FINANCIAL STABILITY CONFERENCE 2015

THIRD JOINT CONFERENCE ON EU REGULATORY REFORMS

FINANCIAL RISK AND STABILITY NETWORK

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report

How to design the future EU Financial System? Resolution Framework, Crisis Prevention and Capital Markets Union

28 October 2015, European School of Management and Technology, Berlin

PREFACE

Dear Conference Participants, dear All,

Our joint Financial Stability Conference 2015 has been a great success as regards its aim and motivation. We succeeded in having an excellent line-up of speakers and panelists as well as a big audience of more than 200 participants actively and controversial debating the agenda topics.

The problems in the EU financial sector are not yet solved. We still have a fragile banking system, unsustainable business models, legacy issues, an unsolved bank-state nexus, problems with non-performing loans and a lack of consolidation. The risks did not vanish. In addition, we have a higly interconnected and complex financial system; on the other hand we see increasing fragmentation happen in the European Union in the last years. This all hinders intermediation, credit supply to the economy and the prospects for sustainable growth in EU member states. This was the reasoning to set the agenda topics and to organise this event.

The conference has been discussing critical questions as regards resolution framework, macroprudential policy and the action plan for a Capital Markets Union. We are still missing orderly resolution in action, Europe has so far not much experience with this. The years since the financial crisis have been a muddling through in a setting of diverging national interests. Now, progress has been made: the Banking Union is setting a comprehensive pan-european institutional and legal framework to address future crisis challenges.

But some critical points remain such as the financial stability-exception clause for bail-in in the BRRD directive and the fear that in a systemic crisis bail-in will not be released. The Single Resolution Fund is for the next years much to small when no private solution can be reached. We are missing a common EU Deposit Guarantee Scheme to complete the Banking Union. There is now the proposal of the commission for a EU-wide bank deposit reinsurance scheme on the table, but EU member states have controversial positions on this matter.

Cross-border resolution is a big issue, especially if it comes to resolution of a systemic institution where UK and US authorities and different jurisdictions are involved. Then the question of bail-in-able liabilities, TLAC and MREL: what will happen in crisis situations when markets are panicing and liquidity becomes scarce? In crisis situations there is furthermore the challenge to overcome national interests and to come to a cooperative management at the political levels. These are some of the points which have been explored in the morning.

In the afternoon important aspects as regards macroprudential policy and crisis prevention have been discussed: how can the various instruments work together as well as how can macroprudential policy be employed effectively? Does the roles and the tasks of ESRB, ECB and ESM fit well to manage crisis prevention and is the toolkit sufficient? Last but not least how to address the implications of monetary, fiscal and macroprudential policy?

Vitor Constâncio in his keynote formed the link between the two thematic parts of the afternoon. He addressed the distinction betweeen the monetary policy mandate and macroprudential policy, describing the latter as a toolkit for raising the resilience of the banking system and a key building bloc for sustainable growth. Nevertheless, he pointed to the need to complete the authorities' macroprudential instruments. The concluding panel has been elaborating how to design the financial system that it better fulfills its core functions and supports sustainable growth.

To my impression we had fruitful discussions and participants gained new insights. We should move one with these debates. There is no permanent stability. Crisis will not vanish in the future and financial stability is never a given condition. It is only achieved by adequate rules, good regulation and efficient supervision. And we have to ensure that underlying causes of risk build-up and vulnerabilities are effectively addressed.

The European Union is facing big challenges, politically, economically and social. The current dealing at national and EU levels with the flow of refugees shows very clear what is at risk: a break of the European project. To address these challenges we need a sustainable and diversified financial system which fulfills its core function and serves real needs. The European Union can not afford to go through a big financial crisis like 2008 again. A sound financial sector is key for Europe, its citizans and economic welfare.

An adequate regulatory and institutional framework which can address risk built-ups and manage crisis situations is an essential precondition. The debate on this is crucial and should not be restricted only to experts. Good regulation and hence smooth-funtioning of the financial sector can only come from having an ongoing public debate on regulatory issues. And we do not have to forget for what all this exercises are meant: a good functioning of the economy and therefore of well-being in the European Union. That is what made the conference agenda relevant, to policy and society as well.

Martin Aehling

ORGANISER AND CO-ORGANISERS

Organiser

- Martin Aehling, Head, Financial Risk and Stability Network

Scientific Co-Organisers

- Prof. Henrik Enderlein, Director, Jacques Delors Institut - Berlin, and Hertie School of Governance
- Prof. Marcel Fratzscher, President, German Institute for Economic Research, DIW Berlin
- Prof. Jörg Rocholl, President, ESMT European School of Management and Technology
- Dr. Guntram Wolff, Director, Bruegel

Motivation:

The conference topics relate to the regulatory and political efforts to make the EU financial system more resilient and to push intermediation. The Single Resolution Board shall be fully operational as from January 2016. The resolution framework shall then work in the case of bank failures. Also to prevent future crisis, new regulatory requirements have been set and various measures as well as institutional arrangements undertaken to safeguard financial stability.

In the discussions we critically question these efforts and settings by asking if they are a comprehensive response to the crises, how they may function together and if they do work in practice. This is of overall importance: First, to prevent that tax payers have to pay once more and EU member states run in deficits for bail-outs. Second, because stability and a sound financial sector are preconditions for a smooth functioning of the economy and for sustainable growth. In this regard we also discuss the agenda for a European capital markets union.

The conference brings together regulators, scientists, politicians, industry experts and organizations. We think that generating a public debate on these issues is very reasonable and also necessary to keep on in building a more resilient financial system which fulfills its vital functions in serving the real economy and supports sustainable growth.

