Speech

SAARC Co-operation in Facing Y2K Challenge*

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Let me at the outset congratulate the Governor of the Central Bank of Sri Lanka and his colleagues for organising a seminar on a theme of high critical relevance at this point of time, particularly for the SAARC region. I thank the Governor for inviting me to share some of my ideas on co-operation in the SAARC region in facing the challenges posed by Year 2000 problem. I deem it a privilege to be associated with such an excellent initiative.

In my address I shall not deal with the efforts and initiatives taken in India in meeting the Year 2000 Challenge, since a detailed presentation on the subject will be made by my colleagues with respect to the financial sector.

The Year 2000 problem is universal in that it exists wherever computations are done on machines that have two-digit representation of the year and are date-sensitive. Where computers hold a predominant sway in the conduct of ordinary business of human lives, the problem is likely to be acute. This indeed is the threat that highly industrialised countries are faced with. As the countries in the SAARC region have limited number of computers compared to those in the industrialised economies of the West, one would be tempted to draw a conclusion that the problem can be resolved relatively easily by ensuring that computers are Year 000 compliant. Such an approach, however, can only be partial, in that it would be a pure technology-based solution. But countries do not function in isolation. They are related to one another in a number of ways. As we all know, historically, merchandise trade has been the main point of interaction among nations. In recent years trade-related services have developed, bringing nations together. In addition, financial markets provide additional avenues for financial contact, and cross-border activities in this specific area have increased sharply since about the middle of 1980s, mainly under the impact of growing financial liberalisa-tion across the globe. Countries, as you are aware of, have increasingly adopted current account convertibility in recent years, as the initial step toward furthering openness of their economies. This is particularly evident in Asia and Latin America. A large number of developing countries have also provided relaxations in respect of a wide array of capital account transactions, and are gradually and perhaps with caution, given the recent experience of Asian economic crises, opening up their capital accounts. The growing integration of commodity, financial and services markets across the countries has been facilitated not only by sharp advances in information technologies involving interconnectivities, but also by the countries' commitment to growth with stability as the main objective of economic policy. Nations have become increasingly conscious that the scale of their activities should not be guided only by the extent of their own domestic demand. External demand has also become an additional, vital at that, element in the growth calculus. Clearly, opening up of economies would greatly enhance chances of raising real growth rates by orders that are not easily possible under closed economic regimes.

It is against this backdrop that one should appreciate the fact that it is not enough that a country is Year 2000 compliant for purposes of ensuring domestic business continuity. Such a country would not still be operable in the world of international business, if countries with which it partners and interacts are not Year 2000 compliant. Adoption of modern technologies has brought the countries together but it has also necessitated dependencies in the sense that implementation of solutions has to be all along the line both nationally and internationally in all activity processes, in order to promote the common end, namely business and economic continuity. This would imply that not only the financial sector should be Year 2000 compliant, but also all the segments of real and infrastructure sectors have to be so compliant. For, it is no use having Year 2000 compliant systems in banks, to illustrate, if the power and telecommunications that provide the essential infrastructure base to the effective conduct of financial operations, are not Year 2000 compliant. The problem has to be, therefore, addressed on a system-wide and on a global basis.

The global initiatives in this area received a strong impetus in April 1998, with the Basle Committee on Banking Supervision, the Committee on Payment Systems, the International Association of Insurance Supervisors, and the International Organisation of Securities Commission announcing the setting up of the Joint Year 2000 Council. The Council works under the auspices of the Bank for International Settlements, and Global 2000, the main international private sector body addressing Year 2000 issues. The work of the Council in recent months is of some relevance for this Conference since it provides rich insights on how best to approach the Year 2000 Challenges.

First, it is important to note the objectives of the Joint Year 2000 Council in order to highlight their relevance to the regional co-operation in the matter. The main objectives are: (a) to ensure proper co-ordination, both between the various financial sector authorities, and between private and public sector organisations in the financial markets; (b) to provide a platform for sharing of information on strategies and on developments with respect to achieving Year 2000 readiness; and (c) to assist in the policy formulation and the development of coordinated action by financial market authorities. The Council has established an External Consultative Committee (ECC) which groups a large number of international private and public sector organisations, trade and industry bodies including the world wide association for telecommunication companies, operators of international payment and settlement systems, and credit rating agencies. The Council meets at least once a quarter to review developments and take initiatives. The Council has established a global contact list of financial market regulators and central banks. The Council's website (maintained at the BIS website: *www.bis.org*) provides opportunities for global regulatory institutions to post any information on the Year 2000 problem. The 'country pages' are detailed and contain information provided by major financial market infrastructure operators on the status of preparedness. The Council has also organised a number of regional meetings, with the assistance of local central banks or regulators – at Sydney (Asia-Pacific and Transcaucasia), Frankfurt (Western and Eastern Europe), Miami (Western Hemisphere), Riyadh (Middle East and North Africa) and Pretoria (Sub-Saharan Africa).

