Opening Remarks

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To most people, the words “central bank” evoke monetary policy and bank notes. In recent years, however, central banks that have not had an explicit mandate to supervise the banking system are paying greater attention to the efficiency and stability of the financial system, especially in the wake of the banking crises that struck the Scandinavian countries in the early 1990s and Asia between 1997 and 1998. A number of central banks followed the lead of the Bank of England and created a division to specifically address the issue of financial stability as distinct from monetary stability.

In 1999, the Bank of Canada formally acknowledged the importance of setting goals for the financial system and resolving the issues related to financial stability. One year ago this month, the Bank launched the *Financial System Review*, a quarterly publication intended to discuss changes and trends, to take note of recent policy developments, and to summarize current research. This year, the financial system became one of the Bank of Canada’s five core functions, alongside monetary policy, currency, financial management, and services related to retail investments.

In the area of financial system stability, central banks have always been concerned with systemic risk and systemic issues. This concern arose from their historical role of lender of last resort, and has been manifested in the central banking services provided to key clearing and settlement systems, as well as to the oversight of these systems.

Since the concept of contagion is closely related to systemic issues, it is appropriate that the first session of the conference be devoted to that topic. Contagion in the financial system can be connected with either inter-relationships between or among financial institutions or the transmission of shocks from one financial market to another. Both types of contagion are, in a sense, considered in the first session.

Countries with weak financial systems have often experienced substantial instability. From a safety and soundness perspective, therefore, regulators and central banks have been concerned about financial institutions whose asset mix is not suitably diversified and about financial institutions exploring new product areas that they may be familiar with. Central banks are also concerned with the efficiency of financial markets and recognize that diversification could improve the efficiency of financial institutions (for example, if economies of scope are present). Diversification issues are the focus of the second session of the conference.

Capital standards have been seen as one way of dealing with the safety and soundness of banks. Basel I was the first major step in the direction of risk-based capital requirements and in the direction of raising capital levels. The level of Basel capital requirements is likely one reason why Canadian banks and large international banks in general have come through the recent economic downturn relatively unscathed—in strong contrast to the situation in the early 1990s.

But the distortionary nature of some of the classifications in Basel I became increasingly apparent and was one impetus towards the development of Basel II, now well along. Academics, however, have raised questions about the approach to capital regulation, as well as to many of the details of both Basel I and Basel II. Consequently, it is appropriate that the third session of the conference, as well as the memorial lecture, deal with issues regarding the regulation of bank capital.

There are other aspects of the regulatory system that are important, and a number of them are examined in the fourth session. In the world after Enron and WorldCom, there has been an increased emphasis on corporate governance. And in central banks—especially inflation-targeting central banks—there has been growing emphasis, at least in the monetary policy area, on greater transparency and accountability, as well as on other governance issues, including the appropriate degree of independence of central banks. So now is an ideal opportunity to ask questions about the appropriate governance of financial regulators and of central banks in their role in the financial stability area, including their transparency and accountability.

Indeed, here at the Bank of Canada, as we are reviewing the policies surrounding our role as lender of last resort, we are asking questions about the suitable degree of our transparency and accountability in this area. As well, questions arise regarding the governance of financial institutions themselves. The last two papers in the conference are devoted to questions regarding the governance of these two types of organizations.

As is characteristic of our annual conferences, we have a broad representation of papers from academia, foreign central banks and international institutions, and the Bank of Canada itself. This year, we are fortunate to have Professor Douglas Gale of New York University to give the John Kuszczak Memorial Lecture. Our wrap-up panel features Chuck Freedman, my predecessor as Deputy Governor; Angela Redish of the University of British Columbia, a former special adviser at the Bank; and Claudio Borio of the Bank for International Settlements.