

## Tarisa Watanagase: Risk-focused supervision and risk assessment

Opening address by Dr Tarisa Watanagase, Deputy Governor of the Bank of Thailand, at the APEC Financial Regulators Training Initiative Regional Seminar on Risk-Focused Supervision and Risk Assessment, Bangkok, 6 September 2004.

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Distinguished Guests,  
Ladies und Gentlemen,

It is a pleasure for me to be here at the opening of the APEC Financial Regulators Training Initiative on Risk-Focused Supervision und Risk Assessment. In making this opening address, I would like to personally extend a warm welcome to all the participants and to express my appreciation to the Federal Reserve experts who have kindly agreed to share with us their knowledge und experience on risk-based supervision.

This regional seminar is held at an opportune time, about two months after the Basel Committee on Banking Supervision released the Basel II capital framework. As you all are undoubtedly aware of, Basel II aims to strengthen financial stability by encouraging sound risk management practices at banking organizations. The tools uscd are a more risk-sensitive capital regime (Pillar 1); the application of risk-based supervision (Pillar 2); und improved public disclosures to enhance market discipline (Pillar 3).

Of the three pillars, one of the most formidable challenges for emerging market supervisors will be to properly implement the Pillar II risk-based supervisory framework.

Since risk-based supervision is the main topic of this seminar, it may be useful to provide a few thoughts on some of the broader regulatory und supervisory implications associated with implementing this framework.

On the regulatory side, the adoption of a risk-focused supervisory framework entails a shift away from a rigid, rules based approach to regulation and towards more "incentive compatible" prudential standards. By "incentive compatible", I am referring to broad, principles based standards that encourage banks to develop and continuously update their internal risk management systems to ensure that it is commensurate with the scope and complexity of its operations. While the benefits are obvious, there are also some consequences for the supervisory side of our business that may not be readily transparent.

First, an emphasis an broad prudential standards - while useful rot fostering sound risk management practices - will inevitably create significant challenges for front-line supervisors. This is because they will need to rely much more on sound professional judgment and critical analysis, and less on rules-based compliance criteria, in order to make proper risk assessments. This in turn, will require supervisory staff members to have a fundamental grasp of risk-based supervisory concepts and how it is applied in the field. The challenge for every emerging market supervisory authority is to equip our front line supervisors with the requisite knowledge, skills, and abilities, in order to help make their transition to a risk-based framework as smooth as possible.

At the Bank of Thailand, we have placed greater reliance an this risk-based philosophy during the past several years. Wc are increasingly moving towards more principles based prudential standards; in addition, we have revamped our supervisory framework to provide a more structured and risk-oriented approach to the on and off-site examination process, while encouraging our front-only supervisors to think analytically. Despite these achievements, we still have substantial work ahead of us. Above all, our experience with risk-based supervision indicates that there is no going back to the mles-based approach of supervision given the dynamic nature of the banking business. And second, building a robust risk-based supervisory regime requires substantial time and resources and it will necessitate a material shift in the way both supervisors and bank management think about risk and risk management.

I must therefore, commend APEC for this initiative in bringing together bank supervisors from the Asia-Pacific region to learn and to share views on this very important topic. It is my sincere hope that all of you take this opportunity to gain insights from our highly experienced and knowledgeable experts as well as from each other on the practical aspects of risk-focused supervision.

Ladies and Gentlemen, I am pleased to declare open the APEC Pinancial Regulators Training Initiative Regional Seminar on Risk-Focused Supervision and Risk Assessment. I wish you all stimulating discussions in the week ahead and a very pleasant stay in Bangkok.

Thank you.