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What is the appropiate structure for managing systemic risk? What are the important challenges for the EU in this regard?

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Frankfurt, 15 June 2012

Outline

- What is the appropiate structure for systemic risk?

- Structural Changes: the HLWG mandate

- What are the Particular Challenges for the structural reform in Europe?

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- **What is the appropiate structure for systemic risk?**

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First consideration: there is already a very wide range of banking structures in Europe

Structures differ by:

- Product: Universal/diversified/monoliners

- **Customer:** Retail/Commercial/Investment

- **Geography:** Domestic/European/Global

- **Size:** small, medium, large, TBTF

- **Ownership:** cooperatives, savings/foundation based, equity-based

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Second consideration: There is already a regulatory structure in place

- Single market for financial services
- Common currency in part of the EU
- National supervision with supranational coordination (Basel agreement, EBA, ESRB, supervisory colleges)
- National resolution schemes:
  - within the EU state-aid framework
  - with some ad-hoc supranational coordination
  - With national fiscal backstops

Third consideration: Recent history

- **Underlying assumption**: any banking structure could be managed with: internal management, market discipline and appropiate prudential supervision

- **Evidence:**
  - Institutions were neither managed by management nor supervised by supervisors
  - Micro supervision did not take into account systemic vulnerabilities
  - Institutions did not have enough capital
  - Too much reliance on (apparently) liquid markets
  - Fiscal burdens from the sector hugely underestimated

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Preliminary consideration: Regulatory changes under way

Since the start of the crisis, lots of changes in financial supervision/regulation

- Supervision requirements: Basel III,
- Capital surcharges: G-SIFIs, national measures
- Resolution regimes, resolvability
- Transparency
- OTC derivatives, CCPs
- Europe infrastructure: ESRB, ESAs, crisis management

Is there a need for additional measures?

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High-level Expert Group on reforming the structure of the EU banking sector

- Group created by Commissioner Barnier on February 2012

- Members: Erkki Liikanen (Chair), José Manuel Campa, Louis Gallois, Monique Goyens, Jan Pieter Krahnen, Marco Mazzucchelli, Carol Sergeant, Zdenek Turma, Herman Wijffels,

- Hearings and open consultation has taken place

- Expected report by end of summer 2012

The Mandate of the Group

- Consider the need for structural reforms of the EU banking sector or not.
- Pay particular attention to:
  - Ongoing structural reforms (UK ICBC, Dodd-Frank, Volcker)
  - Reduce the risks of the banking system as a whole
  - Reduce the risks that individual firms pose to the financial system
  - Reduce moral hazard by making market exit a viable option
  - Promote competition
  - Maintain the integrity of the single market

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- Structural Changes: the HLWG mandate
- **What are the Particular Challenges for the structural reform in Europe?**

Let´s Focus on three challenges

- Reduce systemic risk and burden from financial sector

- Preserving the internal market

- Challenges of a common currency

Reduce Systemic burdens from financial sector

Goals in principle similar to other jurisdictions:

- Provision of payments systems
- Provision of deposit-taking entities
- Channelling of savings to investment for households, business and governments
- Reduce burden to fiscal accounts
- Enhance robustness of financial system

Preserving the Internal Market

- **Structures that are consistent with**:
  - Avoiding systemic risk across the internal market and within each national jurisdiction
  - Avoid shifts in systemic risk to other areas of financial sector
  - Minimize fiscal burdens within the internal market
- **Structures that do not**:
  - detract from the effective provision of financial services across the single market
  - Distort competition within the EU single market
  - Create competitive disadvantages with third countries
  - Generate incentives for regulatory arbitrage

Challenges of the common currency

The scope of geographical mandate between sovereign and central bank is different

