



“European Banking Supervision: Time to Be Specific”

FINANCE FOCUS BREAKFAST

with

Giorgio Barba Navaretti
Professor of Economics, University of Milan

Guido Ferrarini
Professor of Law, Univ. of Genoa and Vice-Chair, Eur. Corporate Governance Institute

Carmine Lamanda
Head of Institutional and Regulatory Strategic Affairs, UniCredit Group

Sebastian Fairhurst, discussant
Manager, European Financial Services Round Table

The April session of the Finance Focus Breakfast series was devoted to discuss European cross-border banking supervision with some of the authors of a report recently published by Unicredit Group¹.

The presentation started with a discussion of the rationale for multinational banks (MNBs). These institutions are a reality in Europe and have grown considerably in recent years in terms of assets and geographical scope. Their growth is however in danger of reversion, especially as a consequence of the current crisis. MNBs have emerged also because of the potential of synergies and economies of scale, in spite of the integration costs. MNBs are most importantly at heart of economic integration in Europe, especially in retail banking, tapping market shares of local non tradable activities.

The current framework for regulation and supervision of MNBs has problems in normal times that are widely acknowledged now. In stress situations, additional problems have emerged and made more visible the ineffectiveness of supervision and the inefficiencies in the internal capital market in Europe.

Significant steps towards a comprehensive reform of the regulatory framework have been taken with the publication of the De Larosière Report and the Turner Review. However, from the MNB perspective, the reform should be complemented to address specificities of MNBs and aimed at simultaneously ensuring efficient capital allocation in an integrated capital market and preserving local financial stability, i.e. neutralising the geography of risks.

In particular, what is missing to achieve this double objective is a clear definition of responsibilities and binding powers among supervisors of MNBs, even within the proposed European System of Banking Supervisors. Additionally, the new regulatory framework should be neutral with respect to the organisation of cross-border activities, i.e. let banks define the composition of branches and subsidiaries.

The steps ahead to overcome the current limitations of the regulatory and supervisory architecture should include two elements: 1) clear definition and harmonisation of risk management, capital requirements and clear responsibilities and powers of parent banks and the rest of the group, taking into account protection of minorities and creditors; and 2) a framework to attribute responsibility to supervisors and to define early intervention and burden sharing. Specifically, deposit insurance and lender of last resort powers should be centralised at EU level or remain at national level given certain conditions. These conditions require definition of responsibilities among member states ex ante, enhancement of powers over monitoring and prudential and liquidity requirements, and the possibility to address individual cases at supranational level in coordination with member states.

¹ <http://www.unicreditgroup.eu/en/events/Event0431.htm>

The discussant was in agreement with the importance of the establishment of stronger pan-European regulatory bodies but stressed that a revised financial regulation must cover all activities, products and participants, taking into account specificities in terms of business models and risk. In this context, the review of a European System of Financial Supervisors needs clarification as concerns the structure in order to guarantee a successful implementation.

In the ensuing exchange with participants, the evidence of economies of scale as a driver for MNBs was questioned. Although economies of scale are not the main MNB driver, they have played an important role for some specific activities' mix. MNBs have in any case improved underdeveloped financial systems and also exerted a pro-competitive effect. The key question is MNB effects on systemic risk, on which there is not much available empirical evidence.

Another issue was the burden sharing schemes under the reformed regulatory framework. Burden sharing is an obstacle when discussing harmonisation, because it is difficult to reach an agreement on its rules *ex ante*. The De Larosière Report includes proposals in this area but failed to identify criteria. This means that the design of burden sharing agreements is the way to go. The Unicredit report promotes the mobilisation of private resources to minimize fiscal burden. In addition, a European banking authority should play the role of coordinator in the bargain process between national authorities under premise of minimum cost.

The next issue argued that the EU should first set the regulatory framework in the region in order to be able to influence global regulation. In the past, there has been tension and ambiguity between global and European regulation, as the EU imported some rules. At this opportunity, the EU can play a more influential role if it acts quickly at regional level, taking into account international groups.

Finally, some comments were made on the issue of organisation of banks in subsidiaries and branches and how the regulatory framework affects this. Banks should be able to organise activities as they prefer, but incentives and corporate governance is affected by the regulatory framework. Large divergence of regulation creates a bias. In any case, regulation should be able to address a banking group as a whole while tracking both branches and subsidiaries activities, in order to prevent ring fencing and other types of harmful protectionist and nationalistic behaviour.