



## **Implementation of Basel II: Regulatory and Supervisory Challenges**

**Dr. Tarisa Watanagase**  
**Deputy Governor, Financial Stability**  
**Bank of Thailand**

Seminar on Policy Challenges for the Financial Sector:  
Basle II: The International Banking System at the Crossroad  
June 2, 2004, Washington DC



## **Basel II**

- **IRB approaches under Pillar I have attracted most attention, but may not be most relevant for emerging markets**
- **Will take time to meet IRB pre-requisites**
- **Practical to adopt Standardized approach: not radical change from current accord**



## **Pillar I: Limitations of Standardized Approach**

- Provides only a rough proxy for credit, operational, and market risks
- Does not explicitly consider other material banking risks
- Does not consider risk management quality

**Beware: Regulatory capital requirement not a substitute for proper analysis of capital adequacy**



## **Pillar II Supervisory Review: Critical**

**Proper implementation of Pillar II most important / challenging**

- Requires an in-depth assessment of actual credit, operational, and market risks
- Assesses adequacy of balance sheet provisions
- Incorporates all other material banking risks not explicitly considered under pillar I capital requirements
- Considers quality of risk management practices



## **Pillar II**

### **Implications for Supervisory Practices**

- **Not enough to set “best practice” prudential standards**
- **Staff must be equipped to implement standards:**
  - **Extensive training in conceptual, analytical, judgmental skills**
  - **Risk-focused on-/off-site supervision manuals**
  - **Practical examination guidance**
  - **etc.**



## **Pillar II**

### **Implications for Legal Framework**

- **Supervisors need powers to seek capital in excess of the minimum regulatory requirements.**
- **Supervisors need powers to intervene even when banks meet or exceed minimum capital adequacy requirements.**



## **Pillar III: Market Discipline**

- **Blanket guarantee undermines market discipline**
- **The links between public perception and market discipline**
- **Costs vs. benefits**



## **Conclusion and challenges ahead**

- **Supervisory review of capital must be viewed from the lens of risk-based supervision and not merely a regulatory compliance issue.**
- **What does “Basel II compliant” mean?**
- **International bodies must focus more attention on Pillar II implementation issues.**