Jean-Claude Trichet: Financial integration, development and stability – lessons from the crisis (introductory remarks)

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the conference "Financial integration and stability: the legacy of the crisis", sponsored and organised by the European Central Bank and the European Commission, Frankfurt am Main, 12 April 2010.

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Ladies and Gentlemen,

I would like to welcome you to this conference on financial integration and stability, jointly organised by the ECB and the European Commission. I would like to thank in particular Commissioner Barnier for participating in this event, and his services for the smooth co-organisation of it.

This joint conference is an illustration of the very good cooperation that exists since a long time between the two institutions. The European Commission is in the driving seat on all what concerns financial integration. The ECB also a strong interest in this topic, because of the implications for the single monetary policy, our primary mandate, and also on financial stability and the operation of payment systems, areas where we have a statutory responsibility. The very good cooperation between our institutions has intensified in the wake of the financial crisis. Let me just mention the recommendations and guidance we developed in the course of last year on support measures for banks in difficulties. This joint work limited the risk of unilateral and uncoordinated support measures by governments and was therefore crucial in maintaining a level playing field and in preserving the Single Market.

It is a great pleasure for me to chair now the panel that will discuss some of key policy issues raised in the two reports presented to you earlier. We have the privilege of having four outstanding panellists with first hand experience in dealing with financial integration and stability at the highest level.

Michel Barnier is since early this year European Commissioner for Internal Market and Services and before that he held various ministerial posts in French cabinets, including that of Minister of Foreign Affairs and of European Affairs.

Jaime Caruana is since April last year General Manager of the Bank for International Settlements. Previously, he was counsellor to the Managing Director and Director of the Monetary and Capital Market Department of the IMF. Jaime was also Governor of the Bank of Spain, and in that capacity he served on the ECB's Governing Council.

Vikram Pandit is since end 2007 CEO of Citigroup, a truly global financial player which has a history of being present in more than 100 countries worldwide. He took the helm of Citi at a very difficult time, and since then has initiated a turnaround in the business model of the bank. Before that, Vikram had a long successful career in other financial institutions, including Morgan Stanley and Citi itself.

Alessandro Profumo has been CEO of Unicredit Group since it was founded in 1997. Unicredit Group can probably be qualified as the quintessential European cross-border banking group, with operations in 22 European countries and, amongst these 22, in 19 Central and Eastern European countries. Alessandro is also the President of the European Banking Association.

The last 2 to 3 years have been especially eventful for financial integration and stability, with once in a life-time developments. After Lehman Brothers filed for bankruptcy in September 2008, the global financial system experienced unprecedented stress and policy makers had to tread unknown territory in dealing with it.

The financial crisis has raised a host of policy issues that will provide food for reflection for generations to come. I will mention a few of them to set the scene and to kick-start the discussion.

The first set of issues relate to the developments in the late nineties and early 2000s. The combination of high economic growth, ample liquidity, increasing financial integration and development, and "light handed" regulation sewed the seeds of the crisis to come. I believe that a number of people and organisations, including mine, identified vulnerabilities in the financial system before the crisis erupted. Nevertheless, we did not anticipate the timing and the intensity. We should ask ourselves what we missed in the run-up to the crisis and what the lessons are for the future.

Once the crisis erupted in full force, a first casualty were the money markets, which provide the oil to make the banking system run smoothly. Money markets came to an unprecedented stand-still. Because they are so closely linked to monetary policy, they had shown signs of almost full integration right after the introduction of the euro. But with the crisis, a degree of re-segmentation took place again along national borders; and the Eurosystem had to step in to take on the intermediation role that these markets play in normal times.

Another set of issues relate to banking. Banks expanded both across borders and financial sectors, often combing commercial banking, investment banking and insurance business in one and the same group. The two groups whose CEOs are in the panel are clear examples of this evolution. But cross-border integration of rules and prudentials, including the institutional framework, has not proceeded with the same speed and there continue to be clear differences according to the activity type. Banking consolidation also raises sensitive moral hazard and crisis management questions, as painfully illustrated by the crisis.

The securities markets showed strong growth in the years before the crisis and clear signs of integration, though not to the same extent as observed in the euro money markets. With the crisis, bond price indictors showed signs of more dispersion across countries in Europe, but the question is whether this points to more segmented markets or rather increased risk awareness on the part of investors. Very topical in this respect is also the CDS market and its interaction with the underlying (sovereign) bond market. Finally, the integration of a securities market depends to a large extent on the integration of the supporting market infrastructure. This is an area where the Eurosystem and the European Commission have taken significant measures, but integration continues to be affected by legal, fiscal and technical issues.

An important set of issues on which the panellist may want to comment relate to the regulatory reform process, where the G20 provides the strategic impetus, the Financial Stability Board (FSB) plays an important role in policy coordination, and the Committees and working groups (such as the Basel Committee on Banking Supervision, which is the emblematic Global Committee) the review of specific international standards. Important regulatory reforms are underway in Europe, as well as in the United States, and I want to elaborate on them because they have important implications for the ECB.

As you know, the proposed reform for the financial supervisory framework in the EU will be based on two pillars. The micro-prudential pillar, the European System of Financial Supervisors (ESFS), will be composed of the national supervisors and three European Supervisory Authorities (ESAs). The European Systemic Risk Board (ESRB) will form the macro-prudential pillar.

Under the proposals of the European Commission, the ESAs will carry out a range of activities, including the issuance of binding and non-binding rules which will provide the basis of a so-called "single EU rulebook". The ESAs will further promote a consistent application of EU legislation and of a common supervisory culture, and provide for mediation in the case of disagreements between national supervisors. All this should lead to a more harmonised regulation and supervision across countries, and as a result also foster financial integration.

For central bankers, the part of the reform which directly concerns them is the establishment of the ESRB, a new independent body that will for the first time carry out a comprehensive macro-prudential oversight of the financial system of the EU. The ESRB will also issue risk warnings, and, where appropriate, recommendations, and follow up their implementation. This body will bring together the central bankers, the heads of the three supervisory authorities, the Commission together with the supervisors of the 27 EU Member States to regularly discuss and assess the financial stability conditions in the EU. In that respect, the ESRB shows some keen similarities with the Financial Stability Council in the proposed financial reform in the United States.

The ESRB is expected to support financial integration through its contribution to financial stability in the EU. Indeed, if market participants are confident that the authorities take properly into account the interdependencies between countries and the various components of the financial system, they are likely to fully exploit the possibilities offered by cross-border activities in the EU.

On the part of the ECB, I can assure you that we stand ready to support the ESRB, in particular taking into account the important presence of the members of the General Council of the ECB in the ESRB and the fact that the ECB will provide the secretariat and analytical, statistical, logistical and administrative support to the ESRB, as required under the legislative proposals. Preparatory work at the ECB has been organised through the setting up of an ad hoc team and is under way so that the ESRB can take up its work after its formal establishment. The ECB is in the process of enhancing its capabilities for monitoring and assessing financial stability risks. Only a number of weeks ago, we reformed our Directorate Financial Stability and Supervision into a Directorate General Financial Stability with more resources. In all this, we also try to draw as much as possible on synergies with existing work and resources, both within the ECB and the European System of Central Banks (ESCB), the constellation of the 27 national central banks of the European Union.

I would now turn to the panel and ask our guests to share with us their observations.