Klaus Liebscher: Regulatory challenges for European financial markets

Opening address by Dr Klaus Liebscher, Governor of the Austrian National Bank, at the CEPR/ESI Annual Conference: "Regulatory Challenges for European Financial Markets", Vienna, 20 September 2002.

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Ladies and Gentlemen,

It is a great pleasure for me to welcome you all to the conference "Regulatory Challenges for European Financial Markets" hosted by Oesterreichische Nationalbank. I am particularly grateful to the Centre of Economic Policy Research (CEPR) and Professor Eijffinger, Dr. Hochreiter and Professor Koedijk who have organized this academic conference with a highly interesting selection of papers on a very important topic.

The financial system fulfils several essential functions for the performance of the real economy. It plays a crucial role in the allocation of resources by channelling funds from households to enterprises, it provides risk-sharing opportunities for households and firms and it helps agents to economise on transaction and information costs. An economic environment in which these functions can be fulfilled smoothly and efficiently is therefore essential for the welfare of an economy.

The accelerating process of European integration has abolished various obstacles that were previously in place because of national boundaries and different legislations. And the development of a single financial market in Europe has led to a situation where the financial system can fulfil its core functions much better than it could fulfil them two decades ago.

This integration process has been accelerated and reinforced by the introduction of the single currency. Its success has supported the process of financial market integration and structural change. There are good reasons to believe that we are only at the beginning of this process.

But financial market integration by itself is not enough to guarantee that the financial system can fulfil its functions efficiently. It has been clear to economists and policy makers for a long time that financial markets can only work smoothly and efficiently, if they can rely on a complementary legal and regulatory infrastructure. Thus the economic integration of European financial markets has to be accompanied by the necessary adoptions of regulatory frameworks and regimes.

The topic of the conference is therefore a very important one. The problems that arise in this process are a big challenge for supervisors and regulators. They are also a challenge for central bankers because central banks are traditionally among the institutions closely involved in the supervision of the financial system.

The regulatory challenges for European financial markets arise from a combination of necessary adaptations to general technological developments such as, for instance, electronic money - an issue addressed in the lectures of this conference - and the specific problems that arise from the integration of regulatory regimes that have previously been separated by national boundaries and different legislation into a framework that works efficiently for a newly integrated financial market with a single currency.

The debate about regulatory issues has attracted much attention recently by intensive discussions both at the national and the European level. At the national level the focus of the debate has been the future role of central banks in the process of prudential supervision of the banking system. The issue most intensively discussed at the European level has been the question of a centralized versus a decentralized model of supervision. These debates reflect the active response of policy makers and the general public to developments in financial markets brought about, inter alia, by the process of European integration.

Let me address these issues in turn:

At the national level we have been observing various proposals to reorganise and restructure financial markets supervision. Some countries have already taken steps of major institutional reforms.

In the course of this debate the active involvement and the key role of central banks in supervising the banking system has repeatedly been challenged. Models of new national institutions in charge of supervising banks, financial markets and the insurance industry under one roof of a general financial service authority have gained some popularity among politicians.

The merger of various supervisory fields, which have technically quite different tasks, is a highly ambitious and rather difficult organisational problem. In the same way as with mergers in industry the advantages and disadvantages of these organisational forms will have to be assessed in the light of practical experience.

Whatever reorganisation design is under debate, however, it is in any case of crucial importance to take a clear position about the role of the central bank. It's historically intimate involvement in supervising the banking system has proved useful in many countries around the world and there is a strong case for keeping this close involvement under any model of supervisory reorganisation.

The close involvement of central banks in the supervisory process has various advantages. It gives the central bank a much clearer picture of the economic reality that is behind the numbers visible in the books of banks. This information facilitates its role in safeguarding financial stability and creates a special advantage in spotting early warning indicators of financial crises and potential situations of economy wide financial distress. Moreover, as a part of the Eurosystem central banks are integrated in an already functioning network of national and supranational institutions. Such a network is of decisive importance in the light of the structural change in European financial markets that already has taken place or is likely to come in the near future.

Let me next turn to the debate about the European regulatory framework. The Economic and Financial Committee (EFC) has only recently provided an assessment of existing arrangements in the Brower Report. A central result of this assessment was that the current framework that strongly relies on national responsibilities is appropriate. The report found that there is at the same time a need to enhance arrangements for cross-border and cross-sectional co-operation, to improve the alignment of supervisory practices and to reinforce the collaboration between supervisory and central banking functions.

I want to point out that developments have already started that implement some of these recommendations. Let me just mention the activities of the Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB). These activities strongly rely on the close cooperation between central banks and banking supervision authorities.

Not only in the area of banking supervision, but also in recent attempts to implement the Lamfalussy recommendations in the field of security market regulation considerable progress has been made. Consistent and efficient implementation of regulatory rules has been promoted by new institutional arrangements delegating rule-making powers to a committee or regulators whereas implementation at the national level is undertaken through a committee of supervisors.

These two examples, which I have briefly touched here, illustrate that initiatives are under way and debate is ongoing. However, not all of the recommendations of the Brower Report have been implemented and many other issues still need further investigation and debate. But developments show that we are heading in the right direction.

I have argued that policy makers and central banks are well aware of the regulatory challenges for European financial markets. They have already tried to find some practical answers to these challenges. These answers are based on the principles of national responsibility, transnational co-operation and the close involvement of central banks into the supervision of the banking system. Clearly, many issues in this process are still open and need further discussion. But I am sure that your conference will make an important contribution towards a deeper understanding of those issues and to point out directions, where further activities are needed.

CEPR/ESI Price for the Best Central Bank Research Paper

Ladies and Gentlemen,

It is a great pleasure now for me to announce the **winner of the newly established CEPR/ESI Prize for the Best Central Bank Research Paper**. This price shall promote high-quality research at European central banks, both within and outside the Eurosystem. It is important to acknowledge research papers by young European central bankers. Therefore, the CEPR European Summer Institute has established a special session of its annual conference for the three to four best submitted papers and an annual prize for the very best research paper.

The paper was selected from twelve central bank research papers by the Programme Committee of this year's CEPR/ESI Conference consisting of Professor Sylvester Eijffinger, Eduard Hochreiter and Professor Kees Koedijk.

It is my privilege to announce that the CEPR/ESI 2002 Prize for the Best Central Bank Research Paper goes to **Elena Carletti of the University of Mannheim and Philipp Hartmann from the European Central Bank for their paper "Competition and Stability: What's Special About Banking?"**.

They examine the relationship between competition policies and policies to preserve stability in the banking sector. The core part of the paper is an analysis of the relative roles of competition and supervisory authorities in the review of bank mergers for the G-7 industrialized countries. It turns out that the widely accepted trade-off between competition and stability does not generally hold. The paper is considered by the Programme Committee as an excellent analytical contribution to the academic literature on central banking and banking supervision with important consequences for competition and supervisory policies.

I wish the winners of this year's prize a lot of success in their very promising academic and central banking career!