Mr McDonough discusses sound banking systems: a new growth imperative

Speech by Mr William J McDonough, President of the Federal Reserve Bank of New York, before The Monetary Authority of Singapore, Singapore, on 24 March 2000.

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I am delighted to be with you today. It's a special pleasure to be among so many old friends and colleagues.

It's also a great pleasure to be in Singapore under such happy and promising circumstances. Just two years ago, financial and economic conditions throughout Asia were rather grim and the outlook was uncertain. But since then, to the great credit of the people of Asia, significant progress has been achieved. In Thailand, Indonesia, Malaysia and especially Korea, meaningful headway has been made toward recapitalizing the banking systems, ridding banks' balance sheets of problem assets, and improving supervisory and regulatory frameworks.

And that hard-earned progress on the banking front is already bearing fruit. The economic contraction that devastated so many in the region has generally been halted and even, in some countries, impressively reversed. Equity markets have rebounded impressively, and yields on government securities have been cut by nearly two-thirds as foreign capital has begun to return. Without question, this is truly a remarkable turnaround.

It must also be acknowledged that the economies of Asia are not out of the woods just yet. Important and even difficult work still lies ahead. At this critical juncture in the Asian recovery process, I think it is worth reviewing just how important a stable banking and financial system is to the health and vitality of any market economy - and particularly emerging market economies - and the crucial role that supervision plays in achieving and preserving financial stability. Indeed, effective supervision represents a crucial cornerstone of financial stability, both locally and globally. It is also clear that, given the accelerating pace of change and innovation in the financial services industry, our notion of supervision must encompass discipline applied by the marketplace, as well as official supervision.

With these thoughts in mind, and noting the critical role banks play in a market economy, in my remarks today I will discuss the nature and form of an effective supervisory framework for the 21st century, addressing the role to be played by banks themselves, the broader marketplace and official supervisors. On the subject of official supervision, I will address the Basel Committee's Core Principles for Effective Supervision, and then conclude with a discussion of the Committee's major initiative to revise and refine the 1988 Capital Accord.

Banks' role in a market economy

Let me first discuss the crucial role banks play in a market economy. While specific arrangements may vary from country to country reflecting differences in history, custom and culture, the basic principles are common to nearly all market economies.

Bringing savers and borrowers together

As we all know, starting a business, expanding an existing business, or embarking on any other kind of creative or entrepreneurial enterprise, requires money - investment capital. Therefore, any society's long-term economic prospects are best served when households and businesses freely decide to save part of their current income.

But the decision to save is not, in itself, sufficient to ensure economic growth and prosperity. Some institutional mechanism must exist through which society's savings can be collected and channeled into productive investments. Moreover, because savers will naturally perceive risk in parting with their money, they must be induced to entrust their savings to that institution that can then put their capital to work in sound and productive ways.

For this to happen, a class of financial institutions must exist that the public views as a safe and convenient outlet for its savings, where at least some fraction of those savings are maintained in the form of highly liquid assets, and assets by which payments for goods and services can be made quickly, easily and safely.

The single dominant class of institution that has emerged to play this crucial role of intermediating between savers and borrowers is the commercial bank. In virtually all countries, banks function as the repository of a large fraction of society's liquid savings and the entities through which payments are made. Even in mature industrial societies with highly developed capital markets, the commercial banking system continues to be the most important single element of the financial system.

Transaction accounts - the means of intermediation

The prominent position of banks in the financial systems of market economies around the world stems from their unique role as the issuers of transaction accounts. Transaction accounts are bank liabilities that are immediately payable on demand at face value - "at par" - and that are readily transferable to third parties. Because a depositor may transfer or convert into currency the balance of a transaction account on demand, such accounts are often referred to as "demand deposits". Owners of transaction accounts can withdraw deposited funds, write checks up to the full amount in the account, or transfer a portion or the full amount of the account to a third party. The liquidity, acceptability and transferability of these accounts induce savers to entrust their savings to banks, and facilitate the broad range of transactions that sustain economic activity.

The unique capacity to incur liabilities that are payable on demand at par distinguishes banks from all other kinds of institutions, and is the determining characteristic that enables banks to perform their essential functions in a market-based economy. Banks are also the only type of institution that can create transaction accounts by way of the lending function, and thereby expand the money supply by way of the money multiplier. The flexibility of credit and liquidity that banks provide - stemming from this unique capacity to create transaction account liabilities - is vital to the smooth development and growth of market-based economies.

