Ambitions and limits of financial disintermediation in the Euro Area

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Summary: This paper deals with the causes and consequences of the financial disintermediation that for some time has been taking place in Europe, particularly since the last financial crisis. Firstly, we present the evolution of bank and capital markets funding, which can be largely explained by the singular economic context we have experienced since 2008. Secondly, we analyse the objectives pursued by some national and European institutions, which campaign for more disintermediation against what they consider to be "overbanking". Finally, we critically analyse the effects of disintermediation in terms of access to funding for (small) companies, as well as its impact on economy and financial stability.

Zusammenfassung: Dieser Beitrag setzt sich mit den Ursachen und Konsequenzen von Disintermediation im Finanzsektor auseinander. Der seit einiger Zeit in Europa zu beobachtende Trend zur Disintermedation hat sich in den Krisenjahren seit 2008 verstärkt. Zunächst untersuchen wir, welche Entwicklung die Bank- und Kapitalmarktfinanzierung seit 2008 genommen hat. Anschließend befassen wir uns mit den Zielen jener nationalen wie europäische Institutionen, die für mehr Disintermediation und gegen das sogenannte „Overbanking" kämpfen. Schließlich betrachten wir, wie sich Disintermediation auf den Finanzierungszugang für (kleine) Unternehmen, die Wirtschaft und die Finanzstabilität auswirkt.

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1 Introduction

When the Basel III discussions began, the risk of financial disintermediation was quickly brought up in Europe. It was argued that tighter regulation would destabilize the banking sector, increase the funding costs for agents who did not have access to capital markets (small and medium-sized companies and households), and encourage securitization, which played an important role in triggering the crisis.

However, a few years later, disintermediation is no longer perceived as a danger. It is even hoped for and encouraged. On the one hand, some banking institutions have realized that activities related to the issuance of securities, private placements or securitizations can be very profitable. On the other hand, and above all, European regulators and supervisors look favourably upon the disintermediation movement, considering that it can particularly improve the system's stability.

The term disintermediation is nonetheless worthy of clarification, since it is often used too broadly. It specifically refers to securitization transactions transforming illiquid assets into liquid ones, which can be moved off the balance sheet, even when the relationship between the bank and the borrower is preserved. It should be noted, however, that in this case, as in the case of private placements (PP), assets are generally purchased by financial institutions. Thus, it is preferable to talk about "banking disintermediation". Behind the fiction of the market, financial institutions are the main players of this financial "disintermediation", performing similar functions to those of credit institutions.

That being said, disintermediation is not a new phenomenon in Europe. We notice that it has tended to increase since 2008. But this is largely explained by the current economic situation, and primarily concerns large companies. It is therefore useful to ask whether this trend will continue in a more stable environment, and if that would actually be desirable.

In order to answer these questions we will first examine the disintermediation movement as observed in the euro zone, as well as the various forms it has taken. Then, in the second part, we will analyse the objectives pursued by some national and European institutions, which are campaigning for more disintermediation in order to counteract what they see as an "overbanking" of the financial system. Finally, in the third part, we will try to assess the extent to which increasing the role of financial markets is likely to help meeting the goals.

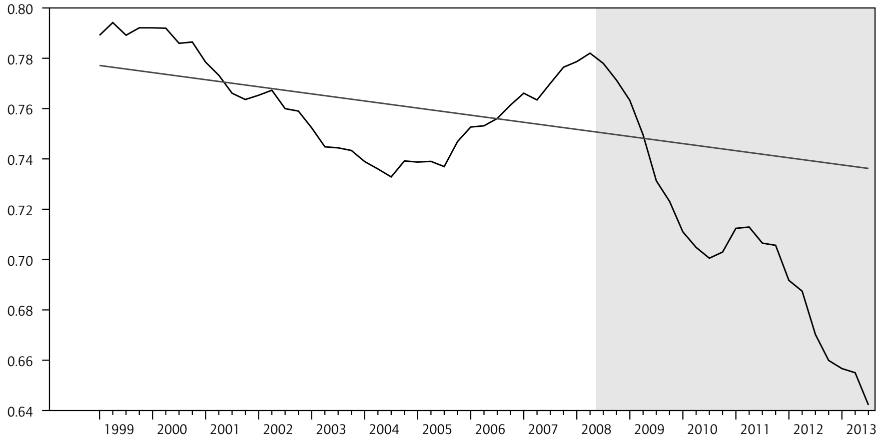
2 Trends in loan and securities financing

