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G20/FSB/BCBS Proposals and their Integration  
into the European Framework

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# G20/FSB/BCBS Proposals and their Integration in the European Framework

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**Abstract:** After the crisis, the leading international political actors realised that to reaffirm the global nature of finance a new balance was necessary, where the revision and hardening of regulatory standards had to go hand in hand with new mechanisms capable of soothing national fears. In the banking industry, the new balance mainly concerns three elements: a revision of the Basel framework, a novel mechanism of crisis resolution for the SIBs and the introduction of structural measures. We show that a tension exists between fully restoring global finance and erecting national safeguards, which implies redrafting the axiom of the level playing field, previously based on the harmonisation of rules. Despite the goal of designing for the entire Union a single rulebook and supervisory handbook, different national reactions to the crisis and the widening and deepening of regulation have sharpened inside the EU existing differences. While countries adhering to the banking union are sailing towards enhanced harmonisation, the other EU member countries obtained relevant national discretion to be inserted in the new directives and regulations. The EU is thus not fully escaping the general tendency to leave single jurisdictions to deal with cross-border banking by judging the equivalence of results, not by the compliance with specific rules.



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## 1. Introduction

The political and social direness brought about by the crisis have led governments to take a more direct role in promoting and monitoring a comprehensive revision and completion of the regulatory architecture, thus partly reverting their previous almost full delegation to independent regulatory authorities and standard setters (Backer 2011, Bengtsson 2011). The poor performance of regulators and supervisors before the recent crisis and the enlarged discretionary powers attributed to them by the post-crisis regulatory revisions, now also focusing on macro-prudential issues, are additional relevant reasons for explaining this shift. Consequently, the international, regional and national development of existing institutions or the building of new ones has come to characterise the regulatory response to the recent financial crisis.

At the international level, it was soon clear that the meetings of G20 second-tier government delegates and technical experts put up after the Asian crisis of the late 1990s had not enough political weight to face the new challenges. Starting from 2008, political leaders have assumed responsibility for the G20 meetings, now Summits, and for delineating policy programmes. The Financial Stability Board (FSB), coming from the transformation of the pre-existing ineffectual Financial Stability Forum, was designed as the operational arm of the G20 in the financial regulatory sphere. The qualifying presence of representatives of national finance ministries and treasury departments in the FSB constitutes a further proof of the above-mentioned political shift (Gadinis, 2013). However, more than taking the sole responsibility of regulation, public authorities have designed the FSB as a cooperative model.<sup>1</sup>

A similar evolution is visible in the European Union (EU). Because of the Lisbon Treaty, the European Parliament has acquired wider co-decision powers in the economic and financial field, while later reforms have enhanced the political standing of the European Commission. New institutions, such as the European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB), mark a shift towards more centralisation, as in a higher degree does the newly created Banking Union for a subset of EU countries. For the financial sector, the goal was to adopt a single rulebook and a single supervisory handbook across all member countries. On the other hand, the crisis has also increased economic, financial and political fragmentation, producing in some member countries a rethinking on the transfer of national sovereignty due to the increased sensitivity to tailor rules and monitoring on local needs. In the financial sphere, this might mean

that minimum international standards may acquire more relevance for the EU than their questioned homogeneous implementation inside the area.

The enhanced political drive has relevant implications. Social and political reactions to the recent crisis have widened the range of objectives and the potential for trade-offs. For instance, the goal to keep the financial system global and managed by systemically important financial institutions (SIFIs) may in a significant measure conflict with the goal of national stability and the sustainability of government finance (Persaud 2010, Pistor 2010). We will argue that the recent regulatory developments configure the search for a new political balance between global finance and national interests, posing new problems of coherence at the international level. In addition, political cycles and the fading memory of the recent crisis may in the future redirect or weaken the thrust for reforms. With respect to the past, this may introduce a larger dose of time inconsistency, i.e. higher regulatory uncertainty.

A further implication concerns the relation between politics and supervision. The recent reforms have created new authorities or strengthened old ones to deal with the enlarged scope of regulation. Being the current approach to regulation mainly based on principles, the effect is to increase further the discretionary powers of supervisors, whose practices result difficult to discipline inside clear and effective guidelines. We have already clear signs that politics does not intend to leave sensitive issues in the sole hands of independent authorities. For example, this is the case for the US Financial Stability Oversight Council, where the Treasury secretary has the last word on matters related to systemic firms. For the UK, the government and the Parliament have the power to decide where to put the division in their ring fencing scheme, and the Treasury to approve the authority's proposals extending or restricting the general rules for individual firms. This in top of frequent political practices, such as the spoil system and the control of the authorities' funding, which often render the autonomy of such agencies at least dubious. Enhanced supervisory powers with a heavier political presence and attention make the new political balance more difficult to design and more unstable, both at the national and international level.

Given the above premises, we analyse in Section 2 the main features of the G20 approach to financial reforms, which constitute the basis of its mandate to the FSB. We argue that the goal to preserve and deepen financial globalisation is encountering obstacles due to the defensive reactions by some national authorities, to the lack of coincidence in national interests,

strengthened differences in regulatory approaches, and to the difficult task of homogenising rules and practices when the scope of regulation widens and trade-offs multiply. The difficulty encountered in giving substance to the G20's general principles is a necessary premise for the analysis that we offer in Section 3 on the work done by the FSB and several international standard setters, the Basel Committee on Banking Supervision (BCBS) in particular, up to the recent Brisbane G20 Summit. The results and proposals presented at that meeting are supposed to end the first phase of the FSB's work, which has mainly focused on the production of new standards and the revision of old ones related to the resilience and to crisis resolution processes, especially for global systemic banks (G-SIBs). Given our focus on the banking industry, we discuss the activity of the BCBS on and around the new Basel III standard, its cooperation with the FSB on matters such as compliance with the new standard and principles on bank risk management, and the initiatives by the FSB on crisis resolution and G-SIBs. We then analyse in Section 4 the wide range of reforms adopted and proposed by the EU for the banking sector, including those related to the new institutional setup. The European experience is particularly revealing of the difficulties of adopting common global rules due to the heterogeneities that characterise even an area supposed to possess a single financial market. Section 5 offers some conclusions and perspectives.

## **2. The global market and international standards**

Stripping its declarations from abundant rhetoric, the G20 action was and continues not to be much effective for enhancing policy cooperation to deal with the economic and fiscal aspects of the recent crisis.<sup>2</sup> Counting on the FSB, better results were obtained for financial reforms, where the focus has been on safeguarding the global nature of finance by means of a stronger assertion of the common adherence to strengthened international regulatory standards and codes. Given the negative cross-border financial and economic externalities produced by the crisis, the absence of effective coordination even where supranational institutions existed, as in the European Union, has produced national ring-fencing reactions, with the possibility of their de-facto transformation into de-globalisation strategies. A coordinated response was then put high in the G20/FSB agenda. Absent a single international supervisor capable of enforcing common standards, the chosen goal to preserve and deepen global finance did not leave much room for a radical rethinking of the pre-existing regulatory framework, if such rethinking was ever taken into consideration. The passage

from the G8 to the G20, incorporating the more relevant emerging economies, has not up to now introduced relevant changes in the former agenda. Some excerpts help to clarify the continuity in the general approach to regulation.

The G20: “We pledge to strengthen our regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances. [...] We will also make regulatory regimes more effective over the economic cycle, while ensuring that regulation is efficient, does not stifle innovation, and encourages expanded trade in financial products and services.” (G20, 2008, p. 3)

The President of the (then) FSF: “The goal will be to strengthen the resilience of the system without hindering the process of market discipline and innovation that are essential to the financial sector’s contribution to economic growth” (Draghi, 2008, p. 7).

The G20: “Financial markets will remain global and interconnected, while financial innovation will continue to play an important role to foster economic efficiency” (G20, 2009, p. V).

The US Treasury Secretary: “[T]he central objective of reform is to establish a safer, more stable financial system that can deliver the benefits of market-driven financial innovation even as it guards against the dangers of market-driven excess” (Geithner, 2009, p. 2).

The G20 2009 London Summit agreed to transform the Financial Stability Forum into the FSB, with the following mandate:

- assess vulnerabilities affecting the financial system and identify and oversee action needed to address them;
- promote co-ordination and information exchange among authorities responsible for financial stability;
- monitor and advise on market developments and their implications for regulatory policy;
- advise on and monitor best practice in meeting regulatory standards;
- undertake joint strategic reviews of the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps;

- set guidelines for and support the establishment of supervisory colleges;
- manage contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the IMF to conduct Early Warning Exercises.

In the FSB website we also read "As obligations of membership, members of the FSB commit to pursue the maintenance of financial stability, maintain the openness and transparency of the financial sector, implement international financial standards (including the 12 Key International Standards and Codes<sup>3</sup>), and agree to undergo periodic peer reviews, using among other evidence IMF/World Bank public Financial Sector Assessment Program reports. The FSB, working through its members, seeks to give momentum to a broad-based multilateral agenda for strengthening financial systems and the stability of international financial markets. The necessary changes are enacted by the relevant national financial authorities."

Following the Action Plan established at the London Summit, the G20 Seoul Summit in 2010 endorsed the framework proposed by the FSB for addressing the too-big-too-fail (TBTF) issue, which included the methodology for singling out systemically important institutions (SIFIs) and the need to subject them to additional loss absorbency capacity, increased supervision and effective resolution mechanisms. In other words, SIFIs are not to be dismantled, but they should bear the weight of stricter rules and more intense supervision.

