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Abstract

Faced with the effects of the financial crisis on its financial markets, its banking sector and its economy, Europe did not remain inactive. The European Central Bank (ECB) intervened several times to calm tensions in the interbank market. Public resources were used to support activity and recapitalize institutions close to bankruptcy in some exposed countries. At Community level, the lessons of the crisis must also be drawn: by ensuring the transparency of the banks' liabilities and their exposure to the risks associated with securitization; by better structuring the derivatives markets; by modifying the rules applicable to the rating agencies; strengthening banking supervision at Community level, in particular for institutions operating in more than one Member State of the European Union (EU).

Europe was not spared by the crisis financial from the United States: its banks recorded significant losses through the securitization of subprime mortgages; some were saved from bankruptcy by public intervention (Northern Rock in the UK, Sachsen LB and IKB in Germany); stock indexes fell; some Member States were facing a downturn in their property market and growth slowed to just 1.9% in the euro area and 2.1% in the EU in 2008 compared with respectively 2.6 and 2.9% in 2007). In this situation, the EU institutions did not remain inactive. The ECB intervened in the summer of 2007 to avoid a liquidity crisis and worked in cooperation with the US Federal Reserve (Fed). On the other hand, the Commission and the Member States announced on several occasions their intention to learn quickly from the financial crisis. To this end, they defined a roadmap for the Ecofin Council (Council for Economic and Financial Affairs) of 13 November 2007, which identified four objectives:

- to improve market transparency (notably information on securitized debts);
- strengthen valuation standards for assets illiquid and complex financial instruments;
- to change the prudential framework of the banking sector;
- better regulate the role of rating agencies.

These issues were first discussed at the informal meeting of the ECOFIN Council on 4 and 5 April 2008. Here we present the elements that would allow Europe to provide a coherent and effective response to the current crisis. . The ECB reassured the markets by demonstrating that it can play its role as lender of last resort and by establishing effective cooperation with the Fed. Uncertainty about the extent of the losses associated with direct and indirect bank commitments on the market subprime had indeed created a movement of mistrust between the banks themselves, who became very reluctant to make loans. Faced with the risk of a liquidity crisis on the interbank market, the ECB had to intervene in August 2007, then in December of the same year, in the form of very short-term loans. These interventions were relatively effective: the spread between three-month rates and overnight rates on the interbank market returned to reasonable levels in February 2008, or 0.33 percentage points, instead of one percentage point at its maximum in December 2007. The interbank markets remain, however, subject to tension and regains it is not excluded that new interventions are needed. Nevertheless, could the ECB - which leaves its rates unchanged at 4% - have done more by imitating the Fed which reduced its interest rates from 5.75% in July 2007 to 2.25% in March 2008? This divergence of monetary policies has led to criticism from both sides, some accusing the Fed of reacting precipitately, others regretting the indifference ECB's to risks to activity and the exchange rate. In fact, the economic situation of the euro area was less worrying than that of the United States (Jamet 2008): the risk was that of a pronounced slowdown, not of a recession, and the euro zone was currently facing a real estate crisis. In addition, price stability remained the main objective of the ECB.

In a context where inflation reached 3.3% year-on-year in February, its Monetary Policy Committee remained justifiably cautious, especially as energy and commodity prices remained at very high levels and wage demands had risen in Europe without productivity having increased significantly. The stability of the ECB's key interest rates (which implies a reduction in real interest rates due to the acceleration of inflation) therefore seemed an appropriate response given the narrow path left to monetary policy. If inflationary pressures ease in the second or third quarter of 2008, the ECB could lower gradually its rates to limit the risk of credit contraction and transmission of the financial crisis to the real economy.

In the longer term, the ECB should also learn from the mistakes made by the Fed in the run-up to the crisis. Indeed, the Fed has encouraged the expansion of credit and the creation of the housing bubble by prolonging too long the interest rate cut that followed the financial crisis of 2000-2001: it has thus maintained negative interest rates in 2003 and 2004 when growth was strong (2.5% in 2003 and 3.6% in 2004). This overly accommodative monetary policy created a situation of "moral hazard" because the Fed had hinted that it would intervene strongly (which is legitimate) and prolonged (which is much less), without quickly raising its key rates stance once the systemic risk has been removed. The precipitous rise in the Fed's rates since 2004 then led to the explosion of the real estate whose effects must now be limited bubble in the emergency. It will be important not to repeat this error in the future.

