



Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

# Indonesia

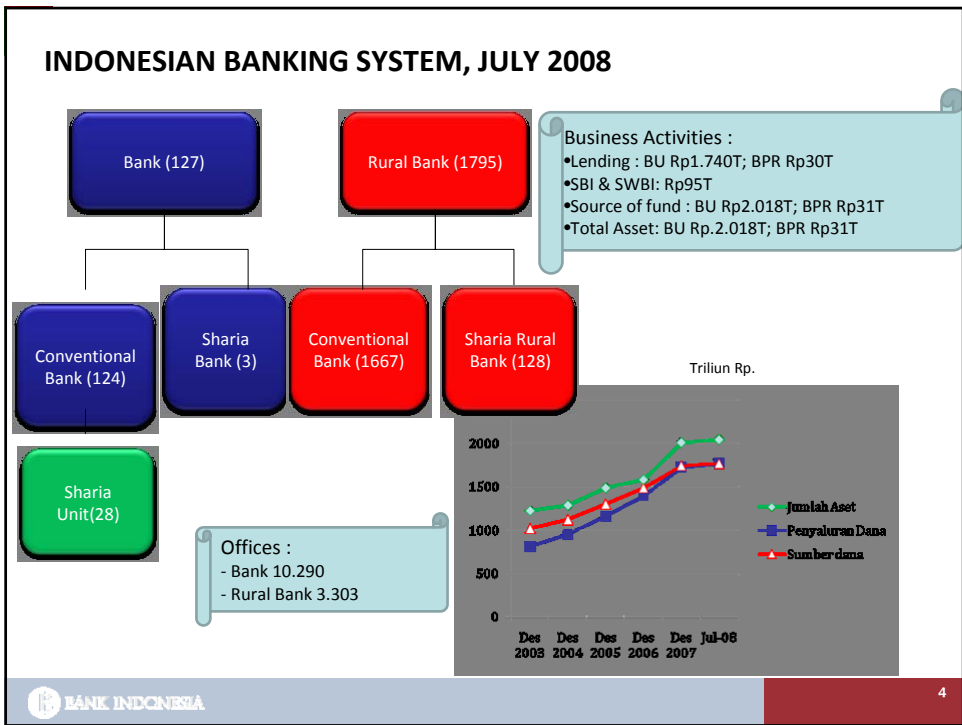
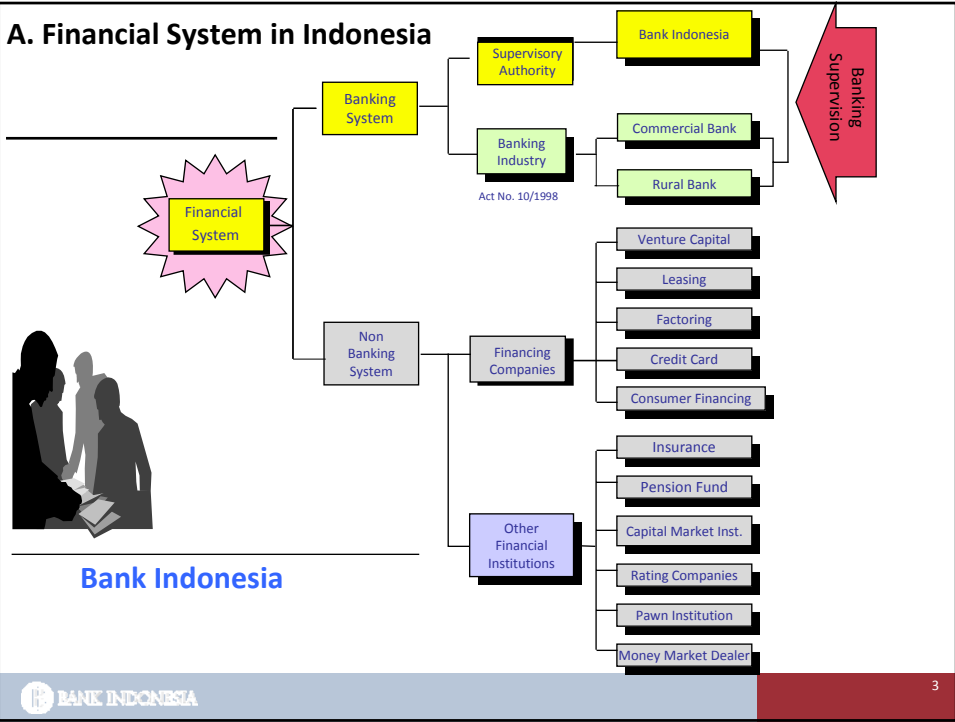
# IMPACT OF CURRENT GLOBAL CRISIS TO INDONESIA'S ECONOMIC

APEC MEETING  
Enhancing Risk Management and  
Governance in the Region's Banking  
System to Implement Basel II and to  
Meet Contemporary Risks and Challenges  
Arising from the Global Banking System

DIDIK MADIYONO  
MIRZA YUNIAR  
Bank Indonesia  
8 - 11 December 2008

## AGENDA

- **Current Indonesia's Banking Policies**
  - A. Indonesian Financial System
  - B. Risk Based Supervision
  - C. Good Corporate Governance
  - D. Basel II
- The global financial crisis
- Implication of global crisis
  - Economic Condition
  - Banking Industry Condition
- Policies Respond
- Closing



## C. RISK BASED SUPERVISION

### The Differences Between Compliance & RBS

#### Compliance

- Picture drawn on the past
- Based on accounting record
- Point-in-time and surprise entry
- Same scope
- Legal entity approach
- Checklist of management questionnaire

#### RBS

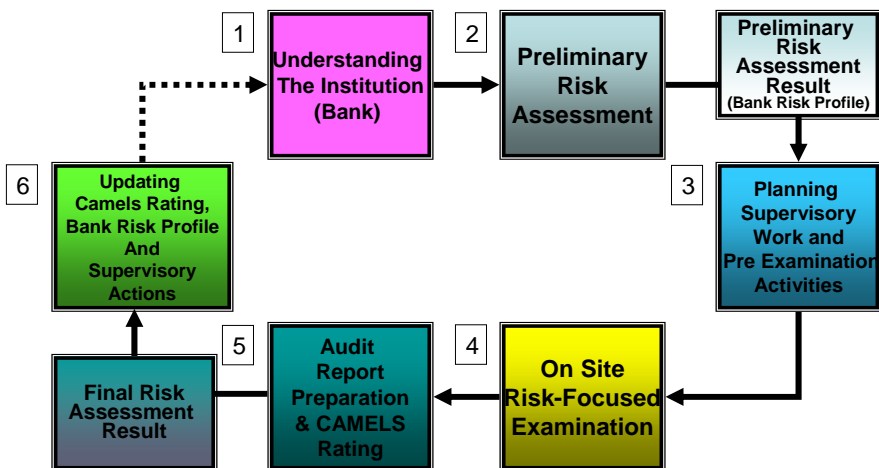
- Historical figures, Forward looking & judgement
- International Standard (BCP)
- Continuous supervision and meeting with board
- Prioritized scope
- Business line/activity (focus on areas with the greatest risk)
- Risk management process and internal control

5

5

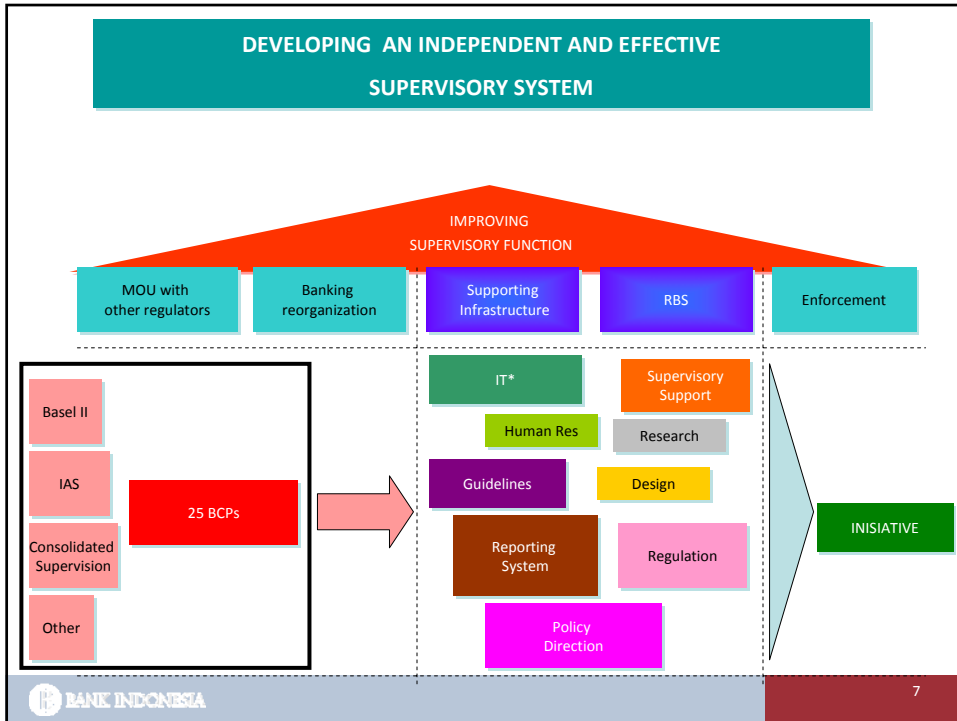
## C. RISK BASED SUPERVISION

### Integrated Process of RBS



6

6



## Risk Management

### The Scope of Risk Management:

- Active Supervision by the Board of Commissioners and Board of Directors
- Adequacy of policy, procedure and establishment of limits
- Adequacy of processes of identification, measurement, monitoring and control of risks; and the Risk Management Information System , and
- Comprehensive Internal Control System

## Risk Management

Requirements for implementing Risk Management :

- A large scale bank with highly complex business operation shall be required to apply Risk Management for all types of risks (credit, market, liquidity, operational, legal, reputational, strategic, compliance risk)
- A less than large scale bank with highly complex business operations shall be required to apply Risk Management for at least the 4 (four) types of risks.

9

## Prudential Regulations

- Capital Adequacy Ratio (CAR)
- Asset Quality
- Provision of Asset Quality
- Legal Lending Limit (L3)
- Net Open Position
- Liquidity

10

## D. GOOD CORPORATE GOVERNANCE

- Bank Indonesia issued Regulation No. 8/4/PBI/2006 about Good Corporate Governance (GCG) for Banks amended by Regulation No. 8/14/PBI/2006.
- The regulation requires banks to implement GCG principles (TARIF- Transparency, Accountability, Responsibility, Independency, Fairness), which is reflected in :
  - Board Commissioners and Directors roles and responsibilities;
  - Committee's establishment and its functions to uphold GCG; serta
  - Others :
    - Functions of compliance, internal auditor, external auditor;
    - Risk Management;
    - Loan disbursement to related party and large exposure;
    - Bank Strategic plan; and
    - Transparency of bank condition and financial statement.
- Bank must carry on *self assessment* and provide BI with GCG Implementation Report.

## Finished Deliverables

- Conducted a *pilot project self assessment*, by circulating Guidelines of Bank Self Assesment to all banks to deteminta bank's preparedness in implementing GCG and receive feedback for improvement.
- **The self asesment** is intended for initial preparation in order to accelerate the process of identification and analysis of bank's weaknesses and to propose follow up actions and timeline for corrective action before the obligation of self assesment is enacted in end of 2007.

## GCG Programs

- To encourage banking forum activities for sharing knowledge and experience in implementing GCG in banking system;
- To issue Circular Letter with regard to Implementation of GCG for Banks;
- To conduct education and training programs about GCG regulation;
- To review dan evaluate GCG implementation;
- To have close relation and cooperation with other institutions to develop and improve the implementation of GCG in banking system.

