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1 THE FINANCIAL CRISIS – CHALLENGES AND NEW IDEAS

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Discours prononcé à la **Luxembourg School of Finance**,
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I am very pleased to be here tonight and wish to thank the Luxembourg School of Finance for providing me with this opportunity to speak on the recent financial crisis, the policy response, and the challenges ahead.

The run-up to the crisis was driven by animal spirits, which encouraged excessive risk-taking by investors and a significant increase in financial sector leverage. Asset price declines triggered an unexpected departure from the normal functioning of the financial system, plunging agents into unquantifiable “Knightian” uncertainty. This unleashed panic, characterised by a “flight to safety” and fire sales of financial assets that amplified the crisis. The risk to systemic stability required intervention by the authorities that was unprecedented both in its extent and in its form.

It is important to recall that we have very limited knowledge of many aspects of the crisis. All financial crises share certain phases of market behaviour, but they are all different. In recent years some warnings highlighted existing imbalances and vulnerabilities, but nobody predicted the timing and nature of such a sudden break in market behaviour. As the crisis unfolded, authorities had to take policy decisions rapidly although their effects had become uncertain, as normal market functioning could no longer be expected.

What was most surprising in the recent crisis was the role played by liquidity. In retrospect, it is easy to conclude that it should have been monitored more closely and that pro-cyclical behaviour needed to be mitigated more effectively. However, these suggestions only represent “preventative care”. The implementation of such measures could reduce the likelihood, or at least the extent, of future crises. Once a crisis hits, it is too late for “preventative care” and the authorities have to implement “emergency interventions”. These carry significant costs for the taxpayer, so it is natural to ask how the private sector can help share this burden.

In my remarks, I will begin with the recent past, reviewing the crisis and the policy responses of both central banks and governments. Then I will turn to the lessons of the crisis and the challenges both in the immediate future and at a longer horizon. I wish to focus on the need to reform the current financial architecture. This process is already underway at the global level as the April meeting of the G20 endorsed Financial Stability Board proposals in this domain. One important objective is to re-align incentives in the financial sector from an excessive focus on short-term profits towards more “socially useful” activities that include reducing systemic risk and encouraging the creation of long-term wealth. Finally, I will comment on some “new ideas” that may contribute to this aim.

1.1 THE POLICY RESPONSE TO THE CRISIS

In the financial crisis, monetary authorities intervened to address liquidity issues and government authorities intervened to address solvency concerns. These complementary roles were clearly established long ago. However, it is generally agreed that the recent crisis somewhat blurred this distinction in practice. As a central banker, I will begin by reviewing the response of the monetary authorities.

1.1.1 Central Bank policy response

The financial crisis initially appeared in August 2007 as a sudden shortage of liquidity in the money market. Traditionally, central banks monitor the functioning of this market very carefully, because it is here that monetary policy is implemented through regular refinancing operations. This is why the Eurosystem was the first to respond with massive liquidity injections.

The decline of asset prices reduced the value of complex structured finance products, which were widely disseminated across the banking sector. It suddenly became difficult to find a buyer for these instruments. As trading volumes collapsed, it also became difficult to value these assets accurately because prices were no longer observed on the market. Uncertainty increased dramatically and banks began to view each other with suspicion as they realised that individual exposures were not transparent.

As the inter-bank market dried up, banks found themselves hoarding cash to rebuild their liquidity buffers. This induced them to tighten credit standards, posing the risk that they might cut back loans to firms and households, transmitting the financial crisis to the real economy. In mid-September 2008 the collapse of a major financial player set off a global financial panic. Given the severe downturn in the euro area economy and receding inflationary pressures, the Governing Council of the European Central Bank responded by rapidly lowering interest rates to 1%, a historical low for the euro area countries in the post-war period.

In addition to standard monetary policy measures, the Eurosystem introduced a policy of “enhanced credit support” intended to limit the role of liquidity in the propagation of the crisis, to maintain the transmission of interest rate decisions, and to enhance the flow of credit to the real economy.

