

Unofficial Translation prepared by The Foreign Banks'
Association

This translation is for the convenience of those unfamiliar with
the Thai language.

Please refer to the Thai text for the official version.

STRATEGIC RISK MANUAL

Content	Page
Part 1 Definition of Strategic Risk	
1.1 Definition of Strategic Risk	
1.2 Source of Strategic Risk	
1.2.1 <u>External factors</u>	
1.2.1.1 competition	
1.2.1.2 behavioral change of target customer	
1.2.1.3 technological change	
1.2.1.4 economic factors	
1.2.1.5 regulation	
1.2.2 <u>Internal factors</u>	
1.2.2.1 organizational structure	
1.2.2.2 work process and procedure	
1.2.2.3 adequacy and quality of personnel	
1.2.2.4 adequacy of information	
1.2.2.5 technology	
1.3 Risk Mitigation Factors to Strategic Risk	
1.3.1 qualifications of the board and senior management	
1.3.2 formulation of strategic plan and business plan	
1.3.3 quality of personnel and proper training	
1.3.4 risk management system	
1.3.5 stable customer base	
1.3.6 leadership in products and services	
1.3.7 adequate access to information	

Part 2 Best Practice in Managing Strategic Risk

2.1 Oversight by the board of directors and senior management of a financial institution

2.2 Strategic risk management

2.2.1 Identification and measurement of risk

2.2.1.1 Significant roles of the board, delegated committees, and senior management

- (1) strategic planning
- (2) organizing
- (3) staffing
- (4) directing
- (5) controlling and monitoring

2.2.1.2 Strategic planning process

- (1) Support or participation of the board, delegated committees, and senior management
- (2) Participation of staffs from various departments
- (3) Adequacy of information in forming assumptions
 - (3.1) economic factors
 - (3.2) position of the financial institution compared to competitors
 - (3.3) current competitive position and future market trend
 - (3.4) customers' need
- (4) Consistency of the business plan and the overall objective of a financial institution
- (5) Feasibility of a strategic plan
- (6) Assessing actual performance against a strategic plan

2.2.1.3 Business planning process and budget

- (1) Business plan and budget
- (2) Consistency of the business plan and budget with the strategic plan

(3) Reasonableness of the assumptions used in formulating the business plan and budget

(4) Adequacy of budget allocated for management and supporting function

(5) Monitoring of actual performance against the business plan and budget

(6) Adequacy of compensation

2.2.2 Risk monitoring and reporting

2.2.2.1 Management information system (MIS)

2.2.2.2 Monitoring report

2.2.3 Risk controlling

2.2.3.1 Risk controlling system

2.2.3.2 Policy, procedure, and risk limit

2.2.3.3 New product review

2.2.3.4 Minimum standards or criteria in new product review

2.2.3.5 Quality and effectiveness of an internal control system

2.2.3.6 Management succession plan and training

2.2.3.7 Business continuity planning

Part 3 Examination Procedure

3.1 Examination objectives

3.1 Examination scope

3.2.1 Assessing level of risk

3.3.2 Assessing risk management

Appendix 1 Example of Reports for Monitoring Strategic Risk

Appendix 2: Assessment Scope for Corporate Governance

Part 1: Definition of Strategic Risk

1.1 Definition of Strategic Risk

Strategic risk is risk that arises from formulation of strategic plan, business plan, and implementation of the plan that is inappropriate and inconsistent with internal factors and external environment that may affect earnings, capital fund or viability of the business. Therefore, the board of directors (the board) and senior management must carefully formulate the strategic plan and business plan, support corporate governance, and arrange to have internal infrastructure appropriated for implementation of the plans such as organizational structure, personnel, budget, management information system, monitoring and controlling system in order to accomplish the business goal and efficiently manage problems of a financial institution.

Strategic plan is a map indicating the operation direction and reflecting the vision or goal of a financial institution, generally for a period of 3 to 5 years. A good strategic plan must be clear, in consistent with the goal, flexible, and adjustable to changing environment.

Business plan is a plan specifying the overall operation framework of a financial institution to support successful implementation of a strategic plan and is a guideline for each business unit to set an action plan. Generally, a business plan is a short-term plan, not exceeding 1 year, comprising goal, profit, responsibility, resource to be used, work time frame, and monitoring criteria for performance, which should all be consistent with the budget of a financial institution as well.

1.2 Source of Strategic Risk

Strategic risk can arise from 2 main sources, namely, external risk factors and internal risk factors.

1.2.1 External risk factors mean external factors difficult for a financial institution to control or that a financial institution has no control over, which affect or deter the implementation of a strategic plan from meeting the goal. For example, competition, behavioral change of target customers.

1.2.1.1 Competition A financial institution must forecast and adjust in accordance with the ever changing market conditions, including establishing a strategic plan and business plan to be in line with the current and future competition. Competitors, price competition and new products must be considered.

(1) **Competitors:** A financial institution is exposed to risk from competitors that are the same type of financial institution or are in different business but provide services similar to a financial institution. The competitors may have advantages over cost, management system, innovation and/or expertise in new financial products.

(2) **Price competition:** A financial institution will be exposed to risk from competitors that have lower overall cost structure and offer services at lower cost. Such price competition will affect spreads and profit margins, which will ultimately affect earnings and capital fund of a financial institution.

(3) **New products:** When a rival financial institution constantly develops new products and services in an effort to attract customers, a financial institution must stay abreast of such new product offerings and may expedite its own new product offerings without following proper procedure

1.2.1.2 **Behavioral change of target customer:** Change in demographic and customer profile will affect customer base, earnings, and capital fund of a financial institution. The board and senior management must monitor the process to identify potential customers and the approach to best serve these customers to mitigate the risk of losing the market share and profit margins.

1.2.1.3 **Technological change:** A financial institution faces risks from technology through the efforts of competitors to develop more efficient systems and/or services, with lower cost. In highly competitive markets, if a financial institution does not manage the risk from technology, it may be exposed to a loss of market share due to its inability to compete on the basis of services and prices. In less competitive markets, a financial institution may not need to follow the latest technology, but it should ensure that the level of technology employed is sufficient to keep the customer base.

1.2.1.4 **Economic factors:** Global, national, regional, or local level economic conditions affect the level of profits and capital fund of all financial institutions, especially during a recession. However, the severity level of the effect depends on financial institutions' scope of operations and ability to adjust. Therefore the board and senior management should continuously assess the risk level of an organization, as well as monitor the current level and the trend of economic conditions and forecast the effect that may incur in the future.

1.2.1.5 Regulation Rules and regulations of authorities such as the Bank of Thailand, the Stock Exchange of Thailand or the Anti Money Laundering Office may deter operations, affecting the implementation of a strategic plan and business to meet the goal and may require adjusting of the plan and compliance with the rules and regulations of the authorities. A financial institution should, therefore, arrange to have a unit and responsible persons to monitor the rules and regulations on a continuous basis.

1.2.2 Internal risk factors mean internal factors that are controllable by a financial institution but can affect or deter the implementation of a strategic plan from meeting the goal, namely, organizational structure, work process and procedure, adequacy and quality of personnel, adequacy of information, and technology.

1.2.2.1 Organizational structure Organizational structure is important to the implementation of a strategic plan and business plan to meet the goal and be efficient. If a financial institution is dominated by management or a group of shareholders, or does not have clear segregation of duties, management may lack independence with no checks and balance. Such may cause problems in management and lines of authority. A financial institutions should have an organizational structure that is in consistent with its strategic plan and business plan and be able to prevent conflicts of interests among insiders such as directors, managers, shareholders, and staffs.

1.2.2.2 Work process and procedure A financial institution that does not specify clear work process and procedure, or specify duplication of duties may cause delay and error in implementation of a business plan and action plan and make it difficult to conduct accurate and timely monitoring and reporting. A financial institution should specify a systematic work procedure and set clear scope of responsibilities, as well as have a process of review for accuracy and a process of continuous monitoring in order to prevent any deficiency in internal control.

1.2.2.3 Adequacy and quality of personnel Efficient strategic plan and business plan is dependent on the knowledge, experience, and vision of the board and senior management. Success of implementation of a strategic plan and business plan at all level of an organization depends on the quantity and quality of personnel. The number of staffs should be sufficient for conducting the entire amount of work and transactions. Staffs should have the necessary expertise and training to conduct their assignments in an efficient and effective manner. For

example, a financial institution that specializes in retail credits should have staffs that are professional with adequate knowledge and expertise in the issue to ensure that they meet the needs of customers. Lack of competent loan officers or insufficient level of officers the quantity of credits or number of customers will affect credit quality or operating performance and reputation of a financial institution.

1.2.2.4 Adequacy of information A financial institution must have receive adequate information for managing strategic risk. Inadequate, inappropriate, inaccurate and untimely access to information will hinder understanding of the market conditions, thereby affecting formulation of a strategic plan, business plan, goal setting, and organizational management. A financial institution should have information of target customers, their need, and developments of the competitors to be used in setting a business strategy and maintaining the market share and earnings.