Other essential functions

This money-creating capacity also enables banks to perform other essential functions. For example, banks serve as the primary and back-up source of liquidity for other classes of institutions, financial and non-financial. Even in advanced financial systems, the capital markets rely heavily on the banking system to meet day-to-day cash flow needs and to provide standby financing facilities. In addition, the banking system is the mechanism, or transmission belt, by which the policies of the central bank regarding money and credit creation are implemented, and the pace of economic activity determined.

Simply stated, without an effectively functioning banking system for encouraging, collecting and deploying society's savings, providing the means for quick and reliable payment, and performing these other essential functions I've just mentioned, there would be little hope for any economy to mobilize the real resources necessary for economic growth and stability. If money and credit are the lifeblood of a market economy - and they are - the banking system is its beating heart.

Public confidence - the key to intermediation

But banks' ability to collect and mobilize society's savings by attracting deposits is only half of the story. Their ability to retain those deposits is just as critical. This may seem an obvious point, but the retention side of the banking equation is too often forgotten or overlooked.

The willingness of savers to entrust their money to a bank presupposes that those savers have confidence in the financial integrity of the institution - in other words, that their savings will be available when they need or want access to them. If that confidence is undermined, society's ability to collect and deploy its savings will be impaired, and the principal means to economic growth and rising living standards - intermediation by banks - will be short-circuited. With this reality in mind, it must be acknowledged that, in the final analysis, commercial banks have only one asset that really matters - public confidence.

Sound lending - the key to preserving public confidence

The key to maintaining the financial integrity of any banking company - and, therefore, to preserving the all-important asset of public confidence - is the credit process. If credit is extended carelessly, banks are likely to incur losses, which in turn will undermine their ability to honor deposit obligations. And if banks' ability to honor deposit obligations falls into question, if the public's confidence is undermined, households and businesses will likely rush to redeploy their savings, raising the specter of a flight to cash and real assets with all the associated implications for inflation and destabilizing runs on banks. The best defense against this serious and very real threat is for banks to extend credit wisely, objectively and impartially.

In this connection, it should be emphasized that, because of the inherently partisan nature of politics, and for other reasons as well, the government or state is not well-equipped to make credit decisions. Recent experience here in Asia, and before that in the former command economies of Eastern Europe, makes clear just how dangerous "policy lending" can be. Decisions as to who gets credit and who does not must be left to private initiative within a context where those making the decisions have a major stake - their own capital and economic livelihood. If the system is working properly, those receiving credit will be the most efficient, competitive, and profitable - those most capable of producing the stream of goods and services that will enable the economy to grow and, as a result, for living standards to rise.

The purpose of supervision - preserving financial stability

This, then, is the fundamental tension of commercial banking - how to meet the credit needs of a healthy and expanding market economy, which necessarily entails the taking of calculated risks, and yet preserve the confidence of depositors whose savings are the raw material that enable banks to perform their essential functions. Negotiating that tension, helping banks meet that challenge, is the critical task of supervision.

And so what is the purpose of supervision in the 21st century? What are the objectives? How can those objectives be best pursued? Let me say first of all that there is no quick-fix or single answer. The 21st century financial marketplace is too dynamic, too complex, and supervisors must work within the political realities of our respective nations. Instead, what I envision is a flexible, multi-faceted strategy that emphasizes prudence and prevention, compatibility with the market, and that fosters a close and cooperative partnership between the private and public sector.

With these priorities in mind, I believe there are three essential elements of a modern supervision framework:

- effective bank-level management;
- market discipline; and
- official supervision.

Let me discuss each of these in turn, noting that each should reinforce the others to effectively promote a safe and sound financial system.

Effective bank-level management

Primary responsibility for the safe and sound operation of a banking institution lies with its board of directors and senior management. The purpose of the board of directors is to oversee the development of the overall strategy of the organization and the decisions made by senior management in pursuit of those strategic objectives. The role of senior management, in turn, is to oversee day-to-day decisions made within the organization and to ensure their consistency with long-term objectives and policies as determined by the board.

There are several aspects to effective bank-level management. First, I would underscore the importance of good corporate governance, the basic elements of which include:

- independent and competent outside directors;
- capable and experienced management;
- a coherent corporate strategy and business plan; and
- clear lines of responsibility and accountability.