13

## E. Basel II : Policy Direction

- Basel II will be implemented starting from year 2010 due to the current global financial crisis.
- The implementation of Pillar 1-Basel will commence with the least sophisticated approach as follows :
  - *Standardized Approach* – credit risk;
  - *Basic Indicator Approach* – operational risk.
- In managing market risk exposure, banks can adopt standardized model. Banks are opt to apply internal model approach, subject to supervisor's approval.
- Any banks capable of meeting preconditions and prerequisites adequately will be allowed to move to more advanced approaches upon supervisors approval including implementation of Advanced Measurement Approach (AMA) in operational risk.
- It is expected that by year 2011 the Framework will be applied in full scope covering all pillars
- BI's preparatory agenda : . Year 2008 issued regulation on Capital Adequacy Requirement based on Basel II, IAS 39. Year 2009 : Bi will issue regulation on credit risk and operational risk based on Basel II; supervisory manual to do SREP ; *exit policy* regulation

Banks are obliged to implement standardized approach by year 2010 at the latest

2009

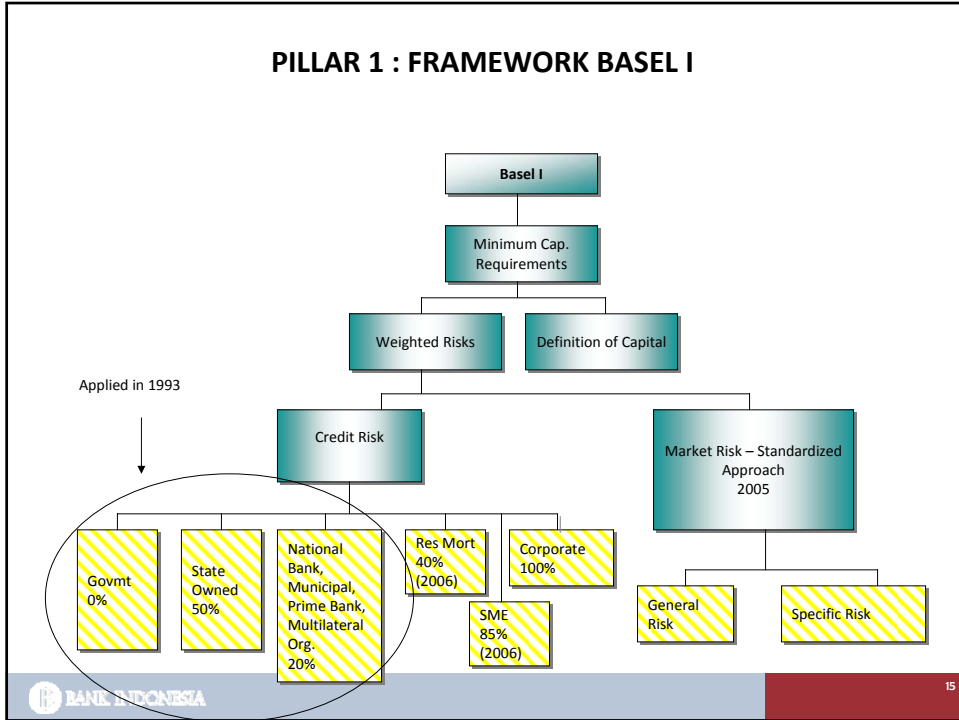
Banks could migrate to a more advanced approach by year 2011 subject to BI's approval

2011

14

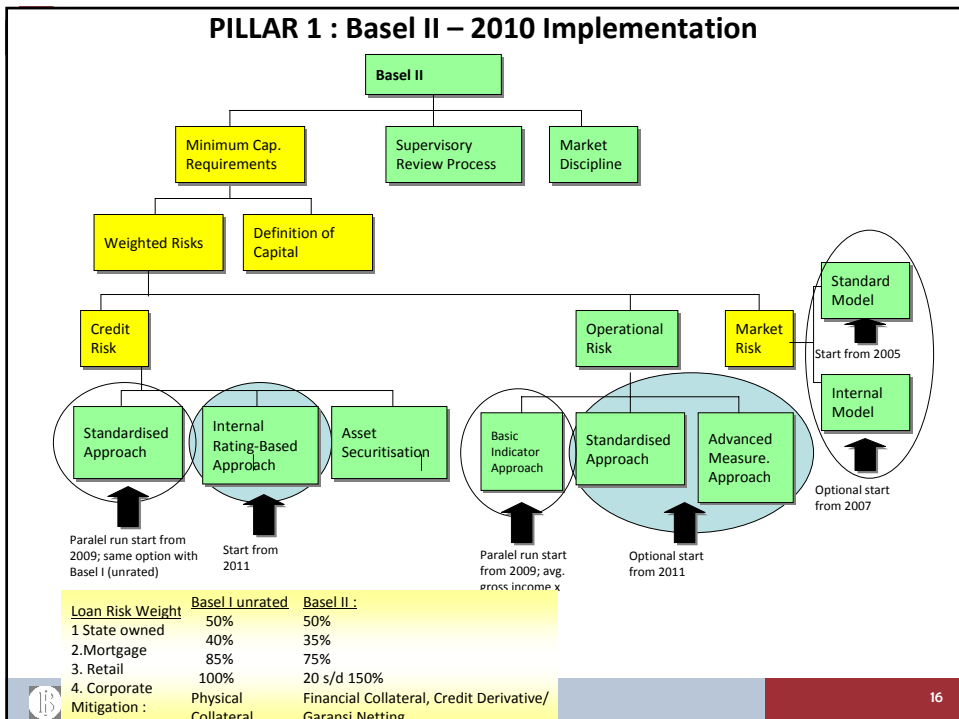


## PILLAR 1 : FRAMEWORK BASEL I



15

## PILLAR 1 : Basel II – 2010 Implementation



16

# Basel II Challenges

- **Information Technology :**
- **Pillar 2 Implementation :**
  - The beauty of pillar 2 : flexibility in implementation depend on bank's size and complexity.
  - Challenge for Bank Indonesia :
    - How supervisors exercise judgement
    - How to improve supervisory framework according to 25 BCPs, IAS, Consolidated Supervision and other *international best practices* .
    - Improvement of supervisory system to monitor bank's monthly report.
    - GCG and Risk Management in supervisory process.

17

17

# Challenges for Banks

## Pillar 1

### Credit Risk

- ✓ Mapping of collateral :
  - ✓ For each facility
- ✓ Exposure category :
  - ✓ Risk weight mapping
  - ✓ Calculation of provision
- ✓ *External Credit Assessment Institutions* (ECAI)
  - ✓ Mapping ECAI to risk weight

### Operational Risk

- ✓ Mapping financial statement to capital charge calculation

### Market Risk

- ✓ Subject to Basel I,
- ✓ If banks opt to internal model, then banks should have adequate understanding including senior management, treasury, internal control and risk management unit.

IT related issues

18

18

# Challenges for Banks

## Pillar 2

- ✓ How banks conduct ICAAP in considering the operation's scope and complexity of all banks ?
- ✓ How to cover risks not yet calculated in Pillar 1 ?

To Strengthen  
Risk  
Management

## Pillar 3

- ✓ Provide better quality of information and transparency without breaching *proprietary* and *confidential* matter.

To Improve  
Market  
Discipline

19

19

# AGENDA

- Current Indonesia's Banking Policies
  - A. Indonesian Financial System
  - B. Risk Based Supervision
  - C. Good Corporate Governance
  - D. Basel II
- **Implication of global crisis**
  - Economic Condition
  - Banking Industry Condition
- Policies Respond
- Closing

20

## IMPLICATION OF GLOBAL CRISIS

- *Liquidity squeeze* caused by the diminishing confidence and difficulties to obtain loans lead to capital flight to world financial center in USA and other industrial countries.
- World recession influencing the export growth of developing countries which the developed countries become their export target.
- Minimum impact to Indonesia's economic and financial condition due to limited holding of structured products and notes issued by international financial institutions.
- Weakness in Indonesian financial system as source of Banking Crisis in 1997/1998 has been reduced :
  - Higher CAR of banking industry (16%) above minimum threshold 8%
  - Better asset quality (NPL<4%)
  - No breaching in legal lending limit
  - Prudential regulation encourage banks to improve governance, transparency and risk management quality
  - Established financial safety net

## IMPLICATION OF GLOBAL CRISIS

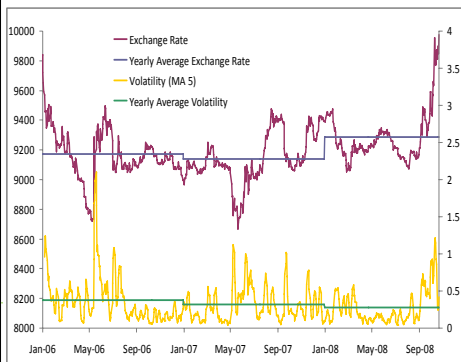
- Economic grows in slower pace since QIII-2008.
- Current account tend to be deficit along with the declining export and inclining import.
- Foreign exchange reserve in QIII-2008 reaches USD57.1 billion of 4.2 months of import and payment of government foreign debt but as of December 2008 is decreasing to USD50.2 billion.

# IMPLICATION OF GLOBAL CRISIS

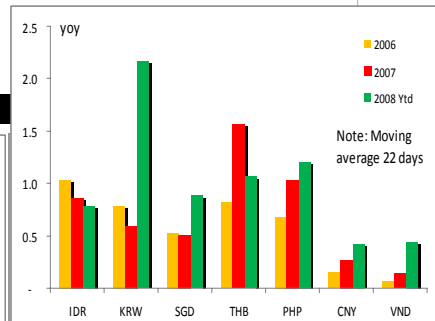
## Exchange Rate

Rp is depreciating but still quite stable....

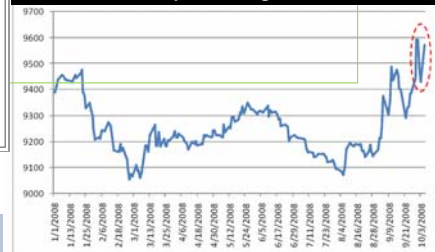
### Level & Volatility Rupiah



### Comparison of Volatility in Region



### Rupiah During 2008



# IMPLICATION OF GLOBAL CRISIS

## Exchange Rate

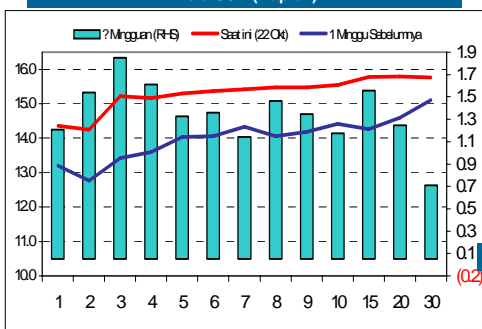
Currencies in Asian Region facing depreciation due to high demand of USD. As of 27-Oct, IDR has weakened 17% against USD year to date.

Exchange Rate	Early 2008	Change (%)				
		End of Aug 08	End Of Sept 08	30-Oct-08	30 Oct 08 to 30 Sep 08	30 Oct 08 to 1 Sep 08
JPY	111.65	2.7	6.2	13.0	6.4	9.2
KRW	937.6	-13.8	-22.3	-26.1	-4.9	-12.0
SGD	1.4396	1.7	0.7	-1.6	-2.3	-2.6
THB	29.9	-12.7	-11.8	-14.2	-2.7	-1.5
<b>IDR</b>	<b>9390</b>	<b>2.6</b>	<b>0.05*</b>	<b>-12.2</b>	<b>-10.4</b>	<b>-14.3</b>
PHP	41.23	-10.1	-12.4	-15.3	-3.4	-5.0
EUR	1.4679	0.3	-2.4	-11.7	-9.0	-11.2
NZD	0.7745	-9.9	-14.6	-29.6	-13.1	-16.6
CNY	7.2934	6.7	7.0	6.8	0.3	0.0
VND	16000	-3.2	-3.6	-5.0	-1.4	-1.7
MYR	3.3105	-2.5	-3.8	-6.3	-2.6	-3.4

\* IDR end position is on Sep 26th 2008

# IMPLICATION OF GLOBAL CRISIS

Yield SUN (Rupiah)



## Capital Market



SUN (T-Bill) market is narrowing lead to increase in yield and plunge of SUN price and become 70%

Capital Market Index



a. The plummeted stock index around 10,38% (higher than other world stock exchange 4-5%) and unhealthy market practice lead to suspend of capital market 8-10 October 2008.

b. Government has prepared fund to buyback state-owned companies stocks.

## Capital Market

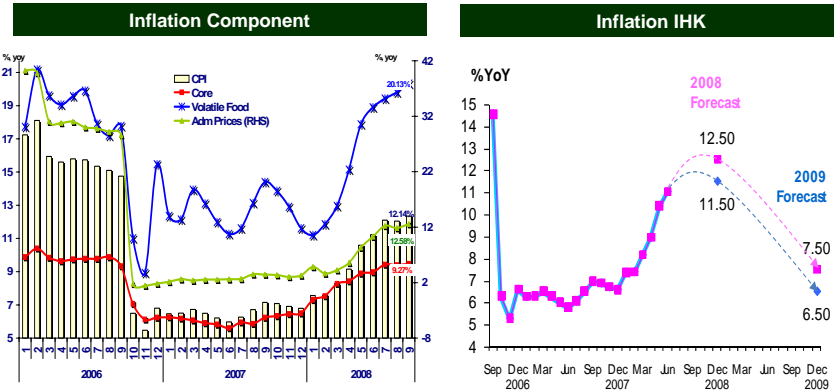
Capital Market Index in other countries also plummet down...

Equity Index	Early 2008	Change (%)				
		End of Aug 08	End Of Sept 08	22-Oct-08	22 Oct 08 to 29 Sep 08	22 Oct 08 to 1 Sep 08
AS	13044	-11.5	-16.8	-35.8	-17.8	-26.2
Eropa	3635	-19.8	-27.5	-39.6	-14.0	-23.3
Jepang	15308	-14.6	-26.4	-43.3	-26.1	-32.4
Malaysia	1436	-23.3	-29.0	-37.4	-11.3	-17.8
China	5273	-54.5	-56.5	-64.0	-17.3	-18.5
Filipina	3617	-25.7	-29.0	-42.2	-19.7	-22.1
Singapura	3444	-20.5	-31.5	-47.5	-22.9	-32.9
HongKong	27561	-22.9	-34.6	-48.7	-20.2	-31.8
Indonesia	2732	-20.7	-32.9*	-49.8	-24.7	-36.3
Korea	1853	-20.5	-21.9	-40.2	-22.1	-19.8
Thailand	843	-18.8	-29.2	-45.8	-22.6	-31.1
Taiwan	8323	-15.3	-31.3	-42.8	-18.0	-28.6
Vietnam	921	-41.5	-50.4	-59.6	-21.7	-30.5

\* JCI's end position is on Sep 29th 2008

## Inflation rate is predicted to become moderate

The effect of oil price increase in May 2008 has diminished in August on the other hand, the decrease in global commodity price is predicted is predicted to be able to lessen the inflation pressure.



