



ABB conference (9-10 Dec. 09) on Basel II accord (Implementation of Capital Adequacy and Risk Management)

The Westin Hotel, Gulshan, Dhaka
9.30 a.m., 09 December, 2009

Inaugurating speech by Dr. Atiur Rahman, Governor, Bangladesh Bank

Mr. Chairman of ABB, Mr. Zakir Hossain of GSE, participants, resource persons and invited guests; a very good morning to you all.

I am pleased to be invited to open with some introductory remarks this ABB conference on implementation of Basel II capital accord in Bangladesh. It is very heartening to see our banking community as keen and enthusiastic about implementing the new capital regime as we in BB expected them to be.

We may quite rightly feel happy about our banks and financial markets having weathered the recent global financial turmoil virtually unruffled, retaining the ability of helping out the real sector while financial markets and institutions in mature advanced economies needed rescue with huge government bailouts. Despite some lingering legacies from past non-market era of directed lending and weak lending discipline, we in Bangladesh have opted to be ambitious in embarking on initiatives aimed at earliest possible attainment of global best practice standards in soundness, solvency and risk management processes in banks. Implementation of the Basel II capital adequacy framework is a major component of this thrust. Following year long extensive preparatory work the implementation processes were formally kicked off in December 2008, with BB guidelines issued to banks for working out and reporting their regulatory capital requirements under Basel II regime on a quarterly basis from 2009 onward. For the first year (2009) this was to run in parallel with the preceding 'Basel I minimum plus 2 percent' regime, with full transition to Basel II from 2010. I am happy to note that this transition is taking place without any major kick up.

Basel II capital regime documentations are quite formidable in bulk and complexity, reflecting the range and complexity of the businesses of modern banking. The underlying premises and rationale are fairly straightforward however, based on three pillars.

Regulatory capital, *the first pillar*, requires banks to maintain adequate risk weighted capital cushion against expected and unexpected losses from all types of risks inherent in each and every asset holding and business line. Besides credit risk and market risks taken care of in the preceding (which has been amended) Basel I

regime, the Basel II regime also provides methodology for working out capital requirements against operational risks that triggered quite a few episodes of collapse of large globally active banks in the past decades.

Supervisory review, *the second pillar* of Basel II capital regime requires banks and the supervisors not just to ensure that banks hold adequate capital cushion against all risks associated with their businesses, but also to ensure that banks have policies and processes in place for assessing, monitoring and prudent management of the risks. For the banks this second pillar enjoins active board and senior management oversight, forward looking capital adequacy assessment bearing in mind the ambient business cycle phase; adequate processes for monitoring and reporting of risk exposures; and periodically reviewed strong and effective internal control processes. For supervisors the second pillar enjoins regular review of adequacy and effectiveness of capital assessment, risk management and internal control practices in banks; seeing to it that banks operate above their minimum regulatory capital ratios; intervening early for preventing slippages of capital ratio below the regulatory minimum; and rapid remedial actions in the event of any such slippage.

Market discipline, *the third pillar* of Basel II complements the regulatory capital and supervisory review pillars, with requirement of sufficient transparency to enable stakeholders to make their own assessments about the risk profiles of the asset holdings of a bank and the adequacy of its capital in meeting probable losses. This pillar enjoins banks to develop formal disclosure frameworks providing sufficient qualitative and quantitative disclosure of validated (i.e., audited) material information in regular periodicity.

As elsewhere, the standardized (rule based) approach in calculating the risk weights for credit and market risks and the basic indicator approach in calculating capital charges for operational risks have been prescribed for adoption by banks in Bangladesh in the implementation guidelines issued by BB; two external credit assessment agencies have been accorded recognition for rating of borrowers in the standardized approach. Over the medium term, banks are expected to develop finer tuned internal model based borrower rating and capital assessment approaches; with the BB developing its capacities for supervisory validation and authorization of the model based approaches developed by banks.

The very structure of the Basel II capital adequacy framework requires the risk management capacities and practices of banks to improve concurrently with implementation of this new framework. For banks in Bangladesh successfully implementing the Basel II, this would therefore mean huge leap forward in strength

and credit rating; with commensurate gains in ease of access to correspondent relationships, credit lines and other linkages with the global financial markets.

Banks in Bangladesh must be under no illusion that implementation of the Basel II capital regime is an easy task, to be handled casually. Actual implementation in proper spirit will be arduous and painstaking, entailing comprehensive overhaul and up gradation of previous approaches and practices in risk assessment and management, requiring adoption of new IT based tools and techniques, perhaps with support services of outside consultants and professional experts. The BIM, and local firms offering IT solutions and other professional consultancy services can be of assistance to banks in this respect, where necessary with support and collaboration of external associates. In particular, I would love to see the energy and talents of the young crop of local software service professionals utilized in tailoring risk management solutions appropriate for the local market context. A lot however, depends on the commitment of the top leadership of our banking sector. That they are aware of this responsibility is reflected in this timely initiative of theirs.

I would like to conclude here wishing Godspeed for deliberations of the conference, with thanks to ABB for organizing the important event.

With these few words I would like to declare the conference formally opened.

Thank you all.
