Prasarn Trairatvorakul: Journey towards a more competitive, inclusive, connected and sustainable Thai banking system

Speech by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Association of International Banks (AIB) Dinner Talk, Bangkok, 21 May 2015.

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Ladies and gentlemen,

It is a great pleasure for me to be here on this special occasion.

The topics I addressed in previous occasions focused on economic situations and developments. So much has been said and discussed on those issues, so today I would like to talk about the future development of the banking system in Thailand which is equally important. As many of you here are already aware, we are drafting the third Financial Sector Master Plan which will cover the next five years time span. The process is quite challenging because it involves many stakeholders, both in the public and private sectors, including foreign banks like yourselves. We thank you for your suggestions and feedback provided individually and also as a group through the AIB. Today I will share with you briefly the concept and aspiration behind the development plan for the banking system in Thailand.

Thailand is currently at a crossroad in need of structural reforms to cross over the middle income trap. This requires commitment from all stakeholders. The public sector is already taking the lead on infrastructure development to promote urbanization and more equitable income distribution. For the private sector, they will need to make a transition toward production with innovation and higher value-added. Realization of these commitments requires long-term funding at reasonable cost from the financial sector.

Therefore, the roles of the financial sector should be highlighted.

The ambition can be likened to the destination of our journey. What is our destination? It is to have a ***banking system that is responsive to changes in the real economy and able to meet its ever-changing needs***. With this destination in mind, milestones are set at different stages with signposts to prevent us from getting lost or sidetracked along the way. For the banking system, these milestones and signposts are laid out in the Financial Sector Master Plans.

We have come a long way since the 1997 financial crisis and have put in place foundations which shaped the country's core financial system. ***In our first milestone of structural improvements,*** the number of financial institutions was consolidated from above 100 to about 30 today. International standards and best practices on risk management were adopted, built upon necessary infrastructures including the core payment system, the Deposit Insurance Scheme and National Credit Bureau.

With our second milestone to enhance efficiency, new qualified foreign entries with sufficient capitals and well-designed business model brought meaningful competition. With these reforms, the banking system has become more robust and competitive with good risk management and governance, sufficiently capitalized according to Basel III and show notable growth.

Nonetheless, I believe that efficiency can be further enhanced through improvement in IT systems, data development, and utility sharing. The recent global financial crisis serves as a reminder that status quo is never good enough.

Financial development is therefore a journey that should never end, with milestones along the way.

As we move on to the next stage of our journey, it bodes well with a saying that “Yesterday was a walk in the park. But tomorrow is a step in the dark.” While I would not exactly call our past events a walk in the park, there are approaching challenges that depict dark clouds above our path.

The contextual ***trends and challenges*** that I am going to highlight tonight derive from technological developments, the ageing society, urbanization, and regionalization.

Firstly, with ***technological developments***, traditional barriers to entry were brought down, allowing non-banks such as fintech companies and cross-border players to the market, and helped reduce operating costs. At the same time, consumers expect better and more timely services. Banking is something that customers want to do “anytime and anywhere”, and they want to do it cheaply as well. While technology may help us reach our destination faster, it also dictates that we be more adaptive and responsive to changes. Banks that get stuck in the past will lose out quickly.

A second challenge that put banks’ adaptability to the test is the shifting demographic structure of Thai population. It is expected that by 2025, the number of older people in Thailand will account for 20% of the population and exceed the number of children under 15 years old. In an ageing society, banks that are able to cater to the needs of older population and tailor their products to accommodate changing demands would be successful.

The next trend, ***urbanization***, happening in many East Asian countries, brings both challenges and opportunities. According to the World Bank Research that just came out early this year, almost twelve million people in Thailand now live in urban areas; about ten million live in Bangkok alone. The number seems low for the area outside Bangkok because of the strict definition of urban areas employed by the World Bank. The same research also says that, cities outside Bangkok are growing at a much faster rate, and some cities such as Surat Thani have more than doubled its population in ten years. Urbanization results in increased purchasing power and fuels domestic demand. More infrastructure investments such as housing, electricity and transportation will be required. This is where the financial sector can contribute and benefit from the development.

The trend towards ***regionalization*** poses a fourth challenge as well as an opportunity for the banking sector. With the commencement of the AEC in 2015, competition will intensify, benefiting those prepared to pursue opportunities across borders. ASEAN as a group has already agreed on its Financial Integration Post-2015 Vision for 2025, and now is in the process of operationalizing it with the milestones and targets to be set in all areas including banking, capital market and, insurance. But this is another topic that I don’t think we will have time to cover today.

The message that I want to stress is that banks need to plan ahead and invest more to meet these challenges. Banks can no longer afford to focus on maximizing short-term returns at the expense of future growth and competitiveness.

Against this backdrop, you may wonder what’s the next milestone of our journey?

Bearing in mind these challenges, the third Financial Sector Master Plan will guide financial developments up to 2020. ***The milestone for the next stage of our journey, as the title says, is a more competitive, inclusive, connected and sustainable Thai banking system.***

Competitiveness, what do we mean when we say we want a more competitive banking system? How can we be more competitive and innovative?

If our peers are driving the newest computerized hybrid cars, while we are driving a 10-year-old car, we will be slower, less safe, and consume more fuel. Thus, a possible alternative to keep up with our peers and ensure that traffic flows smoothly is to upgrade our vehicles to the latest reliable technology.