Together, these elements contribute to an overall operating process conducive to long-term health and prosperity. A tightly run ship with a disciplined crew led by an experienced and competent cadre of officers is far better able to survive a long journey that will inevitably confront sudden storms.

Closely related to good corporate governance and critical to any banking institution's well-being is a rigorous internal control apparatus. Of course, effective internal control systems have always been centrally important to sound banking. This point becomes clear if we consider for a moment their basic purposes:

- to provide reasonable assurance that the bank's and its customers' assets are safeguarded, that its information is timely and reliable, and that errors and irregularities are discovered and corrected promptly;
- to promote the bank's operational efficiency; and
- to ensure compliance with managerial policies, laws, regulations and sound fiduciary principles.

With these purposes in mind, it is clear that the success of any banking organization depends on the effectiveness of its internal control apparatus. And never has this been more true than today. As the activities of commercial banks have become increasingly diverse and complex, internal controls have become critically important to the sound and successful execution of banks' strategic objectives.

I want to stress this point as strongly as I can. As a former commercial banker myself, I know there is a powerful temptation for management to focus its attention and resources on the front office - those areas and individuals that generate profits for the institution. But if something goes wrong in the back office, it can quickly become the most important aspect of a bank's operations. It is essential that sufficient resources, staff and managerial attention are devoted to the back office and internal audit functions.

Firmly rooted on the foundation of good corporate governance and rigorous internal controls is the central importance of effective risk management. As I mentioned earlier, banking by its very nature is a business of taking calculated risks. If they didn't take risks, banks could not perform their essential functions in a market economy. But sound banking also entails the prudent management of those unavoidable risks. Each banking institution must have in place the technical systems and management processes necessary to identify the risks associated with its activities - lending and otherwise - and to effectively measure, monitor and control those risks.

But even if an institution has an effective risk management and control structure in place, that structure must also be accompanied by the institutional management culture required to ensure that written policies and procedures are actually translated into practice, with buy-in at all staff levels. And ultimately, an institution's culture is determined - once again - by the board of directors and the senior management it chooses to install. Management must take active steps to ensure that their commitment to an operating environment that includes effective risk management and rigorous controls filters down the line of the organization.

To summarize, these aspects of effective bank level management - good corporate governance, rigorous internal controls and effective risk management - constitute a kind of internal safety net and represent the first and most important line of defense against potential problems. And this will increasingly be the case as the activities of banks and other financial institutions become more complex and more global.

Market discipline

After effective management at the bank level, the second line of defense against financial instability is market discipline. As financial institutions and their activities become more complex, diversified and global, market discipline becomes an even more important ally of the official supervisor.

Of course, effective market discipline is not possible without meaningful public disclosure. While significant progress has been made in recent years, it unfortunately remains the case that disclosure practices have not kept pace with the rapid changes in banks' business activities and risk exposures, and with how these exposures are measured and managed. For this situation to be fully remedied, notions of what is proprietary information and what should be in the public domain need to change. Knowing a company's appetite for risk and its approach to, and methodologies for, managing risk is essential to understanding the risks of being a shareholder, a creditor or a counterparty. I strongly encourage all financial market participants to approach the issue of disclosure as *users* of financial statements rather than as issuers. What we all need to know about each other to be comfortable and secure in making our credit decisions should drive the debate, rather than concerns about proprietary information.

There is little question about the urgency of achieving dramatic progress in this area. Clearly, a full appreciation of risk cannot be achieved without sufficient information. All of us know that there is no greater enemy to a stable financial marketplace than a loss of confidence - and nothing undermines confidence more than a lack of reliable information. Discipline imposed by markets might not always be pleasant, but more, higher quality information - in a word, transparency - bolsters the confidence of depositors and other creditors and therefore makes doing business easier and more secure.

Here in Asia, as in other markets, more work needs to be done to improve the quality of disclosures regarding traditional banking activities. Time and again experience has shown that in periods of stress, insufficient or inaccurate information about asset quality can lead to rumors and overreactions in the marketplace, creating the potential for problems to spread to institutions that may otherwise be in good health.

Of course, progress on the disclosure front will be limited until accounting standards are enhanced to ensure proper valuation and to reflect innovations over the past decade, both in terms of new products and modern risk management techniques. Accounting systems serve a variety of purposes, but none more important than helping creditors make rigorous decisions as to which enterprises meet market tests of efficiency, competitiveness, and profitability that are necessary for those enterprises to fulfill their obligations. Sound accounting systems also enable investors to determine the value of enterprises, and, in so doing, assist in attracting capital, both foreign and domestic. With these important purposes in mind, ongoing efforts to enhance accounting standards worldwide should continue and even intensify.