1.2.2.5 Technology A financial institution needs to ensure that its technology can compete and serve its customers' need, especially, complex transactions such as cash management or derivative transactions. An information technology system should also be enhanced to enable competition and support new transactions.

1.3 Risk Mitigation Factors to Strategic Risk

Risk mitigation factors means factors that help in implementation of a strategic plan to meet the goal, namely, qualifications of the board and senior management, formulation of strategic plan and business plan, quality of personnel and proper training, risk management system, stable customer base, introduction of products or services before competitors, adequate access to information.

1.3.1 Qualification of the board and senior management The board and senior management should be knowledgeable, with diverse and useful experience, independent, active, have clear understanding of the market, economic, and competitive conditions, and be ready to make a decision and implement it. There should be board members who are independent to serve as a check and balance on the activities of management to meet the targeted goal.

1.3.2 Formulation of strategic plan and business plan In order to formulate clear and effective strategic plan and business plan, the board and senior management should assess the changes in internal and external factors and continuously assess how these changes may affect the

financial institution, as well as adjust the plans to minimize the impact of these changes.

Furthermore, the financial institution must set a time frame for implementation of the strategic plan and establish performance evaluation system and clear compensation system.

1.3.3 Quality of personnel and proper training Knowledge, expertise, and experience of staffs will understand the market conditions, competition, and can predict the trend of products and services to offer target customers in consistent with the specified strategic plan and business plan. Particularly, adequate training on risk management will help staffs to be aware of the risks that ay incur, as well as try to prevent and reduce operation errors, thus resulting in efficient implementation of the strategic plan and business plan.

1.3.4 Risk management system A financial institution must have an organization-wide risk management system. All types of related risks must be taken into account during the formulation of a strategic plan and business plan, including risk monitoring and mitigating methods, by setting a policy, procedure, and risk limit.

1.3.5 Stable customer base Preference and need of customers may change slowly or rapidly depending on the changing environment, society, or technology. A financial institution that can serve customer satisfaction well will be able to keep the customer base, although it is difficult accurately judge the need of customers.

1.3.6 Leadership in products or services A financial institution that is a leader of new products will be able to set the type and price of services, so long as there is no other financial institutions competing. However, such situation will last for a certain period of time only as competitors will eventually enter to compete for a market share.

1.3.7 Adequate access to information Adequate, accurate, and timely information will help in the understanding of competition, environment, and customers' need, making a financial institution to be able to offer appropriate products and services tailored to their needs. Information source can be research houses, experts, consultants, correspondent financial institutions or other market information. In addition, a financial institution obtaining the technology to collect, process, and analyze various data that may affect business performance of the financial institution, both information on environmental factors and market researches, will help the financial institution in the design of products and services that better serve the needs of target customers. For example, a financial institution will be able to set appropriate pricing by

using demographic information and consumers' credit information of the customers categorized by level of risk.

Part 2 Best Practice in Managing Strategic Risk

Strategic risk is risk from formulation of a strategic plan, business plan, and implementation that is inappropriate or inconsistent with external environment and internal factors. Such may affect setting of a direction, business plan, and action plan for each business line of a financial institution. Therefore, it is necessary that the board and senior management set a guideline in managing the risk efficiently and appropriate to the business environment to ensure that the risk level is acceptable and that the risk management system is adequate to identify, measure, monitor, and control the risk.

2.1 Oversight by the board of directors and senior management of a financial institution

In this strategic risk manual (the manual), the board means the board of directors of a financial institution who are appointed by the resolution of the shareholders' meeting, senior management means manager, deputy manager, assistant manager or those with equivalent positions but with different names for the positions who has the top 3 managing authority in the financial institution, and management means the person with the subsequent managing authority after the top 3¹.

The board and senior management are considered to have appropriate knowledge, capability, and experience to perform the duty of managing and monitoring compliance with laws, regulations, and shareholders' resolutions. The board should perform its duty of loyalty and care which ordinary prudent individuals in the like position and circumstance should have, and senior management should have accountability of professional persons for the maximum benefit of the organization, shareholders, and staffs. Although the duties and responsibilities of the board and senior management may differ depending on the organizational structure and authorities specified, in case of loss, the board and senior management must be personally responsible both in a commercial and criminal case. Moreover, an excuse that they do not have the duties of a director or management or lack information on a financial institution cannot be used to free themselves from being guilty of neglect to perform such duties. The detailed guideline on what duties should the board perform is in the Financial Institution Directors' Handbook.

¹ Circular No. ThorPoThor.SorNorSor. (31) Wor. 2770/2545 dated 3 December 2545 Re: Board Structure to Promote Corporate Governance of a Commercial Bank

In practice, the board may delegates certain authority to sub-committees or management to consider and make a decision for speediness of business operation. Nevertheless, the board, delegated committees, and senior management must monitor and ensure that there is compliance with law, rules, and regulations of the associated authorities such as the Bank of Thailand, Stock Exchange of Thailand, the Anti Money Laundering Office to promote corporate governance. For example, notifications and circulars of the Bank of Thailand Re: Board Structure to Promote Corporate Governance of a Financial Institution, taking directorship positions in other limited companies of the directors or senior management of the financial institution, and guideline for financial institutions in taking deposits.

2.2 Strategic Risk Management

As market conditions constantly changes and structure of each financial institution differs, the risk management system that is appropriate for different financial institutions may differ. Each financial institution should develop risk management system necessary and appropriate to the size, complexity, and scope of business. However, a good risk management system must be able to identify, measure, monitor, and control risks of the organization.

2.2.1 Identification and measurement of risk

Identification and measurement of risk are the responsibility of management to ensure that the level of risk existed and in the future are realized. A financial institution should identify and measure risk exposures continually to monitor the outcome from changing environments.

Identification and measurement of strategic risk can be determined through strategic planning, formulation process of a strategic plan, and the reasonableness of the strategic plan. Moreover, a business plan and formulation process of a business plan should be consistent with the specified strategic plan. Both the strategic plan and business plan should be consistent with the business scope, complexity, external environment, and internal factors of the financial institution so as to the business goal and to solve a problem of the financial institution.

2.2.1.1 Significant roles of the board, delegated committees, and senior management

Changes in the structure of the financial institutions system, business scope of financial institutions, technology, market volatility, increased competition and innovation have posed higher risk. Therefore, a financial institution must continuously have good planning as well as periodic review of the strategic plan as circumstances change. The board, delegated committees,

and senior management have 3 important duties, namely, strategic planning, organizing, staffing, directing, and controlling to achieve the stated objectives and goals.

1. *Strategic planning* The board or delegated committees and senior management must set business direction in the future of a financial institution and plan in accordance with the changing environment and circumstances. Moreover, they should formulate a business plan, target customers, target customer base, and performance evaluation against the plan, as well as risk management system, information technology system, and other support systems to control strategic risk.

2. *Organizing* The board or delegated committees and senior management must organize the organization and specify work procedures to facilitate implementation of the strategic plan and arrange to have appropriate checks and balances.

3. *Staffing* The board or delegated committees and senior management must proceed to allocate staffs to suit their qualifications and responsible duties to implement the strategic plan efficiently and in line with changes of organization structure, including specify a system of recruiting, training, and compensation that encourage staffs to comply with the strategic plan in order to achieve the goal of the financial institution.

4. *Directing* The board or delegated committees and senior management must direct to have operation of a financial institution achieve the goal by clearly and explicitly specify the line of authority to help with quick and efficient decision making, feedback, measurement, and evaluation.

5. *Controlling and monitoring* The board or delegated committees and senior management must arrange to have an effective mechanism to control implementation of the strategic plan, which can be observed in case of deviation from the plan, and introduce timely corrective actions. There should be a system to report the detailed progress of implementation of the plans and objectives, including comparison of actual performance against the business plan and budget, and the business continuity plan² for unusual circumstances to facilitate unexpected changes in the environment.

² Business continuity planning means “ a process to ensure that a financial institution can maintain or revive the operating system and provide services to the customers when there is a unexpected crisis such as natural disaster, failure of information technology system, operating errors, or terrorism. The objectives are to reduce financial loss and to enable the financial institution to provide services to its customers and counter parties

2.2.1.2 Strategic planning process

Setting future business direction is the responsible duty of the board or delegated committees and senior management. If the planning process is not appropriate, the assumptions are not reasonable, or strategic plan is flawed, a financial institution may encounter failure as in the case of inadequate granting of credits. Therefore, the financial institution must encourage to have an appropriate strategic planning process and implementation as follows:

(1) Support or participation of the board, delegated committees, and senior management

The board or delegated committees and senior management has direct duty and responsibility for strategic planning and implementation of the strategic plan, so they must fully participate and carefully decide on the basis of information from staffs within the organization and market researches to ensure that such plan is feasible and appropriate. The strategic plan and performance evaluation method should be approved and reviewed by the board or delegated committees and senior management regularly in order to determine appropriateness and consistency between the strategic plan, business plan, and various analyses.

