The system of clearing and settlement of securities implemented by STICODEVAM is consistent with best practices.** The main characteristics of the system are as follows: paperless securities and a fully automated accounting system; delivery of securities against cash payment the same day; standardized time period for the unwinding of transactions; and guarantee of cash settlements (final and conclusive settlement at the BCT) and deliveries of securities on a simultaneous and irrevocable basis at the close of business at STICODEVAM. To the extent that transactions are settled directly on the books of the BCT, the credit and liquidity risks are passed onto the participants in the clearing and settlement process at the BCT. The system's performance would be further improved by moving from T+4 settlement to the international standard of T+3.

D. Financial Sector Strategy, Crisis Management, and Safety Nets

72. **The strategy of the Tunisian authorities over the past 15 years has emphasized the importance of maintaining state control of leading players in the financial system.** Foreign participation has been encouraged, but foreign acquisition of a controlling majority share requires prior approval of the Superior Investment Council. To cope with the challenges of growing integration with regional and global markets, the authorities need to reconsider the extent of state-ownership and to develop a clearer approach to the

[10] In the year 2000, the BCT was allowed to hold government securities in all maturities for the conduct of monetary policy. However, it continues to allocate part (i.e., one-third as of February 2002) of its weekly refinance credit against banks' claims on strategic sectors.

consolidation of institutions, and open markets to greater foreign competition. The authorities have started to take action in this direction and have retained the services of an investment bank to assist them in the sale to strategic investors of majority shares of two state-owned commercial banks.

73. **Regarding crisis management, the Banking Law empowers the BCT Governor to appeal to market solidarity or to enlist the support of shareholders in the event of a banking crisis.** This system puts the BCT at the core of the banking crisis management mechanism. It also does not specify the amounts, which the distressed bank's depositors may claim, and consequently the amounts that may be sought from other banks on the basis of market solidarity. In the event of a crisis this would lead to sharp tensions between the various participants, delaying and complicating efforts to pay back deposits. Therefore, the system should be discontinued.

74. **The BCT should prepare to cope with specific crisis situations.** In the event of the outbreak of a banking crisis it will be important to have a system in place for coordinating the participants involved (BCT, the Ministry of Finance (MoF), official receiver, courts, and the deposit insurance mechanism) and ensuring the effective implementation of certain decisions.[11] Most important, the scenarios should take into account substantive or legal questions that may arise, such as whether the general right of bankruptcy applies to banks. In the event that an official receiver and administrator or court-appointed liquidator were to follow one another in succession, it would be important to avoid conflicts of jurisdiction, and to avoid creating grounds for challenging decisions adopted by the various participants, potentially causing the decisions (or the procedure itself) to be deemed null and void.

75. **The BCT is planning to institute a deposit insurance system, as provided for in the new banking law.** The financing mechanism (pre-funding or ex post assessments) and other operating features, which are not specified in the law, should be carefully designed to balance insurance considerations against the risks of moral hazard. It would be particularly important to specify in advance the precise conditions under which the deposit insurance system would be involved, in order to prevent challenges in the event of a crisis. A detailed study to be undertaken by the BCT should examine the merits and weaknesses of alternative financing mechanisms.

[11] These decisions generally follow a sequence: receivership possibly followed by a liquidation procedure, combined with the intervention of a deposit insurance mechanism.

SECTION II. FINANCIAL SECTOR SUMMARY ASSESSMENTS

This section contains the assessments of Tunisia's observance of major international standards and codes relevant for the financial system. The summary assessments reflect the conclusions of detailed assessments of areas of stability and vulnerability, and the capacity of the authorities to address the potential risks in the financial system.

Detailed assessments of standards were undertaken based on a peer review process, as part of the Financial Sector Assessment Program (FSAP), by Stephanie Gobert (World Bank) and Léon Chaize (Consultant, French Commission Bancaire (retired)) for the assessment of the *Basel Core Principles for Effective Banking Supervision*; Dimitri Vittas (World Bank) and Marie-Noelle Bérubé (Consultant, Commission des Valeurs Mobiliéres du Québec, Canada) for the *International Organization of Securities Commissions' Objectives and Principles of Securities Regulations*; Dimitri Vittas (World Bank) for the *Principles of Insurance Regulation and Supervision*; Serge Vachon (Consultant, Bank of Canada (retired)) for the *Core Principles for Payment Systems*, and Abdourahmane Sarr and Joseph Crowley (IMF) for the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies*. The expert team prepared detailed assessments by drawing on information provided by the Tunisian authorities, including self-assessments, and on fieldwork during the February and May 2001 missions. The information was updated in February 2002 to take into account the changes introduced by the Banking Law enacted at the end of 2001.

The assessments confirm that very significant, albeit uneven, progress has been made by Tunisia in introducing frameworks for an effective implementation of international standards. The quality and effectiveness of banking supervision have improved considerably in recent years and Tunisia has established the key pillars for effective banking supervision. However, several weaknesses were identified, mainly in the areas of credit risk management and provisioning policies, and the lack of anti-money laundering legislation, which Tunisia needs to adopt. Considerable progress has also been made in securities markets in establishing a sound institutional and operational framework for securities market supervision: market regulation and supervision is based on modern legislation and on efficient trading, settlement, and surveillance facilities, and compliance with IOSCO principles is advanced. However, securities supervision suffers from weak enforcement of rules against insider trading, market manipulation, and conflict of interest situations. Progress is less advanced in the insurance sector. However, an ambitious action plan to overhaul the insurance regulation and supervision is being implemented. Formal cooperation between the three supervisory agencies (banking, securities, and insurance) has become necessary. This is because banking groups have extensive interests in nonbank financial institutions as well as in the commercial, industrial, and tourism sectors. Regarding the payment system, the planned implementation of a large-value transfer system will place Tunisia in a strong position with regard to payment systems risk management. Finally, observance of transparency principles is generally strong with regard to monetary policy conduct and the securities markets, but needs further strengthening with regard to supervision policies on banking and insurance. Also, a clarification that price stability is the primary objective of the monetary policy would strengthen further transparency of monetary policy.

VI. Compliance with the Basel Core Principles for Effective Banking Supervision

General and legal and institutional framework

76. This assessment of compliance with the Basel Core Principles for effective banking supervisions is based on extensive discussions with the staff of the *Direction Générale du Contrôle des Banques et de l'Inspection* at the BCT. Visits were made to several commercial and development banks, the Professional Association of the Banks of Tunisia and auditing firms. The assessment is based on existing laws, regulations and supervisory practices, as well as responses to a questionnaire. It was updated to incorporate the changes introduced by the new Banking Law enacted in July 2001 and where relevant the updated assessment will be noted. A summary of authorities' recent actions to remedy deficiencies noted in the original assessment will also be provided in the authorities response section.

77. The BCT is the primary regulatory and supervisory authority for the supervision of commercial and development banks, and leasing and factoring companies. It is an autonomous entity and has a high degree of financial independence, and its Governor reports to the President of the Republic. The MoF issues banking licenses on the basis of a report prepared by the BCT, the BCT is the supervisor, and the Banking Commission is a disciplinary authority that imposes penalties not within the powers of the BCT Governor.

Main findings

78. In recent years, the legal framework for commercial and financial transactions has been modernized, with a law on business groups and holding companies recently enacted. Accounting and auditing standards have been brought in line with international principles, and draft accounting standards on consolidated accounts and the treatment of business groups and holding companies were prepared and should become effective shortly.