Likewise, for our banking system to be competitive, each bank should aim to increase its own efficiency. By promoting digitization, both for banks’ own internal operations and for customers' experience, the cost for both parties would be lowered. Additionally, we may set up and promote more usage of common utilities such as banknote handling centers or common Point of Sales (POS). From the policy perspective, standards and ecosystem should be developed to ensure compatibility, interoperability, security and confidence. Moreover, competition in market segments with low competition, particularly payment services, will be promoted in the third Financial Sector Master Plan.

On inclusiveness, merely upgrading the technology would not be sufficient. Following our earlier analogy of driving a car on a journey, we must take into account the needs of all the passengers. In this case, ***our next milestone is to achieve a more inclusive banking system that serves all groups of customers, particularly household and SMEs***, many of whom have been left on the side of the road while others are driving by on the journey.

For individuals and households, they should be able to more easily access financial services and at a more reasonable cost. I am not merely talking about loans, but also basic services such as deposits and fund transfers. The latest financial access survey indicates that lack of access is partly because of the distance to nearest service providers is too far and the cost is too high. This is where technology and collaboration such as the use of agents can help. Moreover, as our population is ageing fast, we should all start to save for retirement now, and I strongly encourage banks to develop and promote more products to satisfy this growing customer segment. There is also a growing class of older people who have too little knowledge or weaker capabilities to manage their own financial wealth after retirement. This is another area that banks can help.

For SMEs, which contribute significantly to employment in Thailand, we need to work together to promote their access to funding. This calls for a joint effort between the government, banking sector, and SMEs to improve available information and its flow. In this regard, as bankers, such as guests here today, are close to the SMEs, see their account movements, and provide financial advice you will play a key role here. I believe there are a lot of rooms for banks to provide funding for SMEs, both directly and indirectly, perhaps through more innovative products that can benefit from banks' own information and more collaboration between banks. Equity financing, including venture capital, for SMEs will also be promoted in our plan. In my opinion, innovation and entrepreneurship of SME, which need supports from banks, is one of the most important drivers for Thailand to overcome the middle-income trap.

As for large corporates, Thai conglomerates now operate in multiple countries, and as their businesses grow, they would require more cross-border services to meet their needs. A bank intending to serve such conglomerates should have an integrated system across countries and advisory services for alternative funding such as from the capital market. These require more investment in IT and people.

On connectedness, financial integration has a key role in supporting business opportunities in ASEAN. If you compare the pace of financial integration to economic integration, there is still a lot of catching up. For example in Thailand, foreign assets in the banking system account for about 10 percent of total assets, still well below intra-ASEAN trade at 24 percent and investment at 17 percent. Currently, financial institutions are already on the journey toward financial integration through outward presence, as well as strategic partnerships and alliances. ***This will be further enhanced with Qualified ASEAN Banks (QABs) and greater cohesiveness and transparency of regulation in ASEAN.***

To underpin ASEAN's promising future and growth potential, infrastructures necessary to facilitate financial integration is also important. ***Further linkages of financial infrastructures should be encouraged and promote usage of already integrated systems, such as the regional payment systems.***

I must admit that the regulatory landscape for banking in ASEAN countries are quite diverse and include many legacy regulations which impede integration. This makes financial integration more difficult to achieve. This is one area that ASEAN as a group has recognized and will tackle under its financial integration plan Post-2015 to accommodate AEC 2025 agenda.

Finally, on sustainability, a banking system that is competitive, inclusive, and connected needs to also be sustainable. Just as when we travel on a journey, we need not only reliable vehicles, but also skilled drivers and passengers that are cautious explorers, and enforceable driving laws to ensure that we arrive at our next destination safely. The fact that the Thai banking system has been able to withstand many incidents in the past years, including the great flood, the subprime crisis, and the economic slowdown, testifies to the fact that we have been on the right path on sustainability. But again, complacency must be avoided.

In this context, our banking system needs experienced bankers with good governance, excellent risk management practices and banking regulations to ensure safety and soundness, as well as financially literate customers.

In my opinion, banks, as the first touchpoint to the customers, play a central role in promoting financial literacy and usage of new channels such as digital banking. ***More convenience does not mean a compromise on security and reliability of financial services, critical for customer's confidence in the usage of digital channels.***

As QABs are increasingly interlinked with more cross-border transactions, it also calls for closer cooperation on the part of home and host supervisors in line with the global regulatory reforms to ensure stability of the financial system, similar to enforceable international driving laws.

Last but not least, human resources are another key aspect that needs to be continually improved as without sufficient talent pool, the above milestones may not be achieved.

This comes to the end of key milestones of our journey, but the actual action is just about to begin.

Although I end my address today, our journey towards a more competitive, inclusive, connected and sustainable banking system is not yet concluded. Our journey will be a continuous one as it's imperative for banks to constantly adapt to dynamic financial needs of the real economy. Policymakers and regulators alike must also be proactively involved and adapt to the changing ecosystem. Although much has been achieved domestically, regionally there is still much to be done. As such, reaching the destination will require dedication and cooperation from all travelers to arrive safely. ***The key message that I would like to leave with you today is that do not get stuck with maximizing short-term returns or past successes, but we must invest more for the future.***

I wish you all a safe journey. Thank you.