These extraordinary measures lead to a doubling of the central bank balance sheet in the euro area and an even greater expansion in the US. In effect, the money market ceased to exist and the central bank took over its intermediation role. This emergency intervention contributed to a broad-based improvement in financial markets and a return to a more normal functioning of the money market. According to the most recent figures, the Eurosystem’s balance sheet has already shrunk by 11% from its peak in December 2008, while in the US it has remained stable. Overall, central banks appear to have successfully performed their function as “lender-of-last-resort”.

1.1.2 Government policy response

Turning to the government policy response, this took three forms: (i) the fiscal stimulus, (ii) asset support and (iii) capital injections and guarantees.

In October 2008 the intensification of the financial crisis began to affect the real economy and the need for a *fiscal stimulus* became apparent. In April 2009 the G20 summit in London signed a global plan for recovery and reform. Although justified by the extent of the crisis and varied in extent across countries, this fiscal stimulus caused a substantial deterioration of public deficits and debt-to-GDP ratios.

In addition to asset support, governments also intervened on the liabilities side of bank balance sheets, with direct capital injections and with state guarantees. Since these measures are the subject of tonight’s conference, I will discuss them in more detail in the second part of my speech.

For now, let me just recall that so far euro area governments have committed 26% of GDP to supporting the financial sector (although the sum actually drawn is only about 10% of GDP). This support was necessary, not for the banks’ sake, but for the sake of the central role they play in the market economy. This is particularly true in the euro area, where banks are firms’ main source of external funding, as opposed to other economies whose financial system is sometimes considered more “market based”. These differences



across economies also determined different policy responses. The US and the UK initially focussed on asset support that was intended to return markets to proper functioning. Eventually, they turned to their second line of defence, with direct capital injections to support the banks. In the euro area, this order was reversed, with authorities more focussed on the banking sector and turning to asset support as a second line of defence.

1.2 PREPARING FOR THE FUTURE

Having described the recent policy response to the crisis, I turn now to the challenges that remain for the future.

I will divide my remarks in three parts. First, the immediate challenge is to implement *exit strategies* from the current extraordinary monetary and fiscal measures. Second, a longer term challenge is to design and implement *financial reform* that effectively mitigates systemic risk. Finally, I will discuss some *new ideas* advanced within this process of reform.

1.2.1 Immediate challenge: monetary and fiscal exit strategies

First, let me consider the exit strategy from current extraordinary monetary measures. As I mentioned before, there are signs of substantial improvement both in financial markets and in the real economy. These suggest that the Eurosystem extraordinary liquidity measures are not all needed to the same extent as in the past. However, unwinding of enhanced credit support must be both timely and gradual. It must be timely because there are risks associated with acting either too early or too late and it must be gradual because the situation is only improving progressively. The process of withdrawal is facilitated by the fact that many of the non-standard measures were designed to phase out naturally over time unless renewed by explicit policy decisions. For other measures, the situation has improved sufficiently for Governing Council to initiate the gradual process of withdrawal.

The cornerstone of the exit strategy is the ECB primary objective of price stability in the medium term. This has guided the introduction of enhanced credit support and will govern the process of withdrawal. As with the monetary policy strategy, the exit strategy cannot pre-commit Governing Council to a given timing or sequence of actions. These must be decided with reference to changing economic and financial circumstances.

Now I wish to briefly address the exit strategy from the current *fiscal stimulus*. In addition to government measures supporting the financial sector, the extraordinary fiscal stimulus and the so-called automatic stabilisers have substantially deteriorated public finances during the current economic crisis. According to autumn 2009 forecast of the European Commission, the deficit ratio in the euro area should reach 6.9% of GDP in 2010, while government debt is expected to reach 84% of GDP in 2010. These significant fiscal imbalances undermine public confidence in the sustainability of public finances, which may place an additional burden on monetary policy in maintaining price stability.