Source: Bank Indonesia

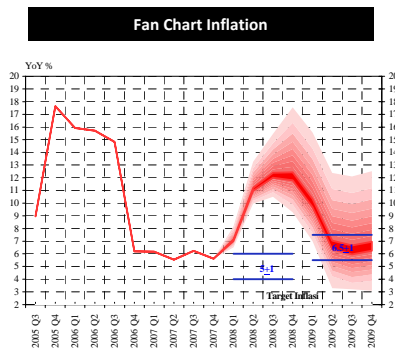
## Inflation Outlook

- Inflation pressure is alleviated from 11,5-12,5% (2008) to 6,5-7,5% (2009).
- The decrease is contributed mostly by low imported inflation.

**Projection of Inflation 2008-2009**

		YoY			
		CPI	Core	VF	Adm
2008	Q1	7.1	7.0	13.9	3.1
	Q2	11.0	8.8	18.7	10.3
	Q3	12.1	9.3	20.1	12.6
	Q4	11.9	9.9	16.2	13.6
2009	Q1	10.0	8.6	13.3	11.2
	Q2	6.7	5.7	8.3	7.7
	Q3	6.4	5.3	8.5	7.6
	Q4	6.8	5.3	8.6	9.1

Note : Since June 2008, BI estimates the aggregation of the CPI.



# KEY ECONOMIC INDICATOR

	2005	2006	2007	2008E*	2009E*
<b>National Accounts</b>					
Real GDP (% yoy)	5.7	5.5	6.3	6.2	5.8
Domestic demand ex. Inventory (% yoy)	5.8	3.7	6.0	7.4	6.8
Real Consumption: Private (% yoy)	4.0	3.2	5.0	5.5	5.5
Real Gross Fixed Capital Formation (% yoy)	10.8	2.9	9.2	12.7	9.5
GDP (USD Bils.) — nominal	287	364	433	486	567
GDP per capita (USD) — nominal	1,308	1,641	1,925	2,132	2,460
Open Unemployment Rate (%)	10.3	10.3	9.8	8.0	7.1
<b>External Sector</b>					
Exports, fob (% yoy, US\$)	22.9	19.0	14.0	10.0	3.0
Imports, fob (% yoy, US\$)	37.2	6.3	15.4	25.0	6.0
Trade balance (US\$ Bils.)	17.5	29.7	32.8	23.2	20.7
Current account (% of GDP)	0.1	3.0	2.4	0.4	0.1
External debt (% of GDP)	48	37	30	26	23
International Reserves-IRFCL (US\$ Bils)	34.0	42.6	56.9	60.0	64.0
Import cover (months)	4.3	4.5	6.2	4.6	4.6
Currency/US\$ (period average)	9,711	9,167	9,139	9,325	9,325
<b>Other</b>					
1M SBI (BI policy) Rate (% period average)	9.0	11.9	8.6	8.7	9.3
Consumer prices (% period average)	10.5	13.1	6.4	9.8	9.5
Fiscal balance (% of GDP; FY)	-0.5	-1.0	-1.3	-1.3	-1.3
S&P's Rating - FCY	B+	BB-	BB-	BB-	BB

# AGENDA

- Current Indonesia's Banking Policies
  - A. Indonesian Financial System
  - B. Risk Based Supervision
  - C. Good Corporate Governance
  - D. Basel II
- The global financial crisis
- **Implication of global crisis**
  - Economic Condition
  - **Banking Industry Condition**
- Policies Respond
- Closing



## Banking Performance August 2008\*






\*Review data Juli'08 -Ags'08

National banking industry has showed resilient to current turmoil :

- High CAR level (Agustus 2008 16,0%).
- Third Party Fund grows in slower pace and even with negative growth during Ags'08. Working capital loan is increasing which make LDR augmented from 79,0% (Juli'08) to 81,6% (Ags'08). The increment of loan decrease NPL ratio.
- Monthly Net Interest Income in Ags'08 start to diminish. Bank's interest rate becomes thinner but ROA is relatively stabil.

Total Asset	↑	Increase by Rp9,5 T (0,5%), to Rp2.066,6 T (Des'07: Rp1.986,5 T). Increase yoy Rp246,2 T (13,5%), ytd increase Rp80,2 T (4,0%).
Credit	↑	Increase by Rp35,7 T (2,9%) from Rp1.210,9 T to Rp1.246,6 T. Increase yoy Rp309,8 T (33,1%), ytd increase Rp200,9 T (19,2%).
Third Party Fund	↓	Decrease by Rp4,8 T (0,3%) from Rp1.532,9 T to Rp1.528,1 T, which comes from <i>demanda deposit</i> (decrease by Rp18,1 T) and <i>saving deposit</i> (decrease by Rp2,8 T), while <i>time deposit</i> increase Rp16,1 T. Increase in yoy Rp135,5 T (9,7%), ytd up Rp17,4 T (1,2%).
NPL	↑	Nominal NPL increase Rp0,2 T. NPL <i>Gross and Net</i> improving, decrease from 4,04% and 1,57% to 3,95% and 1,42%, due to increase in loan and formation of loan provision.
Earning & Profitability	↓	NII Ags'08 (Rp9,40) decreases from NII Juli'08 (Rp9,63 T). ROA is still at level 2,7%.
Capital	↓	CAR decrease from 16,2% to 16,01%, due to augmented loan.

## Banking Risk Profile

Risk	Level	Trend
 <b>Liquidity Risk</b>	<b>High</b> rasio <i>liquid asset to non core deposit</i> 84,89%, decrease from Juli'08 (91,98%). The decrease has taken effect since January 2008.	<b>Increasing.</b> Along with the decrease in <i>secondary reserves</i> , whilst financial market and capital market is still under tight condition
 <b>Market Risk</b>	<b>Moderat</b> – the matured bank's position which generally holding short position in short term under increasing interest rate environment will give bigger pressure on SUN's price.	<b>Increasing.</b> Market risk is tend to increase especially due to the volatility of Rp and SUN (Treasury Bill) price.
 <b>Credit Risk</b>	<b>Moderat</b> - NPL nominal increasing a little (Rp0,2 T Ags'08) whilst NPL ratio sedikit turun, yaitu dari 4,04% (Juli'08) menjadi 3,95% (Ags'08).	<b>Potentially increasing</b> according to increase in interest rate and strengthened USD to Rp while demand of consumer goods decreasing then the NLP tend to increase in the future.
 <b>Profitability</b>	<b>Decreasing</b> – Monthly NII declines a little from Rp9,63 T to Rp9,40 T, but ROA is relatively stable at 2,7%.	<b>Potentially decreasing</b> along with trend of narrowing interest rate <i>pread suku bunga</i> and inclining NPL amount.
 <b>Modal</b>	<b>Decreasing</b> - CAR decreases (into 16,01%). There is a concern that banking capital can not commensurate its risk.	<b>Potentially under extensive pressure</b> along with the increase of loan growth, decrease in profit and volatility in financial and capital market local and international.

# AGENDA

- **Current Indonesia's Banking Policies**
  - A. Indonesian Financial System
  - B. Risk Based Supervision
  - C. Good Corporate Governance
  - D. Basel II
- The global financial crisis
- **Implication of global crisis**
  - Economic Condition
  - Banking Industry Condition
- **Policies Respond**
- Closing

## **10 Government Policies to Prevent Adverse Impact of Global Crisis (28 October 2008)**

1. To supervise of foreign exchange transaction of state owned companies in one clearing house
2. To accelerate completion of foreign capital funded project
3. For State-Owned companies not to transfer fund between banks
4. To buy back T-Bill by government
5. To maximize the usage of borrowed foreign exchange from Japan, Korea and China
6. To guarantee the risk in export credit payment
7. To decrease export tax of crude palm oil into from 10% into 0%
8. Flexibility of assumption in National Income and Budget year 2009
9. To prevent illegal import
10. To scrutinize more on circulated goods

*This policies is taken in order to maintain balance payment and uphold stability of financial sector as well as national income and budget credibility. ..*

## BANKING POLICIES TO ANTICIPATE GLOBAL CRISIS IMPACT

1. **BI has increased BI rate** by 25 bps since May 2008 up to 9,5% on 4 September 2008 to prevent *capital flight* . This is followed by increase in domestic interest rate. But as of 3 Dec 2008, the BI rate decrease 25 bps to 9.25%.
2. Issuance of Regulation Subtituting Law No. 2 year 2008 dated 13 October 2008 about amendment of Law No.23 year 1999 about **Bank Indonesia** which covers :
  - a. BI can provide loan or financing based on Sharia up to 90 days to bank to help short term financial liquidity difficulties;
  - b. Such loan or Sharia based financing must be guaranteed by accepting bank with high quality collateral which value at least equal to amount of loan or financing;
  - c. In certain financial difficulties condition which has systemic impact and potentially incur crisis harm the soundness of financial system, BI can provide emergency facility which funded by government;
  - d. Collateral form is expanded which allow loan asset as collateral of such Short Term Funding Facility (FPJP).
3. Issuance of Regulation Subtituting Law No. 3 year 2008 dated 13 October 2008 regarding amendment in UU No. 24 year 2004 about **Deposit Insurance Agency** :
  1. Increase limit of insured deposit 20-fold form Rp100 million to Rp2 billion (\$20.000) and the maximum guarantee rate raised by 75bps to 10.0% .
  2. Insured deposit must fulfil requirements :
    1. Banking fund drawing in big amount
    2. Mounting up inflation in several years
    3. Number of depositors which are under deposit guarantee program are under 90% of total depositors
    4. Occurrence of crisis threat which threaten soundness of banking system, stability of financial system and decrease of public confidence.
4. Issuance of Regulation Subtituting Law No 4 year 2008 dated 15 October 2008 about Financial System Safety Net which initiate the establishment of Financial System Stability Committee to prevent and tackle crisis.

## BANKING POLICIES TO ANTICIPATE GLOBAL CRISIS IMPACT

5. BI stipulated policies to ensure adequacy of foreign exchange and Rupiah liquidity, on 14 October 2008 to provide flexibility for banks to manage its liquidity :
  - a. **Lengthen tenor FX Swap** from 7 days to 1 month (effective from 15 October 2008). This is expected to meet temporary demand of USD in order to give additional adjustment time for banks and market participants before rearrange its portfolio composition.
  - b. **Provide foreign exchange stock for domestic companies through banking system in** (take effect as of 15 October 2008), in order to increase certainty and availability of foreign exchange stock for domestic companies.
  - c. **Decrease foreign exchange reserve requirement for conventional banks and sharia based banks** from 3,0% to 1,0% (take effect as of 13 October 2008) to inject USD liquidity for banks.
  - d. **Revoke article 4 of Regulation No. 7/1/PBI/2005 to eliminate threshold of daily balance of short term foreign loan** by eliminating dengan meniadakan batasan posisi saldo harian Pinjaman Luar Negeri jangka pendek (starting from date 13 Okcober 2008). This policy is intended to alleviate buying pressure of USD because of the transfer of Rp account to foreign exchange account by foreign depositors.
  - e. **Simplification of Rp reserve requirement calculation** (take effect as of 24 Oktober 2008) from previous regulation that linked reserve requirement to LDR into statutory reserve expected to be at least 7,5% of Third Party Fund in order to increase liquidity in banking system. In transition period this policy can be applied :
    - 5% in the form of statutory reserve in Bank Indonesia.
    - 2,5% in the form of secondary reserve in SBI and/or T-Bill and/or demand deposit in Bank Indonesia. This can be fulfilled by banks 1 year after 24 October 2008 at the latest.

## BANKING POLICIES TO ANTICIPATE GLOBAL CRISIS IMPACT

6. Issuance of **regulation No. 10/28/PBI/2008 regarding Purchase of Foreign Currency against IDR through Banks** in order to monitor USD transaction and limit the speculative motive of transaction which can affect Rp stability. For transaction above USD100,000 customers must provide supporting documents evidencing underlying transactions, copy of ID, Tax identification number.

## POLICY DIRECTION TO IMPROVE BANKING SYSTEM RESILIENCE

- To improve loan disbursement
- To accelerate banking consolidation
- To strengthen Risk Management System
- To accelerate improvement of Risk Based Supervision
- To intensify surveillance on systemic risk.

# AGENDA

- **Current Indonesia's Banking Policies**
  - A. Indonesian Financial System
  - B. Risk Based Supervision
  - C. Good Corporate Governance
  - D. Basel II
- **The global financial crisis**
- **Implication of global crisis**
  - Economic Condition
  - Banking Industry Condition
- **Policies Respond**
- **Closing**

# CONCLUSION

- The ongoing current global financial crisis will influence national, regional and international economic and financial performance condition in the future.
- Regulators will take necessary policies and actions in order to strengthen financial institution condition and improve resilience and stability of financial system
- Coordination and cooperation between local and cross border regulators and authorities is very important to anticipate and mitigate adverse impact of the crisis.





Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

# Malaysia



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

## **Risk Management & Governance Practices in Malaysian Banks & Key issues faced by regulators**

---

8 December 2008



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

### **Scope**

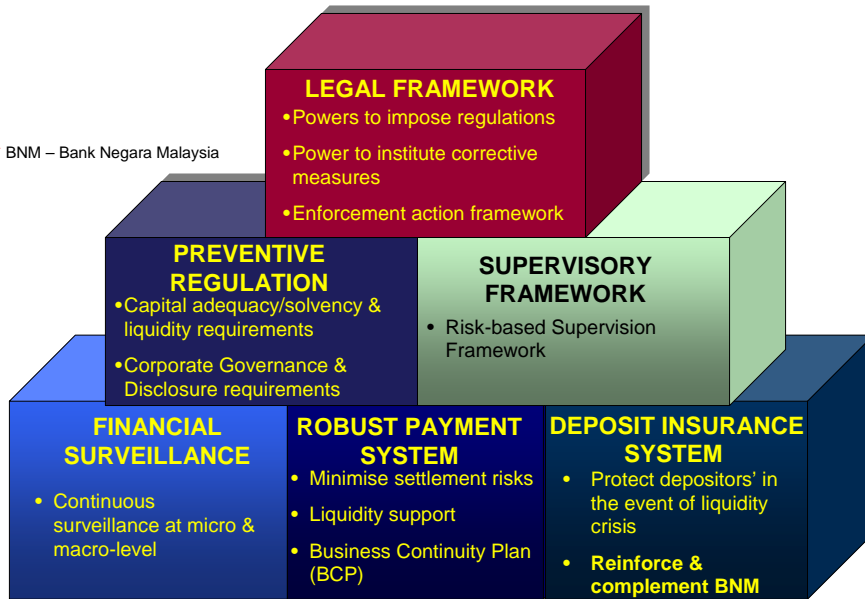
- System & frameworks of financial institution regulation in Malaysia
- Current Risk Management Practices in banking institution.
- Current Governance Practices in banking instituon.
- Regulatory challenges in risk management & governance practices in the current global financial crisis environment



## System & framework of financial institution

**Robust legal, regulatory & supervisory framework are instrumental towards ensuring financial stability...prevention is better than cure**

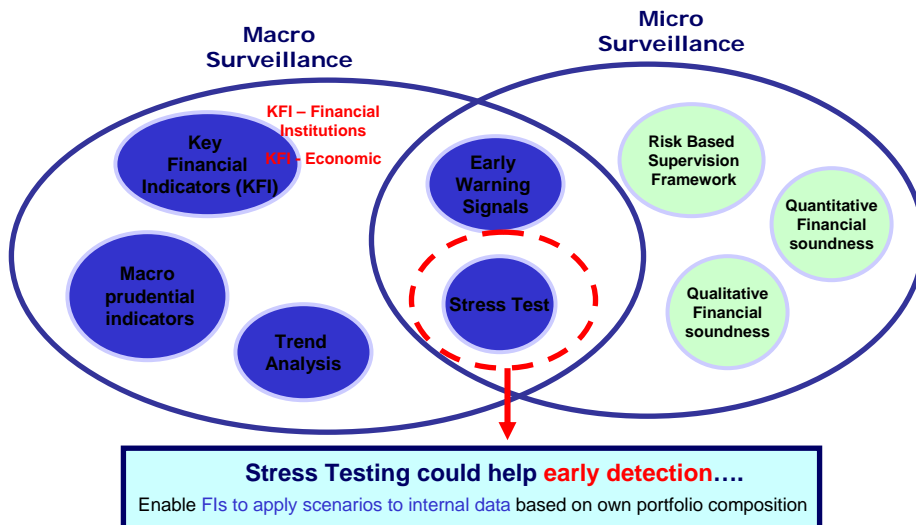
\* BNM – Bank Negara Malaysia



3

## System & framework of financial institution

**With robust mechanisms in place, failures could be detected at early stages...**



\* FIs – Financial Institutions

4

## Risk Management Practices

### Credit Risk

Risk Identification	<ul style="list-style-type: none"> <li>• Identify all types of risk that the bank exposed to when they grant loans to customers</li> <li>• Identify risk that may arise from introduction of new products</li> <li>• Produce credit policy that defines risk tolerance, responsibilities &amp; accountabilities</li> <li>• Communication of credit policies</li> <li>• Sound credit granting process</li> <li>• Conduct credit analysis</li> <li>• Performing stress testing &amp; scenario building</li> </ul>
Risk Measurement	<ul style="list-style-type: none"> <li>• Credit risk rating system (for all portfolio) to quantify all credit risk</li> <li>• Use credit risk rating system as a tool for portfolio management &amp; decision making</li> </ul>
Risk Control	<ul style="list-style-type: none"> <li>• Imposition of risk tolerance limit</li> <li>• Quality &amp; independence of internal credit review</li> <li>• Management of problem credit</li> <li>• Internal control, segregation of duties, dual control</li> <li>• Credit administration</li> <li>• Accuracy, completeness &amp; integrity of MIS &amp; reports</li> <li>• Compliance with regulatory &amp; accounting guidelines</li> </ul>
Risk Monitoring	<ul style="list-style-type: none"> <li>• Updated MIS</li> <li>• Credit risk rating system &amp; reporting that accurately stratifies credit quality</li> <li>• Adequacy of portfolio management</li> </ul>

5

## Risk Management Practices

### Market Risk

Risk Identification	<ul style="list-style-type: none"> <li>• Identify, assess and review market risk within existing and new products</li> <li>• New product approval program ensures that all risks in new products are identified, measured and managed</li> <li>• Communication of credit policies</li> <li>• Sound credit granting process</li> <li>• Thorough credit analysis</li> <li>• Performing stress testing &amp; scenario building</li> </ul>
Risk Measurement	<ul style="list-style-type: none"> <li>• Employ various risk measurement tools to identify market risk - Value at Risk, Earning at Risk, Duration Analysis, Simulation &amp; Sensitivity Analysis</li> </ul>
Risk Control	<ul style="list-style-type: none"> <li>• Formulate framework, policies and procedures to govern market risk activities</li> <li>• Establish various market risk limits and triggers to cap/manage market risk exposure within acceptable risk levels</li> <li>• Conduct daily/periodic monitoring to ensure adherence to approved limits and policies</li> </ul>
Risk Monitoring	<ul style="list-style-type: none"> <li>• Prepare scheduled reporting to senior management and ALCO/RMC/ Board to facilitate informed decision-making</li> <li>• Prepare exception reporting on risk limits/policy breaches to ALCO/RMC/Board in accordance to established policies &amp; procedures</li> </ul>

6

## Risk Management Practices

### Operational Risk

Risk Identification	<ul style="list-style-type: none"> <li>• Risk Control Self Assessment is an ORM tool to Identify operational risks inherent to the respective department in the bank.</li> </ul>
Risk Measurement	<ul style="list-style-type: none"> <li>• Incident Management Data Collection is an ORM tool used to log in operational risk incident occurred in the Bank</li> </ul>
Risk Control/ Monitoring	<ul style="list-style-type: none"> <li>• Key Risk Indicators report to Risk Management Committee and Board of Directors</li> </ul>

## Current Governance Practices

Board	<ul style="list-style-type: none"> <li>• Approving strategic issues</li> <li>• Ensure approved credit standard &amp; all other practices consistent with BI's capital strength, management expertise &amp; risk appetite. Also in line with BI's mission &amp; overall business strategies</li> <li>• Board receive reports on overall credit exposure of the BIs</li> </ul> <p>Board Committee</p> <ul style="list-style-type: none"> <li>• Credit Review Committee</li> <li>• Audit Committee</li> <li>• Risk Management Committee</li> <li>• Remuneration &amp; Establishment Committee</li> <li>• Nomination Committee</li> </ul>
Senior Management	<ul style="list-style-type: none"> <li>• Enforcing strategies approved by Board</li> <li>• Develop policies &amp; procedures</li> <li>• Ensure delineation of line of authority &amp; responsible for managing credit risk</li> <li>• Proper channel of communication to ensure credit policies &amp; procedures are clearly communicated</li> <li>• Ensure adequate operational procedures, internal controls, system</li> <li>• Comprehensive risk reporting process/ management information system</li> <li>• Sufficient resources &amp; competent personnel</li> <li>• Independent assessment by risk management</li> </ul> <p>Senior Management Committee</p> <ul style="list-style-type: none"> <li>• ALCO – market &amp; liquidity risk Loan Committee</li> <li>• Executive Risk Committee – Credit &amp; Operational risk</li> </ul>

## Current Governance Practices

Independent Risk Management Function	<ul style="list-style-type: none"> <li>• Ensure day-to-day management risk performed by business line is effective             <ul style="list-style-type: none"> <li>➢ Credit Risk</li> <li>➢ Market Risk</li> <li>➢ Operational Risk</li> </ul> </li> <li>▪ Ensure Risk measurement systems and methodologies in place to support robust risk assessments</li> </ul>
Internal Audit	<ul style="list-style-type: none"> <li>• Assisting management &amp; business units to detect &amp; mitigate potential risk at early stage</li> <li>• Provide an ongoing review of the internal control systems and risk management processes</li> <li>• Report internal audit findings and recommendation to senior management &amp; Board</li> </ul>
Compliance Function	<ul style="list-style-type: none"> <li>• Assist senior management in setting or reviewing policies &amp; procedures to ensure adherence to applicable regulation and regulatory requirements</li> <li>• Monitor compliance with policies &amp; procedures</li> <li>• Report compliance matters senior management &amp; board</li> </ul>

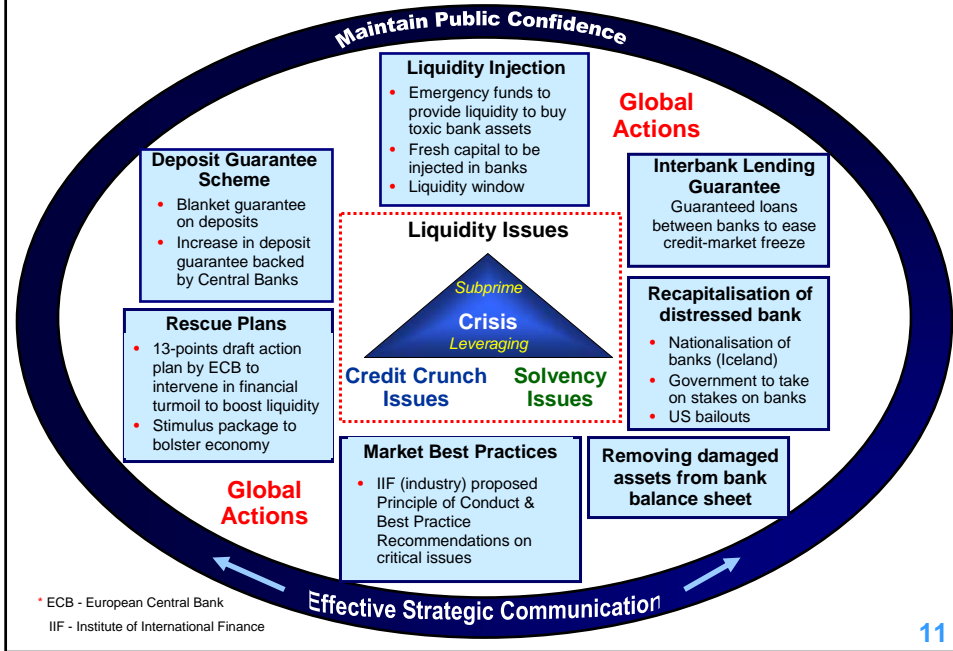
9

## Regulatory challenges in risk management & governance practices during the financial crisis

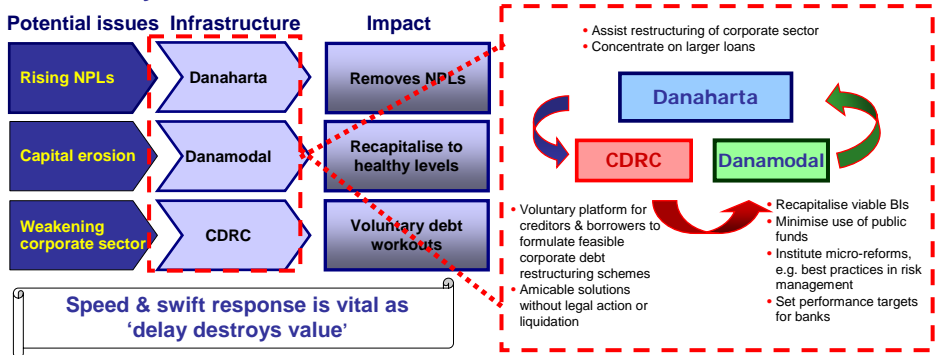
- Regulators need to be updated with the complex financial products
- To educate the Board and Senior Management on risk management culture
- To conduct stress testing, to determine vulnerabilities of financial institution during the financial crisis and if any capital injection required
- To come up with revised guidelines during the crisis
  - Loans – to allow the bank to reschedule the loans without prior approval from Central Bank
  - Securities portfolio – to allow banks to transfer the HFT portfolio to HTM
- Malaysian banks overseas expansion will result in exposure to country and regulatory risk (need to keep abreast with the operating & regulatory environment of the overseas operations)

10

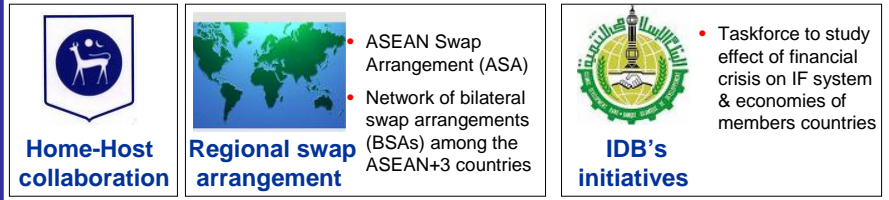
In managing crisis, **liquidity, solvency and credit crunch issues** need to be dealt with in order to maintain confidence...



Pertinent infrastructure must be in place to weather unexpected storm in the financial system...

