Inconsistencies in EU Prudential Regulations & the complexity of federalized bank supervision: A brief comment

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Paper findings

- Significant supervised entities in the EBU are subject to the exercise of options and discretions granted to Competent Authorities and Member States by European prudential legislation
- This legal complexity was probably unavoidable, but the ultimate result is the application of a diverse legal framework also to significant credit institutions under direct ECB supervision with many instances in which the ECB is required to apply national law deriving from 19 different national legal frameworks.
- Several legal obstacles deriving both from the SSM regulation and the applicable European prudential supervisory framework (CRR and CRDIV) are still hindering the establishment of a truly centralised prudential regulatory and supervisory framework across the EBU
- The diverse legal framework also applicable to significant credit institutions under direct ECB supervision hinders market integration

Why diversity is supervisory application of prudential rules is an impediment to effective supervision?

- Significant obstacles are still present in European secondary law and prevent the ECB from supervising significant banking groups within the SSM as in a single regulatory and supervisory jurisdiction
- It makes difficult the day-to-day application to significant banking groups by the ECB of prudential requirements that vary according to the Member State of establishment
- Inconsistency in the ordering and application of macroprudential buffers and other macroprudential controls:
  - While the SSM does not deal with the macro-prudential options and discretions provided for by the CRDIV and the CRR (e.g. Art. 458 of the CRR), since, in general macro-prudential options and discretions are entrusted to Member States, still NCAs have a significant role in their exercise
  - E.g., in the case of some macro-prudential powers such as the recognition of the systemic risk buffer rate in article 134.1 of the CRDIV

Impediments to market integration and cross-border liquidity management

- The author argues: the unavailability of cross-border prudential waivers even within the SSM and the presence of some critical options and discretions still granted to Member States by the CRR, the ECB cannot allow the free flow of financial resources within the Euro-area for significant banking groups once again hindering the fungibility of money and ultimately surrendering to regulatory ring-fencing along national lines
- E.g., article 400.2 is article 400.2.c on intra-group large exposure exemptions, especially in combination with a cross-border liquidity waiver pursuant to article 8.3 (83) of the CRR, it potentially allows a banking group to freely move resources between credit institutions and other financial entities within the group also across borders, i.e. even if the subsidiaries and the parent company are established in different Member States.
- But the combination of those provisions which entrust the competent authority with the power to remove prudential barriers to the free circulation of financial resources (capital and liquidity) across the EU may impede that those mechanisms of private risk sharing we have briefly referred to above will eventually emerge.
- *This is possibly a remnant from the pre-SRB/SRF period? and ought to be amended*

Uniformity in Prudential Regulation?

- It is a valid point that for a truly integrated banking market de-linking the capital of local banks from the volume of local credit supply is important especially in terms of risk and income stream diversification
- But these have also to do with the dynamics of the shareholder body and different business plant
- The EU/EU focus on level playing and rule uniformity is mostly justified in the field of systemic risk, for the same reasons that you cannot have regulatory competition when it comes to safety standards for nuclear power plants
- BUT more plurality when it comes to smaller banks fostering new entry and competition is not necessarily a bad thing esp. since younger banks seem more keen to lend and more adaptable to the technological challenges of the era
- E.g., smaller bank regulation is far from uniform in the USA

Evaluation/ Conclusions(i)

- The paper proves beyond all doubt through rigorous research and doctrinal analysis that the important parts of the current regulatory regime are contradictory
- the inconsistency of application of waivers across the EBU adds to confusion,
- it creates an uneven playing field especially as regards the counting of intra-group exposures and the allocation of intra-group liquidity and makes the job of the single supervisor rather challenging
- Clearly a codification exercise is overdue in this area to clear up the mess identified by this very robust paper

Conclusions (ii) - Market integration?

- BUT market integration is not only impeded by the clearly identified inconsistencies of the EU prudential regime
- deleveraging, the burden of new regulations, increased threats from smaller operators, language and cultural barriers as well as differing consumer protection regimes may be as big or even bigger barriers
- Also the EU according to all studies is over-banked it does not need bigger but better banks
- without a single deposit guarantee scheme there may never be a single EBU banking market
- The EU expects new funding to come from the capital markets and esp. the markets for securitised debt and deep bonds markets for SMEs not more bank lending

Conclusions (iii)

- As regards the second argument that such streamlining will aid market integration that is a <u>very good and insightful point</u>
- But an asymmetric regulatory framework where the rules on smaller operators are less onerous is not necessary a terrible thing as it would also help business models evolve
- Moreover further growth will (should) not come from bank finance but rather from market-based finance
- What Europe needs is <u>more robust and not bigger banks</u>
- Development of deeper bond markets and consistent insolvency regimes and recovery regimes, as per the EU Commission's express objectives in promulgating the CMU instruments is a much more sound and effective way to foster market integration across the EU make capital formation, risk management and hedging cheaper

Conclusions (iii)

- Brexit is a clear opportunity for the EU-27 to move from bank funded to the development of deep capital markets, inc. markets for securitised debt -
- And the development of infrastructure for wholesale finance including taking advantage of the opportunities offered in this area by fintech, since blockchain platforms will certainly be cheaper to build, trade on and clear and settle trades than today's heavy CCHs/CCPs that dominate the industry and can easily stifle innovation
- The restrictions on risk finance, especially venture capital and PE funds ought to be eased as these can be essential in, first building a robust innovation economy exploiting Europe's academic powerhouses, and secondly restructure failing firms, stagnant markets and even help in the reduction of NPLs in the periphery of the EU