

**ASSOCIATION OF FINANCIAL SUPERVISORS
OF PACIFIC COUNTRIES**

**OPENING ADDRESS BY
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RESERVE BANK OF VANUATU**

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Coordinator of Pacific Technical Assistance Centre, Suva, Fiji

Representatives of the Financial Stability Institute and Resource Persons

Diplomatic Corps

Fellow participants

Ladies and Gentleman

It is a great pleasure for me to extend to you a warm welcome to Vanuatu and the Reserve Bank of Vanuatu. I know the Reserve Bank of Vanuatu and the Pacific Financial Technical Assistance Centre has done a lot of work to ensure that the seminar is organized in Port Vila. I would also like to take this opportunity to thank the Chairman of the Association of the Financial Supervisors of Pacific Countries for inviting me to make the opening address to this important seminar on *“Economic Capital Issues, the Supervisory Review Process of Basel II and Problem Bank Resolution”*.

This is the first time the Reserve Bank of Vanuatu has hosted a meeting of financial supervisors, and I would specifically like to welcome the presenters from the Financial Stability Institute, the ANZ Bank and the Australian Prudential Regulation Authority and delegates alike to Vanuatu and I hope that you enjoy all that Vanuatu has to offer.

Many of you in this room were involved in the establishment of the Association in late 2002. The establishment of Association, which now comprises ten member countries from the Pacific including – Cook Islands, Fiji, Federated States of Micronesia, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga and Vanuatu, was a significant step towards closer cooperation and coordination between Pacific Island Countries in the field of financial supervision. The role of the AFSPC is to ensure that the “voice of the Pacific” is heard in international forums where financial supervisory issues are debated. Recently, the Chairman represented the Pacific at the annual meeting of the Basel Committee of Bank Supervisors in Madrid and no doubt he will be updating those of you attending the Heads of Supervision meeting, which will be held on Friday, on matters discussed.

One of the key goals of supervision is to ensure the existence of a stable and sound financial system which is essential for economic development in the Pacific Island Countries. Supervisors play a key role in the process but of course they cannot do it without legislation and unwavering political commitment. Supervisors are required to be up-to-date with the latest innovations in financial markets and at the same time be across an ever expanding number of issues, such as dealing with money laundering and terrorist financing. In addition supervisors now find themselves supervising different types of financial institutions and some of us have expanded our financial supervision to include insurance and pension funds.

To a lot of people, supervision of financial institutions is either a mystery or is the reason why a bank will not lend them money. As you all would know, there are a number of technical issues that supervisors need to be aware of and for that reason most people are content to leave it to the experts and that supervisors are rarely seen except when there is a problem and then everyone wants you deal with it.

The focus on this seminar – Basel 2 and Problem Bank Resolution – are topics which on one hand, such as Basel 2, will not directly impact members of the public, while the question of how central banks and Governments should deal with the issues associated

with the failure of a bank are important given the potential impact on society and the economy. The two topics are probably more closely related than most people would think.

As all supervisors know only too well, capital is the cornerstone of a bank's strength. The Basel Committee has reached agreement on the new capital Accord, Basel 2, in June 2004. It brings with it a more complex methodology to calculate the adequacy of a bank's capital given its business activities and risk profile. The new Accord consists of three mutually reinforcing pillars. The three pillars to the new Accord are: First Pillar – minimum capital requirement; Second Pillar – supervisory review process; and the Third Pillar – market discipline. The proposals recognize that minimum capital requirements alone cannot be the sole answer to adequate capitalisation and risk management in banks or safety and soundness in a banking system. Strong risk-based supervisory review with early intervention and market discipline under Pillars 2 and 3, respectively, complement minimum capital requirements.

Implementation of the new Accord will be a challenge for supervisors and banks alike and while it could be argued that aspects of the new Accord, such as the refinements in calculating a bank's minimum capital requirement may not be appropriate in some Pacific Countries. The second pillar, which requires supervisors to ensure that each bank has sound internal processes in place to assess the adequacy of its capital based on a thorough evaluation of risks, is very relevant to the Pacific.

As we are all aware, and some of us have had the unfortunate experience, bank failures can cause considerable disruption to a country's financial system regardless of the size and sophistication of the country and its economy. A sound banking system is in the interests of depositors and investors alike and also important for the maintenance of macroeconomic stability in the economy. Unfortunately from time-to-time banks do fail or supervisors need to deal with a bank in distress. When risk management is not enough, when provisions are exhausted, when capital fails, the bank itself fails. It is therefore important that bank supervisors have in place processes that allow them to deal

with failures and that those supervisors learn from the past to and identify problems not only with banks but also their supervisory own processes and regulatory framework.

While bank supervision issues are the focus of this seminar, on Thursday there will a presentation on the supervision of pension funds. Pension funds are increasingly becoming a more important participant in the financial landscape and it is important to ensure that they are well supervised. Late last year, the Government agreed to give the Reserve Bank of Vanuatu supervisory responsibility for the Vanuatu National Provident Fund. In Fiji, the Reserve Bank of Fiji has also been given supervisory responsibility for the Fiji National Provident Fund. This is a new area for the Bank supervisors and although many of the techniques and concepts used in supervising banks can be applied to pension funds, it is important that we keep up to date with international requirements, such as the OECD's Core Principles for Pension Fund Supervision.

In conclusion, I wish you all well in your discussions over the next few days. I hope you all enjoy your stay in Vanuatu and that presentations will be practical and generate a lot of discussions, enable supervisors to share their experiences and most of all to ask questions of the presenters.

Without further ado, I now declare that the 2004 seminar for the Association of the Financial Supervisors of the Pacific countries is now opened.

Thank you for your attention.

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