


Presentation on
The Future of Card and Payments:
A Regulator's Perspective
21 September 2005

Slide # 1 : Title



สำนักงานพัฒนาธุรกรรมทางอิเล็กทรอนิกส์

The Future of Card and Payments:
A Regulator's Perspective

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Distinguished guests,

Ladies and Gentlemen,

It is my pleasure to participate in the *Cards and Payments: Asia Pacific 2005 Conference* and I want to thank the Lafferty Group for their kind invitation.

Slide # 2 : Outline


 ธนาคารแห่งประเทศไทย

Outline

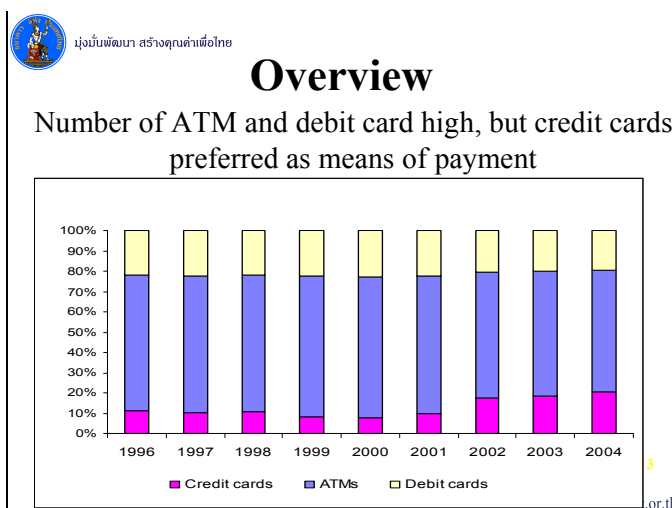
- Overview of the payments card industry.
- The objectives of payments card oversight.
- The supervisory concerns and expectations.

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Today I would like to share with you the Thai regulator's perspective on card and payment issues. First, I will provide a brief overview of the payments card industry in Thailand, followed by the rationale behind our recent regulatory initiatives governing the credit card industry. I will close by outlining our supervisory expectations – going forward- in regards to risk management and consumer protection issues.

Slide # 3 : Overview



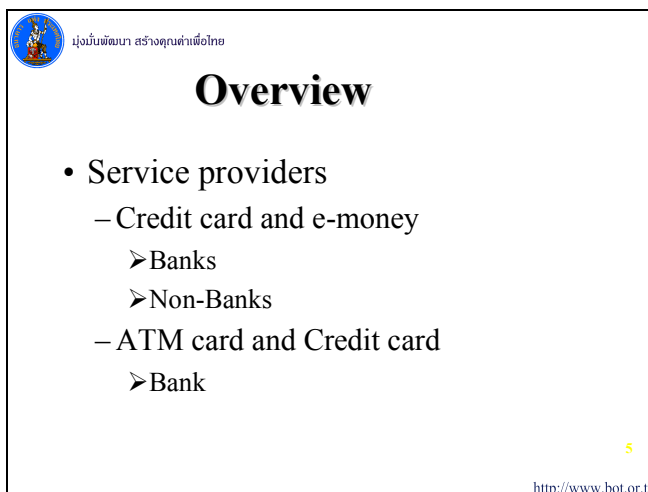
Let me begin by providing some background information on payments instruments.

First, electronic payment instruments have now become widely accepted in Thailand; and the irreversible shift away from cash based payment

modalities has been beneficial for both consumers - in terms of convenience; and for market participants- in terms of new revenue sources and greater potential for cost savings.

It is interesting to note that although the number of ATM and debit cards remain significantly higher than credit cards, consumers still prefer to use credit cards to make payments; most ATM and debit card transactions are used primarily for cash withdrawals. Not surprisingly, Thai customers' preference for settling payments with credit cards may be due to the "buy now, pay later" feature of most credit card programs; another reason may simply be the lack of consumer awareness that debit cards can be used to make payments.

Slide # 4 : Overview



Logo of the Bank of Thailand: มูลนิธิพัฒนา สร้างคุณค่าเพื่อไทย

Overview

- Service providers
 - Credit card and e-money
 - Banks
 - Non-Banks
 - ATM card and Credit card
 - Bank


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In terms of service providers, banks remain the sole providers of ATM and debit cards, but non-banks have made major inroads in the credit card and e-money businesses. At present, there are 12 credit card companies and 6 e-money companies in Thailand, which in turn has created a more competitive landscape among all service providers, including the commercial banks.

At the Bank of Thailand, we view the increased competition as beneficial for both consumers and the industry. At the same time, we also believe that there are compelling reasons- in certain cases- to extend our regulatory framework to non-bank service providers who are in the same line

of business as traditional banks. Let's explore this issue in greater detail in the next slide.

Slide # 5 : The Objective of Payments Card Oversight



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The Objective of Payments Card Oversight

- Consumer protection issue
 - To protect consumers with respect to unreasonably high interest rates and service charges.
- Competitive issue
 - To ensure a level-playing field in the payments card industry.
- Safety issue
 - To avoid card fraud that leads consumer to use less payment cards.

