

**Mr. Meister reports on the Year 2000 problem from the perspective of German banking supervisors** Luncheon speech by Mr. Edgar Meister, a member of the Directorate of the Deutsche Bundesbank, at the Year 2000 meeting of European central banks and financial regulators organised by the Joint Year 2000 Council and the Deutsche Bundesbank in Frankfurt/Main on 30/10/98.

## I

I am pleased to contribute to this conference on the Year 2000 and how the millennium date change poses a very significant risk for financial institutions and markets.

The media have now been reporting regularly, and sometimes with flashy headlines, on the many problems which the Y2K problem or “millennium bug” can pose to the economy and public administration. One has visions of planes crashing, assembly lines coming to a standstill, pensioners being asked to register for school, babies receiving old age pensions, contracts becoming null and void, or deliveries being interrupted.

We are all well aware that the Year 2000 problem impacts on the whole economy and the public administration. Therefore, joint action must be taken now if we are to avoid potentially serious problems down the road.

Acting in my role as a central banker and as chairman of the Banking Supervision Committee of the European Central Bank, my primary concern is on the role financial institutions play in this context. That is why I want to take this opportunity to give you a short overview on the implications of the problem on the financial sector and a brief summary of the measures taken by German banking supervisors to promote and intensify the necessary Year 2000 preparations.

## II

In the banking and insurance sectors, the impact of systems being insufficiently Year 2000 compliant can be particularly drastic. Some vivid examples are the possibility of interest and redemption payments on loans being calculated inaccurately, statements of accounts and insurance periods being updated incorrectly, cheques and credit cards being rejected by ATMs (automated teller machines), and futures contracts being cancelled.

However, the more pressing risks are to be found in the danger that payment systems might collapse, liquidity bottlenecks might occur, and the number of credit defaults might increase, owing to Year 2000 problems on the part of banks’ customers. For this reason, banking supervisors have alerted the banking industry to the possibility of significant changes in customers’ behaviour occurring at the end of 1999 as far as their demand for cash goes. A lack of public confidence in the ability of the financial sector to solve the Year 2000 problem could trigger increased withdrawals of deposits and demand for cash.

The particularly close technical and financial interdependency within the banking sector, as well as with all sectors of the economy (owing to the banks’ corporate customers), makes it necessary to take particularly comprehensive action. Not only must the banks’ own systems be reassessed but also the Year 2000 preparations being made by their business partners.

There is a further factor that compounds the situation: Germany and the other member states of the forthcoming European Monetary Union must deal with the dual challenge of preparing their computer programs for the changeover to the single European currency and at

the same time take the necessary preparations for the century date change. Numerous parallels show up here, and what we nowadays call “synergy effects” are the result. They will surely be limited, yet they do clearly exist, such as in cashless payments.

For one thing, there is a heightened awareness of how to handle such cross-country and cross-system conversion processes, for which there is hardly any historical precedent. For another, completely new procedures such as the cross-border TARGET system have been developed. In these systems, it was possible to take timely account of the changeover to the Year 2000, which will take place in 427 days. The absolute necessity of preparing these systems anew for the euro has allowed the Bundesbank and the credit institutions to simultaneously make virtually countless EDP systems in the accounting sections and “back offices” Year 2000 compliant.

The practical experience which must almost inevitably be gained during the weekend of the changeover to the euro from 1998 to 1999 will also provide welcome knowledge that can be used for the century date change. It will probably once again become clear to all those involved that the interplay of different systems can be different in real life than in a test scenario, however realistic it may be. The Year 2000 changeover has a different type of complexity than the introduction of the euro, since there is an interaction between different EDP applications, system components and external software components, as well as processor-driven systems. Substituting the euro for the DM will involve the organisation of workflows and operating procedures; in computer-related terms, that means new software must be installed. However, in the changeover from December 31, 1999 to January 1, 2000, the hardware components of the EDP systems, i.e. the nearly innumerable number of chips, must be transformed.

The Bundesbank and the credit institutions, which were already required to play a pioneering role when the euro was introduced, are again forced to play a key role in getting the financial sector ready for the millennium date change. Responsibility for the overall coordination of the exchange of information and ideas on this problem among the various sectors of industry, though, is in the hands the Federal Government. (To this end, the Federal Ministry of Economics has set up, among other things, a Year 2000 expert group in its ministry, in which representatives of the most important sectors of industry and administration affected by the problem are actively participating.)

### III

What measures are German banking supervisors taking to help the financial sector achieve a successful crossover to the new millennium?