As stressed by the ECB Governing Council, national governments must abide with the EcoFin Council agreement to communicate timely, ambitious and credible fiscal exit strategies as soon as possible. The fiscal consolidation process should be transparent and should be guided by the rules of the Stability and Growth Pact (SGP). Current government commitments to start consolidation in 2011 at the latest represent a minimum requirement for all euro area countries. Furthermore, given the future challenges raised by ageing populations, fiscal consolidation efforts should provide a strong focus on expenditure reforms. Developing and communicating fiscal exit strategies is an urgent policy priority.

1.2.2 Financial reform process to mitigate systemic risk

Beyond the immediate challenges, I wish to focus on the ongoing programme of wide-ranging financial reform. The objective of this process is to counter systemic risk and enhance the future resilience of the financial system.

The recent crisis provided us with three important lessons that could guide this process of financial reform:

- First, systemic risk needs to be monitored by an operational macro-prudential framework, extending the perimeter of regulation and mitigating the pro-cyclicality of the financial system
- Second, incentives need to be aligned on creating long-term value and not short-term profits
- Third, cooperation in surveillance and oversight needs to be improved

Let me expand on the first lesson, the need for an operational *macro-prudential framework*. The analysis and control of systemic risk was a key missing ingredient in the run-up to the crisis. The problem is that although banks may seem resilient when considered individually, the banking system as a whole may still be vulnerable. This paradox can be explained through the two key dimensions of the macro-prudential framework. First, the cross-sectional dimension focuses on the risk of joint failures that reflects similar exposures or interconnectedness. Second, the time dimension focuses on interactions within the financial system, as well as feedback between the financial system and the real economy. These links account for the pro-cyclical behaviour of the financial system, which can aggravate systemic risk by amplifying the effects of the business cycle.


The Basel Committee on Banking Supervision has already agreed on a set of proposals aimed at improving the resilience of the system. These focus on raising the quality and quantity of bank capital in order to better absorb future shocks. They also suggest introducing a bank leverage ratio, although this will have different effects in the US and the EU unless there is convergence in accounting standards. More generally, there is agreement on the need to require banks to build up countercyclical buffers in good times that can be drawn down during bad times. In addition, the Basel Committee and the CEBS (Committee of European Banking Supervisors) are developing new standards for liquidity. The European Union has also enhanced its macro-prudential framework by creating the European Systemic Risk Board, with responsibility for issuing early warnings and recommendations.

The second lesson was that *incentives* need to be aligned on creating long-term value rather than short-term profits.

The final lesson of the crisis was that it clearly revealed the need to improve *cooperation* in surveillance and oversight. This requires better links between the two pillars of financial supervision: the micro approach, which focuses on individual institutions, and the macro approach, which focuses on systemic risk.

1.2.3 New ideas to prepare for the future

I have described the immediate challenges linked to exit strategies and the longer-term process of financial reform that is already underway. Let me now comment on some new ideas advanced in the wake of the crisis to prepare for the future.



In a Financial Times column entitled “how to save banks without using taxpayers’ money”, Professors Wolff and Vermaelen describe a financial instrument called Contingent Convertibles (also known as CoCo bonds). In the recent crisis, these could have helped distressed institutions to convert debt to equity, reducing the need for capital injections from the state. The advantage of Contingent Convertibles is that they would not require a negotiated decision by the firm or an intervention by the authorities, but would convert debt to equity automatically when the value of equity falls below a level specified in advance. The process appears to be transparent, predictable and dictated by market developments. Professors Wolff and Vermaelen add a twist by providing the original shareholders with a call option to buy back the converted debt. This serves to smooth the conversion process and avoids an incentive problem that can create so-called “death spirals.” I expect Professor Vermaelen, who will speak next, will provide more details.

