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Effective Design of Regulatory and Policy Framework

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Post Global Crisis Responses-Basel III's major measures

- Higher and better capital
- Better management of leverage, liquidity, (SIFIs),
- Better market infrastructure: clearing/settlement, collection of data and monitoring through exchanges, OTC derivative market reform

Basel III's major measures (cont.)

- Counter cyclical: capital buffer, forward-looking provisioning
- Use of macro-prudential tools against systemic risk, cyclicality
- Regulations extended to non-bank financial institutions
- Basel III a major improvement but weaknesses remain

Principles of effective design

1. Focus on risk-based supervision

- Nature and sources of risks change because of technologies, innovations➔ Risk-based supervision is more important than regulation
- Pillar II is an important tool ➔Take supervisory actions when concern arises. Crisis did not happen because of lack of regulations

1. Focus on risk-based supervision (cont.)

- After Asian crisis, BOT and banks focus on risks. Board members made accountable for own risk management
- Constant dialogues to foster risk awareness and improve risk management
- Transparent supervision and examination
  - Examination manuals available on website
  - Feed backs to banks on their performance vs peers

1. Focus on risk-based supervision (cont.)

- 2006, banks required to observe IAS39 on impaired asset and provisioning, two years ahead of Thai accounting body’s planned schedule . Banks met higher provisioning requirement from profits, increased since preceding few years
- Risk awareness capped investment in CDOs to a mere 0.1% of total asset

2. Incentives must be right

- Pay attention to moral hazard issues: remuneration, prosecution of misbehaviors
- Under new banking act, top management and board members of a failed bank will be removed and blacklisted. If found guilty of gross negligence or fraud, will face a personal fine and/or jail term

3. Financial sector must serve the real economy

- Financial sector must not just serve itself
- Need proper balance between market-based disciplines and supervision
  - In 2008, BOT, banks and Credit Guarantee corp. jointly worked out a scheme to mitigate credit crunch on SMEs
  - 2002, min requirements on monthly income, monthly payment, max i etc. on credit card loans introduced for consumer protection and over-indebtedness

4. Beware of financial imbalances

- Financial imbalances have both macro and micro stability implications
- Macro prudential tools are useful in mitigating financial imbalances

BOT’s Implementation of MPTs

- Identification of systemic risks:
  - Monitor regularly by relevant departments 7 areas of vulnerability: external sector balances, fiscal balances, housing and property, capital market, financial strength and indebtedness of banking, corporate and household sectors
  - Regular meetings of working group with staffs from economic research, monetary policy, supervision, examination, financial markets and treasury operation to leverage expertise

BOT’s Experience with MPTs

- 2003, with early signs of heating in the high-end property market, loan-to value ratio of 70% for that market segment introduced.
- Banks asked to report their financing of big property development projects with loans exceeding 100 million baht per project