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FIGURES AND IMPRESSION

Figures:

26 speakers, panelists and moderators
300 guest registrations
240 attended participants

Participants breakdown by groups:

Regulatory authorities: 26
Banks: 25
Financial institutions and consultancy: 36
Policy and political organisations: 26
Ministries: 18
Scientists and research institutions: 52
Organisations: 8
Associations: 18
Press: 12
Others: 17

RESOLUTION FRAMEWORK AND BAIL-IN

Program

9:00 Opening
Martin Aehling, Head, Financial Risk and Stability Network

9:15 Address
Klaus Feiler, State Secretary, Berlin Senate for Finance

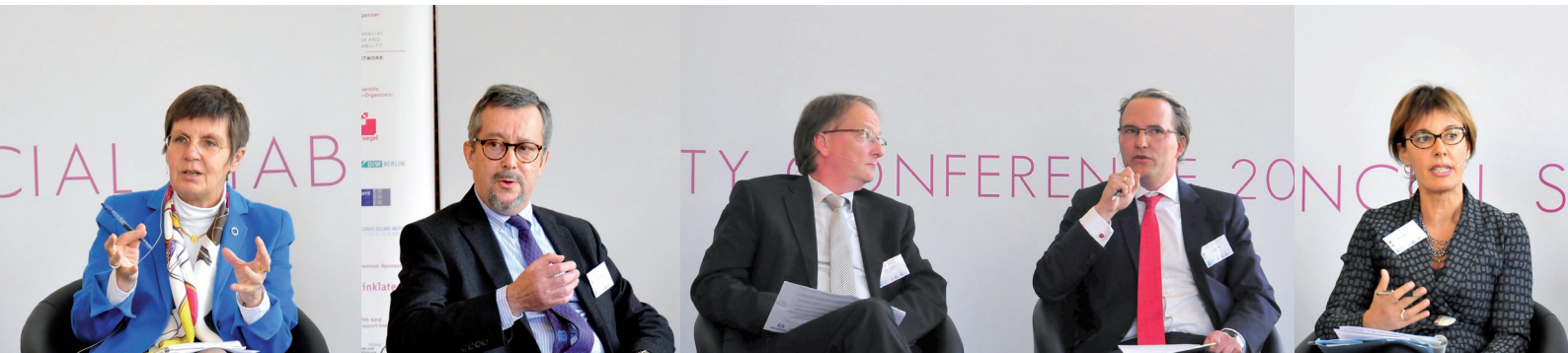
9:30 Keynote
Ending „Too big to fail" – Have we completed the Job?
Dr. Elke König, Chair, Single Resolution Board

10:15 Panel Discussion I
Resolution Framework and Resolution Board: Is the Work done?
- Preparing Resolution and Evaluation of Living Wills: Are we on Track?
- Resolution Powers: How independent is the Board from Interferences?
- Implementing credible Resolution Planning: Are Taxpayers out now?
- Lagging behind: A common legal Bank Insolvency Regime in the EU

Olivier Jaudoin, Director Resolution,
Prudential Supervisory and Resolution Authority
Dr. Elke König, Chair, Single Resolution Board
Christophe Nijdam, Secretary General, Finance Watch
Fatima Pires, Head of Financial Regulation Division, European Central Bank
Emiliano Tornese, Deputy Head, Resolution and Crisis Management Unit,
European Commission
Moderation: Prof. Jörg Rocholl, President,
ESMT European School of Management and Technology

11:45 Panel Discussion II
Resolution Tools: How to make Bail-in operational and effective?
- Are the Settings and Requirements for Bail-in-able Liabilities sufficient?
- How to organise orderly Liquidation and Resolution Plan Transparency?
- Cross-border Banks in the Case of Failure: How to resolve in Practice?
- How have Banks to adopt and change their Business Structures?

Günter Borgel, Member of the Management Board,
Federal Agency for Financial Market Stabilisation
Dr. Thomas Dohrn, Policy Expert, Resolution Unit, European Banking Authority
Monica Marcucci, Senior Lawyer, Legal Department, Bank of Italy
Dr. Wilfried Paus, Global Head Risk Analytics and Living Wills, Deutsche Bank
Dr. Sven Schelo, Partner, Linklaters
Moderation: Prof. Marcel Fratzscher, President,
German Institute for Economic Research, DIW Berlin



Program

14:00 Panel Discussion III

Crisis Prevention and Macroprudential Policy: Mission impossible?

- What are the various Instruments and how can they work?
- How will they interact with Monetary and Fiscal Policy?
- How shall Macroprudential Policy be organised effectively?
- What are the Repercussions on the EU Banking Sector?

Prof. Arnoud Boot, University of Amsterdam, and Co-Director, Amsterdam Center for Law and Economics
Prof. Stijn Claessens, Senior Adviser, International Finance Division, Board of Governors of the Federal Reserve System
Francesco Mazzaferro, Head of the Secretariat, European Systemic Risk Board
Dr. Rolf Strauch, Member of the Management Board, European Stability Mechanism
Moderation: Prof. Henrik Enderlein, Director, Jacques Delors Institut – Berlin, and Professor of Political Economy, Hertie School of Governance

15:45 Keynote

Macroprudential Policy in Europe: Ensuring Financial Stability in a Banking and Capital Markets Union

