New Capital Accord
Basel II
Challenges for the Asia-Pacific Region

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The New Accord

- Three Basic Pillars
  - Minimum Capital Requirements
    - Weighted Risks
      - Credit Risk
        - Standardized Approach (SA)
        - Internal Ratings Based Approach (IRB)
          - Foundation Approach
          - Advanced Approach
      - Operational Risk
      - Market Risk
    - Definition of Capital
  - Supervisory Review Process
  - Market Disciple

Three approaches on credit risk

- SA – relies on external credit assessments
- IRB – Internal risk management systems
  - Lack of historical data on losses
  - Absence of benchmark risk weight assessments
  - IT system
  - Investment in human resources
  - Training
- How many banks in Asia are ready yet?

Role of external credit rating agencies

- Few external credit rating agencies in developing countries
- The number of rated firms in G-10 countries is 24 times greater than in low-income countries
- International credit rating agencies have to play a greater role

Role of external credit rating agencies

- Investors overreact to the rapidly revised credit information
- Mass withdrawal of capital
- Little information on Asian corporations
  - Poor corporate governance
  - Lack of transparency
  - High cost
- Creditability of national credit rating agencies

Role of external credit rating agencies

- Reduction in the flow of capital to developing countries that tend to be lower-rated
- Indonesia, sovereign rating for foreign currency loans below B- faces a loan risk weight of 150%
- Singapore are assigned a 0% sovereign risk weight and a low 20% corporate and inter-bank loan risk weight.

Role of external credit rating agencies

- Greater transparency and disclosure on the criteria used in assigning ratings
- Consistent with best practice

Challenges for banking sector in the region

- Loans secured by non-residential land assets, 100% capital change
- Common practice in many Asian banks
- Further inflate capital requirements and may be detrimental to economic growth.
- Lending to SMEs

Challenges for regulators

- More emphasis on the supervisory review process
  - Human resources
  - Training
  - Funding
- Cross border coordination

Remarks

- In wake of Enron, WorldCom & co.
  - Will this really work?
- Regulatory arbitrage
- Could we keep it simple
- Allow for more room
  - Capital adequacy ratio ↑ when economy needs to slow down
  - Capital adequacy ratio ↓ when economy needs to expanse
- Design a new risk assessment system for S&M banks

Thank you