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"Banking risks, regulations and supervision"

Introductory speech by François Villeroy de Galhau,

Governor of the Banque de France

and Chairman of the Autorité de contrôle prudentiel et de résolution

Ladies and Gentlemen,

I am delighted to welcome you to this new conference organised by the Autorité de contrôle prudentiel et de résolution (ACPR). The three issues that will be discussed this morning – banking risks, regulation and supervision – are all essential and are naturally highly interdependent. To introduce this conference, I would particularly like to focus on the issue of regulations and their impact on the financing of the economy and growth.

As you know, this is the subject we chose to address this year in the Banque de France's Financial Stability Review, which will partly serve as a framework for your discussions this morning. Ten years after the beginning of the financial crisis and eight years after the G20 summits in London and Pittsburgh that forged a global action plan, it is time to take stock. We brought together 14 remarkable and complementary views for the Financial Stability Review from public authorities, academics and industry representatives. What emerges is, to my mind, both an achievement and a challenge.

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I. Firstly, an achievement: the banking and financial system is substantially more resilient today than it was ten years ago. This is thanks to unprecedented international cooperation on financial reforms under the aegis of the Financial Stability Board and the coordination of the Basel Committee in the banking sector, and thanks to the remarkable efforts made by the banking industry. Thankfully, the world of finance in 2017 is not what it was in 2007.

That is particularly true for banks in Europe and in France. It is important to stress this achievement, as the European banking sector is often criticised, particularly from the other side of the Atlantic, solely in the light of its difficult cases or institutions that are trailing at the rear, whereas on the whole, it is clearly far more robust than before the crisis. Banks in France for example, have doubled their levels of capital since the crisis and generate a return on equity (RoE) of 7%, and even up to 9% or 10% when adjusted for one-off items. As regards this return, it is clearly lower than the pre-crisis levels, but in certain respects, this can be expected and is reasonable. We cannot ask banks to generate a double-digit return on equity when interest rates and the risk-free rate are so low and banks are indeed more resilient than they were. Moreover, this improvement does not only concern the banks: it can also be seen in the non-banking sector and the financial markets, with particular progress made with regard to over-the-counter derivatives and the shadow banking system.

Regarding the **economic consequences** of the reforms, it is important first to remember the cost of the financial crisis: according to IMF data, the total loss of global output from 2007 to 2014 amounts to 25%. Compared to this considerable loss, the potential cost of financial regulation is very small. And above all, no one can seriously claim that in France or more generally in the majority of advanced economies the supply of credit has been excessively constrained by banking regulations. On the contrary, lending to the economy remains robust, with housing loans in France up 5.6% year-on-year in April 2017 and loans to non-financial corporations up 5.4%. In the coming months, this strong overall growth may actually warrant general vigilance and closer scrutiny by the High Council for Financial Stability, in which I participate.

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II. Nevertheless, we are still faced with a challenge for the future, which brings me to my second point: even if the achievement is now on solid foundations, there is clearly no room today for complacency or respite. Although the risks of a future crisis have diminished, no one should believe that they have disappeared entirely.

So what measures are required? For **banks**, the priority is to stabilise the regulatory framework and therefore we must finalise Basel III. Here, it is useful to remember that, essentially – let's say approximately 80% – Basel III was already completed in 2011. In addition, there is now a broad consensus on risk measurement approaches. The main point that is still undecided and which continues to occupy the Committee members is the setting of the so-called "output floor" for banks that apply internal models. Let's be clear: I read and hear the banking industry, and French banks in particular, giving its advice for negotiations on this point. A little restraint would not go amiss, and it is not our intention to defend corporate interests. If an output floor of 75% is not acceptable, it is because this floor – and consequently the standardised approach – would become the constraint for half of the international banks. I must stress that **our goal is to finalise Basel III, based on improved models that remain risk sensitive, and not to move onto Basel IV, which would use the standardised approach**. Therefore, an agreement must be reached on a lower output floor along with a tightening of controls over the banks' internal models, much like the targeted review of internal models (TRIM) that was approved for the Single Supervisory Mechanism and the results of which we are more than willing to submit to peer-review. This stance is shared at the very least by other European countries such as Germany and the Netherlands, and by the European Commission.

International cooperation on financial reforms is a common good that has been extremely precious during these past eight years and is crucial to our future. The temptation to go back on it is extremely dangerous and would increase the risk of another financial crisis. In this respect, the current situation in the United States is worrying. Generally speaking, the measures that will be effectively adopted and implemented by the new administration and the competent government agencies regarding financial and banking regulation still have to be clarified. There is a possibility that the regulations already finalised in Basel such as the Fundamental Review of the Trading Book (FRTB) or the Net Stable Funding Ratio (NSFR) could be called into question. Unilateral deregulation would be nothing less than a lose-lose scenario with serious consequences for the stability of the global financial system as well as the competitive landscape for US and European banks. In view of this, the integration of a possible agreement on Basel III into European standards should be finalised while keeping a close eye on what the other major countries will do, starting, as you will have understood, with the United States.

We must also avoid regulatory arbitrage. For **non-bank** players, significant progress is required on liquidity management by funds and asset management companies, on fintechs and more generally on the major digital platforms, which, if they carry out financial activities, will have to comply with similar regulations sooner or later. As for the financial markets, the decrease in market liquidity must be explained, and in doing so we must also consider the role of high frequency trading and its highly debatable social utility.

A final word on **central counterparties** (CCP): I would like to acknowledge the valuable proposals recently made by the European Commission to insist that those CCPs whose activities are "super-systemic" for the EU market establish themselves in the European Union. They are a step in the right direction and represent the only viable mechanism to guarantee that European authorities and national central banks in particular, can control and manage the risks that CCPs are likely to pose to the financial stability of the European Union. Once the provisions on the resolution of CCPs have been finalised, the compensation framework within the EU will have been improved considerably.

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Let me conclude with a general remark that concerns the economy: we need a system to assess, ex post, the economic effects of the reforms. France fully supports the work of the FSB to develop a structured analytical framework, which Germany has rightly included in its priorities for its G20 presidency.

Europe, and Germany and France in particular, now has a special duty to protect financial regulation – a regulation that is sensitive to risk, balanced in its treatment of banks and non-banks and binds the entire international community. Generally, that is what we've been doing well since 2009, and it is what continues to inspire us. Thank you for your attention and I wish you an excellent conference.