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Presentation of seven country studies on the impact of implementation of EU Directives on Banking and Finance on national regulatory systems

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Presentation of seven country studies on the impact of implementation of EU Directives on Banking and Finance on national regulatory systems

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Abstract: This Report provides an introduction to the seven country studies on the implementation of the European Directives on Banking and Finance in the period from the introduction of the Single European Act to the 2007/8 Global financial crisis and the additional national measures that have been taken in response to the crisis.[1] Each of the country studies provides a narrative of the domestic financial regulatory structure at the beginning of the period, defined as the date of the Single European Act, as well the means by which the EU Directives have been introduced into domestic legislation and the impact on the financial structure of the economy. In particular, the studies highlight how the Directives have been modified to meet the then existing domestic conditions and financial structure as well as how they have modified that structure. To provide a roadmap to these legislative changes, each country study is accompanied by a grid noting the dates and relevant national legislation implementing the Directives. To aid in cross-country comparison, a grid presenting the legislation for each country for the major Directives is also included.[2]

Since each country has complied with national insertion of the various Directives, and since each faced particular national circumstances, this summary will simply highlight for the individual countries those particular characteristics of more general importance for potential modification of the way regulations are introduced into the member states' jurisprudence.

Key words: financial regulation, European Single Market

[1] This report is combines two FESSUD deliverables (D4.05 and D4.07); each country study similarly combines two FESSUD deliverables (D4.03, covering reforms up 2007, and D4.06, post-2007 developments). Full country studies will be available as separate FESSUD working papers.
[2] The comparative grids are available under this link: https://www.dropbox.com/s/lsi3k7823nirzd2/D4.03%20grids%20new%201.04.214.xlsx.

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Introduction

This Report provides an introduction to the seven country studies on the implementation of the European Directives on Banking and Finance in the period from the introduction of the Single European Act to the 2007/8 Global financial crisis and the additional national measures that have been taken in response to the crisis.[3] Each of the country studies provides a narrative of the domestic financial regulatory structure at the beginning of the period, defined as the date of the Single European Act, as well the means by which the EU Directives have been introduced into domestic legislation and the impact on the financial structure of the economy. In particular, the studies highlight how the Directives have been modified to meet the then existing domestic conditions and financial structure as well as how they have modified that structure. To provide a roadmap to these legislative changes, each country study is accompanied by a grid noting the dates and relevant national legislation implementing the Directives. To aid in cross-country comparison, a grid presenting the legislation for each country for the major Directives is also included.[4]

Since each country has complied with national insertion of the various Directives, and since each faced particular national circumstances, this summary will simply highlight for the individual countries those particular characteristics of more general importance for potential modification of the way regulations are introduced into the member states' jurisprudence.

1. The Background to EU Regulation

The intention of the 1986 Single European Act was to provide renewed stimulus to the process of European integration started in the 1957 Treaty of Rome creating the European Economic Community or European "common market". By the early 1970s the expansion in intra EEC trade driven by the erection of a common external tariff and elimination of internal tariff barriers had slowed. It became clear that if economic integration were to progress beyond the limits set by the simple application of a common external tariff, more radical steps would have to be taken to

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implement full integration of money and financial markets. Although there were diverse proposals and Expert Commission Reports on how this fuller financial integration would be achieved, the decision was eventually taken to proceed via the creation of a common European currency. This path had several clear implications at the institutional level of the EU. In particular, it required a single issuing authority for the common currency which took the form of a European Central Bank (ECB), independent from the government of any member state. Following the example of the post-war Bank Deutscher Länder (itself modeled on the United States Federal Reserve System's composition of a central Board supported by geographically dispersed "District" banks,) the ECB was supported by a similar system comprised of the Central bank, supported by the existing national central banks who became the operative agents of monetary policy determined by the central institution. Following the German example, and the dominant economic theory of the period, the ECB and European System of Central Banks (ESCB) were given by statute a single objective, price stability which was to be implemented by a single monetary policy effectuated through the management of uniform interest rates. For a common interest rate policy to be effective in implementing the policy objective, and have similar impact on the member states adopting the common currency called the Euro, all member states would have to have similar financial performance and similar financial architecture to insure the efficient transition of the single monetary policy actions implemented by the central bank into national financial conditions.[5]

In order to ensure the required uniformity in economic performance a number of conditions of entry into the single currency were imposed in the form of a maximum rate of inflation, similarity of interest rates, compliance with the existing exchange rate mechanism (ERM), a maximum fiscal and debt position and a sustainable current account balance of payments. Because monetary policy is primarily transmitted through the impact of interest rates on the performance of the lending behavior of the private financial system, the decision to adopt a single currency also meant the creation of a common institutional structure for the financial systems of the member states. Indeed, the divergences in the institutional financial structure and monetary policy instruments and operating procedures used in the national banks of the component member states were as large, and in some cases even larger, than the differences in inflation

[5] Article B of the Maastricht Treaty makes it clear that among the goals of the newly rebranded European Union there is "the establishment of economic and monetary union, ultimately including a single currency" for all member countries. The only possible exceptions are the indefinite opt-out permitted to UK and Denmark.

performance or government fiscal policy stance. Most governments of the initial member states had made extensive use of direct controls over lending or interest rates, management of exchange rates and direct ownership of the domestic financial system, to implement monetary policy in the 1950s and 1960s in support of their post-war recovery programs. Opening such diverse domestic financial systems to a uniform, open European financial market made this approach to financial policy untenable as the existing apparatus of controls and subsidies could no longer be limited to or targeted toward domestic financial institutions. In particular, the widespread use of directed and concessionary interest rates became increasingly difficult in the face of market determination of interest rates in other countries and their defence required both capital controls which were in contrast with the objective of a single financial market, and exchange rate management, which was in contrast with the move to unified financial markets.

As a result, after the initiation of the path towards increased monetary integration via limitations on exchange rate volatility via the "snake" procedures instituted after the breakdown of the Bretton Woods System in the early 1970s and the more formal Exchange Rate Mechanism of the European Monetary System as part of the move to Economic and Monetary Union at the end of the 1970s, the European Commission initiated a series of measures starting in the 1980s to widen the scope of the single market to include integration of the markets in financial services. In particular, the controls on cross border investments that had been a major part of domestic policies of directed lending, interest rate limits and exchange rate management were eliminated. With open financial borders, the adoption of common rules and homogeneous supervisory practices became an integral part of the objective of integration of the European financial markets.

