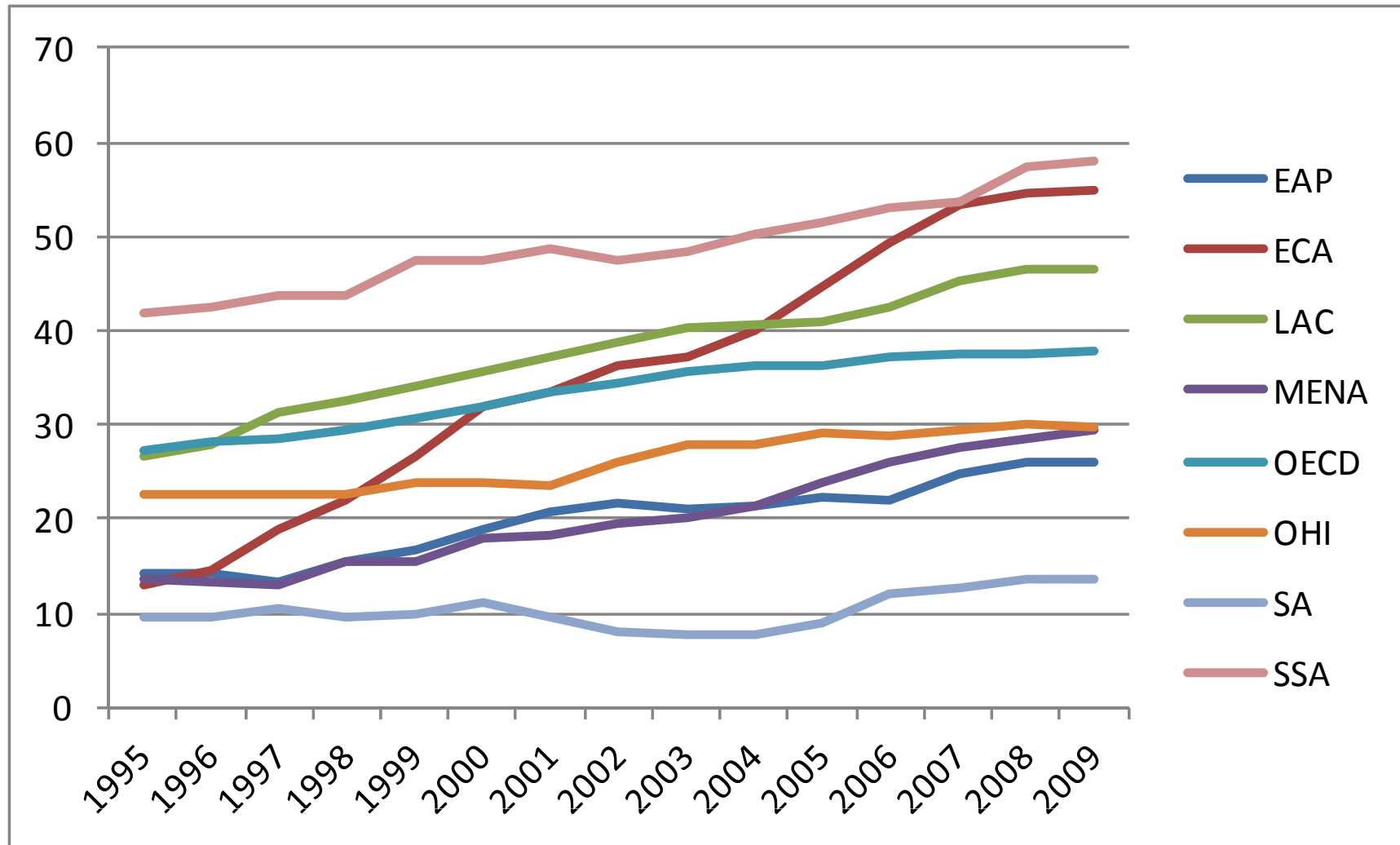


Supranational regulation – how much and for whom?