Summing up. The system should remain global; private financial innovation in products and institutions remains at the heart of financial dynamics and must not be stifled by regulation (confirming that the morphology of the financial system remains substantially market driven); operational efficiency maintains their central role, so that, for instance, SIFIs are a physiological presence in the framework; and regulatory reforms must mend the previous system only as far as the latter had permitted 'excesses'.

Let us briefly linger on some problems connected with the above position.

Global finance requires free movement of capital and intermediaries. For financial contracts, this poses the problem to elect a jurisdiction for eventual disputes; for cross-border financial firms the



issue is under which national rules they must operate and be supervised. Cross-border banks conduct their foreign operations by means of branches or subsidiaries. While foreign branches are not separate legal entities from their parent firm and, as a rule, are subject to the home country control, subsidiaries are legally independent local companies owned by foreign capital and, to a certain extent, are regulated and supervised by the authorities of the host country. Another relevant difference is that, contrary to branches, subsidiaries are normally subject to limits for intra-group funds transfers.

However, the impulse given in the 1970s to global banking by the end of the Bretton Woods agreement and the two petrol crises began to present an increasingly complex scenario. Some crises of cross-border banks, such as the one of Banco Ambrosiano, showed the necessity of consolidated regulation and supervision and of cooperation between home and host authorities, especially on how to share the burden of crisis resolution.

Starting from the 1975 Basel Concordat, which began to outline the principles of consolidated supervision and of the home country control, international standard setters have identified two related fronts. First, minimum international regulatory and supervisory standards in order to ease the process of mutual recognition. Second, crisis resolution procedures in order to safeguard the interests of both home and host investors. Actually, although the second front was in fact what promoted the entire process, as we shall see in the following sections only recently it was possible to obtain some significant results, but due to a different goal, that of safeguarding a 'hidden' investor, the government as rescuer of last resort. In any case, sustainable global banking requires finding appropriate solutions on the two fronts.

International common minimum standards have been identified as the way to put global players on a level playing field and consequently to weaken barriers against foreign operations. In the absence of 'hard laws' coming from a supranational regulatory authority with enforcement powers, two problems arise: the enforceability of agreements reached at the level of the international standard setters, the so-called soft laws, and the appropriateness of common rules for different jurisdictions.

Regarding the enforceability of soft laws, experience shows that relying on voluntary international cooperation is not an effective solution (Brummer 2010). Hence, the attempt of building international institutions that might acquire some features of hard law producers. The discussions

about FSB's powers, on which more in the next section, concern whether some of its outputs, such as peer reviews and public disclosures, may *de facto* force, at least FSB's members, to effective compliance of its deliberations.

The limit to the enforceability of soft law would not produce serious consequences if the various jurisdictions were homogeneous enough to make it easy to design a commonly accepted framework. To a certain degree, the principle of the regulatory playing field assumes that the same rules are applicable to different jurisdictions, their heterogeneities mainly seen as possessing quantitative not qualitative dimensions. A bank is a bank; a capital market is a capital market, independently of where they operate.

If we descend from the paradise of formal models to the purgatory of reality, a more nuanced approach seems preferable, where qualitative legal, political and social differences are relevant. In these conditions, a possible international hard law could only resemble a sort of constitution, stating very general principles and leaving each jurisdictions to adapt them to local circumstances. But this means that only general objectives should inform the constitution, such as a stable contribution of finance to growth and development, not the level playing field defined as the homogenisation of rules. When heterogeneous jurisdictions prevail, the necessity to reach widely accepted agreements obliges to put the pole of minimum standards low and leave them open to national discretion, thus contradicting the objective of the level playing field. It is not by chance that the deliberations of international standard setters are mainly based on principles and that large doses of discretion are also present in their rules (Jordan and Majoni, 2002).

In the present and foreseeable conditions, an international authority with effective enforcement power is out of question since critical non-coincident national interests or fiscal implications are involved. Facilitating cooperation among jurisdictions and reporting on the adoption of international standards is as far as any international agreement, and presently the FSB, can go. However, given the above scenario, judging on compliance is not a clear and cut affair, leaving room for asymmetric exertion of influence.

These are enough reasons for complicating the FSB's mission because of the difficulties to find an equilibrium between the necessity for a wide, global acceptance of a large set of standards and their homogeneous implementation. A task made more difficult by the post-crisis proliferation and tightening of standards and rules.

Despite the neo-liberal agenda that characterises the FSB's mandate, the lesson of the recent crisis has led even the major global financial jurisdictions (such as those of the UK and the USA) to search for a political compromise between the interests of their financial global players, domestic stability and the involvement of government as rescuer of last resort. Critical components of this re-balancing are structural reforms and resolution procedures for tackling the crises of systemically important banks. Moreover, the asymmetry of power between unleashed global finance and most jurisdictions has increasingly dented the full acceptance of the free movement principle.<sup>4</sup>

Worth to note is that also the most powerful financial jurisdictions have felt the need to adopt structural measures for shielding their domestic financial systems from fragilities coming from foreign activities. Although the USA and UK are trying to preserve their dominance in shaping international regulation, also following the principle that who comes first dictates the agenda, they are moving on two slightly different planes. The disproportion between the City of London and UK's domestic market leads to favour discretionary mutual recognition, based on the principle of equivalence of results not on the formal compliance of specific rules, to ensure free movement for wholesale banking, while trying to shield the domestic economy by ring fencing retail banking. This means that the UK approach prefers international regulation based more on general principles than on detailed rules, hence leaving supervisors to evaluate discretionally the equivalence with other jurisdictions.<sup>5</sup> Counting on a deep domestic financial market, the USA now seem, on the contrary, wanting to assert their central international role by imposing to large banks stricter specific standards, via the Volcker rule, higher capital requirements, stronger stress tests, resolution requirements and obliging relevant foreign institutions to the same treatment as domestic ones.<sup>6</sup>

In addition, although urged by the defence of the internationalisation of finance, the recent focus on the resolution of international banks might come to introduce some limits to global banking. For banking groups, two resolution methods are available. The bottom-up or multiple points of entry method, where the parent company and its subsidiaries comply separately with the conditions of resolvability dictated by local regulation, thus fragmenting the regulatory requirements and intra-group activities of the bank. The top-down or single point entry method, which requires that the resolvability conditions are satisfied by the parent company for the entire group but also that the host authorities are satisfied by the formal commitments given by both the

parent company and its resolution authority. Especially when local branches or subsidiaries are domestically relevant, host authorities could prefer the bottom-up solution or could dictate strict conditions for accepting the top-down approach (Herring 2007).

The idea that ex ante common stricter stability requirements will not impede the repetition of banking crises is gaining traction even among regulators and supervisors. This may open more space for tailoring rules on local conditions, thus putting the onus on national supervisors of proving to their international peers the effectiveness of their domestic regulatory framework. However, the acceptability of global banking increasingly depend on the belief that G-SIBs can fail without endangering home and host countries. Reliable supervisory practices completed by effective resolution regimes are expected to put a brake to the de-globalisation of financial systems.

In any case, it is clear that any form of subsidiarisation, whether concerning retail banking or systemic institutions, leads to a certain degree of fragmentation in global banking and widens the field for relevant country regulatory differences.

We have argued elsewhere (Tonveronachi 2010) that the post-crisis reforms have dangerously enhanced the discretionary power of supervisors without intervening in the causes that made supervisory practices pro-cyclical in the past. Besides, given the increased attention by politicians to finance, supervisors should be now even more conscious of how difficult is leaning against the wind (and the lobbies) and that the dynamic complexity of both finance and regulation leaves ample room for mistakes and loss of reputation. These problems reach their apex for banks that are too big to fail, to manage and to supervise, or that are simply too big. Banks reaching ten thousand between subsidiaries and branches, with complex international operations and relations may present unsurmountable problems to be swiftly resolved. Recently the FDIC, now the agency also in charge of the resolution of large US banks, rejected the living wills of the 11 US biggest banks because they could not permit to manage their resolution without creating large externalities. If the resubmission would fail again, a formal interpretation of the Dodd-Frank could trigger the provision that banks that cannot be properly managed, supervised and resolved should be dismembered.<sup>7</sup> Since we do not believe that the political context will allow for this solution, we are back to the problems that prompted the first Basel Concordat, with the aggravating factor that now banks are larger and more global than in the 1970s.

The scenario offered by the adopted and ongoing reforms is therefore one in which the quest for a new political balance where national stability and the defence of government finance weight more with respect to the previous scenario that was substantially directed at creating the conditions for the international expansion of finance. Although the fundamentals of regulation have not changed, the recent crisis has convinced national and international authorities to introduce some doses of realism into the former ideologically dominated approach, with some timid form of structural regulation entering an otherwise pure prudential framework. Obviously, the reform agenda continues to be dictated by the problems posed by large international intermediaries. In the banking industry, on which our focus is directed, the new equilibrium is based for ex ante resilience on stricter Basel standards and on new outlines of banks' risk management for realigning incentives. Ex post, recovery and resolution procedures for systemic intermediaries should avoid both the recourse to public funds, when their failure might endanger the basic functions of the financial system, and pre-emptive national defensive strategies that would fragment international finance. As we shall see, *ob torto collo*, also small doses of ring fencing and structural regulation come to be tolerated as minor evils with respect to the re-nationalisation of finance. These are the new equilibrium's ingredients that will be discussed in the following sections.