While this process of convergence of financial structure was implicit in the movement to the integration into a Single market via a common currency, it also took place within an global trend toward deregulation of financial institutions and the liberalisation of financial markets in the major financial centers of the developed world that commenced after the US suspended the Bretton Woods gold parity of the dollar in 1971. This approach implied an increasing emphasis on the role of market forces in the global distribution of financial assets and the regulation of financial institutions. Increased market competition was seen as a more effective means than government controls to improve efficiency, the allocation of financial resources, and the support of long-term real growth. Markets would be more efficient in providing the innovation of financial practices, products and institutions in support of financial and economic stability. Thus, relaxation of the constraints on international financial flows and the activities of international financial service providers accompanied the reduction of controls on capital flows and institutions within the European Community. The enduring regulatory dispute between strict application of prudential rules versus discretionary interpretation of financial regulations by national supervisors was won by the latter and the new common European regulatory structure was influenced by and largely reflected this approach to place greater reliance on market discipline and what came to be known as "light touch" regulation.

Given the particular requirements of the European integration process, the process of the creation of a common financial market as reflected in the details of its legal agenda became more far reaching than the similar movement on the international level. The single European passport for financial institutions incorporated in, and regulated by, the home regulatory authority provides one example. The extension of the Basel I regulations to all banks, rather than only to those operating at the international level as was the original intention of the first Basle Accord, is another.

However, given the preservation of national regulatory jurisprudence and supervisory jurisdictions, based on diverse national legal codes and practices meant that substantial discretion was left to individual member countries in the practical implementation of the common EU rules and principles. As a result the legal incorporation of the common financial market place was effectuated via the issuance of European Directives which in difference from Regulations are not introduced directly into member country jurisprudence, but have to be adapted and adopted with the agreement of national legislative bodies.

Another important source of national differentiation within the introduction of common principles is the use of subsidiarity and proportionality in the national application of EU legislation. In practice this means that minimum rather than maximum harmonisation will be the standard achieved in national legislation.

In addition, the failure to introduce a common EU regulatory agency, as provided for in the Maastricht Treaty, meant that national authorities retained full discretionary powers in the interpretation and application of EU Directives once incorporated in national legislation. The recent crisis has made evident the difficulties in this approach and has led to the support for tighter interpretation and application of existing regulation, as well as widening its application to encompass maximum harmonisation through a series of institutional reforms such as the

European Supervisory Authorities, the Single Resolution Authority and a Single Supervisory Mechanism.

2. The Initial Implementation of the Common Regulatory Approach

The seven country studies showcasing the process of introduction and implementation of EU financial regulation surveyed in this report demonstrate the diversity in financial structure and regulatory and supervisory frameworks at the beginning of the EEC and in particular at the beginning of the process of providing the level financial playing field initiated with the Single European Act. The countries chosen demonstrate a variety of different experiences encountered by countries starting from three very diverse initial conditions. It includes three countries that were initial members of the EEC, France, German and Italy, and whose financial systems evolved within the full process of trade integration preceding the introduction of the move to a common monetary and financial structure. It includes a late adhesion country, Spain, exhibiting the problems of catching up of a country of similar size as the initial member states. Finally, it includes three even more recent members who were formerly planned economies from Eastern Europe, Estonia, Hungary and Slovenia, to give a flavour of the different problems faced by these countries adapting the entire structure of their economic and political systems in the process of homogenization of their financial structures.

Wide divergence is exhibited by the first group of initial member states. For example, France had a highly controlled, segmented State owned credit system with generalised use of indicative planning supported by directed lending and interest rate controls, while Germany was the only EC country with a continuous history of universal banking and more market directed credit allocation, but within a financial structure that contained a large and active regional government controlled financial system which allowed an indirect form of subsidized credit provision. Italy also had a segmented system in which directed lending and concessional interest rates were an essential element of domestic regional development policies. Regulation and supervision were integrated within a specific operational unit within the central bank in Italy and jointly by the central bank and the Ministry of Finance in France, while in Germany the regulatory authority was an independent unit but highly integrated with monetary policy and monitored and largely implemented by the Bundesbank.

While Germany moved quickly to introduce current and capital account convertibility and to open its borders to trade and financial flows, both France and Italy maintained some form of administrative controls on trade and capital movements for exchange rate management and other purposes until the introduction of the Single European Act. In contrast, Spain moved rapidly from a highly controlled State dominated financial system to rapid conformity with the new European norms. These changes occurred against a shift in the organizational principles of harmonization in support of European unification. The initial impetus based on rationalization and consolidation of production activities to produce larger Community level units, as envisioned for example in the consolidation of steel production envisaged in the European Coal and Steel Community, was soon replaced by mutual recognition and the support of national champions in individual countries.

Finally, the former planned economies moved from a virtual absence of a regulatory structure under a closed, State directed and supported monobank financial system, to an open, market-based system that had to construct virtually all the attributes of a market-based financial system from scratch. Structural changes were total for countries (such as Estonia, Slovenia) that in a relatively short time-span had to switch, not only to a legal and operationally market-based economic system, but, as late entrants, but also to manage the introduction of the already complex European *acquis communautaire* in the financial sphere. Hungary presents an intermediate case as one of the leaders in market reforms under socialism due to its early membership in a number of international financial organisations.

On the other hand all countries the introduction of Directives initiated shift in the domestic balance of power in favour of and central banks and Regulatory agencies at the expense of national parliaments and executive branches of governments. However, this shift was not peculiar to EU members states, reflecting a more general disengagement of government from direct economic responsibility due to the increasing dominance of political parties supporting greater market regulation on the one hand, and the increasing complexity of regulations which shifted decision-making from elected governance structures to technical experts at the national and in the case of the Basle Committee, international level.

While each country experienced particular historical and structural problems they all faced the same objectives of implementing the EU directives into their existing domestic legislative frameworks. It would be impossible in this summary report to provide a full summary of each of these national experiences. Instead, this summary will seek to identify the difficulties and impact on national conditions of the introduction the most important of the various Directives for their relevant history within the EU (for example only from dates of accession for the more recent members of Eastern Europe), as well as to draw some general implications from the experiences of particular countries in order to provide proposals for how the process of financial integration may be made more efficient and effective as the forces leading to greater convergence and commonality appear to be increasing.

As already mentioned, this appears to be a reflection of the impact of the recent financial crisis which may be seen as a watershed in the theoretical approach to regulation, favouring the application of more general rules imposed from the EU level, rather than the discretionary approach previously applied through the introduction of Directives into national legislation. The country reports thus also provide a narrative of the way the different countries have responded to this change of approach to EU regulation in the period after the financial crisis.

3. Regulatory Initiatives Provoked by the recent crisis

The topics of regulatory and supervisory activity chosen for presentation by the country studies may be divided into three notional categories: those that were fully incorporated into EU regulation; those lightly or partially regulated; and those left outside the scope of formal regulation. As stated, the recent trend appears to be towards the elevation of the elements of the latter two categories to the higher category, increasing harmonization and reducing the space for national diversity.