Dr. Vitor Constâncio, Vice President, European Central Bank

16:30 Panel Discussion IV

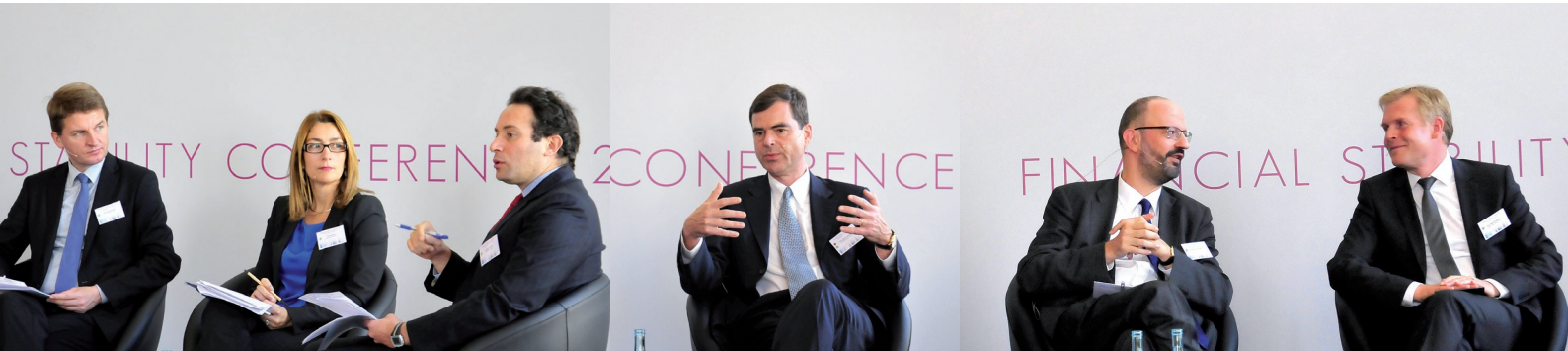
The EU Financial System: How to better design for sustainable Growth?

- How to overcome Fragmentation and push Intermediation?
- Which regulatory and policy Settings are inducing Growth?
- Can the Capital Market Union be an appropriate Stimulator?
- What Policy Choices and alternative Options do we have?

Colin Ellis, Chief Credit Officer, Moody's
Dr. Levin Holle, Director General, Financial Markets Policy Department, German Federal Ministry of Finance
Liz Meneghello, Head of Capital Markets Union and CCP Resolution, HM Treasury
Martin Merlin, Director Financial Markets, European Commission
Dr. Christian Thimann, Member of the Executive Committee, Axa Group
Moderation: Nicolas Véron, Senior Fellow, Bruegel

17:45 Closing

Organiser and Co-Organisers



Parallels between securing Financial Stability for Berlin and for Europe

Klaus Feiler, State Secretary, Berlin Senate for Finance

State Secretary Klaus Feiler opened his address by pointing out that Berlin, too, was no stranger to financial instability and its negative repercussions on the public budget. 15 years ago Berlin was in financial crisis. Today, this is no longer the case; rather, Berlin is in a mid-field position fiscally when compared to other German Bundesländer. There were multiple reasons for Berlin's financial crisis. The costs of re-unification had already lead to a significant increase in Berlin's public debt, and, following the crisis in the Bankgesellschaft Berlin in 2002 and its subsequent bailout, public debt grew still further to 60% of local GDP. The partially publicly-owned Bankgesellschaft had inadequate governance structures and poor risk management and oversight; there was political meddling but too little actual control - all familiar features that were present in the 2007-08 financial crisis, too.

Without the fiscal union across the German federal states, the local banking failure would presumably have led to Berlin being cut off from capital markets.

Feiler observed that without the fiscal union across the German federal states, the local banking failure would presumably have led to Berlin being cut off from capital markets. Berlin's authorities had decisively shifted their policy approach since then. To strengthen Berlin's economy and regain financial stability for the region, the Berlin government embarked on a course of strict fiscal consolidation, a cap on public spending, privatisation, and an almost 50% reduction in public sector employees, from 200,000 to 104,000. As a result, in 2015 Berlin will probably see the 4th year in a row of budget surpluses; this is predicted to continue to at least 2020.

The debate has shifted to the practical questions of how to effectively apply regulations and how to use the new macroprudential tools.

Klaus Feiler explained that as a co-legislator and in light of the potential repercussions from financial instability on Berlin's budget, the Senate closely follows the discussion about financial stability and the regulatory process. The State Secretary noted that the debate has shifted from regulation to implementation - to the practical questions of how to effectively apply regulations and how to use the new macroprudential tools. In practice, this will require a change in work-flows, a recruitment of new personnel, and changing business models. There is, of course, still some uncertainty as to whether the rules will work in a new crisis situation. People will ask: are the decision-making structures sufficient, can a crisis be mitigated rather than transmitting the damage across Europe? Are the rules robust and clear enough to restore market confidence quickly?

Prudent financial management in Berlin has been successful. Despite the initially sharp fiscal contraction, economic growth in Berlin has outpaced the rest of Germany in seven out of the last 10 years. According to the latest draft budget, public sector investment is to increase from EUR 1.4 billion to EUR 1.7 billion, with an additional 1.7 billion being invested by Berlin's publicly-owned firms. The Berlin example, Mr Feiler concluded, should give people a sense of optimism that overcoming financial and fiscal crises can work, in Germany and elsewhere in Europe.

Keynote 1

Ending "Too big to fail" - Have we completed the Job?

Dr. Elke König, Chair, Single Resolution Board

Ms König began her keynote by referring to State Secretary Feiler's opening address. The parallels he had drawn on the lessons to be learned from Bankgesellschaft Berlin and the situation in Europe were very valid. Like Berlin, Europe had to respond to the crisis by redesigning its tool-box and institutional structure for financial stability. The initial focus on securing financial stability was the right one. Now, seven years after the Lehman Brothers' closure, two years after the Banking Union, and in the first year of the Single Resolution Board (established in January 2015), Europe looks and is more financially stable than a few years ago. Regulation, however, cannot exist for its own sake - jobs and growth must go hand in hand with financial stability.

Regulation cannot exist for its own sake - jobs and growth must go hand in hand with financial stability.