Turning to other “new ideas,” the “Tobin” tax on financial transactions reappeared in the recent policy debate to finance the cost of future bailouts. This is an old idea dressed up in new clothes. The Tobin Tax appears to be a solution in search of a problem, as it has already been suggested to finance developing countries, offset the cost of global warming, prepare for population ageing, etc. Even in the present case, a transaction tax would still not address the underlying problem. In fact, it may actually aggravate it, acting as an additional source of moral hazard. By raising costs, this tax could actually encourage higher risk taking, preparing the ground for the next systemic crisis.

The Jackson Hole Conferences in 2008 and 2009, in which I participated, presented several additional “new ideas” in this context. Most recently the discussion focussed on Ricardo Caballero’s analysis of the “surprising” nature of the recent crisis. He stressed that the “surprise” was not the decline in property prices, but the repercussions this had in the financial sector. The unexpected departure from the normal functioning of the financial system plunged agents into unquantifiable uncertainty. This unleashed panic, characterised by a “flight to safety” and fire asset sales that amplified the crisis. At this point, the role of the authorities is to fight the panic, which involves providing some form of insurance. In the 2008 Conference, Anil Kashyap and his co-authors suggested that capital insurance could be provided by the private sector, while in 2009 Caballero argued that only the state can insure against systemic risk.

Necessarily, any insurance arrangement is contingent, so it may share some of the features of Contingent Convertible bonds. However, if all banks were required to contribute to a common insurance pool, the risk coverage would be spread more broadly than if the scheme is limited to the “too-big-to-fail” banks. Caballero proposed Tradable Insurance Credits (TICs) that institutions could attach to individual assets or liabilities on their balance sheets. Since TICs could be traded between banks, they would allow insurance coverage to flow to where it is needed in a crisis, without the authorities needing to specify in advance the nature of the contingent event to be covered. Banks that find themselves less exposed in a crisis could choose to sell their insurance to distressed banks at a premium, a reward for prudence that most insurance schemes do not offer.

I find some of these features attractive, but any insurance scheme is also subject to important limitations. Private insurance schemes require freezing huge amounts of resources to cover the insurance promises. The failure of some mono-line insurers in the recent crisis indicates that private sector resources can turn out to be insufficient, aggravating financial instability. On the other hand, public sector insurance schemes jeopardise the sustainability of public finances as they transfer the risks to the taxpayer and distort incentives as mentioned above.

1.3 CONCLUSION

Let me conclude.

Financial crises are an inevitable part of the business cycle. It would be misguided to expect to eliminate them completely. However, we *do* have a responsibility to learn from them in order to reduce the inefficiencies in the financial system and improve its resilience in future episodes of turbulence.

I wish to stress that there is no “silver bullet” solution just as there was no single error behind the financial crisis. If we are to improve on the current situation, there are *many* changes that need to be implemented.

Some critics have argued that the response of governments and central banks raised moral hazard problems that sow the seeds of the next crisis. However, it is important to recognise that moral hazard also appears *within* the crisis. This was spread over many months, allowing agents to adapt their short-term behaviour to authorities’ decision whether or not to intervene. The policy response had to simultaneously stabilise the short-term situation while accounting for long-term costs.

Today it is generally accepted that the extraordinary policy measures taken were necessary to prevent a collapse of the financial system with even worse economic consequences. Let us hope that the ongoing process of financial reform will enhance the resilience of the financial system, reducing the need for extraordinary interventions in the future and their associated costs.



2 THE FRAMEWORK FOR SHORT-TERM PROVISION OF INTERNATIONAL RESERVE CURRENCIES TO SOVEREIGN STATES AND THEIR CENTRAL BANKS

Par **Yves Mersch**,
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Discours prononcé au **5th High-level Seminar of Central Banks
in the East Asia-Pacific Region and the Euro Area, Sydney,**
le **10 février 2010**

Good afternoon, ladies and gentlemen!

Today, I would like to discuss “**the framework for short-term provision of international reserve currencies to sovereign states and their central banks**”. Let me begin by reviewing the recent evolution of global liquidity. Then, I will discuss different concepts of supplying foreign reserves and consider their recent developments. In the third part of my speech, the pros and cons of these concepts will be explored. Finally, I will point out certain trade-offs with other economic objectives and draw conclusions on the evolution of the global framework.