2.1 A growing trend in market financing

The intermediation ratio, defined as the ratio between bank loans and the sum of total debt financing (bank loans + debt securities), has been decreasing since the 2000s in Europe. Figure 1 represents this intermediation rate for the aggregated outstanding securities and debt of non-financial firms in 8 European countries (Austria, Belgium, Germany, Spain, France, Italy, Netherlands, Portugal). The linear trend is the one prevailing before the crisis period, namely between 1999 Q1 and 2008 Q3. We can observe that the decline of the intermediation rate has accelerated

Figure 1

Aggregated intermediation rate in eight euro area countries



Source: National Financial Accounts.

in the wake of the financial crisis, from 78 percent in 2008 to nearly 65 percent today, far below its notwithstanding decreasing trend (Figure 1).

However, the increase in capital markets funding is generally limited to large companies. SMEs rarely benefit from it. This is mainly due to the high issuance costs with respect to the amounts of capital raised, as well as the disclosure requirements that often exceed the means of such companies. Moreover, the current yield curve favours disintermediation. Finally, in times of crisis, flight to quality and compositional effects may explain why market financing, mainly destined to large firms, is more dynamic than bank financing, which rather concerns SMEs. Still, many European countries have not suffered from credit rationing. Even though credit conditions have sometimes tightened, for instance in Greece, Spain or Italy, it is hard to see how capital markets would have made it possible, either structurally or short-term, to bypass banking systems under pressure or in the process of restructuring.

It should also be noted that substituting equity for bank debt could also be considered as disintermediation. From this point of view, since the crisis began, large companies have experienced serious difficulties when issuing new shares, due (for a substantial time) to the poor stock market conditions and to their search for leverage in order to raise their return on equity. This may also explain the dynamism of bond issues.

2.2 Asset-backed securities and private placements

Asset-backed securities (ABS)

Banks are the main players in the sale of securities and at the same time, they are the main holders. Their motivations are many[1]. First, securitization allows new loans to be substituted for those that have already been disposed of. Second, it allows banks to partially offset credit risk. From a prudential standpoint, the disposal of assets reduces the denominator of the equity ratio and lightens the balance sheet in order to meet regulatory requirements. Lastly, since the crisis, the disposal of high-quality assets has been favoured, since they are eligible securities under the non-conventional monetary policy frameworks.

This kind of disintermediation developed rapidly in Europe during the 2000s. Starting from scratch in 1999, outstanding ABS reached 300 billion USD in 2009, before being halved as a result of the financial crisis. Then the context has become less favourable to securitization. First, there is uncertainty about the performance of the underlying loans. Second, risk premiums on ABS remain sensitive to sovereign risk. In addition, although the required spreads over the risk-free rates have declined since 2011, the attractiveness of these securities remains low. Finally, securitization suffers from competition with covered bonds, which are eligible as collaterals to the European Central Bank (ECB), and benefit from more favourable regulation. Securitization thus remains a rather restricted method of funding in Europe.

Private placements (PP)

Private placements can be seen as an attempt to bypass the constraints imposed by an organized market. They are financed by a limited number of institutional investors, usually with the assistance of a bank. As a result, disclosure requirements are lower and are generally negotiated between the borrower and the investors. This facilitates the access of medium-sized companies to this type of financing. For their part, insurance companies or certain mutual funds seeking higher yields and diversification can find a solution to their management constraints here, particularly in the current environment of very low interest rates.