### 3. Banking regulatory reforms up to the G20 Brisbane Summit

After its constitution, discussions have aroused on whether the FSB would be able to overcome two pre-crisis limits that have characterised the adoption of international standards.

The first was the uneven adoption and enforcement of international standards and codes, also considering that the task of making them more even has been made more difficult and more necessary because of the widening and strengthening of regulation and supervision.

We have already argued that, having to take into account the heterogeneities of different jurisdictions, standards are primarily based on principles and anyhow the rules too are drafted to allow for national specificities. If supervision is a field where principles and discretion prevail, regulation too is open to heterogeneous implementation, as crucially has been the case for the definition of the components of the different tiers of the banks' regulatory capital. A country may also decide for a partial adoption of the standards, or for inserting changes in relevant aspects.<sup>8</sup> The international playing field may be rendered further uneven by some countries introducing

stricter standards, which, if coherent with the principle of minimum harmonisation, may pose problems for the recognition of cross-border activities. Some commentators single out the FSB's periodic peer reviews as the instrument that can tight the discipline of, at least, the G20 member countries.<sup>9</sup> Under this respect, the G20's 2009 London Summit had also asked to strengthen the role of the Financial Stability Assessment Program conducted by the IMF and World Bank.<sup>10</sup> Other commentators (e.g. Eichengreen 2010) would have preferred a WTO type of solution, where outlier behaviour by some jurisdictions could allow retaliatory measures.

The FSB is also called to tackle another problem inherited from the pre-crisis period, i.e. the uncoordinated production of standards and codes by specialised international institutions, each looking at its own piece of garden. Some of the causes leading to the recent crisis can be ascribed not only to faulty domestic supervisors, but also to the piecemeal approach to regulation and supervision by both domestic and international regulators. Requirements with different severity applied to different parts of the financial system, incoherent overlapping and unregulated institutions produced an increasingly fragile framework, of which the violent growth of the so-called shadow banking sector is just an example. Hardly this lack of strict cooperation may be satisfactory solved at the supervisory level. The present effort by the FSB and international standard setters is to redesign consistently the various pieces composing the regulatory framework under the general umbrella that we have outlined in the previous sections.

Consequently, the FSB has identified six 'priority areas' (Basel III, compensation practices, resolution regimes, SIFIs, OTC derivatives markets, shadow banking) on which to focus its progress reports and peer reviews, and eleven 'other areas' (regulatory perimeter, hedge funds, securitisation, enhancing supervision, macro-prudential frameworks and tools, oversight of CRAs, accounting standards, enhancing risk management, deposit insurance, integrity and efficiency of financial markets, financial consumer protection).

We may judge the work done so far from the vantage point of the progress report and the new proposals submitted by the FSB and other standard setters to the G20 Brisbane Summit of November 2014.

Significantly, the FSB considers as substantially completed the first phase of its mission, which was to fix the "fault lines that caused the crisis." (FSB, 2014a) This means moving "away from the design of standards [...] towards new and constantly evolving risks and vulnerabilities." (Ibid) In the

new phase, the Board will continue monitoring on standard compliance and cooperation among jurisdictions. Noteworthy is the call for support from the G20 to maintain for the future “the FSB’s effectiveness as a decision-making body.” (Ibid).

In the paragraph dedicated by the Brisbane G20 communiqué (G20, 2014) to financial reforms we read:

Our reforms to improve banks’ capital and liquidity positions and to make derivatives markets safer will reduce risks in the financial system. We welcome the Financial Stability Board (FSB) proposal [...] requiring global systemically important banks to hold additional loss absorbing capacity that would further protect taxpayers if these banks fail. Progress has been made in delivering the shadow banking framework and we endorse an updated roadmap for further work. We have agreed to measures to dampen risk channels between banks and non-banks. But critical work remains to build a stronger, more resilient financial system. The task now is to finalise remaining elements of our policy framework and fully implement agreed financial regulatory reforms, while remaining alert to new risks. [...] We welcome the FSB’s plans to report on the implementation and effects of these reforms, and the FSB’s future priorities.

The communiqué refers to the progress made in the six priorities area singled out by the FSB and to the proposed future priorities. The FSB’s general report to the G20 (FSB 2014b) summarises the state of the art on reforms as it can be derived by a series of documents produced by the same Board and by other standard setters. We will examine those regarding the banking industry, beginning with the work done by the BCBS.

### **3.1 Basel III and surroundings**

The Basel Committee has presented to the G20 Brisbane Summit three reports, on the implementation of Basel standards (BCBS, 2014a), on national discretions in applying the capital framework (BCBS, 2014b), and on the excessive variability in banks’ regulatory capital ratios (BCBS, 2014c).

To a large extent, the end of the first phase of the post-crisis agenda declared by the FSB is due to the BCBS having substantially completed its work on Basel III, including the capital frameworks for global and domestic SIBs and the final standards for the leverage ratio and the two liquidity ratios

(LCR and NSFR). Being most of the BCBS 27 member jurisdictions well in track for the adoption of Basel standards, the Committee is also strengthening its Regulatory Consistency Assessment Programme (RCAP), which includes monitoring the progress in adopting Basel III, assessing the consistency of national or regional regulations with it, and analysing their prudential outcomes.<sup>11</sup> Although many of the largest banks are already satisfying most of the requirements due for 2019, the feedbacks from the RCAP show that some problems that were already afflicting the Basel II release have not disappeared. The specific reports, on national discretions and excessive variability of risk weights, points to two relevant factors capable of weakening comparability, hence the regulatory level playing field.

The first report show the use of a very different mix of the many discretions left by the Basel standards, also by the EU legislation and across the EU member countries when they are allowed by European directives and regulations. The Committee will begin in 2015 to consider which discretions should be eliminated or redrafted to increase the comparability of implementation.

However, this is not the entire story because national supervisors may apply the same principle or rule with different vigour. For instance, regulatory bank capitalisation, the core of the Basel standard, depends not only on the definition of the components allowed to form the different tiers of regulatory capital, but also, given the same mix of risks, on differences in banking and supervisory practices as especially reflected in the output of internal risk models in terms of risk weighted assets. It is well known that the 'philosophy' of the BCBS is making capitalisation sensitive to risks. If local supervisors and banking practices may twist the computation of risks, the entire Basel edifice goes in disrepute. Three studies conducted by the Committee for the banking and trading books show a variability in the risk weights that cannot be explained by different mix of risks.<sup>12</sup> The introduction of the un-weighted leverage ratio into the Basel III framework testifies to the necessity to put at least a floor to the undervaluation of risks. However, the second specific report also contains some proposals directed at strengthening the standardised approaches, to use them as floor and benchmarks for the internal model approaches, to review modelling practices, and review the calibration of the leverage ratio. The experience gained since Basel I.5 (that introduced for the first time internal modelling for the trading book, later extended to the banking book by Basel II) has seriously shattered the confidence in internal modelling to the point of forcing to introduce unsophisticated and un-weighted risk floors.<sup>13</sup>



Although clearly in a defensive position, the BCBS sticks to the comparability-level playing field paradigm, proposing to limit both national discretion and the variability of risk weights.<sup>14</sup> The fact is that the very philosophy of founding prudential regulation on risk sensitive measures is at risk. Strengthening floors ultimately means to subtract credibility and effectiveness to risk modelling. It was explicitly a goal of the Committee to allow internal modelling to make regulatory capital to converge to economic capital, i.e. the one freely computed by banks. The expected result were a diminution of regulatory capital, as the transitory floors adopted in Basel II with reference to Basel I also testify. As expected, but with the bad timing of happening at the outset of the recent crisis, the adoption of the internal rating based approach (IRB) led to lower capital requirements, and many banks were allowed to shift to the advanced IRB approach in order to further save capital (Haldane 2011, Le Leslé and Avramova 2012, Vallascas and Haggendorff 2013). Basel II.5 and Basel III have in some instances increased risk weights, especially for the trading book, showing that the calibration of the different components of the regulatory framework becomes crucial. If the new floors proposed by the Committee will result high enough, they may easily render the capital requirements coming from the IRB approach ineffective.<sup>15</sup> In other words, the higher is the evaluation of model risk, stronger is the case for abandoning costly modelling methods.

This is fundamentally the position taken by Tarullo (2014a), the Fed official responsible for regulation, when proposing to adopt only standardised methods and the leverage ratio and to add, only for systemic banks, stress test exercises.<sup>16</sup> Such a change could even prefigure just adding stress tests on top of an un-weighted leverage. This would be a fatal stroke for the Basel approach, which was dreaming with Basel II all banks, small and large, to migrate to IRB methods. Proposals such as that of Tarullo in reality means to switch to a different concept of risk sensitivity, one where the relevant supervisory focus is on systemic risks evaluated for systemic banks through stress tests. The regulatory and supervisory framework that is being adopted by the US authorities also prefigure a different approach with respect to the Basel one. Instead of treating all banks alike and imposing to everyone the methods calibrated for the large ones, the distinction is made between local banks that base their operation on lending customer relationships and large banks operating at arm's length (Tarullo, 2014b).

Apart from adjustments and simplifications also coming from the dialectic working of the RCAP, for the time being the essentials of Basel III will remain the reference standard, at least for large

banks. However, as the above discussion and the EU implementation, which will be discussed in the next section, show, some relevant fissures begin to appear in the very fabric of the level playing field paradigm.