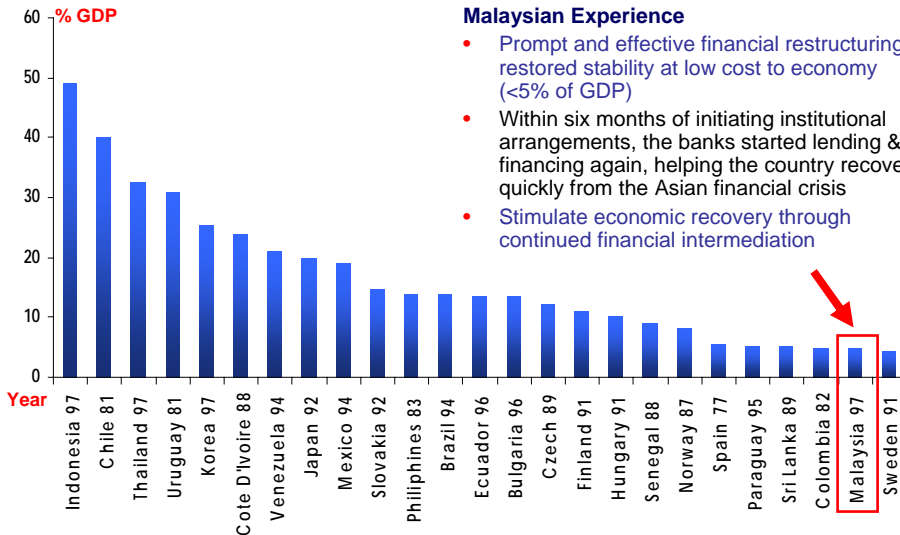


Regional & Global effort must be in place in managing crises...



**Early detection and action is critical as bank failures are costly & have adverse implications on economy**

**Financial crisis – the cost (% GDP)**

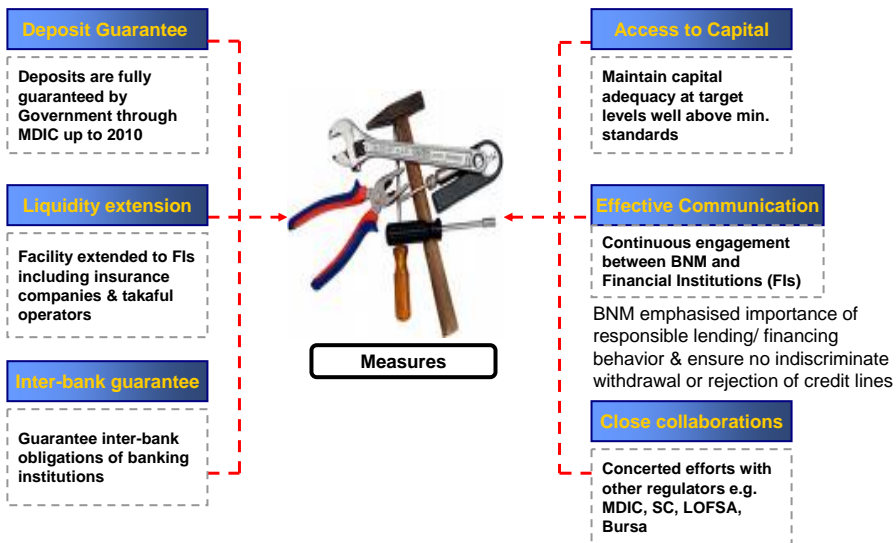


**Malaysian Experience**

- Prompt and effective financial restructuring restored stability at low cost to economy (<5% of GDP)
- Within six months of initiating institutional arrangements, the banks started lending & financing again, helping the country recover quickly from the Asian financial crisis
- Stimulate economic recovery through continued financial intermediation

Source: Krasno Financial Advisory, IMF & Bank Negara Malaysia

**Malaysia: In position of strength...current measures to pre-empt crisis & to re-instill confidence...**



\* BNM: Bank Negara Malaysia; MDIC: Malaysian Deposits Insurance Corporation; SC: Securities Commission; LOFSA: Labuan Offshore Financial Services Authority; FIs – Financial Institutions

For more information on regulatory framework...



- <http://www.bnm.gov.my> - Bank Negara Malaysia
- <http://www.bnm.gov.my/fxadmin> - Malaysia's Foreign Exchange Administration system and rules
- <https://www.fast.gov.my> - Fully Automated System For Issuing/Tendering
- <http://rmbond.bnm.gov.my> - Ringgit Bond Market
- <http://iimm.bnm.gov.my> - Islamic Money Market
- <http://www.sc.com.my> - Securities Commission Malaysia
- <http://www.bursamalaysia.com> - Bursa Malaysia
- <http://bondinfo.bnm.gov.my> - Bond Infohub

THANK YOU

15

## Law/ Guidelines

- Central & Banking Institution Act
- Banking & Financial Institution Act
- Islamic Banking Act
- Various circulars & guidelines
  - Corporate Governance
  - Risk Management (Credit, Market, Operational)

16



Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

**Mexico**





# Mexican Financial System

**Fabrizio López-Gallo Dey**

2008 Workshop on Risk Management in Commercial Banks  
December 2008, Shanghai

The views presented here are my own, and do not represent official positions of Banco de México



## Contents

1. General Review
2. Risk Management Practices in Banking
3. Governance Practice in Banking
4. Regulatory Challenges



## General Review

The Regulation and Supervision of the Mexican Financial System is in charge of the following entities:

- Ministry of Finance (SHCP)
- Central Bank (Banco de Mexico)
- Banking Commission (CNBV)
- Financial System Users Ombudsman (Condusef)

Source: Bank of Mexico



## General Review

Banco de Mexico regulates the following:

- Banks' Assets and Liabilities,
- Securities, FX and Derivatives,
- Financial Trusts,
- Liquidity both in pesos and in FX,
- Lender of Last Resort,
- Payment Systems and
- Credit Bureaus.



## General Review

Coordinated with other authorities Banco de México designs prudential regulation for banks:

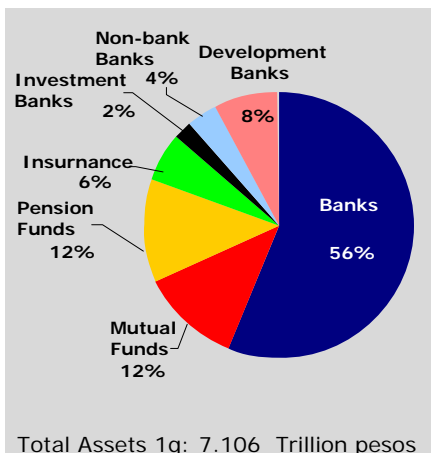
- Capital adequacy rules for banks and security traders,
- Risk concentration limits for common risk, single name and related parties,
- Loan loss reserves and provisions,
- Early warnings and prompt corrective actions.

5

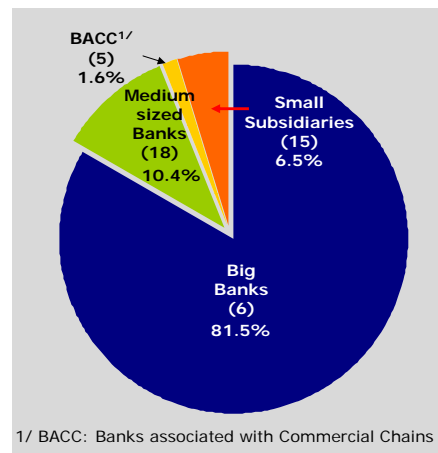


## General Review

Mexican Financial System  
Percent of total assets



Banking System Structure  
Percent of total assets

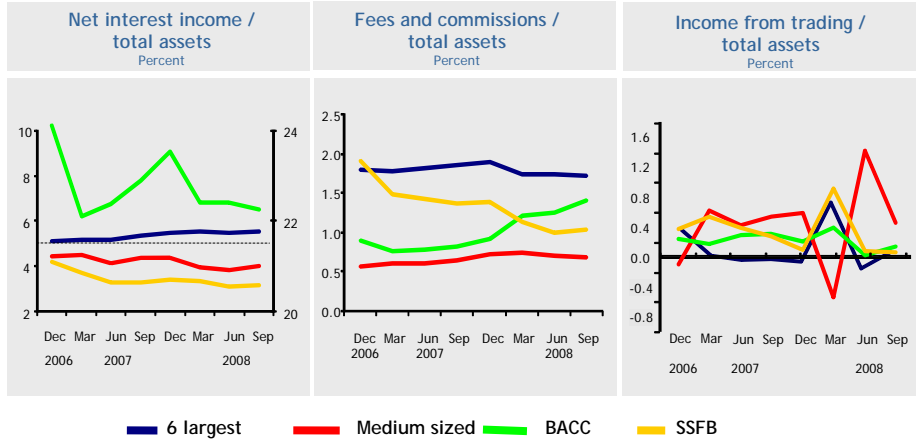


Source: Bank of Mexico



# General Review

In the 6 largest banks, net interest income has been stable as a percentage of assets (September 08).

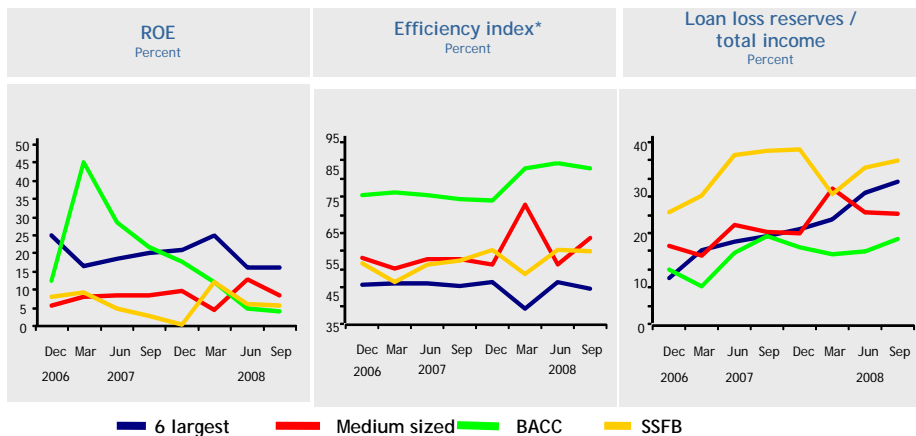


Source: Bank of Mexico and CNBV



# General Review

ROE in the 6 largest banks decreased as a result of a rise in loan loss reserves and trading losses. ROE in BACC falls as net interest income decreases and the efficiency index rises (worsens) as a result of their expansion programs.



Source: Bank of Mexico and CNBV



## Risk Management practices in banking

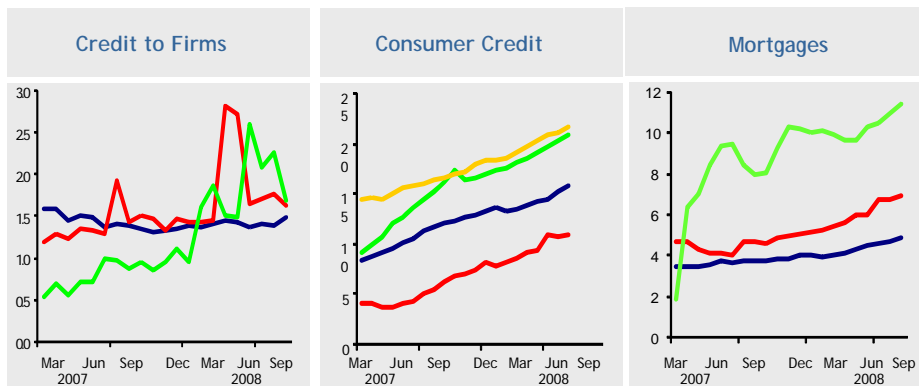
Banks should have an independent risk unit that:

- Measure all the risk both for the entity as well as for its financial subsidiaries in a consolidated basis,
- Develop and adopt risk models,
- Verify risk limits,
- Compute capital charges,
- Etc...



## Risk Management practices in banking

Adjusted Delinquency Rates  
Percent



Adjusted Delinquency Rates include past due loans and credit portfolio write offs.

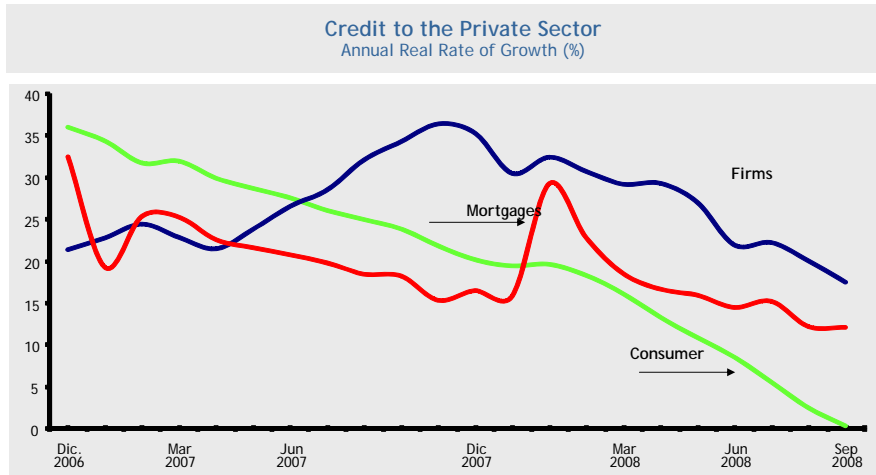
■ Six Largest ■ Medium Sized ■ BACC ■ SSFB

Source: Bank of Mexico and CNBV



# Risk Management practices in banking

The growth rate of consumer credit continues to decrease.