There is also a need for greater harmonization of accounting standards across countries. We simply must get to a point where supervisors and market participants alike can analyze and compare all internationally active financial institutions on a consistent basis. And it will not be possible to have uniform capital standards until we have achieved some consistency in accounting standards across countries. I'll have more to say about market discipline and its role in the evolving framework of regulatory capital in a few moments.

Role of supervisors

While effective bank level management and meaningful market discipline are crucial elements of an overall strategy for promoting and preserving financial stability, neither can substitute for the critical role played by official supervision. While banks perform functions that are indispensable to the success of any market economy, these same functions, by their very nature, introduce risks that are capable of undermining the prospects for such success. This reality was acknowledged by Adam Smith over two centuries ago in his seminal tract *The Wealth of Nations*. And it is with this fundamental reality in mind that governments have long recognized that banking and other financial institutions must be subject to at least some form of regulation and official oversight.

The reasons for official supervisory intervention in the banking system, and in the financial system more generally, can be summed up as promoting financial stability and minimizing systemic risk. This is a broad mandate - one that encompasses the responsibility to ensure that markets operate in a fair, transparent and efficient manner, and that participants comply with the rules of the game.

Indeed, supervisors bring a number of comparative advantages to the table that enable them to play this critical role in the broader supervisory framework. First, supervisors have clear incentives to monitor risks to the financial system as a whole. While each financial institution is best positioned to monitor its own risk exposure, it does not have the incentives to internalize the costs it may impose on other financial institutions should it experience difficulties.

Second, supervisors are able to obtain and monitor proprietary information about an institution's risk exposures, its management information systems and its internal controls when such information is not publicly disclosed.

Third, supervisors are in a unique position to observe trends across groups of financial institutions and, based on these insights, to provide the industry with a perspective on what constitutes best practice.

Fourth, official supervision is needed to enforce compliance with applicable laws and regulations. We have observed that poor compliance, beyond simply being wrong, can result in serious operational problems, including capital allocation deficiencies, managerial oversights and increased reputational risk. As we have seen, such problems can threaten the wellbeing of a financial institution and carry the potential for systemic risk.

Finally, supervisors are able to assure that prompt corrective actions are taken when serious financial or other problems are identified, particularly if the problems are not known to the market. The importance of the role supervisors can play in problem cases, both through public enforcement and through other less visible means, cannot be overstated.

Changes in the financial services industry present new challenges for how official supervision is to be carried out most effectively. It is clear that the fundamental approach, scope and methodologies of official supervision must evolve in line with the way financial institutions manage their activities, which increasingly is along business lines rather than legal entities.

With this in mind, we as supervisors should continue our efforts to develop a more dynamic, risk-focused and process-oriented framework, reflecting the reality that banks and other financial institutions are increasingly able to alter their risk profiles at will. By "risk-focused", I mean that supervisory resources should be directed at the most material risks to which the institution and its capital are exposed, given its array of business activities. By "process-oriented", I mean that examiners and auditors should ascertain whether management processes and methodologies are sufficiently rigorous and effective, given the institution's identified risks. Institutions that demonstrate a sound control structure and effective management processes should be subject to less intrusive supervision than institutions that do not have this essential infrastructure in place.

As I alluded to earlier, specific supervisory arrangements, practices and techniques vary from country to country depending on differences in culture, financial system structure and internal political realities. Having said that, a set of basic principles can be identified that should guide all supervisors in an increasingly interconnected, global financial marketplace. In 1997, the Basel Committee on Banking Supervision issued a set of twenty-five Core Principles for Effective Banking Supervision intended to serve as a benchmark against which the effectiveness of particular supervisory regimes can be assessed. If you're not familiar with the Principles, I'm pleased to bring them to your attention today.

The Core Principles document brings together concisely all of the fundamental elements needed to carry out effective bank supervision - a remarkable achievement in its own right. Equally important, in my view, the document also balances the desire to set high standards for supervisory practices with the pragmatic recognition that not all countries are in the same stage of financial market development. As such, the Core Principles document is of particular importance for developing market economies, as it establishes a clear set of standards against which each country's current approaches and progress can be measured.