(2) Participation of staffs from various departments

The board or delegated committees and senior management responsible in strategic planning process should comprise members from different departments both the core and supporting functions to set a framework or guideline that the core functions and supporting functions can operate together to achieve the overall goal of an organization, without dominance by any one or department in the strategic planning process. Therefore, cooperation is vital as different departments have to work together in the implementation of the plan. For example, when the board or delegated committees and senior management set the goal to increase the loans by 20% from previous year, the core functions such as a treasury department must identify a source of fund and capital allocation to satisfy the increased credits; the supporting functions such as an accounting department should participate in the planning to prepare for the increased transactions; and most importantly, all staffs must be aware of the importance of the plan and cooperate or

continuously, and reduce adverse effects on the strategic plan, reputation, operation, liquidity, credit quality, and compliance with laws.

involve in giving their opinions so that the management has a chance to give and receive information supporting the strategic planning more efficiently.

(3) Adequacy of information in forming assumptions

Supporting data used in forming assumptions must be reliable and sufficient for making a decision in order to support an analysis and forming of reasonable assumptions. The data can be from assessment of economic factors, position of the financial institution compared to its competitors, competitive environment at present and future market trends, and customer needs.

That is,

(3.1) *Economic factors* Current economic conditions and future trends are fundamental data in forming assumptions and strategic planning. If a financial institution does not collect and thoroughly analyze market data, other internal and external factors, it will not be able to form the assumptions for the planning in a comprehensive and realistic manner. Such may lead to failure to achieve the goal. For example, no specification of appropriate credit growth, no analysis of potential responses by competitors, no estimation of loan loss in proportionate to increased credits.

(3.2) *Position of the financial institution compared to competitors* to identify strength and weakness, opportunity and threat, by considering environment changes and future trends that may affect a financial institution. For example, a financial institution may have strength in leadership in new products or services but may not be able to find cost of fund or transaction lower than the market so that the pricing of a new product or service is not as attractive. Nevertheless, the financial institution may be able to make profit from unsaturated market but its profit will decline once new competitors enter the market and set a more attractive price.

(3.3) *Current competitive position and future market trend* namely, detail of market competitors such as asset size, structure, nature of growth, core business, strength and weakness of competitors, as well as market share by type of product and business line. A financial institution should assess the market conditions regularly especially when there are major changes such as new product offering or merger.

(3.4) *Customers' need* by considering demographic, income, and customers' behavior to understand the current market condition and target customer group, timing of the need for product and future market trend. Researches should be conducted periodically to ensure that a

financial institution is prepared and can timely respond to any changes of competitors and the market. Such researches can be done by the financial institution or external research houses.

(4) Consistency of the business plan and the overall objective of a financial institution

The goal of operation should be consistent with the strategic plan and overall objective of a financial institution. Formulation of the business plan should also be consistent with allocation of budget and funding source. For example, when a strategic plan sets to have retail credit growth of 20 percent, a financial institution may specify a business plan to extend its customer base to a new group of customers, as well as promoting sale of new product or using pricing strategy to attract customers from competitors. Budget and existing source of fund should be taken into account as well. In addition, a criteria to assess actual performance against the plan should be established to help evaluate success of the plan, as well a clear operating time frame for each procedure. When the evaluation result deviates from the expectation, the business plan should be adjusted in consistent with the changing environment or circumstances. For example, if a financial institution aims to be the leader in retail credits market, the plan should specify the evaluation method, the market share, number of customers, number of credit applications, or survey of customer satisfaction.

(5) Feasibility of a strategic plan

A financial institution should set the goal to be consistent with its capacity, potential, current market share and competitive environment such as quality of credits or debtors in the credit portfolio. A strategic plan that sets too broad a goal or has no clear direction can make it difficult to specify a business plan and action plan, and to adequately assess the operating performance. For example, if a financial institution's goal in a strategic plan is merely to increase income from previous year, without clearly specifying the marketing goal by type of business.

(6) Assessing actual performance against a strategic plan

The board or delegated committees and senior management should periodically evaluate actual performance against the strategic plan in order to monitor and adjust a business plan appropriately and in consistent with the changes. The criteria in performance evaluation should be measurable and evaluation frequency should be adequate, with an alternative that is consistent with each different circumstance. For example, the board or delegated committees and senior management can assess the success of e-banking services by comparing to the weekly or monthly

target, number of users, daily transactions, speed of each transaction, number of errors, and problem remedy time period so that the data can be used to adjust the business plan in the future.

2.2.1.3 Business planning process and budget

The board or delegated committees and senior management is responsible for formulating the overall business plan and budget, while each department's duty is to establish a business plan and budget, by month, quarter or year, to be in consistent with the overall business plan and budget. The business plan and budget can be done by a top down approach or bottom up approach or a mix of the 2 approaches.

(1) The top down approach is a strategic planning process where the board or delegated committees and senior management delegate and allocate the operating targets to each department as appropriated. The advantage of this approach is it is convenient in the planning and controlling the budget. However, the disadvantage is the strategic plan may not be realistic or not consistent with the potential of each department or difficult to implement according to the strategic plan.

(2) The bottom up approach is a strategic planning process where a business plan and budget from each department are put together to become the strategic plan. The advantage is each department sets its target and allocates its resource with an aim to achieve the strategic plan set by its own. The disadvantage is it is more difficult to apply the bottom up approach than the top down approach since there may be shortage of resource in each unit and the business plan and budget of each department may not be consistent both at the overall and departmental level.

In determining appropriateness of strategic planning process of a financial institution, the board or delegated committees and senior management must review the business plan together with the budget to help understanding the plan for future business and other important issues such as capital adequacy, liquidity, source and use of fund, level and quality of earnings, and management efficiency. The following issues must be considered when assessing appropriateness of the business plan and budget:

(1) Business plan and budget

A financial institution can use the budget to forecast and control the overall or part of the operation, as well as assess management efficiency in decision making, planning, and

implementing by comparing the budget with actual performance, for example, budgeting and forecasting over 4 or 5 years. Comparing the actual performance with the long term projection will differ more than comparing with the short term projection due to the changing environment such as market interest rate, competition, economic factors and other environmental factors. The long term projection should therefore be reviewed at least annually in order to adjust the plan to the changes appropriately and to be able to closely monitor the operations and make an adjustment quickly. The financial institution should review the short term projection at least monthly or quarterly to submit the information to the board or delegated committees and senior management. Performance evaluation to set compensation should depend on the budget and projection formally and originally approved by the board or delegated committees and senior management before the projection review so as to reflect actual potential. Moreover, the financial institution should prepare the projection under different assumptions, using different level of unusual circumstances in line with an analysis of economic trend and business experience.

(2) Consistency of the business plan and budget with the strategic plan

The business plan and budget of each department should be consistent with the overall strategic plan and budget. When inconsistency is detected, the management of each department should clarify to the board or delegated committees and senior management the problem and difficulty in implementing the plan, as well as contingency measures in order to set the overall business contingency plan. For example, if a financial institution with the goal to increase credits to SMEs, the credit department should prepare the data to support the business plan and budget as follows:

- (2.1) the quantity of credits increase by type of debtors and SMEs credits growth trend
- (2.2) projection of loan loss and provision to be increased to support the loan loss
- (2.3) projection of funding as well as source of fund and financial instruments to be used
- (2.4) increase of staffs to be appropriate to the work load, both the staffs in the marketing and sales department and in the credit review and audit department.
- (2.5) problems and difficulties to make credit approval not in accordance with the target.

(3) Reasonableness of the assumptions used in formulating the business plan and budget

In determining reasonableness of the assumptions used, the data used as a basis in formulating the assumptions must be reliable, sufficient, and updated and be consistent with the data used in strategic planning process. Example of unreasonable assumptions is a rapid increase of credit quantity while an economy is in recession, or growth while a financial institution faces with more intense competition, or increase of credit quantity while loss or provisioning rate is unchanged.

(4) Adequacy of budget allocated for management and supporting function

The board or delegated committees and senior management should place as much importance to the supporting functions and allocate adequate budget as to the core functions, and should improve the risk management system, information technology system and reporting on a regular basis.

(5) Monitoring of actual performance against the business plan and budget

The board or delegated committees and senior management has the duty to monitor actual performance compared to the business plan and budget regularly, as well as analyze the reason for significant deviation and set a guideline to remedy the problem. Such comparison can be used to assess the overall success of the organization and each department very well.

(6) Adequacy of compensation

The board or delegated committees and senior management should set a compensation policy that is appropriate and consistent with the actual performance compared with the established business plan and budget, as well as compliance with the authorities' notifications such as the circular of the Bank of Thailand re: Payment of cash or other assets as compensation to staffs or employees.

2.2.2 Risk monitoring and reporting

A financial institution should monitor and report on risk regularly to ensure that the level of risk is acceptable. The board or delegated committees and senior management should receive relevant reports that are accurate, timely, and of appropriate frequency to be used as information for a decision making.

Effectiveness of risk monitoring depends on ability to identify and measure all the risks, which must be supported by appropriate, accurate and timely management information systems or model to help with an analysis and decision making. Therefore, the board or delegated committees and senior management must develop and upgrade the information system to identify and measure the risks in an accurate and reliable regularly to be consistent with the complexity and diversity of the financial institution. For example, large financial institution with many complex transactions should have a reporting system and risk monitoring system that can measure the overall risk level. In addition, the information technology of large financial institution should be able to collect internal data such as financial data, accounting data, and external data such as economic conditions, competition, technology and regulatory requirements.

