LE NOUVEL ENVIRONNEMENT RÉGLEMENTAIRE A-T-IL RENDU LE SYSTÈME FINANCIER PLUS SÛR ?

1ère Table Ronde. Entretiens du Trésor,

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Some progress

- Capital requirements
- Countercyclical buffer
- Centralized exchanges (prudential regulation of exchanges?)

Question marks: many, among them:

- Banking union
    - quality of supervision (prompt corrective action)
    - resolution/backstops
    - decoupling banks-sovereign

- Asset income runs (maturity rat race)

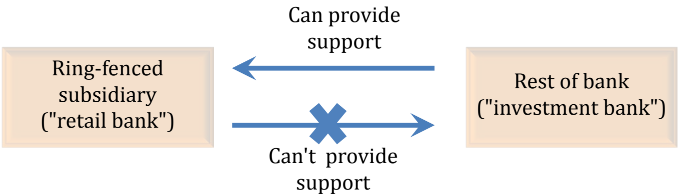
Focus on three: structural reforms, shadow banking, liquidity

I. STRUCTURAL REFORMS

Many variants

[Glass-Steagal, Volcker, Liikanen, French law, Vickers; take latter as illustration.]

Benefits: a) monitoring of X-subsidies and b) easier resolution.



Remaining risks

(a) *Macro risks on banking book*. E.g.,

- Real estate risk
- FX; interest rate
- European banks' capital guarantees

(b) *Hedging function*

Reduces or increases risk-taking?

Credibility of absence of bailout of the investment bank?

[US episode]

II. MIGRATION ISSUE: POLICY TOWARD SHADOW BANKING

Stricter regulations are fine. However migration toward less regulated segments. Shadow banking is fragile:

transformation without public-sector enhancements (CB liquidity, deposit insurance).

- Level-playing field: Can't have access to taxpayer money, yet be unregulated.

  Yet bailouts of shadow banks because, e.g.,

  - cross-exposures (AIG)
  - concerns about fire sales
  - lending relationships.

QUESTIONS

(1) *Regulation through SIFI rules?*

- How do we know who is systemically important?

  [LTCM? AIG? Clearly not just a matter of size. Moving target. Brings us to next point.]

- Supervisors understaffed to oversee even retail institutions.

(2) *Should Basel III liquidity requirements and access to CB liquidity be extended to non-banks?*

(3) *Shouldn't one rather insulate prudentially regulated entities (retail banks, insurance companies, pension funds) from non-bank counterparty risk in order to avoid having to bailout unregulated entities?*

III. LIQUIDITY

Academic input: solid, but rather theoretical/not directly operational knowledge

(1) *Normal times*: regulation warranted, but trade-off between
- limiting *individual* and *collective* moral hazard (externalities on borrowers, counterparties, Treasury and Central Bank); excessive maturity transformation triggers *unpriced* LOLR (individual) and monetary bailouts (collective);
- repressing natural transformation/lending activities (liquidity is costly).

(2) *Tail liquidity risk*: State has not only ability to increase aggregate liquidity supply; but also a comparative advantage in providing liquidity in low-probability events.

Fits well with idea that notions of "HQLA" differ for LCR and CB-compliant-collateral purposes (micro and macro shocks).

QUESTIONS

(1) *Should Central Bank eligible assets be part of the buffer?*
- Only if priced (upfront fee in RBA's Committed Liquidity Facility)?
- Macro-shocks contingent lines of credit?

(2) *How should one account for countries' idiosyncrasies?*
- Structural scarcity or abundance of HQLA (combined with current renationalization!)
- Liability side idiosyncrasies

(3) *How would you treat home country public debt? More generally, how do you view relationship between accounting standards and liquidity regulation?*
- Prudence vs. predictability/absence of procyclicity.

(4) *Are you concerned about the LCR impacting interbank lending?*

(5) *Will LCR be subject to threshold effects?*