The general areas covered for the period up to 2007 were

Liberalisation of capital movements; Cross-border competition and permitted activities; Capital requirements; Consolidated supervision; Supervision of financial groups and conglomerates; Large exposures; Investment services; Deposit guarantee schemes; Crisis management schemes; Accounting standards.

The areas covered for 2008 to present were: Augmented capital requirements; Corporate governance; Deposit guarantee schemes.

As noted above, the liberalisation of cross border capital movements and the single European passport for banks and providers of financial services were the first relevant measures in laying the foundation for the implementation of a single financial market. The implementation of capital requirements was in general driven by the Basle Committee on Bank Supervision process and in general corresponds to those recommendations. Common principles on consolidation in reporting and consolidated supervision were necessary appendixes to what essentially remained cross-border activities rather than EU-wide establishment and operation of financial institutions through branches or subsidiaries. Given this framework, it was necessary to avoid unfair competition due to divergent national legislative implementation by imbedding the various regulations in the various versions of the Basel Accords and in the specific legislation that national government's applied to different market institutions via the Markets in Financial Instruments Directive. The introduction of more binding EU rules on large exposures introduced more precision into the necessarily vague Basel principles and reduced the tendency toward discretionary application.

These are the major areas in which the EU Directives concentrated attention and in which the country studies show the largest degree of regulatory convergence, although this has not necessarily been accompanied by supervisory convergence. Due to the continued presence of national regulatory and supervisory agencies that had the option of national exception in incorporation into national legislation and then discretionary interpretation of these principles meant that strong initial differences have made the de facto convergence much more limited than is exhibited by the changes in national legislation and financial structure.

In addition, the country reports cover a second range of issues in which greater national discretion has allowed for increased divergence in those lightly or partially regulated financial operations including deposit guarantee schemes, recovery and resolution procedures and accounting standards. Although the creation of deposit guarantee schemes and participation became compulsory for all banks, the differences for the funding and coverage of the various national systems have remained substantially unchanged. The conditions covering bank recovery and resolution were mainly directed at specifying the responsible authority for cross-border crises, rather than imposing homogeneous procedures on the liquidation or recapitalization of insolvent institutions.

The homogenisation of accounting standards towards IFRS international standards was compulsory for only large banks; moreover, the determination of this standard is outside the direct control of the EU and thus leaves banks and national authorities with a wide set of options and discretion. This issue is of crucial importance in interpreting the actual application of regulations since accounting practices are central to a system of core bank regulation that relies on the accounting calculation of regulatory capital as a risk-weighted minimum. This second category of measures also includes topics that have taken on additional relevance due to the role of their aleatory application and implementation in the evolution of the recent financial crisis.

The third category of regulatory issues includes topics such as rules on liquidity, competition policy, usury and taxes. The provision of liquidity was a topic of the Basel Core Principles that was left to the implementation of local supervisory authorities and only subsequently included in the second pillar of Basel II on the basis of discretionary interpretation of principles more than strict rules and in any case, only implemented in Europe since 2007.

There is no specific competition policy for the banking sector for the EU, leaving large variations in the degree of bank concentration. Usury laws are present only in few European countries. Finally, tax treatments are widely different across European member countries, but are crucial for the economic implications of policies on provisioning policy of impaired assets.

4. Reaction to the recent crisis

The recent crisis has shown relevant limits inherent in the application of the three categories of regulations presented above. Remedies have been proposed after the crisis to expand and augment the regulations surveyed in the first category via the revisions of Basel II.5 and then Basel III which was designed to remedy some deficiencies of the previous versions, incorporating the formal treatment of liquidity.

Primary attention had been given to the creation of common EU institutional framework in order to migrate towards a single rulebook and a single supervisory handbook and for the adoption of macro-prudential policies. Hence, the creation of the three European Supervisory Authorities and of the European Systemic Risk Board. A directive on minimum harmonisation at the EU level of bank recovery and resolution has recently been finalised. For a subset of EU countries, the Banking Union should deepen harmonisation, and the recent approval of a series of measures leading to the implementation of the Single Rule Book, the Single Resolution Fund and the outlines of the EU Banking Union. However, similarly to the Dodd-Frank Act in the US it will be necessary to draft some 400 technical regulations to fully implement the new legislation. The crisis has thus produced a shift of those items that were previously subject to weak or national discretion in coverage into the group of items to be covered by obligatory EU harmonisation.

Apart from the efficacy of these reforms, a number of questions remain. First, how many items will be covered by obligatory EU rule making and enforcing institutions, and how the rules will be formulated. For example, the systemic nature of banks has traditionally been dealt with without reference to conditions of competition. Second, how much the push towards maximum harmonisation for the entire EU is already facing structural obstacles given the opposition coming from countries whose financial systems exhibit differences that do not properly fit into strict common rules and thus may be subject to additional regulatory distortions. Third, how to manage the unavoidable problems coming from the cohabitation of an inner circle of maximum harmonisation for countries covered by the Single Supervisory Mechanism, and a 'periphery' with minimum coverage and additional discretion. Consider in this regard the cross-border problems pointed out by Estonia, especially with reference to bank resolution. Fourth, how to manage the unification or coexistence of different national initiatives on structural reforms.

5. Implications of the Initial EEC Member Country Studies

As noted above, the three country studies prepared for the countries who were initial members of the EEC-6 showed substantial variation in terms of their financial structure and regulatory frameworks. Germany in particular has been a European exception in that it preserved its universal bank structure after the 1930s collapse of most European financial systems. Italy and France took a route to reform that was more similar to that in the US, replacing industrial banks with a more segmented system with substantial State control over and ownership in financial institutions the use of this control to direct lending flows and interest rates. It was something of a paradox that although universal/industrial banks were considered as a major cause of instability in the prewar period, Germany has had an enviable record of stability with the same financial structure in the post-war period. It is thus also something of a paradox that the impact of the EU banking Directives were to move France and Italy back to an organizational form for their financial systems which had been considered as inherently prone to instability and the source of prior crisis.

The key to the German success was twofold, one was in the regulatory structure that supported its universal banking system, and the second was the diversity of the different institutional structures that comprised the German system, with its important component of Regional Lander banks and its Cooperative banks.

5.1 Germany – Regulatory Regress

An example of the imposition of common standards leading to a minimum implementation may be seen in the application of the fourth amendment to the Banking Act which took into account the introduction of the Directive implementing the Basle I capital ratios. In response to increasing off-balance sheet activities and counterparty and price risks, the German regulator had expanded the coverage of German regulation Principle I dealing with capital adequacy to increase the risk-weighted capital requirements from 5.58 to 8 per cent. However, the fourth amendment of the Banking Act broadened the eligible capital base that banks could use to cover their regulatory requirements. This can be seen as a major change in the overall direction of capital regulation in Germany since the new rules did allow for including positions as capital that did not conform to the three principles (positions had to be fully paid up, capable of meeting current losses and permanently available to the bank).