In the last years, a significant part of the activity of the FSB and BCBS was also devoted to produce the outlines for banks' corporate governance and risk management. Since we are rather sceptic on the 'didactic' activity by regulators and supervisors, we refer the interested reader to section 2.2 of FSB (2014b), where reference may be found to the numerous publications by the BCBS and FSB. More relevant because concerning incentives on which regulators are legislating, or may do it in the future, is the issue of compensation practices.

Distorted incentives coming from compensation practices are considered as having played a relevant role in the recent crisis. Apart from ethical and distributive aspects, the argument is that remunerations weighted excessively on banks' non-interest costs, thus depriving banks of a precious internal source of capital, and that their structure, with high share of bonus linked to short-term results, produced incentives leading to excessive risk taking. For the first point, Basel III's rules on the conservation buffer include provisions for supervisors to limit bonus payments when Core Tier 1 capital becomes lower than 7%. The FSB principles and standards for sound compensation practices (FSB 2009a, 2009b) explicitly abstain from dictating specific rules while providing some general principles that include:

- independent and effective board oversight of compensation policies and practices;
- linkages of the total variable compensation pool to the overall performance of the firm and the need to maintain a sound capital base;
- compensation structure and risk alignment, including deferral, vesting and clawback arrangements;
- limitations on guaranteed bonuses;
- enhanced public disclosure and transparency of compensation; and
- enhanced supervisory oversight of compensation, including corrective measures if necessary.

One crucial element is the definition of material risk-takers (MRTs), i.e. of the part of the bank's staff to which the remuneration policies apply. As the FSB recognises, now that the implementation of the above principles "by FSB jurisdictions is essentially completed, ... there remain significant differences among jurisdictions in the approach to, and implications of, identifying the MRTs ...; these can lead to potential level playing field issues." (FSB, 2014b, p. 6) We have a further example of how, having to face heterogeneous realities, the widening and deepening of international standards produces more the appearance than the substance of the level playing field, as we shall see in section 4.1 for the EU.

### 3.2 Too big to fail and crisis resolution

The second element of what we have defined the new regulatory balance is the too big to fail issue. As we have already stated, the chosen approach is to let systemic banks survive. Enlarging the risk-sensitive framework from idiosyncratic to systemic risks, G-SIBs are to be subject to higher capital and liquidity requirements, more intense supervision, including more robust stress testing, and an effective resolution regime.

Following the mandate by the G20, Basel III contains an additional core tier 1 capital requirement for G-SIBs, going from 1% to 2.5% according to their systemic footprint.<sup>17</sup> This measure marks a further step in the no confidence on, and departure from risk-sensitive IRB modelling. Moreover, enhancing the Pillar 2 activity of Basel III, more intense supervision gives further room to national discretion and weakens comparability and time consistency. As the recent experience of EU and US stress testing shows, we are far away from deriving from them useful comparative judgments (Montesi, 2014, Steffen 2014).

The weakening of confidence both on ex ante prudential measures to sustain bank resilience, and on spontaneous loss sharing related to international banking failures, has led to work actively for the first time on the resolution of systemic financial institutions. In 2011 the FSB published its Key Attributes of Effective Resolution Regimes (KA).<sup>18</sup> We read in its preamble that an effective resolution regime should "make feasible the resolution of financial institutions without severe systemic disruptions and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and

uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation [bail-in].” (FSB, 2011, p.3) This means that the resolution regime should be applied only when such dangers exist, i.e. only to systemic banks, in order to protect the economy from systemic externalities and public debt from bail-out interventions. To exclude the latter requires resolution authorities having the power to impose bail-in with legal certainty. Furthermore,

Jurisdictions should have in place a resolution regime that provides the resolution authority with a broad range of powers and options to resolve a firm that is no longer viable and has no reasonable prospect of becoming so. The resolution regime should include:

- (i) stabilisation options that achieve continuity of systemically important functions by way of a sale or transfer of the shares in the firm or of all or parts of the firm’s business to a third party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions; and
- (ii) liquidation options that provide for the orderly closure and wind-down of all or parts of the firm’s business in a manner that protects insured depositors, insurance policy holders and other retail customers.

In order to facilitate the coordinated resolution of firms active in multiple countries, jurisdictions should seek convergence of their resolution regimes through the legislative changes needed to incorporate the tools and powers set out in these *Key Attributes* into their national regimes. (Ibid)

G-SIBs are required to “have in place a recovery and resolution plan ... are subject to regular resolvability assessment ... and are subject of institution-specific cross border cooperation agreements [crisis management groups]” (FSB 2011, p.5).

Because orderly resolution may require temporary funding, resolution authorities “should make provision to recover any losses incurred (i) from shareholders and unsecured creditors subject to the ‘no creditor worse off than in liquidation’ safeguard; or (ii) if necessary, from the financial system more widely. Jurisdictions should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism with *ex post* recovery from the industry” (FSB 2011, p.12).

Although stating the need for cooperation inside the crisis management groups, the document seems to express a preference for the single point of entry approach to resolution (see previous

section 2). The resolution authority of the home country should be in command of all the resources of the firm, provisional to the equal treatment of domestic and foreign creditors.

The KA document makes it clear that cross-border recognition of resolution actions is necessary to dispel legal uncertainties and thus make the resolution regime effective. This issue is also the object of a more recent consultative document, which focuses on three points (FSB, 2014c).

Critical for the effective resolution of international banks is that “entry into resolution ... should not trigger statutory or contractual set-off rights, or constitute an event that entitles any counterparty of the firm in resolution to exercise contractual acceleration or early termination rights ... the resolution authority should have the power to stay temporarily such rights” (FSB 2011, p.10). The Lehman failure has shown that without stay agreements the firm’s counterparties may ask a foreign court for the immediate execution of the contracts irrespective of the resolution going on in the home country. Recently, 18 G-SIBs and other large dealer banks have voluntarily signed a protocol under which counterparties agree to the cross-border enforceability of temporary stays on early termination and cross-default rights in over the counter bilateral derivative contracts (ISDA 2014). An international private agreement that overcomes the difficulty of inserting comparable legislation in many jurisdictions may be read both as a confirmation of the necessity of private-public cooperation and as a pre-emptive private move for the protocol to be taken as model by national jurisdictions. The FSB (2014c) suggests that its members should adopt the above protocol model as uniformly as possible, viewing the private agreement as a valuable addition for reinforcing “the legal certainty and predictability of recognition under the statutory framework once adopted” (FSB, 2014c, p.iii).

The second critical prerequisite concerns the transfer of assets and liabilities required by the resolution process. Legally empowering and assisting foreign resolution authorities to dispose of assets and liabilities, also regarding local branches and subsidiaries, is part of the general recognition framework.

The third prerequisite concerns the write-down and conversion of debt (bail-in) because also in this case the action of the resolution authority may not be recognised and enforced by courts outside the issuer’s home jurisdiction. As we have seen for the first point, the FSB favours a private contractual solution as filling the gap until jurisdictions will adopt a statutory framework according to which “prudential or resolution authorities should require entities issuing debt governed by the

law of a foreign jurisdiction to include recognition clauses for statutory bail-in in those debt instruments.” (FSB, 2014c, p.15)

Because the above documents lack a specific proposal on loss-absorbing capacity of G-SIBs, which is required to align the resolution authorities to a common minimum standard thus facilitating cross-border recognition, the FSB has presented to the G20 Brisbane Summit a consultative document, developed in consultation with the BCBS, on total loss-absorbing capacity of banks (TLAC) (FSB, 2014d). In it we read that “for home and host authorities and markets to have confidence that systemically important banks are truly no longer ‘too big to fail’ and are resolvable without the use of public funds, they must have confidence that these firms have sufficient capacity to absorb losses, both before and during resolution.” (FSB, 2014d, p.4) To note that according to the FSB, completing the reform package with this proposal would meet the G20 mandate to end the too big to fail problem (FSB 2014a).

The TLAC proposal is composed of two pillars. As we shall see below, the first pillar contains specific requirements for resolvability. The second pillar may add further requirements according to the evaluation by the resolution authorities of the systemic footprint of the G-SIB or its components.

The proposal for the pillar 1 sets a minimum TLAC between 16% and 20% of the risk-weighted assets, being satisfied by the instruments included in the Basel III minimum capital requirements and by additional debt instruments that contractually can bear losses or transformed into equities with legal certainty. As in Basel III, a leverage ratio, defined as the minimum TLAC/Exposures and not lower than 6%, acts as a floor.<sup>19</sup> In addition, to ensure an early resolution entry of the G-SIB and thus the loss absorbency capacity required by resolution, it is proposed that debt instruments should not be lower than 33% of the minimum TLAC requirement.

Another relevant feature of the proposal is the definition of the resolution entity to which the TLAC applies.

A G-SIB may consist of one or more resolution groups. It may form a single resolution group with the parent company, which may be a holding company or an operating entity, as the sole resolution entity or, alternatively, consist of two or more resolution groups with a corresponding number of resolution entities. Under this proposal, a Minimum TLAC requirement will apply to

each resolution entity within each G-SIB and will be set in relation to the consolidated balance sheet of each resolution group. When a resolution entity enters resolution, TLAC issued by the resolution entity and held by external creditors would be written down and/or converted into the equity of the (re-capitalised) resolution entity (or a newly established bridge entity). Losses would be absorbed in the first instance by the shareholders and thereafter by the external creditors of the resolution entity according to the applicable creditor hierarchy. (FSB, 2104d, p.7)

The next point is one that we have often raised before, that the resolution regime must strike a balance between the global activity of a G-SIB and the defence of national interests.

