KEYNOTE ADDRESS

BY

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ON

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Chief Executive Officers of Commercial Banks,
Management Colleagues, Bank of Sierra Leone
Members of The Fourth Estate
Course Facilitators and Participants
Ladies and Gentlemen,

It gives me great pleasure to address you at the official opening of this Course on Risk-based Supervision. Let me also take this opportunity to add my word of welcome to you. I hope our facilitators who have travelled all the way from Canada, did not only have a pleasant trip but will also find time to enjoy our hospitality, good weather and fine beaches.

The primary goal of banking supervision is the promotion of a stable, safe and sound banking system, which is a critical condition for financial markets stability and sustainable economic growth. The rapid pace of technological change, deregulation, globalization, economic regionalism, and the development of complex financial instruments have warranted a paradigm shift in approaches to banking supervision. Consequently, modern banking supervision has become

increasingly concerned with risk management as a major vehicle to achieve supervisory goals.

In 1988, the Basel Committee on Banking Supervision (BCBS) introduced the Basel Accord (Basel I) - a framework of recommendations on banking laws and regulations, which primarily focus on credit risk and prescription of a set of minimal capital requirements for banks.

Basel I has been replaced by the more comprehensive set of guidelines known as Basel II, introduced in 2004. Among other things, Basel II aims at developing more intensive procedures for computing risk-sensitive minimum bank capital requirements; ensuring greater market discipline through policies that compel banks to disclose accurate, transparent, and complete information to market players and the public – referred to as market discipline. By tying regulatory capital to risk management, Basel II has established powerful incentives for all banks to develop and maintain state-of-the art risk management processes that are consistent with adaptable international standards.

In order to meet the challenges of the Basel Accords, banks have put in place risk management principles that influence their daily credit allocation decisions. The most sophisticated banking organizations use risk-rating systems that characterize credits by both the probability of default and the expected loss.

Whereas lending to individuals was once driven by the subjective judgment of loan officers, banks now forecast default risk in retail lending with the aid of statistical models. Corporate lending is now informed by models that estimate the risk-adjusted return on capital, thus allowing the pricing of relevant risks before loan origination.

The new supervisory regime encourages improvements in bank-systems for managing quantifiable risks. It emphasizes that banks take full responsibility for understanding and managing their risk profiles. Basel II also requires regulators to assess all other risks a bank may face such as systemic risk, strategic risk, reputation risk, liquidity risk, operational risk, and legal risks, known in Accords terminology as residual risks. Banks are permitted to use their own estimates to calculate their capital

requirements. This freehand does not however remove the precision required to estimate the risks and calculate the associated capital requirements.

This underlines the importance of capacity building in the vital area of risk management in order to develop sound internal models for risk evaluation for the maintenance of adequate levels of capital. Basel II is quite flexible and allows banks to choose their level of sophistication. This is in recognition of the fact that risk management models raise a number of difficult issues, including model and parameter uncertainties. It is for this reason that the Bank of Sierra Leone, in collaboration with the Office of the Superintendent of Financial Institutions in Canada, is organizing this seminar which bank operators and examiners should take advantage of if they should boost their competences in the area of risk identification, assessment and management.

Ladies and Gentlemen, the role of the supervisor in modern banking supervision is to ensure that the risk management

systems in place and the capital held are appropriate for the variety of identifiable risks to which banks expose themselves.

The supervisor must have the authority and expertise to review and intervene in risk management processes where necessary. This involves monitoring and evaluation of the risk profiles of banks in relation to their business strategies and peculiar risks, and construction of a risk matrix for each bank. Bank regulators and supervisors must understand new financial instruments and market practices to have the expertise to develop models, assumptions and views of banks, and certify the risk management of banks. Supervisory review must focus on
an assessment of the quality of a bank's procedures for evaluating, monitoring and managing risk and of the bank's models for determining economic capital.

Critical to good risk management are four key elements that have been identified by bank supervisors. These are good corporate governance; consistent application of policies, processes, procedures, and limits; use of appropriate risk-measurement techniques and reporting; and adoption of

comprehensive internal controls. While efforts should not be spared to ensure that inadequate risk assessments of banks do not lead to banking fragility, the need to ensure that overregulation does not retard the development of the financial system and hence domestic savings mobilization cannot be over emphasized.

Lastly, special attention needs to be paid to legal and reputation risks. Recent events have underscored the imperative of the highest ethical standards. Bank supervisors need to devise means of assessing these risks.

The objectives of the training course which will be carried out by this team of experts and practitioners are to enhance participants' appreciation and understanding of the mechanics of risk-focused banking supervision; to enable participants to relate the core principles of effective modern banking supervision to current supervisory environment; and to provide opportunities for participants to develop skills in risk-focused supervision.

Ladies and Gentlemen, it is my expectation that you will find this training beneficial and value adding to your job performance. I invite and urge you to participate actively in the exchange of views and ideas over the next few days.

With these words, it now gives me great pleasure to declare the Seminar on Risk-Based Supervision open and to wish you all fruitful and successful deliberations.

Thank you.