MONETARY PANEL
Madrid - 30 January 2009
Minutes of the meeting

Present

Wim BOONSTRA, President of the Monetary Panel

Andorra	Jan-Olaf SIPKES
Belgium	Jean-Claude KOEUNE Jean-Jacques REY
France	Philippe JURGENSEN Paul MENTRE
Germany	Rainer BODEN
Netherlands	Ruben van LEEUWEN
Spain	Javier ARIAS Roman ESCOLANO Carles GASOLIBA Rosa Maria GELPI

Speakers

Bouke de VRIES - Senior Economist Researcher - Rabobank Nederland
Pedro Pablo VILLASANTE - Secretary General - Spanish Banking Association

ELEC Secretariat

Jerry van WATERSCHOOT, Secretary General

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Introduction

The *President* took the chair at 9:15 and thanked BVBA for hosting the meeting. He recalled with pleasure the working dinner offered the night before and the lively discussion which had followed a stimulating presentation by Rafael Doménech, BVBA Head Economist for Spain and Europe, on the subject "Is the current financial crisis posing new challenges for EMU?".

1. Adoption of the agenda

The agenda was adopted.

2. Approval of the minutes of the last meeting

The minutes of the meeting held in Brussels on 7 Nov. were approved.

3. Deposit Guarantee Systems

The *President* gave the floor to Bouke de Vries for a presentation entitled "Reform of deposit guarantee systems and impact of government interventions". Mr *de Vries* first recalled the emergence of the credit crisis, retraced the chain of causes and events which had led to the forming of a bubble in the United States followed by its bursting, and stressed the vast amounts of capital ($2,200bn by IMF's latest count) that had already been lost in the process. He went on to show how governments and central banks had managed the crisis thus far and analyzed the effectiveness of their interventions, referring in particular to the solution imposed by the Dutch government for the rescue of ING. He finally focused on deposit guarantee schemes, underlining the main dilemma's faced by such systems and presenting the recommendations made by Rabobank in this regard.

The *President* thanked Mr de Vries and opened the floor for a debate. For the sake of clarity the numerous interventions were regrouped under the following headings:

- <u>On the financial crisis</u>: Mr *Boonstra* stressed the tolerance of huge external imbalances as a contributing factor; Mr *van Waterschoot* wondered whether the considerable easing of monetary policy undertaken to restore liquidity in the system might not generate another bubble in a few years; Mr *Jurgensen* retorted that, with new credit having steeply declined, such easing had not provoked so far excessive money creation; Mr *Sipkes* stressed that the ongoing deleveraging process implied that economic growth, whenever it would resume, would not go back to its former levels, which were highly leveraged.

- <u>On government interventions in general</u>: Mr *Gasòliba* stressed the dangers of "neo-interventionism" and of misguided regulation that might stifle innovation; Mr *Jurgensen* retorted that the world was now suffering from an excess of past financial innovation and that financial supervision had been not so much deficient as incomplete, since it did not extend for instance to offshore centres and rating agencies; Ms *Gelpi* argued that the risk lay less in over-regulation than in its differentiation across countries; Mr *Gasòliba* expressed concern over the management of public deficits which were rising much above the limits set by the Stability and Growth Pact; Mr *Jurgensen* stressed that there were indeed limits to the bailing-out of banks by governments on account of excessive levels of public debt, but that there were no such limits if the bailing-out was done by central banks; Mr *Rey* suggested having a meeting of the Panel in Frankfurt in 2010 in order to hear the ECB give its retrospective analysis of the financial crisis and of its management.

- <u>On deposit guarantee schemes</u>: Mr *Mentré* referred to the unlimited guarantee given to Irish banks and wondered whether Germany had not taken the same road; Mr *Boden* said that there had indeed been a political declaration to that effect, but that it had not been put into law; Mr *Arias* wondered to what extent such schemes ought to be funded; Mr *de Vries* said that any funded system would be insufficient in case of failure of a big bank; Mr *Boonstra* argued that accumulated interest on deposits should be kept out of the guarantee; Ms *Gelpi* stressed the need to avoid moral hazard.

- <u>On "bad banks" and the Dutch solution in the ING case</u>: Mr *van Leeuwen* raised the question of the correct pricing of "toxic assets"; Mr *de Vries* said that the solution imposed by Dutch authorities avoided forcing new prices upon markets; Mr *Arias* said it had the merit of buying time; Mr *Boonstra* argued that the Dutch government had in fact overruled IFRS; Mr *Boden* stressed the huge procyclicality of IFRS; Mr *Mentré* indicated that the last US rescue package for Citigroup was fairly similar to the solution adopted for ING; Mr *Rey* wondered to what extent the recession did not make the distinction between good and bad assets less and less relevant; Mr *Boden* argued that a "bad bank" solution could be useful in solving the short-run problem of how to restart credit but created a longer-term problem of how to liquidate the "bad bank", and he referred to the solution engineered by Sweden in its banking crisis of the early 1990s; Mr *Boonstra* said that a major issue was the prices at which banks could sell their "toxic assets" to the bad bank and that this could give rise to important distortions; Mr *Arias* stressed that the ING solution was better in that respect.

