



***Financial Regulation - Stability versus Uniformity
A focus on non-bank actors***

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Ladies and Gentlemen,

It is a great pleasure for me to introduce this Conference on a particularly topical issue: “Financial regulation-stability versus uniformity, a focus on non-banks actors”. The title of the conference invites all the participants to reflect on the puzzle policy makers are facing these days:

- on the one hand preventing regulatory arbitrage and ensuring a consistent approach to financial regulation between sectors
- and on the other hand taking into account the idiosyncratic business models and risks of each actor or sector of the financial system.

To explore further this question, I would like first to thank Professor Jean Tirole, the 2014 Nobel Memorial Prize in Economic Sciences who will deliver the keynote address today. I am also honored to welcome the distinguished speakers, academics, policy makers, industry representatives who agreed to share with us their views on how best to regulate non-banks actors.

Other the past few years, the Banque de France has developed a close cooperation with Jean and his colleagues from the Toulouse School of economics. This partnership is taking various forms, among which, for instance, the organization of several joint conferences on liquidity or on the future of regulation or on public debt and which materialized as special issues of our Financial Stability Review. Jean has also developed his thinking about macroprudential policy and strategic interactions. This is at the heart of today's conference.

Non-banks actors are frequently referred to in the media as "shadow banks". However, this does not mean that they are unregulated. Insurance companies, sometimes included in the definition of "shadow banking", are tightly regulated in France and supervised by the ACPR while the AMF supervises asset managers.

Regulating the shadow banking system has been and still is, as you know, a major objective for the G20 and the FSB since the 2008 financial crisis. The underlying objective was to prevent regulatory arbitrage and risk transfers outside the banking sector at a time where banking supervision has been considerably strengthened.

Even though this objective is a very legitimate one as far financial stability is concerned, I would like to emphasize two ideas:

(1) The first idea is that a number of pitfalls have emerged along the way. Indeed, consistency should not be mistaken with uniformity of the rules

(2) And the second idea is that a "one size fits all" approach of shadow banking regulation could lead to unintended adverse consequences.

- 1. Let me develop the first point: The 2008 crisis illustrated that the so called « shadow banking sector » played an important role in propagating and amplifying financial instability throughout the financial system. Shedding some light on these entities and regulating them to prevent contagion and regulatory arbitrage has been therefore a key milestone of the G20 Financial regulation agenda ever since. The Banque de France has been involved in this policy work from the outset.**

A first part of the work consisted in defining what the "shadow banking sector" is about. It does embody a wide variety of institutions worldwide which accomplish credit intermediation

along with maturity transformation outside of the “traditional” banking sector. As an output, it transforms illiquid assets into liquid ones.

The approach of shadow banking has progressively expanded to a variety of actors and activities: Money Markets Funds; Securitization, Repos and Securities Financing Transactions. The work dedicated to preventing the financial risks arising from the shadow banking system became intertwined with the work aiming at ending “too big to fail”. In the wake of the Globally Systemically Important Banks, the Financial Stability Board started working on identifying and defining a regulatory regime applicable to Globally Systemically Important Insurers (GSIs), Non-Bank-Non Insurance SIFIs (NBNIs), Critical Market Infrastructures/CCPs.

The focus of the work also shifted from monitoring/statistical reporting to rule making. Beyond the yearly shadow banking monitoring exercises, policy makers intended to make sure that no part of the financial system would be left unregulated and that a similar set of rules should apply to a similar set of risks. For the sake of a better regulation of globally systemically important institutions, some progress remains possible in the monitoring, and the need for relevant data in particular as regards the better understanding of inter-linkages among G-SII. Cross-sectorial consistency was seen as a key factor to prevent any opportunity for regulatory arbitrage and preserve appropriate level playing field.

The Financial Stability Board following the G20 recommendation has launched an ambitious regulatory program which aims at better controlling risks which are related the shadow banking sector. Indeed, the US have recently adopted a regulatory framework for Money Market Funds (July 2014). Other reviews are still ongoing, I am thinking of the assessment of risks and systemicity of asset managers whose assets under management have experienced a major growth these last few years, or the rapid development of ETFs providing real time liquidity on their liability while their matching assets have a lower liquidity.

In Europe, this global initiative translated into a number of regulatory initiatives such as the Securities Financing Transactions Regulation (repos and SFTRs) or the Regulation of Money Market Funds. The final objective was to turn the shadow banking sector into a safer and regulated “market-based financing”.

- 2. Coming now to my second point: even though regulatory arbitrage is a risk, consistency between sectors should not be mistaken with uniformity and a “one size fits all” approach could lead to unintended adverse consequences.**

From a financial stability perspective, one can easily draw the conclusion that risks of bank's runs and shadow banking entity's runs are very similar and therefore should have a similar regulatory treatment. Yet, the timing and consequences of higher lapses in insurance are hardly comparable to the banks' one. Moreover, the shadow banking sector is much more complex, not harmonized and hard to fully capture, even after the massive reduction of activities related to this sector which followed the financial crisis. Indeed, entities such as insurance companies, CCPs, asset managers and any other non-bank actors have their own business models and specificities.

Therefore mirroring by duplicating the GSIBs approach to these non-bank actors may either lead to inadequate policy options (TLAC for CCPs, ill calibrated Higher Loss Absorbency (HLA) for GSIBs) or to fostering pro-cyclicality. In this latter case, all market players would take the same positions, on the same financial instruments at the same time fostering a "one way" market. This herd behavior can lead to detrimental consequences in terms of financial stability by amplifying an irrational market decision based upon no fundamentals, which could rapidly spread to the whole financial sphere.

In addition, none of these sectors is unregulated today in Europe (AIFM directive for alternative funds, UCITS directives for funds, Solvency 2 for insurance, EMIR for CCPs) and replicating some rules stemming from banking supervision to these entities would simply be irrelevant.

More generally, it is up to the policy makers to act consistently and try to anticipate and mitigate any possible unintended effects of their policy decisions. For instance it might seem contradictory to encourage central clearing of derivatives or trading on organized trading platform as a means to reduce systemic risks on the one hand, while on the other hand levying a Financial Transaction Tax on these operations if they are deemed safer.

Policy makers should make sure their actions will not be a factor of market instability which could spread to the market and create another crisis.

Conclusion

As we can see, policy makers have still a lot of work on their plate as regards the design of an adequate regulatory framework for the "shadow banking sector" and for it to be sufficiently sound to be providing a sustainable "market based financing". The Capital Market Union's project launched by the European Commission is aiming at achieving to achieve a sound regulatory framework. To this end, for instance, the European Commission with the help of

the European Banking Association (EBA) has recently defined criteria for Simple, Transparent and Standardized (STS) securitization. The idea is both to regain investors' confidence in securitization assets, which we must admit still suffers from the US subprime crisis, and to encourage banks to deleverage loans portfolio from their balance sheet to refinance the real economy. By encouraging this new type of securitization, the European Commission is mindful to avoid another subprime crisis.

Indeed, rebalancing the financing mix of the EU economy as promoted in the CMU initiative is a valuable objective provided a rightly calibrated regulatory and risk framework is in place. These are some of the challenges to tackle in the years to come. And let me wish you a fruitful conference. I now leave the floor to Jean Tirole.