IMPACT OF FINANCIAL REFORMS IN THE EURO-MEDITERRANEAN AREA
Marseille, 3-4 May 2018[1]

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On May 3 and 4 2018, senior policymakers from the Euro-Mediterranean area[2] assembled to take stock of key financial sector reforms initiated in the postscript to the 2008 global financial crisis. The crisis highlighted and increased major shortcoming in capital adequacy and liquidity of banks. This, in turn, led to loss of investor confidence, the rise of systemic risk in the international financial system, and a significant degradation of the real economy. In this context, the G20 took the lead on financial sector reforms, calling notably for strengthening the prudential framework and setting up new rules in macroprudential and resolution areas. In December 2017 the Basel Committee on Banking Supervision finalized Basel III reforms that provide regulatory certainty. The Basel III framework introduces notably revised standards for capital and new standards for liquidity and leverage frameworks, as well as macroprudential elements.

The event provided a platform to ascertain the impact of these reform agendas on financial stability and economic growth in participating economies. The event was also an opportunity to advance regional cooperation, peer learning, and joint policy approaches on financial sector development priorities. **Participants confirmed financial sector reforms have provided the foundation for a more resilient financial system and notably led to a significant increase in capital and liquidity buffers of banks.** Reforms have been implemented during a period of expansionary monetary and fiscal policies, which shows that the full efficiency of these policies relies in particular on their proper coordination

Within European Union jurisdictions, most of the components of financial reforms, including Basel III, as well as macroprudential and resolution tools, are in place. The crisis also led certain European Union economies to restructure their financial (banking) systems, including restructuring of stakeholders and private banks, overhauling corporate governance practices, and reforming insolvency regimes. **Countries in the Middle East and North Africa are more heterogeneous in nature. They have advanced, however, on core tenants of Basel II and III,**

[1] This high-level dialogue was initiated in 2013 thanks to a partnership between Banque de France, the World Bank Group and the Center for Mediterranean Integration (Marseille).

[2] The Euro-Mediterranean is an economic community of those countries bordering the Mediterranean Sea. From Europe attendees represented France, Italy, Spain, Malta, Cyprus, Greece, Portugal, Turkey, Albania, and Croatia. Attendees from the Middle East and North Africa represented Morocco, Tunisia, Libya, Egypt, Jordan, and Lebanon. Participants from international institutions and regulatory bodies were on hand from the World Bank Group, the Basel Committee Bank of International Settlements, and the European Central Bank.

particularly with regards to the risk-based capital framework, including capital buffers and revised approaches to credit risk, and to the liquidity framework and the minimum leverage ratio requirements.

Participants underscored the importance of implementing reforms taking into account the structure of individual economies and regions, as well as the broader development objectives such as economic growth and financial inclusion of both households and small and medium-sized enterprises. Participants discussed elements of proportionality embedded in the Basel regulatory framework, most notably the different approaches available for different types of risks (credit risk, market risk, etc). Also, they noted that the majority of the banking system comprises non-internationally active banks so that a further proportionate approach may be warranted for such banks.

Authorities have increased efforts in implementing microprudential reforms in line with financial stability objectives, and given the structure and vulnerabilities of individual financial sectors. As these reforms are still relatively recent policy tools, efforts in many jurisdictions focus on building supervisory capacity to identify and address emerging risks and related supervisory challenges. These include outstanding macro fiscal positions, fluctuations in capital flows to emerging economies, and potential impact of reforms on market liquidity and asset prices. This in addition to broader financial stability concerns surrounding shadow banking and alternative credit channels resulting from fintech developments.

Work with regards to macroprudential supervisory tools continue, including through the implementation of countercyclical buffers under the Basel III framework. Eurozone policymakers are advancing on elements of the banking union, specifically the single supervisory and resolutions mechanisms -that are already in place and are functioning - and the single deposit guarantee system - on which authorities are still working. **A new resolution framework is emerging across economies, including more proactive intervention measures, and stronger power and tools for authorities (bail-in provisions, bridge banks, a last resort common backstop, and resolution funds). Practical guidance in implementing such tools will be critical to their success.**

National authorities stressed the importance of monitoring, evaluating, and managing the cross-border impact of financial reforms and preventing regulatory fragmentation, particularly given that large banking groups operate across both the European Union and the Middle East and North Africa.

National authorities noted the increase in supervisory mandates at the regional level in terms of conducting macroprudential reviews as well as being able to conduct microprudential supervisory actions (e.g. onsite inspections, capital buffers). Participants noted the complexity and challenges with the implementation of a large number of new regulations, particularly for legal/judicial bodies who are at the forefront of transposing and interpreting such regulations. There is an ongoing need to advance on proactive management of NPLs, which continue to drag down banking sector performance by putting pressure on their profitability and are a source of

risk. With regards to fiscal policy, there is a need to closely monitor overall debt levels in the context of an expansionary monetary policy. This is particularly true for countries with pegged exchange rates, which would have challenges using monetary policy during periods of financial stress.

Financial inclusion and inclusive financing sources for SMEs remain a policy priority. Financial inclusion is a key driver to promote economic inclusion of vulnerable groups and critical to the expansion of productive firms, including start-up firms through early stage equity capital. With regards to long-term finance, promoting adapted approach to regulation for small firms and promoting a greater balance between banking and market-based financing mechanisms, can strengthen financial stability through diversification and reducing maturity mismatches.

Overall, participants noted that the regulatory response since the 2008 financial crisis has been robust, bridging fiscal, monetary and prudential policies alongside new global regulatory frameworks addressing structural issues surrounding credit, liquidity, and leverage-related risks. **Moving forward, participants highlighted the need for further cooperation and technical precision to ensure effective implementation of both micro and macroprudential regulatory reforms.** This is particularly true within the Eurozone’s single supervisory mechanism as regulatory frameworks are rolled out across the Eurozone. Given the increasing number of standards, the expected impact on financial sector operations and efficiency must be regularly assessed.

Looking ahead, participants agreed to redouble efforts to ensure a stable financial sector in the Euro-Mediterranean as a critical precursor to sustainable and responsible economic growth. The CMI, in partnership with the World Bank and Banque de France, recognizes inclusive and sound financial sector intermediation as a key vector of Euro-Mediterranean integration, paving the way for future events on the topic.