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Roundtable 3: capitalizing on the new G20 regulatory steps

Introductory remarks by François Villeroy de Galhau,
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Ladies and Gentlemen,

It is a pleasure to be with you today to introduce this roundtable, which could not be more topical, just a few days after the leaders of the G20 met in Hamburg. From London in 2009 to Hamburg last week, there is only 450 miles as the crow flies; but there has been considerable progress in terms of financial regulation. Thanks to international cooperation between the 20 major economies, the resilience of the global financial system has significantly improved in eight years, without impeding the financing of the economy or global economic growth. We can all be proud of these achievements, but there is no room for complacency today. Let me elaborate on what I see as the three priorities for further work, and the two requirements to consolidate what we have achieved so far.

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1. Three priority areas where further work is needed.

First, we have to **finalise the Basel III framework**, "without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field". I wish to stress that this commitment was reaffirmed in Hamburg a few days ago by the whole G20, including the United States – and this is important as we need to preserve, in the words of the G20 Leaders' Declaration, "an open and resilient financial system, grounded in agreed international standards"[i]. Regarding Basel III, I sincerely hope that we can reach a balanced agreement among Basel Committee members by next autumn. The vast majority of the Basel III framework has indeed already been agreed and is now largely implemented, notably in Europe since 2014 with the CRD IV package. The main outstanding point of discussion is, as you know, the so-called "output floor" which would apply to banks using internal models. The objective of Basel III is to lay the foundations for a strong, balanced and risk-sensitive international regulation, while reducing the undue variability of risk-weighted assets (RWAs). So we need a prudent but a reasonable level of the output floor, combined with strengthened supervision of banks' internal models – and Europeans made sensible proposals to achieve this. But should the output floor be set at too high a level, the consequences in terms of the reduction of risk sensitivity and the increase in capital requirements would be unacceptable: for example, a 75% output floor would affect half of international banks. It would de facto result in creating a "Basel IV" framework based on the standardised approach. The output floor is to serve as a backstop, not as the primary driver of capital requirements: yes to Basel III, no to Basel IV.

Having said that, **the main issue now is no longer the solvency of banks, but the liquidity of non-banks**. Therefore the bulk of the regulatory efforts must now be focused on the **shadow banking system,** which has risen from USD 73 trillion of assets in 2007 to USD 92 trillion in 2015[ii] – i.e. 150% of total GDP – in the jurisdictions monitored by the Financial Stability Board. And those parts of shadow banking that may pose financial stability risks represent USD 34 trillion; two-thirds of which is composed of collective investment vehicles (CIVs) with features that make them susceptible to runs. It is thus of key importance that authorities develop and use system-wide liquidity stress-testing tools, in order to address the risks of a "funds-run" in adverse market conditions. The FSB decided on this; it has to be implemented with a strong commitment by IOSCO and national regulators.

The third main area of work is the regulatory framework for **central counterparties** (CCPs). The clearing obligation of OTC derivatives has fortunately reduced OTC transactions, but as a result CCPs have also become more and more systemic and concentrated. The FSB guidance on a recovery and resolution framework, which is currently being transposed into EU legislation, is a good step forward. Faced with Brexit, Europe has the additional imperative of not letting sources of systemic risk for the EU grow outside the EU. In this regard, the proposal recently made by the EU Commission is a step in the right direction, but it should be streamlined and strengthened to make sure that euro-denominated clearing activities are supervised and so located in the European Union when they exceed certain thresholds.

One additional word about **cyber-risks**: as we have been reminded by the two viral attacks carried out in the last two months, we are at the same stage that medicine was at before Pasteur and vaccinations. The challenge is to take swift and decisive actions to enhance cyber resilience in the financial system, building notably on the G7 recommendations: the G7 is, at this stage, the key forum to act.

2. Two requirements to consolidate what we have achieved so far.

Although there are still some areas of work, tremendous progress has been made since the crisis to enhance the resilience of the global financial system. I believe that two requirements are necessary to consolidate our achievements. The first one is to **remain vigilant to avoid any backtracking**. As you know, the US Treasury recently published a "Report", exploring the possibility of adjusting its national banking regulations[iii]. Some adjustments to national regulations, applying for instance to locally-active entities, or the Volcker rule, may indeed be deemed appropriate and legitimate. But withdrawing from internationally-agreed minimum requirements which apply to globally-active entities – such as the FRTB or the NSFR standards, I want to insist on the Trading Book – would be completely different and a source of great concern for all. Any temptation of competitive deregulation would be a lose-lose game which would increase the risks of a new financial crisis and therefore weigh on economic growth. International cooperation on financial sector regulation is our common good, and, fortunately, the Hamburg G20 Summit reaffirmed it.

The second requirement is to **carefully assess the impact of these new financial regulations**. The Banque de France has supported the work of the FSB from its inception, notably to build the "policy evaluation framework" to assess the effects of G20 reforms. This was endorsed by the Leaders of the G20 at the Hamburg Summit. This is a key part of the credibility of global financial reforms. Ex-post evaluations will make it possible to assess whether G20 financial regulatory reforms have actually achieved their intended outcomes. Going forward, these evaluations are meant to provide a basis for the possible fine-tuning of post-crisis regulatory reforms, where relevant. What matters now is to make sure that this framework is used in a timely manner. To this end, a tight schedule should be defined by the end of the year, so that the first evaluations can be carried out in 2018.

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Ladies and Gentlemen, let me conclude by a word on **the Paris ecosystem in a post-Brexit Europe**. Brexit was and remains bad news, above all for our British friends. But it brings for us an opportunity. The EU post-Brexit financial system will certainly be less concentrated than it is today and more active on the continent, based on Eurozone abundant savings. And, in this new environment, the Paris financial centre has obvious advantages, building on the very welcome measures announced by the Prime Minister to strengthen Paris' attractiveness. To name a few, France has the most developed capital market in continental Europe, the largest asset management industry and is the leading private equity investor; French universities are renowned worldwide for the excellence of their finance teaching. Paris has everything it needs to be one of the best financial centres in the euro area: it depends on us, on all of us. You can rest assured that Banque de France and ACPR are strongly committed to fully playing their part in supporting the Paris ecosystem.

[i] G20 Leaders' Declaration, Hamburg, 7/8 July 2017.
[ii] Assets of "Other Financial Intermediaries" (OFIs); sample of 21 individual non-euro area jurisdictions and the euro area aggregate. Source: FSB, Global Shadow Banking Monitoring Report 2016, May 2017.
[iii] See U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities", June 2017.