Thorsten Beck

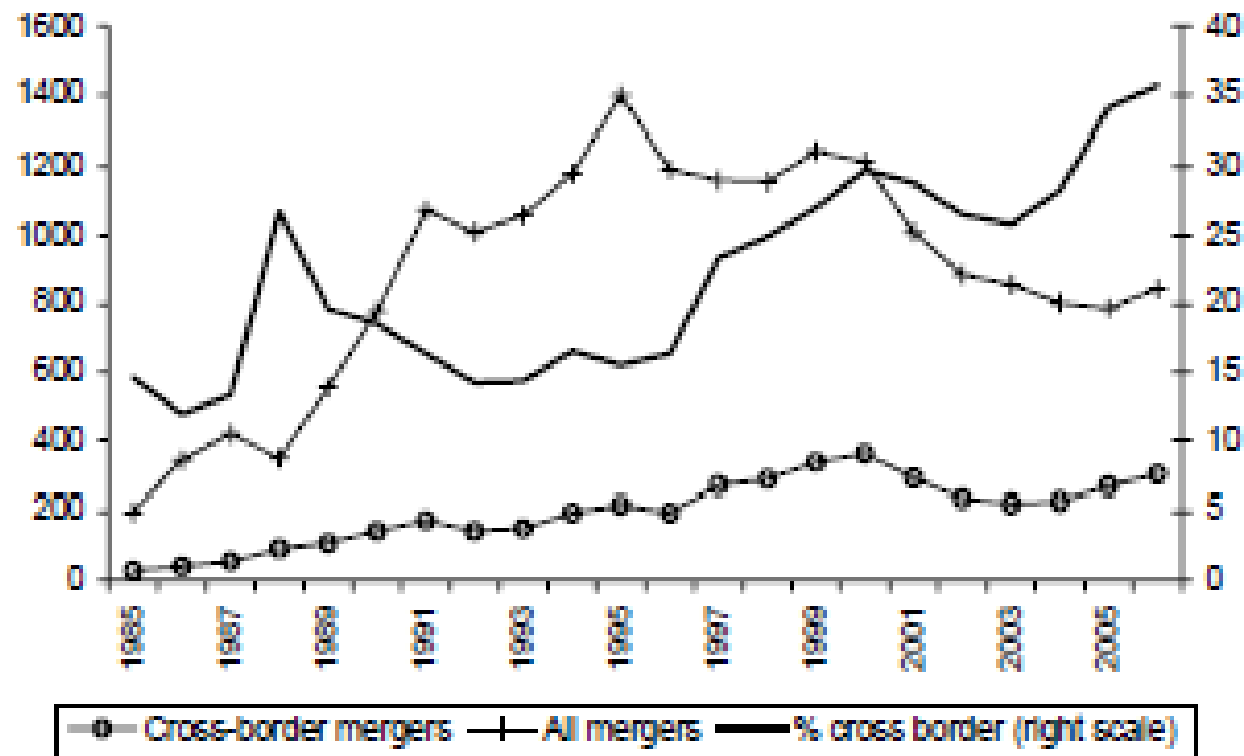


Increase in cross-border banking over time



Source: Claessens and van Horen (2013)

Merger activity becoming international



Source: Buch and de Long (2010)