The possibility of using public resources has been widely discussed, notably in the United States (and the International Monetary Fund (IMF), in order to support activity and recapitalize institutions close to bankruptcy (Kirrane 2017). However, must be this approach used with discretion. In the EU, the relevance of a fiscal stimulus varies from one Member State to another, depending on their exposure to the economic downturn and the state of public finances.

The crisis was to some extent an asymmetric shock: some countries like Spain, the United Kingdom, Ireland were exposed to a reversal of their real estate market, unlike other countries like Germany. These were, in addition, the countries for which the slowdown in growth

Should have been the most spectacular. The good state of their public finances nevertheless allowed them to have room for maneuver that they could use to temporarily support consumption and investment. On the other hand, this option was not open to other countries that were nevertheless exposed to the slowdown: this was the case in France because of its inability to return to a balanced budget in periods of above-potential growth, Italy because of the level of its public debt, and the Baltic countries where inflation is high. The use of public funds for the recapitalization of the financial system also requires a certain degree of caution: banks are certainly not companies like the others and the cost of a general loss of confidence in the financial system would be very high; We must therefore limit public intervention to what is necessary to ensure the solvency of banks so as not to create a situation of moral hazard (deprivation of profits when all is well and socialization of losses when everything goes wrong).

The opacity of financial instruments - such as (CDOs *collateralized debt obligations*) and(SIVs *special investment vehicles*) that have played an important role - has limited market transparency for investors who have as a result, taken undue risks , encouraged by the reassuring assessments of rating agencies. Providing new guarantees as to the transparency and quality of the information available on products resulting from financial innovation is therefore necessary. The EU has an important role to play in this regard, either by demanding commitments to good conduct from financial institutions or by supplementing existing regulations. It has also launched a major effort to standardize and reinforce the rules applicable to the European financial market with a view to promoting its integration since 1999. More than 26 framework directives as well as numerous implementing regulations and directives have been adopted under the Services Action Financial Plan. However, some fundamental issues remained outside the scope of the reform, in particular the exposure of banks to securitization, the structuring of derivatives markets and the role of rating agencies.

The lingering uncertainty about the amount of' liabilities banks- which sometimes took a long time to recognize that they were affected - has triggered repeated shocks in the financial markets, creating a situation of damaging mistrust. The first obligation of banks and credit institutions was therefore to restore the transparency of their balance sheet, the first element of an evaluation of the necessary actions. It was also a question of guaranteeing this transparency for the future so as to allow the return of trust. Banks will have to be more cautious about off-balance sheet commitments and securitization.

The EU must ensure that banks and credit institutions formally undertake to communicate to the public in a standardized manner the nature and amount of their commitments in the securitization markets, as well as the characteristics of the structured products they introduce: the shareholders of the banks, who must be demanding on this point, will thus know their real exposure to the risks related to securitization. The requirement to institutionalize audit committees to monitor risk exposure controls and their consequences would also be a useful step in this direction. It is also necessary to create an aggregation information capacity on financial instruments structured in circulation in order to facilitate regulation. The Commission has been working on these issues with the sector's industry associations - such as the European Banking Federation - which have committed to putting in place the necessary instruments by June 2008. It will be necessary to ensure that this self-regulatory effort is effective.

The crisis also raised the question of the organization of markets and the liquidity of derivatives credit. Credit institutions and supervisors of financial markets and the banking sector should work together to standardize derivatives and asset-backed securities. In view of the growth in transaction volumes processed "OTC" (*over the counter*), the creation of markets organized based on a clearing-house system would make it possible to reduce counterparty risk and ensure daily valuation of the value of contracts based on *market price*. This work should be undertaken starting with products that have proven themselves as fixed income securities *(fixed income* securities), the *swap* rates and credit derivatives for which trading volumes are already significant. This would contribute to the transparency of these markets and reduce the liquidity risk. In addition, issuers of securities backed by debt packages should be required to retain some of the associated risk (eg the riskiest tranche) to force a minimum of caution in issuing such securities and thus draw lessons from the subprime crisis .