79. The principal weaknesses identified include: (i) loan collection and collateral foreclosure procedures suffer from judicial delays. Proposed revisions to the Code of Civil and Commercial Procedures aim to reduce these delays, although problems in executing judgments remain to be addressed; (ii) informal coordination takes place between the different supervisory authorities, but no written agreements exist for the exchange of information between them; and (iii) market discipline and the development of the credit culture have suffered from Government intervention in credit operations until the mid-1990s.

80. The Banking Law gives the BCT governor the power to call on stockholders or on the banking system (i.e., other banks) for financial assistance in the case of a bank crisis. However, no plan is in place, which clearly defines the steps to take to resolve specific types of crises, and there is currently no explicit deposit insurance or guarantee mechanism in Tunisia. Following the enactment of the new Banking Law which establishes the principle of a deposit insurance mechanism, the authorities have started making preparations for the introduction of such a scheme.

81. In the last decade, the BCT has made important progress in the overall effectiveness of its banking supervision. Bank capitalization and provisioning have improved significantly and steps have been taken to clean up banks' loan portfolios. Nevertheless, the level of nonperforming loans continues to be high by international standards, and some areas of banking supervision need to be strengthened.

82. Given the high level of NPLs in bank portfolios, priority needs to be placed on actions, which could help banks improve their loan quality. In particular: (i) consolidated accounting would help banks better assess the risk of lending to groups and interrelated companies, and consolidated supervision will allow authorities to evaluate systemic concentration risks; (ii) provisioning levels should accurately reflect banks' prospects of loan recovery; (iii) minimum guidelines for bank credit policies should emphasize the analysis of borrowers' repayment capacity and loan collection procedures; and (iv) a requirement that loans to bank insiders and related parties must be made on terms and conditions that are not more favorable that those prevailing in the market should be introduced. Other recommendations for improving bank supervision include (i) arrangements for exchanging information with other financial sector supervisory authorities in Tunisia and abroad should be formalized; (ii) explicit know-your-customer rules which exist in regulations should be implemented, requiring banks to obtain information from their clients which could be used to avoid money laundering or other criminal activities; (iii) remedial enforcement actions (even regarding small cases of non-compliance with prudential regulations) should be applied consistently, so as to set appropriate incentives in the sector; and (iv) in order to prevent undue political interference in the management of the BCT the reasons for which the Governor can be removed from his position should be specified in the law.

Table 6. Recommended Actions to Improve Compliance with the Basel Core Principles

Subject	Recommendations
Objectives, Autonomy, Powers, and Resources (CP 1)	The banking law and the central bank legislation clearly define the roles and responsibilities of the various entities involved in banking supervision with the BCT playing a central role in licensing and enforcing regulations. The BCT has sufficient resources to carry out its mission but its independence could be enhanced by specifying grounds for removal from office of members of its governing body. The BCT participates in the work of the other bodies involved in supervising the financial system but formal arrangements for sharing information should be established.
Licensing and Structure (CPs 2–5)	Financial institutions licensed for banking activities and subject to banking supervision are clearly defined. Licensing criteria are described in the banking law and are largely adequate. The BCT has authority to review and reject transfers of significant ownership or controlling interests in banks and the new Banking Law has defined thresholds beyond which the BCT should be informed. The BCT has established criteria for review of major acquisitions by banks, and the new Banking Law has defined clear assessment criteria for authorizations and waivers.
Prudential Regulations and Requirements (CPs 6–15)	The banking law or prudential regulations establish the minimum capital requirement and a capital adequacy ratio, and actions or sanctions that may be taken based on levels of capital shortfall. However, the capital adequacy ratio would need to be calculated on a consolidated basis. Although the BCT requires that bank audit reports include an opinion on the quality of management and on written policies and procedures, it has not itself defined minimum guidelines for appropriate credit policies. While loan classification rules are in line with best practices, loan evaluation and loan loss provisioning remain weak despite significant efforts in

Subject	Recommendations
	recent years; they need to be strengthened. Largely adequate regulation to control large exposures and connected lending is in place. The BCT requires that banks have appropriate internal controls and audit systems, and the new banking law has further strengthened the obligations imposed on banks in this regard. Legal provisions to prevent money laundering need to be established.
Methods of Ongoing Supervision (CPs16–20)	The BCT conducts on-site and off-site supervision and maintains regular contact with bank management and appointed contacts in each bank. Banks are also audited by external auditors. Warning levels for ratios analyzed should be established and financial information should be analyzed on both individual and consolidated basis.
Information Requirements (CP 21)	Tunisian accounting practices are generally adequate but could be improved in particular with the concept of consolidation, which is being introduced.
Formal Powers of Supervisors (CP 22)	Although the BCT has adequate powers to bring about appropriate corrective actions when banks fail to meet prudential requirements, the powers are not systematically used. The BCT should make every effort to use its powers in a more systematic manner.
Cross-border Banking (CPs 23–25)	Tunisian banks have limited activities in foreign territories. Foreign banks in Tunisia are subject to local prudential regulations. The relations maintained by the supervisory authorities with their counterparts abroad are however informal. Formal agreements on information sharing, subject to confidentiality, should be established.

Action plan and authorities' response

83. While the authorities were in broad agreement with the assessment, they pointed to areas where differences of interpretation remained. Regarding credit policies, even though the authorities were of the view that arrangements in place were strong, the mission took the view that there was room for improvement given the high level of NPLs in the banks' portfolio, the banks' policies, practices and procedures related to the granting of loans and the ongoing management of the loan portfolio. Regarding loan evaluation and provisioning, the authorities believed that current policies were adequate; the mission took the view that full deduction of real estate collateral values from provisioning requirements in a context of cumbersome and long judicial procedures for recovery was not sound practice. Furthermore, tax rules do not encourage adequate provisioning. Finally, key data for an assessment of the adequacy of provisions (i.e., age of NPLs and recovery rate of collateral) is not available at the BCT. In collaboration with the World Bank, the authorities have agreed to conduct a study, which will provide this data. Regarding remedial measures, the authorities were of the view that current arrangements were appropriate given that the BCT continually monitors compliance with the regulations in force, and has the power to impose penalties for non-compliance; however, the mission noted that the BCT has not made a systematic use of its powers to issue injunctions and impose sanctions on non-compliant banks.

84. The authorities have implemented several legal, regulatory, and administrative measures to enhance banking system oversight following the FSAP assessment. The new Banking Law has corrected several weaknesses with regard to compliance with the Basle Core Principles for effective banking supervision. In particular, the new law specifies that the minimum required capital must be paid as soon as a bank is created; the roles of a bank's internal audit function have been strengthened; the definition of connected parties has been clarified and expanded; conditions under which a bank's provisional administrator is appointed and the administrator's associated powers have been specified; and the law

establishes the legal framework for a deposit insurance scheme. A new law defining groups and holdings has also been enacted and the law on consolidated accounting should be enacted shortly. Prudential regulations have been reinforced, notably concerning quantitative rules to monitor and control banks' large exposures and their liquidity positions. At the administrative level, the off-site and on-site supervision functions of the BCT have been merged into the same department to enhance coordination of these two complementary functions.

85. The authorities also indicated that existing laws to some extent incorporate regulations to combat money laundering and that preparatory work to draft specific legislation necessary to fill in any gaps against money laundering is underway. The authorities noted that BCT circulars to banks require know-your-customer rules, which allow identifying bank account owners and individuals initiating transactions on bank accounts. The authorities indicated that Tunisia has legislation against drug trafficking and the associated money laundering. They have also signed international convention on fighting terrorism. However, there is no obligation for the banks to report suspect operations to the police, the courts, or a specialized agency.