A key objective of the new TLAC standard is to provide home and host authorities with confidence that G-SIBs can be resolved in an orderly manner and thereby diminish any incentives to ring-fence assets domestically. A resolution entity should generally act as a source of loss absorbing capacity for its subsidiaries where those subsidiaries are not themselves resolution entities. The FSB proposes that subsidiaries located outside of their resolution entity's home jurisdiction that are identified as material and that are not themselves resolution entities are subject to an internal TLAC requirement in proportion to the size and risk of the material subsidiaries' exposures... The FSB proposes a quantum of internal TLAC for review in the QIS that must be pre-positioned at material subsidiaries be equivalent to 75-90% of the TLAC requirement that would apply to a material subsidiary on a stand-alone basis, but that the specific internal TLAC requirement is defined by the relevant host authority in consultation with the home authority and validated through the RAP. This quantum of pre-positioned internal TLAC is intended to provide sufficient comfort for host authorities that sufficient resources are available to absorb losses in local material subsidiaries but provide some flexibility to deploy non-pre-positioned internal TLAC as necessary across the group in resolution. (FSB 2014d, pp.7-8)

Since the debt share of the TLAC can be as low as 33%, this means that 66% of TLAC may be made up of common equities (CET<sub>1</sub> in the Basel parlance). With a TLAC of 16% of RWA, this means that CET<sub>1</sub> may reach 10.56% of RWA. If we take the minimum local TLAC of a subsidiary at 75% of its stand-alone level, the prepositioned (local) TLAC may require CET<sub>1</sub> as 7.9% of RWA, i.e. a level that is a bit higher than the minimum 7% Basel common equity requirement. The result is, for material subsidiaries, a subsidiarisation of G-SIBs to "provide sufficient comfort for host authorities". Obviously, the announced future calibration, on whose methodology we are not

given any hint, may change these percentages and therefore the previous result. Anyway, evident in the proposal is the weight of the US intermediate holding approach to foreign relevant intermediaries.

### 3.3 Structural reforms

In collaboration with the OECD and IMF, the FSB (2014e) has recently produced a Report to the G20 on the cross-border consistencies and global financial stability implications of structural banking reforms, an issue that constitutes the third and final element of what we have defined the new regulatory equilibrium.

A long citation from the Report well clarifies the issue.

Structural banking reforms have recently been implemented or proposed in a number of jurisdictions, which account for a material share of global banking assets. The most far-reaching reforms are in jurisdictions that are home to global systemically important banks (G-SIBs), as well as host to substantial operations of G-SIBs. The recent financial crisis highlighted concerns around the complexity and resilience of banking group structures. A broad aim of many structural banking reforms is therefore to introduce a separation between certain 'core' banking activities – such as payments and retail deposit-taking – and the risks emanating from investment banking and capital market activities. The reforms are designed to reduce risks to banking groups stemming from trading activities, limit the range of activities covered by the public safety net, and more generally to simplify legal and operational structures of complex banking groups, in order to enhance their supervisability and resolvability with a view to reducing systemic risk, enhancing depositor protection and limiting fiscal exposures. The reforms have mostly taken the form either of functional separation of types of financial activities through outright prohibitions, 'ring-fencing' or subsidiarisation; or of geographical separation via local subsidiarisation requirements for domestic operations of foreign banks. (FSB 2014e, p.1)

Among the jurisdictions that have adopted, or are in the way of adopting structural measures, the most relevant are the USA, the UK and the EU.<sup>20</sup> The report offers a comprehensive summary and assessment of what are up to now are not quite finished designs. A brief analysis of these schemes is useful for our discourse.

The USA have introduced two measures.<sup>21</sup> The Volcker rule, which vetoes proprietary trading and relevant connections with hedge and private property funds; the rule is not intended to exclude from banks with insured deposits the most risky activities, but only those that are not useful from a



social perspective. The foreign banking organisations rule, which obliges relevant foreign subsidiaries to organise as intermediate holding companies (IHC), subject to the regulatory and supervisory requirements applied to similar US bank holdings. Since, contrary to the original proposal, foreign branches and agencies are not included in the IHC rule, the result is in fact a process of enhanced subsidiarisation, linked mainly to entities with relevant retail activities, which weakens the principle of the home country control. With IHCs obliged to satisfy regulatory and supervisory requirements locally, a certain degree of fragmentation in international banking derives, coherent with what we have already seen for the TLAC proposal.

Less definite is the picture coming from the Act with which the UK has adopted part of the proposals contained in the Vickers' Report on ring fencing.<sup>22</sup> The legislated rules are full of exemptions that also apply to individual entities and that are dealt with in the secondary legislation. Since the latter is yet in progress and, being subject to the political orientation of the government and parliament might change in the course of time, the discussion of the rules must take into account this type of flexibility. The purpose is to ring fence retail activities, the definition of whose perimeter is subject to general and individual specifications, from the more risky investment ones. The legislation applies to UK-incorporated entities with more than £ 25bn of core deposits, including subsidiaries of foreign banks, but excluding branches of foreign banks and overseas subsidiaries of UK banks. As far as possible, the ring-fenced body should be legally, financially and operationally independent from the rest of the corporate group. Proprietary trading, market making and commodity trading are prohibited in principle, but are allowed to be performed by other entities inside the same group. Branches of banks incorporated outside the European Economic Area are subject to recognition by the relevant UK supervisory authority following the equivalence principle and on the guarantee by the foreign authority on equal treatment and on the effectiveness of the resolution framework. As for the USA, international wholesale banking is not subject to specific rules and it is thus open to the recognition judgment of the supervisory authorities. With respect to the USA legislation, in principle the ring-fenced body is allowed a more restricted range of activities, but the separation is weaker remaining the forbidden activities inside the same group.

The EU Commission has prepared a draft proposal for a Regulation based on the Liikanen Report, which has to be discussed and approved by the Council and the European Parliament. The

proposal, which is a sort of mix of the US and UK schemes, applies to parent EU banks and subsidiaries and branches of EU and non-EU banks, exceeding certain dimensional thresholds, and bans proprietary trading also inside the group. The possible ring fence of other activities, notably market making, from deposit taking is decided by supervisors. The scheme also allows supervisors to pose limits to intra-group and external connections. Recognition of similar schemes adopted by other jurisdictions is based on the principle of equivalence.<sup>23</sup>

Worth to note are the more open regime reserved to wholesale banking (except for the EU draft), the 'unstable' powers given to politicians or to supervisors in shaping a new sort of limited specialisation, and the potential relevance of international agreements. For the latter, the principle of equivalence stems from the new version of the BCBS Core Principles (BCBS, 2012b), being a restatement of the home-host relationship. Overall, the aim is to defend the deposit insurance and the public purse from (un-necessary) risky activities and at the same time to simplify the process of crisis resolution. Although the schemes have different implications for international banking, some degree of fragmentation is an intended consequence (FSB 2014e, p.14).

#### **4. European institutional and regulatory reforms**

We have recalled in the Introduction the set of institutional reforms introduced in the EU in order to decrease differences in financial rules and supervisory practices, with the goal of arriving at a single rulebook and single supervisory handbook that were thought to be necessary conditions for the effective attainment of the single European financial market. Besides, one of the lessons derived from the recent financial crisis was that with highly interconnected national markets the weaker regulatory and supervisory components are liable to produce strong negative externalities in the other part of the Union.

The European Banking Authority became operational in 2011, empowered both with the production of the common technical standards necessary to make EU Directives and Regulations related to the banking industry enforceable, and with overseeing on their homogeneous application. This and focusing the financial legislation more on regulations than directives, according to the initial intent should have marked a trend towards maximum harmonisation,

departing from the traditional policy of dictating minimum standards and leaving ample room for national discretion.

However, different national causes and consequences of the financial and economic crisis, and different political evaluations derived from them, boosted the institutional fragmentation already existing inside the Union. On the one side, the countries pertaining to the euro area decided to jump to a near- maximum harmonisation model through the creation of the Banking Union (BU), while the adoption of the euro by other member countries was put on hold.<sup>24</sup> On the other side, some member states, notably but not only the UK, are rethinking on the opportunity to follow that trend, and are on the contrary pursuing the re-nationalisation of some of the powers previously transferred to EU institutions. The wider scope and the deepening of regulation and supervision discussed in the previous sections have also represented a relevant centrifugal factor. A confused variable institutional geometry results, where in the land between the two polarised sides stand countries that might enter into the BU without pertaining to the euro area and countries that are variously attracted by the UK model of Europe *à la carte*.

According to the EU treaties, institutional subsets like the BU cannot adopt measures that are inconsistent with those applied to the Union in general. Because the Single Supervisory Mechanism (SSM), the first pillar of the BU, must follow the rulebook produced by directives, regulations and EBA's technical standards regarding the entire Union, its harmonisation activity should be primarily felt for the supervisory practices adopted by its members. Given the ample discretionary powers given to supervisors, this might count more than the maximum harmonisation of rules, thus deepening the differences with the rest of the Union.<sup>25</sup> A second implication is that the institutional and political fragmentation might be felt in the production of primary and secondary EU legislation because directives, regulations and technical standards have to allow for greater national freedom than the one envisaged when the new institutional architecture was designed. How much that design was realistic is, however, matter for discussion. Even inside the more demanding euro area, historical, legal and procedural differences still count for the admissibility of maximum harmonisation, potentially obliging to transfer to the general EU legislation wider casuistic or weaker requirements than otherwise necessary. As we will see, this may affect the way in which international standards are converted into EU legislation.