These are the reasons why this kind of disintermediation has developed somewhat in recent years. However, it remains limited in size and very fragmented within each European country, due to (1) lack of standard information on the borrower's creditworthiness, (2) lack of liquidity in the secondary market, and (3) relative weakness of long-term investors due to (pay-as-you-go) pension systems prevailing in continental Europe. European companies have only raised EUR 45 billion in private placement markets (including the U.S. market) in 2015, with the German market (Schuldschein) now dominating. It should also be noted that activity in these markets is highly volatile as it is very sensitive to short term economic and financial conditions. That is, there is significant uncertainty about access or roll-over.

1 See, for instance, the manner in which Nassr and Wehinger (2015) and Aiyar et al. (2015) praise securitization.

3 Extended disintermediation's objective and mechanisms

A certain number of observers and public decision-makers (IMF, BIS, ECB, ESRB, European Commission, etc.) expressed their wish to reduce the weight of banks in European financial systems which they assessed as excessive. Some have even denounced "overbanking", without this expression being defined rigorously. We will therefore put forward the objectives that this disintermediation—or, more appropriately, dis-banking—policy is supposed to pursue, and then discuss the initiatives taken or to be taken in order to achieve them.

3.1 The objectives of the financial disintermediation

Disintermediation can be justified in at least two ways. On the one hand, the financing conditions for agents and, above all, for SMEs and medium-sized companies should improve. On the other hand, disintermediation should, via more diversification of risk, ensure better stability for economic and financial systems.

The first thing to remember about corporate finance is that, in continental Europe, tools and access to the market show little diversity, whereas in the United States, share and bond markets, private placements and securitization are much more developed. One third of market finance versus two thirds of intermediated finance in Europe are often mentioned figures, while the proportion is reversed in the United States. This statistic, indeed too simplistic, deserves to be narrowed down in order to examine what exactly lies behind it, but in itself it illustrates the exceptional weight that banking intermediation has in the European finance model. This is due to a combination of factors (lesser importance of pension funds, as a consequence of pay-as-you go pension systems, corporate structures, etc.) that do not necessarily point to a weakness or imperfection of the model. Nonetheless, financing conditions in Europe might improve by diversifying financial products and capital-raising channels; which in turn would increase direct financing and non-bank intermediation. As a consequence, it would be easier and less expensive to access diversified types of funding. Moreover, the willingness to promote the creation and development of innovative firms and to take advantage of the rise of new technologies implies that companies increasingly resort to equity, since banks do not easily lend to these kinds of companies given the atypical probability distribution of their expected profits. This may justify setting up or developing equity markets suited to these companies.

Besides, the crisis has taught us that a greater diversity of funding channels might strengthen the stability and resilience of the economic and financial systems. In the event of an intermediation breakdown due to huge write-downs in the securities or bank loan portfolios, capital markets can replace bank loans. When these circumstances occur, credit institutions are forced to limit their lending activity in order to comply with their regulatory capital requirements, in line with the banking capital channel (Levieuge, 2009), as is still the case today in certain "peripheral" countries in the euro zone. Resorting to capital markets or to non-bank intermediation can then compensate for this fall in bank lending and thus mitigate the impact on investment and business activity. Several recent empirical studies have attempted to show that economic recovery is faster and stronger in economies with more developed capital markets (Allard and Blavy 2011, Gambacorta et al. 2014, Grjebine et al. 2014). But there might, of course, also have been confounding variables contributing to differential recovery speeds (fiscal and monetary policy, bank resolution etc.).

3.2 Proposals and initiatives for disintermediation

The European Commission has recently backed the creation of a Capital Markets Union (European Commission [2015]). This project aims to ensure a better movement of capital within the EU through a deeper, more liquid, easily accessible and cheaper market. Other initiatives have been taken to alleviate capital issuance constraints and to make securities more attractive. In particular, retail bond markets have been launched since 2010 in several countries (UK, Germany, Italy, Spain, France). Similarly, attempts have been made to ease small amount issuances (pooling of debentures, small caps).

These initiatives may help to provide markets with more significant dimensions and to progress towards integration. It remains to be seen, on the one hand, what the comparative advantage of institutional investors might be, compared to banks, in this type of funding. Is it connected to regulation or to taxation? This is all the more intriguing because it is widely known that institutional investors do not benefit, unlike banks, from the additional income deriving from distribution of credit. On the other hand, a question mark hangs over the potential risks this activity entails, insofar as the assets being created are less transparent and less liquid.