The Council's initiatives and functioning have been very helpful for national initiatives to develop strategies to be Year 2000 compliant. Here the emphasis has to be placed not only on institutional and operational arrangements to promote Year 2000 readiness but also on policies that delineate the implementation of co-ordinated strategies within the nation and with outside world.

The SAARC Co-operation needs to be viewed in the light of the need for sharing in full and in a comprehensive manner information on the scope of the Year 2000 problem in respective countries and the measures taken by the national authorities to ensure Y2K readiness. Such information is vital for remediation and testing efforts that are already under way as also for evolving efficient business continuity plans. It is here that a proactive stance has to be adopted, since member countries of the SAARC region interface with one another in different functional areas – trade in goods and services, banking and telecommunications, to name a few. One would expect the present Conference to give important insights on the status of the Year 2000 preparations in the region and on the critical elements on which co-ordination among the national authorities is required right till the onset of the new Century.

From the SAARC perspective, it is important to focus undivided attention now on the Year 2000 Contingency Planning. This is because the initial steps of inventorisation of identified critical areas, and testing for date compliance would have already been completed almost fully by now in all the countries of the region. Contingency planning would have to ensure that all economic activities would continue to function in an efficient manner during the transition to the Twenty-first Century. Surely, it would not entail provision of mere backup for computer systems. For, if the computer systems fail, their back-ups which are replicas of the original systems, will also fail. Contingency planning has to be, therefore, about focussing on core activities in a market and business context, so that the businesses survive.

Institutions will have to critically examine the resources that they would have to put in place in the event of Year 2000 failure. It is generally accepted that in most industrialised countries resources that would have to be used for establishing business continuity plans and for implementing them will be substantial. In developing countries, however, resources will have to be spent on areas where computer systems are intensely used and are interconnected and where operations have many embedded chips. In this context, it is useful to recognise that many new businesses including financial institutions and utilities in developing countries have adopted modern technologies where computerised operations predominate. They are likely to be susceptible to risks of non-compliance and therefore, their contingency plans will need to be based on processes and systems that place less reliance on external factors that are outside the control of the institutions.

In general, contingency planning during this calendar year should take care of two major risks: (a) operational risk arising from failures in internal systems and problems with facilities such as elevators, air-conditioning, and back-up power/heating arrangements, and disruptions in the services of utilities such as water, electricity and telecommunications; and (b) credit and liquidity risks to which financial institutions are exposed. Credit risk occurs when financial loss takes place due to counterparty default or depreciation in the value of assets of the institution concerned. Liquidity risk could occur when financial institutions face unexpected cash-flow shortfalls, for example, due to the inability of business concerns to trade and settle in the context of Year 2000. There could be yet another risk that contingency planning may have to contend with, namely, reputational risk when a financial institution is not well prepared to address the Year 2000 problem and is therefore, perceived negatively by customers, counterparties or market participants.

In order to ensure that the financial system is not faced with credit and liquidity risks,the central bank authorities in India have specifically placed emphasis on the need to set in place in the last quarter of 1999 manually operable systems especially accounting and computational systems and test them for their quick and efficacious adoption. This is possible since a number of banks in India are not fully computerised and interconnectivities are found only in specific areas. This appears to be a practical and feasible solution. It is possible to adopt such a solution elsewhere in the developing world, if it has not been done so far.

It is important that banks and other institutions do not face reputational risks. They need to evolve clearcut approaches to create credibility and instill confidence of the public in the functioning of the financial sector through the Millenium change. It would be in the best interests of the sector that the public is made aware of not merely the Year 2000 problems but the status of Y2K preparedness of the sector. This can be achieved by financial institutions making disclosures on their own either through special bulletins/press releases or through balance sheets. Such self-assessments could also contain information about the contingency plans being put in place.

National authorities would also have to take three more policy decisions relating to Year 2000 problem. Governments and market regulators in some countries have announced exceptional holiday schedules covering December 31, 1999 (Friday) and/ or January 3, 2000 (Monday) in the context of Year 2000. Some other countries have not taken specific decisions on this matter. The Joint Year 2000 Council has recommended that Governments and regulators should consider the potential benefits and disadvantages of declaring exceptional holidays and announce their decisions as soon as possible. The Council has identified a number of potential benefits of declaring exceptional holiday or holidays. They are worth mentioning here.

(a) Declaration of holiday allows early start to year-end processing and back-up;

(b) It allows additional time to react and rectify problems that may be encountered; and

(c) It allows additional time to validate systems with counterparties in actual Year 2000 environment.