2.2.2.1 Management information system (MIS)

An information system is a system or process that provide information necessary to make a decision and manage effectively, which will support implementation of the strategic plan, generally with the following objectives:

- Provide, Collect, and process data
- Support the strategic goals and direction of a financial institution
- Reduce operating cost
- Enhance communication among staffs
- Deliver complicate data through an organization

Effective information system must be adequately supportive of objectives, goal, and provision of services of the financial institution, be able to timely report in a desirable format, and appropriately specify information access levels, either through an automated system or processing system by staffs, or both. It is very important to appropriately define a controlling method to ensure that the data is accurate and prevent from error in retrieving data from many work systems, which may result in erroneous reporting and decision making.

The board or delegated committee or senior management must place importance on development, installment, and reviewing the MIS regularly, as well as set a policy, operation framework, and procedures on MIS, which include development, maintenance, security, repair or upgrade the system to maintain the standard. The board or delegated committee or senior management must establish an MIS system that comprises the 5 following characteristics.

(1) Timeliness – A financial institution should have a reporting system that can provide and distribute timely data to users. Such should be able to collect data, summarize results, and correct errors promptly.

(2) Accuracy – There should be a system to check input data, information system, and results to ensure accurate data processing process. An internal control, inspection and assessment by internal auditor and external auditor, as well as a regular review should be established.

(3) Consistency – Data collection and processing should be consistent and uniform for comparing performance between business line, and analyzing of data and trends. Reporting procedures and data collection may change as appropriated. The board or delegated committee or senior management should establish written process and procedure to allow for systems changes and should communicate to all appropriate employees.

(4) Completeness – The report should be complete so that the board or delegated committee or senior management have access to complete and pertinent information for making a decision or solving a problem.

(5) Relevance - Information submitted to the board or delegated committee or senior management should be relevant and appropriate to the management level and must always obtain the data necessary for a decision making process.

2.2.2.2 Monitoring report

To assess adequacy and appropriateness of risk monitoring and reports submitted to the board or delegated committee or senior management, as well the information system of a financial institution, each business unit must consider the following factors:

(1) Monitoring and reporting methods that cover all aspects of risks and are in writing.

(2) The data and procedure should be appropriate, documented, and regularly tested for reliability.

(3) The performance reports and communication within an organization should be consistent with the quantity and complexity of transactions of a financial institution.

(4) There are reports to the board or delegated committee or senior management in an accurate and timely manner, with sufficient information for assessing trends and level of risk of a financial institution.

Example of information that the board or delegated committee or senior management should receive so that they can monitor and control strategic risk is provided in Appendix 1, with contents and warning signs.

2.2.3 Risk controlling

The board or delegated committee or senior management is responsible for the overall operation of a financial institution by setting risk controlling guidelines such as policy, standard, procedure, risk management system, internal control system, risk monitoring and reporting system such as report comparing actual performance with projection, internal audit report. To control risk, financial institution should consider the following factors.

2.2.3.1 Risk controlling system

The board or delegated committee or senior management should establish a risk controlling system in accordance with international best practice. Risk monitoring and controlling unit must be independent of the risk taking function to have balance in management. Checks and balances should be maintained to prevent any loophole in the internal control system, as well as a regular test of risk controlling system by both independent units, internal and external, to ensure that the financial institution has corporate governance and appropriate risk controlling system.

To establish risk controlling system and risk management unit independent from risk taking function can be accomplished by separating the risk controlling unit. For example, setting up of a credit review function or internal audit, a risk management committee that does not directly involved in business decision or day-to-day operations, including personnel with appropriated expertise and qualifications, understanding nature of the transactions, and the impact of risk level over the specified limit.

The scope of responsibilities of a risk management committee is more than formulating a policy and establishing risk management procedures. It should cover review of compliance with risk limits, specifying frequency of review, and type of risk to be reviewed. The frequency of such review depends on the level of risk in the underlying function, for example, foreign trading transactions should be reviewed daily, credit concentration should be reviewed weekly or monthly. Moreover, the board or delegated committees and senior management should receives a variety of reports for risk review and monitoring, for example, reports on assets and liabilities

management (ALCO), liquidity, high risk transactions, transactions concentration, credit exception, market risk, performance against the target, and exceptions to the established policy.

2.2.3.2 Policy, procedure, and risk limit

The board or delegated committees and senior management should establish clear, detailed, and written risk management policy and procedure by types of risk to be guidance for the day-to-day operation, including risk limits to contain loss within an acceptable level.

Moreover, the board or delegated committees and senior management should review the risk management policy and procedure to ensure that they are modified to respond to changes in activities of an organization and business conditions as follows:

(1) risk management policy, procedure, and risk limit must include identification, measurement, monitoring, and control of risks of major activities such as lending, investment, trading, and contingent liabilities.

(2) risk management policy, procedure, and risk limit should be consistent with the objective, goal, and the overall capacity of an organization. Activities not specified in the policy or strategic plan must always be approved from the board or delegated committees and senior management.

(3) There should be a policy for review of new activities to ensure that the financial institution has necessary tool or system to identify, measure, monitor, and control the associated risks before initiating the new activities.

(4) Clear accountability and lines of authority for risk management procedure must be established so as to have management and responsible persons for each business unit, activity, or project.

(5) Clear and measurable risk limits must be set.

2.2.3.3 New product review

In undertaking a financial institution business, the board or delegated committees and senior management must monitor market changes, advance in technology, and try to offer new services or products to maintain the ability to compete and respond to customers' need. However, offer of new services or products may increase risk of the financial institution, if careful consideration is not taken. Therefore, the financial institution must be very careful in formulating a strategic plan for new product to minimize any problems or errors, and there should be a review

process for new products or services before offering to customers by assessing the effect to 5 major risk areas of an organization, namely, strategy, credit, market, liquidity, and operation.

In addition, the financial institution may use a model to examine the effect on financial standing, earnings, and capital funds that may occur from new product offerings. Consideration and experience of an expert should be taken into account in making a decision. Although a model may have limitation and cannot cover all potential scenarios, it can be used a tool to assure analysts to a certain extent. In this respect, the financial institution should specify a comprehensive new product review process and improve an operation system and controlling systems before offering the new product or services to customers, including:

(1) establishing clear accountability in a review process

A financial institution should establish a working group or sub-committee comprising senior member of each business unit associated to ensure that the financial institution can comprehensively assess the potential impact that may incur from offering new products. Moreover, core business lines such as credit department, treasury department, and risk management department and supporting business lines such as accounting department, legal department, personnel department, and internal audit department should be involved in approving new product offering. Comments of various business lines should be periodically reported to the board or delegated committees and senior management.

(2) analyzing and reviewing new product

A unit responsible to analyze and review product must clearly understand the nature of the new product to ensure that the review covers all important aspects, namely

(2.1) name and description, and objective of the new product, and targeted offering period

(2.2) similarity or differences between new product and existing product or service

(2.3) target customers that are existing or new customers or new untested target market

(2.4) projected growth and profitability

(2.5) feasibility of product offering

(2.6) expected material effects on risks and related business units.

(2.7) methods to identify, measure, monitor, and control risks from new products, and responsible persons

(2.8) limitation on applying the new product to the existing work system and information system and preparation to facilitate the new product

(2.9) knowledge, expertise, and experience of relevant staffs

(2.10) expected increase in activities

(2.11) expected default rate

(2.12) approval and comment from associated business units

2.2.3.4 Minimum standards or criteria in new product review

A financial institution should have a process and criteria in approving new product offering in a prudent and careful manner, mostly, by analyzing minimum profit and comparing with acceptable earnings, expense, and risk, for example, risk adjusted return on capital. In addition, the financial institution should have report on performance after introducing the product to determine the level of success and what to do in the next stage. For example, if the product fail, the financial institution may contemplate corrective actions or decide to terminate that product offering.

2.2.3.5 Quality and effectiveness of an internal control system

An internal control system will help promote effective operation of a financial institution and reliable reporting, safeguard assets, and ensure compliance with laws, regulations and stated policies. The financial institution should have an independent internal control auditors report the internal control audit or system review results directly to the board or an audit committees in writing to be able to expedite resolution. The financial institution should proceed or have the following items:

(1) adequate internal control system appropriate to the type and level or risks from the nature and scope of activities

(2) clear and written lines of authority and responsibility for controlling and monitoring adherence to risk management policy and procedure and risk limits

(3) clear segregating of duties between operation and controlling units, for example, in a trading room, front office reporting must be separated from middle office and back office

(4) independent and objective audit and review process for internal controls, namely scope and procedure, reporting, findings, and corrective actions, including an information and reporting system

(5) reporting of an audit and review and reporting of non-compliance with laws and regulations, as well as reliable, timely, and documented investigations and corrective actions

(6) an audit committee or the board should regularly review the effectiveness of internal audits and other controls in order to appropriately and timely rectify any significant deficiencies

2.2.3.6 Management succession plan and training

Personnel administration function includes designing organizational structure of a department responsible for recruiting, job position and description, appropriate training and development, performance evaluation and compensation system, salary administration and effective communication network.