Let me start by highlighting current developments in global liquidity. For this purpose, I define global liquidity as the sum of monetary aggregates of the major advanced economies.

Global excess liquidity may be understood as monetary liquidity that is not needed by economic agents to finance real economic transactions. In theory, excess liquidity may be measured by comparing long-run developments in money supply and GDP. Assuming the trend of velocity of money remains stable over time, nominal GDP is a proxy for the transactions demand for money. In practice, recent disruptions in the money market substantially complicate the assessment of excess liquidity in the short to medium term. In this context, the ECB monetary policy strategy proved appropriate in taking a broad based perspective focussing on threats to price stability in the long term. This makes it possible to cross-check the results of the monetary analysis with the results of the economic analysis focussed on short to medium term developments in inflation and growth.

In recent past, the injection of liquidity by central banks was higher than at any time in the last 15 years. Its stocks remain large and continue to build up. Of course, the fast pace of excess liquidity creation reflects not only growth in money aggregates but also shrinking nominal GDP.

Before the crisis, global excess liquidity was often ascribed to global imbalances reflecting on one hand large current account deficits in countries like the US and the UK and on the other hand substantially increased savings and sizeable current account surpluses in some advanced, emerging and oil-producing economies, which accelerated the accumulation of their foreign exchange reserves. Another source of global liquidity consisted of large interest rate differentials between major economies, which encouraged investors to engage in carry trade transactions in foreign exchange.

Short-term risks to consumer price stability are currently dampened by a drop below potential in most economies and rising unemployment. However, the situation can change abruptly. One should not underestimate the risk of prolonged excess liquidity on unwelcomed developments in specific asset classes. Global excess liquidity also reduces investors’ willingness to hold liquidity at the current low level of returns and might fuel their risk appetite. This could provide a renewed chase for performance.

Recent experience indicates that even in a situation of abundant global liquidity, local markets in foreign currencies can seize up and currency shortages swiftly propagate across currencies, international markets and time zones. This highlights the importance of the global liquidity provisioning concepts to counter illiquidity of particular markets.

In a liquidity crisis, monetary authorities can engage in foreign currency liquidity-providing operations which can be classified into the following four **major concepts**: national foreign exchange reserves, pooling of reserves, inter-central bank swap lines or repos and monetary units or loan facilities by supra-national monetary authorities.

Central banks maintain foreign **reserves mainly in key currencies** but also in high-value liquid assets like gold. They may redirect the investments of such foreign reserves towards bank deposits, in an endeavor to offset the withdrawal of bank deposits in foreign currency by investors.

At the outset of the crisis, global foreign exchange reserves had reached an unprecedented Euro 3.5 trillion (USD 5 trillion) compared to only Euro 2.3 trillion (USD 2 trillion) in 2001. The share of Asian countries more than tripled during that period and China alone now holds reserves worth about Euro 1.7 trillion (USD 2.4 trillion).


Another possible strategy to ward off potential future currency crises (proper exchange rate regimes and exchange rate management notwithstanding) consists of schemes that **pool foreign reserves of several central banks**. This concept generally requires a binding arrangement between sovereign states specifying the pooling mechanism and its management.

In May 2009 the **Chiang Mai Initiative** of the ASEAN+3 group agreed to transform its network of bilateral currency swap agreements into a multilateral facility that would pool together Euro 85 billion (USD 120 billion) of reserves. So far, these arrangements have never been called upon.

An additional source of reserve currency can be **inter-central bank swap lines and repos**. These involve two transactions. First, foreign currency is delivered against collateral in form of assets or domestic currency. Second, on a specified date in the future, accrued interests are paid and transactions are unwound, which implies that currency positions or repoed assets are retransferred.