In the past the European Commission lacked the tools and authority to manage the failure of financial institutions. In these circumstances, the only options policy makers had was to fall back on a tax-payer bailout or to let an institution go bankrupt and accept any wider ripples that such a closure might set off. During the financial crisis, bailout became the norm, which meant abandoning or ignoring the rules of the market economy. Now, Elke König outlined, Europe has regulation policies and authority to guide implementation to promote financial stability. These instruments aim at ending the idea of "too big to fail", and at using banking supervision and resolution to re-establish the rules of the market economy.

The Single Resolution Mechanism (SRM), one of the main pillars of the European Union's Banking Union, which centrally implements the EU's Bank Recovery and Resolution Directive (BRRD), provides the framework for the recovery and resolution of credit institutions and investment firms found to be in danger of failing. This resolution scheme will take effect on 1 January 2016, provided that the Single Resolution Fund (SRF) has been established and funded prior to this date. The SRM will work in close collaboration with the Single Supervisory Mechanism (SSM). This is great progress, but there remains a gap between regulation and implementation at a national level - as Elke König explained, "Not all member states have yet implemented the BRRD before the December 2014 deadline, and this must now be done."

An ongoing priority is working with the ECB and the national banks to deepen cross-border relations.

The Single Resolution Board (SRB) will play a crucial role in closing such gaps. Part of their initial focus has been internal matters - described by Ms König as "the first time in my career that I have run a startup, dealing with HR one day, the lease for the new office the next." Alongside this, however, the SRB has been working on resolution planning for 2016, specifically developing standard policy guidelines for the Resolution Planning Manual. An ongoing priority is working with the European Central Bank and the national banks to deepen cross-border relations, as well as harmonising the work planned by the National Resolution Authorities.

The assessment of resolution processes revealed that many of the obstacles have not gone away.

During this time, they have conducted a rigorous assessment of the resolution processes in individual banks and how feasible those processes are. The assessment revealed that many of the obstacles identified last year have not gone away, including the adequate and timely exchange of information between the banks and authorities, as well as dealing with confidentiality issues. Furthermore, without a single global authority, cooperation between national authorities is essential. The US shows great willingness for cooperation, but it will still be a long journey, one positive step on which would be mutual recognition of resolution directives. According to Elke König, "Resolution is not a zero-sum game; cooperation makes it better."

The Single Resolution Fund is there primarily to resolve a bank, not to resurrect it.

Ongoing, the goal of the SRB is to resolve any bank facing serious difficulties with as little cost to the taxpayer as possible. Ms König stressed that the SRF is not conceived to "solve structural problems in banks. [...] The fund is there primarily to resolve a bank, not to resurrect it." Private sector solutions to difficulties in a particular bank should always take precedence over using the fund, which should be viewed as a last resort. Only in cases where a bailout is considered cheaper will the SRB proceed with resolution tools.

Ms König concluded her keynote by emphasising that the SRB is a game-changer in banking resolution and it can effectively promote financial stability in member states. There is lots to be done, but they are prepared for the task. They must be forward-looking and work on resolution planning and enhancing financial stability by addressing the existing obstacles to resolution. Only safe and sound banks can support the real economy; to that end "we must avoid bailouts and place the burden on banks, shareholders, debt holders, and none on the tax-payers."

Keynote 2

Macroprudential Policy in Europe: Ensuring Financial Stability in a Banking and Capital Markets Union

Dr. Vitor Constâncio, Vice President, European Central Bank

Mr Constâncio began his keynote by reflecting on the current sluggish economic recovery in Europe following the global financial crisis. One reason for this, he suggested, is the low inflation and the ongoing risk this presents. To counter this, the ECB has decided to bring inflation closer in line again with the eurozone inflation target rate of below but close to 2%. At a time when the risks to the global economy are increasing due to growing weakness in emerging markets, the ECB will continue to monitor these developments and stand by with all the available monetary policy instruments in its mandate to ensure price stability.

Monetary policy cannot address instability in asset markets or broader financial stability risks.

More generally, it would be a mistake to divert monetary policy from this objective of price stability to directly address asset price misalignments and other risks to financial stability. The business cycle and financial cycle are no longer synchronised, as was traditionally believed. This "disconnect" creates a dilemma for traditional macroeconomic policy and especially monetary policy, which should be used to ensure price stability for goods and services. It cannot address instability in asset markets or broader financial stability risks, in part because it is not well suited to target asset market prices and because it is too blunt a tool to cope with specific imbalances in the financial sector. Rather, this is the task of macroprudential policy: with the objective of containing systemic risk in the financial system. If done effectively, macroprudential policy can represent a key building block for high and sustainable economic growth in the euro area.

In a monetary union, where economic and financial conditions may significantly differ across member states, macroprudential policy is even more important. It has two main objectives: first, enhancing the resilience of financial institutions and the whole financial system, and, second, smoothing the financial cycle when affected by credit, leverage, and asset price fluctuations, which may lead to boom-bust episodes.

Macroprudential policy provides the most appropriate tools for staving off financial stability risks in the specific areas they arise.

Macroprudential policy has granular and targeted instruments, including most of the micro-supervision instruments for capital and liquidity requirements. It extends to other areas such as limiting loan-to-value ratios in housing credit, counter-cyclical capital buffers, and global leverage ratios. With these, it provides the most appropriate tools for staving off financial stability risks in the specific areas they arise, whether at a country, sector, or financial institution level. The result is that, if conducted effectively, macroprudential policy helps keep monetary policy focused on fulfilling its price stability mandate whilst keeping in check risks to broader financial stability.

