Coordination of banking regulation in the EU

Nedelchev, Miroslav

2015

Coordination of banking regulation in the EU[*]

Miroslav Nedelchev

The formation of international banking groups was stimulated by pan-European policies. The emergence of sophisticated to regulate organizational structures and provision of difficult to control financial services hampered the exercise of effective banking supervision. The situation in the banking market significantly ahead in time the adaptation of supervisory framework for the expansion of activities abroad and entering into other financial sectors. The regulation policies remained into the national borders and failed to reach the degree of financial integration.

In addition to private goods, the society wants other commodities such as financial stability and information on the financial situation of credit intermediaries. The role of supervisory policy is to provide “public good”. It is achieved by the central bank through its two functions - the lender of last resort and maintaining of confidence in the interbank market. With the expansion of activities abroad, began to recognize the importance of the supervisory authority of the host country.

Before the global financial crisis, the regulatory paradigm was based on principles, with a large dose of self-regulation. It is achieved through a "soft" law - the conclusion of memoranda of understanding. The leading role was played by the supervisory authority of the home country who is convinced in possession of sufficient capital and reserves to cover risks in its territory. In this way, the financial system was divided into the "center-periphery".

The globalization of banking activities put new challenge - a new kind of systemic risk that financial instability in one country is transferred to the international financial system. Arises real need to improve the strength of the financial system.

International organizations formed modern supervisory framework. Since 2009, the Financial Stability Board (G20) apply globally coordinated approach to rescue packages through networks of regulatory authorities. In practice, entered new persons (colleges of supervisors and ministries of finance) and new instruments ("bridge bank" and "bank hospital"). Thus overcoming protectionism of various laws and maintain confidence in the interbank market.

By the end of 2008, every government has taken independent measures to reduce the effects of the global crisis. The results not restored confidence between

---

[*] Avangard Print, Sofia, 94 pages, 2015, forthcoming

banks and society. *Ad hoc* actions of individual governments used taxpayers' funds to rescue troubled banks. The national policy provides rescue of bank assets and operations in their territory, which led to contagion in other Member States and provide competitive advantages for rescued banks. The individual jurisdictions used different criteria for beginning and form of unilateral interference by the state. The EU financial integration was accompanied by an opposite trend in which countries maintained national laws on financial stability which tend to the emergence of "balkanization" of supervisory policy.

In isolated cases were reported positive results: measures taken by the banking group itself (where the subsidiary is crucial for the survival of the whole group) and measures taken by several countries (where the parent bank and its overseas subsidiaries are systemically important for respective countries). The key cases in banking history are cases with low supervisory coordination at Nordea (divergence of interests between the supervisory authorities in individual countries in determining of the leading supervisor and selection of a national system of deposit insurance) and Fortis (unrealized agreement for unified rescue plan, including nationalization due to different estimates of individual supervisors). Only in the case of Dexia has reported a high degree of cross-border cooperation between bailouts of supervisors.

The supervisors provided “semi-public good”, as the cost of financial stability are specific to each country. On the agenda was put the need for coordination of national policies.

Since 2009 was constituted the new supervisory framework in the EU. The architecture of the EU banking system was restructured of in line with the new reality. It represents a fundamentally new stage of financial integration with the delegation of powers to the sovereign rights of national authorities to pan-European institutions. The net effect is to prevent new crises and putting in first place the public interest before corporate interests. Supervisors provide pan-European financial stability ("shared public good"). The guiding principles provide for the protection of the interests of taxpayers, taking all the financial consequences of shareholders, temporary nature of financial intervention and real opportunities for governments to change management. The introduced restrictive measures on banks that have received state aid during the crisis led to a destructuration of financial groups through the European Commission's requirements for separation of commercial banking from insurance activities, separation of investment and commercial banking activities, contraction of branch network and separation of foreign subsidiaries.

The new reality is characterized by equality between supervisors in the home and host country. Modern supervisory framework provides *ex ante* arrangements for *ex post* sharing of losses from cross-border insolvency. Taking measures the governments should provide secondary effects on other Member States. The coordination of supervisory policy provides financial stability throughout the EU ("pure public goods"), as opposed to "exceptional public goods", which are primarily provided to nationals.

It is recommended that in the near future to review the definition of cross-border group and to take into account not only the performance of activities abroad, but also a threat to systemic risk and involvement of supervisors from other countries in transformation.