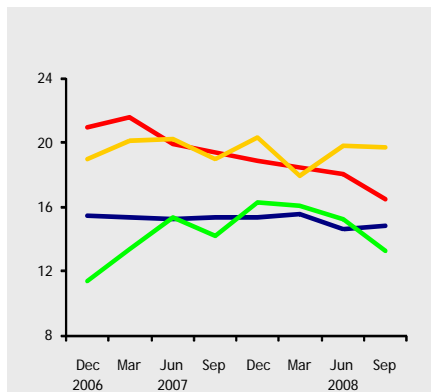


Source: Bank of Mexico

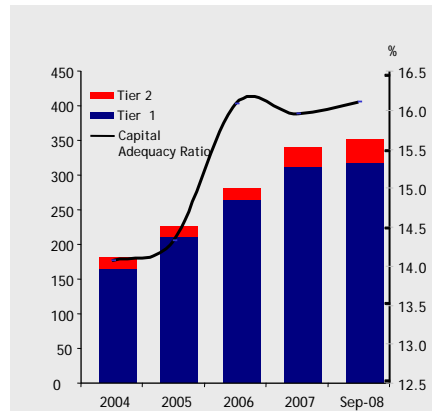


# Risk Management practices in banking

Capital Adequacy Ratio  
Percent



Capital Adequacy Evolution  
Billion Pesos



■ Six Largest ■ Medium Sized ■ BACC ■ SSFB

Source: Bank of Mexico and CNBV



## Governance Practices in Banking

- Independence between risk and business areas,
- Related parties,
- Minority shareholders.

Source: Bank of Mexico



## Regulatory challenges

- Adjusting the rules for the LLR.
- Foreign parent banks.
- Regulating banks related to commerce.
- Rating Agencies.
- Liquidity risk.
- Basel III?

Source: Bank of Mexico



Thank you





Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

**Peru**



**Ministry of Economy and  
Finance of Peru**

# **Basel II: Implementation in Peru**

**Andrés Zacarías  
Sofía Calderón**

**General Directorate of Economic and Social Affairs**

December, 2008

1

## **Contents**

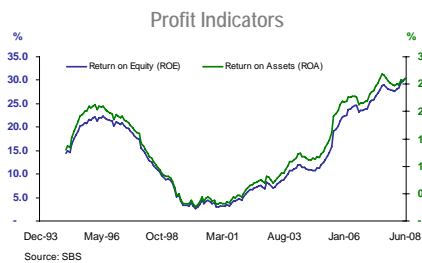
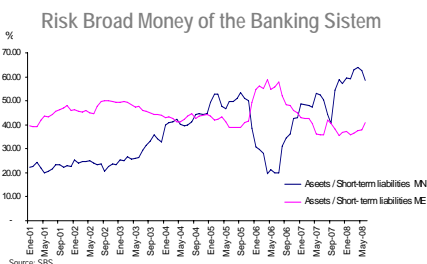
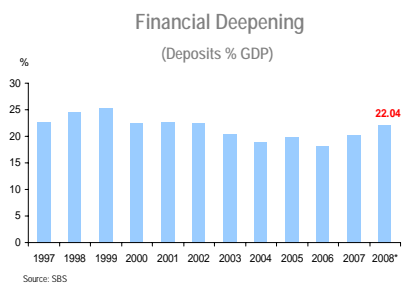
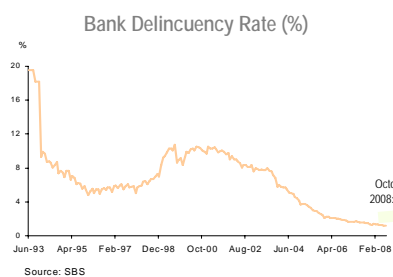
---

- I. Situation of Peruvian Financial System
- II. Pillars
- III. Basel II: Implementation in Peru

2

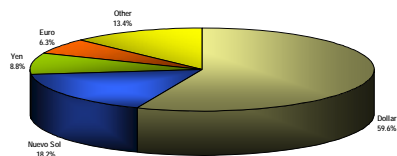
# I. Situation of Peruvian Financial System

## 3. Financial sector consolidates more and more...

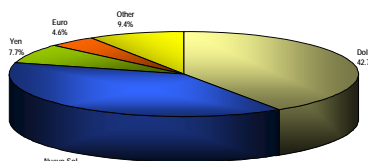


# Prudent Debt Policy: a new profile of public debt

Public Debt Structure by Currencies



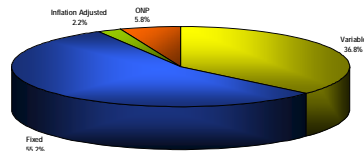
June 2006



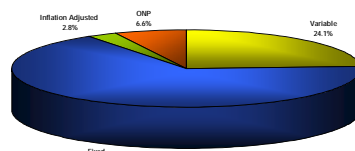
June 2008

Source: MEF

Public Debt Structure by Interest Rate



June 2006



June 2008

Source: MEF

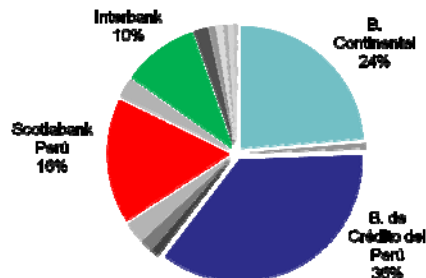
5

# Peruvian Financial System Structure

Structure of Peruvian's Financial System  
October 2008

	N°	Assets (%)
Bank industry	16	93.5
Financial Firms	3	0.6
Non Banking Microfinancial Institutions	36	5.9
Municipal Credit and Saving Funds	13	4.3
Rural Credit and Saving Funds	10	0.8
Edpyme	13	0.8
<b>Total FS</b>	<b>55</b>	<b>100.0</b>

ASSETS = US\$ 53, 440 millions



6

# Financial Regulation

Credit Exchange Risk (Res. 041-2005 and others)	January 2005	Sets minimum prudential standards respect to the grantings of foreign currency credits, as an additional component to define the ability to pay.  Addionat provisions will be set in case of failure the requirements.
	May 2005	
Over indebtedness (Res. 1237-2006 and Res. 6941-2008)	September 2006	Commands that companies must establish in their trade policies, as well as granting, amendment and revision of revolving lines of credit, the criteria and explicit measures that incorporate explicit over indebtedness risk of debtors retailers.  Additionally, sets minimum requirements for the administration of overindebtedness, otherwise additional provisions will be established under the non used portion of revolving credit lines for retail and Smes
	August 2008	

# Financial Regulation

New Banks Law (DL. 1028) Legislative regulation that modifies the General Law of the Finantial System	June 2008	It allows the implementation of the new international standards of capital allocation (Basel II). Increases the minimum capital ratio of 9.1% to 10% (8% at International Standards). Establishes additional capital requirements accorging to risk profile.
Dynamics Provisions (pre publication) New Rules for the Evaluation and Classification of debtors.	October 2008	It sets new criteria for the classification of debtors It establishes greater provisions for the revolving credit lines not used of MES (Micro enterprise) and retail. Establishes a framework of cumulative provisions during the growing phase of economic cycles.
New Capital Requirements (pre publication) Regulations capital requirement for market risk Regulations capital requirement for operational risk  For publishing Regulations requirement for credit risk capital Regulations for a capital risk securitization	October 2008	It allows the peruvian scheme of capital allocation to international standards. It demands additional requirements for operational and market risks. Makes more risk-sensitive the calculus of capital requirements for credit risk.

## II. Pillars

---

9

### Background

---

- According to the recommendations of the Basel Committee for Banking Supervision, the Superintendancy of Banks, Insurance Companies and Pension Fund Managers of Peru – SBS decided to adopt the International Convergence of Capital Measurement and Standards, or the New Capital Accord - Basel II (NAC) for the domestic financial system.
- This means, for calculation purposes of regulatory capital, the use of standardized methodologies, on a mandatory basis.

## Pillars: Basel II

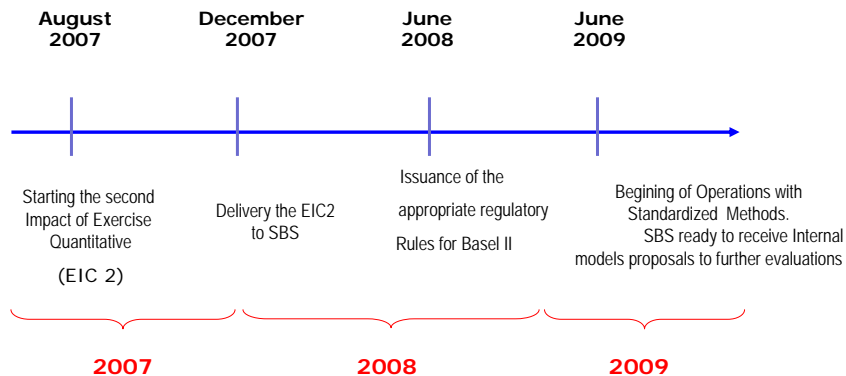
---

- **Pillar I**
  - Capital requirements
  - Credit Risk
  - Market Risk
  - Operational Risk
- **Pillar II**
  - Supervisory Review Process
- **Pillar III**
  - Market discipline

## Implementation Timetable

---

### FASE1: Impact Studies and Issuance of Standardization



## In June 2009

---

All Banks will embrace the Standardized Method. That means they will use the new rules of Basel II using the criteria of the SBS.

At the same time, Banks and other financial institutions will can (optionally) submit their proposals to advanced methods to estimate capital requirements.

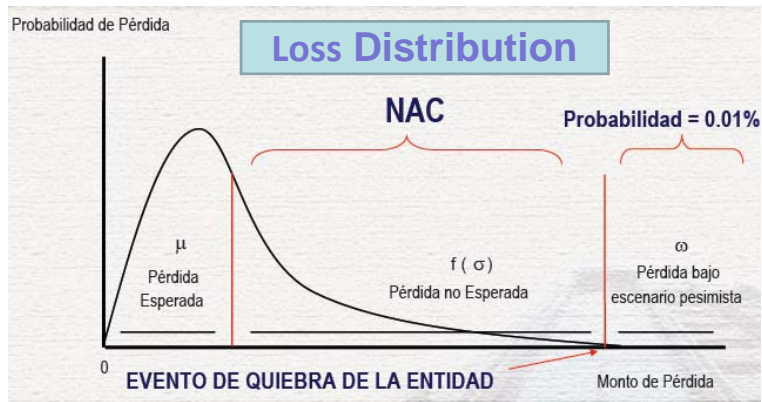
Applicants to advanced models will enter a process of validation by the SBS, which, once completed, it can be used to estimate their required minimum capital.

## IRB Models in Peru

---

- There are two schemes of IRB Models:
- Fundamental IRB: Only for entities that have only the information and requirements to estimate PD.
- Advanced IRB: For entities that match with the informations and requirements to estimate PD, LGD and EAD.
- *What is the incentive?....At the end, institutions that adopt IRB models will need less capital requirements for their operations since the estimations are more accuracy*





## Banking Supervision

### IN SITU SUPERVISION

- Maintain the Portfolio audit
- Reinforce internal audit systems
- Reinforce risk mitigants evaluation

### EXTRA SITU SUPERVISION

- Validation and monitoring of internal Models
- Stresstesting and Backtesting of Internal Models

### SUPPORT TO SUPERVISION

- Desing of benchmark models
- Calibration of parameters (PD, LGD, EAD)
- Update of benchmark models

It is important to reinforce IN –SITU procedures and to intensify and specialize EXTRA -SITU Procedures.

## Market Discipline

---

All financial institutions must have always a disclosure policy that allows economic agents to evaluate different financial alternatives and to be informed how the institutions will manage their funds.

Transparency: It is the process by which relevant information must be clear, accessible and mainly, understandable.