In Europe, the macroprudential policy framework has been in place since the adoption of the CRR/CRDIV legislative package. With the start of the SSM in November 2014, the ECB received macroprudential powers, shared with

national authorities in the eurozone. The goal of the ECB's current monetary policy stance is to incentivise economic risk taking, in the form of better financing conditions for households and firms. At the same time, it is key for macroprudential policy in Europe to assess the consequences that the globally low interest rate environment and ample liquidity - notably in asset valuations and the search for yield phenomenon - may have for financial stability. There is no sign as yet of a general asset market overvaluation in the eurozone.

Progress has been seen in the national authorities' adoption of borrower-based instruments.

The particular focus of macroprudential policy has been on structurally raising the resilience of the banking system and preventing the emergence of possible imbalances, in particular in the real estate sector. Progress has been seen in the national authorities' adoption of borrower-based instruments, such as loan-to-value, loan-to-income, or debt service-to-income. This indicates how useful these instruments are within Europe to curtail excessive credit and house price growth by acting directly on the borrower's conditions, as has been seen in Ireland and Belgium. In addition, a number of macroprudential authorities in the eurozone have activated three types of capital buffers - for global systemically important institutions, for systemically important institutions and the systemic risk buffer - to address the problems stemming from "too big to fail" institutions and specific structural risks from exposure to areas affected by geopolitical tensions.

We need to complete the European authorities' macroprudential toolkit and extend it beyond the banking sector.

As illustrated, Vitor Constâncio concluded, macroprudential considerations lead to policy decisions through a broad range of instruments and with varying legal powers, ranging from moral suasion over recommendations to provisions with clear sanctions. Going forward, he suggested that we need to complete the European authorities' macroprudential toolkit. Two important areas for activity include further enhancing the European authorities' ability to intervene quickly and efficiently with macroprudential action, as well as extending the toolkit beyond the banking sector to cover risks among non-banks and the financial markets as a whole. This requires three specific developments: first, closing data gaps and broadening the information-base of financial market activities; second, developing tools targeting liquidity in non-bank financial institutions; and third, tailoring specific rules and tools for financing activities at the juncture between banking and non-bank financial intermediation. Doing this will enhance consistency and policy coordination, which will enable Europe to address financial stability risks emerging outside the banking system. This will be a key step to accompany further European market integration and the creation of a true Capital Markets Union.

Panel 1

Resolution Framework and Resolution Board: Is the work done?

with Olivier Jaudoin, Director Resolution, French Prudential Supervisory and Resolution Authority; Dr. Elke König, Chair, Single Resolution Board; Christophe Nijdam, Secretary General, Finance Watch; Fatima Pires, Head of the Financial Regulation Division, European Central Bank; Emiliano Tornese, Deputy Head, Resolution and Crisis Management Unit, European Commission; moderated by Prof. Jörg Rocholl, President, ESMT European School of Management and Technology

Referring to Ms König's remark on the abandonment of market economy rules, Jörg Rocholl opened the discussion by emphasising the suitability of the location (the former Staatsrat of the GDR which ESMT now uses) to debate such questions.

From there, the panel concurred that much progress has been made, particularly at the national level, in terms of resolution policy. What is still missing, however, as Emiliano Tornese highlighted, is "now that the BRRD is in place in EU member states, even those not participating in the Banking Union, it has to be made operational". Fatima Pires echoed this sentiment, adding that the "8% bail-in requirement to access the SRF is a fundamental game-changer" in providing enough loss-absorbing capital in times of crisis to ensure continued operations. For her, introducing a common insolvency regime is an area for future work to ensure that resolution actions will work effectively across borders.

Introducing a common insolvency regime is an area for future work.

Mr Nijdam highlighted areas of perceived weakness, including the feasibility of acting quickly, with clarity, and decisively to avert a future crisis. Taking the example of EU Living Wills and 18,000 page resolution plans for some banks, he questioned: "do we know whether they can resolve an issue in a bank over a weekend?" Confidentiality remains a major stumbling block. Furthermore, he was sceptical that in practice the taxpayer would not be burdened, suggesting that bail-in-able liabilities would not be sufficient and resolution not realistic for "too big" institutions. Resolution, he argued, is impossible for the biggest institutions, especially when considering the complexity of their structures and the political environment with which and in which the resolution authorities have to operate. Ultimately member states will seek to protect their own national interest.

Bail-in-able liabilities would not be sufficient and resolution not realistic for "too big" institutions.

Elke König agreed with the concern raised by Ms Pires about the lack of harmonised insolvency laws across Europe, but stressed that what Europe does have is mutual recognition of resolution policy at an EU-level. Getting this has been a giant step for Europe. At a global level, this cooperation is voluntary, but work is being done to strengthen resolution planning beyond the eurozone, with the Bank of England, with the US, and with countries in Asia. With regards to the size of bail-inable liabilities, she was confident that it is sufficient. The 8% bail-in is a minimum requirement, and more is expected. On the question of resolving a bank over a weekend, this has to be seen in the context of longer process of dealing with a failing institution.

The 8% bail-in is a minimum requirement, and more is expected.

There are now many more checks and balances in the system. Resolution planning has to have a forward-looking dimension - working to separate critical functions and secure them.

Each authority is learning to use their own tools and sharing their experience with other authorities.

Fatima Pires suggested that the enhanced information exchange being developed by the SSM and SRB plays a significant role here. Olivier Jaudoin reiterated this, saying that "each authority is learning to use their own tools and sharing their experience with other authorities", and reminded the audience that the resolution is not a technical exercise but has social impact. The SRB, he said, "is unique in its position to take such a strong decision."

A range of insightful questions from the audience picked up on the preference in Europe for private sector solutions before using the SRF; ensuring adequate liquidity provision for international banks by involving more than one central bank; and a reiteration of how beneficial it would be to harmonise insolvency laws across member states, as Fatima Pires concluded, "It would be better to find a European solution rather than a patchwork solution."