Since December 2007 certain central banks around the globe have been participating in a temporary network of inter-central bank swap lines and repo agreements. In particular, this included the US Fed supplying unlimited liquidity in US dollars to the ECB, the Bank of Japan, the Bank of England and the Swiss National Bank. Other swap lines have also been put in place, for example the ECB provides Euros to the Fed. At the peak of the crisis in December 2008, the US Fed provided globally Euro 432 billion (USD 583 billion). Since then, demand has receded continuously and the swap lines have been discontinued.

Lastly, **monetary units or loan facilities created by supra-national monetary authorities** can grant liquidity to their member states. In response to the crisis, IMF member states agreed a Euro 175 billion (USD 250 billion) general allocation of Special Drawing Rights (SDR). In times of need, members can exchange SDRs for key currencies through **voluntary trading arrangements** with other IMF member countries; otherwise SDRs count as part of the official international reserves. The discussion whether SDRs could play a greater role as an international reserve currency has been re-opened during the crisis.



In addition, the “**New Arrangements to Borrow**” boosted IMF facilities by Euro 345 billion (USD 500 billion). The IMF redesigned its lending framework with the introduction of a “**Flexible Credit Line**” for countries with a sustainable strong economy and enhanced “**Stand-by Arrangements**” that are more widely accessible.

Let me now suggest some criteria to evaluate the alternatives that I have just mentioned. These criteria include effectiveness, costs, efficiency and moral hazard.

First, effectiveness in alleviating liquidity shortages in foreign currency depends on the speed and size with which foreign reserves can be mobilized.

The discretionary nature of national reserves in foreign currency means that in principle they are available at **short notice**. In turn, this might have a reassuring effect on market confidence. The same also applies to other sources, such as standing swap lines, pooled reserves or IMF facilities that can be accessed unconditionally.

In addition, foreign exchange reserves should be available in a **size sufficient** to match outstanding demand. This can require very large volumes in a systemic crisis. While national foreign exchange reserves might alleviate temporary shortages in an individual institution or economy, their limited quantity might reduce their effectiveness during large systemic events. This suggests a need for additional sources involving cross-border cooperation.

However, measures that are provided at the **discretion of monetary authorities** are based on a case-by-case assessment and a decision by the respective lender. These will reflect several factors, including the objectives of the creditor, whether the crisis is systemic, country-specific or institution-specific and also the form of the measure: For instance the lending authorities might favor a secured repo agreement, although this removes collateral from the borrowing central bank. Compared to repo agreements, lending in the form of a currency swap preserves the potential to add new liquidity.

Second, the effectiveness of liquidity provision in foreign currency has to be judged against its **economic costs**. Every time a country receives foreign currency support from an external creditor, the costs depend on the respective agreement. Foreign exchange reserves, on the other hand, bear an opportunity cost representing foregone alternative investments. An efficient international currency system based on pooling or similar concepts will require a lower overall amount of reserves. Of course, such an international system requires political agreement and additional administrative costs associated with managing the reserve pool.

A further cost is associated with **risk**. **Credit risk** arises whenever a national central bank provides liquidity to domestic counterparties. However, it will also arise when one central bank furnishes liquidity to another central bank, or when the IMF provides liquidity to a national government. Besides, foreign currency reserves fluctuate in value and are therefore also subject to **foreign exchange risk**. A priori exchange rate volatility increases the required volume of reserves as well as its opportunity costs.

A **third** criterion to judge liquidity provisioning in foreign currency is linked to **moral hazard**. This arises whenever individuals, institutions or countries expect that they will not have to bear the consequences of their actions. This will incite them to act less prudently than they would otherwise, leaving third parties to bear some of the consequences of their behaviour.

For financial institutions, the prospect of emergency provision of foreign currency liquidity may encourage excessive risk-taking in carry trades or in foreign currency lending. This potentially increases the likelihood of a systemic crisis. For national authorities, the prospect of emergency liquidity provision from abroad

might reduce the incentive to conduct sound economic policies and accumulate adequate reserves. This leads to the paradoxical situation that unconventional measures applied in a crisis might lower the incentive to maintain preventive measures during normal times. In turn this increases the likelihood that unconventional measures will be needed again in the future, i.e. crisis resolution might trade-off with crisis prevention.