**Ministry of Economy and  
Finance**

# **Basel II Implementation in Peru**

**Andrés Zacarías  
Sofía Calderón**

**General Directorate of Economic and Social Affairs**

December, 2008



Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

# Philippines



# Overview of the Philippine Banking System



1

8 December 2008

## Philippine Financial System

BSP and PDIC

SEC and IC

### Banking System

- Universal and Commercial Banking System
- Thrift Banking System
- Rural and Cooperative Banking System
- OBUs and branches of foreign banks

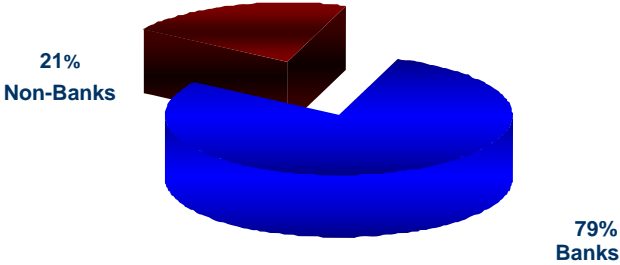
### Non-Bank Financial Institutions (NBFIs)

- Non-banks without Quasi-Banking Function: Investment Houses, Financing Companies, Investment Companies, Securities Dealers/ Brokers, Lending Investors, Pawnshops, Venture Capital Corporations, Government Non-Bank FIs, Non-stock Savings and Loan Associations, Credit Card Companies
- Other FIs: Insurance Companies and Mutual Funds

Note: NBFIs with quasi-banking functions (e.g. Investment Houses and Financing Companies) are under BSP supervision

2

# Strong Presence of Banks in the Philippine Financial System

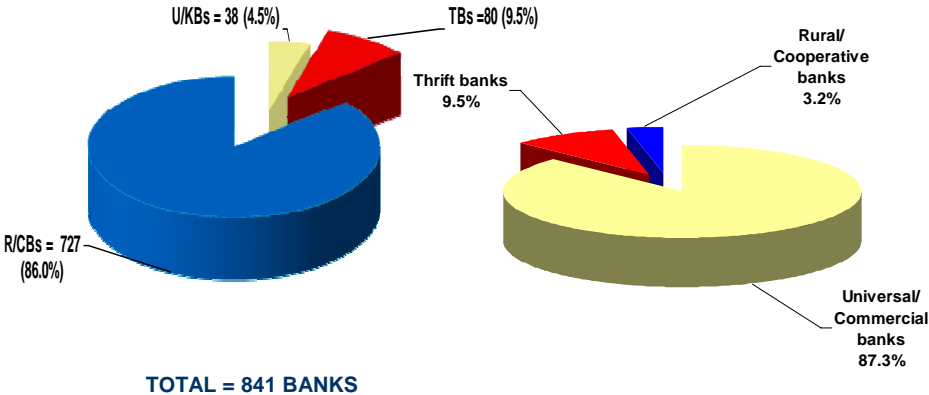


P8.0 Trillion Assets

# Philippine Banking System

**NUMBER OF OPERATING BANKS**  
As of End-June 2008

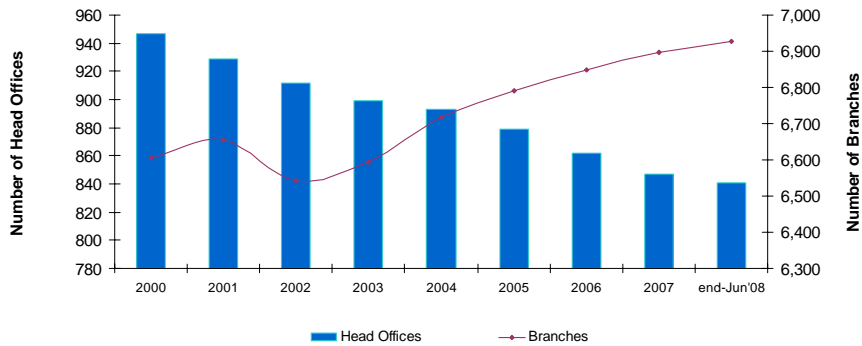
**ASSET SHARE BY BANK CATEGORY**



# Philippine Banking System

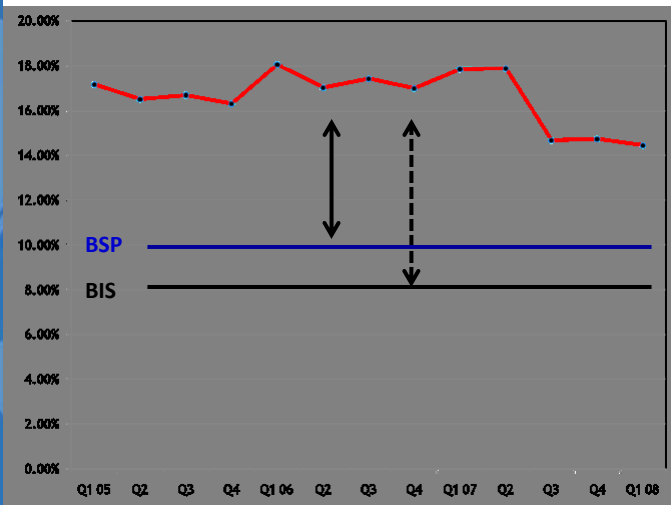
*streamlined structure*

**PHILIPPINE BANKING SYSTEM: TOTAL BANKING UNITS**  
As of End-Years Indicated and  
as of end-June 2008



# Philippine Banking System

*strong capital position*



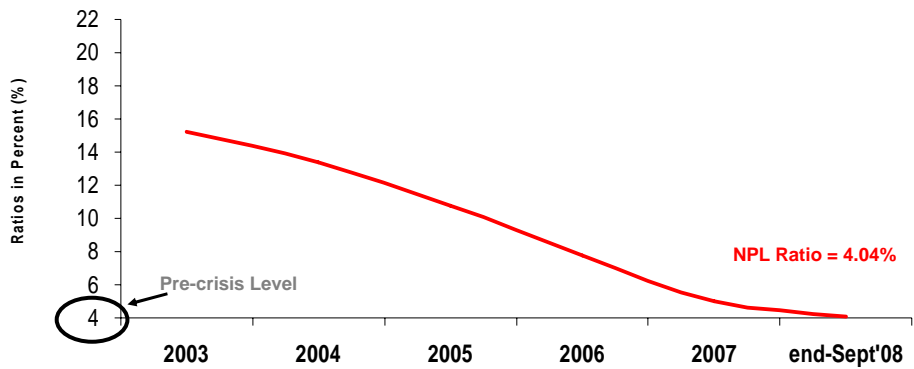
Latest data for Capital Adequacy Ratio (CAR) of Universal and Commercial banks stands at 14.46%

This is much higher than the BSP prudential standard of 10% and the Basel standard of 8%

# Philippine Banking System

*improving asset quality*

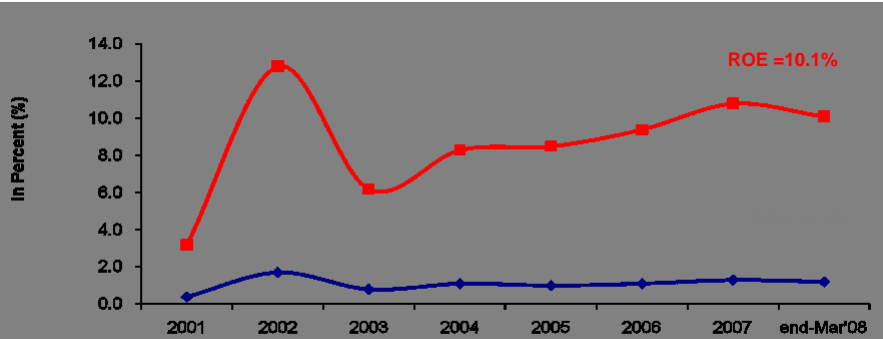
**BANKING SYSTEM: LOAN AND ASSET QUALITY RATIOS**  
As of End-Years Indicated and end-Sept 2008



# Philippine Banking System

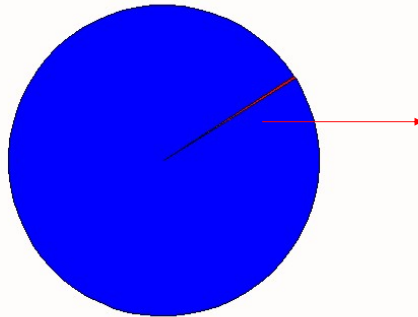
*sustained profitability*

**BANKING SYSTEM: RETURN ON ASSETS (ROA)  
RETURN ON EQUITY (ROE)**  
For One Year Period Ended 31 March 2008



## The Extent of Banking Exposure

Total Assets



Extent of bank exposures to Lehman Brothers amounts to less than  $\frac{1}{2}$  of 1% of total assets.

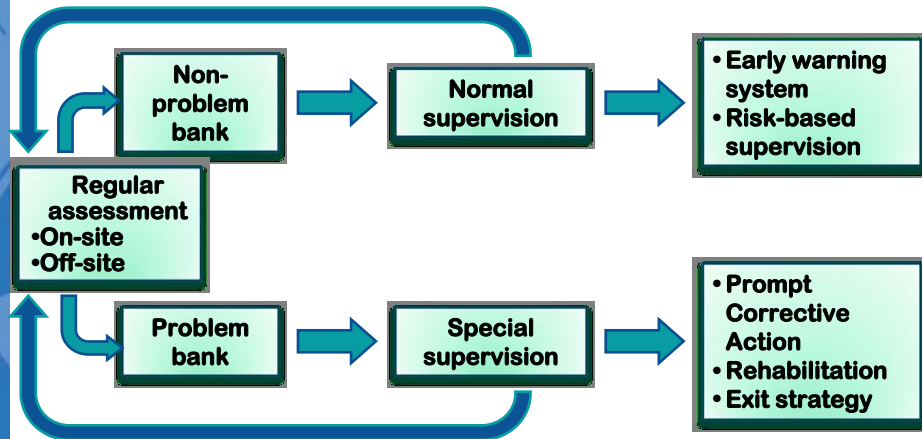
This includes transactions related to Special Purpose Vehicles (loans, bonds) as well as derivatives (CLNs, CDOs, repos)

### Framework for BSP Supervision Risk-Based Approach

- Prioritization of supervisory activities
- Use of standards-based regulations vs. prescriptive rules
  - Risk-based capital regulation
- High quality supervisory data required
- Consolidated supervision
- Coordination with other financial regulators



## Bank Supervision Strategy



11

11

## Bank Classification Criteria

Capital Category	CAR	BSP Intervention
Well Capitalized	12% or above	Normal supervision
Adequately Capitalized	10% or above	
Undercapitalized	Below 10%	Special supervision
CAMELS Rating below "3" or Management rating is below "3"		
Serious compliance issues		

12

12

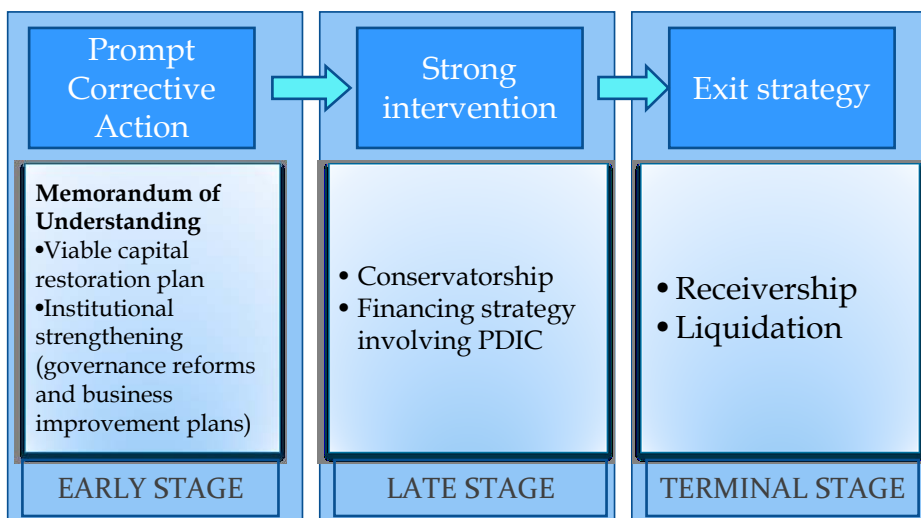
## Normal Supervision

- Applying the risk-based approach
  - A process whereby risk exposures of banks and the quality of their management are systematically assessed by the BSP and the appropriate supervisory activities designed and executed in an efficient manner to promote continuing safety and soundness
- Use of early warning systems
  - On-site review
    - CAMELS Rating System
    - Risk Assessment System
  - Off-site review
    - Bank Performance Analysis
  - Off-site statistical analysis
    - Bank Failure Early Warning System

13

13

## Special Supervision



14

14


## Current Risk Management Practices


Risk Management	Risk Management Committee, Integrated Risk Management
Credit Risk	Standardized Approach, ICRRS
Market and Liquidity Risk	VAR, MCO
Operational Risk	Standardized Approach

15

## The BSP's Implementation Plans A Snapshot

2005	2006	2007	2008	2009	2010
Gradual phasing in of certain Basel 2 provisions (securitization SA, past dues, highest credit quality corporates)		<u>Credit risk</u> -standardized approach <u>Operational risk</u> -basic indicator or standardized approach			<u>Credit risk</u> -FIRB and AIRB allowed <u>Operational risk</u> - AMA allowed


 Pillar 2 (Supervisory Review) – a continuing process


 Pillar 3 (Market discipline) – gradual implementation starting 2007

16

## Current Governance Practices

- Fit and proper standards for directors and officers
- Directors are required to attend special corporate governance seminar
- Election of independent directors
- Accreditation of external auditors
- Adoption of international accounting standards
- More stringent disclosure requirements

17

**BSP's RESPONSE TO THE FINANCIAL TURMOIL**

18

## BSP's Response to the Financial Turmoil

- Timely communication and transparency
- Ensuring adequate peso and dollar liquidity
- Reduction in bank reserve requirements
- Directed relief to banks by allowing reclassification of financial assets
- Information sharing with regional peers
- Active and regular dialogue with stakeholders

19

**POLICY DIRECTIONS AMID GLOBAL CRISIS**

20

## Charting a course through the global financial storm: Policy directions to ensure financial stability in the Philippines

### ❖ Financial sector

- Strengthen prudential oversight of risk management
- Improve disclosure of risk on- and off-balance sheets
- Improvements in small businesses' access to credit
- Further deepening of the domestic capital market
- Supporting key legislative reforms
  - Amendments to the New Central Bank Act
  - Corporate Recovery Act

21

## Headwinds to the Philippines

- **External**
  - Weaker external demand
  - Slower capital inflows
  - Pressure on balance of payments
  - Tighter external financing conditions
- **Real economy**
  - Risk of weaker remittances
  - Weaker fiscal revenue growth
- **Financial system**
  - Strains in dollar liquidity
  - Risk of weak corporate profitability

22

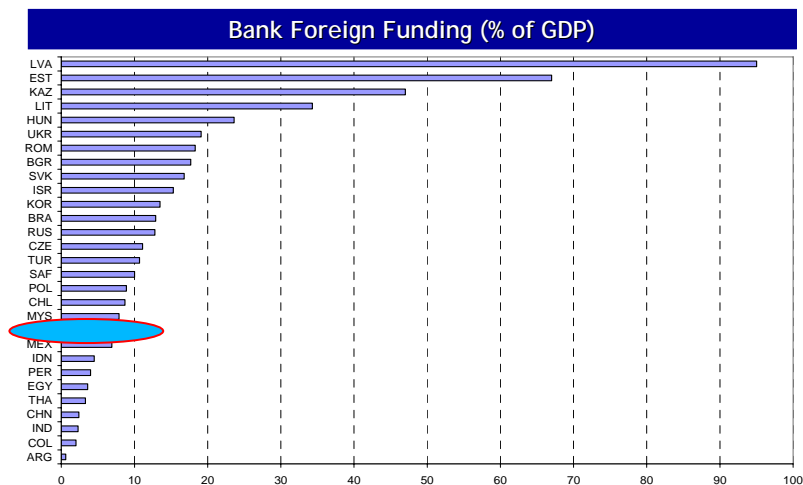
## Initial Headways

- Domestic demand as major growth contributor
- Easing inflationary pressures
- Policy space for fiscal stimulus
- Manageable external payments position
- Well-capitalized banking system
- Low exposure to financial strains

23

## The Philippines is less affected by key transmission channels of financial strains

Philippine bank exposure to foreign funding is low by EME standards



24

Source: IMF, July 2008

## The Philippines is less affected by key transmission channels of financial strains

Reasons:

(1) The Philippine financial institutions have relatively limited exposure to structured credit and related derivative products which were the main cause of the large losses of international banks. Derivative licenses have been given out prudently. (In particular, extent of Philippine bank exposures to Lehman Brothers amounts to less than 0.5% of assets of banking system)

(2) Philippine banks rely more on traditional banking services such as deposits than foreign financing. Corporate sector bond financing is also minimal and private sector reliance on external loans is limited.