In what follows, we shall analyse how the Basel III framework and the FSB's Key Attributes for resolution has been translated into EU legislation.<sup>26</sup>

#### 4.1 Compliance with Basel III

The Basel III framework has been translated into EU legislation in 2013 through the Fourth Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) that came into force on January 1, 2014. Consistently with the effort to homogenise regulations across member states, the substantive part of standards (Pillar 1 and 3) is contained in the CRR, which applies directly, while the implementation of previous Basel releases were made by means of directives. However, given that the legislation applies to all EU banks, irrespective of their magnitude and legal form, and given the heterogeneous financial morphology and development of EU member countries, the CRR contains significant doses of national discretion and much of what is related to supervision (Pillar 2) is left to the national implementations of the CRD IV.

The BCBS has recently produced a report assessing the implementation of the Basel capital framework in the nine EU member states that are members of the Basel Committee (BCBS 2014d).<sup>27</sup>

The assessment focused primarily on a detailed review of the CRD IV/CRR package along with its accompanying European Banking Authority (EBA) standards and guidelines as of 30 June 2014. The review also examined Member State-level requirements under CRD IV/CRR. The approach was to ascertain whether the EU banking prudential framework incorporates Basel minimum standards in both letter and spirit and that it is clearly specified, transparent and consistently adopted so as to promote confidence in prudential outcomes in the nine Member States. Where EU-wide capital regulations or Member State regulations and provisions were identified as deviating from the Basel framework, they were evaluated for their impact on the capital ratios of a set of internationally active banks in the nine Member States. (BCBS 2014d, p.2)

An interesting feature of the document is that it assesses compliance both at the EU level, for primary and secondary legislation, and at a country level. As a recognition of the attempt to provide for a single rulebook, the RCAP notes that many technical standards produced by the EBA, and endorsed by the Commission, "will go beyond what is described in the Basel framework, for

instance by specifying harmonised rules for the entire EU in areas where the Basel framework allows national discretion" (BCBS 2014d, p.11). To note that the materiality of eventual deviations from Basel III is evaluated with reference to significant internationally active banks. In other words, although recognising that the Basel framework is applied to all EU banks, the RCAP focuses on whether deviations from Basel may give to SIBs unfair international competitive advantages and is particularly sensitive on compliance for the innovations introduced since Basel II.5 on risk weighting and the quantity and quality of capital.

The latter qualification is relevant when reading Table 1, taken from the report (BCBS 2014d, p.15). The table summarises as materially non-compliant the results of the EU assessment. Many deviations that are not considered material for the 20 large banks in the sample, but that could be so for national banking industries, do not affect the result. A relevant instance are deviations from standardised or IRB approaches. Since large banks mainly use the IRB approach, significant deviations from the Basel standardised approach do not qualify as material.

Many deviations singled out by the RCAP come de facto from EU legislation accommodating specific interests coming from individual or groups of member countries. Examples are capital deductions for investments in capital instruments of insurance subsidiaries; capital instruments issued by mutually owned institutions; discounted risk-weights for exposures to SMEs; and preferential treatment for covered bonds.

Specific interests also play a significant role for the key components where the document uses the red lights. First of all the extent to which large banks may cherry pick between standardised or IRB approaches, as best suited to save capital. According to Basel, a bank using the IRB approach is allowed to "permanently apply the standardised approach for non-significant units and asset classes that are immaterial in terms of size and perceived risk profile. By contrast, the scope allowed under the CRR extends well beyond that envisaged under the Basel framework. It covers a variety of exposures including sovereigns, Member States central banks and regional governments, local authorities, administrative bodies, public sector entities, institutions and intragroup exposures, and equity exposures incurred under legislative programmes to promote specified sectors of the economy." (BCBS 2014d, p.20). For instance, the fact the IRB approach may variously produce higher or lower risk weights for sovereigns than the standardised approach may lead a bank to select the more favourable approach in a point of time and afterwards, if

obliged to stick to it, afterwards to 'distort' its portfolio to save capital. If on the contrary supervisors were flexible, they would allow for regulatory arbitrage. According to the report, at present the result is an overstatement of CET<sub>1</sub> ratios.

In the same vein, the EU results non-compliant, thus affecting its overall grade, for the counterparty credit risk framework, which represents a key innovation of the later versions of Basel. The counterparty valuation adjustment (CVA) represents an adjustment of the nominal exposure coming from the evaluation of the counterparty risk, and thus introduces a further risk capital charge. According to the report, the CRR is non-compliant because of the exemptions allowed for "transactions between EU banks and 'CVA-exempted entities'. Banks subject to the CRR can exclude exposures to pension funds, Member States central governments, regional governments and local bodies wherever they qualify for a 0% risk weight under the Standardised Approach for credit risk, as well as qualifying non-financial end-users. This constitutes a material departure from the Basel framework in that it materially boosts bank capital ratios." (BCBS 2014d, p.21)

We leave the reader to give name and address to the jurisdictions that may have pushed for introducing into the CRR the above 'deviations' from the Basel standard. More interesting is a general point that we have already addressed in section 2, whether legitimate local differences and policy priorities should be allowed by international standards. The report does not and cannot address the problem whether the 'exemptions' of the CRR come from legitimate interests. The problem lies with Basel III, in the scope of allowed national discretions that, as we have seen in 3.1, are under review for further tightening.

Once again, we are facing the difficulty in striking a balance between the international level playing field and national or regional interests. In this perspective, it is instructive to read the part of the RCAP document reporting the counter deductions offered by the relevant EU authorities (BCBS 2014d, pp.6-7). Without going into the specific points, two aspects are worth mentioning. First, the conflicting interpretations advanced on key aspects of Basel III come from the vagueness proper of a standard based on principles. Second, the ability of strong jurisdictions to put the case for significant revisions. We have already seen that, according to our interpretation, the new BCBS proposal on external ratings may derive from the necessity to accommodate its framework with the mandate of the US Dodd-Frank. Here, the EU authorities make explicit reference to new

discussions inside the BCBS that might render some of the contrasted points minor or null deviations. According to the BCBS, the RCAP should serve to discipline its member jurisdictions. The reality shows that, at least in part, the opposite may be true.

Building on the CRD III, which had broadly incorporated the FSB's principles and standards for sound compensation practices (see before, section 3.1), the CRD IV, and the technical standards delegated to the EBA, introduces new provisions directed at reducing the variability of rules across EU member countries.<sup>28</sup> The production of more homogeneous standards necessarily requires including provisions that are more specific and go beyond those produced by the FSB. In particular, the CRD IV introduces the so-called 100/200% rule (according to which bonuses cannot be higher than 100% of fixed remuneration, a percentage that can reach 200% if approved by shareholders with a qualified majority), and quantitative and qualitative criteria for the identification of material risk-takers. Notwithstanding stricter rules, the FSB reports that several EU countries are introducing additional rules on top of those provided for by the CRD IV (FSB, 2014f). Other member countries, the UK in particular, substantially object to the design and to adopting the EU subsidiarity principle in this matter. This is a further case of national reactions related to extending the scope of regulation while keeping, or deepening, the level playing field at the international or regional level.

#### **4.2 The EU on bank resolution**

The directive on bank recovery and resolution (BRRD), agreed in April 2014 and to be implemented by EU member states by end 2014<sup>29</sup>, broadly complies with the FSB Key Attributes discussed above, section 3.2 (FSB 2014g, BCBS 2014d).

Along with the objectives stated in the FSB's KA, preserving essential operations and minimising exposure of government finance to losses, the BRRD also seeks to prevent domino effects in an increasingly integrated area. Specific attention is then paid to cooperation and agreements between home and host authorities inside the EU.

The BRRD seeks "to tackle potential bank crises at three stages: preparatory and preventative, early intervention, and resolution." (Council of the European Union 2014, p.1) For every stage, the

proportionality principle should apply, which means that this special regime should replace ordinary liquidation procedures only when systemic effects are expected by a bank's failure.

The first stage is dealt with banks having to draw up recovery and resolution plans that must be approved by the relevant authorities. Differently from the KA, the BRRD also includes provisions for recovery powers, i.e. for preventive action exercised by the supervisory authority. A bank must draw up a recovery plan that should include all possible measures that could be taken by the management of the troubled institution when the conditions for early interventions are met. For both recovery and resolution plans, the directive expresses a strong preference for adopting the top-down approach, although for relevant branches and subsidiaries of foreign groups the host authority may reasonably argue for these plans being drafted and approved on a local individual basis.

