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Publication of the Financial Stability Journal (Number 32)

The Banco de España has today published on its website (www.bde.es) edition no. 32 of the Financial Stability Journal, which on this occasion includes four articles on the following subjects.

José Manuel González-Páramo analyses the benefits and risks of the digitisation of finance. These risks stem chiefly from digital infrastructures, new business and distribution models and new customer solutions. The author considers it is necessary to renew the regulatory and supervisory framework to address the new risks in terms of cyber security, consumer protection, operational continuity and fraud, among others. This framework should rest, at least, on four pillars: well-defined policies on the control and management of new technological risks in the financial sector; the launch of innovation hubs; the creation of supervised safer environments for market experimentation (regulatory sandboxes); and the acquisition of new digital skills and a collaborative mindset.

Pedro Gete and Juan Pedro Gómez analyse the recent literature on the connection between firms' leverage and executive compensation. To draw conclusions from a regulatory policy-making standpoint, the authors review the dynamics of pay-for-performance compensation and the existing literature on the relationship between firms' leverage and the structure of executive compensation. In particular, despite recent papers showing positive outcomes in the control of firms' leverage regulating executive compensation, the authors raise a cautionary note: under certain conditions, regulating leverage directly seems more efficient than regulating executive compensation.

Luna Azahara Romo González provides an update of the determinants of dollar-denominated long-term debt issuance by euro area banks, with a particular focus on deviations from covered interest parity (CIP). The author finds evidence that the higher issuance of dollar-denominated debt by euro area banks is in response to recent regulatory reforms (which have incentivised subordinated and long-term debt issuance) and to an interest in benefiting from the traditional depth and breadth of the dollar investor base (i.e. strategic issuance). The article concludes by analysing possible financial stability consequences of banks' reliance on dollar markets and, in particular, how the supply of dollars by non-bank entities, chiefly located in emerging economies, may pose risks to the global financial system.

Francisco Manzano describes the new standardised approach for capital requirements for counterparty risk proposed by the Basel Committee on Banking Supervision, whose main aim is to mitigate the weaknesses identified in the previous standardised method: specifically, the non-recognition, in an appropriate fashion, of the mitigating effects of collateral and netting agreements. The author also describes the proposed regulatory transposition of this new approach at EU level and finalises the article with some personal considerations. In particular, he believes that the new proposed alternative will offer minimum capital requirement figures better tailored to the risks actually assumed and which will provide for cross-entity comparability. In addition, he raises a note of caution in connection with improving counterparty risk management practices; in particular, the importance of having appropriate collateral management policies at hand as a tool for aligning the interests of those with credit exposure in derivatives with those responsible for managing the ultimate underlying risk.

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