German banking supervisors do not and cannot even dare to guarantee that banks will be fully compliant; rather the emphasis is on ensuring that

- banks’ senior management have focused on the scale of the problems facing their institution,
- they are taking responsibility for solving them,
- the banks systematically plan the relevant projects and implement them in a timely manner, and
- they have contingency plans in place to rectify any slippage or system failure.

Since the beginning of their Year 2000 activities in 1994-95, and particularly since 1997, the Bundesbank and the Federal Banking Supervisory Office have been leaning on the

banking industry to press ahead with its Year 2000 preparations with great intensity. Therefore the state of the banking industry's preparations for the Year 2000 is also a major focal point of ongoing banking supervision.

On-site validation procedures through independent auditors during audits of the banks' annual accounts for as early as the year 1997 constitute one important point. Another very important action is a Year 2000 survey conducted in June 1998. The Federal Banking Supervisory Office and the Bundesbank asked all the approximately 3,600 credit institutions under supervision and 200 stockbrokers in Germany about their Year 2000 preparations. The analysis of the preparations is supplemented by personal discussions of banking supervisors with individual credit institutions, particularly those having branches and subsidiaries abroad. Immediate actions are taken where the existence of the institution is in jeopardy owing to insufficient preparations for the Year 2000.

With regard to the timetable, German banking supervisors have not set any official target dates, yet they have made it perfectly clear in discussions and surveys that the external testing of these systems should be completed by mid-1999. This target date will also be used for the final prudential assessment of the state of preparations of individual credit institutions.

Although legal problems, particularly liability issues, are being given increased attention in connection with the Year 2000 problem, no legislative changes are currently being envisaged, because the legal system is flexible enough to cope with these problems.

Ladies and gentlemen, the turning of the clock at midnight on December 31, 1999 cannot be postponed - as you all know. Time is a scarce asset with regard to the necessary preparations. As all credit institutions are depending on each other to be sufficiently prepared, the issue is hardly a factor of competition. On the contrary, an exchange of experience and information is crucial in order to enhance the efficiency of the changeover work. Therefore, the Federal Banking Supervisory Office and the Deutsche Bundesbank have been playing a proactive role in coordinating the efforts across the financial institutions: at their instigation, the Central Credit Committee (ZKA) established a forum comprising several banking associations for exchanging experience on the Year 2000 problem at the expert level. The Federal Banking Supervisory Office and the Deutsche Bundesbank are involved in the forum's work.

Supporting the banking industry in its efforts to solve the Y2K problem is an ongoing process that will continue until the crossover takes place. Nevertheless, I must reiterate that the ultimate responsibility lies with the management of the individual institutions themselves. This is why handling the Year 2000 problem responsibly is a criterion for the Federal Banking Supervisory Office when assessing whether or not banking business is being conducted properly.

#### IV

I could go on and on about the supervisory aspects of the Y2K problem. However, a luncheon speech does not seem to be the appropriate setting to go into too much detail.

Furthermore, when I look at the impressive programme of this conference, it seems to me that all the important elements of this topic will be covered by this morning's and afternoon's panels.

However, looking at a lunch as a social event, one aspect of the Y2K problem comes to my mind that is not covered by today's programme and that might be worth bringing to your attention - if nothing else, at least as a potential problem in the course of the century date change that deserves thought. Let me call it the social aspect of the Y2K problem.

New Year's Eve 1999/2000 will be a social event of major proportions, according to some people even an event of biblical significance. Millions of people will drive either to one of many organised New Year's parties or to pay a visit to relatives or friends in order to celebrate the new millennium. Are you aware of the fact that there are about 30 different data-dependent embedded chips in a modern-day automobile?

Getting to the parties before midnight should not be a big problem. However, imagine what will happen to the mood of the parties if cars stop working after the millennium date changes, which would mean the parties would have to continue, but the second and third glasses of champagne would only be lukewarm at best because all the refrigerators are out of order?

V

However, looking at some humorous side effects of the problem does not make it any less serious for society in general. Looking at the international banking system as a whole, I believe that we have already made considerable headway in limiting the possibility that Y2K disruptions will have systemic consequences for our markets. However, we must all continue to work hard in the time remaining to ensure that the existing threat can be averted to the greatest possible extent.

In that spirit, ladies and gentlemen, I would like to conclude my remarks and commend the Joint Year 2000 Council for organising such regional conferences. They take account of the fact that in a globalised economy, a worldwide effort is necessary to successfully face the challenges of the Year 2000 computer problem.