

Discussant comments on session IPM68: Risks in finance – the state of the art in statistical methods

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Madoda Petros explained the supervisory review and evaluation process in South Africa, based on his experience of implementing this process in the Bank Supervision Department of the South African Reserve Bank. The internal capital adequacy assessment process (ICAAP) was implemented for the first time under the Basel II Framework, in addition to the minimum capital requirements in Basel I. The ICAAP aims at measuring the economic capital of banks and thus creating a buffer for various risks.

For measuring credit risks, I would like to raise the issue of data consortia. Databases of credit risks have been used to measure banks' regulated capital. To measure their economic capital, databases must be strengthened. In Japan, several associations of credit risk databases have been established recently. I wonder if there has been a similar phenomenon in South Africa.

Stress tests are one of the important elements in measuring the economic capital of banks. This issue is interesting, as there have been further developments in the light of the current financial crisis. In the recent stress tests in the United States, the authority provided a scenario from the macroeconomic perspective and had each bank consider its own scenario for stress testing. It will be interesting to learn how stress tests are conducted in South Africa at present and whether the South African Reserve Bank intends to conduct tests similar to those of the United States.

Lastly, a final package of measures to enhance the three pillars of the Basel II Framework was approved by the Basel Committee on Banking Supervision. This proposal introduces new standards to promote the build-up of capital buffers. It would be interesting to know how the South African Reserve Bank will modify banking supervision practices based on this proposal.

Jan Lubbe highlighted the advanced measurement approach (AMA) for banks based on his experience in implementing this approach in the Firststrand Banking Group. The AMA is the most complicated area in Basel II, requiring the expertise of the brightest engineers. Nevertheless, I found that it has interesting implications for central bank statisticians.

Currently, quite a few banks are also working on operational risk management. But so far, not many banks have been authorised by their countries' authorities to adopt the AMA. The biggest obstacle in implementing the AMA appears to be limited data availability. In the absence of a data consortium, banks have a difficult time obtaining external loss data. Banks tend to hesitate to provide operational loss data to other banks. Although there are some private data vendors who are trying to create data consortia, there might not be enough momentum. I assume that similar obstacles exist in South Africa as well.

Jan Lubbe pointed out that implementing the AMA would lead to an improved risk management process and more sophisticated risk measurement mechanisms. In this respect, banks face a dilemma. For results to be useful for management purposes, they

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should have a detailed classification of categories of risks, while the measurement of risks for detailed classifications tends to be subjective in the absence of source data. It will be interesting to learn how the Firstrand Banking Group has resolved this dilemma.

Finally, I would like to know how the Firstrand Banking Group has overcome the difficulty of hiring clever engineers, who can deal with statistics in the AMA. In fact, a lack of engineers is one of the reasons why many banks are not rushing to implement the AMA.