(3) While credit growth has been strong, it has not fuelled concerns of overheating or asset price booms.

25

Source: IMF, July 2008

## Shaping Up and Standing Up

- **Regional cooperation**
  - Macro surveillance, sharing of information and policy intent
  - Pooling of resources, e.g. Chiang Mai Initiative
- **Real sector**
  - Policy stimulus (fiscal, monetary)
  - ODA financing for government projects
  - Export competitiveness (power costs)
  - Continued vigilance in inflation management (including expectations management)

26



**Thank You!**



Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

**Russia**

# An overview of Russian banking sector

Shanghai, 8<sup>th</sup> of December, 2008

Irina Yakimova, Banking Regulation and Supervision  
Department, Bank of Russia

Yulia Trubinova, Department of Financial Policy, Ministry of  
Finance of Russian Federation

## I. Banks dominate on the Russian financial market

**From the institutional point of view the banking sector is the foundation stone of the Russian system of financial intermediation**

**Number of credit organizations - 1136**

**Banks on 01.01.08 (bln. \$)**

**Assets - 724**

**Capital - 95,6**

**Financial mediators on 1.01.08 (bln. \$):**

**Insurance organizations, insurance premium - 27,3**

**Collective investment undertakings (CIU), net assets - 25,5**

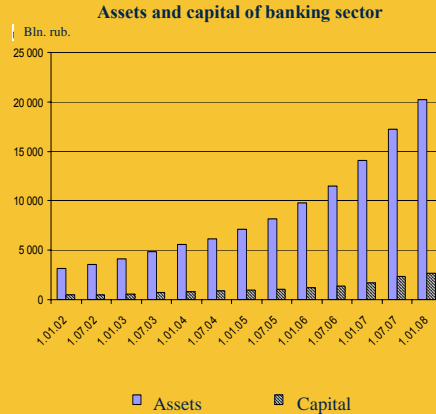
**Non-state pension funds, volume of own assets (on 1.10.07) - 20**

## The macroeconomic role of banking sector is growing in Russia

Strong growth is reflected by key macroindicators:

	1.01.08	1.01.02
Assets/GDP	<b>61.4%</b>	(35.3%)
Capital/GDP	<b>8.1%</b>	(5.1%)
Deposits of population/GDP	<b>15.6%</b>	(7.6%)
Credits to nonfinancial organizations/ GDP	<b>27.4%</b>	(13.7%)

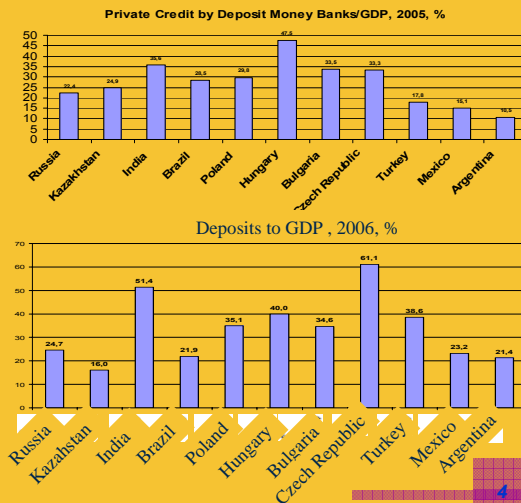
On 01.12.2008 1\$ = 27.6 rub.



3

## The banking sector becomes more comparable internationally

By such indicators like credits/GDP (22%\*) and deposits in banks/GDP (25%) Russia can be compared with the most countries with developing markets



\*Source: World Bank, A New Database on Financial Development and Structure (1960-2005), information upon the last accessible date

4

## II. Banking regulation issues

- # Current situation
- # Nearest future perspective
- # Long-term perspective

5

## Current situation (Basel I)

- # **Assets are classified in 5 groups according to the level of risk – 0, 10, 20, 50, 100% (Instruction of the Bank of Russia № 110-I)**
- # **No capital requirements for OR**
- # **Capital adequacy ratios:**
  - 10% for the banks with capital at least 5 mln. euro
  - 11% for the banks with capital less than 5 mln. euro

6

## Nearest future perspective (Basel II)

- # **Simplified Standardised Approach for credit risk (STA)**
- # **Basic Indicator Approach for operational risk (BIA)**

**We have the draft of amendments to our Instruction Nº 110-I aimed to implement STA and separate draft of Regulation for OR**

7

## Long term perspective

- # **We are looking for advanced approaches**
- # **Collaboration with EU experts about IRB approach (agreement for mutual work until the end of 2010)**
  - 3 working groups
  - meeting once in a quarter (the first was in October 2008, the next will be in February 2009)
  - sharing experience by mutual visits and getting more understanding of advanced approaches

6

### III. Our response to financial crisis environment – measures taken by the Bank of Russia

- # Loans without collateral for the terms up to 180 days (for 5 weeks – \$16 bln.; interest rate - 9-10%)
- # Lombard (secured) loans up to 30 days with the fixed rate
- # Intraday credits - \$71 bln., lombard credits for 14 days – \$53 mln., 30 days – \$378 mln., 3 month – \$171 mln.
- # Deposit interest rates were raised from 3,75% to 4,25%
- # Required reserves were reduced to 0,5% on any obligations (before on obligations to banks-nonresidents – 4,5%; to citizens – 1,5%)
- # Banks allowed to reclassify securities out of fair value through profit or loss category (amendments to IAS 39)

9

### Other measures taken by Russian government

- # **\$33 bln. were provided to the major Russian banks (VTB, Rosselhozbank, Sberbank)**
- # **Guaranteed amount of deposits has raised from \$14 285 up to \$25 000**
- # **From 01.01.2009 profit taxes will be reduced to 20% (from 24%), payment on advanced basis have been cancelled**

10



**Thank you!**





Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

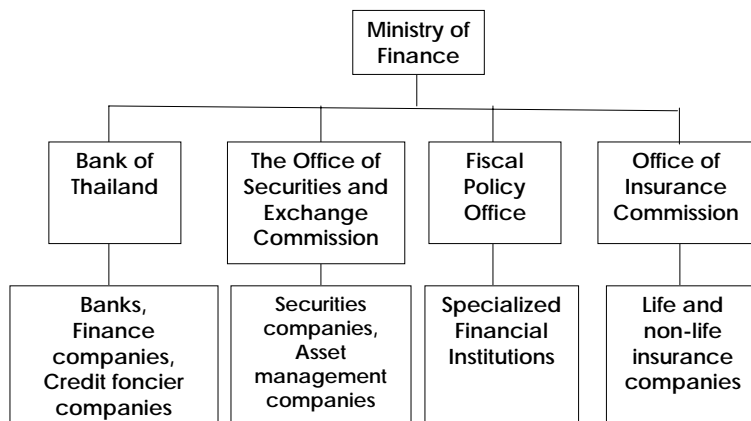
**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

*Session 2.3*

# Thailand

# Financial Services Sector Supervision In THAILAND

## Financial Services Sector Supervision



## Current Risk Management Practices in Banking

- After the Asian Financial Crisis
  - ▣ Risk-base supervision (2000-today)
    - Strategic Risk
    - Credit Risk
    - Liquidity Risk
    - Market Risk
    - Operational Risk
  - ▣ Market Risk Capital Charge (2003-today)
  - ▣ Basel II (from 2008 onwards)

## Current Governance Practices in Banking

- Qualification of BOD and Senior Management
- Composition of BOD and Sub-committee
  - ▣ BOD must have Independent Directors
  - ▣ Must have Risk-management Sub-committee and Audit Sub-committee
  - ▣ Should have Recruitment Sub-committee and Remuneration Sub-committee
- Roles and Responsibilities
- Code of Conduct

## Regulatory challenges

- Current Crisis has minimal effect to Thailand
  - Small exposure to the innovative instruments
  - BOT closely monitor with the situation + stress test
  - Close communication with Banking Industry
  - Well experienced from the previous crisis
- Going Forward
  - Basel II – ready to implement
  - Deposit Insurance Scheme
  - Consolidated Supervision



Enhancing Risk Management and Governance in the Region's Banking System to Implement Basel II and to Meet Contemporary Risks and Challenges Arising from the Global Banking System

**Training Program ~ 8 - 12 December 2008**  
**SHANGHAI, CHINA**

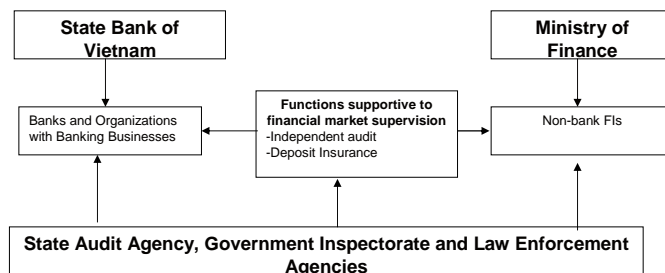
*Session 2.3*

**Vietnam**

# Banking supervisory system of vietnam

## CURRENT STATUS OF THE VIETNAM BANKING SUPERVISORY SYSTEM

### Institutional structure and tasks of financial supervisory agencies



## **Legal framework on banking supervision**

- Law on Supervision and its guidelines.
- Specialized legislations: Law on State Bank of Vietnam, Law on Credit institutions and respective guidelines.

## **Legal framework on banking supervision(continued)**

- Decree No. 91/2005/ND-CP issued by the Government on the Organization and Operations of the State Bank of Vietnam's Inspectorate.
- Decrees issued by the Government on administrative fines in banking, insurance and securities businesses.

## **EXTENT OF COMPLIANCE WITH BASEL'S PRINCIPLES, STANDARDS IN VIETNAM**

Basically, Vietnam is adopting Basel I, though it is limited only to capital adequacy ratio against credit risk. Full adoption of capital adequacy requirement as stated by the 1996 Revised Basel Accord has not yet been made.

-Definition and capital structure: Significant compliance with Basel I

Own capital of Credit institutions consist of:

- Tier 1 Capital: Chartered capital (paid-in capital), reserves supplementary to chartered capital, financial standby reserves, investment fund for professional development, retained earnings.
- Tier 2 Capital: 50% of increased asset value thanks to revaluation, 40% of increased investment securities value thanks to revaluation, convertible bonds or preferred shares, certain long-term liabilities, general reserves.
- Of which: maximum value of tier 2 capital is up to 100% of the value of tier 1 capital as own capital is calculated to comply with the required capital adequacy.
- Required capital adequacy ratio: 8% as minimum – in compliance with Basel I, however it covers only credit risk, not yet the operation risk.
- Resolution of credit risk relating to derivative trading: Vietnam adopts 2<sup>nd</sup> method (initial exposure)
- Asset classification: Basel I is complied with fundamentally
- Resolution of credit risk relating to off-balance-sheet transactions: Basel I is complied with fundamentally



## **Challenges to Vietnam's banking system in complying with Basel II**

- Low development level of the banking system
- Poor governance of Credit institutions
- Severely constrained MIS and banking IT.

## **Challenges to Vietnam's banking system in complying with Basel II**

**(continued)**

- Tremendous weakness of CI's personnel in quick access to international risk management techniques.
- Constrained capability of banking supervisory agencies in introducing incentive schemes and prudential regulations to improve banks' risk management capability.

## **Shortcomings and constraints that reduce effectiveness of banking supervision, inspection**

- Severely constrained organizational structure of banking supervision, inspection
- Lack of mechanisms on information exchange and coordination among the Banking Inspectorate and local, international financial supervisors to detect, prevent, subdue and deal with banking risks.

## **Shortcomings and constraints that reduce effectiveness of banking supervision, inspection (continued)**

- Current skills, ability of supervisory staff are far limited to absorb and adopt international practices, standards on banking supervision, even to fulfill their duties.
- Incomplete legal framework on banking supervision
- Insufficient infrastructure to secure efficient banking supervision and monitoring
- Poor risk management, especially on the part of Credit institutions.