## Willem F Duisenberg: The role of the Eurosystem in prudential supervision

Speech by Dr Willem F Duisenberg, President of the European Central Bank, on the occasion of the conference organised by De Nederlandsche Bank on the 50th anniversary of Dutch banking supervisory legislation, Amsterdam, 24 April 2002

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I am very pleased to be here tonight on my "home ground" and to participate in this conference celebrating the 50th anniversary of Dutch banking supervisory legislation. I would like to thank President Wellink for giving me the opportunity to meet with this distinguished group of experts and former colleagues who have come together to discuss highly topical issues in the field of banking supervision.

The law enacted 50 years ago formalised the role of De Nederlandsche Bank in banking supervision. These duties had to some extent developed "organically", through the history of the Bank, out of its original function as provider of liquidity to commercial banks and its gathering of statistical data from them. I should probably not boast too much as I was myself involved in overseeing the Dutch banking system in my former position as the President of De Nederlandsche Bank. However, the supervisory system in the Netherlands has been undeniably successful. Dutch banks – like the financial system as a whole – have prospered and steadily improved their efficiency, and the stability of the system as a whole has generally withstood structural changes and episodes of financial market turbulence.

The fact that we are celebrating a supervisory law which was established so long ago might give an image of a static regulatory and supervisory system. Some sceptical observers even take the general view that supervisory structures are rigid and are only ever discussed critically after major disruptions in the financial system.

As we know, this image does not correspond to reality. In the Netherlands, many adjustments have been introduced over time in response to market developments rather than crisis events. For instance, co-operation mechanisms between the authorities in charge of supervising banks, securities firms and insurance companies were established – in the form of the "Raad van Financiële Toezichthouders (RFT)" – in reaction to the growing importance of financial conglomerates and the development of close links between different financial products. Moreover, the Dutch Ministry of Finance proposed last year – with subsequent approval by Parliament – to strengthen the role of the central bank in the prudential supervision of banks and financial conglomerates and to establish even closer links with the prudential supervision of insurance companies. These responsibilities are separate from the tasks of overseeing the conduct-of-business and consumer protection aspects. Among other things, this model honours the close links between the systemic stability interests of central banks and the prudential supervision of financial institutions. Financial stability is always in the direct interest of central banks, because of its importance for the successful conduct of the basic central banking tasks in the fields of monetary policy and payment systems. Although one should always be cautious in exporting national institutional structures to other countries, the Dutch model might provide useful insights to others.

The current supervisory landscape in other European Union countries, as well as at the Community level, is also far from being static. Discussions of the appropriate institutional structures and mechanisms have intensified both at the national and European level. These debates are very healthy and demonstrate an active response by policy-makers to the development of cross-sectoral links in the financial industry, as well as to the changes brought about by the euro and financial integration.

Tonight, I would like to review briefly these national and European discussions. As the issues are manifold, I would like to concentrate on the role of the national central banks and the Eurosystem in prudential supervision. The role of the Eurosystem is rooted in the Maastricht Treaty, which gives it the task of contributing to prudential supervision and financial stability, while keeping the primary responsibilities in these areas at the national level.

Let me first turn to national developments. Following the creation of the Financial Services Authority in the United Kingdom, proposals have been put forward in a number of European countries, for instance in Austria, Germany and Ireland, to set up a single supervisory authority in charge of all financial institutions. In some cases – unlike here in the Netherlands – the proposals have also included a reduced role for the central bank in prudential supervision, while increasing the responsibilities of the separate supervisory agency. In ten out of twelve euro area countries, the central bank is still either directly responsible or otherwise closely involved in the operational conduct of supervisory duties. Only in Luxembourg and Belgium this is not the case, and in the latter a reform is being proposed that increases significantly the involvement of the central bank.

As we have often said, the Eurosystem strongly supports a continued involvement of national central banks in prudential supervision, although the institutional set-up of financial supervision needs to be tailored to the structure of the respective national financial system. Any solution other than direct responsibility should be coupled with close co-operation and operational involvement of central banks in order to allow the potential synergies between central banking and prudential supervision to be exploited. Central banks' knowledge of the overall economy and financial system, and their information from payment and settlement systems and monetary policy operations, are valuable for the performance of the supervisory tasks. Conversely, for central banks, supervisory information can play an important role in the oversight of payment and settlement systems and of market infrastructures, and in managing liquidity crises.

Strong comments have been made against this view. The most often used arguments against central bank involvement in supervision have been the increasing importance of financial conglomerates and the blurring of the distinction between the three segments of the financial sector. These developments would call for the establishment of a single financial supervisor which should not be the central bank – the argument runs – since this would worsen conflicts-of-interest between central banking and prudential supervision and would lead to a concentration of power. In my view, one should not be too dogmatic about these arguments. Situations in which such conflicts of interest would arise are very rare in practice and central banks, like all other public bodies, are subject to accountability procedures. In any case, these concerns are dispelled in the euro area setting by the fact that decision-making takes place at different levels: euro area-wide for monetary policy, national for prudential supervision.