Already during the preparation of the Basel guidelines on which the EC-directive was eventually based, the Bundesbank had made clear that it was opposed to such a softening of capital requirements. Nonetheless, it could not prevent a relative softening compared to the prevailing German rules that the EU Directive implied by dividing own funds into core and additional capital. This reduced core capital (which met the traditional three principles) to 4% of the risk-weighted assets, rather than 8 per cent. Meeting the common standards thus produced a substantial reduction in the effective capital adequacy required of German banks because the additional elements include some positions which have not been acknowledged as regulatory capital until then, e.g. contingency reserves, unrealised reserves and subordinated liabilities.
It is interesting that the inclusion of unrealised reserves was an issue in German parliamentary discussions. The Bundesbank generally was opposed to allowing unrealised reserves because of their pro-cyclical behaviour. Lobbying by the banks in support of inclusion used an argument similar to US banks opposition to stricter regulations, that excessively strict requirements would put them at an international competitive disadvantage. Therefore, the translation of the directive into German law, supported by domestic financial institutions, led to major changes in the capital requirement regulations in Germany. Besides broadening the assets to be included (this was already for a while on the agenda in Germany before the directive), it led to a softening of the established eligibility criteria for regulatory capital (Deutsche Bundesbank, 1993). It is paradoxical

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that the new Basle III capital regulations on core equity capital represent a partial return to the original German position against the arguments of the bank lobby.

Under German national bank regulation, Principle II dealt with liquidity and enshrined the so-called golden rule of banking that long-term assets should be financed by long-term liabilities. Principle III limited external leverage for illiquid short and medium term assets. Both Principles were adapted and amended to accommodate changes in banks' operating procedures, while similar limitations on liquidity and leverage are only now being introduced into Basle and EU regulation and will in all likelihood present a case in which German regulation will again be weakened by the imposition of common EU regulations.

Another unique characteristic of the German financial structure was the combination and co-existence of a big four or three universal banks with a wide range of cooperative and savings banks group in joint national structures such as the Girozentral and the Landesbanken. These were mutual societies or regional government supported institutions which provided the benefits of local banking organisations with the advantages of large scale banking institutions. They were in general conservatively managed until the EU forced them to become limited liabilities equity-ownership institutions that had to compete for returns. Indeed, one of the ways that sub-prime loans penetrated the German financial system was the result of the reach for yield of collateralised sub-prime mortgages by regional banking organisations which were no longer able to count on support of their regional Land governments.

Finally, Germany has always had an independent regulatory agency, on the grounds that the monetary policy mandate should be independent of the financial stability mandate. Nonetheless, the Bundesbank has played a major role in the implementation and supervision of German regulations. The basic rule has been that the pursuit of the objective of monetary policy should not be conditions by the potential impact on the stability of financial institutions. As a result of the creation of the ECB, the role of the Bundesbank in regulation of German banks has been strengthened, even as German regulations have been weakened as a result of the common EU regulatory framework, absent a common EU regulatory body.

5.2 Italy

Italy represents the different arrangement in which the Bank of Italy has always been the responsible for bank regulation and supervision. Since the fascist period Italy has had national regulation on the protection of savings and the Central Bank is bound by this law to ensure that its policy and regulatory actions are consonant with this legal obligation to prevent losses of private savings. In addition, Italian banks were traditionally organised as owned by non-profit foundations who represented stakeholders such as the surrounding community and provided for the beneficial distribution of bank profits to them. After the first banking directive the Bank of Italy published a white paper on banking reform outlining the transformation into limited liability private equity institutions, although the former foundation owners remained as shareholders. Embodied in the Amato Act these reforms allowed banks to operate as universal banks, to invest in non-financial stocks and, above all, to remove all the constraints between short and long term operations. The reform led to a large number of listed banks that, given the modest dimension of the Milan stock exchange, produced the distinctive character of a stock exchange whose trend and volatility is much influenced by those of banks. The second directive dealing with the European passport opened the financial system to foreign competition, yet the system remained essentially dominated by Italian banks and both foreign operations and the acquisition of Italian banks were actively discouraged by regulators. This led initially to domestic pressure to larger bank combinations to resist foreign buyers, in de facto if not de jure contradiction to EU regulations. As an alternative to pushing for radical reorganisations, this M&As process, actively encouraged by the Bank of Italy acting within its conservatorship and receivership powers, was seen as an orderly way to reach the larger dimensions that would have permitted gains in efficiency and profitability and at the same time would have rendered foreign acquisitions more difficult. Furthermore, Italian banks reacted to potential foreign entrants with a territorial expansion that lead to significant over-branching. To a certain extent, these two processes have for a long period entrenched incumbent banks and impeded the enhanced competition coming from deregulation to produce more solid gains in their resilience. However, a change in the position of the authorities has now opened the domestic market more fully to foreign competition and acquisition which is believed to provide greater financial stability. However, greater cross-border acquisition would likely lead to larger banking conglomerates, providing a different source of instability in the moral hazard created by too big to fail banks and the difficulties involved in cross-border resolution. Since the most relevant foreign banks operating in Italy have Eurozone headquarters, it is hoped that the introduction of the single resolution authority will resolve the resolution problem.

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The Italian experience suggests that one of the ostensible benefits of the effective limitation on opening domestic markets is that Italy had little exposure to the securitisation of mortgages that produced difficulties in both the US, France and Germany, since Italian regulators prevented Italian regulated banks from participating in them.[6] This is not to say that there were no regulatory problems in the Italian system, as crises such as Parmalat testify. However, it does highlight the benefits of home country regulation and control of banks operating within common regulatory boundaries and the implementation and verification difficulties that will be involved in the newly proposed Banking Union.

5.3 France – The State as Architect of a Market Driven Financial System

Post-war reforms of the French financial system led to a segmentation similar to that in many other countries after the 1930s crisis with the creation of three categories, *deposit* banks, investment banks and medium and long-term lending banks. Each category specialized in specific types of financing activities in support of the need of industrial reconstruction. Alongside the nationalization of banks, the French authorities multiplied the incentives for non-financial agents (households in particular) to increase their savings and tried to steer these, through the specialization and supervision of financial intermediaries, towards certain areas — *e.g.* housing and the productive investment of resident companies. In addition, from the 1970s, regulated interest rates and monetary controls were overseen by government supervisors.

Liberalisation of this system commenced with legislation on free movement of capital in the Debré law of 1966. However, article 3 authorized "temporary exceptions" to free movements of capital which persisted until the introduction of EU legislation in 1989.

