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**SBP GOVERNOR, DR. SHAMSHAD AKHTAR DESCRIBES
BASEL II AS A REVOLUTION IN RISK MANAGEMENT**

Addressing the 56th Annual General Meeting of the Institute of Bankers Pakistan today, Dr. Shamshad Akhtar, Governor, State Bank of Pakistan, gave a comprehensive briefing on the theory and practical dimensions and elements of Basel II. She termed Basel II as a “revolution” in regulation and risk management, while pointing out that it is not just the banks which will change in the Basel II scenario, this accord will also affect rating agencies, external auditors, banks’ customers and regulators alike.

Dr. Akhtar said that the main element underlying the Basel II framework is the recognition and management of risk. ‘One cannot dispute the inevitability of effective recognition and proper risk capital weightage of different types of risks in bank operations in the current financial architecture’, the Governor noted. In her speech, Dr. Akhtar discussed in detail some of the key challenges pertaining to the implementation of the Basel II Accord, namely, a) Reliability of Risk Management systems, 2) Asymmetry in Supervision, 3) Imperfect Markets, 4) Pro-cyclicality, 5) Access to Finance for the disadvantaged sectors, 6) Need for development of risk management expertise, 7) Operational costs and 8) Cross-border challenges.

Dr. Akhtar laid great emphasis on the access to finance for all sections of society. Keeping in view the fact that the new accord would require banks to hold higher capital allocation for assuming higher credit risk, she highlighted the potential concern that small businesses and poor segments of the society might receive negligible or very costly credit under the new regime. Even under the old framework, the problem of access to finance for low income segments is quite significant for developing countries. She emphasized that this issue is closely linked to the poverty alleviation efforts of the government, and cannot be addressed in isolation. However, she said, policies should be made to bring more segments in the ambit of financial services without seriously compromising the banks’ risk profile. As a regulator the SBP may need to look into the possibility of designing a modified risk assessment system for the development finance activities of banks.

The SBP Governor said that in her view, the foremost challenge facing banks in Pakistan, as well as across the region, is to develop well-functioning, efficient and integrated risk-management systems. Banks in Pakistan in particular, have become more cautious in their credit appraisal and monitoring system, however the risk management expertise of the entire banking sector needs to be improved further in order to meet the challenge imposed by Basel II.

She elaborated that the entire framework is based on reliability of good quality data to assess risks accurately. Banks have to rely on External Credit Rating Institutions (ECRIs) which in turn have considerable reliance on external auditors of the borrowing entity. State Bank has taken various measures to ensure that the quality of ECRIs and External Auditors.

Dr. Akhtar said that some important steps towards achieving an effective implementation of Basel II include a) concerted capacity building measures for the training of human resources in targeted fields, b) developing internal risk models and advanced risk management systems at SBP, c) enhanced coordination with SECP over issues arising out of Basel II implementation, and d) maintaining regular contact with banks in order to evaluate their compliance and provide guidance wherever necessary.

The Central Bank has chalked out a roadmap for the implementation of Basel II accord in a phased manner. ‘SBP has to ensure that the implementation is achieved in a smooth manner’, the Governor added. ‘The transitional period is expected to provide the banks the requisite time to fine tune their systems and hone their technical and human resource capabilities’.