VII. Observance of IAIS Insurance Core Principles

General and legal and institutional framework

86. This assessment of observance of the IAIS Core Principles for Insurance Supervision is based on meetings with representatives of the DGA, the Tunisian Federation of Insurance Companies (FTUSA), and a number of insurance companies. It is also based on a review of current laws and regulations and responses to a questionnaire

87. The DGA, which forms part of the MoF, is the supervisory authority for the insurance sector. It is not an independent authority and does not have its own budget. The DGA is responsible, among other things, for all legal, technical, and economic issues pertaining to insurance operations, enterprises, contracts and special regimes, as well as questions connected with professional education and training. The DGA is also responsible for supervising insurance and reinsurance companies and intermediaries.

88. The DGA is supported in discharging its functions by the National Insurance Council (CNA) and the Consultative Commission on Insurance (CCA). The CNA is chaired by the Minister of Finance, and its membership includes representatives of insurance companies and professional experts. The CCA, established within the CNA, is responsible for giving its opinion on licensing issues. Decisions pertaining to the insurance sector are always taken officially by the Minister of Finance, on the basis of files examined by the DGA, and in consultation with the CNA and CCA.

89. The FTUSA represents the interests of insurance companies. It plays a limited role as a self-regulatory organization but its importance is likely to increase in the future, since it

will be called upon to play a central part in developing a code of good conduct for insurers and brokers and in building a national database on loss experience and mortality tables.

Main findings

90. The limited resources and capability of the DGA in the past has been reflected in infrequent on-site inspections and weak enforcement of prudential regulations. As a result, several companies have been allowed to operate with inadequate capital or technical reserves. Corrective action has been slow and deficient. Several of the private companies with foreign shareholders are strongly capitalized, fully provisioned, and operate efficiently and profitably.

91. The DGA has recently adopted a more active approach. With support from an Ad Hoc Committee of Insurance Experts, it has ordered the undertaking of detailed audits by all companies. These have confirmed a significant insufficiency of technical provisions in a number of companies. The DGA has also undertaken an examination of the Insurance Code and has drafted amendments for its modernization in key areas, and appropriate amendments to the Code are ready for submission to the Chamber of Deputies. The DGA has also initiated a major review of the legal and regulatory treatment of motor insurance, especially the branch of compulsory third party liability. Another major initiative of the DGA concerns the strengthening of its supervisory functions which will involve creation of a new organizational structure, hiring and training expert staff, undertaking a program of regular off-site analyses and on-site inspections, and stricter enforcement of prudential rules.

92. The legal system is favorable to an efficient functioning of insurance supervision. The weaknesses that have existed in the past have resulted from the weak enforcement of existing regulations and the inadequacy of financial and human resources of the supervisory agency. The new approach, comprising the proposed amendments to the insurance code, the more fundamental reform of motor insurance, and the strengthening of supervision, and supported by the new Code on business corporations and the new accounting and auditing standards, will satisfy the basic preconditions set out by IAIS. Implementing more effective corporate governance provisions and adopting a code of good conduct will complete the legal framework.

93. The current action plan that has been adopted by the authorities in the context of the restructuring and development of the insurance industry goes a long way toward improving and strengthening insurance regulation and supervision. The plan covers the more rigorous application of prudential rules, the restructuring and recapitalization of weak companies, the modernization of some provisions of the Insurance Code, the longer-term reform of the branch of automobile insurance, and the promotion of group life insurance.

94. In revising the insurance code and the prudential regulations, attention needs to be focused on the gaps identified in this assessment, such as the adoption of clear rules on the financial resources of owners of insurance companies, on corporate governance and internal controls, on sound and transparent financial policies, and on protecting the interests of policyholders. With regard to the internal organization of the DGA, a reorganization plan has

been adopted that aims at strengthening enforcement of prudential and conduct rules, hiring and training expert staff, developing independent funding sources (e.g., levies on regulated companies), and eventually creating an independent regulatory commission.

Table 7. Recommended Actions to Improve Observance of IAIS Insurance Core Principles

Subject	Recommendations
Organization of an Insurance Supervisor (CP 1)	The DGA is part of the MoF—which has official decision-making authority—and does not have its own independently funded budget; to ensure efficiency, the DGA should be financially autonomous. The DGA, the CNA and the CCA are consulted before making decisions. Inadequate capacity at the DGA is reflected in infrequent on-site inspections and weak enforcement. DGA personnel have inadequate legal protection.
Licensing and Changes in Control (CPs 2–3)	Licenses are issued by the MoF after consultation with the CCA and after the DGA has examined the application; a manual of licensing procedures should be prepared. Several insurance company stockholders have inadequate resources to meet new capital requirements; suitability criteria for officers and board members is not clearly specified, and the DGA has limited authority to reject license applications. The DGA, while notified when there is a substantial change in control of a company has no authority to block the change. The DGA should have the authority to reject a license application if it finds that the management is not qualified to run the company appropriately.
Corporate Governance (CP 4)	Apart from the Law on Commercial Companies, which covers all types of firms in Tunisia, there are no laws on governance in the insurance industry, and the DGA has no specific authority regarding governance. The board members of insurance companies have no explicit fiduciary responsibility to serve the best interests of policyholders. These concepts need to be introduced in Tunisia's legal framework for the insurance sector.
Internal Controls (CP 5)	The new chart of accounts includes specific rules governing internal controls, but the DGA has no specific authority to review or enforce internal controls, and on-site inspections are too infrequent to provide useful information. Insurance companies are required to appoint auditors, but these auditors are not required to share information with the DGA. Measures to enhance the legal framework should be taken so as to enable the supervisory authority to take more direct action at the insurance company level. The responsibility and authority for supervising internal controls should not simply be delegated to accounting auditors but should be shared with the DGA.
Prudential Rules (CPs 6–10)	There is a list of assets accepted as part of technical provisions, and a chart of accounts approved in 2000 clarified rules pertaining to the presentation of financial statements and insurance companies' investments. The calculation of provisions for technical reserves is clearly specified. Nevertheless, DGA supervisors are unable to match assets and liabilities during their on-site inspections, and lack the authority (as well as capacity and expertise) to require insurance companies to establish an investment strategy, to evaluate and challenge valuation assumptions for technical reserves, or to assess the company's overall financial strategy. The powers, capacity, and expertise of the DGA in these areas need to be strengthened. The calculations of capital and solvency margins are defined but they should be brought in line with international standards. The DGA needs to strengthen its supervision of reinsurance given that there are no limits or restrictions on and virtually no supervision of the sector.
Market Conduct (CPs 11)	The existing regulations contain no provisions in this area apart from the requirement of a professional identity card for intermediaries and agents, damage surveyors, and loss adjusters. There are no specific standards on the code of conduct, ethical principles, conflicts of interest, or the protection of insurance contract beneficiaries. Relevant rules and regulations need to be established.
Monitoring, Inspection and Sanctions	Companies are required to produce an annual report and submit quarterly statistical statements pertaining to their insurance and investment operations. Accounting standards specify the criteria and frequency for the reporting of financial information by insurance

Subject	Recommendations
(CPs 12—14)	companies and that auditors at insurance companies are responsible for providing this information. However, consolidated accounting and legislation on the treatment of groups should be established. Sanctions are specified in the Insurance Code, but the DGA has neither the resources nor the authority to conduct effective on-site exams, so sanctions are difficult to implement. The resources and mandate of the DGA in these areas need to be strengthened.
Cross-border Business Operations (CP 15)	NA
Supervisory Coordination and Cooperation, and Confidentiality (CPs 16–17)	Formal protocol for sharing information between national supervisory agencies needs to be established. International cooperation should be encouraged with a view to ensuring its beneficial impact upon the supervisory authority's capacity to perform its functions more effectively and to conform to international standards. DGA personnel are subject to professional secrecy constraints, but there is no legislation for the sharing of confidential information for supervision purposes with insurance supervisors in other jurisdictions; such legislation needs to be established.