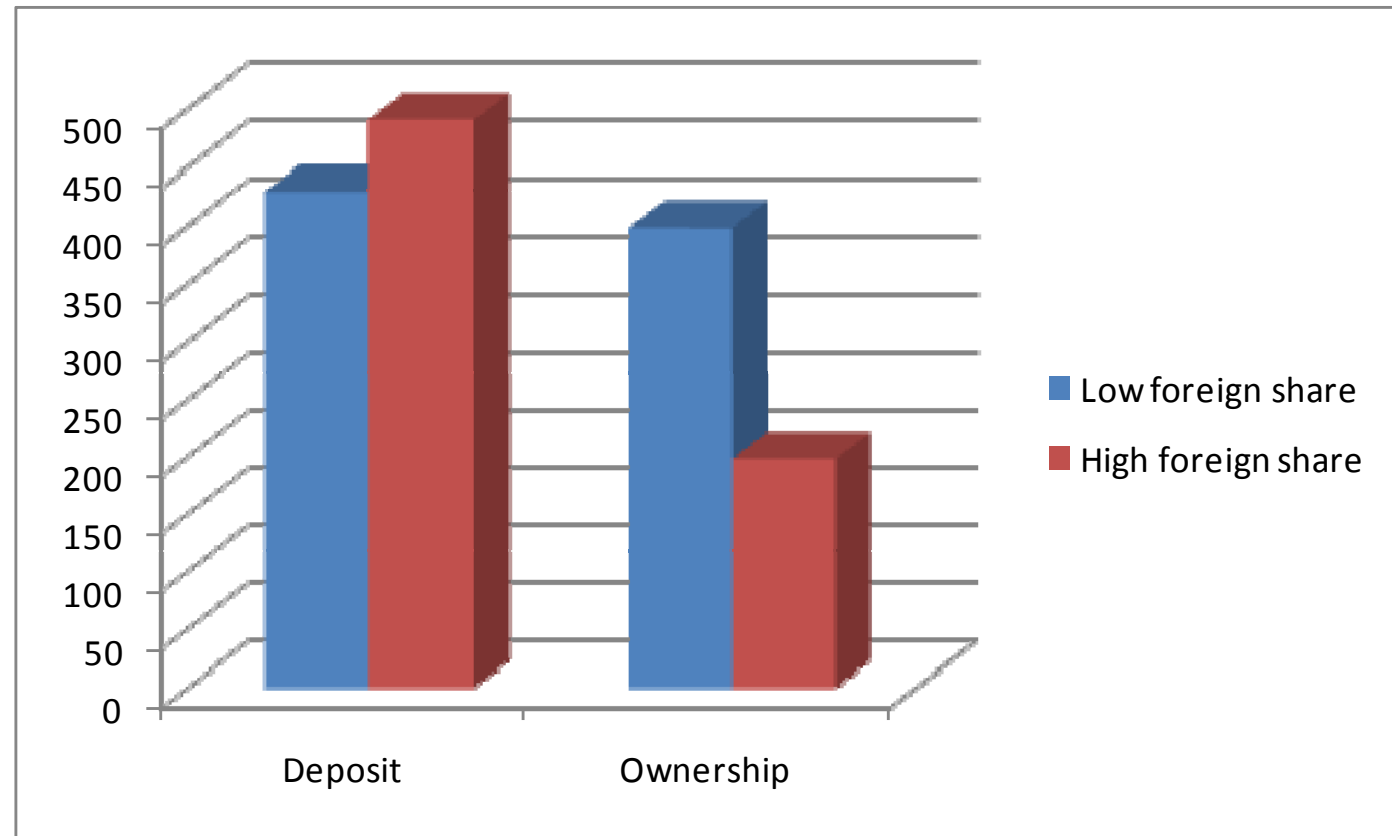
Why regulate cross-border banking?

- Failure of cross-border bank imposes costs on foreign stakeholders that are not taken into account by home country supervisor
- Contagion effects through common asset exposures, fire sale externalities, informational contagion, interbank exposures etc.
- Within-in monetary union: additional externalities
 - Close link between monetary and financial stability
 - Lack of exchange rate tool exacerbates impact of asymmetric shock
 - Common lender of last resort leads to tragedy of commons problem

Biased supervisory incentives to intervene in cross-border banks

- Beck, Todorov and Wagner (2013)
- Supervisor maximizes benefits to domestic stakeholders (equity holders, depositors and borrowers) when deciding to intervene into weak bank or not
- Cross-border activity introduces distortions
 - Foreign equity: earlier intervention
 - Foreign assets and deposits: delayed intervention
 - Total effects depends on mix
- Supra-national supervisor can help if
 - Information as good as on national level
 - No higher costs of resolution
 - Match between geographic perimeter of bank and supervisor