Since 2011, the ECB has significantly relaxed the eligibility criteria for ABS as collaterals. The ECB requires, in return, loan-by-loan information on the underlying ABS assets. The objective here goes beyond the implementation of unconventional monetary policies: it is to make debt-backed securities more transparent, better standardized and thus less nationally fragmented. Information is centralized through a European DataWarehouse, created under the auspices of the ECB, which expects to ensure the access of SMEs to additional sources of funds.

At the same time, in its October 2013 report on Global Financial Stability (Chapter 2), the IMF stresses the importance of developing securitization of loans to SMEs. Similarly, reorganization of securitization markets was included in the European Commission's Green Paper on "long-term funding of the European economy". The development of new capital markets instruments for SMEs is presented, as a measure likely to help fulfil their funding needs. As a result, action was pledged by the Commission in its communication to the European Parliament on the economy's funding, on March 27, 2014, in order to promote standardization and transparency in securitization activities. One of its relevant new features is the proposal to set up a European label (Prime Collateralized Securities), which would amount to certifying the quality of certain ABS, whose structure would meet well-defined standards.

More specifically, the European Banking Authority and the Basel Committee decided in January 2013 to accept certain securities into the numerator of the liquidity coverage ratio, which obviously supports demand for these assets. In addition, the 315 billion euro European Investment Plan presented by the European Commission in November 2014 must be accompanied by measures encouraging the use of securitization. Furthermore, Banque de France supported the creation of the securitization vehicle ESNI (Euro Secured Notes Issuer) in April 2014, whereas the legal framework governing securitization had already been changed in 2008. Finally, the reform of the Insurance Code, in 2013, modified certain investment rules for insurance companies, which can now invest in securitization funds.

However, despite these efforts, these markets remain limited in size and highly fragmented across countries. ABS are mainly held by the issuers on their balance sheet as potential collaterals vis-à-vis the Eurosystem. (Actually, they might have been created with this purpose in mind.) Therefore, they do not contribute to fund SMEs.

Finally, governments at both national and European level have sought to strengthen the framework of private placements (PP) markets. France, for instance, launched a Charter for Euro PP in 2014 to standardize practices. The European Commission also plans to make recommendations along these lines. But the effects of these initiatives are so far limited.

4 Will disintermediation meet the objectives sought?

4.1 Funding for (small) companies?

Access to markets

Compared to the United States, the capital markets debt of European companies is extremely low. At the start of the crisis, the volume of outstanding bonds issued by U.S. companies was about four times larger than those of euro zone companies. Today, the volume is six times larger, primarily because U.S. firms have hugely raised their borrowings in order to buy back their own shares.

This large gap is mainly due to the fact that medium-sized European companies do not have access to capital markets, unlike large companies. But from this we cannot infer that the American example is one that should be followed. First, because the European and American banking systems cannot be compared directly: they do not have the same structure, the same operating system or the same relations with their customers. On the other hand, due to the specifics of loan agreements, competition between financial intermediaries and capital markets may lead to undesirable changes in the relationship between companies and banks. Finally, there is no clear evidence that European companies face a competitive disadvantage as a result of their funding conditions. This is, what ultimately counts: Do differences in financial structures imply pertinent differences in economic welfare?

The difference in size between the European and American bond markets is reflected in the equity markets. Market capitalization relative to GDP is 139 percent in the U.S., compared to 65 percent in the euro zone (with significant differences between countries: 51 percent in Germany, 87 percent in France, 97 percent in the Netherlands). However, it should be noted that these differences do not reflect the uneven importance of markets in terms of equity financing. This is apparent in the fact that, since the early 2000s, the issuance of shares net of buy backs in the U.S. has become negative. In other words, there were, on net, no funds provided by equity markets.