Action plan and authorities' response

95. The DGA was in broad agreement with the assessment and it was noted that the proposed revision of the insurance code and the reorganization of the DGA will allow compliance with a number of current weaknesses (capital adequacy and solvency; inclusion of reinsurance operations under the control of the regulator; and strengthened effectiveness of on-site inspections). Furthermore, a code of good conduct may be issued by the insurance association. Areas where differences of interpretation remained have to do with the organization of the insurance supervisor, where the authorities were of the view that, except for the lack of financial autonomy, all the other aspects comply with the required standards and conditions. In the opinion of the mission, a higher assessment could not be justified given the current state of regulation and supervision of the sector. Regarding internal controls and prudential rules, the authorities thought that current regulations were adequate. However, the mission noted a higher assessment would have been justified if the IAIS principles were based on a classification scale with six categories, which is not the case currently. Furthermore, the fact that the recent external audits of insurance companies established a significant insufficiency of technical provisions in four companies does not permit a higher assessment.

VIII. Observance of IOSCO Objectives and Principles of Securities Regulation

General and legal and institutional framework

96. This assessment of implementation of the objectives and principles of securities regulation of the International Organization of Securities Commissions (IOSCO) is based on discussions with representatives of the CMF, the BCT, the BVMT, the Central Securities Depository (STICODEVAM), the Association of Market Intermediaries (AIB), market

intermediaries, and other market participants, as well as on a review of the laws and regulations in force and in preparation, and responses to a questionnaire.

97. The CMF is the primary regulatory and supervisory agency for the securities markets. It is an autonomous entity and enjoys a high degree of financial autonomy. Its President reports to the President of the Republic. The CMF plays an active part in initiating the preparation and drafting of relevant laws and regulations, although these are subject to the approval of the Minister of Finance. Draft laws are submitted by the Minister of Finance to the Chamber of Deputies for deliberation and adoption, while implementing regulations are issued in his name.

98. The CMF is responsible for the supervision of market participants, the BVMT, the STICODEVAM, market intermediaries, and collective investment schemes. The BVMT, STICODEVAM, and the AIB play a very limited role as self-regulatory organizations, although the part played by the AIB is likely to grow in the future, following the elaboration and adoption of a code of good conduct by intermediaries.

99. Cooperation between different national regulatory agencies takes place on an informal and ad hoc basis. The need for formalizing and increasing such cooperation by signing formal Memoranda of Understanding is now fully accepted.

100. The BVMT is the national stock exchange where listed equities and bonds are traded. It was privatized by its conversion into a *société anonyme* owned by its members in 1994, when the CMF was also established. The BVMT has a fully automated trading system and an electronic surveillance system. The shares of 44 companies are listed and traded on the exchange, although some trading also takes place on the unlisted market.

101. The STICODEVAM provides highly automated record keeping and depository services and facilitates the clearing and settlement of transactions through accounts held by banks with the central bank. All securities are now registered on book-entry system and participation in the market by brokers requires a high level of automation and ability to meet the technical standards set by STICODEVAM.

102. The AIB represents the interests of brokers (currently 26, more than half of which are affiliated with banks). Market activity is concentrated in the hands of the largest four or five brokers. Several of the smaller brokers are considering exiting the market, especially in view of the growing cost of regulation. This situation, however, necessary to enhance the investor confidence in market integrity and transparency and thus a reduction in the number of market intermediaries may be unavoidable.

Main findings

103. The regulatory framework is modern and the basic objectives of regulation are in line with the fundamental principles advocated by IOSCO. The CMF has the power to issue prudential and solvency regulations, as well as general and specific regulations on securities

market supervision, subject to the approval of the Minister of Finance. It issues licenses to market intermediaries and can revoke or suspend such licenses on the advice of the AIB.

104. Self-regulated organizations (SROs) play a limited role in the regulatory system. The fact that the BVMT is partially owned by market intermediaries has constrained its ability to impose disciplinary measures on its members. The BVMT is responsible for issuing regulations on the operation of the listing system and the conditions for listing financial products. These regulations are subject to approval by the CMF. STICODEVAM has prepared a manual of technical procedures that market intermediaries must follow to ensure that the system functions properly, allowing it to play an indirect regulatory role.

105. Public offerings of securities are subject to a comprehensive set of regulations that require the disclosure of complete, accurate and reliable information. A remaining problem is the absence of consolidated accounts. There are extensive regulations and detailed disclosure rules on mergers and takeovers, on reporting transactions by insiders and any changes in significant shareholdings, and on the equal treatment of shareholders that aim at protecting the interests of minority shareholders and outside investors.

106. Listing requirements are set by the BVMT subject to the approval of the CMF and the Minister of Finance. For a company to be listed on the main (first) equity exchange, it must have published audited financial statements for the three fiscal years preceding the listing application. For a company's shares to be listed on the second exchange it must have published certified financial statements for the two fiscal years preceding the listing application, and the company must have 10 percent of its shares held by at least 300 shareholders.

107. Licensing requirements for market intermediaries are set by the CMF, and their regulation is adequate. A Market Guarantee Fund was created for the purpose of guaranteeing the successful conclusion of transactions negotiated among market intermediaries. The regulations also provide for the establishment of a Customer Guarantee Fund to cover customers' noncommercial risks, i.e., losses from fraud or gross negligence, although it has yet to be established.

108. The CMF has broad powers to enforce the relevant laws and regulations, and can impose fines. It uses an electronic surveillance system to detect any irregularities in market prices that might reflect attempts at market manipulation or insider trading. It has the authority to conduct regular inspections as part of its normal ongoing supervision of market participants, as well as ad hoc inspections following the detection of irregularities. Its employees can conduct on-site investigations of any individual or legal entity.

109. The CMF has exhibited a degree of flexibility in enforcing sanctions. Because the local market is still in its infancy, the disciplinary sanctions imposed are not always commensurate with the violations committed by market participants. To counter any weakening of investor confidence in the integrity and transparency of the market because of the leniency of most sanctions, many of these sanctions would need to be strengthened.

110. There is no formal protocol of cooperation among national regulatory agencies and limited formal cooperation with foreign regulators. The growing role of financial conglomerates call for formal cooperation among the various regulatory agencies.

