Mr. Meister discusses the future of money and financial services Statements by Mr. Edgar Meister, a member of the Directorate of the Deutsche Bundesbank, to be put forward at the Generation Bridge Symposium "Money tomorrow" in Eltville on 11/9/98.

First statement:

Supervisors are open to innovations in banking business — but banks and financial intermediaries in general must be able to manage the risks arising from new techniques.

Supervisors have never stood in the way of innovations in banking, but instead have always worked hard to give entrepreneurs in this field a reliable legal basis for product development. For example, the legal definition of banking operations in Germany was extended to include prepaid card business and network money business by amending the Banking Act.

Yet attention must always be paid to sensitivity in confidence and to possible dangers for the functioning of the financial system. Disruptions in payment transactions — even the defaulting of a financial market participant — can rapidly affect financial markets adversely and even hamper the development of the real economy.

Things are only in their infancy. The issuance of electronic money should generally be restricted to banks. That is primarily for reasons of safety; banks as issuers of electronic money are regulated and monitored according to prudential guidelines. To keep monetary policy efficient the option to introduce minimum reserves on electronic money makes sense.

Second statement:

Recent financial crises have proven again: progress in information technology and new risk management techniques cannot replace solid capital requirements for banks.

Internal risk models for the calculation of capital requirements for market risks are important innovations in the field of risk management - supervisors respect such developments. But risk models are not infallible. Against the background of recent

financial crises there are some doubts whether short-term high market volatility has always been covered adequately by the assumptions of the models (which use 250 days averages for volatility).

Credit risk models which are developed now can help to measure credit risks more exactly. Capital requirements however must cover all risks of a bank, i.e. operational and legal risks, too. Consequently a licence to use credit risk models or generally new risk management techniques must not result in weaker capital requirements for banks considering generally rising risks in the financial world.

Precisely the recent financial crises demonstrate how difficult it is to determine bank-specific risks with sufficient accuracy. Own capital as a cushion for losses is therefore a modern prudential requirement.

Third statement:

The banking world will be changing even faster - but neither the size of a financial institution by itself nor applying modern strategies are guarantees of quality.

The process of concentration in the banking industry will continue and probably result in fewer banks as well as a general increase in the size of units.

Mergers in Germany are in many cases welcome, as they improve the viability of institutions. The idea here is to safeguard the diversified nature of business inherent in the universal banking concept through suitably sized banks. The situation is different in the United States, where mergers sometimes take place in order to surmount the restrictions on business imposed by the specialised banking system and to achieve a higher level of diversification.

Mega-mergers have the disadvantage of making structures less transparent and groups more difficult for management to control. On the whole, the number of institutions which, in terms of systemic risks, are "too big to fail", will rise.

Alternatively or complementary to the massive growth we are seeing in many places at present, specialisation, the return to core business or measures denoted by the term „lean banking", i.e. the attempt to reduce costs by outsourcing activities, shrinking the range of in-house banking services or purchasing outside services. From an economic point of view these may be important strategies for the banks in the future, but outsourcing must never affect regularity of business or the possibility to control business for the management as well as for the supervisory authorities.

Fourth statement:

Changes in the banking scenery also affect supervisors - supervision must be kept efficient, time has not come for an „outsourcing" of core functions of supervision.

Supervisors must also react on global integration. One proposal to reform supervision is to leave supervision and development of supervisory concepts to a large extent to the market, respectively to a small group of global players. Supervisors are open to new approaches. There are, however, some fundamental reservations against this proposal.

The current proposals of self regulation do not respect the context between stipulating risk control norms and the responsibility for preventing systemic risks. More self regulation would simultaneously require that market participants take over major responsibility for preventing systemic risks and therefore setting up private agencies to intervene during liquidity crises. But as long as private institutions are not prepared to install such agencies and to take over responsibility for systemic risks, time for outsourcing of essential elements of supervision has not come.

Fifth statement:

In the information age, central banks can operate as an anchor of prudential supervision owing to their "natural" presence in the market.

The central bank establishes contacts with market participants and receives valuable information almost automatically by virtue of its market presence; similar to a seismograph, it may record tremors in the financial system at an early stage and react accordingly. Moreover, in many cases the central bank is in a good position to strive for market-enhancing and prudentially justifiable deregulation and technical innovations.

However, during liquidity crises, central banks should not assume an official, predetermined function of "lender of last resort" because of the associated problem of moral hazard. Instead, liquidity crises should be solved by private or semi-private agencies before they reach the central bank. In Germany the Liquidity Consortium Bank serves as an example for such strategy in case of liquidity problems.