As in other countries, economic policy in the United States, and the subsequent push to deregulation that it set in train had a profound impact on the State controlled financial system. Rising US interest rates and dollar appreciation made exchange controls essential to maintaining concessional directed interest rates. This intensified the contradiction between the tighter controls needed to maintain the financial system and the openness required by increasing financial integration in Europe and on the global level. In addition French banking was facing problems of loan losses due to the Latin American debt crisis and poor profitability. This led the government to

[6] This in large part due to strict interpretation and enforcement by the Bank of Italy of the regulatory requirements on balance-sheet consolidation.

introduce a fundamental reform of the financial system via nationalization of the banks in 1982 in order to orchestrate the (de)regulation of the system through the Banking Act of 1984. The reforms sought to free interest rates from administrative and policy controls and establish a unified monetary and financial market. It laid the groundwork for the introduction of "universal" banking. The freedom to carry out every type of operations peculiar to credit organisations applied to the Members of the French Banking Association such as BNP-Paribas or Société Générale, as well as "mutual" or cooperative banks (such as Crédit Agricole), the savings banks, the local credit banks, the financial societies and the specialized financial institutions. The management by the government of this transformation may be seen in the efforts made to establish interest futures and options derivatives markets the MATIF/MONEP which would allow bankers, unused to market determined interest rate volatility, a means to hedge interest rate risk until they became used to operating in a free financial market environment.

As in other EU countries, French legislation of 1984 to a large extent preceded the Banking Directive dealing with liberalisation of capital movements (EU directive in 1988), cross-border competition and definition of permitted activities (EU directive in 1989 and 1993), capital requirements (EU directive in 1989), definition of investment services (EU directive in 1993), deposit guarantee (EU directive in 1994), and crisis management schemes (EU directive in 2001). It is an open question then whether the restructuring of the French system was driven by the dynamic of the global move towards integration and deregulations or the internal dynamic of the drive to monetary union. Whatever the major force, the EU competition policy appears to have been a major determinant of the reprivatisation of the financial system, initiated by a right wing government but completed by a Socialist government which had been the original proponent. France thus also provides a useful example of the way government control may be involved and efficient in creating a financial system that is independent of direct government controls. In France the government was central in the operation of the financial system, but it was also central in initiating and completing the process of transition to a market-based financial system in which the State is the regulator of market forces.

5.4 Spain – Countercyclical Provisioning and Financial Innovation

The Spanish financial system prior to entry into the EEC in 1986 shows similarities to both Italy and France in terms of its role as an instrument in government industrial policy and its functionally segmented structure. However, it is of particular interest because of the rapid transformation in both political and economic conditions in the period preceding entry created special conditions for implementation. Spain is also of interest because it experienced severe financial crisis both before and after joining and implementing the EU banking directives.

Pre-entry banking regulations involved strict controls on banks; the Ministry of Finance set maximum and minimum interest rates on deposits and on loans as well as preferential rates for "priority industrial sectors" and all banking operations were subject to controls. By 1976 in the midst of the political transformations ushered in by the death of Franco partial deregulation of the financial system led to a crisis caused by excessive credit expansion, and poor selection and monitoring of borrowers in the context of a weak regulatory framework in which the old structural controls had not been substituted by non-discretionary prudential regulation. The crisis occurred in the midst of the negotiations that led to the Moncloa Pacts, in which leaders of Spain's major political parties met and agreed to share the costs of, and the responsibility for, economic reforms that eventually led to Spain's entry into the EU. The process of adapting to EU Directives thus coincided with the process of adaptation of the financial system to the new political and economic policy reality of democratic institutions. As a result of this endogenous process of reforming financial legislation to replace the Franco era regulations, Spain adopted policies of early or anticipated adoption of international bank solvency standards which made implementation of subsequent EU Directives a simpler process than in some other countries.

There is another area in which Spain has been in the avant guard of financial regulations. Spain has been an example of innovative macro prudential measures, prioneering the introduction of counter-cyclical, dynamic or statistical provisioning aimed at forcing banks to set aside loan loss reserves for the expected losses which are embedded in their expanding credit portfolios during good times, allowing them to use the reserve to cover realized losses during bad times. Such ruling introduced a novel mechanism of statistical or counter-cyclical provisions which were referred to some years later as one of the references for the reform of the solvency regulation within Basel III. In particular the granting of a loan by a Spanish bank should be accompanied by a loan loss provisioning consistent with the historical loss experience of such loans, even in the absence of any signs of impairment. By using long-run historical losses, counter-cyclical provisions were intended to counter the natural procyclicality of specific provisions. There is some evidence to suggest that the proactive provisioning system had a significant impact upon loan-loss provisioning levels in

Spain. For example, in 1999 the loan-loss provisions of Spanish banks were the lowest among OECD countries. In 2006, the Spanish banking system had by far the highest coverage ratio among Western European countries, at 255%. However, despite these measures Spain experienced a banking crisis as severe in any other country facing a cyclical expansion of lending in real estate markets.

In this context it is interesting to note that Spain also experienced one of the most rapid increases in mortgage securitisation amongst the major European countries, passing from a negligible share of housing finance in the 1990s to one of the highest in Europe in the late 2000s. It is widely accepted that the rapid expansion of securitisation played a role in the rapid increase in lending to the private sector and was one of the drivers of the rapid rise in real estate prices. Thus, securitisation was a major driver of the cyclical expansion of lending to the private sector and to real estate and should have generated increasing provisions by banks and have provided a cushion in the crisis. Yet this did not happen. One possible explanation is because securitization allowed banks to off-load loans to other investors thereby lowering regulatory pressures on capital requirements allowing them to avoid provisioning. The rapid development of securitization occurred in a period of low risk aversion and few defaults which not only resulted in credit rating agencies underestimation of risks of these instruments, but also may have reduced provisioning because banks' risk management models were also based on loan performance figures that underestimate default and liquidity risks. Indeed, some have suggested that the very existence of the counter-cyclical provisioning measures led to excessive confidence in the minds of regulators concerning the stability of the system and to an undervaluation of risks by the lenders.

The three Eastern European economies included in the country studies, Hungary, Slovenia and Estonia represent substantial differences in the way these former centrally planned economies responded to the transition to a democratic political structure and a market based economic and financial system in which implementation of the EU Directives played a central role. It also includes the experience of a country that remains outside the Eurozone, as well as one country with experience of introducing a new national currency as well as being the first of the former Socialist countries to adopt the Euro, and one of the most recent adherents to the Eurozone that was fully integrated into the Soviet system of central planning.

5.5 Hungary – Sequencing of Capital Market Liberalisation

Pre-war Hungary had a sophisticated financial system and many of the managers of that system maintained positions in the post-war planned system. Even during this period Hungary was one of the more innovative countries, offering foreign accounts and a number of other features that were not present in the other financial systems in the region. Thus Hungary was in the forefront of the reform of its financial system after the fall of the Berlin Wall and many reforms preceded the implementation of EU Directives.