The arguments for keeping central banks closely involved in prudential supervision are even reinforced in the context of Monetary Union. More integrated financial markets can absorb shocks more easily than in the past, which is a very beneficial outcome. However, if shocks do occur, they are likely to have a wider impact across borders through wholesale banking and capital market links – or through payment and settlement systems. Thus, the contribution of the Eurosystem to monitoring vulnerabilities in the financial system on a euro area-wide basis will be greater if the central banks are extensively involved in prudential supervision.

Let me move on to the European debate. The Economic and Financial Committee has already assessed the adequacy of the existing arrangements for prudential supervision and the safeguarding of financial stability in the European Union in the two reports produced under the chairmanship of Henk Brouwer from De Nederlandsche Bank. I wish to congratulate him on these important achievements. The outcome of this analysis was that the current institutional system based on national responsibility is appropriate, but there is a need to strengthen cross-border and cross-sectoral co-operation between supervisors, to enhance convergence in supervisory practices and to reinforce collaboration between supervisory and central banking functions. The Eurosystem supports these conclusions. There are clear benefits in keeping supervision close to the institutions being overseen at the national level, while financial integration requires co-operation between the relevant authorities to be stepped up.

In my view, positive developments have already occurred in the implementation of these recommendations. For example, the Banking Supervision Committee of the European System of Central Banks – chaired by Deutsche Bundesbank Directorate member Edgar Meister – has enhanced and continues to develop its regular monitoring of the soundness of the European Union banking system as a whole, as well as its analysis of structural banking and financial developments. These activities rely extensively on the close and constructive co-operation established within the Committee between central banks and banking supervisory authorities. Indeed, the Eurosystem regards the promotion of co-operation between central banks and supervisory authorities as one of its main contributions in the field of prudential supervision. However, the full implementation of the "Brouwer recommendations" requires additional work in order to establish an effective information exchange – both in times of calm and in times of crisis – and to achieve further convergence in supervisory practices.

In addition to the financial stability considerations, the issue of supervisory co-operation also needs to be looked at from the angle of the efficiency of the financial system. Indeed, increasing attention is being paid by policy-makers and market participants to the remaining inefficiencies in the financial sector and the residual obstacles to financial integration. For instance, the recent “Gyllenhammar report” drew attention to the need for greater standardisation of supervisory compliance requirements and practices because of the cost burden on financial institutions developing cross-border businesses. These conclusions were further reinforced in the recent report by the Economic and Financial Committee under the chairmanship of yet another compatriot of mine – Kees van Dijkhuizen, the Dutch Treasurer-General.

In a similar quest for greater efficiency, considerable attention has also been paid to the Community regulatory process, with emphasis on the need to achieve swift rule-making and consistent implementation in different Member States. The recent institutional agreement achieved on the implementation of the “Lamfalussy procedures” represents a major step forward in the field of securities regulation. It removes the burden of detailed and cumbersome regulation at the Community level by delegating rule-making powers to a committee of regulators and by promoting consistent implementation at the national level through a committee of supervisors. Extending such a mechanism to banking and insurance would probably also produce tangible benefits, though differences existing between the three sectors should be taken into account. As we know, a particularly important regulatory exercise is ahead in the transposition of the new Basel Capital Accord into the EU regulatory framework, in which the European Commission will play a key role.

All in all, there are strong reasons to continue deepening supervisory co-operation at the EU level. The current debate on how to achieve this objective is intense, and not yet finished. I perceive the part played by the Eurosystem in nurturing this debate not – as it has been suggested – as an attempt to enhance the supervisory role of the ECB but instead as a constructive contribution to setting up a comprehensive architecture for an effective multilateral supervisory co-operation. The latter, I believe, is a common goal of central banks, supervisory authorities and ministries of finance.

In the banking sector, the Eurosystem feels – in line with what I highlighted earlier – that there is a need for continued involvement of central banks in multilateral supervisory co-operation, along the lines of the work of the Basel Committee on Banking Supervision. I would definitely not welcome a solution that would alter the current situation by excluding central banks without supervisory responsibilities from supervisory co-operation. Firewalls should not be unnecessarily created between central banks and supervisory bodies. The Banking Supervision Committee of the ESCB is an existing EU forum catering for co-operation between central banks and supervisory authorities. In principle, it could also be suitable as a forum for co-operation between banking supervisors, provided that it operated in a setting which ensured an adequate degree of autonomy for this activity.

To conclude, I would like to congratulate De Nederlandsche Bank, as well as the Dutch Ministry of Finance, on their constructive contribution to the recent European and global developments in supervision and regulation. I also wish you the best of success for the continuation of the conference tomorrow.