Objectives of personnel administration include (1) to ensure continuity of operations and consistency with the policy and standard of a financial institution (2) to have sufficient qualified staffs to fulfill their responsibilities and adequately recruit qualified staffs for replacement. Therefore, personnel administration has a vital role in preparing staffs to be consistent and supportive of strategic direction of the financial institution.

In addition, the financial institution should appropriately specify detailed job description, performance evaluation system, salary and compensation structure, and penalty so that the performance and responsibilities are consistent with the stated strategy and goal. Moreover, a management succession plan should be in place to ensure continuity of operations. One approach is to support new generation managers who have the necessary capability, knowledge, and experience for higher-level management. The management should identify minimum qualifications of persons to take the management positions in detail, as well as necessary training program.

To ensure that a financial institution can maintain experienced management, the board or delegated committees should set the following measures:

(1) *Review performance of senior management against the stated goals at least annually* to see whether the performance is satisfactory, capable of attaining the stated goals or not by assessing the performance, both qualitative and quantitative, against the business plan and budget, share price to book value, market share, competitiveness, and risk level.

(2) *Establish policy or plan on management succession* the policy should be formulated and reviewed at least annual to be consistent with the organizational structure and job description, covering necessary training, minimum qualifications for each position in detail, career path, etc.

(3) *Review employment contracts for outside management that are of materiality* In case where there are outside professional manager, consultants, or experts hired to perform special tasks, appropriateness of the employment contracts to specify clear roles, responsibilities, and performance evaluation and compensation criteria. In this respect, the board or delegated committees should have the right and authority to make important decision, as well as evaluate the performance of such persons.

The board or delegated committees should monitor and control performance of outsiders to prevent the organization from exploitation, for example,

(3.1) clearly specify scope, duty, responsibility

(3.2) develop a formal rule to cover minimum and acceptable work standards and clear time frame

(3.3) evaluate performance against the expectation

(3.4) employment contract should be reviewed by a legal department and approved by the board or delegated committees

(3.5) stipulate in a contract that the financial institution has the right to cancel the contract in case of non-compliance with the agreed goals

(4) *Set compensation guidelines and methods for senior management* The board or delegated committees should take part in determination of senior management compensation to be appropriate, either in the financial or non-financial form. This should be appropriate to the financial standing of a financial institution at that time as well.

(5) *Set a training plan* A financial institution should allocate adequate budget for training and put appropriate staffs who have knowledge and understanding of personnel administration to be responsible for managing training programs of an organization and are capable of arranging for a training session by internal speakers or employing a training institute or inviting external speakers.

Training is an important factor to assist an organization in developing qualified staffs, which facilitates successful operation in consistent with the goal. It is one of the channels to communicate the business plan and goal of the organization to staffs. General training is, for

example, organization's policy on business strategy, overall risk, business nature and products, operation procedure, and personnel management policy. Specific training is, for example, treasury management or special training when new products and services are introduced. The training plan should be on going and consistent with the business goals and strategy of the financial institution. In addition, the financial institution should encourage staffs to further their education to increase their knowledge, skills, and potential to keep up with latest know-how necessary for operation in the future.

2.2.3.7 Business continuity planning

Business continuity planning is to prepare to have continuation of business operation in the event of an emergency by establishing business continuity plan for many crisis scenarios, for example, inability to accomplish the strategic plan, crisis from serious economic recession or crisis from accidents or natural disasters such as flood or fire that significantly affect an operation. Moreover, the board or delegated committees and senior management should specify the detail of management and persons to be in command and/or have signatory authority at each level, in case that certain senior managers are unable to do their duties. The business continuity plan should consist of:

(1) operation contingency planning, namely, alternate operation locations and electronic data processing (EDP)

(2) management contingency planning, namely, management of liquidity crisis from volatile market and contingency plan for failure to accomplish the strategic plan

Part 3 Examination Procedure

3.1 Examination Objectives

1. Determine if a financial institution has clearly assign units or persons to formulate a strategic plan to ensure that

- (1) the responsible units or persons comprise representatives from various business line or coordinate with the representatives from both core and supporting functions;
- (2) staffs are knowledgeable and understand the job they are responsible for;
- (3) staffs are adequately allocated;
- (4) resources to support the implementation are utilized efficiently.

2. Review if the strategic plan is formally approved by the board or delegated committees, and senior management, for which, directors and managers of core and supporting departments, as well as other units in the organization involve in formulating and monitoring the implementation of the strategic plan and business plan, and they regularly attend the meetings.

3. Review if the strategic plan formulation follows the specified procedure and timeframe, including the readiness of plan implementation by reviewing the business plan formulation and the budget whether the management style is top down or bottom up in the following aspects:

- (1) the clarity of monitoring methodology for the business plan implementation and the budget; and
- (2) causes and consequences of the failure to adhering to the business plan and the budget.

4. Assess key opportunities and threats, and strength and weaknesses of the organization with consideration on the strategic plan formulation if there is appropriate analysis and market research, as well as assessment of changes such as current economic conditions and trends. This should include external environment such as economic, legal, competition, technological factors, and internal environment such as resources, quality of staff, internal and information system, as well as close and continuous monitoring of their trends.

5. Review if there is thorough communication within a financial institution during and after plan formulation in the following aspects:

(1) various departments are notified of policy direction and objectives of the annual business operation to be used in setting the goal, business plan and the budget consistent with the overall policies and objectives of the organization; and

(2) meetings are arranged to clarify on procedure, relevant document, and forms used in the plan formulation, including notification of clear timeframe for each procedure of operation.

6. Review if a financial institution has the strategic plan by assessing if there is any risk that might affect its position, operating result and survival. Comments should be made on major changes in the organizational structure or the direction of business operation such as too aggressive growth target, focus on certain transaction with no expertise, unclear sources of fund etc.

7. Assess the overall strategic and business plans in the following key aspects:

(1) the overall strategic and business plans are consistent with the main objectives of the organization;

(2) the business plan, the action plan and the budget are consistent with the strategic plan and cover every level of business line, while the management should allocate adequate resources to each department;

(3) the overall strategic and business plans are clear with specification on the goal—both qualitative and quantitative—and implementation period, operational in practice with designation of responsible staff; and

(4) the financial institution should formulate the strategic plan in writing and if it is not in writing a financial institution should communicate it to all relevant departments to ensure effective implementation.

8. Assess the feasibility of the strategic and business plans from the following factors:

(1) reliability, rationale and assumption, as well as supporting reasons such as the difference of the strategic plan from those of its peers, the reasonableness of the business plan for the operational survival, and the extent that the strategic and business plans will be able to solve the problems and support the objectives of the financial institution etc;

(2) the consistency of the strategic plan with the analysis of both internal and external environment such as the analysis of the residential credit market, to allow a financial institution to target itself as a market follower, leader or niche service provide etc; and

(3) comparison between the actual operation result and the strategic and business plans whose results are in material discrepancy and impacts on the overall position and operation such as profit lower than projected, or expenses and income or the market share below targets must be analyzed to identify the reasons for such discrepancy and impacts to be reported to the management for action.

9. Review the organization structure, personnel, and key business departments in the following aspects:

(1) there is clear segregation of duties and complete coverage of various departments to avoid redundancy in practice;

(2) there is specification of line of command and segregation of duties to ensure operational independence, thereby averting gaps in the internal control;

(3) there is check and balance between departments to ensure efficiency in the internal control;

(4) there is reporting in the line of command and operation following the designated structure;

(5) consideration must be given to any change of structure or managerial staff in key positions that may affect operation, as well as the reasons behind such change; and

(6) consideration must be given to the authorization whether it follows the structure and responsibility or it is influenced by the management or any shareholder.

10. Review the procedure for the introduction of new products to the market with due consideration on the following:

(1) the introduction of new products should be consistent with the overall strategic and business plans, the organization structure, external factors and internal resources;

(2) the procedure and guidelines on the introduction of new products should be specified formally and decided by authorized person and department based on information of the features of new products, the assessment and control of risks, and the projected operation;

(3) various departments and business lines which are affected by new products should participate in the proposal of new products include the board or delegated committees and senior management, departments responsible for the introduction of new products, risk management unit, compliance, accounting department and legal department etc.; and

(4) the introduction of new products should take into account various categories of risk and risk management system, and effectiveness and validity testing.

3.2.2 Assessment of risk management

1. The organization structure and key positions are in place to support the strategic plan.

2. The strategic plan and business objectives are communicated to relevant staff at all levels in an effective manner to ensure consistent operation.

3. Assessment of operational control and revision of the strategic and business plans and the budget should take into account the following aspects:

(1) departments and staff responsible for monitoring and impact assessment are clearly specified;

(2) there are efficient methodologies and instruments in place;

(3) there is assessment of the operational control according to the business plan to keep track of progress regularly and analysis of the causes of material discrepancies including management instruction to correct the encountered problems; and

(4) the business plan and budget are regularly reviewed while correction measures are introduced when the plan cannot be accomplished.