Hungary was the home of some of the most innovative reform economists in the period before democratization and Hungary had already experimented with market-based reforms, including taking membership in international financial institutions such as the IMF and the OECD. Thus the reform of the banking system in Hungary was driven as much by its commitments to these institution as to the implementation of EU regulations and as a result the introduction of new financial market regulations preceded both domestic political reforms and reforms in other Comecon countries. There was thus a predisposition and creation of preconditions for the operation of a modern banking system in place before the actual transition from a planned to a market economy. A series of reforms in 1985 to 1987 led to the creation of Western European style banking system with the central bank given the task of maintaining financial stability, providing liquidity, supervising banks, managing foreign exchange reserves and making monetary policy while commercial banks provided financial services to households, corporations and local government. In addition to the creation of the central bank, three new commercial banks as well and some middle and small banks were created under State ownership and control. Foreign-owned banks were already operating as the reform proceeded.

The decision to seek membership in the EU led to ratification of the Europe Agreement in 1994 that required opening domestic banking market to foreign competition. The 1993 "Copenhagen criteria" set the basic accession standards and required restructuring of the banking sector to increase its competitiveness and enable it to operate in a highly competitive business environment. This led to the necessity of privatizing the banking system, which Hungary initiated in 1994, somewhat after other Comecon countries that had made privatization the initial step in their transition process. Indeed, in Hungary process of privatization of the banking system was only completed in 2003.

One important characteristic of the original centrally planned monobank system was the monopoly of retail deposits of the economy in the National Savings Bank (OTP). Simple privatization of the financial system could not entail the forced transfer of customer funds into newly created financial institutions. The transition of the financial system was thus dominated by competition between the new banks and OTP for core deposits.

One of the factors slowing the privatization process was the decision to invite strategic investors rather than financial investors as the main form of bank privatization. Given the underdevelopment of the capital market at that time it was a widely held belief that this method would produce a higher sale price. The sale of OTP was the only exception to this process because it controlled over two-thirds of Hungarian household savings could have been under the strategic control to a single investor (George Soros was a bidder). The privatization process thus favourised foreign investors in banking sector.

The major element of transition after privatization was thus the competition between the restructured domestic banks and OTP. A result of this competition was a rapid increase in the rate of credit expansion and a relaxation of lending standards reinforced by the appearance of interest-subsidized forint housing and consumer loans. The result was an increase in the ratio of household loans to GDP from 8% to 33% between 2000 and 2008. Much of this increase was due to an institutional innovation, the creation in 1997 of specialized banks to issue mortgage bonds to finance mortgage loans at subsidized interest rates via domestic banks.

However, when the interest subsidy was rescinded banks sought alternative sources of income through low interest rate foreign currency loans. This was made possible by simultaneous legislative measures in 2001 to implement the Council Directive for the implementation of Article 67 of the Treaty which removed limitations on capital flows and made the Hungarian Forint freely convertible. Driven by the large interest rate spread, the relative stability of the exchange rate of forint and the overwhelming presence of well-funded, foreign-owned credit institutions, and the expectation of the adoption of the Euro by 2007 the domestic loans in foreign currency surpassed forint lending, creating a classic currency mismatch for the Hungarian banks, corporate and household borrowers.

Hungary raises an issue of cross-regulatory consistency between Euro and non-Euro countries that is also present in a different context in the case of Estonia. While the kind the cross-currency lending practiced in Hungary should in principle be the subject of monitoring of systemic risk via the European Systemic Risk Board (ESRB), it is not clear what enforcement powers the

ESRB would have available and given that Hungary is outside the Eurozone the ECB would not have any possibility for direct regulatory sanction.

5.6 Slovenia – Regulatory Overkill?

Slovenia offers the unique case of nation building, separating from Yugoslavia, by means of the creation of a national currency and then building up a domestic financial structure to support it. In this respect it provides a microcosm of the experience of the EU in introducing a common currency and then proceeding to the creation of a central banks and the organization of the underlying structural changes in the financial system.

But the rules and institutions introduced in creation of a new market economy from a planned economic system are usually based on those currently viable in a developed old market economy; but they do not necessarily lead to the same results because the impact of regulations depends crucially on changing the existing norms and patterns of social behavior that have been created over many years. The introduction of new market financial regulations in Slovenia and its adjustments to the EU regulation provides an example of this proposition.

The introduction of the new regulations had two distinct periods. Regulation in the period 1991-1998 was based on the objective of the creation of Slovenia as an independent self-sufficient economic entity, dominated by a formally and active autonomous and powerful Bank of Slovenia (BS) which was aware of the development of financial regulation elsewhere (Basel I, for example). This was followed by the 1999-2007 period in which the Slovenian financial regulation was adapted to EU and EMU financial regulation.

Slovenia is often cited as an example of a successful transition. There are two reasons for that result. First, because of the peculiar Yugoslav approach to socialist planning, and the regional independence within Yugoslavia, many essentials of a market economy exited in Slovenia before 1989. Productive enterprises were autonomous, basic market institutions existed, and government used many standard economic policy tools. Second, Slovenia implemented macroeconomic stabilization cautiously, refusing patronage of international financial institutions and foreign economic advisers. Nonetheless, its successful entry into the Euro and introduction of EU legislation has not saved Slovenia from the worst consequences of the recent financial crisis.

The first period of regulation is defined by The Foreign Exchange Act and the creation of the Bank of Slovenia under the Bank of Slovenia Act together with the Basic Constitutional Charter on Independence and Sovereignty of the Republic of Slovenia and the Constitutional Act on the Implementation of the Basic Constitutional Charter. Article 152 of the Constitution of the Republic of Slovenia made the central bank independent and responsible directly to the Parliament.

The main responsibilities of the central bank were to maintain stability of the national currency, liquidity of the banking system within the country, and general liquidity of the country with foreign countries. In order to carry out this task, the Bank was responsible for most financial regulation, including money supply, liquidity of banks and savings banks, general liquidity in payments abroad, supervision of banks, issue of banknotes and coins, guarantees for deposits and provision of certain financial services for the Republic of Slovenia.

The major financial legislation, the Banks and Savings Banks Act of 1991 was short, clear and very precise without any references to EC directives and regulations. Three major issues crucially influenced creation of Slovenian financial regulation: (1) introduction of managed floating exchange rate regime, (2) privatization, and (3) rehabilitation of the banking system.

The decision to enter the EU and adopt the Euro and EU regulation thus presented a radical change in the approach to regulation, transferring much of the power that had resided in the central bank to national legislation and to the European Central Bank. Slovenia was the first former socialist country to enter the euro after a short period of possessing its own currency - one of the symbols of her sovereignty. Indeed, Slovenia was created as an economic entity on October 8, 1991, when the Slovenian Tolar was introduced and regulatory policy was dominated by the central bank; when the country replaced the Tolar with the Euro the country turned into a province of EU and ceded control over monetary policy and financial regulation to the ECB.

