OPENING REMARKS OF

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AT THE 29TH SEACEN-FSI REGIONAL SEMINAR ON

STRESS TESTING IN SUPERVISION AND RISK MANAGEMENT

Bangkok, Thailand, 16-19 March 2015

Mr. Ronadol Numnonda, Assistant Governor, Supervision Group, Bank of Thailand,

Mr. Jeff Miller, Senior Financial Sector Specialist, FSI, BIS Representative Office for Asia and the Pacific,

Distinguished Speakers,

Seminar Participants,

Ladies and Gentlemen,

Good morning and a very warm welcome to the 29th SEACEN-FSI Regional Seminar on Stress Testing in Supervision and Risk Management, hosted by the Bank of Thailand, in this vibrant city of Thailand, Bangkok.

First of all, I wish to express my deepest appreciation to the Governor of the Bank of Thailand, Dr. Prasarn Trairatvorakul, for hosting this learning programme and for his continuing support to The SEACEN Centre. I would also like to thank Mr. Ronadol Numnondo, Assistant Governor, Supervision Group for officiating this opening ceremony and delivering the opening remarks. My special thanks go to the Bank of Thailand and its secretariat team led by Ms. Vitra Vanasrisawad. The team has been working closely with The SEACEN Centre months before this event to ensure that excellent arrangements and warm hospitality are extended to the participants and resource speakers.

I would also like to record my sincere thanks to the Financial Stability Institute (FSI) for collaborating with The SEACEN Centre in organizing this learning event. My special thanks go to

Mr. Jeff Miller, Senior Financial Sector Specialist, FSI, BIS Representative Office for Asia and the Pacific, for his support to the collaboration between our two institutions and in particular for his contribution to this event. We are fortunate to have with us 8 other resource speakers in addition to Mr. Miller, who have travelled from far and near to share their wealth of knowledge, expertise and experience in this Seminar. They are namely, in the order of appearance: Ms. Silvia Pezzini, Bank of England – secondment to Hong Kong Monetary Authority; Ms Lily Chan, Monetary Authority of Singapore; Ms. Christine Ott, Deutsche Bundesbank; my colleague Mr. Michael Zamorski; Mr. Zachary Thor, Bank Negara Maalysia; Ms. Budsakorn Teerapunyachai, Bank of Thailand; Mr. Poonpat Sripleng, KTB Bank and Ms Sarin Anantarak, Kasikornbank PCL for sharing your experience in this Seminar. With such an impressive combination of speakers, I am certain our participants would learn much from this Seminar which will help them to develop and enhance their knowledge and skills in stress testing in supervision and risk management in their central banks.

Ladies and Gentlemen,

In this opening day of SEACEN-FSI Seminar on Stress Testing in Supervision and Risk Management, I would like to say a few words on what bank supervisors should understand about the real importance of bank stress tests.

A stress test is a simulation exercise designed to determine the ability of financial institutions to deal with a financial crisis. Large international banks began using internal stress tests in the early 1990s. And in 1996, the Basel Capital Accord was amended to require banks and investment firms to conduct stress tests to determine their ability to respond to market events.

Beginning in 2007, it has become increasingly widespread, and has been taken up by various financial regulators or inter-governmental bodies such as the European Banking Authority and the IMF. In India, legislation was enacted in 2007 requiring banks to undergo regular stress tests. In the US, in 2012, U.S. regulators unveiled new rules requiring the largest American banks to undergo stress tests twice a year, once internally and once conducted by the regulators. In 2014, midsized US financial firms with $10-50 billion in assets were required to conduct Dodd-Frank Act Stress Testing. In 2012, federal regulators also began recommending portfolio stress testing as a sound risk management practice for community banks or institutions that were too small to fall under Dodd-Frank requirements. The Office of the Comptroller of the Currency (OCC) and the

FDIC also recommend stress testing as means to identify and qualify loan portfolio risk. As the European crisis continued to affect credibility of European banks in their ability to respond to the crisis, in 2014, 25 banks failed stress tests conducted by the European Banking Authority. All these regulatory reforms show that stress tests have become a main useful tool to ensure financial system stability in many regions around the world.