In the U.S., equity markets no longer contribute, from an overall perspective, to the growth of corporate capital. Their main functions nowadays include business valuations, assessing mergers and acquisitions and, secondarily, enabling private equity funds to divest their stakes in the companies they helped to grow. They also allow for a redistribution of risk. The contribution of equity markets to equity funding is therefore at least modest, and the role they play in financing innovation is only indirect. Thus, the extension of market space is not the only solution to increase the efficiency of European financial systems.

Securitization

Meanwhile, the securitization of bank loans could improve credit conditions by reducing the cost of banking resources due to capital requirements and liquidity constraints. But first and foremost, there must be a genuine market for the securitization of loans. That being said, the securitization of loans to SMEs does not represent more than 10 percent of securitized assets in Europe. It is therefore not a source of disintermediation to fund these companies, at least for the time being.

The many initiatives mentioned above are intended to bring to life or help revive the securitization of loans, thanks to the standardization and better transparency of assets. They naturally deserve to be considered. But, in a sense, they show to what extent investors distrust these products today. Moreover, in order to be viable, that is to say, in order for it to be relevant from the point of view of the issuing banks, securitization must meet two conditions:

(1) Interest rates on loans eligible for securitization must be substantially higher than yields required by potential investors in these products. In other words, banks do not have an interest in selling loans in their portfolio, at a loss.

In the current situation of very low credit rates this first condition is generally difficult to satisfy. Yields on securitized products are higher than rates on certain types of loans. This is notably the case with real estate loans, but also with loans granted to top-rated companies. Returning to a less atypical yield curve level should make satisfying this condition easier. But competitive pressures in some segments of the loan market will remain an obstacle to securitization.

It is true that there are higher interest loans, such as consumer loans, bank overdrafts and more risky loans granted to small and medium-sized companies. But this securitization raises other problems (particularly regarding the treatment of information asymmetries – standardization becomes fiendishly difficult) and moves away from "high-end" securitization or the PCS (Premium Collateralized Securities) label that is supposed to relaunch the securitization process.

(2) Yields required by investors (plus the cost of securitization) must be lower than the cost of banking resources, including the regulatory cost of capital. This means that banks do not have an interest in selling the credits they can hold (and thus finance) less expensively.

It is harder to assess the more or less restrictive nature of this second condition, as it depends on several parameters, which, in turn, depend on the characteristics of the institutions concerned and on the financial situation. To illustrate this, let us take a set of loans with a risk-weighted coefficient of 100 percent. The bank that holds them keeps a capital ratio of 10 percent, the tax rate on its profits is 10 percent, and there is a 5 percent difference between the required return on equity and the cost of its debt. The calculation shows that, under these conditions, the regulatory extra cost is 100 bp. The problem is then whether the cost of the bank liabilities, that is, the cost of debt increased by 100bp, is higher or lower than the required yield for the securitization product (the ABS issued for the specific circumstance), plus the cost of the securitization transaction. The answer is far from obvious, as ABS may be less transparent and less liquid than the bank's debt securities (for example, a covered bond issued by the same bank).

4.2 Disintermediation: a factor of economic and financial stability?

From the outset, it should be noted that there is no clear link in Europe between the structure of financial systems and their resilience. In Germany, for instance, where the financial system is largely dominated by banks, ECB surveys show no difficulty for companies to access financing during the crisis; while in Italy or Spain, whose financial systems are just as "bank oriented", credit conditions have been seriously and permanently affected. The surveys also reveal severe shortages of lending in the Netherlands, even though in this country market financing and securitization are quite strongly developed; while in France, which appears in view of the statistics as the most capital market oriented European country, credit conditions have remained fairly good. Obviously no general conclusion can be drawn from such comparisons, but at the very least they should warn against unfounded assertions.

That being said, it is hard to see why disintermediation would make the financial system more stable and decoupled from the economic system as a whole. In a way, this suggestion is even paradoxical. It is well known that markets, including bond markets, are subject to high volatility in terms of prices, issuances and trade volumes. During recessions, in the United States, it is usual to observe higher premiums on "high yield" markets than on bank credit ones, like in 2011. The result is a higher company default rate. As banks seek to smooth credit conditions in the face of real or monetary shocks, markets tend to amplify them.