The core of financial regulation for the new period was set by a new Banking Act 1999 which was passed assuming that Slovenia will become a member state of EU and EMU. This brought banking legislation into conformity with the First Council Directive, the Own Funds Directive, the Solvency Ratio Directive, the Directive on Deposit-Guarantee Schemes (effective as of January 1, 2001), the Directive on Money Laundering and to a big extent the 25 Core Principles for Efficient Banking Supervision adopted by the Basle Committee on Banking Supervision in 1997. In 2002 another new Bank of Slovenia Act came into effect to comply with Directive 2006/48/EC and Directive 2006/49/EC. These directives brought the significantly more complex standards included in Basel II. Since these regulations called for extensive changes in key areas of regulation of the banks, particularly in risk management and control, which would require supplement, or amending legislation in almost all chapters of the 1999 act it was necessary to completely rewrite the Banking Act.

Entering the EU and preparation for the Euro thus implied exchanging the simple transparent initial financial regulation for new and extremely cumbersome regulation evident by comparison to the three consecutive Banking Acts introduced in the short period of fifteen years: the initial Banks and Savings Banks Act of 1991 had about 5,000 words, its first replacement containing EU legislation, the Banking Act 1999 was five times larger at just over 25,000 words, and the most recent revision of the Banking Act in 2006 is over 47,000 words. And this is likely to grow with the new Basle III regulations on leverage and liquidity ratios. Given that the Slovenian banking system is one of the smallest in the euro area with total assets at the end of 2012 of EUR 46 billion, equivalent to 139% of GDP and the third lowest figure in the euro area with the highest proportion of government ownership this raises the question of whether the implementation of all EU regulations, mainly targeted at large, global banks in the larger EU countries is really necessary in Slovenia with a banking system that is comprised of only 17 banks, three foreign bank branches and three savings banks. Indeed, the question of regulatory costs for small country financial systems is more general for it also applies to small and medium sized banks in larger countries. This represents an incentive towards banks of larger size at the same time as the general regulatory approach is to attempt to eliminate the risks caused by moral hazard in too big to fail large banks by reducing bank size. The introduction of a single resolution authority may solve the problem for larger banks but it does not resolve the fact that the level European playing field is not necessarily leveled by a common regulatory structure. At the same time, excessively complicated legislation not only places an excessive burden on the financial institutions but also on the domestic supervisory agency which may not have the financial support to fully implement the regulations.

5.7 Estonia – Regulation of a Satellite Financial System

Estonia represents an economy that was fully integrated into the Soviet system of central planning. It also represents one of the most rapid of the new accession countries to join the Euro-zone achieving this in just seven years. It is also peculiar in that there are virtually no indigenous financial institutions remaining in operation.

The Soviet period banking Act of 1989 which was based on Soviet accounting and planning principles was still in force in 1994 until the 1995 Credit Institutions Act was introduced. The need for reform of regulations was perhaps best demonstrated by the two banking crises that emerged under the old Soviet legislation. The 1995 legislation provided for universal banking and allowed banks to own and finance other financial institutions, which entailed introduction of principles for consolidated financial statements. Tighter regulation of credit risks, foreign exchange risks, and market risks, such as off-balance sheet risks, underwriting commitment risks, derivative risks, and equity position (own and trading portfolio) risks were specified. The law also included provisions for Tier 3 capital, various liquidity and solvency ratios, and exposure limits in lending and investments.

In 1996, decrees of the President of the Bank of Estonia set out guidelines and reporting principles consonant with the EU banking directives. However there was no creation of deposit guarantees, anti-money laundering issues or debt and contract matters. The new legislation was not sufficient to prevent a third banking crisis in 1998, due in part to stock market speculation by banks. This led to the introduction of Credit Institutions Act in 1999, based on EU Banking Directives, the national legislation of many countries, materials from Basel Committee on Banking Supervision and recommendations made by several foreign experts. One of the underlying changes in the Credit Institutions Act concerned the risk assessment, management and control of credit institutions to improve the transparency as well as market discipline. But, in addition, the Act established the roles and responsibilities of the Banking Supervision Department in executing oversight, specifying specific rights for obtaining information, executing on-site inspections, engaging third party auditors or experts, demanding revitalization plans and issuing prescriptive orders.

In parallel with Credit Institutions Act, the Deposit Guarantee Fund Act created a guarantee institution based on ex-post financing. By 2000, by and large, Estonian legislators had adopted the regulations for banking sector, accounting practices and organization of work in accordance with the practices of western European banking sector. Amendments made in the early 2000s were mostly related to continuing amendments of national legislation to preserve full integration with the EU directives in preparation for accession in 2004.

To this end additional amendments to the Credit Institutions Act in 2004 concerned the procedures for banking license application, clarifications of relationships between market participants and the Financial Supervision Authority, and the modifications of credit institutions' prudential requirements, e.g. risk weightings for claims of residents of EU-10 states in calculating capital adequacy ratio were decreased and the 50% risk weighting ratio established for local governments and investment companies was reduced to 20% according to EU directives. On the other hand, the risk weighting of housing loans was raised from 50% to 100% in calculating capital adequacy, implying the need to increase the share of own funds in housing loan activities, which in general increased capital buffers of banks. Further strengthening of capital adequacy regulations was caused by the need to adopt new Basel II framework.

Similarly to other late accessions, the impact of capital openness on the financial system has also been important in Estonia. Combined with the experience of three banking crisis this has led to the dominance of foreign financial institutions in the Estonian economy, primarily of Swedish and Finnish provenance. The introduction of prudential legislation thus satisfies the conditions of membership in the EU, but has little real application over the behavior of the financial system. As example, each year the Central Bank issues a Financial Stability Report, but the financial stability of the resident banks is largely outside the control of the domestic regulators.

There is some evidence of a mere formalism in the harmonization of the Estonian legislation on the banking activity with the EU rules by importing EU directives that are of little relevance and importance for the actual structure of the Estonian banking. Hence, there are regulations incorporated in Estonian regulations for conditions that are not present in the system. For instance, there are no e-money institutions in Estonia, but there is legislation to regulate them based on the respective EU directive. No hybrid instruments have been used in Estonia in calculating Tier 1 capital, but they are regulated on the basis of the EU directive on capital requirements. Similarly, the relevance of the EU directive on remuneration policy of banks in the Estonian case could be questioned, due to the prevalence of foreign ownership of the Estonian banks. Moreover, two largest banks, SEB and Swedbank, reward the management on the basis of achieving profitability measures based on economic capital rather than book capital. As a small financial system, Estonia thus also represents the difficulties identified in Slovenia concerning the costs and burden of regulation for both the banks and the local government supervisory agencies. While it is not necessarily wasteful to legislate for conditions that do not exist, but might exist in future, to dedicate resources to these activities may not be a rational use of limited financial support for financial supervision.

