BANCO DE ESPAÑA
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WORKSHOP OF THE EUROPEAN SHADOW FINANCIAL REGULATORY COMMITTEE (ESFRC)

FINANCIAL REGULATION: WHAT ELSE?

CLOSING REMARKS

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"Do not make many rules, and if you do, try to make them good, and above all, make sure they are followed; for if rules are not followed, it is as if they did not exist."

Miguel de Cervantes, Don Quixote, 2nd Part,1615

"No hagas muchas pragmáticas; y si las hicieres, procura que sean buenas, y, sobre todo, que se guarden y cumplan; que las pragmáticas que no se guardan, lo mismo es que si no lo fuesen."

Don Quijote de la Mancha, Segunda Parte; Miguel de Cervantes, 1615

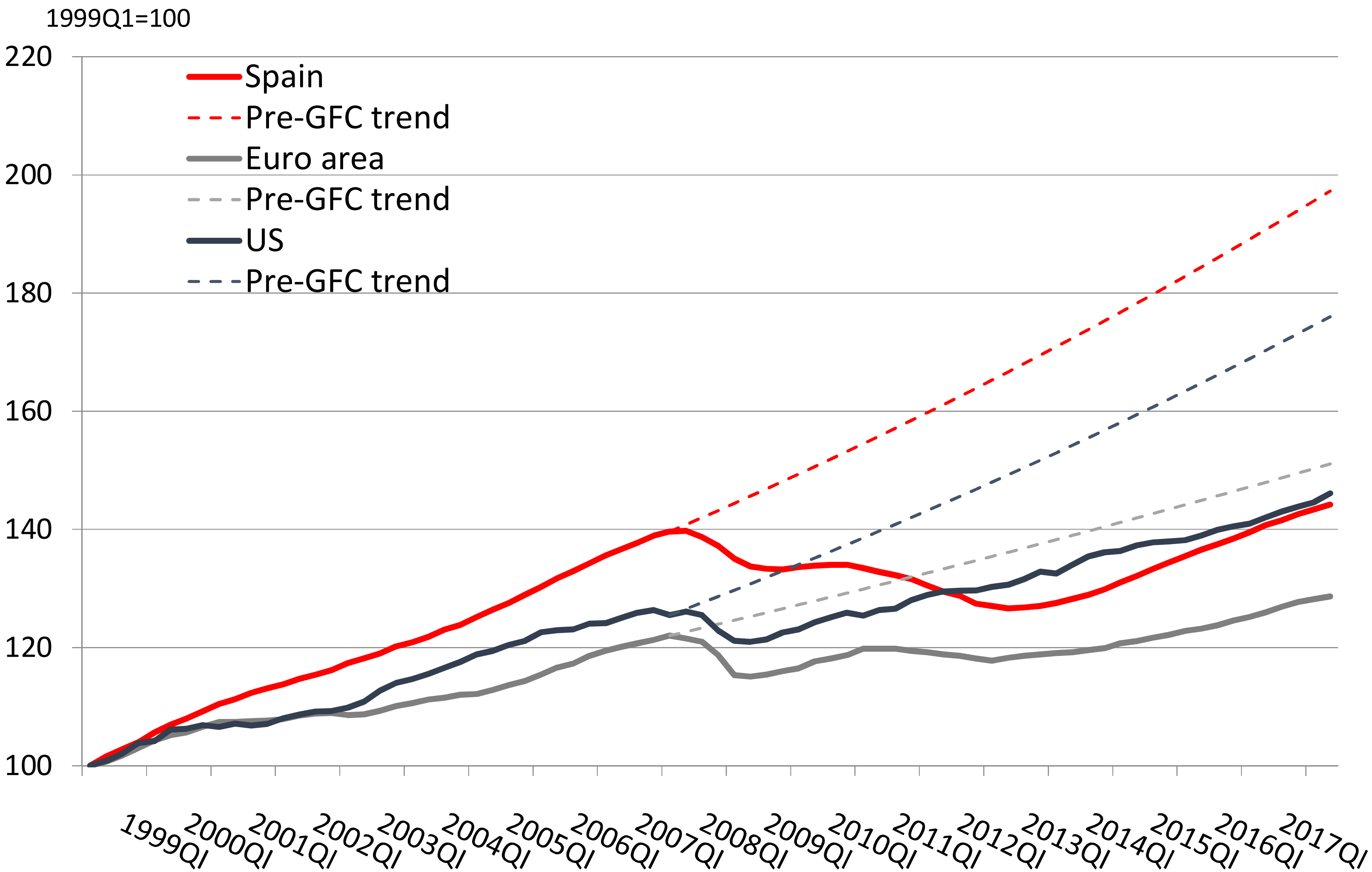
OUTLINE

- Financial regulation

- What else?