The potential disadvantages of declaring exceptional holidays are the following:

(i) It introduces operational complications to systems already prepared for Y2K;

(ii) It increases transaction volume to the next working day, placing stress on capacity

(iii) It places liquidity pressures and additional settlement risk across prolonged holiday period

(iv) It introduces interest and tax complexities due to shifting of contractual payment due date; and

(v) It impacts on public confidence and could send signals to the effect that the authorities are not certain of their Year 2000 preparedness.

The national authorities will have to weigh the relative power of potential advantages and disadvantages of announcing exceptional holidays. The decision in this matter cannot be based on precise quantification of costs and benefits and will have to be judgemental. In India, for example, there is no intention of declaring exceptional holidays. It appears that the Federal Reserve System too does not favour extra holidays declared on this count essentially to avoid spread of any panic. One of the main arguments in favour of the Indian viewpoint on the subject is that January 01, 1999, being a Saturday, the volume of financial transactions is likely to be limited, and it should therefore be possible for senior managements of banks to rectify the problem over the week-end, should it arise, and ensure that by January 3, 2000, the system is totally Year 2000 compliant.

There is also the issue of providing temporary and specific liquidity support in case a bank faces serious Year 2000 problem. This measure, announced recently by the Fed, is essentially in the nature of an assurance to U.S. banks that any liquidity problems that may arise in the Year 2000 context would be taken care of. The Fed also assured that it will be prepared to place adequate hard cash in circulation, should the demands for cash transactions rise at the end of December 1999. This problem may not, however, be acute in the SAARC region where use of hard cash for transaction purposes is very high. The issue of liquidity support to banks in the specific Year 2000 context may not arise in the region but central banks in the region will have to make a determination on this issue as the new Millenium approaches.

The Joint Year 2000 Council also raised an issue of considerable relevance in the present day context of industrial restructuring. Financial authorities were recommended to consider, while evaluating merger and acquisition proposals, the firm's preparedness for Year 2000 and its plans for ensuring that Y2K does not impede the firm from expanding the size or scope of its operations. This problem is likely to be more serious in industrialised countries than in developing countries. However, it is important not to lose sight of this problem, since there is growing evidence in recent years of increasing number of mergers and acquisitions in the SAARC region as well, under the impact of the ongoing financial liberalisation efforts.

From the SAARC viewpoint, it is necessary to see that there are no disturbances in cross border transactions owing to Y2K problem. From all accounts, it appears that SWIFT programme on Year 2000 has gone on course, providing a great deal of reassurance and comfort to all the users of SWIFT. However, at this stage, it is important to monitor all the channels for communication of documentary credits and remittances for their validation and for successful implementation of their contingency plans.

There is very limited time available from now on till the onset of the next Century and therefore, information sharing in the region on the Year 2000 problem has to be quick, intensive and focussed. It is for this reason, the idea of information sharing has to be spelt out in some detail. It is probably essential to identify persons for contact, call them Y2K Councillors if you like, drawn from each central bank of the region and let them interact with one another each month on matters of concern from the Year 2000 point of view, and to provide possible resolution to the problems that they fear would arise. The stress is on interaction rather than on face to face conferencing, and only if need arises, the Y2K Councillors could meet, preferably not before the middle of December 1999 to review and discuss problems that may affect the business interests of the region and that remain to be addressed. While ideally, the Councillors should keep in touch with one another on the Global Year 2000 efforts on an individual basis, their reports, and evaluations of the developments in regard to Year 2000 problem would have to be formalised and co-ordinated through the office of the Chairman of SAARCFINANCE. This office on receipt of information sharing reports by the middle of each of the remaining months of 1999 from each Councillor, will quickly prepare an overall report giving the regional preparedness on Year 2000 problem. By the middle of November, there would be four reports from each Councillor and four comprehensive reports from the office of the Chairman of SAARCFINANCE. The Chairman may have to decide at that point of time whether the Councillors should be brought together in a Conference to discuss problems that have cross border implications having impact on the SAARC region's economic interests. The Councillors may also be allowed to continue with their work beyond January 1, 2000, till the current uncertainties about the Leap Year issue are firmly resolved. It is only after the Year 2000 issue is fully settled both nationally and globally, should the institutional arrangement of Councillors be dismantled.

Finally, let us make sure that there is transparency in the practices and measures taken to resolve the Year 2000 problem, so that the public confidence in the working of our economic systems is furthered. This is essential also to give a boost to the ongoing economic reforms aimed at bringing about structural changes in the economies of the SAARC region. Our individual and co-ordinated actions to face up to the Year 2000 Challenges will truly be a value addition to the growth and stability of the region.

*** Keynote address by Dr. A. Vasudevan, Executive Director, Reserve Bank of India at SAARCFINANCE - Y2K Conference on Year 2000 Problem and Regional Co-operation for Business Continuity in the Banking Sector at Kalutara (near Colombo), Sri Lanka on July 12, 1999.**