Basically, stress tests are one of the key instruments for bank supervisors to assess the resilience of individual banks in an adverse risk scenario. But in the event of an adverse risk scenario being realized, it can also serve as a safeguard for inducing rational responses from investors and market participants by continuously enhancing the credibility of stress tests.

If the recent global financial crisis taught anything, stress tests, whether conducted by banks or supervisors, must consider “unlikely but plausible” scenarios, as described by the IMF, including tail events with potentially highly adverse effects. In the period leading up to the global financial crisis, too many banks and regulators were naively skeptical of the possibility of a rapid and severe deterioration of intermediating functions of the financial market and the entire financial system.

Also, good and integrated management-information systems are critical to the ability of banks to manage their credit, market and liquidity risks. Many of the systemically important banks, during the episode of the US subprime mortgage crisis, were unable to quickly and consistently consolidate risk exposures across products, business lines, legal entities, and geographies.

I would also like to highlight the importance of having multiple inputs into the risk-assessment process. It is important not to overly resort to any one model or method of loss estimation. It is in many cases the combination of rigorous, data-driven analysis and prudent judgment that makes the stress tests indeed effective and credible.

Most importantly, a key success factor in stress tests is that bank supervisors should have macro-prudential perspectives in assessing the result of stress tests which will allow them to better understand holistic interrelationship of financial institutions and its implications for systemic risks.

Early this month, the Federal Reserve Board announced the result of its supervisory stress tests for the largest 31 US-based bank holding companies. From this, we can find one example of how the supervisory authorities have been strengthening the rigorousness of their stress tests. The

FRB used a severely adverse scenario which features a deep recession with the unemployment rate peaking at 10 percent, a decline in home prices of 25 percent, a stock market drop of nearly 60 percent, and a notable rise in market volatility. Under this scenario, it was projected that loan losses at the participating companies would total $340 billion during the nine quarters tested. These firms' aggregate tier 1 common capital ratio would fall from an actual 11.9 percent in the third quarter of 2014 to a minimum level of 8.2 percent. As bank capital helps to ensure that losses are borne by shareholders, not taxpayers, it is crucial to conduct bank stress tests under deliberately stringent and conservative scenarios and to use supervisor's own independent projections of losses and income for each firm.

All these points I have highlighted so far are certainly daunting tasks for today's financial regulators. In this context, I believe that this SEACEN-FSI Seminar on Stress Testing in Supervision and Risk Management will serve as a good guidance for participants to play a leading role in further developing expertise and skills in this important area.

Therefore, the coverage of this learning event is timely and highly relevant for central bankers in this region. The importance and relevance of the topics to be discussed in this Seminar is evident from the overwhelming response received to our invitation for nomination. It is a pleasure to inform that we have here with us today a total of 32 well-qualified and suitable participants representing 17 institutions. I am confident that the next two days will be a highly intensive time of learning. The SEACEN Centre believes that the interactions between participants and speakers would enrich their learning experience in this complex and evolving area of financial supervision. Furthermore, this event also provides a regional platform for sharing of knowledge and experience as well as fostering closer co-operation among central bankers and regulators.

Ladies and Gentlemen,

Allow me to say a few words about The SEACEN Centre. As approved by the Board of Governors in February 2011, our vision is "To be the Regional Learning Hub for Central Banks in the Asia-Pacific Region". As a Learning Hub, SEACEN aspires to drive central bank excellence in learning for the region, by being a platform for collaboration for members to synergise efforts in central bank learning among themselves, and across SEACEN's network base. The vision would be achieved through SEACEN's mission in building capacity in central banking and fostering networking and collaboration. With strong commitments from our stakeholders as seen in this Seminar, we are confident that our vision will become a reality.

Coming back to the Seminar, I hope that the participants will find it both fruitful and rewarding. Above all, the interaction among participants and with the resource speakers will provide an opportunity to learn from one another and strengthen the bond of friendship and cooperation. I also hope that you will be able to find the time to enjoy the culture and beauty of Bangkok, Thailand.

Allow me to conclude by thanking once again the Bank of Thailand for hosting this event; organizing committee and the secretariat team of the BOT for the excellent arrangements and warm hospitality; resource speakers and their respective institutions for the generosity and support; and finally to all our member central banks and associates for nominating suitable participants for this Seminar. I wish you a productive and rewarding learning experience. Thank you.