The extensive empirical literature devoted to this issue has not convincingly demonstrated that the structure of the financial system has an impact on economic growth and stability. What emerges most clearly from these works is that intermediated systems tend to reduce short-term fluctuations prompted by "real" shocks. On the other hand, recessions followed by banking crises (often associated with real estate crises) have a stronger and more lasting impact on growth[2]. This is all the more true in that these are systemic crises that neutralize the functioning of the finance system when overly dominated by banks. These events are rare but of great magnitude, and are generally a consequence of credit bubbles derived from weaknesses in micro and macro-prudential controls.

Securitization has shown, in the very recent past, that it can be a source of credit bubbles and of subsequent bursts of financial flows. The existing literature emphasizes the problems associated with it in terms of financial stability. According to Nadauld and Sherlund (2013), securitization reduces incentives for lenders to control borrowers. Uhde and Michalak (2012) and Uzun and Webb (2007) show that securitization has significantly increased the financial fragility of banking institutions in Europe and the United States, respectively. Finally, it increases the exposure of banks to liquidity crises and capital markets risks (Loutskina [2011], Franke and Krahnen [2006], Uhde and Michalak [2010]) and to systemic risk (Battaglia & Gallo [2013]).

2 Like several previous studies, Gambacorta et al. (2014) conclude that there are no significant differences between "bank-based" and "market-based" economies; however, they observe that the more intermediated economies have a growth deficit in recessions caused by financial crises. Langfield and Pagano (2015) show, on the contrary, with a sample of 55 countries and over the period between 1998 and 2011, that the ratio credit bank/market capitalization negatively affects growth. Nonetheless, this result is undoubtedly biased by the singularity of the observation period, with several large-scale banking and real estate crises taking place throughout. Moreover, the sample mixes countries with very heterogeneous economic systems.

It is probably possible to correct some of these failures. To this end, it was suggested setting up rules on the initiative for securitized loans, aligning the interests of all actors and spreading specific (more granular) risk measurements on securitized assets (Segovanio et al. [2015]). But practically all this remains to be done, and it is very difficult to assess whether the problems will be solved in this precise way.

This notwithstanding, yesterday (that is, at the end of the 1980s) and today, the basic idea of disintermediation is to diversify risks among many investors rather than to concentrate it within the hands of a few credit institutions. This would help avoid systemic risk, while individual risks would be diversified, managed and carried by investors based on their ability to take them on. However, this tale does not match the facts, since the securitized assets are acquired by entities that are still difficult to pinpoint, are poorly regulated or not at all, are potentially subject to panic situations, and keep relationships with the "official" banking system, whom they are likely to endanger. Thus, systemic risk is not removed at all. This is precisely the conclusion of the empirical analysis by Nijskens & Wagner (2011), which shows that securitization actually aggravates systemic risk.

Furthermore, if we consider that competition from shadow banking entities may lead banks to give riskier credits, it is easy to understand that, from a macroeconomic perspective, it is wrong to behave as if there was a certain amount of risk that can be shared without modifying its level.

In any case, the direct or indirect transfer of risks to non-financial agents will have an impact on the stability of the economic system. With disintermediation, households could shift away from traditional, less lucrative bank savings (banks would be less inclined to attract savings as they would grant fewer credits) in favour of assets issued by companies (either directly or through institutional investors). This would result in a greater variability of household incomes, an increase in risk premiums as demanded by rather risk-averse agents, and a higher risk of massive sales (fire sales) in the event of a shock. As a result, highly volatile asset prices would lead to commensurately greater variations in consumption and investment. We could expect a reciprocal amplification of financial fluctuations and economic activity.

Moreover, the evolution of the relationships between companies and their financial environment should logically modify the business model. The existence of long-term relationships between banks and companies enables the former to maintain lasting ties with the company's stakeholders (employees, suppliers, customers). Banks, which are more dependent on capital markets and their short termism (particularly due to their securitization transactions), and must also face a more competitive environment, should abandon their strategies of sustainable engagement with their clients and turn to a transaction banking model.

