Bandid Nijathaworn: Risk management and Pillar II implementation

Opening address by Dr Bandid Nijathaworn, Deputy Governor of the Bank of Thailand, at the FSI-SEANZA Regional Seminar on the Implementation of the Supervisory Review Process (Pillar II) of Basel II, Bangkok, 21-24 April 2009.

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Distinguished Speakers; and colleagues from SEANZA central banks and regulatory authorities,

Let me begin by extending a warm welcome to all of you to Bangkok, and on behalf of SEANZA members, I would like to express our appreciation to all the speakers, as well as the FSI, for their contributions to make this FSI-SEANZA Regional Seminar on the Implementation of the Supervisory Review Process possible. This is all the more so as this seminar had to be rescheduled from last year, and in this regard, let me express our commitment that the Bank of Thailand stands ready to facilitate you and ensure that your experience here will be a fruitful and enjoyable one.

Ladies and gentlemen,

The current global financial crisis underscores the need to strengthen risk management and risk-based supervision, so that we can deal more effectively with the increased complexity arising from both financial product innovation and increased interconnectedness between financial institutions.

As for the current crisis, while many causes have been identified, what has become very clear is that financial institutions, capitals were not adequate given their risks, and this had allowed over-leveraging by financial institutions as well as by their customers, leading to over-indebtedness and asset price bubbles. The issue, therefore, underscores the inadequate risk management, covering the entire process: from the lack of proper risk measurement, especially with regard to complex product, as well as liquidity risk, to inadequate risk management and control, and to micro-prudential risk-based supervision. In addition, there is now greater attention being paid to the importance of macroprudential approach, in recognition of the risk from procyclicality and interconnectedness of institutions, especially the large and highly complex financial institutions. Also, greater recognition is given to the problem of the unregulated shadow banking sector, like the hedge funds, which are also key in systemic risk process. All these issues pose a major policy challenge, as indeed the various working groups and committees of the BIS are now working on the guidelines, and on the key issues such as accounting, valuations, procyclicality, and adequacy of capital and provisions.

In view of the depth of the current problem, and the fact that it may be quite sometime before the global standards on these issues can be settled, regulators, in my view, must be ready to take the needed action to ensure that we address these risks in our financial systems systematically. This is why Pillar II is all the more important, because the essence of Pillar II is to ensure that financial institutions have adequate risk management process and capital, commensurate with their risk profiles. And this is why we are seeing increased vigilance by regulators and the financial institutions themselves, in terms of the rigour in the use of stress-tests, which is essential in the environment of heightened volatility that superseded historical norm.

The implementation of Pillar II is, however, a challenge, not only in terms of the technical and quantitative expertise for reviewing Internal Capital Adequacy Assessment Process, or ICAAP, but also on qualitative aspects such as how to foster an on-going two-way dialogue with the supervised institutions that would enhance the ICAAP process. To meet this challenge, regulators need to establish a strong credibility so as to strengthen the impact of their recommendations and requirement on ICAAP, and in some cases, increase capital requirement to ensure capital appropriate to the material risks, not yet covered in Pillar I. Also, there are challenges on the legal and institutional capacity aspects on how to handle the more principle-based, and therefore, more institution-specific regulatory requirement.

As for the Bank of Thailand, our progress on Pillar II implementation is continuing. By working closely with all stakeholders especially Thai Bankers, Association, we have issued three prudential guidelines for Basel II since 2006. Pillar II formally took effect the end of last year, while Pillar III will be implemented in June this year. As far as Pillar II is concerned, we expect Thai banks to put in place the ICAAP within this year and establish the comprehensive process by the end of next year. Overall, we are on track with the implementation of Basel II, thereby reaffirming our commitment to international best practice. With this brief initial remark, it is my hope that this seminar would provide the needed knowledge and skills to supervisors from SEANZA countries for the challenges posed by Pillar II.