# The Financial Sector: At the service of the real economy?

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## Conference Report

After introducing each speaker, Mr. Etienne Davignon, President of the Egmont Institute, ceded the floor to Eric De Keuleneer, Professor at the Solvay Brussels School of Economics and Management. During his presentation, Prof. De Keuleneer discussed his most recent policy paper on reforming the financial sector. The first issue Prof. De Keuleneer addressed was risk taking in the commercial sector. According to Prof. De Keuleneer, commercial banks currently take too many risks and do not do enough to protect their deposits. For this reason, Prof. De Keuleneer believes that states must play a role in protecting deposits. In his opinion, state involvement should be modelled after the Federal Deposit Insurance Corporation (FDIC) in the United States, and should exist at both the Member State and Union level. Unfortunately, inadequately securing bank deposits is not the only problem currently plaguing the financial system. To this extent, , the ongoing centralization of derivatives would substantially reducing systemic risk within the financial sector. According to Prof. De Keuleneer, reforming banks' administrative bodies is central to financial sector reform. Such reforms should be focused on eliminating fraudulent behaviour within bank administration by transforming the "bonus culture" that encourages risk taking and takes undue advantage of depositors. Banks need to become more honest and transparent in order for financial reforms to fully take root.

Following Prof. De Keuleneer was Charles Goodhart, Director of the Financial Regulation Research Programme at the London School of Economics. Prof. Goodhart began his commentary on Prof. De Keuleneer's presentation by discussing the four most recent economic crises in the United Kingdom. According to Prof. Goodhart, each crisis was characterized by a sharp decrease in lending, and was preceded by a major property boom facilitated by a massive expansion of credit. When faced with a significant decrease in lending, politicians typically pass laws that prohibit property foreclosures, which, according to Prof. Goodhart, is not the quickest path to economic recovery. In order to mitigate the impact of the next financial crisis, which Prof. Goodhart predicts will occur in 2025, policymakers should focus on the housing market. To make the banking sector more secure, Prof. Goodhart advocates changing the equity ratio, reforming the remuneration system and allowing the European Central Bank to lend to the European Stability Mechanism to recapitalise banks. Regardless of which measures are taken, Prof. Goodhart believes that it will take two to three years for the financial sector to fully recover from the crisis.


Next to give his opinion on the current state and future of the financial sector was Mr. Olivier Guersent, the Head of Commissioner Michel Barnier's Cabinet. According to him, the European Union's priority should be to build resilience within the financial sector. However, Mr. Guersent also noted that the EU needs to find a balance between improving the resilience of the banking sector and using the banking sector to foster economic growth and stability. Contrary to Prof. Goodhart, Mr. Guersent strongly believes in focusing on the derivative markets, as "shadow banking" is riddled with risks. In addition to addressing the problems within the derivatives market, Mr. Guersent feels the EU needs to establish a set of unified principles for the EU tax regime and diversify finance sources for the economy by expanding the scope and authority of EU regulation. Furthermore, the EU should, according to Mr. Guersent, tackle market fragmentation and legitimize securitization by turning short term savings into long term investments.

Prof. Goodhart echoed Mr. Guersent's sentiments regarding fragmentation, and further stated that the ECB should seek to recapitalize markets through bail-in measures, through government involvement, and by allowing the ECB to finance the ESM. Prof. De Keuleneer highlighted the link between securitization and financial sector reform, and believes the EU needs to start exploring different approaches to securitization, including the approach the U.S. has taken.

The final speaker of the day was Koen Geens, Belgium's Federal Minister of Finance. Minister Geens began by discussing one of Europe's biggest upcoming challenges: establishing a Single Resolution Mechanism and a Resolution Fund. This "second pillar" of the Banking Union implies to some extent the mutualisation of risk. In order to establish a resolution and mechanism fund, however, the ECB must first visit all major European banks and asses their financial stability. In the event that a bank cannot cope with its problems on its own, the EU needs to implement backstops to prevent disorderly bank defaults. Each Member State has a different idea as to what these backstops should be. Another issue the EU must address is the structural reform of banks. While he acknowledged that it is a difficult issue, Minister Geens did argue that some iteration of the United States' Glass-Steagall Banking Act of 1933 should be considered.

Report by Rebecca Giles