Panel 2

Resolution Tools: How to make Bail-in operational and effective?

with Günter Borgel, Member of the Management Board, Federal Agency for Financial Market Stabilisation; Dr. Thomas Dohrn, Policy Expert, Resolution Unit, European Banking Authority; Monica Marcucci, Senior Lawyer, Legal Department, Bank of Italy; Dr. Wilfried Paus, Head of Risk Analytics and Living Wills, Deutsche Bank; Dr. Sven Schelo, Partner, Linklaters; moderated by Prof. Marcel Fratzscher, President, German Institute for Economic Research, DIW Berlin

Marcel Fratzscher welcomed the opportunity to discuss the practical details of bail-in with such a well-placed panel representing both the public and private sector.

For Thomas Dohrn, bail-in policy is a very positive step, which gives the authorities the confidence that bail-ins are both feasible and credible. There are some issues to fix before it can become fully operational: these include ensuring sufficient loss absorption capacity, working towards harmonising insolvency laws, and practical steps in improving a timely and accurate valuation process. More standardised financial products would make valuation, as well as supervision and any potential resolution, easier.

Transparency of the resolution plan - a playbook on how to execute resolution - is essential.

From his perspective at Deutsche Bank, Wilfried Paus addressed the practical steps banks are taking to reduce the barriers to resolvability and enable them to run a bank resolution bail-in in a very short space of time if required, including rationalising bail-in liabilities and assessing what would have to be done to open a bank on a Monday morning following recapitalisation via a bail-in. Transparency of the resolution plan - "a playbook on how to execute resolution" - is essential.

Resolution should also be viewed as restructuring; it is not just about liquidation.

Sven Schelo outlined the legal factors within the resolution toolbox. Despite the guidance of supervisory and resolution rules, any process to make a particular bank more stable would be very individual and would require an ongoing, in-depth dialogue between resolution bodies and banks. Resolution, he argued, should also be viewed as restructuring; it is not just about liquidation but about a business opportunity to shore up a bank's credibility.

Monica Marcucci outlined the existing legal obstacles to resolution. She suggested that there is a mismatch between bank resolution authority and general legal liability. Progress has been made through the Financial Stability Board, but there still needs to be greater political awareness on this, especially in the area of non-harmonised insolvency laws.

For Günter Borgel, the success of bail-in would be dependent on three factors: first, making sure the IT systems are in place in banks to enable valuation in 48 hours and this could be effectively communicated to all those necessary to meet legal requirements; second, that liquidity funding is credible enough to give the market reassurance - as he later reiterated "without liquidity there is no life"; and third, that banks are operationally prepared to execute these processes.

The panel agreed that, for the banks, this level of preparation involves significant infrastructure projects to improve internal information flows and to change IT systems from quarterly to one-day reporting (a process which would necessarily take some time to bring into being). Though costly, Wilfried Paus suggested that such projects represent an "opportunity" for banks to "tidy-up" and function more efficiently.

The current harmonisation is not a global panacea, and we should continue to consider other ways to address conflicts in varying laws.

The issue of internationally harmonising the resolution process was discussed in detail, with a specific focus on the ranking of creditors, treatment of securities, and on derivatives. For Thomas Dohrn, the benefits of harmonising are clear, but the current risks should not be exaggerated, as the BRRD does already provide mediation in this field. Ms Marcucci contended that: "It is a risk we should keep in mind: the current harmonisation is not a global panacea and we should continue to consider other ways to address conflicts in varying laws and misalignments in jurisdictions." This concern was shared by Sven Schelo, who argued that, "There have been lots of cases in which harmonisation was really needed." Wilfried Paus added that the real issue is outside Europe - it is a positive sign that the dialogue on this has at least started.

The questions from the audience concerned the approach to rapid valuation of a struggling bank - whether this would mean a "fire-sale" or regular valuation. The aligned response from Mr Borgel and Mr Schelo was that they could see no reason, unless in highly exceptional circumstances, that there would be a fire-sale valuation and, in the case of insolvency, assets would be sold off at market value. There was also a question on the learnings from the recent bail-in in Cyprus, which according to Mr Dohrn was "not a positive example and showed the need for harmonised rules rather than an ad-hoc solution combined with certain bilateral agreements."

Panel 3

Crisis Prevention and Macroprudential Policy: Mission impossible?

with Prof. Arnoud Boot, University of Amsterdam, and Co-Director, Amsterdam Center for Law and Economics; Prof. Stijn Claessens, Senior Adviser, International Finance Division, Board of Governors of the Federal Reserve System; Francesco Mazzaferro, Head of the Secretariat, European Systemic Risk Board; Dr. Rolf Strauch, Member of the Management Board, European Stability Mechanism; moderated by Prof. Henrik Enderlein, Director, Jacques Delors Institut - Berlin, and Professor of Political Economy, Hertie School of Governance

Henrik Enderlein´s first set of questions to the panel addressed whether the European Systemic Risk Board has effectively managed the complicated interactions between monetary policy to ensure financial stability and macroprudential policy to ensure economic stability, and whether there is a difficulty in the ECB's dual mandate. Francesco Mazzaferro put forward that macroprudential policy, which is so essential to the eurozone because of its varying financial cycles, is already a reality. It is being used, especially in smaller countries; as Arnoud Boot supported, though adding that there still have to be further political developments at national and European levels to ensure that macroprudential policy can be employed effectively.

The European Stability Mechanism has shown that it can be a very efficient firefighter.

