The financial architecture and control measures of the financial institutions

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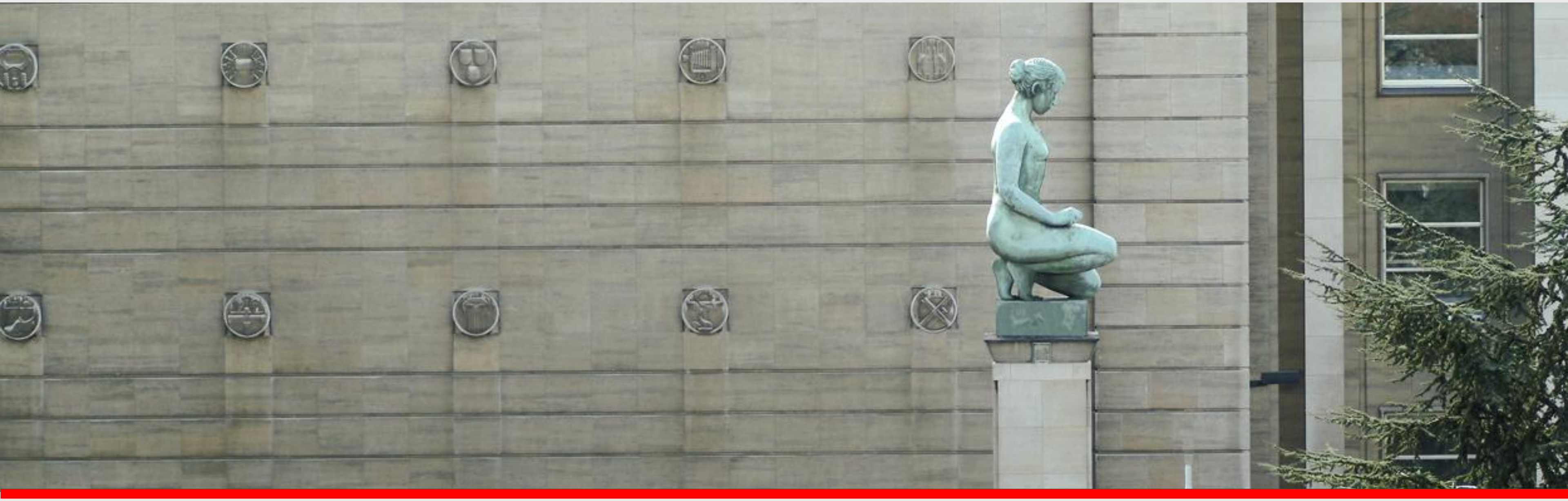

NationalBank OF BELGIUM

Eurosystem

1. Introduction

- In the aftermath of the crisis, ambitious reforms have been launched:
  - they concern all financial system stakeholders (financial institutions, credit-rating agencies, mutual investment funds, prudential supervisory authorities, etc.)
  - they target all stages at which risks are taken
    - normal periods during which there could be excessive risk-taking
    - crisis period during which risks materialise
  - they target not only prudential rules, but also the whole financial architecture

- The three main lines of the presentation
  - oversight: strengthening the prudential supervision framework
  - prevention: tightening up the requirements on the financial sector
  - intervention: reinforcing the crisis management framework

2. Strengthening the prudential supervision framework

- Tension between:
  - the micro-prudential approach of national supervisors
  - global and systemic nature of crises

  → need to tighten up the macro-prudential approach

- How can the macro-prudential approach be reinforced?
  - by defining instruments to make macro-prudential policy more operational
  - striking a balance between macro-prudential supervision and market integration
    - on a geographic basis
    - at sectoral level

- Reforms underway
  - At European level: European Systemic Risk Board being set up
  - At Belgian level: implementation of twin peaks model

3. Tightening up the requirements on the financial sector

- Re-regulation process
  - aiming to strengthen credit institutions' capital base and liquidity reserves: for example, Basel III
    - core own funds: from 2% at the moment to 4.5% in 2015
    - capital conservation buffer: 2.5% from 2019 onwards
  - harder to negotiate in a multipolar context
    - risk of ending up with just the lowest common denominator
    - may require local complements (e.g. governance in Europe, Volcker Rule in the United States, etc.)
  - involving a lobby pointing up the costs
    - i.e. cost for financial institutions and possible repercussions for growth
    - Conversely, some studies show that the cost is only temporary and quite small compared with the collective benefit (see Cecchetti, 2010, Admati et al., 2010)

4. Reinforcing the crisis management framework

- Reinforcing the crisis management framework is essential...
  - whatever the prudential requirements, the chance of a crisis occurring can never be ruled out
  - crisis management mechanisms have an influence on the way in which stakeholders behave in normal times

- ...but extremely difficult:
  - since highly technical subjects are involved:
    - for example: harmonising the power of banking resolution authorities, bankruptcy laws, etc.
  - with implications for cost-sharing
    - with the private sector:

      → how can costs be imposed on the private sector before the State intervenes?: bail in, contingent capital, etc.
    - between authorities from different countries

      → repercussions for allocating supervisory tasks and responsibilities

5. Conclusions

- Essential to tackle the whole issue and to work on the three axes at the same time
  - Prevention
  - Supervision
  - Crisis management

- Arduous work because there is a lot of resistance
  - coming from the financial sector
    - which is mixing up defence of its own interests with the collective interest (capacity to finance the economy, for instance)
  - and from the national authorities
    - that have to act within the limits set by their national legislative framework
    - that represent national interests
    - anxious to defend their powers

- The reforms therefore have to be born out of compromises that must draw the line between private and collective interests, while giving priority to the common good