Table 8. Recommended Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation

Subject	Recommendations
Principles relating to the regulator, (CPs 1–5)	The CMF has a clear mandate to guarantee the protection of savings invested in securities and marketable financial products and any other investment in public issues. The CMF is an independent legal institution with financial autonomy, although its members can be removed by decree in a discretionary manner. It has adequate legal authority to carry out it functions, but lacks sufficient capacity, and it need to prepare a procedures manual to ensure compliance with standards of fairness. The members and staff of the CMF are bound by professional secrecy rules.
Principles of self-regulation (CPs 6–7)	Self-regulatory organizations (SROs) play a very limited role in the regulatory system. The BVMT imposes limited disciplinary measures on its shareholders, while the STICODEVAM has prepared a manual of technical procedures that market intermediaries must follow to ensure that the system functions properly. Both are subject to continuous supervision by the CMF. The role of the AIB could be expanded, inasmuch as it has in-depth knowledge of market practices, and self-regulation is likely to encourage compliance with ethical rules.
Principles for the enforcement of securities regulation (CPs 8–10)	The CMF has the authority to conduct regular inspections, as well as ad hoc inspections following the detection of irregularities, and its employees can conduct on-site investigations. It has broad powers to enforce laws and regulations and impose disciplinary measures, including fines, but it exhibits a degree of flexibility and general lack of severity that could weaken investor confidence in the integrity and transparency of the market. Measures should be adopted to increase the severity of sanctions and gear them to violations, so as to reinforce the regulator's credibility and the integrity and transparency of the market. The creation of a disciplinary (enforcement) department could be helpful in this area.
Principles for cooperation in regulation (CPs 11–13)	The CMF cooperates informally with the MoF, the BCT, and judicial authorities, and can cooperate or sign agreements with international authorities, and has established cooperation agreements with France and a few Arab countries. Formal agreements on information sharing with the other national regulatory agencies, subject to confidentiality, should be established.
Principles for issuers (CPs 14–16)	Laws governing the provision of clear and reliable public information on publicly listed companies, and protecting the rights of shareholders, are sound and clear, and the CMF has been diligent about educating issuers and overseeing the quality of information provided. New accounting standards consistent with best international norms have been introduced. However, consolidated accounts by industrial, commercial, and financial groups need to be established. Auditing standards have been upgraded and aim at increasing independence of auditors. The capacity of the CMF to protect shareholders could be enhanced with further regulation and additional training of staff.

Subject	Recommendations
Principles for collective investment schemes (CPs 17–20)	The regulations in place at the time of the assessment provided for the operation of investment companies or collective investment schemes and the creation of open-end, closed-end, and venture capital investment companies as well as common investment funds, but the Tunisian authorities deemed these regulations inadequate. New robust legislation has been enacted since the completion of the assessment. The regulations require that a detailed prospectus be prepared and submitted for CMF approval, and that audited financial statements be published. However, rules on the erection of Chinese walls between the various activities of managers need to be established. Regulations specify the required frequency of reporting asset valuation, and though clear rules on valuation methods are not specified, new accounting standards approved in 1999 and gradually being established largely rectify this shortcoming.
Principles for market intermediaries (CPs 21–24)	Market intermediaries are licensed by the CMF, on the advice of the AIB, according to requirements that are specific and clear. The regulations clearly define the minimum level of equity capital, but they should be amended to specify that market intermediaries are to maintain sufficient financial resources to meet cash requirements. The ethical and internal control standards are consistent with IOSCO principles. The CMF has worked hard to educate market intermediaries about the need to complying with these standards. A Market Guarantee Fund guarantees the successful conclusion of transactions negotiated among market intermediaries, while a yet-to-be-established Customer Guarantee Fund would cover customers' noncommercial risks.
Principles for the secondary market (CPs 25–30)	The BVMT manages the secondary debt market and the equity market, subject to CMF supervision, in a sound and clearly defined manner, and the Stock Exchange's rules governing trading, the delivery of securities, and cash payments are appropriate and effective. The BVMT and STICODEVAM are subject to continuous supervision by the CMF, and the General Securities Exchange Regulations and the trading floor regulations are approved by the CMF. The BVMT has adopted a successful electronic quotation system. Detection of unfair practices functions effectively, but sanctions should be strengthened, partly because of the difficulty of proving infractions with certainty. The prudential rules are currently sufficient to manage large exposures, but as financial liberalization proceeds further regulations will be needed to control the risks that will arise as new instruments become available. The securities transactions clearing and settlement system is strong.

Action plan and authorities' response

111. The CMF has agreed with most of the findings of the assessment. In its comments it has indicated areas where there is room for difference in subjective interpretation. This relates particularly to the apparent inadequacy of sanctions and the underlying concern of avoiding an overreaction that might discourage both issuers and investors from participating in the markets. However, the CMF fully endorsed the importance of protecting the interests of investors and instilling greater confidence in market transparency and integrity. It has taken steps to encourage the development of a code of conduct by the association of market intermediaries.

112. With the expected adoption of new laws on collective investment schemes, company groups, and holding companies as well as the new accounting standards on consolidation, the modernization of the regulatory framework would be further advanced. The CMF agrees that

its future action plan should focus on improving its internal organizational structure, probably by creating a specialized enforcement unit, completing the drafting of various manuals covering licensing, inspection and enforcement, developing a more efficient information system, and continuing with its program of hiring, training and retaining staff of high caliber and integrity.

113. As part of its ongoing support from multilateral institutions, the CMF is conducting two studies, one covering its internal organizational and information system needs and the other addressing the obstacles to the further development of the Tunisian securities markets.

114. The CMF also fully supports the need for formal memoranda of cooperation between the various national regulatory authorities, while it continues to pursue the signing of conventions with foreign securities commissions, similar to the convention already in place with the *Commission des Operations de Bourse* (COB) of France.

IX. Observance of the CPSS Core Principles for Systemically Important Payment Systems

General and legal and institutional framework

115. This assessment on Observance of the CPSS Core Principles for Systemicaly Important Payment Systems is based on discussions with BCT representatives, responses to a questionnaire; a review of the main laws and regulations governing the payment system, and the proposed arrangements for the introduction of a large-value transfer system (REV).

116. The commercial banks and the central bank form the cornerstone of the payment system. The commercial banks hold the vast majority of deposits, while the BCT plays a primary role in the operations and regulation of the national clearing system for checks and collection items. Manual clearance of checks is done by the clearinghouses of the BCT, which is also the regulator for the Interbank Teleclearing Corporation (SITBEL), the owner of the teleclearing system for transfers and debits.

117. The BCT also intends to implement a REV, and will offer real-time gross settlement of large-value payments, and final settlement on the value date. The BCT will own, operate and regulate the system.

118. Tunisia has a complete and generally up-to-date legal framework, covering all types of conventional payments as well as the most modern electronic payments. With respect to the REV, the legal framework, rules and procedures are still being prepared.

Main findings

119. The national clearing and settlement system for checks and collection items handles more than 90 percent of payments by value, and thus has systemic importance. However, the system is not compliant with core principles 4 and 5 of the CPSS since final settlement is

deferred until the following day (D+1). In addition, in this system, if one participant is unable to make settlement, the consequences for other participants in terms of credit and liquidity risks are potentially severe because the unwinding procedure in place may not guarantee settlement.

120. The BCT should move quickly to implement the REV. The specifications of the system will allow for final settlement of payments on the day of value, and for effective control of systemic risk. In terms of the message dissemination structure used, the BCT should consider a V structure rather than a T structure.[12]

121. The REV system will handle interbank transfers, and its rules and operating procedures are primarily of interest to the commercial banks. Nevertheless, other system users such as non-financial corporations will also want to understand the scope of the rules and procedures. Therefore, the BCT should adopt a transparent approach and make the rules directly accessible to all interested parties.

122. The authorities should migrate large-value payments to the REV. Many of these payments relate to purchase and sale of securities through the STICODEVAM. The authorities should assess the implications that this major shift might have on controlling payment risks to which account holders and other STICOVEDAM clients are exposed. In the interest of the proper functioning of the REV, the STICOVEDAM should eliminate the two-day waiting period to which its transactions are subject for pledging securities to the BCT. Migration of payments to the REV will automatically entail reducing the settlement time from D+4 to D+3.

