Banks and Investment Firms Capital Requirements

Lunch Talk, Bruegel, 30th of September 2011

The main driver underpinning the Commission proposal is to guarantee sustainable growth and long-term financial and economic stability in Europe. Bank capitalisation is crucial in this regard. In particular, the Commission proposal aims at offering a complete set of rules for the European banking system. Other countries, like the US, have chosen more selective regulatory frameworks, transforming Basel III rules into binding jurisdiction only for international banks. This choice has been possible because truly federal States dispose yet of alternative mechanisms for dealing with internal banking issues. As the European Union (EU) as a whole does not dispose of such additional mechanisms, adopting an approach as complete as possible was the only option available. The proposal aims also at strengthening the Single Market. The decision to create a single rulebook for all EU Member States, anyway leaving them to have some degree of flexibility in transposing European rules into national laws, is a natural implication of the jurisdictional definition adopted in the proposal. Choosing a European definition entails having uniform rules at EU level. And finally, the proposal has been launched with the scope of upgrading the banking legislation, reducing the amount of national exceptions.

The European Commission proposal translates Basel III rules into a European regulation and a European Directive. The Regulation will assure the necessary level of uniformity in legal requirements regarding capital, liquidity, leverage ratio, and counterparty credit risk. The Directive will instead allow for flexibility, giving States the possibility to regulate capital buffers, corporate governance rules, sanctions, and systems of enhanced supervision at national level without throwing the Single Market belly up.

The impact assessment of these legal measures does support the Commission proposal. As most of academic literature equally underlines, in the evaluation of the Commission proposal achieving long-term stability is found to more than out-weight short-terms costs linked to possible tensions in the loan market.

The Council and the European Parliament will need to approve the Commission proposal. As they have already had been involved in the drafting process, their approval may come before the end of the Danish presidency in June 2012.

First, as banks do highly differ among each other, banking supervision needs a high degree of flexibility in order to address similarly analogous issues and dissimilarly not comparable issues. On the one hand, regulation has to be highly uniform to not distort location decisions of a bank headquarter. On the other hand, supervision has to be flexible. National supervisory cultures, more than practices, need to be harmonised in the domain of supervision.

Second, in order to have a fully functioning banking regulation, macro-prudential policies have to be regulated along with micro-prudential policies and fiscal responsibility of governments. While the first is fully harmonised in Europe, too little has been done so far for the harmonisation of micro-prudential policies, whilst fiscal responsibility remains a government prerogative.

Third, the international dimension will influence the effectiveness of European rules. The Commission proposal is a great step ahead by itself, but its efficiency may be multiplied or diminished by the number of countries that will transform Basel III rules in binding laws and by the way in which they will actually do it.

The discussion following the presentation was centred on the appropriateness of Basel III rules. The following was observed. First, their application in Europe is quite strict, requiring for example capital buffers on top of capital conservation buffers; they are also rather extensive, as they will concern all banks. Second, these rules will assure that banks will be actually covered against leverage risks. A better banking regulation will hence aid in restoring financial and economic stability in the European Union but, for restoring growth, it will need to be coupled with other policy measures supporting the demand side, which is where most of the problems lied in recent times.

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