Thus Estonia resembles Slovenia in terms of its small size and the inappropriateness of much of existing EU legislation, which is made further nugatory by the fact that most financial institutions are foreign owned and generally under the regulation of their home country authorities, which are all EU (if not Euro) members. This can create additional problems, for example when Swedish owned Estonian banks offered Euro mortgages to Estonian home buyers, much like what occurred in Hungary, creating a dual mismatch for the Swedish parent banks who were funded in Swedish Kroner with exposure to the Euro mortgages offered to Estonian households earning Estonian Kroon in the period before 2011.

In addition, given the fact that Estonia is a member of the Eurozone, it will be a member of the soon to be implemented Banking Union and its Single Resolution Mechanism, while its major foreign bank owners such as Sweden may only be subject to the looser EU Directive on recovery and resolution. In particular, difficulties may be caused by the fact that the Single Supervisory Mechanism will be the responsibility of the ECB, while for non-Euro countries supervision remains within the purview of the national legislation and supervisory authority.

6. Conclusion

The regulation process promoted by the Single European Act has undoubtedly produced a convergence on rules, supervisory practices and, above all, on institutional and structural features for the seven countries represented in this report. As might have been expected, the changes were more marked for the formerly centrally planned economies. Since the Directives introduced were in large part consonant with a convergence towards international standards in all developed financial systems, the general framework, if not specific national features, would have been followed in many cases even in absence of the push towards unification of the financial systems in EU member states. The level playing field created by the introduction of the system of a single European passport has, however, produced a greater harmonisation than might have been reached otherwise.

6.1 The return of the old problem of EU harmonisation

The limited degree of convergence that has resulted by the acceptance of a minimum level of harmonisation and the discrepancy between formal rules and supervisory practices had already been a subject of debate before the recent crisis. However, the crisis has given impetus not just to a revision of the applicable regulations, but also to the reshaping of the overall structure of financial institutions, via pursuit of increased centralization of decision and implementation, and the general degree of regulatory harmonisation. This approach is clearly evident in the pursuit and specification of the terms of the single rulebook and single supervisory handbook.

The comparative analysis provided by the country studies raise questions on whether the past and more recent changes are contributing to increase the financial stability and efficiency of individual banks and national financial systems. The crisis has demonstrated the drawbacks of formulating the regulatory framework on standards borrowed from the 'best' industry practices from the large developed countries, originally designed exclusively for large global banks, but now applied to all financial institutions.

In addition, the complexity of supervisory tasks surpasses the ability and resources of even large, high income countries. The rejection of structural measures in favour of prudential regulation, based on market-based risk hedging, has been the result of the deregulation of financial systems and the isolation of financial policy from government fiscal policies driven by the presumed importance of central bank independence in implementing monetary policy with the sole objective of managing inflation. This has deprived single countries of tools capable of managing specific problems, particularly serious for economies undergoing structural adjustments in their political and economic systems. Especially for the members of the Eurozone, the disappearance of these degrees of freedom has come on top of losing control of monetary and fiscal policy to the ECB and the recent reforms of the Stability and Growth pact. The current push for EU peripheral countries to undertake more extensive structural changes within the given fiscal limits make them more cumbersome. With significant structural differences still characterising the EU economies, the benefits of a higher level of financial harmonisation and centralisation appears questionable, given that the main power of economic intervention to deal with specific problems remains at national level.

6.2 The Resistance to Recent Attempts to Greater Harmonisation

Further, resistance from individual countries has been evidenced in the difficulties surrounding the most recent proposals and adoption of the regulatory treatment of large, systemically important financial institutions that are present in only a few member states, but operate throughout the EU. As in the US and the UK, the threat to stability caused by the systemic nature of large banks have been dealt with by imposing more stringent regulatory and supervisory requirements. Because there are doubts about the efficacy of such measures to prevent future crises, an EU Directive on the recovery and resolution that is tailored to the problems raised by the insolvency of large banks, has also been recently approved. Its objective is to prompt early intervention in order to allow the rapid resolution of insolvent instituitions without requiring public financial assistance and to provide protection of the payment system. The Commission has also sought to enhance the protection of retail banking and render the resolution of large complex banks more effective through a proposal that mixes the US Volcker rule and the ring fencing proposed for the UK by the Vickers' Commission. The proposl would prohibit banks and bank holding companies from engaging in proprietary trading and national authorities could further impose the transformation of banks into holding companies in order to ring fence other risky activities in separate subsidiaries which would individually comply with regulatory requirements. This proposal has attracted the opposition from several member countries. Some, like France and Germany, have already introduced their own national regulations. Apart from minor differences, these only provide for ring fencing, while permitting proprietary trading and other speculative activities to bank subsidiaries within a holding company structure. Thus, he French and German proposals involve the minimum possible modification to the universal bank model. The next European Commission, to be formed after the recent European elections, will have the difficult task to try to harmonise the different solutions adopted by France, Germany and the UK, and their application across the smaller member states.

6.3 Summary Table

The above-described country experiences can be summed up in a table format depicting general reform trajectories, key institutional and regulatory changes. following the adoption of the EU financial legislation prompted by the Single European Act:

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	General trajectory of reforms	Key institutional changes	Key regulatory changes
Germany	Regulatory Regress	None	Basel type capital requirements
France	The State as Architect of a Market Driven Financial System	From being a tool of indicative planning to market driven banking, and bank privatizations	Liberalisation, prudential regulation
Italy	Home Country Regulation and Control of Banks	Bank' privatization and authority consolidation	Liberalisation, prudential regulation
Spain	Countercyclical Provisioning and Financial Innovation	From state directed to market driven banking	Liberalisation, micro and macro prudential regulation
Hungary	Sequencing of Capital Market Liberalisation	Passage to EU type of institutional setting, banks' privatizations, dominant presence of foreign banks	Liberalisation, swift adoption of EU prudential rules
Slovenia	Regulatory Overkill	Swift adoption of EU type of institutional setting, partial bank privatization	Liberalisation, hurried and unwieldy adoption of EU regulation
Estonia	Satellite Financial System	Passage to EU type of institutional setting, bank privatizations, overwhelming presence of foreign banks	Liberalisation, unwieldy adoption of EU regulation

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

THE PARTNERS IN THE CONSORTIUM ARE:

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Participant Number	Participant organisation name	Country
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
7	Tallin University of Technology	Estonia
8	Berlin School of Economics and Law	Germany
9	Centre for Social Studies, University of Coimbra	Portugal
10	University of Pannonia, Veszprem	Hungary
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