These moral hazard considerations are a well-known problem whenever insurance is provided in a context of asymmetric information. Their negative effects can be mitigated to a certain extent. For instance, appropriate pricing of foreign currency liquidity provision can limit its function to that of an emergency backstop facility which is costly for banks to use.


Additionally, the framework has to be in line with global economic objectives, such as price stability, balanced growth and efficient international allocation of resources.

- Policies that preserve **price stability** in the long term should also ensure stability of the financial system. However, in short term these two objectives might appear to conflict. Even when liquidity in domestic currency is provided to another country, it might find its way back to the domestic economy and contribute to inflationary pressure, if not sterilised.
- A buildup of **national reserves** might itself contribute to **systemic instability**. A reserve framework requires stability of the reserve currency in order to act as a global store of value and an anchor for price stability. However, the Triffin-dilemma notes that the accumulation of reserves implies persistent current account deficits of the reserve-issuing country. This potentially creates instability and fuels global imbalances. Moreover, such a reserve system aggravates interdependence between the reserve accumulating countries and the reserve-issuing country. For instance, the US Treasury market relies largely on demand from emerging market central banks. This dependence is likely to increase as the Federal Reserve phases out its asset purchase program, reducing US demand.
- This is connected to potential negative side effects of reserve accumulation or intervention in foreign exchange markets. In consequence, it can **distort exchange rates and prices** of other assets and might be difficult if not impossible to disentangle from its benefits.
- Finally, an acceptable solution from the country perspective might not appear desirable from the global perspective. For instance, excessive accumulation of foreign exchange reserves might distort **international capital allocation**.

This leads me to the general conclusion that there are many practical obstacles to a first-best solution for foreign exchange reserve provisioning.

Ultimately, I will conclude with some considerations on the challenges facing the global framework for short-term international reserve provisioning

- In general, the discussion requires a **common understanding of international liquidity** and its economic interlinkages with credit markets and the real economy.
- The **immediate challenges** we are facing include the implementation of exit strategies from exceptional measures of support. In terms of evolution of new concepts, it has been discussed whether it would be desirable to develop a network of standing inter-central bank swap lines. It was also proposed that central banks should consider extending their collateral requirements to accept foreign currency denominated assets or obligations booked abroad during emergency operations.

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- Constitutive elements of an international **crisis prevention** setup have to be defined and the different objectives of involved parties taken into account. Thus an element of political coordination will be inevitable to set the trade-offs and accommodate different national interests. More automatic mechanisms can help reduce the need for repeated negotiations to obtain political consensus.
 - Moreover, **crisis resolution** requires a provisioning framework with sufficient flexibility to respond adequately rapidly to a variety of possible shocks. This suggests relying on different sources, while preferring market solutions and turning to national foreign exchange reserves as the first line of defence.

Thank you very much for your attention!

3 DESIGNATED AUTHORITY TO NOTIFY OPENING OF INSOLVENCY PROCEEDINGS

LUXEMBOURG, 29 JANUARY 2010

In accordance with the terms of the law dated 10 November 2009 relating to payments services (the "Law"), the Banque centrale du Luxembourg is, as from 1 November 2009, the designated authority to notify insolvency proceedings relating to a Luxembourg participant to the other Member States' designated authorities.

The Banque centrale du Luxembourg is, from 1 November 2009 on as well, the designated authority to receive from the Member States' designated authorities, notification of insolvency proceedings taken by the Member States' relevant authorities vis-à-vis a participant.

The list of all Member States' designated authorities (including Luxembourg's) is published on the European Commission's web site (www.ec.europa.eu).

The Law implements Article 6.2 of the Settlement Finality Directive 98/26 relating to the designated authority to notify opening of insolvency proceedings.

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