FINANCIAL REGULATION

OUTPUT LOSSES and THE FINANCIAL CRISIS
Real GDP



Source: Eurostat and BEL

MICROPRUDENCIAL SUPERVISION (1/2)

Regarding microprudential supervision, the Basel Committee on Banking Supervision (BCBS), **spurred by the G20/FSB**, developed a new regulatory framework known as **Basel 3**

It introduced substantial changes to the preceding framework (Basel 2), improving its transparency and consistency. The main reforms include:

- Better **definition and quality of ordinary capital**.
- **Increased minimum capital requirements** and **capital conservation buffer**.
- Minimum **leverage ratio** requirement.
- Minimum **liquidity requirements**:
  - **Liquidity Coverage Ratio** (LCR)
  - **Net Stable Funding Ratio** (NSFR)
- **Improvements in risk coverage**: securitisations, trading book and counterparty credit risk.

MICROPRUDENCIAL SUPERVISION (2/2)

The "second wave" of the post-crisis reforms to Basel 3 focused on the denominator of the capital ratio: the Risk-Weighted Assets (RWAs). The overall aim was **to reduce unwarranted RWAs variability**. Main revisions included:

- **Credit risk:** revisions to the standardised approach (SA) and the internal rating-based approach (IRB).
- **Operational risk:** new standardised approach replacing all current approaches.
- **Leverage ratio:** new additional leverage ratio for G-SIBs (set at 50% of a GSIB capital surcharge).
- **Output floor:** new output floor whereby RWAs are bound to a minimum of **72.5% of total RWAs** calculated using the available standardised approaches in the Basel framework.

MACROPRUDENTIAL SUPERVISION

A key lesson from the financial crisis was that a regulatory framework based exclusively on microprudential aspects was insufficient.
The G-20/FSB promoted a reshaping of the regulatory framework to enable the identification and assessment of macroprudential risks.

- **Systemic Banks:** Reinforce the capital requirements for GSIBs
- **Cyclical systemic risks:** The BCBS developed as part of Basel 3 a countercyclical capital buffer, with the objective of preventing and mitigating cyclical systemic risks stemming from the excessive credit growth
- In Europe, there is also a **surcharge for domestic systemic banks (OSIIs),** a **Systemic Risk Buffer** as well as **article 458 of CRR**

Combined buffer	**CCyB 0-2.5%**
	G-SIB surcharge 1-3.5%
	Conservation Buffer 2.5%
Minimum Pillar 1 requirements	**T2 2%**
	AT1 1.5%
	CET1 4.5%

On top of that, **microsupervisors** have a Pillar 2 Requirement (**P2R**) as well as a Pillar 2 Guidance (**P2G**) in the SSM.

During the crisis, authorities were forced to rescue banks whose failure could had meant the collapse of the financial system (TBTF problem).

Part of the international measures to reduce the TBTF problem focused on developing effective resolution mechanisms, in **a shift of paradigm from bail-outs to bail-ins**.

- **“Key Attributes of Effective Resolution Regimes for Financial Institutions”:** these standards, developed by the FSB in 2011, set out some key principles to guarantee orderly resolution, including the development of a bail-in tool to avoid the usage of public funds in resolution.
- **TLAC (Total Loss-Absorbing Capacity):** FSB developed this international standard in 2015. Its objective is to guarantee banks’ loss absorption and recapitalization capacity to be able to implement an orderly resolution process that minimizes the impact on financial stability, ensures the continuity of critical functions and avoids the usage of public funds.
- In Europe, the **resolution directive (BRRD)** sets a Minimum Requirement of own funds and Eligible Liabilities (MREL) to allow for an orderly resolution process that avoids bail-out.

ADDITIONAL REFORMS

The G-20 has also promoted a number of additional regulatory reforms at the international level. This is a broad set of measures, among which stand out:

- Strengthening and harmonization of international accounting standards.
- Improvement of corporate governance and remuneration practices.
- Strengthening the regulation and monitoring of non-banking sectors.
- Other regulatory measures such as strengthening of OTC derivatives operations, improving disclosures, etc.

- **All these regulatory measures should contribute to be better prepared for the future**

WHAT ELSE?

COMPLETING THE BANKING UNION IN EUROPE

- Banking Union based on three pillars
  - Single supervision: SSM up and running
  - Single resolution: SRB up and running
  - European Deposit Insurance System: missing
- How to ensure that after the resolution tool has been applied, the bank will not suffer liquidity stress?
- Need to develop a (large enough) backstop for the Single Resolution Fund at the European level
- Finish the regulatory building in good times, to be prepared for next bad times
- A significant risk reduction has already happened while risk sharing is still missing

WHAT ELSE?

- Macroprudential authority
- Macroprudential instruments
  - Monetary and Banking Union with different lending cycles among countries
- TLAC vs MREL scope
- RWA density diversity
  - Standardized Approach vs IRB-model Approach
- Build up of capital and MREL
  - Balance between enhancing resilience of banks to shocks while being able to support the economy

Thank you very much