

Jean-Claude Trichet: Shaping the future of global financial market regulation

Transcript of a short video interview with Mr Jean-Claude Trichet, President of the European Central Bank, at the Netherlands Bank's Amsterdam Financial Forum 2009, Amsterdam, 28 November 2009.

* * *

President Trichet, we really appreciate your willingness to address the Amsterdam Financial Forum. What would be your main messages for the Financial Forum?

It is a great pleasure to address the Financial Forum that will discuss topical issues for the long-term stability of the financial system and for the economy as a whole. Regrettably I cannot join you in person. By the time you see this video, I am on my way to China for our euro area-China dialogue. Nevertheless, I would like to share with you some of my views on the ongoing regulatory reform agenda.

I would like to pay tribute to the role of the Basel Committee and its Chair, my colleague Nout Wellink. The Basel Committee is one of the major fora shaping the future of financial market regulation. I would like to highlight in particular the Committee's main priorities over the short-term and the challenges it faces in the coming year.

President Trichet, what impact did the decisions of the G20 have on the work of the Basel Committee and its governance?

The leadership of the G20 in determining the new financial regulatory framework has led to a strengthening of the Basel Committee and of its governance. The Basel Committee broadened its membership in June to include new representatives from the G20 countries as well as from Hong Kong and Singapore. Strengthening the governance of the Basel Committee was crucial to enhance the Committee's ability to carry out its core mission of improving global supervisory practices and standards. Its new governance is expected to also contribute to the effective implementation of reforms, including in major emerging countries.

What exactly is your role in the Basel Committee?

I have the honour of chairing the oversight body of the Basel Committee. We have extended the membership to supervisory authorities and central banks of 27 countries. In September, we met in the new composition for the first time. This was, indeed, a very important and, I must say, challenging meeting given the issues at stake. I was very pleased that we reached agreement on a comprehensive set of priorities for the work of the Basel Committee in the short-term. These measures will constitute a major overhaul of the prudential framework and will improve the resilience of the financial system. In particular, we have committed to improve the risk-weighted capital requirements; to establish countercyclical capital buffers; and to introduce a global liquidity standard as well as a leverage ratio that will supplement risk-weighted capital requirements.

Could you elaborate a little further on these issues? What will be the implications for financial institutions?

First, financial institutions will have to raise the **quality, consistency and transparency of capital**. Tier 1 capital should be predominantly composed of common shares and retained earnings to increase its loss-absorbing capacity. A common definition of capital and appropriate disclosure of its components will be internationally established. This will contribute to increased transparency and comparability.

Second, a framework of **countercyclical capital buffers** above the minimum requirement will be introduced. The Basel Committee will set up appropriate indicators for the build-up

and release of these buffers. Measures for the conservation of capital will also be considered, such as constraints on its distribution.

Third, a non risk-based leverage ratio will supplement risk-based capital requirements and help to curb excessive balance sheet growth. To ensure the comparability of the leverage ratio at the global level, necessary adjustments, for instance in accounting rules, will be made.

Fourth, banks will be subject to a minimum **global standard for funding liquidity**. This new standard will include a stressed liquidity coverage ratio that will be underpinned by a longer-term structural liquidity ratio.

Finally, there is one more very important issue that I would like to mention. This issue is **compensation**. The G20 Leaders endorsed the Financial Stability Board's implementation standards to align compensation with prudent risk-taking and long-term performance. The Basel Committee has set up a network of senior supervisors to monitor the implementation of these standards. As discussions around bank bonuses resurface, it is of the utmost importance that banks implement these standards immediately, and in time for the 2009 bonuses. I urge supervisors to ensure timely and consistent implementation. And once again I urge banks to behave responsibly in this respect and resist short-term temptation. We all have to be conscious that in the current episode, profit developments in individual institutions cannot be seen in isolation from the very large public support granted to the financial system as a whole.

President Trichet, are you satisfied with the results of regulation so far?

Yes, I am quite satisfied with the progress but the proof of the matter of course lies in the implementation. The far-reaching measures being developed by the Basel Committee under the presidency of Nout Wellink will result, over time, in higher capital and liquidity requirements as well as in less leverage and procyclicality in the banking system. The proposals on these measures will be issued by year-end. The calibration will take place in 2010. Their implementation will be phased in, taking into account expectations for the improvement of financial conditions and economic recovery.

But even though this comprehensive package is an achievement, it does not imply that the work is over. The challenges related to finalisation of the package in the coming years should not be underestimated. These include assessing the interplay of the adopted and upcoming measures, and deciding on the overall level of capital in the financial system.

What do you mean by the interplay of the various measures, will they complement or reinforce each other?

There will be an important interplay of the various measures. We will undertake an **impact assessment** to analyse their cumulative effect. The aim is not to simply add-up the various measures, but to take into account their interrelation. We need to look at the measures already taken and assess how they combine with the upcoming changes to the definition of capital, the introduction of a leverage ratio and of countercyclical capital buffers.

Are you not concerned that these measures will hamper efficiency of the banking sector?

We need to reach agreement on the **overall level of capital in the financial system** compared to pre-crisis levels, building on past and recent experience including national stress-testing exercises. In doing that, we need to strike a balance between a level of capital that promotes long-term financial stability without unduly compromising growth and efficiency of the banking sector. This will be no easy feat. We have challenging years ahead of us and I strongly urge the work of the Committee to continue at full speed. We mustn't lose either the momentum or the window of opportunity for reform.

How will these new regulations contribute to strengthening resilience of the financial system?

Speaking towards an audience in the Netherlands let me illustrate it with an analogy, drawing on a project well known to you. The Dutch have through time developed the Delta project – a series of defences to protect the stability of the nation, guarding it against floods. What we are trying to build is the Delta Project of the financial system that will protect it from risk excesses. If I may say, in this sense we are fortunate that the Basel Committee is chaired by a Dutchman!

As you know, the Delta Project, considered one of the seven wonders of the modern world, comprises different types of constructions, such as dams and dikes, that together protect the nation from the risk of flooding. Similarly, the set of regulatory measures being developed by the Basel Committee will act together as a series of defences against risks to financial stability. We also need to agree on the height of the defences we are putting in place as this is linked to the overall level of protection we are aiming at. This will determine the appropriate level of capital.

The official goal of the Delta Project is to reduce the risk of flooding. Let this be an inspiration for us in our efforts to safeguard the stability of the financial system.

Mr Trichet, thank you very much for your contribution.

Thank you for your attention. I wish you a stimulating and constructive discussion.