- <u>On competitive distortions</u>: Mr *Boden* expressed concern over the uneven playing-field arising from various types of rescue operations mounted by governments; Mr *Arias* referred to the rescuing of British banks, which through their international operations could well affect other markets; Mr *de Vries* argued that the banking industry itself should come out in favour of rescue solutions that would be less disruptive of competition; Mr *van Waterschoot* said that politicians, being focused on the next election, tended to adopt solutions they could easily "sell" to the public; Mr *Escolano* argued that too often the conditionality of aid, which dampened its competition-disruptive effect, was forgotten; moreover he perceived a blind spot in EU-legislation concerning exit strategies, as a result of which governments having set foot in banks and being tempted to stay could not be legally prevented from doing so; Mr *Boden* said that indeed the Commission did not have the power to force governments to privatize, and that the new Commission at the end of the year would likely face strong pressures from governments.

- <u>On dangers to the internal market:</u> Mr *Arias* expressed concern over the risk of undermining the internal market; Mr *de Vries* feared that, with national solutions being put in place, the cross-border banking model was under threat: in his view, an integration of Fortis NL with BNP-Paribas would be a better solution than the big national bank which the Dutch government seemed inclined to promote, and Mrs Kroes should step in to prevent such a national bank from having too large a market share; Mr *van Waterschoot* referred to the case of KBC in Belgium being rescued by the Flemish regional government because the federal government was divided.

The *President* brought the discussion to a close and asked whether ELEC should not publicly take a position and express its concern over competitive distortions and the threats to financial integration arising from misguided government interventions. Mr *Rey* advised caution, stressing that one was still facing emergency situations requiring prompt actions and that any reservations on such actions expressed by ELEC might be misinterpreted. Mr *Boden* volunteered to draft a preliminary statement with the help of Mr Arias. The Panel agreed that further discussions of the issues were needed and asked the Secretary General to investigate the possibility of organizing a meeting in Amsterdam in the afternoon of March 5, that is just before the start of the Monetary Conference- former "Kronberg" meeting- to be hosted by ING on March 5-6, with Panel members present at this meeting being encouraged to stay for the Monetary Conference.

4. Supervision and regulation

The *President* gave the floor to Mr *Villasante*, who first commented on the European responses to the crisis and the "tool-box" that was used, stressing that the recapitalization of banks with public funds could distort competition and arguing that state aid should be conditioned by the requirement of restructuring plans approved by the European Commission. He went on to analyze the Spanish business model in banking, based on commercial banking focused on customers, with no room for a "shadow-banking" system: Spanish banks, he said, had refrained from investing in opaque financial products, and whatever risks they assumed had remained on their supervised balance-sheets.

Further he gave his opinion on future reforms, stressing the need for strengthening capital requirements and risk management procedures, and pleading for greater transparency which however, in his view, would not be a new burden for Spanish banks, as they were already submitted to very demanding regulatory requirements by their central bank: he referred in this context to the system of "dynamic provisioning" introduced by the Bank of Spain in order to reduce procyclicality, which was attracting interest from abroad. Finally he exposed the position defended by the Spanish Bankers Association (SBA) on the future of banking supervision, promoting an evolutionary and pragmatic model giving priority to a unified system of capital requirements and to the granting of greater powers to a committee of European supervisors.

The *President* thanked Mr Villasante and opened the floor for a debate, which took place over lunch. Mr *Boden,* referring to Mr Trichet's recent statements, said that public discussion of future supervision had gone much beyond SBA's proposals. Mr *Villasante* replied that SBA's position was in line with the one taken by the European Banking Federation, which insisted that, pending an agreement on the

final architecture of the supervisory system, one should be pragmatic and first build on existing institutions. Mr *Koeune* referred to the housing crisis in Spain and asked whether Spanish supervisory authorities had sufficiently warned banks about the real estate bubble. Mr *Villasante* answered that the problem had mostly arisen from real interest rates being too low for Spain in the eurozone. Mr *Mentré* asked for details on the "dynamic provisioning" system. Mr *Villasante* indicated that initially it mostly considered the rate of economic growth but had become more refined and now took account of expected losses. Mr *Jurgensen* wondered whether future European supervision should be based on a single authority covering the whole financial sector (banking, insurance, and financial markets) or on several European bodies. Mr *Arias* raised the question of acceptable collateral and wondered whether the "level 3 committees" were effective enough to cope with current situation. Mr *Koeune* expressed puzzlement at the apparent silence of the European Banking Federation concerning the banking crisis and the many issues it raised. The *President* brought the discussion to a close and thanked Mr Villasante for having shared his views with great openness for the benefit of the Panel.

5.	**Date and place of the next meeting**

Amsterdam, 5 March 2009.

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