123. If the check clearing system remains systemically important after the large value checks are transferred to the REV, the mission recommends that the BCT put in place guarantee arrangements to ensure settlement, since unwinding can result in gridlock. Such arrangements could, for instance, be a pool of collateral that participants would pledge to cover their debit balances. Alternatively, survivors of a failed participant could cover the debit balances of the defaulting bank according to an agreed mechanism before hand (e.g, maximum exposure to the defaulting bank, or prior bilateral limits).

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[12] In contrast to the T structure, whereby the issuing bank sends the payment instruction to the central bank simultaneously with advice to the receiving bank, the V structure ensures that the beneficiary bank receives the payment message only after the transaction has been processed at the central bank.

Table 9. Recommended Actions to Improve Observance of CPSS Core Principles and Central Bank's Responsibilities in Applying the CPs

Core principles	Main findings and Recommendations
Well founded legal basis under all relevant jurisdictions (CP 1)	Tunisia has a complete legal framework that covers traditional forms of payment as well as the most modern electronic payments.
Clear understanding of the system's impact on risks, and risk management procedures (CP 2–3)	Participants understand the system's impact on risks. In the current clearing system, however, where final settlement is on D+1, participants cannot control their balances and hence their credit and liquidity risks on day D.
Prompt final settlement, inability to settle by the participant with largest single settlement obligation (CP 4–5)	For the check clearing system the BCT should ensure that clearing and settlement is done on the same day. Also, unwinding may not ensure timely settlement. The BCT should put in place risk control measures to ensure timely settlement. The REV will ensure final settlement on day of value.
Assets used for settlement (CP 6)	Assets for settlement consist of deposits in the BCT.
Security and operational reliability, contingency arrangements (CP 7)	The BCT should put in place contingency plans to ensure payments system continuity in case of system failure.
Practical for users and efficient for the economy (CP 8)	The BCT should implement measures to reduce the long delay for beneficiaries to received credit for deposited checks.
Objective and publicly disclosed criteria for participation (CP 9)	Access is free for all banks established in Tunisia and participation is non-discriminatory.
Governance arrangements should be effective, accountable in transparent (CP 10)	The BCT should improve observance of CP3, 4, and 5.
Responsibilities of the central bank in applying the core principles (CP 11)	The BCT owns, operates and regulates all systemic payment systems in Tunisia.

Action plan and authorities' response

124. The authorities were in broad agreement with the assessment. They assured the mission that efforts are well underway to implement the REV by the end of 2002.

X. Observance of the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies

A. Banking Supervision

General and legal and institutional framework

125. This assessment of practices in Tunisia in relation to the transparency of financial policies is based on the laws establishing the BCT and governing the banking profession, together with numerous Circulars, data, speeches, and other information, which were available on the BCT's Internet site, as well as discussions with BCT representatives and responses to a questionnaire. The BCT is the body that supervises commercial banks in Tunisia. The MoF issues banking licenses, and the Banking Commission is a disciplinary authority that imposes penalties not within the powers of the BCT Governor.

Main findings

Clarity of roles, responsibilities and objectives of financial agencies

126. The presentation of laws and regulations and the explanation of objectives were generally strong. All laws and most, but not all, circulars are published on the Internet, and with little additional effort the authorities could easily add the missing circulars, as well as any other relevant publications, to their website. Changes to laws are published in advance, but it would be useful to announce them to the public as well and to more clearly formalize the opportunity the public has to comment on impending changes. The processes for formulating and reporting financial policies was also good, but would benefit from a clarification of the procedures governing the employment and accountability of BCT staff, as well as of the division of responsibilities between the BCT and the CMF.

Open process for formulating and reporting of financial policies

127. Major changes in the regulatory framework are published on the *Actualités* (Current Events) page of the BCT's Internet site, although it would also be useful to announce to the public by press release any significant changes.

Public availability of information on financial policy

128. The presentation of data describing the policies and effectiveness of banking supervision need to be strengthened. The Annual Report of the BCT could be enhanced by the addition of a section on banking supervision including a description of its objectives, an accounting of its efforts to achieve these objectives, and providing aggregate statistics on the soundness of the banking sector that do not threaten the confidentiality of the information given by any particular bank. Alternatively, the BCT could prepare a dedicated Annual Report for its banking supervision functions.

Accountability and assurance of integrity of the financial agency

129. The transparency of measures to ensure the integrity of the institution could also be improved, in particularly by publicly disclosing the internal arrangements for the auditing of the BCT and the controls governing the financial affairs of BCT staff.

130. Appointment procedures, terms of office, and criteria for removal are specified only partially in the BCT Law. It would be desirable to specify the criteria for removal of the Governor, the terms of office and criteria for removal of the Vice-Governor, and the criteria for removal of Board members, as well as the professional attributes required of the holders of these posts. The length of the term of office of members of the Banking Commission and the authority appointing them should also be specified.

Table 10. Recommended Actions to Improve Observance of IMF's MFP Transparency Code—Banking Supervision

Subject	Recommendations
Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies	The objectives and responsibilities for banking supervision are clear. Laws and a number of Circulars relating to banking supervision are available on the BCT's Internet site. The procedures used by the BCT, the Ministry of Finance, and the Banking Commission to account for their actions in the area of banking supervision need to be strengthened and publicly disclosed.
Open Process for Formulating and Reporting Financial Policies	The implementation of banking supervision and the communication of information are transparent. However, the relationship between the BCT and the CMF must be specified. The BCT should publish a report, or amend its annual report, with a view to providing a summary of the provisions adopted for achieving banking supervision objectives.
Public Availability of Information on Financial Policies	The BCT Internet site and publications contain aggregate macroeconomic data on banks' assets and liabilities, but not on the overall financial position of the system. The BCT should produce a periodic report on banking supervision.
Accountability and Assurance of Integrity by Financial Agencies	The annual report, which the BCT is required to submit to the President of the Republic, does not deal with banking supervision matters. Internal audit arrangements are not publicly disclosed.

Action plan and authorities' response

131. The authorities were in broad agreement with the assessment. In particular they agreed that aggregate information on their actions should be presented, and said that this could be done either in the Annual Report of the BCT or in a specific report.

B. Monetary Policy

General and legal and institutional framework

132. This assessment of practices on transparency in monetary policy in Tunisia is based primarily on the law establishing the BCT, BCT publications, information available on its website including its bulletins, discussions with BCT executives, and responses to a questionnaire.

Main findings

133. The primary objectives of monetary policy defined in legislation include preserving the value of the currency and to support the economic policies of the government. The main purpose of monetary policy, as further explained on the BCT's website, is to preserve the value of the currency. No clear ranking of the bank's objectives an explanation of the potential tradeoffs is available to the public. The central bank has the authority to utilize monetary policy instruments to attain its objectives but the amount of government securities it can hold for monetary policy purposes cannot exceed 10 percent of government recurrent revenues. Other responsibilities of the central bank including the modalities of accountability are specified in legislation. The institutional responsibility for foreign

exchange policy is not clearly defined and publicly disclosed. The institutional relationship between monetary and fiscal operations is clearly defined.

134. The process of formulating and reporting monetary policy decisions is generally transparent. The central bank explains the framework of monetary policy, including its intermediate targets. The rules and procedures used by the Central bank in its monetary operations and the governance structure of its monetary policy body are publicly disclosed. Main considerations underlying monetary policy decisions, which are contained in board minutes, are however not publicly disclosed. Central bank reports also do not specifically explain progress made toward achieving monetary policy objectives and prospects for achieving them. General public information on monetary policy including relevant central bank data is available to the public. BCT's financial statements are also available to the public although they are not audited by an independent auditor.