Although being reframed in the context of recovery planning, the early intervention framework builds on the experience of the US FDIC and of some EU countries, and is consistent with the prerogatives of the supervisory review process as laid down in the second pillar of Basel III. The early intervention powers should include all circumstances considered necessary to restore the financial soundness of an institution, including the power to appoint a temporary administrator, either to replace or to temporary work with the management of an institution (BRRD, Whereas 40). Early intervention is also a prerequisite for spotting at an early stage if the institution must be promptly enter the resolution procedure when its resources still permit an orderly and less costly resolution.<sup>30</sup>

The third stage, concerning resolution, does not present relevant differences with respect to the FSB's key attributes, although it is necessarily more specific on several aspects. For instance, on the institutional side the EBA's governance must make room for national resolution authorities' membership. The directive also dictates specific quantitative standards for the resolution fund. At regime, it must be at least equal to 1% of secured deposits, coming from the contributions of banks, and the resolution authority may recur to it only after equities and debt subject to bail-in have covered losses for at least the 8% of total liabilities; since the latter include own funds, this means the 8% of total assets. If we take as reference an average risk-weight of 50%, which as we have seen is the implicit reference of the Basel III leverage ratio floor, perhaps not by chance this amount to 16% of the minimum TLAC ratio proposed by the FSB (on this more below). The result



is that the resolution fund should intervene only after the TLAC buffer is exhausted. Moreover, the contribution by the fund "is limited to the lower of 5% of total liabilities including own funds or the means available to the resolution funds and the amount that can be raised through *ex-post* contributions within three years." (BRRD, Whereas 73)

The directive includes the mandate to the EBA for producing technical standards directed at homogenising its implementation across EU member countries. The EBA has recently produced a proposal for technical standards related to minimum requirement for own funds and eligible liabilities (MREL). In the proposal we read, "The EBA expects these RTS to be compatible with the proposed FSB term sheet for Total Loss Absorbing Capacity (TLAC) for Globally Systemically Important Banks (G-SIBs). Where there are differences resulting from the nature of the EBA's mandate under the BRRD, as well as the fact that the BRRD MREL requirement applies to banks which are not G-SIBs, these differences do not prevent resolution authorities from implementing the MREL for G-SIBs consistently with the international framework." (EBA, 2014, p.5) As for the TLAC, the MREL must be coherent with the capital requirements proposed by Basel III, in this case as implemented by the CRD IV/CRR.

The EBA proposal consistently extends the proportionality principle utilised in the BRRD for recovery and resolution plans to the resolvability criteria. In Box 1, p. 10, it presents stylised examples of how to treat differently banks that are small, medium-sized or SIBs.<sup>31</sup> If the small bank may be liquidated without entering the resolution process, its MREL is derived directly from the Basel minimum capital requirement. Larger banks, whose entering into resolution is required to protect critical functions, must be subject to MREL higher than the Basel requirement given the necessity to recapitalise the part of activity that survives.<sup>32</sup> On this account, the EBA correctly deals with the problem whether the limit posed on the use of the resolution fund permits resolution without recourse to public funds. It then adds the condition that the MREL must be set at a level consistent with these two constraints.

The differences between the FSB proposal and the BRRD and the EBA's proposed technical standards come from some requirements included in the directive and the need to take also into account non-SIBs. The MREL is set on a case-by-case basis and does not consequently fix a common minimum standard. The requirements for liabilities to be eligible for MREL differs in some respect to those included in the FSB proposal. The metric of the TLAC is based on risk-

weighted assets, while the MREL is based on total liabilities (after full recognition of counterparty netting rights), even if risk-sensitive capital ratios must be considered. The MREL does not include the condition that a minimum percentage of the MREL must consist of non-capital instruments. Considering that the TLAC also includes a discretionary pillar 2 and the MREL is based on judgmental evaluations of the resolution authority, a quantitative comparative analysis is practically impossible.

A critical component of the banking union is its second pillar, the single resolution mechanism (SRM). As required by the EU treaties, its framework is fully consistent with the BRRD and the EBA technical standards. The differences lie in the creation of a single resolution authority and a single resolution fund, and in the recourse of last instance to the European stability mechanism (ESM).<sup>33</sup>

## 5. Conclusions

The recent crisis produced a significant degree of fragmentation in international finance, especially in the wholesale segment. The leading international political actors soon realised that to reaffirm the global nature of finance a new balance had to be stricken, where a throughout revision and hardening of regulatory standards had to go hand in hand with new mechanisms capable of soothing national fears.

Acting as the operational arm of the G20, the Financial Stability Board have coordinated the activities of the international standard bodies, helped to focus on priority areas, contributed with the new resolution regime, and cooperated in supervising the implementation of the new or revised standards. At the November 2014 G20 Brisbane Summit, the FSB reported on the work done so far, declaring as substantially completed the first phase of its mission based on the design of standards, having thus fixed the "fault lines that caused the crisis".

In the banking industry, the new balance is founded on three elements: a revision of the Basel framework, a novel mechanism of crisis resolution for SIBs and the introduction of some structural measures.

Our analysis of the above three elements has singled out the tension between fully restoring global finance and erecting national safeguards. To a certain extent, the tendency is to allow for some national ring fence for retail banking and to protect the global nature of wholesale banking. This

implies to redraft the axiom of the level playing field, previously based on the homogenisation of rules. National rules are becoming less homogeneous for the retail segment and the internationalisation of wholesale banking is increasingly entrusted to the recognition of equivalent results. The principle of the home country control is thus weakened, especially where some sort of subsidiarisation gets a foothold. Moreover, the wider scope given to supervisors' discretionary power increases the weight of principles with respect to rules.

As far as the above tendency goes, the production of international standards traditionally anchored to homogeneous rules is increasingly assuming the role of regulatory floors, so that the variability of their implementation increases and compliance results more difficult to assess by means of international peer reviews.

Similar arguments apply to the implementation of the new resolution framework, which should help to solve the too big to fail problem. To follow its general principles might appear to be a relatively easy exercise, but the tension between global business and national interests resurfaces again when we look at the international cooperation that they require. When we go into the details of the resolution plans of so large, complex and interconnected banks and on the specific resolvability conditions that they should satisfy, the fears of host countries strongly reappears, so much that even the FSB proposal implies *de facto* a new sort of subsidiarisation.

The first response to the crisis by the authorities of the European Union was to build new institutions with the explicit mandate to increase the harmonisation of rules and supervisory practices among its member countries. The goal to build a single financial market was seen as requiring a highly levelled playing field and it was considered as a priority for opposing the fragmentation caused by the crisis acting on markets that had previously undergone a process of convergence not one of integration. Harder hit by the crisis due to its incomplete institutional design, the euro area has made a further step towards centralisation with the creation of the banking union. For the EU implementation of Basel III and of the resolution framework, the push towards greater harmonisation has meant to avoid some of the national discretion left by the two international standards and to introduce regional specificities; the banking union will further rein, although not completely, in national discretion.

However, also the Union has been interested by centrifugal reactions to the crisis. Without coordination, several countries have legislated on some issues before and independently from the

EU; structural reforms are a clear example. To a certain extent, these were strong signals sent to the central authorities on where not to go. In addition, different national lessons learnt from the crisis and the widening and deepening of regulation have sharpened national sensitivities, which have pushed in the opposite direction to enhanced harmonisation. As a result, the compromise between different views and interests have left the CRD IV and CRR with significant margins of national discretion. The directive on bank recovery and resolution is by definition a minimum standard, and variously customised national implementation will confront the more homogeneous block of the banking union. The future outcome may be an increased polarisation between countries pertaining or not to the banking union and the continued use of intergovernmental agreements concerning a restricted number of EU countries instead of treaty reforms directed at higher political, economic and financial harmonisation for all. The increased harmonisation of some countries will probably confront a higher overall variability. In other terms, presently the EU is not capable of escaping from the regulatory fragmentation interesting the international arena. Whether or not this represents a positive development is a matter for further discussion. However, uncertainty remains and might increase over the identity of the Union.

Table 1. Summary assessment grading

Key components of the Basel capital framework	Grade
<b>Overall grade:</b>	<b>MNC</b>
Scope of application	C
Transitional arrangements	C
Pillar 1: Minimum capital requirements	
Definition of capital and calculation of minimum capital requirements	LC
Capital buffers (conservation and countercyclical)	C
Credit risk: Standardised Approach	LC
Credit risk: Internal Ratings-Based Approach	MNC
Credit risk: Securitisation framework	LC
Counterparty credit risk framework	NC
Market risk: Standardised Measurement Method	LC
Market risk: Internal Models Approach	C
Operational risk: Basic Indicator Approach and Standardised Approach	C
Operational risk: Advanced Measurement Approaches	C
Pillar 2: Supervisory review process	
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C
Pillar 3: Market discipline	
Disclosure requirements	C

Definition of the grades: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant). **Compliant:** if all minimum Basel provisions have been satisfied and if no material differences have been found that would give rise to prudential concerns or provide a competitive advantage to internationally active banks; **Largely compliant** with the Basel framework if only minor provisions have not been satisfied and only if differences that have a limited impact on financial stability or the international level playing field have been identified; **Materially non-compliant** with the Basel framework if key provisions of the framework have not been satisfied or if differences that could materially impact capital ratios and **Non-compliant** with the Basel framework if the regulation has not been adopted or if differences that could severely impact capital ratios and financial stability or international level playing field have been identified.

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<sup>1</sup> According to Backer (2011, p.752) "The FSB template points to the organization of governance as a collegial enterprise in which states and traditional law-based systems interact with nonstate actors and their norm-based systems to develop integrated governance with global reach."

<sup>2</sup> The G20 declarations, starting from the 2008 Washington meeting, may be found in the G20 website. For a review of the first shaping steps taken by the G20 see Wouters, Sterkx and Corthaut (2010) and the literature cited there. To maintain the momentum of its legitimacy, the G20 has afterwards broadened its agenda to matters such as development, energy and climate change, corruption, tax and international trade. See also Rottier and Véron (2010) and Lanoo (2014).