On the ability of the ESRB to act decisively in times of crisis, Rolf Strauch suggested that the European Stability Mechanism (ESM) is the final in line of a number of instruments. It was created as a firewall but now serves as a firefighter - and "we have shown we can be very efficient firefighters". Its role ongoing should be to facilitate a better monetary union, in which macroprudential policy plays a big part. As it stands, the ESM is an effective financial backstop and provides an efficient model for correcting imbalances when a country runs into trouble.

Work still needs to be done to improve the ESRB and ESM's effectiveness.

Stijn Claessen detailed the work that still needs to be done to improve the ESRB and ESM's effectiveness and suggested that, whilst there are some lessons that can be drawn from the US (on banking mechanisms and state insolvencies, for example), many aspects of the European situation are unique, especially when it comes to the political challenges of any fiscal alignment. Mr Boot agreed that democratic legitimacy in the EU is critical. Striving for such legitimacy was in fact behind the creation of the ESRB because at the time of the financial crisis national governments could not take any further steps. This again highlights the importance of macroprudential policy for Europe in "preventing countries running off track with domestic banking systems destroying national economies". Europe, Arnoud Boot argued, has to work towards building the right instruments to regulate a very fluid financial system.

Europe has to work towards building the right instruments to regulate a very fluid financial system.

The discussion moved on to where the next crisis might come from and whether we really are legislating against what might come in the future rather than focusing too much on the past. To this, the panel agreed that,

Future crises are inevitable but we can build a smart system to absorb the shocks.

given the size of the most recent crisis, it is essential to "leave no stone unturned" in understanding how it might have been prevented. Francesco Mazzaferro added how helpful the ESRB's data work has been in achieving this understanding. As Mr Boot explained, this is not an argument, however, for overregulation but for smart regulation. Future crises are inevitable, there will be microeconomic imbalances, but, "we can build buffers, we can build a smart system to absorb the shocks." Mr Strauch was of the opinion that in detecting a future crisis, "analytical tools are good but can only go so far." The eurozone has to become as resilient as possible with effective macroprudential policy. The toolkit available to the ESRB and to national authorities requires additions. Macroprudential works on the supply side, but real estate, for example, should be addressed from the demand side. There are other systemic risks outside of banks to be considered, such as insurance companies because of the huge sums of money they invest, search for yield, and the impact any reverse in quantitative easing might have on them.

The ESRB can deal with credit booms through behind the scenes interventions.

In response to questions from the audience, Arnoud Boot confirmed that the ESRB should not be considered a paper tiger because steps, such as the Banking Union and risk-sharing policies, have been taken to make it possible to act in a crisis; a point supported by Stijn Claessen, who said that it can deal with credit booms through behind the scenes interventions, as well as by Francesco Mazzaferro, who cited the recent examples of Poland, Hungary, and Croatia. All agreed that the ESRB and macroprudential policy puts Europe in a strong position to counteract future crises and shore up economic stability ongoing.

Panel 4

The EU Financial System: How to better design for Growth?

with Colin Ellis, Chief Credit Officer, Moody's; Dr. Levin Holle, Director General, Financial Markets Policy Department, German Federal Ministry of Finance; Liz Meneghello, Head of Capital Markets Union an CCP Resolution, HM Treasury; Martin Merlin, Director Financial Markets, European Commission; Dr. Christian Thimann, Member of the Executive Committee, Axa Group; moderated by Nicolas Véron, Senior Fellow, Bruegel

The Capital Markets Union is a big part of the shift of focus from stability to growth.

This was a stellar panel, Nicolas Véron said, for moving the discussion from stability to growth. That it is now the right time in Europe to shift the focus from stabilisation to growth was supported across the panel. Liz Meneghello gave the UK Treasury perspective, suggesting that the Capital Markets Union is a big part of this shift of focus from stability to jobs and growth. In this, it is important, she said, "to step back and check the overall coherence of the recent financial market reform for anything that might inhibit growth." The financial system by and in itself cannot generate growth, argued Levin Holle, but it can support growth. The question now is how best to do this - one thing that's certain is that there has to be a move to provide financing for the real economy. On whether banking regulation has become

onerous, Martin Merlin stressed that the regulation framework in place has to prove whether it is fit for purpose - providing stability and helping companies in need of investment.

The panel then discussed whether the level of dependence on banks for investment is too high in Europe. Positive signs that this is changing include disintermediation, more active engagement by business angels, and a growing sector of peer-to-peer lending - improvements in part triggered by the crisis, according to Colin Ellis. Making sure high-growth SMEs, who innovate, create something new, and have the potential for rapid expansion, get access to capital is very important. Ms Meneghello added that working to address the problems and gaps in cross-border investment would help here. In response, Mr Merlin outlined the measures being undertaken by the European Commission to aid this, including co-investment activities with EU public money and private money; improvements in venture capital legislation; creating tax incentives for venture capitalists in member states; and strengthening regional financial centres rather than just looking to London, Frankfurt, or Paris for capital.

Europe does not need to mimic the US. Where banks provide financing well, there is no need to change the system.

Mr Merlin emphasised that we should not be making such a clear distinction between market-based finance and banks, as the sectors are intertwined and, either way in Europe, we need to ensure more money is going into the economy. Europe, he argued, "does not need to mimic the US. Where banks provide financing well, there is no need to change the system." For Colin Ellis, establishing a greater balance in Europe between market-based financing and banks would be good thing. Having an insolvency framework in place would help incentivise that, Ms Meneghello and Mr Merlin agreed.

To the audience question on the Cumulative Impact Assessment, Levin Holle stressed the importance of assessing the implications of the softer, more detailed regulation which the national regulatory agencies are now producing following the completion of the policy-making stage. Christian Thimann agreed that this assessment is a great initiative, but added that it is "a mistake to exclude accounting rules." On the securitisation of SMEs, Mr Ellis responded that they represented a difficult class to classify; a point echoed by Mr Merlin because "SME loans are idiosyncratic." The European Commission's onus on the investor to validate the risk of their investments is disappointing, added Mr Thimann. They had hoped to see this done by a central agent - as it stands it is overwhelming in terms of detail and legal consequences.