4. The board or delegated committees and the senior management should consist of persons drawn from relevant multi-disciplinary occupations with qualifications in terms of experience, knowledge and expertise in financial and banking businesses or any fields that are of use to a financial institution. They should pay attention to risk management with attentive working attitude, integrity, transparency and independence—the qualities of which should be verified by the auditors by reviewing the meeting minutes, comments recorded in the minutes or reports with due consideration on the following:

(1) participation of individual board member and executive in terms of expression of opinion or instigation by a single board member or executive or a group of them or through an agent; and

(2) accuracy, completeness and adequacy of information submitted to the board, delegated committee and senior management, especially that for the purpose of risk administration and control.

5. The management of the board or delegated committee or the management should be assessed if they are suitable for the organization. Due consideration should be given to the

qualifications, attentiveness, responsibility and operational competency in an independent and efficient manner of various committees such as the compensation committee, the Assets and Liabilities Committee (ALCO), the Audit Committee, and the Risk Management Committee etc. This can be carried out by reviewing and verifying various risk reports at the daily, weekly or monthly frequency commensurate with the complexity and volume of transactions of a financial institution.

6. The management must have experience, knowledge, proficiency, potential for development and operation following the strategic plan, responsibility and attentiveness in the job, and of importance, integrity, transparency and independence in decision-making.

7. The procedure for human resource management must be clear and consistent with the strategic and business plans with consideration for the following key issues:

(1) appropriate training plan that is regularly updated such as a training project specifically for new products and services;

(2) succession plan for key management with clear selection procedure to ensure managerial continuity such as job rotation, on the job training or targeted training by specialists; and

(3) appropriate and fair structure of compensation such as performance-based promotion or compensation plans.

8. Information and reporting system is in place to ensure accurate, complete and timely reporting to the board, delegated committees and senior management, and capable of supporting the strategies and decision making effectively. The reports should be comprehensive with sufficiently clear explanation on the following trends and factors influencing the financial position of a financial institution:

(1) report in writing on operational results according to the strategic and business plans and budget, including explanation on causes for deviation from the plans;

(2) reports on various categories of existing risk and those expected in the future, as well as compliance with risk limits;

(3) reports on current financial position and its trend with explanation;

(4) summary of current economic, financial, industry, peers and IT conditions and changes together with their trends;

(5) reports on analysis of external and internal factors that may have impacts on the operation; and

(6) reports on progress of the meetings pertinent to the business objectives and budget.

9. Efficient risk management should cover all categories of risk with due consideration on the following:

(1) effective risk policy and limits should be in place with clear and formal guidelines on correction measure and penalty to prevent gaps in the internal control and potential damage that may incur, with immediate reporting of such incidents to the board or delegated committees and senior management;

(2) there is an independent unit separated from risk-creating units and responsible for monitoring and compiling reports on management of various risks submitted to the board or delegated committees and senior management, as well as capable of gaining free access to accounting records, reports on position of various risks and reports on market value of financial instruments;

(3) the risk management system should be reviewed and improved to ensure that risk can be identified, measured, monitored and controlled regularly and efficiently; and

(4) the board or delegated committees and senior management pay attention and support the risk management system in the area of internal control, accounting and back office adequately, and instruction on correction of shortcomings should be accurate and timely.

10. There is a clear contingency plan for various risks that can be implemented and corrects the financial position, as well as regularly reviewed and tested for its efficiency, with responsible and authorized staff formally specified. The plan should cover both general management and operation in the event of failure to implement the business plan, critical events simulated with varying levels of severity impacting the capital fund and business survival. Examples of such plans are data back-up and recovery plan, EDP, the succession plan, the recovery plan for liquidity crisis and the insurance plan.

Appendix 1: Example of Reports for Monitoring Strategic Risk

1. Example of Information for the Board of Directors, Delegated Committees, and Senior Management for Monitoring Strategic

Information and reports that the board, delegated committees, and senior management should receive or review may vary among financial institutions. Complex financial institutions require a more comprehensive reporting system to cover important issues. Information and reports are as follows.

1. A report on operating performance compared to the goals, including a summary narrative of the past performance, continuation of the original plan, and indication whether or not to continue with the original plan, as well as detailed explanation on reasons for deviation from the goals
2. A comparative balance sheet and a monthly profit and loss account on a monthly, quarterly, or year-on-year basis, including explanation on reasons for significant variances.
3. Monthly statements of changes in capital fund and various reserves, including explanation on reasons for any changes
4. Report on lending, with detail of significant pass due credits, payment history, pass due loans, pass due period, change in interest rate, non-performing credits, large credit exposure and new loans, as well as detail terms and conditions
5. Investment reports classified by investment type and objective, indicating market value, book value, yield, and a trading summary, as well as explanation on trading reasons
6. Monthly loan reports, indicating type and the amount of borrowing and borrowing source.
7. A monthly analysis report of current and projected liquidity position
8. An annual projection of capital needs.
9. A summary report on risk positions including current and expected risks and risk management guideline
10. Audit report, specifying guideline to prevent any deficiencies in the future. A review of the audit report and actions taken should be reflected in minutes of the board's or delegated committees', and senior management's meetings.

11. An annual report on all types of insurance coverage such as cash insurance
12. Letters or information from the Bank of Thailand or other important sources necessary and related.
13. A listing of any new litigation, a status report on existing litigation, and potential losses
14. A report on any major issues that require a decision making by directors such as branch openings and closures and new building plan

2. Example of Reports and Information on Strategic Risk

A listing of reports will help financial institutions and supervisors to monitor operation of financial institutions. If the reports are periodically prepared and checked for accuracy, it will be of much benefit to the operation assessment. Warning signs will help financial institutions to realize that an event may affect financial institutions in accomplishing their goals and strategies.

1. Economic Analysis

Management information system (MIS) should include analysis of economic conditions, in a global, regional, country, industry, and local level, that may directly and indirectly affect the financial institution. The analysis should include:

- Economic indicators such as GDP, inflation rate, interest rate, exchange rate, demographic information, wages, and unemployment rate
- Market condition in each industry and provincial market such as demand, supply, and price movements
- Information on competition condition and competitors both financial institutions and non-financial institutions
- Summary of financial, banking, accounting, economic, social, political, and regulatory issues that may have a significant effect on the operation and income of the financial institution
- Data from reliable sources such as the Bank of Thailand, NESDB, various Ministries, financial magazines

Warning Signs

- Not aware or prepared for a crisis

- Recession or trend toward recession
- Over-expansion in real estate in excess of demand by consumers and private sector
- Volatility of interest rate and/or exchange rate

Rationale Because performance of a financial institution depends on changes in economic conditions, the board or delegated committees and senior management should review the economic analysis which is used in the assumptions of a business plan, to help in recognition of an opportunity or threat in the business.

2. Comparative Statement of Balance Sheet and Off-Balance Sheet Items

This report presents assets, liabilities, owner equities, and material off-balance-sheet items compared to the most recent month, quarter, or same period in the previous year, including projections and variances (expressed as amount and percentage) and explanation on reasons for significant variances. There should also be an analysis of consolidated financial statements (if there are subsidiaries). Furthermore, the report should classify material off-balance-sheet items by type (such as obligations with and without recourse), the contract amount, market value, and related information.

Warning Signs

- Significant variances from prior periods or the budget
- Rapid growth or contraction

Rationale Comparative monthly balance sheets are essential in assessing the current financial condition and future trends. The board or delegated committees and senior management should monitor progress in meeting the goal and budget, and address any changing trends. Moreover, the board or delegated committees and senior management should be able to explain the reasons for any significant variances from the business plan and budget.

Rapid increases or decreases in any item on the balance sheet indicate volatility, especially material volatility when compared to the target. The board or delegated committees and senior management should find the underlying causes or reasons for the purpose of adjusting the business plan to be in line with the changes and should also assess the potential effects from credit risk, market risk, and other risks and the effect on capital fund.

3. Comparative Statement of Profit and Loss Account

This report presents income and expense present compared to the previous period and the budget, including explanation on reasons for significant changes to assess the profitability of each line of business

Warning Signs

- Significant variances from prior periods or the budget.
- Rapid increase or decrease in earnings.
- Too high a level of non-operating income to cover up the deteriorating operating performance.

Rationale As income and profit of a financial institution is an important indicator of business viability, the board or delegated committees and senior management should ensure that earnings are sufficient to maintain adequate capital fund and cushion against potential losses in consistent with the size and growth rate of a financial institution. The comparative monthly profit and loss statement will show performance, and help measure the performance compared to the projection and goal.

The board or delegated committees and senior management should assess both return and risk when evaluating earnings. Financial institutions with low risk may have stable earnings. On the other hand, if the management is acceptable to the increased risk in exchange of higher return, loss due to earnings variation may incur.

The board or delegated committees and senior management should be aware of the effect of accounting methods that may lead to misunderstanding such as short term earnings or non-operating income. Furthermore, there should be an efficient system to evaluate performance such as management by profit center will help evaluate performance of each team, division, and business line, allowing the directors and management to ensure that each unit is performing efficiently.