Clarity of roles, responsibilities and objectives of central banks for monetary policy

135. It would be useful to further clarify the central bank's primary objective. This would be helpful, since the BCT is entrusted with several missions in its charter, in particular supporting the government's economic policy, in addition to its general mission of defending the value of the currency and ensuring its stability.

136. The limitation of the amount of government securities that the BCT can hold for monetary operations purposes, at 10 percent of government recurrent revenues, could impair monetary management. The BCT should be able to carry out monetary operations with negotiable government securities, such as treasury bills, in any necessary quantity. If the limit is meant to encourage banks to provide credit to priority sectors as identified by the BCT, it could be interpreted as a measure meant to encourage quasi-fiscal operations. The BCT could then incur significant credit risk. Credit risk for the central bank can be minimized by using treasury bills for money market operations. Furthermore, such practice may be detrimental to the development of a sound credit culture.

137. The law does not clearly designate the authority that decides the exchange rate policy. The BCT website indicates that the central bank ensures the external stability of the currency; however, this is not specifically mandated by law.[13]

[13] It is generally recommended that the central bank not be given the authority to set foreign exchange policy, but rather that it serve as an advisor on the matter. This is because many government policies that the central bank does not control can influence exchange rates, in particular customs and tax policies and their impact on the balance of payments current and capital accounts. Therefore, central bank charters often specify that foreign exchange policy is to be set by the government and implemented by the central bank. It is also generally advisable for the central bank to have the opportunity, under the regulations, to provide explanations to the government and the public when circumstances beyond its control prevent it from reaching the foreign exchange objectives assigned by the government.

138. Greater transparency regarding the criteria for appointing and removing members of the BCT board of directors would be desirable.[14] The criteria are generally specified in the central bank charter for all voting members of the board.[15] Finally, the provisions of the central bank law on the composition of the board give the government considerable influence over BCT decisions. This could also limit the transparency of monetary policy formulation.

Open process for formulating and reporting monetary policy decisions

139. Systematic assessment of the results of monetary policy compared with the declared objectives would allow the public to judge the performance of the central bank's management body. Such an analysis is possible in Tunisia, given the BCT's inflation objective. Therefore, the link between the macroeconomic analysis found in the BCT's Annual Report and the prospects of the BCT reaching its objectives could be analyzed more systematically. This would help the public better understand reasons behind monetary policy decisions and, implicitly, foreign exchange policy decisions.

Public availability of information

140. There is no schedule for submission of the BCT annual report to the public. A predetermined schedule for submission of BCT annual report should be set to prevent the BCT from delaying the publication. Tunisia subscribes to the Special Data Dissemination Standard of the IMF since June 2001. This should help improve the coverage and periodicity and timeliness of the BCT's published data.

Accountability and assurances of integrity by the central bank

141. The code of good practices on transparency recommends that central bank accounts be audited by an independent auditor, preferably one outside of the government. In Tunisia, BCT accounts are audited by the government controller who is also a member of the BCT board. Most central banks have their annual financial statements audited by a private, independent auditing firm to better ensure accounting propriety.

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[14] Best practices recommend that central bank board members with decision-making authority be selected on the basis of their monetary and banking competence. The term of office of board members should preferably exceed that of the government authority that appoints them. This helps to strengthen their independence from the government authority and allows for enhanced integrity in monetary policy formulation.

[15] The decision to remove a member could also be submitted for consideration to a body such as the parliament, or the courts, when there is a conflict between the government and the central bank on this course of action.

Table 11. Recommended Actions to Improve Observance of the IMF' MFP Transparency Code Practices—Monetary Policy

Subject	Recommendations
Clarity of Roles, Responsibilities, and Objectives of Central Banks for Monetary Policy	It would be advisable for the Law to specify whether the government or the central bank defines the exchange rate policy. The legislation could also indicate that the priority objective of the BCT is monetary stability, over and above its other responsibilities to confirm the BCT's understanding. The criteria for appointing and removing Board members should also be clarified.
Open Process for Formulating and Reporting Monetary Policy Decisions	The BCT could plan to publish the minutes of its board of directors' meetings. Monetary operations could be made more transparent through the use of treasury bills or private paper of appropriate credit risk quality.
Public Availability of Information on Monetary Policy	The central bank publishes reports that provide information on monetary policy. More systematic assessment and analysis of the results of monetary policy compared to declared objectives would be desirable.
Accountability and Assurances of Integrity by the Central Bank	Central bank accounts should be systematically audited, preferably by an authority independent from the government.

Action plan and authorities' response

142. The authorities were in broad agreement with the assessment. They clarified that while the law does not explicitly state that price stability takes precedence over the responsibility to support the economic objectives of the government, they see price stability as the primary objective of the BCT. They also indicated that the limit on the amount of government securities that the BCT can hold, was intended to force the government to seek public (nonbank) sources for its financing needs; a second objective was also to induce banks to hold assets that would be eligible for BCT monetary operations.

C. Securities Regulation

General and legal and institutional framework

143. This assessment of financial policy transparency practices in Tunisia is based on the law establishing the financial market and on several decrees, orders, and decisions of the CMF, information available from the CMF website, discussions with the CMF, and responses to a questionnaire. The CMF is the agency that supervises the securities exchange in Tunisia. It is also responsible for oversight of the BVMT and the STICODEVAM.

Main findings

144. The broad objectives, roles, responsibilities and accountability mechanisms of the CMF are clearly defined in laws and regulations available to the public. The composition of its governing board is clearly defined, but criteria for the removal of board members and the length of their terms are not specified. The relationship between the CMF and the BCT (whose supervisory activities overlap for banks involved in financial market activities) are not formalized. The oversight role of the CMF on the agency responsible for securities

settlement systems should be defined and publicly explained. The roles of the MoF and the CMF in the supervision of the BVMT should be clearly delineated and publicly disclosed.

145. The CMF conducts its supervisory role in a transparent manner and all applicable regulations are available to the public. Procedures for formal information sharing with other agencies that supervise the financial system are however not in place. Cooperation agreements (on information sharing and technical cooperation) with similar foreign agencies have not been publicly disclosed. The CMF publishes an annual report of its activities but its financial statements are not publicly available. CMF officials do not have legal protection in the conduct of their duties but this deficiency is being addressed.

Clarity of roles, responsibilities and objectives of financial agencies

146. Criteria for revocation of CMF Board members should be explicit and made public. It would also be advisable to establish a specific duration of Board members' term of office to enhance their independence in discharging their duties.

147. The relations between the CMF and the BCT should be described in detail, possibly in the form of a public memorandum of understanding. This would enable the public to make a clear distinction between the responsibilities of the two agencies, particularly when banks engage in functions similar to those of portfolio management companies. A bank managing a substantial securities portfolio could be accused of gross negligence in exercising this responsibility and be required to repay a customer for assets entrusted to it by that customer for management. When large amounts are involved, the bank's solvency may be affected.

148. The roles of the MoF and the CMF in the supervision of the BVMT are not clearly delineated. For example, the law does not clearly specify the competent authority to which the government commissioner must report legal or regulatory violations that may occur. As the CMF is the financial agency that supervises the BVMT, it should be competent to receive such reports. In this connection, it should be noted that the very role of the government commissioner does not seem necessary and blurs the role of the CMF.