Biased supervisory incentives to intervene in cross-border banks



CDS spreads of large (mostly cross-border) banks three days before intervention during 2008/9 crisis; Source: Beck, Todorov and Wagner (2013)

Externalities through financial integration

- Contagion effects through common asset exposures, fire sale externalities, informational contagion, interbank exposures etc.
- Does not depend on direct cross-border engagements by banks and – on bank-level – not even on direct exposures to international markets
- More prominently as banks move towards market finance

...but one size does not fit all

- Differences in legal systems
- Differences in preferences
 - On government intervention
 - On fiscal independence
 - On return-risk trade-off
- Informational asymmetries
 - Small host country with market-dominating foreign subsidiary (e.g., Uganda) vs. large home country for whom foreign subsidiary does not matter (e.g., UK)

Heterogeneity

Supervisory colleges,
MoUs

Broader cooperation
among stakeholders;
regulatory convergence

Closer cooperation,
especially on G-SIFIs,
regulatory convergence

Asymmetric home-host
country interests:
stand-alone
subsidiaries

Strong ex-ante
agreements on
resolution and burden-
sharing

Joint regulatory and
supervisory authority

Externalities

Need for cross-border bank regulation varies across regions/country pairs

- Low externalities, high heterogeneity: Memorandum of Understanding, Colleges of Supervisors
 - India,.... Low share of cross-border banking, “closed” financial system
- Low externalities, low heterogeneity: move towards extended versions of MoUs and colleges
 - East Africa: joint historic background
- High externalities, high heterogeneity
 - US/Europe/Japan – Europe/UK
 - Focus on G-SIFIs, coordination on market support
- High externalities, asymmetric interests
 - Stand-alone subsidiaries
 - Latin America, Sub-Saharan Africa vis-a-vis European/US banks
- High externalities, low heterogeneity
 - move towards closer cooperation: extended versions of MoUs and colleges; ex-ante burden-sharing agreements
 - Nordic-Baltic
- Banking union

Heterogeneity

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Externalities

How can a banking union help?

- Address macro-economic imbalances, exacerbated by national regulation and supervision of Europe-wide banking groups
- Risk diversification
- Tackle bank fragility in several periphery countries
 - Overcome regulatory and political capture
 - Will ECB be really a more stringent supervisor?
- Help address Eurozone's Tragedy of Commons problem
 - Interest of every member government with fragile banks to "share the burden" with the other members, be it through the ECB's liquidity support or the TARGET2 system
 - ECB and the Eurosystem are being used to apply short-term palliatives that deepen distributional problems and make the crisis resolution ultimately more difficult

Immediate crisis resolution vs. long-term reforms

- Status quo: short-term fixes with enormous pressure and burden on ECB and piece-meal approach to long-term reform
- BUT: Urgent need to address banking and sovereign fragility – transitional solutions
 - Suggestion: European Recapitalization Authority
 - Banking union takes longer time to build necessary institutional framework
- Don't mix crisis resolution with long-term reforms
 - Introducing insurance after the accident
 - Distributional fights
 - Political sensitivity

It's all about politics

- Eurozone crisis is a governance crisis!
- Different narratives about Eurocrisis according to creditor/debtor status
 - No one to represent interest of Eurozone
- Increasing lack of political legitimacy and sustainability
- A banking union can therefore only succeed with the necessary electoral support to not get further caught in a legitimacy vortex.

In a nutshell

- Currency union without banking union not sustainable
- Supra-national supervision without resolution authority and funding counter-productive
- Need for a two-pronged approach to crisis resolution and building up banking union
 - Crisis resolution now! European funded and managed AMC
 - Banking union forward looking!
- There are lots of advantages of a well-designed banking union, there are lots of risks in a poorly designed banking union

Thank you

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