Amando M Tetangco, Jr: Basel II and risk management in the Philippines

Opening remarks by Mr Amando M Tetangco, Jr, Governor of the Bangko Sentral ng Pilipinas (Central Bank of the Philippines), at the Eighth Environmental Scanning Exercise: Basel II and Risk Management, Central Bank of the Philippines, Manila, 6 June 2007.

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Members of the Monetary Board, distinguished speakers, colleagues at the Bangko Sentral, good afternoon. This is the 8th in our series of Environmental Scanning Exercises (ESEs). For the information of our guests, it may be helpful to note that we have been holding ESEs since 2004.

I would like to begin by expressing my appreciation for our speakers who will share with us their insights on the topic of Basel II and Risk Management. The implementation of Basel II is expected to have significant implications on the stability of the banking system as well as the conduct of monetary policy. In particular, the new capital adequacy standards under Basel II should lead to enhanced financial stability as banks are able to: (1) provide capital commensurate to their risk-taking activities; (2) properly assess the risks they are taking while supervisors should be able to evaluate the soundness of these assessments; and (3) appropriately disclose pertinent information. In turn, the greater resiliency in the banking system is expected to increase the credit and lending activities of banks and thus contribute to a more efficient transmission of monetary policy actions.

Our discussion today is meant to provide inputs for the assessment of policies that could help improve the banking system's risk management processes and efficiency as well as provide a leverage to stimulate the diagnosis of, and improvements in, the supervisory framework.

I take a special interest in today's topic for two main reasons. The first reason is that next month will mark the beginning of the process of aligning our existing supervisory framework with the standardized approach of Basel II by Philippine banks, which is a shift in bank capitalization standards approved by the Monetary Board in June 2006. This makes true our expressed commitment to be among the countries that are expected to implement Basel II between 2007 and 2010 .

The implementation of Basel II sets a new dimension in the supervision of the financial system. This is a major step in the groundwork for the revision of risk-based capital adequacy framework of the BSP, some of the initial preparations of which started even before the Asian financial crisis. Moreover, we are aware that our effectiveness as supervisor of banks is as important as the skills available in the banks to implement Basel II. Hence, we have invested heavily in enhancing our supervisory capacity to keep up with the task. This we have done continuously and in line with international best practices.

Second, this new framework is relevant to our aim of promoting and maintaining monetary and financial stability in the country. As I have stated earlier, Basel II strengthens the link between regulatory capital and risk management as it will help us ensure that banks will maintain capital appropriate to their risk-taking activities. Banks are also expected to properly assess and manage the risks. Moreover, banks would be required to disclose pertinent information necessary to enable market mechanisms to complement the BSP's supervisory oversight function. These intensified efforts to deepen and accelerate the evaluation, measurement, and disclosure of risks under Basel II are expected to strengthen the financial system.

In this regard, risk management is consistent with the greater transparency and forward-looking nature of Inflation Targeting (IT), which is the monetary policy framework that the BSP has been using since 2002. As in the IT approach, a wider set of information and disclosure requirements are used to enhance risk management. There is also more emphasis on anticipation of risks over a longer horizon and on greater sensitivity to market views. As a major channel for monetary policy, a stable financial system is a necessary condition for inflation targeting to work well in this country.

Let me now pose some questions that our experts may want to consider for discussion.

1. What are the key challenges encountered by commercial banks in their preparations?

2. What are the implications of the new supervisory framework on intermediation activities of banks and their financial stability, government borrowing, investment and capital flows, and the conduct of monetary policy?

3. Will Basel II increase procyclicality as there are arguments that adopters may tighten credit standards in response to rising capital requirements in the event of a deterioration in credit conditions? Will current developments such as reserve accumulation and rising liquidity in Asia affect the adoption of Basel II in the country?

4. Will the change in the supervisory framework lead to further restructuring of the banking system through mergers and consolidations?

5. How extensive will be its impact on bank lending for the country, and for developed and emerging economies?

The implementation of Basel II underscores the BSP's commitment to deep and far-reaching reforms to promote the stability and soundness of the banking system. It also reflects our confidence in the ability of the banking industry to adapt to new operating standards. The challenges posed by these new standards will allow for the transformation of bank practices over time, and thus, provide greater financial resiliency and sustainability in the economy. I am confident that banks will, beyond compliance, remain supportive in their stance to facilitate a more collaborative implementation of Basel II as we both continue to learn and adapt.

The issues tabled for discussion for today's environmental scanning exercise are varied. I am certain that we all look forward to a fruitful discussion and exchange of insights with our speakers.

Thank you.