It should be emphasized that, in attempting to craft a document that would have the legitimacy, quality and flexibility to meet the needs of bank supervisors around the world, the Committee made a conscious effort to consult broadly throughout the various stages of the project, and particularly with supervisors from emerging market nations. Some might argue that such extensive consultation slows down the process and dilutes the final product. I strongly disagree. Only through this inclusive approach could we design comprehensive principles with broad applicability and support.

Last October, the Basel Committee, in cooperation with the IMF and the World Bank, produced a follow-up document called the Core Principles Methodology. This report was initiated in response to requests from a number of countries for additional guidance on how to interpret and implement the Core Principles. The methodology document provides specific criteria for evaluating and implementing each Core Principle. One set of criteria focuses on issues deemed essential for the minimum implementation of the Core Principles; the other focuses on those issues deemed to represent "best practice". The IMF and the World Bank currently use the new methodology to assess the banking sectors in individual countries.

It should be stressed that the most important efforts to implement the Core Principles are occurring in individual countries and, with this in mind, I am pleased to say that approximately 120 countries - including many here in Asia - have now endorsed the Core Principles. Without the support and backing of national authorities to follow through with the implementation of these principles, our broader efforts simply cannot be effective.

In this connection, the Basel Committee has long recognized the need for effective training of participants in the global supervision community, and over the years has sponsored numerous programs which have been beneficial in allowing supervisors from different countries to share experiences and exchange ideas for improved practices. In 1998, the Basel Committee, along with the Bank for International Settlements, jointly established the Financial Stability Institute, which conducts leadership training of supervisors in emerging market countries and facilitates technical assistance.

This May, the Basel Committee plans to bring together supervisors from emerging market countries and representatives from the IMF and World Bank to discuss the lessons learned from this initiative. The May meeting is part of the Committee's ongoing commitment to ensure that the Core Principles remain current and relevant to bank supervisors worldwide.

Let me move on to the Basel Committee's initiative to revise the 1988 Accord. As you know, capital has played, and continues to play, an important role in the supervisory tool kit. Adequate capital helps ensure that shareholders monitor the risk of financial institutions, and that management puts in place and maintains appropriate oversight mechanisms to help prevent problems from surfacing in the first place. Should an institution experience difficulties, capital serves as a buffer to absorb losses and reduce the risk of spillover from a problem institution to other financial institutions.

The primary tool of capital regulation currently is the set of minimum ratios that were devised in 1988 by the Basel Committee on Banking Supervision. They were set forth in an agreement known as the Basel Accord, and were adopted, among other reasons, to address the slide in international capital levels that was occurring over the previous decade. The Accord was clearly a milestone achievement - for the first time, supervisors in G10 countries were able to use a common yardstick for assessing banks' capital adequacy.

But the Accord has a number of serious shortcomings. For example, it does not adequately differentiate among degrees of credit risk and, as a result, banks have had incentives to take on higher risk exposures within broad risk categories. Banks have also tended to engage in transactions that lower capital requirements without reducing economic risk.

In addition, it has proved difficult to incorporate into the Accord's simple risk-weighting scheme the innovations of the last decade in the way banks manage and mitigate risk. As market risk management techniques developed, we were able to incorporate a state-of-the-art, value-at-risk approach in a 1996 Market Risk Amendment. Still, as credit risk management techniques have advanced, and as the importance of operational risk management has increasingly been recognized, it has become apparent that the long run relevance and efficacy of the Basel ratios as an indicator of capital adequacy has been eroded.

Supervisors have long known that analyzing simple capital ratios in isolation can lead to incorrect conclusions about the relative strengths of institutions. Thus, we also have relied on a review of banks' capital plans and on market discipline to assess capital adequacy. In June of last year, the Basel Committee formalized the link between these elements when it released a Consultative Paper laying out our vision for a new, more refined capital adequacy framework.

In addition to establishing minimum capital requirements, the proposed framework places increased emphasis on the supervisory review of capital adequacy and the role of market discipline. We refer to these elements - minimum standards, supervisory review and market discipline - as the "three pillars". Together these pillars mutually reinforce safety and soundness by aligning capital relative to risk and by encouraging prudent risk management. This evolution in the Committee's thinking about capital adequacy follows from much of our recent work on risk management and the surveys we have conducted on banks' disclosure practices. It is also consistent with the broader notion of supervision I've discussed today.