Already implicated in the Asian crisis in 1997 and at the time of the Enron scandal in 2001, the rating agencies (Fitch, Moody's and Standard & Poor's) wereagain the target of criticism for their effectiveness and ethics (Portes 2008). They were all the more blamed for having acquired a quasi-regulatory role because of the assessments they provide for risks associated with financial products, including the most complex, and rules prudential based on these valuations ratings also have a pro-cyclical effect due to the tendency to snub at the top of the macro-financial cycle score in a and under-crisis to rebuild their reputation (Kirrane 2018). Among the criticisms that have been made of rating agencies, some of them concern the lack of rigor of the methods used, or the fact that the agencies do not take into account the liquidity risk, which likely is to mislead inexperienced investors. The assessment of the risk associated with complex mortgage-backed securities, made difficult by the mix of levels receivables, was most often based on mathematical models provided by the issuers of these securities; these models turned out to be ineffective as soon as the crisis started. This is a primary source of conflict of interest and it is not the only one: not only are rating agencies paid by issuers of securities - not by their buyers - but they also sell advisory services to the former, particularly on the best way to structure the securities in order to optimize the rating of their risk.

To remedy the shortcomings of the system rating, the Commission asked the Committee of European Securities Regulators to make recommendations. Some of the measures usefully suggested include:

- the prohibition for rating agencies to provide consultancy services (Buiter 2007);

- the adoption of a different rating scale for structured financial products (which would eliminate the risk of confusion with more traditional products);

- the obligation to provide information on the sensitivity of valuations to the underlying assumptions in models used for complex products.

In addition, it would be desirable that the activities of rating agencies be subject to control stricter, so as to verify the relevance of the techniques used and the absence of conflict of interest.

To complement the supervision of national banking systems, which have the merit of being close to the institutions and to know them well, co-operation on prudential supervision has been set up at level European in the framework of the Lamfalussy process initiated in 2001. This cooperation is based in particular on the meeting of fifty-one exchange authorities national in the (CEBS *Committee of European Banking Supervisors*), which was set up in 2004. It allowed the adoption of common rules, but work important to be done to ensure that their implementation is harmonized. In the context of the integration increasing of financial markets and the consolidation of the banking sector, the main defect of the system current control for the supervision of banks operating in several European countries: there is currently a credible solution for the management of a pan-European banking crisis (Véron 2007). Despite the existence of cross-border "operational networks", no national or European authority has access to data on all multinationals European in the sector, each of their subsidiaries reporting to supervisory local authorities. This makes it impossible to assess capital adequacy and liquidity risk at the group level, and more generally to estimate systemic risks at the European level.

In order to remedy the shortcomings of the supervision Community banking, the following actions could be implemented:

- strengthen the CEBS to deepen cooperation existing and ensure the homogenisation of prudential practices. As the ECB has recently suggested, CEBS's responsibility towards the institutions European should be increased so that they can express specific expectations; its governance could be improved by the introduction of a qualified majority in the decision-making process.

- create a single authority responsible for the supervision of banks operating in several European countries. This authority would be attached to the CEBS and would make the data it collects available to the banks central of the relevant countries of the Union, enabling them to have all the necessary elements in the event of a crisis. It should be noted that the creation of such an authority is desired by the banks themselves because of the cost savings afforded by the simplification of the supervision system (Pohjola 2007).

- promote the rapprochement of central banks and CEBS while respecting their independence respective. The ECB could accommodate and provide material resources to CEBS in order to facilitate its work. This would promote synergies, for example, by achieving economies of scale in meeting the expertise needed to analyze the most complex financial arrangements and dynamically assess the implications of financial innovation.

- impose on European credit institutions the creation of countercyclical provisions as the Spanish bank does. This makes it possible to build up a liquidity reserve in anticipation of default future payments and thus limit the risks in the event of a crisis.

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