Open process for formulating and reporting of financial policies

149. The CMF regulatory framework and operating procedures are widely available to the public. However, financial policy changes are not promptly explained to the public. Through prompt explanation of policy changes the public is informed of the reasons and objectives for these changes, thereby enhancing understanding, acceptance and support of those changes. Formal information sharing arrangements between the CMF and other domestic supervisory agencies should however, be established.

Public availability of information on financial policy

150. The CMF's financial statements should be published according to a predetermined schedule and should form an integral part of its Annual Report. Regular publication of

audited financial statements makes it possible to ensure ex post accountability of financial agencies on the justification and efficiency of their operations. When financial agencies are financed with fees paid by companies and transactors in the sector, publication of financial statements encourages financial agencies to be accountable for their management activities. A predefined publication schedule would ensure that the information is disseminated regularly.

Accountability and assurance of integrity of the financial agency

151. The CMF should establish formal internal governance procedures and make them available to the public. Publication of such procedures would further strengthen its credibility and reassures the public that the agency is operating prudently to meet its objectives and fulfill its responsibilities.

Table 12. Recommended Actions to Improve Observance of IMF's MFP Transparency Code—Securities Regulation

Subject	Recommendations
Clarity of roles, responsibilities, and objectives or financial agencies for monetary policy	While the CMF's roles and responsibilities are clearly defined in the Law, there is an overlapping of authority with the central bank that requires clarification. The relations between these two agencies also need to be formalized. The role of the MoF should be reduced, if not eliminated, to clarify the CMF's authority in the area of financial market surveillance.
Open process for formulating and reporting financial policy decisions	The process of preparing and announcing financial policy decisions is transparent from several standpoints. But relations and procedures for information sharing with national financial agencies and international counterparts should be formalized and published.
Public availability of information on the financial market	The CMF publishes an annual report, which provides the required information on its financial policy. It maintains an official bulletin and website. The BVMT's transparency policies are also satisfactory.
Accountability and assurance of integrity of the financial agency	The CMF's financial statements are not published. While the CMF indicates that its 2000 financial statements will be published, no schedule has been adopted.

Action plan and authorities' response

152. The authorities agreed with the assessment. The CMF has also indicated that it will publish its 2000 financial statements and will continue to do so in the future.

D. Insurance Supervision

General and legal and institutional framework

153. This assessment of practices in Tunisia in relation to the transparency of financial policies is based on the Insurance Code, the discussions held with MoF representatives, and responses to a questionnaire. The MoF is the body that supervises insurance companies in Tunisia. The DGA, which is part of the MoF, is responsible for all legal, technical, and

economic matters relating to operations, enterprises, contracts, and special insurance arrangements.

Main findings and recommendations

154. The laws and regulations governing the objectives, roles, and responsibilities of the DGA are clear and comprehensive, and are published and widely distributed (though not on the internet). Laws are changed only after informal discretionary consultation with insurance companies, and changes are explained thoroughly in press conferences, newspapers, and the Official Journal.

155. The DGA submits an annual report to the MoF, and this report is publicly available upon request, but is not otherwise distributed publicly. Insurance companies are required to publish their balance sheets, but no aggregate statistics on the sector are kept and no periodic reports on the activities of the DGA are produced. Rules governing the personal financial affairs of DGA officials and legal protections provided to them should be formulated.

Table 13. Recommended Actions to Improve Observance of IMF's MFP Transparency Code Practices—Insurance Supervision

Subject	Main Findings and Recommendations
Clarity of Roles, Responsibilities and Objectives of Financial Agencies Responsible for Financial Policies	The laws and circulars governing supervision are published. It would be desirable to post them on the Internet.
Open Process for Formulating and Reporting of Financial Policies	The laws governing insurance companies and the choice of supervisors are published and are clear. Numerous efforts are made to explain changes in the laws and regulations. In particular, insurance companies are consulted before substantive changes are made to regulations, although this process is not formalized in writing. Having a document giving outlining the consultation process would allow the general public a better understanding of the changes and facilitate a broader consultation process.
Public Availability of Information on Financial Policies	The DGA publishes an annual report, which is submitted to the MoF; this report should be publicly disclosed rather than only made available to anyone who asks for it. Insurance companies are required to publish their financial accounts. MoF and DGA officials give regular press conferences, but there is no fixed schedule. DGA officials could usefully be obliged to give regular press conferences.
Accountability and Assurances of Integrity by Financial Agencies	Where necessary, the MoF's duties include the requirement to appear before Parliament to explain the operations of the DGA. The DGA's internal auditing arrangements are not, however, publicly disclosed; there is no information specific to the DGA on the restrictions applicable to DGA officials in the conduct of their financial affairs, and no specific law or regulation deals with legal protection for such officials. Such rules would need to be defined and publicly disclosed. The budget of the DGA should be isolated within the MoF's budget.

Clarity of roles, responsibilities and objectives of financial agencies

156. The presentation of laws and regulations and the explanation of objectives were generally strong. All laws and most circulars are published, although it would be desirable for them to be posted on the Internet. The processes for formulating and reporting financial policies were also strong.

157. Publication of the duties and responsibilities of the financial agency is complete and transparent: the Insurance Code and the implementing decrees and circulars are published in the *Journal Officiel* (Official Gazette); and are available in bookstores. Public distribution could, however, be enhanced by the setting-up of an Internet site specific to the General Directorate of Insurance. This site could be used to publish laws and regulations and to explain to the general public the duties, activities, and responsibilities of the DGA.

Open process for formulating and reporting of financial policies

158. The process of arriving at and announcing policy decisions is generally transparent. All laws and circulars are published. Amendments to laws are explained at press conferences. Amendments to the law are published in the *Journal Officiel*, distributed to companies, and often published in the newspapers. The Minister is required to appear before Parliament at least during the budget discussion and gives monthly press conferences. Nevertheless, there is no obligation to hold press conferences or to produce periodic reports on the DGA's activities. While the DGA occasionally holds press conferences, it does not have its own public information service.

159. Before laws and regulations are amended, insurance companies are consulted informally. It would be more transparent to have a document giving details of the consultation process; this would allow the general public to gain a better understanding of the changes and facilitate a broader consultation process.

Public availability of information on financial policy

160. There is room to improve the availability of information on the supervision process and the state of the companies being supervised. Although insurance companies are required to publish their balance sheets, the Annual Report of the DGA—which should be publicly disclosed—or some other document should present aggregate statistics on the health of the insurance sector. The DGA should have its own public information service. DGA officials could usefully be obliged to give regular press conferences and produce periodic reports on the activities of the agency. The measures to assure integrity could be strengthened as well, particularly by the publishing of rules governing the personal financial affairs of DGA officials, legal protections that they enjoy in the course of their duties, and the management procedures of the DGA.

Accountability and assurance of integrity of the financial agency

161. It would be useful to publish the management procedures for the DGA, to define the rules concerning the personal financial affairs of DGA officials, and to ensure that the legal protection granted to them is sufficient to allow officials to carry out their inspection duties properly. It would also be useful to isolate the budget of the DGA within the budget of the MoF.

Action plan and authorities' response

162. The authorities generally agreed with the assessment and recognized that there were ways in which the transparency of the supervision of the insurance sector could be improved. They also acknowledged that the Annual Report prepared by the DGA is not published but pointed out that it is available to anyone who requests it and has been distributed to a number of insurance companies. They also indicated that they intended to publish a manual of their inspection procedures in the near future and that the staff of the DGA was available to answer any questions from the public.