Njuguna Ndung'u: Next generation risk management

Speaking notes by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, Thomson Reuters Risk Management Forum "Next generation risk management", Nairobi, 23 July 2009.

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Distinguished Guests;
Ladies and Gentlemen:

It is my distinct pleasure to be joining you this evening at this important Forum. I would therefore wish to express my gratitude to Thomson Reuters, the convenors of this event for the invitation.

The timing of the Forum is apt in view of the prominence that risk management has gained in financial circles over the last few years. The global financial crisis has only served to underscore the importance of scaling up risk management practices and appropriate pricing of risk to counter dynamics in the global financial markets.

I am therefore pleased to see a diverse gathering of financial sector players this evening. Thomson Reuters also brings a vast repertoire of international experience on risk management that we are keen to draw upon.

Whereas risk management has been prominent on the radar of financial institutions and markets, the global financial crisis has unearthed serious shortcomings in risk management practices. And furthermore, coming from the centre, this has been disastrous.

One of the cardinal causes of the crisis is now widely agreed to be deficiencies in risk assessment and pricing of complex products. These complex products were indeed at the heart of the crisis. Markets failed to price these products appropriately and deficiencies in the regulatory architecture precipitated excessive risk taking.

It is imperative that market players and regulators reflect on reviewing risk management practices. I am therefore confident that the local experiences to be shared tonight and the international experiences to be gleaned will only serve to enrich this discourse.

The Central Bank, can share the perspectives on Risk Management from a regulator's viewpoint. The Central Bank of Kenya has over the last five years promoted the inculcation of a risk management culture in the Kenyan banking sector.

The Central Bank has also adopted a risk-based supervisory approach. This approach is premised on the overarching objective of proactively addressing threats to financial sector stability. Maintaining the stability of the banking sector is indeed one of the core mandates of the Central Bank.

I am pleased to note that the banking sector has, to a reasonable extent, embraced risk management. This is perhaps one of the key reasons behind the relative stability of the Kenyan banking sector in the recent past inspite of local and global turbulences.

However challenges remain as the Kenyan banking sector embraces risk management. The first challenge relates to the implementation cost, particularly amongst medium and small banks. Human resource competences are also a constraint. The other key challenge we note from our regulatory seat is the view by some institutions of risk management from just a compliance perspective.

These are not insurmountable challenges and market players should pool resources and efforts to address them. In this regard, the Central Bank will work with the banking sector to entrench risk management. The Bank will also leverage on the Kenya School of Monetary Studies (KSMS) to provide capacity building programs on risk management for the sector.

I would also urge banks not to view risk management just from a compliance perspective but also as a business imperative. Entrenchment of risk management enables institutions to effectively price their products in line with their risk profile. This will not only enhance their competitiveness but also maximize shareholder value. But information must be available to provide assessment on the risk profile.

The Central Bank of Kenya will therefore continue with its efforts to enhance risk management in banks. This drive will be supplemented by initiatives to scale-up surveillance at the system-wide level. In this regard, the Bank's existing early warning system will be scaled up to incorporate both macro and micro prudential indicators of financial stability.

Other measures that the Central Bank will take to strengthen it's supervisory tools include:

- Stepping up supervisory co-operation and co-ordination with domestic and foreign financial sector regulators. This is particularly pertinent as Kenyan banks extend their reach locally and regionally and also as products developed encourage other regulators to come into the picture.
- Encouraging the adoption of forward looking techniques by banks in their risk management framework. This is particularly in regard to the use of stress testing. This measure will however be accompanied by "market education" to ensure that the results are not misinterpreted.

My role this evening was just to set the stage for the lively interactions on risk management that will follow shortly. The Central Bank is certainly open to considering ideas that can push forward the risk management frontier. It now remains for me to wish you fruitful deliberations and a pleasant evening.

Thank you.