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The Bank of Thailand has supervised non-bank credit card companies since November 2002 and non-bank e-money businesses since December 2004. The key question that I'd like to address here, is **why** -in our collective thinking- was it necessary to prescribe regulatory guidance for non-bank credit card and e-money businesses?

This is no trivial matter, given that the conventional wisdom seems to suggest that non-bank players who do not take deposits from the public and consequently do not benefit from the BOT's "safety net" (e.g.- deposit guarantee, lender of last resort facilities, etc.) should not be subject to government regulation and supervision. From my vantage point, central bank involvement in the card business becomes appropriate-and indeed essential- when there are signs that traditional market mechanisms are not working well and/or when material public interests are at stake. Let me spend a few minutes elaborating on these points.

A few years ago, the proliferation in non-bank service providers led to a rapid growth in consumer credit, particularly among lower income borrowers.

These consumers were typically paying effective interest rates – e.g.- stated interest rate + service fees – of nearly 30% for credit cards and 58% for personal loans. While it is certainly true that gaining access to credit is critical to the welfare of all consumers, it is also true that credit access needs to be provided at a **reasonable** price and in a responsible manner. This is particularly important for the less sophisticated and lower income segment of our population who are most vulnerable to less than transparent and -at times- misleading disclosure and marketing practices of the service providers. If left unaddressed, this situation may have had profound adverse consequences from both consumer protection as well as systemic risk standpoints.

It is against this background, that the Bank of Thailand issued regulations aimed at enhancing consumer protection and for preventing the excessive build-up of household debts, especially credit card debts. In this regard, our guideline limits the size of credit lines, places a ceiling on interest rates, requires a minimum monthly income of borrowers, and establishes a minimum monthly payment program.


For e-money businesses, the Bank of Thailand requires operators to: set the scope of accountability of e-money issuers, retailers, and consumers in the event of fraud or loss of card; disclose all service fees; and establish refund policies. Collectively, we believe that these guidelines simply promote sound and ethical governance practices that should enhance consumer protection.

Another important objective of our regulatory initiatives is to ensure a level playing field in the payments card business – by bringing both non-bank and bank service providers - under a common regulatory framework.

Finally, another major component of our regulatory guidance focuses on ensuring that service providers develop adequate systems to prevent and/or to promptly detect card fraud. From the consumer's standpoint, security is a key factor in determining the extent to which they can reliably use various card

payment mechanisms. Therefore, the industry's ability to succeed in its fraud management program, has significant implications for the future growth of the cards payment industry, as major breaches of security can undermine consumer confidence. Thus, we believe that our guidelines with respect to fraud prevention seek to ensure market integrity, promote consumer confidence, and minimize losses due to card fraud. These goals- I might add- are equally shared by all service providers.

Slide # 6 : The Supervisory Concerns and Regulatory Directions in Payments Card Industry



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Supervisory Concerns and Expectations

- Sound risk management practices
 - credit risk management
 - Innovation and fraud
- Enhanced consumer protection
 - public awareness
 - robust disclosures
- Supervisory expectations vs. Regulatory initiatives

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Ladies and Gentlemen, now that you have some idea on the thinking behind our existing *regulatory* initiatives, I would like to spend the remainder of our time today to discuss our *supervisory* expectations- going forward- on the card and payment business. Our supervisory expectations center on two important issues: (a) encouraging sound risk management practices; and (b) enhancing consumer protection.

Before I get into the specifics of these two critical themes, I would first like to emphasize that there is a subtle, but important distinction between

regulatory initiatives vs. supervisory expectations. Our preferred approach is to use less intrusive supervisory methods, where we encourage market participants' to voluntarily adopt our supervisory expectations. If, however, we are not satisfied with the progress made by card payment service providers on our areas of concern, we will – if needed- issue more binding *regulatory* guidance in order to achieve our broader public policy goals of ensuring safety and soundness while fostering the fair and equitable treatment of consumers.

With this in mind, let me spend a few minutes discussing our expectations for enhancing risk management practices, beginning with credit risk management practices.

Slide # 7 : The Supervision Concerns and Regulatory Directions in Payments Card Industry



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Supervisory Concerns and Expectations

- Sound credit risk management practices
 - credit information access
 - credit origination standards
 - credit scoring systems
 - loan review, auditing, and loan workout programs

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We believe that the foundation of a robust credit risk management process begins with having access to accurate and comprehensive credit information on prospective borrowers.

In this regard, obtaining sufficient borrower credit information is the starting point for the credit approval process. Decisions on whether to extend credit and by how much *must* be made based on the repayment capacity of customers.

From our vantage point, we would like to see credit card issuers obtain a baseline level of information on the initial card applications, in order to support the approval process. In addition, any increases to existing borrower credit lines must include proper underwriting analysis to support the increases. At a minimum, credit card issuers should scrutinize their existing loan origination standards to ensure that its practices are not focused solely on increasing the size of the credit card portfolio and short-term earnings, at the expense of longer-term viability.