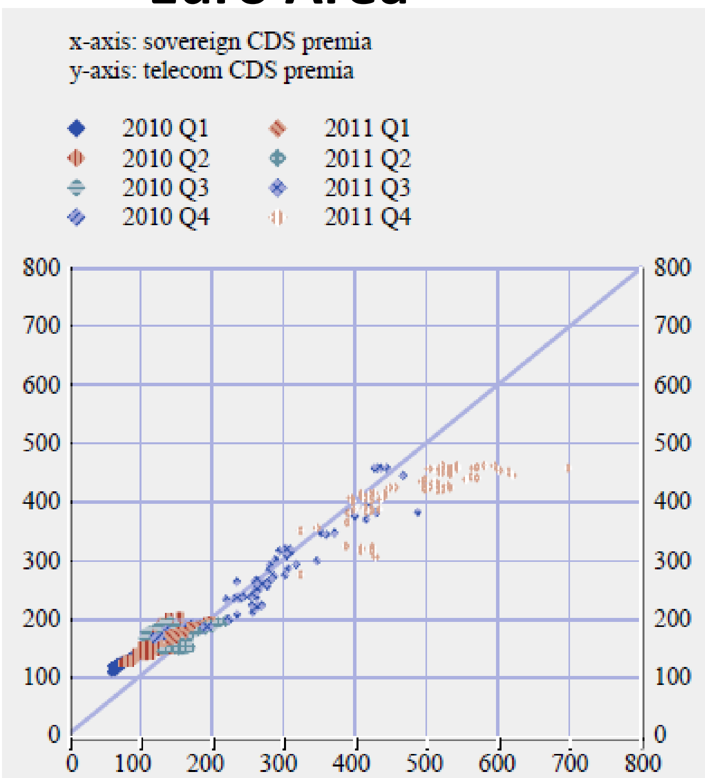
- Basic systemic and infrastructure services are provided at the level of the common currency (payments, settlements)
- Supervision, and financial backstops for the provision of those services remains at the national levels

- **This is an equilibrium as long as:**
  - Coordination by supervisors is very agile
  - Backstop burdens perceived minimum and clearly identified exante
  - Markets remain essentially fragmented along national borders

Challenges of the Common Currency
Situation Today

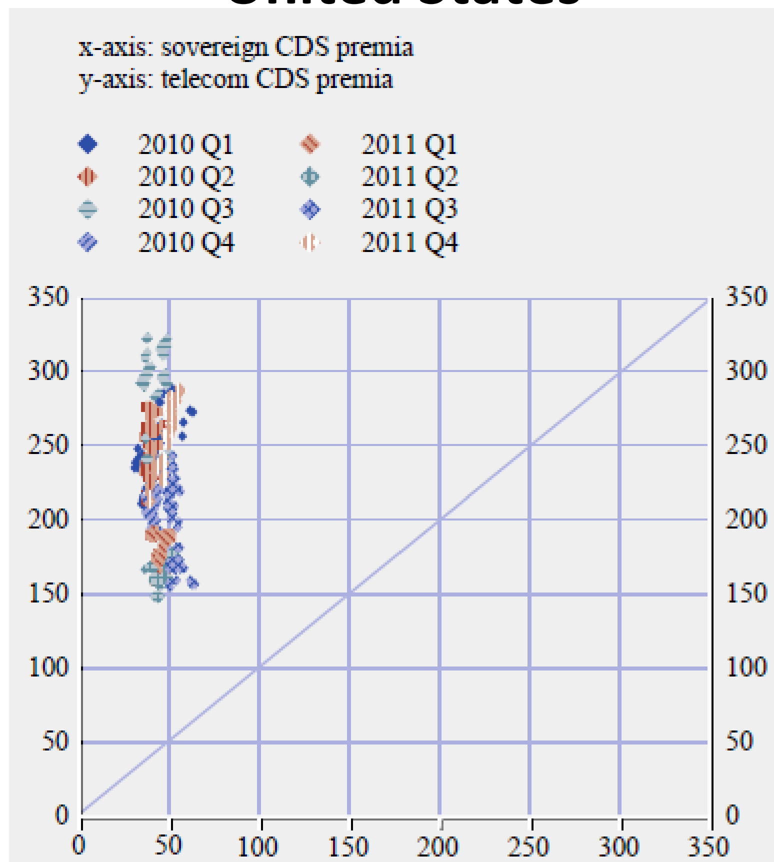
Correlation between Sovereign and Telecom Companies CDS premia

Euro Area



Sources: Thomson Reuters and ECB calculations.
Notes: Each chart presents the daily observations of telecom and sovereign CDS premia, marked for days in various quarters over the observation period. Euro area values are computed as the weighted averages of sovereign (or telecom) CDS premia of individual countries, where weights correspond to the ECB capital key.

United States



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