M R Pridiyathorn Devakula: Risk management - Challenge for the Thai financial institutions and regulator

Opening remark by Mr M R Pridiyathorn Devakula, Governor of the Bank of Thailand, at the Market Risk Management Techniques for the BIS Capital Regime Seminar, held in Bangkok, 12 October 2001.

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Distinguished guests,

Ladies and gentlemen,

I would like to personally extend a warm welcome and to express our deep appreciation to all of our distinguished speakers and panelists who have agreed to come to Bangkok at this difficult time. I would also like to thank our co-host, the World Bank, in the efforts and interest which they have shown to make this important seminar possible. It is also important to convey my appreciation to the members of the financial industry for your interest and enthusiastic participation in this seminar.

As we all know, the New Accord Proposal is scheduled to be finalized early next year, with its implementation scheduled for 2005. Countries that have not yet implemented the consolidated supervision will have until 2008 to comply with the New Accord. Thailand is in this second category since we have yet to be empowered by law to carry out consolidated supervision. The new Banking Act with such a provision is expected to take effect next year.

Even with such a relatively long grace period toward compliance, Thai financial institutions have already taken the first step of the journey toward that direction. We have recently conducted a survey of the financial institutions to check their readiness to conform to the credit risk guidelines under the New Accord. I have been reported that many plan to be ready for the standardized approach, while others are working towards the IRB approach, this is a welcome news. More importantly, financial institutions have all started the effort to strengthen risk management in their respective institutions with some notable progress so far, and we look forward to more progress to come.

I would like to take this opportunity to commend all of you for such efforts. After all, the BIS capital requirement only serves as a cushion of losses or failure of an institution whereas it is the risk management that reduces the chance of failure. The significant progress you have made in the area of risk management deserves our full support and commendation, particularly so as this is a very difficult time for the financial industries.

Ladies and gentlemen,

Coming back to the issue of preparation for the New Accord, one can see that significant challenges remain ahead. I will now turn to these challenges.

First, the technical and infrastructure aspects. It is important to build up a deep understanding of the technicality of approaches and methodology underlying the New Accord. Moreover, it is critical to achieve in-depth knowledge of risk management and the impact of such developments on business model of the financial institution. Therefore the task ahead is very challenging, far beyond just acquiring software that would crank out numbers.

On the infrastructure aspect, data is a critical issue. The data that could be collected at this time would be biased since the economic conditions are not normal. Nevertheless, we still need to start building up the database. In many countries, such a challenge is tackled with the cooperation between the financial institutions and the regulators. For example, in a number of countries, developed countries in fact, regulators plays crucial coordination role in supporting the built-up of the database system, in educating and knowledge transfer. The Bank of Thailand will be more than happy to play this role.

Turning now to the second major challenge for the financial institutions, the intensified domestic and foreign competition brought about by liberalization, globalization and technology.

Banks also experience competition from non-bank financial institutions, with the traditional financial firms and their business line becoming blurred by conventional wisdom. We also see such strategy as M&A across similar financial firms, or between financial firms and non-financial firms such as IT providers. In the meantime, outsourcing and franchising of technology, most notably through the venders for risk management software or solution have also exploded as a phenomenon.

While the picture is still evolving so fast and future landscape hard to forecast, financial institutions find themselves stepping more and more into a less familiar territory, and tremendous efforts must be put in to survive the intense competition and dynamism. At the same time, attention must be diverted to deal with preparation for the New Accord.

The third major challenge is that financial institutions need to further strengthen their financial standing in the recovery path after the crisis. Preparing for the New Accord means cost impact from building capacity in terms of people, know-how, IT, data, and business model re-engineering. Therefore, strong leadership is crucial to propel the financial institution through the short-term difficulties, while at the same time steering the institution with long-term vision and strategy to ensure that the financial institution survives the challenge and complies with international best practices.

As for the regulators, our task at the Bank of Thailand is no less challenging. In addition to the need to build up our own in-depth understanding and capacity to implement the New Accord, we are also responsible for mapping out the strategy for its adoption in such a way that the financial sector will be capable of serving efficiently and effectively both the modern and traditional sectors of the real economy. In a dual economy such as Thailand, having the right financial sector structure for financial institutions to serve the basic function of resource allocation and risk management is a very complex issue due to the various market imperfections where market mechanism fails - particularly when one is dealing with financing smaller clients, and clients in the less developed segments of the country.

In the past such issues were swept onto the domain of specialized financial institutions, but today the financial innovation and sheer creativity have made it possible for private sector solution. Commercial banks around the world have begun to find the technology to tackle such challenges profitably. However, there must be rewards to financial innovation and risk management capability that encourage financial institutions to address these segments of the markets profitably since a financial undertaking which looses money over time is not sustainable. The adoption of the New Accord, therefore, must ensure that the financial need of the dual economy is served.

Secondly, while the Bank of Thailand can help foster the infrastructure for risk management, we must avoid the problem of taking away the incentive for, and accountability of, the private institutions to manage their own internal database that could be used for their own models in the long run or to manage their own risks. If a regulator oversteps the bound, there may be risk of moral hazard. Much difficulty will go into walking the thin line in overseeing safety of a system and to avoid "approving" the risk model or risk management system. I hope that this seminar will shed light on the experience in other countries.

These challenges are complex and difficult in nature, but we must tackle them successfully to ensure that the Thai financial institutions are strong members of the global financial community.

The market risk seminar today is a strong indication of this intention to meet the challenges. Back in 1996, the Bank of Thailand had already embarked on the study and preparation for the adoption of the '96 Accord on Market Risk. However, the implementation had to be postponed with the onset of the crisis. The seminar today represents an effort to catch up with the international standards. With the implementation of the '96 Accord on Market Risk, we would be one step closer to being able to adopt the New Accord in the future.

Ladies and gentlemen,

I would like to take this opportunity to share with you the Bank of Thailand's stance on how we would like to see the industry go forward.

It is our intention to actively promote the development of the strong competency and practice for risk management within the Thai financial institutions. However, we will not expect nor require the financial institutions to develop risk management systems that are more complex and inappropriate for their respective needs. At the same time, the turbulence ahead cannot be underestimated. The Thai financial system and the real economy should be prepared to face increasing risks, and we have a duty to prevent the history of 1997 from repeating itself.

Since capacity building for risk management is a long-term process, therefore I must insist that the Thai financial industry step up its already tremendous effort even more, today and in the future.

Our goal is to adopt the '96 Accord on Market Risk. Timing of its implementation has to be appropriate, however I would look to implementing risk assessment process in 2002, and to require capital charge by a later date, tentatively 2003. Given the major challenge ahead, I feel we are very fortunate to have with us today some of the world's leading experts on these issues. Experts are abound in this room, and I hope you foster good network and contact with all these world class players, some are on the podium, and some are sitting among the audience.

Ladies and gentlemen,

It is a pleasure for me to declare the opening of the " Seminar on Market Risk Management Techniques for the BIS Capital Regime" and I wish you every success in your endeavor to meet these challenges.

Thank you.