Logically, firms compensate for the least flexibility of their human resources management by establishing short-term relationships with their stakeholders and especially with their employees. In other words, they will seek to introduce more flexible employment policies in order to adapt their human resources management to the horizon of financial markets. But they will find that they do not have complete control over their decisions in this area, since they are constrained by laws and regulations forged over a long period of time, subjected to social preferences and political choices. Altogether, this can give rise to serious inconsistencies, even if they have not yet shown up. Or, put differently, there are institutional complementarities between the different dimensions of an economic and social system. This means that the financial system cannot be transformed without also considering its complementarity with corporate governance models, the conditions under which labour market operate, relations between companies, and the different forms of pension systems (which influence the way savings are mobilized)[3]. Forgetting this principle would have far-reaching consequences.

5 Conclusion

Ultimately, it is very doubtful whether the aim to reduce the alleged "overbanking" of the European financial system will be finally achieved. First of all, the extension of the financial markets will have little effect on the financing conditions of companies. The largest of them are already funded through entities from the disintermediation space, while the access conditions for medium-sized companies will always remain constraining and costly despite the efforts made to solve the situation. In addition, commercial banks generally offer medium-sized companies valuable assurance during periods of low economic activity, at least out of systemic banking crises. They provide a liquidity backstop, a core function of banks. Capital needs for start-ups and developing companies are mainly provided by different kind of funds, with capital markets primarily helping to divest said funds. It is therefore not clear how the disintermediation of European financial systems could significantly contribute to improve their efficiency.

On the other hand, it is true that the way European banks have imported and amplified the subprime crisis and especially their inability to sustain an economic rebound is a real cause for concern. We must ensure that such a scenario does not happen again. But the problem, in this case, does not come from an alleged "overbanking". It is the result of two phenomena that have little to do with the position of banks in relation to markets. It's really about:

- On the one hand, the high concentration of banking sectors that for the most part remain fragmented, but also the universal banking model prevailing in many countries, which leads to institutions being too large in relation to their national markets, thus generating systemic dependencies.

- On the other hand, shortcomings in banking regulation that have led to the development and the bursting of credit bubbles, enabling credit institutions to underestimate their risks (hidden in the banking book) and thus keep low levels of equity capital and liquidity (not even addressed in Basel II). Additionally, the systemic nature of many institutions, and more broadly the absence of a formalized resolution process for ailing banks implied certain guarantees that provided additional incentives for risk-taking.

What is at stake here is not the excessive importance of intermediation in the financial systems of the euro zone. It is rather the poor structuring and inadequate regulation of their banking sectors. And in order to address these dysfunctions, solutions involve breaking down the barriers to national banking markets, limiting the burden of systemic institutions, reducing implicit state protection for the financial sector and, of course, strengthening regulation and supervision. Most of these measures will be applied via the implementation of Basel III and the establishment of

3 See Hall and Soskice (2001) on this specific point, particularly the introduction. See Pollin (2010) also.

a single supervisory system in addition to a resolution mechanism within the framework of the European Banking Union.

These measures should ensure greater stability of financial systems while preserving the position of banks. This last clarification is important because it is imperative to understand that intermediation in Europe must be in agreement with an economic and social model that differs from the Anglo-Saxon one, which seems to be the reference for unreflective observers. Trying to impose, whenever it is feasible, greater control over financial markets in continental Europe could lead to regrettable inconsistencies.

However, the new regulatory measures may encourage the development of another form of intermediation called shadow banking, whereby various institutions (investment funds, insurance companies, etc.) operate (notably through transformation) in a way similar to banks but without being subject to the same regulations. Here too, mistakes in the diagnosis and the remedy should be avoided. The objective should not be to lighten bank regulation in order to prevent its bypass. On the contrary, it is a matter of tackling as quickly and as seriously as possible shadow banking regulation, in order to ensure that risks are always handled in the same way, regardless of the institutions that carry them on[4].

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4 Beck and Kotz (2016) have shown that the redesign of banking regulatory system as well as the low interest rate environment have led, in recent years, to an expansion of the shadow banking sector and to an increase in its risk taking.

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