<sup>3</sup> The standards and codes relating to the financial sector concern banking supervision; securities regulation; insurance supervision; crisis resolution and deposit insurance; insolvency; corporate governance; accounting and auditing; payment, clearing and settlement; market integrity.

<sup>4</sup> Besides some national defensive measures against the swings of international funds, the IMF has made a timid reflection on the subject (Kregel 2009; IMF 2012; UNCTAD 2013).

<sup>5</sup> See for example the recent report by HM Government (2014) on the financial services and the free movement of capital in the EU single market. For the ring fencing of domestic retail banks, see the Vickers Report and its partial implementation into law (ICB 2011, UK Parliament 2013). Worth to remember is that the UK law on ring fencing leaves the government and supervisors the power to decide where to put the fence, in general and for single intermediaries. Significantly, banks were recently asked to inform their supervisor on how they intend to ring fence their retail activities.

<sup>6</sup> The requirement for relevant foreign intermediaries to assume the structure of intermediate holding companies is presented and discussed in Tarullo (2013, 2014b).

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<sup>7</sup>To make things a bit confuse, all these 11 banks had passed the Fed stress test exercise. As we will discuss in section 3.2, the attempt is to make the resolvability issue, of which the living wills are part, and the supervisory prudential issue running into coherent directions.

<sup>8</sup> For the banking sector, this is also because the Basel regulation was born to deal only with internationally active banks. Presumably as a consequence of many jurisdictions, the EU in particular, having adopted Basel for every type of banks, its later releases have become less clear on their perimeter, often only distinguishing a different treatment for internationally systemic banks. Differently from the EU, starting from Basel I the USA have tended to tailor regulation for its small communities banks on their unsophisticated operations. This approach has been recently reaffirmed and strengthened by Tarullo (2014c) discussing the adoption of Basel III inside the Dodd-Frank frame. As we shall discuss below, he argues that their lending practices based on customer relationship need a significant flexibility that is not consistent with the schematised Basel rules designed for arm's length operations.

<sup>9</sup> See for example the contributions contained in Griffith-Jones, Helleiner and Woods (2010).

<sup>10</sup> To note that a fundamental, although optional, component of the FSAPs are the reports on the observance of standards and codes (ROSCs). Cfr. IMF and WB 2011.

<sup>11</sup> One of the critical points mandated by the G20 is to exclude or mitigate the reliance of risk-weight computations on external ratings. The US Dodd-Frank law includes a similar provision. Basel III contains, on the contrary and especially for the standardised methods, reference to external ratings, so that the BCBS's recent evaluation of the US adoption of Basel III, although founding it largely compliant, lamented their absence in the securitisation framework. As an example of the dialectic function of the RCAP, the BCBS has afterword produced a proposal intended to reduce reliance on external ratings for securitisation exposures. <http://www.bis.org/bcbs/publ/d303.pdf>

<sup>12</sup> These studies are available at [www.bis.org/bcbs/implementation.htm](http://www.bis.org/bcbs/implementation.htm). In several cases the responsibility of national supervisors comes from permitting banks not to adhere to a single method for every counterparty and every risk, but to cherry pick in each case the method leading to the lower risk weight.

<sup>13</sup> The Chairman of the BCBS, Stefan Ingves, alerts that “if we don’t ... succeed in properly restoring the credibility of risk-weighted capital ratios, a more important role have to be played by other parts of the regulatory system, such as the leverage ratio.” (Ingves, 2014)

<sup>14</sup> The Committee acknowledges that the complexity coming from the pursuit of increased risk sensitivity, which should remain at the core of the regulatory framework for banks, “may not always strike an appropriate balance between the complementary goals of risk sensitivity, simplicity and comparability” (BCBS, 2013, p.1). Worth to note is also the absence in the above reports of the problem affecting comparability due to the adoption of different accounting standards and to the discretion that these standards allow to banks.

<sup>15</sup> To have an idea of the calibration problems posed by the different parts of the Basel framework let us make a simple exercise. According to Basel III, ordinary banks must keep the minimum Tier 1 capital ratio (T1C/risk-weighted assets) comprehensive of the conservation buffer at 8.5% and the minimum leverage ratio (T1C/Exposure) is 3%. This means that the constraint posed by the leverage ratio is that the average risk-weight ratio (RW) cannot be lower than 35.3% ( $RW = \text{Leverage ratio} / \text{T1C ratio}$ ). G-SIBS with the highest systemic footprint must add a further 2.5% to capitalisation, which means raising T1C at 11% and constraining RW to be not lower than 27.3%, eight points lower than smaller banks. Leaving the leverage floor at 3% for all banks means that if a non-SIB computes an RW of 27.3% it must raise its T1C at 11%, the same as a G-SIB. In other words, being the floor for T1C equal to  $\text{Leverage ratio} / RW$ , the homogeneous leverage floor does not discriminate between systemic and non-systemic banks. Having the US proposed to increase the leverage ratio to 6% for its larger banks, respecting the 11% T1C ratio means that their RW cannot fall under 54.5%, thus recognising the systemic nature of the G-SIBs and potentially rendering ineffective their IRB calculations. We can then understand why there so much debate over the definition and calibration of the leverage ratio.

<sup>16</sup> At present, the Basel standardised methods heavily rely on external ratings. The G20, the US Dodd Frank and the EU authorities have variously requested to avoid or weaken the use of external ratings in risk-weighted regulatory capital requirements. The ongoing work in the USA and EU shows the difficulty to design alternative methods while maintaining risk sensitivity without

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leaving banks excessive discretion. When regulation wants to rein in the measure of risks for level playing field reasons such problems resurface in every part of the regulatory framework.

<sup>17</sup> The Committee has also dealt with the issue of domestic systemically important banks (D-SIBs), stating principles akin to those for G-SIBs, but refraining from the prescriptive approach adopted for the G-SIBs framework. Discretion is left to national jurisdictions on D-SIBs' assessment and additional loss absorbency requirements (BCBS, 2012a).

<sup>18</sup> The document refers generically to financial institutions. The FSB published in October 2014 a revised version of the document that differs from the previous one only for containing in Appendix II a sector-specific guidance. We will only refer to banks.

<sup>19</sup> Following the exercise made in the previous footnote 15, the two constraints are now the TLAC not lower than two times the T1C and the leverage ratio not lower than 6%. The implicit RW is 50%. However, the first constraint implies a TLAC ratio of 12%, lower than the 16% minimum with which the bank must anyway comply. Anyway, this leverage ratio is more binding than the Basel one because it becomes effective when RW becomes lower than 37,5%.

<sup>20</sup> For the risks associated to the divergences in the above structural reforms, see Viñals 2013.

<sup>21</sup> The Dodd-Frank Act had also introduced a third measure, the push out rule intended to oblige to discontinue or segregate certain swap activities. This rule has been recently cancelled on pressure exercised by the financial industry.

<sup>22</sup> The Act has crucially not adopted the recommendations on the overseas activities of large UK banks.

<sup>23</sup> France and Germany have already introduced legislation on this matter. Proprietary trading and relations with hedge and private property funds must either be discontinued, or transferred to a ring-fenced entity inside the group. Market making is permitted in order to preserve the universal banking model.

<sup>24</sup> We may envisage a legal breach in this attitude because the EU treaties oblige member countries, excluding the opt-out given to the UK and Denmark, to pursue active convergence policies and adopt the euro once having satisfied the criteria for admission.

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<sup>25</sup> However, the centralisation of supervision on the ECB is limited to the larger banking groups, while national authorities remain in charge for smaller banks under a single supervisory handbook produced by the SSM.

<sup>26</sup> The third aspect of the new regulatory balance, structural reforms also for Europe has been dealt previously in section 3.3.

<sup>27</sup> The nine countries are Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom. The BCBS assessment does not consider compliance with liquidity and leverage ratios and with the treatment of SIBs since they are yet to come into force. Since work on technical standards on these matters is still going on, we will broadly follow the Committee on limiting the analysis to capital standards.

<sup>28</sup> Pushed by the popular outrage produced by asymmetric structures of remuneration and by the CRD III, many EU countries had produced uncoordinated legislation. For a summary, see FSB (2014f).

<sup>29</sup> Exceptions are bail-in powers that must apply from end 2015 at the latest.

<sup>30</sup> We have seen in section 3.2 that the FSB proposal stresses the importance that enough debt instruments are included in the TLAC in order to ring fence enough resources for the bail-in that can only be triggered by resolution.

<sup>31</sup> The examples are not well calibrated. Having chosen in the three exercises an average risk weight of 35%, it is always the leverage ratio and not the risk-sensitive capital ratio that determines the level of MREL. The result is that the computed MREL is always lower than the 16% minimum of the TLAC.

<sup>32</sup> As in the TLAC, if the resolution authority consider that some of liabilities that formally meet the conditions for inclusion in the MREL cannot contribute to loss absorption or recapitalisation, the MREL needs to be increased to account for their exclusion.

<sup>33</sup> On 8 December 2014 the Board of Governors of the European stability mechanism adopted the ESM direct recapitalisation instrument that permits the ESM to recapitalise a systemic and viable euro area financial institutions directly as a last resort measure, i.e. only after private investors have been bailed-in and the resolution fund has contributed. The resources devoted to this



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instrument are limited to € 60 billion. <http://esm.europa.eu/press/releases/esm-direct-bank-recapitalisation-instrument-adopted.htm>

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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:

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
11	National and Kapodistrian University of Athens	Greece
12	Middle East Technical University, Ankara	Turkey
13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain

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