



HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Training on Risk-Based Supervision

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Prepared By

Ian Tower and Inwon Song (IMF Experts)

High-Level Summary Technical Assistance Report

Monetary and Capital Markets Department

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: Supporting the Authority's objectives on development of risk-based supervision of the banking sector, this technical assistance for the Bank of Lao P.D.R., conducted in Vientiane from June 10–14, 2024, provided advice on improvement of the aspects of risk-based supervision, including revising manual and reporting framework.

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International Monetary Fund, IMF Publications
P.O. Box 92780, Washington, DC 20090, U.S.A.
T. +(1) 202.623.7430 • F. +(1) 202.623.7201
publications@IMF.org
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Background

The Bank of Lao P.D.R. (BoL), the supervisory authority for banks, has been engaged in a multi-year program to develop its regulatory and supervisory framework. The BoL is responsible for the supervision of 35 banks, including one state-owned bank, one specialized bank, five joint state-commercial banks, seven domestic private banks, nine foreign bank subsidiaries and 12 foreign bank branches. It is currently implementing the Basel II/III capital and liquidity frameworks. It has also been working on the implementation of the Basel Pillar 2 framework – requirements for the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review Process (SRP). It has been developing its risk-based supervision (RBS) tools and approaches over several years supported by IMF technical assistance (TA). The purpose of this in-person mission is to assist the BoL in strengthening its RBS framework and to provide training to BoL banking supervisors. In particular, it focused on assisting the BSD in updating its RBS manual and reviewing prudential reporting templates. It provided advice on deepening RBS in the areas of banking system-wide analysis and oversight of banks' internal audit practices and governance.

Summary of Findings

The mission led discussions with BSD staff on areas for improvement in its RBS manual and the banking sector-wide analysis framework. Discussions focused on highlighting good practices and identifying areas for further development. The mission addressed the issues related to the selection and use of indicators for both financial analysis and risk assessment. It advised on relevant prudential ratios and the use (and updating) of benchmarks. The importance of exercising judgment, using appropriate qualitative indicators, and not over-relying on quantitative benchmarks was discussed. The discussion on potential gaps in supervisory reporting focused on banks' exposure to interest rate risk and on consolidated supervision. The BSD will be able to address this risk in more depth following the current work program to implement the Basel II/III capital and liquidity standards. Banks currently report only on a solo basis, and this observation led to discussions on the importance of consolidated supervision, although the discussions with the BSD suggested that banks do not yet have significant intra-group financial activities. The supervisory challenges where banks are owned by non-financial conglomerates were also raised by the BSD and discussed with the mission. The mission provided training on selected topics, as requested by the BSD. Presentations were delivered on the role of internal audit in banks' governance and risk management frameworks and the supervisor's role in assessing its effectiveness. Case studies of financial fraud experiences in Vietnam, Korea and the US were discussed and lessons for risk management and internal audit were identified. The mission provided training on good practices for drafting a systemic banking report (off-site supervision report), emphasizing the need to identify the underlying drivers of key developments, to report supervisory concerns and to make recommendations for action. The mission also provided training on the supervisory assessment of key elements of banks' corporate governance.

Summary of Recommendations

The mission recommended that the BoL:

- Review and, if necessary, revise the prudential ratios and indicators which it uses in financial analysis and risk assessment, considering the tools provided by this mission;
- Review the information on banks with subsidiaries, associates and/or interests in joint ventures to ensure that supervisors are aware of the risks, can and do communicate with securities and insurance supervisors, and will be able to apply full consolidated supervision;
- Review the key lessons learned from the mission's training on internal audit and governance and integrate them into its internal processes, including in the RBS manual and supervisory tools (e.g., by developing a set of questions to ask on governance issues);
- Further develop the banking sector-wide analysis framework; and
- Develop a work plan for the period beyond its current Basel standards implementation program, which ends in 2025, with a view to identifying the next set of needed enhancements to its regulatory and supervisory framework to further strengthen its RBS.