4. Capital Adequacy

This report presents the level of capital fund that a financial institution has, including an analysis of performance that may affect the capital fund, both calculated by the regulatory requirement or internal guideline of the financial institution. It should also analyze future capital adequacy, as well as estimated ratios based on the budget that projects general operating expenses

and structure of assets and liabilities for at least three years. In case of insufficient capital adequacy, there should be a report on the reasons and guideline on corrective actions.

Warning Signs

- A declining capital position, approaching the minimum regulatory capital requirements
- Management's inability to meet internal capital levels targeted by the approved business plan.

Rationale As capital fund is a widely accepted indicator of a financial institution's financial standing, failure to meet regulatory capital requirements may result penalties and corrective actions. The board or delegated committees and senior management should periodically monitor the capital position which depends on various factors such as credit quality, risk asset profile, interest rate risk, business growth, and operating performance.

5. Product Pricing

Each accounting period, the board or delegated committees and senior management should review information on the pricing and fee structure that a financial institution offers customers, including interest rates and yields compared with major competitors, and should consider the risks as well.

Warning Signs

- Rates or terms on deposits differ substantially from those offered by competitors or exceed the cost of other sources of funds with the same maturity
- Rates or terms on credits that do not adequately compensate for the risk involved such as credit risk, liquidity risk, or interest rate risk
- Rates or terms on assets and liabilities with same maturities
- Failure to factor in all costs (for example, operating expenses) associated with a product

Rationale Product pricing is essential for profitability. Competitive pressures may lead to inappropriate pricing decisions. Delegated directors or senior management should acknowledge and understand the product pricing process of a financial institution. Setting a price lower or higher than market rates can affect the size and quality of credit, liquidity risk, earnings, and deposit base.

6. Status of Credits and Investments

This report summarizes the current operating performance, standing, and financial information, including current progress on all major credits, subsidiaries or affiliated companies, securities investments, and new business lines.

Warning Signs

- Deviations from the goals
- Lack of progress report on major developments
- Requests for additional funding
- Absence of a firm work schedule

Rationale When a institution commits to funding of credits to affiliated companies, securities investment, or new line of business, the board or delegated committees and senior management should require periodic reports on use of fund and review these reports to evaluate financial performance to guard against loss, economic waste, and fraud. Certain credits and investments may pose more risk due to the size of portfolio, while others carry more risk due to the nature of the activities (for example, the development of raw land). As such, a detailed policy on credits and investments must be formulated, coupled with knowledgeable management, strong internal controls, prior approval, and close monitoring and auditing by the management.

7. Financial Reports on Entities under Supervision of a Financial Institution

This report provides the financial status, operating performance (balance sheet, income statement, statement indicating changes in shareholders, and cash flow statement that may directly or indirectly affects the strength of that financial institution. The report should include a detailed description of all major transactions between the financial institution and its subsidiaries, the effect of subsidiaries or affiliated companies on the financial institution, and an assessment of their compliance with applicable laws and regulations.

Warning Signs

- Financial weaknesses in subsidiaries (for example, operating loss, declining capital fund, asset quality problems, or difficulty in meeting the obligations)
- Immediate liquidity demands by subsidiaries

- Inter-company transactions that are not conducted at arm's length
- Delinquent financial reporting from an equity investment unit and an internal control unit
- Lack of separation between the institution and its subsidiaries

Rationale The board or delegated committees and senior management should be aware of the risks they may incur from subsidiaries with less-rigorous audit and record-keeping standards, which may lead to unauthorized or inappropriate activities. The board or delegated committees and senior management should arrange to have close monitoring of subsidiaries to guard against adverse effects on the financial institution.

8. Report on Management and Personnel Evaluation

The board or delegated committees should perform evaluation of management's performance and compensation at least annually, and include such report in the meeting minutes. In addition, the board or delegated committees and senior management should review reports on employee turnover, salary adjustments, promotions, benefits adjustments, and new hires and may compare them with the compensation and benefits of other similar institutions as well.

Warning Signs

- Performance below target
- Adverse comments regarding management in examination reports.
- High rotation or turnover of staffs
- Increasing complaints or litigation such as litigation on equal employment opportunity, sexual harassment, or other personnel issues
- Employee profile is at various levels of the organization

Rationale Capable management and personnel are important to the success of a financial institution. The most important responsibility of the board or delegated committees and senior management is selection and oversight of management and personnel, including evaluation of management performance. If the board or delegated committees and senior management do not seriously evaluate performance, it may result in performance that does not meet the goal and may result in conflicts due to dissatisfaction of compensation. Such is not good for the overall performance of an organization. The board should reward good performer but should prevent the payment of compensation, fees, and benefits that are inappropriate.

9. New Product or Services

This report provides comparison of actual performance against the budget.

Warning Signs

- Entry into a new activity or business venture without proper:
 1. Management expertise
 2. Policies and procedures
 3. Training
 4. Internal controls
 5. Independent reviews
 6. Supporting capital fund
 7. Supporting information system
 8. Integrated information system for management purpose

- Adverse impact from new products and services

Rationale Entry into new business activities without proper planning, resources, and controls can result in significant losses. The board or delegated committees and senior management should determine whether the new activities are prohibited by regulations, entail excessive risks, or result in any adverse effects or not. In addition, there should be a good accounting system to assess performance of these new activities.

10. Marketing

The board or delegated committees and senior management should review information system for public relation in order to maintain customer base and to make customers continuously aware of the financial institution and its services. This information should include an analysis of the market share for major activities.

Warning Signs

- Excessive marketing costs, not worth the benefits received
- Marketing efforts that present a negative image of the organization, or adverse results from marketing efforts
- A decline in market share

Rationale The increasing competition in financial services industry makes a financial institution to distinguish itself from competitors. The board or delegated committees and senior management should be marketing effort and the market share of its major services and should perform evaluation of new products or marketing programs.

Appendix 2: Assessment Scope for Corporate Governance

Introduction

According to the Bank for International Settlement (BIS) standards, supervisors should understand of the importance of corporate governance and the impact on lack of corporate performance. They should encourage financial institutions to have appropriate organizational structures and appropriate checks and balances. Supervisors should place much importance on transparency and accountability (both as individualism and professionalism) of the board, delegated committees, and senior management.

The board or delegated committees and senior management should be responsible for the operation of a financial institution. Therefore, supervisors should check to ensure that a financial institution is properly managed and pay attention to various warning signs of management not met the target or of adverse impact to a financial institution. Supervisors should encourage the management to be attentive to implement corrective measures in accordance with the examiners' instruction. When the financial institution cannot assess or control its risks, supervisors must ask for clarification from the board, delegated committees, and senior management, as well as require that corrective actions be taken in a timely manner.

Part 1 Assess if a financial institution has sound corporate governance practices

Examiners must assess whether a financial institution has sound corporate governance or not by observing its practices. Supervisors shall review the following practices:

1. Establishing of strategic objectives and a set of corporate values that are communicated throughout an organization by
 - 1.1 Determining whether the board has established a strategy for ongoing activities of the financial institution
 - 1.2 Determine whether the board has established a vision, policy, and corporate value for the organization, for the senior management, and for employees
 - 1.3 Determine whether the corporate values recognize the importance of having timely and frank discussions of problems. Such values should also prohibit corruption and bribery in any corporate activities, both in internal dealings and external transactions.

1.4 Determine whether the board has ensured that the senior management set a policy to prevent transactions that may diminish the quality of corporate governance as follows:

1.4.1 transactions not regarding the interests of a financial institution

1.4.2 clear guidelines on lending to staffs and employees and reporting to the board, including a review by internal and external auditors

1.4.3 preferential treatment for related parties and/or any other forms of favorable treatment shall have a process that allows the board to inspect, for example, lending on highly favorable terms, covering trading losses, waiving commissions.

2. Setting of clear lines of responsibility and accountability throughout an organization. Supervisors shall:

2.1 Determine whether the board clearly defines the authorities and key responsibilities for themselves, as well as senior management.

2.2 Determine whether the management is aware of lines of accountability that are unclear, confusing, and duplicated, which may cause a problem of omission of duties.

2.3 Determine whether the senior management is accountable for setting line of authority and aware of the performance results.

3. Ensuring that the board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not dominated or influenced by the management or related parties outside. Supervisors shall:

Examiners have to :

3.1 Determine whether the board receives sufficient information on a timely basis in order to assess the performance of management

3.2 Determine whether the board is capable of exercising judgment, and is free from any influence of the management and major shareholders.

3.3 Determine whether the board has qualified directors that are not members of the financial institution's management, and that can bring in new perspectives from other businesses to improve the strategic direction for the management.

3.4 Determine whether an audit committee or those with similar function are not members of the management board; such can enhance independence and objectivity.

3.5 Determine whether the board or delegated committees periodically assess their performance, determine their weaknesses, and take appropriate corrective actions.