SMEs represent a difficult class to classify for securitisation. SME loans are idiosyncratic.

The questions, addressed to Martin Merlin, turned to how to assess the impact of financial regulation for society at large. In response, Mr Merlin said that from the evidence he is confident that the benefits of stability and sustainability in the financial system far outweigh the costs. Due to regulation, it is now a better system. The onus now, however, is "not about fighting old battles but about identifying what does not work as it should."

FEEDBACK

Highly valued platform for debate of regulatory issues.

Thank you for organising the Financial Stability Conference, which was held at ESMT European School of Management and Technology. ESMT was pleased to contribute to the very successful event not only by providing the location but also as a scientific co-organiser. In a very short timeframe, the Financial Stability Conference has evolved into a valuable trademark event attracting outstanding international speakers from politics, regulation, academia, and industry. The quality of the discussion and exchange has helped to establish this conference as a highly valued platform for debate of regulatory issues in the financial system. I would be very happy to see it become a fixture in the conference landscape in the future.

Prof. Jörg Rocholl, President, ESMT

Reference in the European circuit for debates on financial policy challenges.

The Financial Stability Conference has become a reference in the European circuit for debates on financial policy challenges. We at Bruegel are proud of contributing to it, together with world-class German-based partner organisations.

Guntram Wolff, Director, and Nicolas Véron, Senior Fellow, Bruegel

Thanks so much for the extremely well-organised and interesting Financial Stability Conference 2015 in the impressive (now) ESMT building. For me as somebody who has just recently begun to dig into the matter it was a fantastic starting point to learn about the most important topics, players and people involved. I am looking forward to hearing and seeing more of your network in general and of your conference in particular.

Dr. Sebastian Wanke, Economist, KfW Bankengruppe

Courage to dissent and orientation on topics which will become most relevant in the future.

Thank you for all the efforts in organising this event. It has been a very stimulating and informative conference: Excellent keynote speeches, top-level panels with a very good mix of participants, courage to dissent and the orientation on topics which will become most relevant in the future.

Dr. Constantin Sobiella, Partner, d-fine

Thank you very much for organising such a wonderful conference. I really enjoyed my time at the conference. I was very impressed by the high quality of the keynote speakers and participants of the different panel discussions. I had great discussions with representatives from authorities, industries and academics. I am looking forward to next year's conference.

Dr. Benedikt Sedlak, Regulatory and Corporate Affairs, BNP Paribas

The different views appeared perfectly reflected in the panels´ composition.

The Conference was perfectly organised in every detail. Even more importantly, the competence of the speakers along with the convivial approach drove the discussion towards the murkier and more debated issues in the European legal framework, giving the audience important insights. The different views currently expressed by scholars and experts appeared perfectly reflected in the panels' composition.

Prof. Lorenzo Stanghellini, University of Florence

Optimally chosen topics, giving room to global approaches to the contemplated issues.

First, the conference was remarkably organised with high-level speakers and audience, along with fine logistics. Second, the topics were optimally chosen, giving room to global approaches to the contemplated issues as well as to practical considerations about the implementation of the latest reforms. Last, it was the occasion to meet a lot of interesting people involved in financial business or regulation and to discuss bilaterally on more specific issues.

Olivier Jaudoin, Director Resolution, French Prudential Supervisory and Resolution Authority

High quality and most informative forum on key financial subjects for society at large.

As part of my duties as Secretary General, I have attended numerous conferences and panels in many European cities, and this one in Berlin was perfectly organised. It was a great conference center and a very high level of panelists in front of an impressively large and sophisticated audience. What Martin Aehling, together with the financial support of prestigious sponsors, has achieved is a high quality and most informative forum on key financial subjects for society at large.

Christophe Nijdam, Secretary General, Finance Watch

Interesting views on the strategic priorities in operationalising the new macroprudential policy.

This was a very interesting conference, fed by high-level speakers with outspoken and strong views. A useful opportunity to update knowledge on resolution framework, tools and bail-in, and realize the challenges when establishing credible and feasible resolution regimes. The session on macro-prudential policy and tools provided interesting views on the strategic priorities in operationalising the new macroprudential policy.

Rudi Bonte, Senior Advisor, Deloitte

Thanks for the well organised conference, with very good speakers, giving insight into recent regulatory activities from different angles. Attendes remain with the impression that many steps have been made towards a more integrated European banking regulation, yet lots of challenges, especially concerning harmonisation within Europe as well as practical implementation, still remain.

Prof. Martina Brück, Professor for Risk Management, Hochschule Koblenz

This event enabled approaching the challenges of the European financial market better.

The 2015 Financial Stability Conference was definitely worthwile attending. Top-class speakers and panelists from policy making bodies, European supervisors, financial players as well as academia and press gave valuable insights. Together with a broad range of attendees, this event enabled developing new perspectives on the matter and approaching the challenges of the European financial market better.

Stephan Lutz, Partner, PwC

FINANCIAL
RISK AND
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NETWORK

HOW TO DESIGN THE FUTURE EU FINANCIAL SYSTEM? RESOLUTION FRAMEWORK, CRISIS PREVENTION AND CAPITAL MARKETS UNION

Joint Conference, 28 October 2015, European School of Management and Technology

The Financial Risk and Stability Network is an independent initiative focusing on regulation and financial sector reforms in the EU. The mission is to offer a frame for open discussion and views exchange, to stimulate debates and to contribute to information on these issues.

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