In addition to enhancing the credit risk origination standards of individual credit card companies, we hope that the industry as a whole, voluntarily shares its individual borrower credit data with the National Credit Bureau Company. A robust and accurate credit bureau system, will in turn, provide more comprehensive borrower credit information to all market participants. Currently, the National Credit Bureau Company has 71 members. Key members include all local banks, 2 major foreign banks, and all non-bank credit card companies.


Let me now turn your attention to the need to develop sound credit scoring systems. Given the small size and the large volume of consumer credit portfolios, it may not be feasible nor cost effective to thoroughly perform a judgment-based credit risk analysis for each applicant. In this regard, we believe that card payment operators should strive to develop robust credit scoring systems as a screening tool to weed out uncreditworthy and/or excessively high-risk borrowers.

Obviously, having access to proper credit data are the raw materials needed to build a robust credit scoring model. In addition to the borrower's personal credit information, the model should contemplate a borrower's overall credit exposure and the pattern of repayment to gauge their risk profile. We believe that the development of robust credit scoring systems can lead to enhanced credit risk decision making, informed risk-based loan pricing, and

well-founded allocations made to the allowance for bad debt. Finally, the credit scorecard can also guide the lenders' decisions on collection, authorizations, and whether to increase or decrease credit lines.

Another important element of a sound risk management process is to implement robust loan review and auditing programs. For example, loan review programs – if properly designed-can observe the spending behavior of higher risk customers (that are flagged by the credit model) and adjust credit lines accordingly. In addition, well-structured loan workout programs –that focus on maximizing principal reduction -are critical to dealing effectively with problem borrowers and for minimizing losses.

Slide # 8: The Supervision Concerns and Regulatory Directions in Payments Card Industry



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Supervisory Concerns and Expectations

- **Innovation & Fraud**
 - Credit card issuers should have resilient security and fraud management practices.
 - Business Operators should have a channel to receive problem notices or consumer complaints.

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An increasingly important element of a robust risk management process, is to develop resilient security and fraud management systems. One promising means to enhance fraud prevention systems is to upgrade existing technological safeguards for all types of payment card mechanisms- for example, the use of chip cards- which may provide an additional line of defense against fraud. In addition, service providers can also develop more

qualitative processes, such as the use of periodic audits to help detect and prevent fraud.

Finally, banks and non-banks should develop a dedicated customer complaints unit that addresses all types of complaints from customers, including fraud. A well-functioning customer complaints unit not only helps to resolve individual problems, but it can also alert the service providers with information on irregular and/or highly suspicious activities in a timely manner.

Slide #9: The Supervision Concerns and Regulatory Directions in Payments Card Industry



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Supervisory Concerns and Expectations

- Consumer Protection
 - Encourage credit card issuers to educate customer on proper and responsible use of credit cards.
 - Require the business operators to disclose information such as interest charges, service fees and other conditions in case of default.

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Let me now turn to the important issue of enhancing consumer protection.


In recent years, the credit card industry has become highly competitive, and card issuers (banks and nonbanks) have responded to increasing market competition with innovations in card products and marketing strategies. One of the by-products has been to provide credit to consumers in the lower income strata, who traditionally have had limited credit access. At the Bank of Thailand, we believe that not all of the product and marketing techniques have had a uniformly beneficial impact, particularly for the lower income and less

financially sophisticated segments of our society. From our vantage point, regulatory concerns arise when these developments carry risks that are detrimental to consumers who are not well informed on the proper uses of, and the true costs related to, their credit obligations.

Against this background, we believe that card issuers have a corporate social responsibility and indeed an *obligation*, to familiarize potential customers on the proper and responsible use of credit cards and the management of their debts. Enhanced consumer awareness and understanding can be beneficial in the long-term, from both a prudential and social perspective.

Second, the adoption of a full, accurate, and an easy to understand disclosure regime that specifies the effective rate of interest, service fees, and other conditions, are critical to enable consumer understanding of the real costs and terms of their credit agreement. This in turn, should enable consumers to better understand the financial and legal consequences of their credit relationship.

I believe that the industry can substantially improve on the quality of its current disclosure practices. From our standpoint, this is not only prudent from a good corporate citizen standpoint, but it is critical in terms of minimizing harm to a card issuer's reputational and legal risks.

Slide 10: Conclusion


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Supervisory Concerns and Expectations

- Conclusion
 - rapid increase in credit extensions to lower income, highly leveraged, and less sophisticated consumers raise safety and soundness and consumer protection issues
 - private sector solutions are preferable to regulatory mandates

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The proliferation of service providers –particularly in the credit card and personal loan business lines- has resulted in greater credit access to increasingly lower income, highly leveraged, and less financially astute segments of our society. The increased credit access may have been accompanied by aggressive marketing strategies, and unclear credit disclosure practices. These lending practices have implications for both safety and soundness and consumer protection issues. At the Bank of Thailand, we will continue to monitor these events closely and we remain hopeful that market participants will increasingly adopt better risk management practices; develop all voluntarily robust consumer education programs; and implement fair disclosure practices. Indeed, we firmly believe that private sector led solutions are certainly more preferable than regulatory mandated directives.

Thank you for your attention.