3.6 Determine whether board strengthens the corporate governance of a financial institution by assessing whether the board:

3.6.1 understands their oversight role and their “duty of loyalty” to the financial institution and the shareholders;

3.6.2 employs a “checks and balances” function to the day-to-day management;

3.6.3 is empowered to question the management and can verify the summary or comments of the board from the clarifications of management;

3.6.4 recommends sound practices collected from various situations;

3.6.5 provides unbiased advices;

3.6.6 does not impose too much control;

3.6.7 acts to the benefits of the financial institution;

3.6.8 meets regularly with senior management and internal audit department to establish and approve policies, establish communication channels, and monitor progress toward corporate objectives;

3.6.9 does not involve in a decision process where it is incapable of providing concrete advices, except the case that it is its duty and responsibility;

3.6.10 do not interfere in day-to-day operation of the management.

3.7 Determine whether the board has given importance to setting up of specialized committees to take care of various assignments such as:

3.7.1 risk management committee to be accountable for oversight of risk management of the financial institution by obtaining information from the senior management that involves in management of credit risk, market risk, liquidity risk, operational risk, and other risks of the financial institution.

3.7.2 audit committee to play the role of supporting operation of both internal and external auditors, approving, appointing and dismissing, reviewing and approving scope and frequency of audit, as well as receiving various reports to ensure there is proper management, appropriate to a situation for the benefit of taking appropriate corrective actions, non-compliance with policies, laws and regulations, and acknowledgement of problems.

3.7.3 compensation committee to oversee remuneration consideration for senior management and staffs and ensure that compensation is consistent with the organization’s culture, objectives, strategy and internal environment.

3.8 Determine if the board involve in discussions or voting on important issues such as compensation, legal contracts with related companies

3.9 Determine if the board acts on the basis of professionalism, integrity for the interest of the organization, shareholders, and staffs.

3.9.1 Has the board taken appropriate actions to prevent any loopholes in internal control function by assessing

- Has the board established an early warning system to prevent any actions that are not of best interests to the financial institution by the board, delegated committees, senior management, or major shareholders?
- Is the organizational structure or delegation of duty to prevent loopholes restraint by the policy, for example, is the best practice publicized throughout the organization?
- Does the financial institution require the management and staffs to fully disclose all insider information?
- Are transactions, which are subject to the authorities' guidelines, between the financial institution and the board, senior management, and major shareholders subject to prior review and approval by the board or delegated committees?
- Are transactions between the financial institution and the board, senior management, and major shareholders that are subject to the authorities' guidelines, disclosed in accordance with the specified guidelines?

3.9.2 Are meeting minutes and information to be given to the board complete and adequate to support the supervision function?

3.10 Determine if the board establish a framework to ensure that its decision is independent from the management. Examiners must consider and assess the following:

3.10.1 Does the board exercise sufficient monitoring over senior management?

3.10.2 Is the overall remuneration structure for the management appropriately and periodically reviewed?

3.10.3 Has the board developed a system of management appointment, evaluation and compensation by establishing

- Selection criteria, such as job descriptions and minimum qualifications,
- Performance benchmarks,
- Monitoring guidelines,
- Compensation packages in consistent with potential
- Criteria for replacing key executives.

3.11 Determine if all executive positions clearly define the responsibilities and performance evaluation criteria by reviewing a sample of job descriptions and related performance evaluation criteria for selected positions and assess if the job descriptions clearly specify the scope of duties and compensation is based on the overall corporate objectives, not short-term profits.

3.12 Determine if there is management succession plan.

3.13 Determine if the process for nominating new management is transparent, and free from dominance.

3.14 Determine if the board members meet their key responsibilities.

3.15 Determine if the board has clearly specified, and delegated responsibility and decision making authority?

3.15.1 Does the reporting line cover all affiliated companies and are duties and responsibilities on the affiliated companies specified?

3.15.2 Is the line of authority established?

3.15.3 Are exceptions to the established policy and procedures required prompt reporting to the board or delegated committees?

3.16 Determine if the board establishes and approves the strategic guideline for the organization, supporting business plan, and budget, and other objectives, including

3.16.1 Does the board monitor the organization operation to be in line with the objectives?

3.16.2 Do all major activities, such as use of capital fund, investment in affiliated companies, approval of large credits, and large securities investment, receive prior approval from the board?

3.17 Determine if the board has established adequate and effective accounting and financial reporting systems and risk management system.

3.18 Determine if the board has established a system to ensure compliance with law, regulation, and notifications of the supervisory authority and if such system is independent and effectively functioning.

4. Ensuring that there is appropriate oversight by senior management by

4.1 Determine if the board arranges checks and balances for senior management as the senior management is key component of corporate management and has the oversight role with respect to business line managers such as directors and department managers.

4.2 Determine if key management decisions are made by only one person or not, including any inappropriate actions as follows:

4.2.1 manager is delegated to be the sole decision maker in a business line;

4.2.2 delegated manager does not have adequate skill and knowledge;

4.2.3 manager does not control over staffs or key personnel that are associated with risky transactions (such as traders).

4.3 Determine if senior management has the management authority, the necessary management skill and expertise, and adequate responsibility.

5. Does the board effectively utilize the work of the internal and external auditors by

5.1 Determine if the board or delegated committees:

5.1.3 recognize the importance of the audit process and communicate this importance throughout the organization;

5.1.2 establish measures that enhance the independence, knowledge, skills, and status of internal auditors;

5.1.3 utilize, in a timely and effective manner, the findings of auditors;

5.1.4 ensure the independence of the head auditor by his reporting directly to the board or the audit committee;

5.1.5 engage external auditors to assess the effectiveness of internal controls;

5.1.6 require timely corrective actions taken by management to the problems identified by auditors.

5.2 Determine if the board recognizes and acknowledges that the internal and external auditors are important agents and support them adequately.

5.3 Determine if whether the board utilizes the work of the auditors as an independent check on the operations of the management, separate from the information received directly from the management.

6. Ensuring that the compensation system is consistent with the organization's objectives, strategy and overall environment by:

6.1 Determine if compensation to senior management and staffs is consistent with the policy approved by the board or delegated committees and is in line with the organization culture, objectives, strategy, and overall environment. Such will help ensure that the senior management and key personnel are motivated to act in the best interests of the financial institution

6.2. Determine if the salary scales are within the scope of general business policy so as to avoid of undertaking excessive risk-taking transactions. Compensation must not tie to short-term performance such as short-term speculations.

7. Conducting corporate governance in a transparent manner.

7.1 Determine if the board or delegated committees and senior management are accountable for their actions and performance. To accomplish this, there must be transparency of information, whereby everybody receives adequate information on a timely basis.

7.2 Determine if the board or delegated committees and senior management have established a process to control and monitor and established accurate and effective communications by

7.2.1 review written policies and procedures of such function.

7.2.2 review disclosure of information covering several financial reporting periods.

7.3 Determine if the shareholders, investors in the market, and the general public receive sufficient information on the structure and objectives of the financial institution to be able to assess the effectiveness of the board, delegated committees and senior management.

7.4 Determine if there is sufficient and meaningful disclosure to the public (e.g. the most recent annual report, media reports, and authorities reports) in the following areas:

7.4.1 Major shareholders and voting control,

7.4.2 Board structure (size, membership, qualifications and committees);

7.4.3 Members of the boards of directors, delegated committees, senior management, as well as remuneration,

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- 7.4.4 Senior management structure (responsibilities, reporting lines, qualifications and experience);
 - 7.4.5 Organizational structure and affiliated companies;
 - 7.4.6 Objectives of the financial institution and progress in meeting the stated objectives,
 - 7.4.7 Information on incentive compensation structure of the financial institution (policies, executive compensation, bonuses, stock options);
 - 7.4.8 Financial and operating performance of the financial institution;
 - 7.4.9 Material risk factors,
 - 7.4.10 Nature of transactions and growth trend of transactions with affiliated companies and related parties.
 - 7.4.11 Transactions with major shareholders, the board, delegated committees, and senior management, insiders, or staffs.
 - 7.4.12 Key governance and operating policies.
- 7.5 Determine if financial statements and disclosure comply with the accounting standards.

Part 2 - Ensure that the environment is supportive of sound corporate governance

Supervisors should determine if a financial institution operates in accordance with good corporate governance, including regulations or rules of supervisory authorities and related authorities, namely.

1. Governments – through associated laws;
2. The Securities and Exchange Commission– through registration and disclosure of information;
3. Auditors – through the audit standards, reporting to the board, delegated committees, and senior management, and supervisory authorities;
4. Associations of Thai financial institutions – through Thai Banker Association, Finance Companies Association, Securities Association, Foreign Bank Association, Thai Trading Association, which bring about initiatives for principles and sound practices.
5. Legal issues, such as the protection of shareholder rights; the enforceability of contracts, clarifying role of the government, to ensure that corporation functions in an environment that is free from corruption and within the legal and regulatory framework. Such can help promote business and legal environments that facilitate supervision and sound corporate governance.

Examiners should be careful when issuing any comment regarding corporate governance. Examiners should be aware that there are external factors that are not controlled by a financial institution and do not facilitate adequate corporate governance.