We encourage comments on the Committee's proposals from both supervisors and industry participants through 31 March 2000 - which is next week - and plan to publish, hopefully early next year, a comprehensive set of proposals that will be responsive to the comments and input we have received.

Let me highlight briefly each of the three pillars and provide some perspective on the key challenges that the Committee faces in relation to each. The first pillar is minimum capital requirements. To address the shortcomings in the 1988 Accord, the Basel Committee has proposed two primary approaches:

- an enhanced standardized approach that ties risk weightings to external credit assessments such as credit ratings; and
- an internal ratings-based approach that would begin by mapping internal risk ratings into standardized risk weightings, but might eventually evolve into something closer to the full use of credit risk models.

Each approach treats the trade-off between simplicity and accuracy somewhat differently and thus one or the other is likely to be relevant to banks with different levels of sophistication. Most importantly, both proposed approaches attempt to introduce greater risk sensitivity into the minimum capital standards to address the unfortunate incentive problems that have evolved from the 1988 Accord.

Some observers - including, perhaps, a few in this room - have noted that the effort to incorporate greater risk-sensitivity into the framework inevitably introduces procyclicality into our standards. That is, the capital requirements for loans to troubled borrowers will tend to increase at just the point when such trouble is becoming apparent. This is an important point, and one that we at the Committee are working to address. It is my view that the global financial system needs to move toward addressing potential credit problems preemptively - before these problems have time to grow from minor disturbances into major disruptions. To best accomplish this objective, any supplements to regulatory capital should be incremental or graduated, rather than a sudden ratcheting that could potentially reinforce a cyclical downturn.

The second pillar in the proposed new capital adequacy framework has to do with the supervisory review of capital - a critical complement to minimum capital requirements. The Consultative Paper proposes that supervisors should ensure that each bank has sound internal processes in place to assess the adequacy of its capital based on a thorough evaluation of its risks. In evaluating the strengths and weaknesses of a bank's internal allocation process, supervisors would draw on, among other things, their knowledge of best practices across institutions.

I want to stress that this proposed approach in no way intends to replace the judgment and expertise of bank management, or to shift responsibility for capital adequacy to supervisors. On the contrary, it is well understood that bank managers have the most complete understanding of the risks their institutions face, and it is they and the bank's directors who have primary responsibility for overseeing those risks. The task for supervisors in this framework is to evaluate how well banks are assessing their capital needs relative to their risks, including whether banks are appropriately addressing the relationship between different types of risks. Most importantly, in proposing this second pillar the Basel Committee intends to foster a more active dialogue between banks and their supervisors.

The third element in the proposed new capital adequacy framework is market discipline. As I discussed earlier, more extensive disclosure and a greater dependence on market discipline complements improvements in bank-level management, official supervision and minimum capital standards. Some areas that we at the Federal Reserve believe are good candidates for greater disclosure would include components of regulatory capital, risk concentrations and transactions involving recourse, such as securitizations.

To the extent that banks develop disciplined internal approaches to evaluating capital adequacy, and greater disclosure enhances market discipline, supervisors will be able to place greater reliance on all three pillars and reduce regulatory inconsistencies. The common interest is to keep the Basel standards as a floor sufficient to ensure financial soundness, but above which banks themselves will choose to operate.

Conclusion

In conclusion, we clearly have an ambitious agenda for perfecting and refining the supervisory framework for the twenty-first century. In implementing this agenda, we should always keep in mind the fundamental objective - preserving financial stability so that banks and the broader financial system can effectively perform their critical functions in a market economy. There is no question that the more effectively a banking and financial system operates, the more likely the economy is to flourish and the citizens of that society to prosper.

This is particularly true in many emerging market economies that have a relative scarcity of savings in relation to their large-scale investment needs. The banking sector in emerging market economies also tends to be more concentrated and represents a larger share of the domestic financial system, suggesting that, if problems occur, they are likely to have an amplified effect on the real economy and on the fiscal cost associated with bank rescue and resolution costs.

In pursuing the objective of financial stability, we must also acknowledge that both the public and private sectors have a critical role to play. While the perspectives of market participants and official supervisors may differ from time to time, our objective is the same - to maintain a strong and vibrant financial system over the long term. Indeed, it is clearly evident to me, as a former commercial banker and now as a supervisor, that only if we work together, each meeting our responsibilities and reinforcing the other, will we be able to successfully manage and supervise a rapidly evolving, ever-more complex financial services industry.