

# The EU and the financial crisis

Karel Lannoo  
CEPS  
[www.ceps.eu](http://www.ceps.eu)



## Outline



1. EU until crisis hit
2. The EU and the financial crisis
3. What is on today?
  1. Regulatory upgrade
  2. Supervisory adaptations
4. In sum...

3/10/2010

2

## 1. EU until crisis



- ▶ Success of single market had brought EU at the centre of financial regulation
- ▶ But crisis changed all that...

3/10/2010

3

## EU rules on financial markets



- ▶ Based upon the freedoms of the EU Treaty
  - Free provision of services
  - Free movement of capital
- ▶ Basic principle: minimum harmonisation of rules in *directives*, home country control
  - Services harmonisation
    - Free provision of services, free **branching** under control of home country (single licence)
    - **Subsidiaries** remain under host country rule
  - Product harmonisation
    - Products can be sold EU-wide with single licence

3/10/2010

4

## EU rules on financial markets



Product harmonisation	Services harmonisation
<ul style="list-style-type: none"> <li>■ <b>Payments</b> <ul style="list-style-type: none"> <li>■ Cross-border payments</li> <li>■ Payment services</li> <li>■ SEPA</li> </ul> </li> <li>■ <b>Investment funds</b> (UCITS I-II-III-IV)</li> <li>■ <b>Consumer credit</b> directive (I-II-III)</li> <li>■ <b>Prospectus directive</b></li> </ul>	<ul style="list-style-type: none"> <li>■ <b>Banking:</b> CRD (2nd banking directive)</li> <li>■ <b>Insurance:</b> life and non-life, solvency II</li> <li>■ <b>Investment services:</b> MiFID (ex-ISD)</li> <li>■ <b>Deposit guarantee schemes</b></li> </ul>

3/10/2010

5

## Rules to ensure free competition



- ▶ Competition policy measures under Art. 101, 102, 105 of the EU Treaty
  - Merger control
  - A-priori control of state aids
  - Concerted practices, collusion
- ▶ Examples
  - Inquiry into retail banking (2007)
  - Inquiry into business insurance (2007)
  - Action against credit card groups
  - Communications on state aids in financial crisis
  - State aid decisions on, e.g. ING, KBC, Dexia, RBS

3/10/2010

6

## 2. Financial crisis and EU

- ▶ Crisis put **nation-state** back in the centre
  - No European Treasury ⇒ no European bail-out plan
  - Eurogroup meeting (Oct 12, 08) gave some coordination
- ▶ Single market **backfired** against EU
  - Deposit-takers of branches less protected than subsidiaries in deposit protection schemes
- ▶ **Failures** in regulation and supervision
  - Too high leverage, Basel ratios provided no comfort
  - Massive moral hazard behaviour
- ▶ **Variety** in approaches of national bail-out plans
  - Compare UK, French, German, Spanish, Dutch, Italian plans
  - Non-discrimination ensured?
  - Huge competition policy implications! Conditionality?

3/10/2010

7

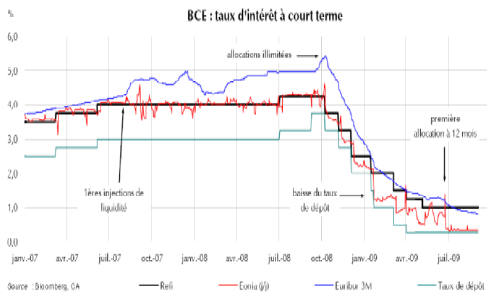
## 12 October 2008 Eurogroup

- ▶ No systemically important bank will be allowed to fail
- ▶ States will guarantee interbank market
- ▶ Capital injections by state
- ▶ Allow to reclassify trading book assets in banking book
- ▶ Lenient attitude of competition policy authorities
- ▶ ECB is asked to take accept wide set of collateral in credit providing operations

3/10/2010

8

## The crisis, two years on



Source : Bloomberg, CA

9

## Stabilisation: the result of enormous state aids

- ▶ Capital injections
- ▶ Debt support banks
  - Subordinated debt
  - Guaranteed liabilities
- ▶ State guarantees interbank market
- ▶ Support of bad assets in 'bad banks'
- ▶ Unlimited liquidity support ECB
- ▶ Quantitative easing
- ▶ Fiscal stimuli
- ▶ Total (without CB and fiscal stimuli):

% GNP	approved	effective
EU-27	31.4	12.7
Eurozone	25.3	11.2

10

## Basel II: Weights In the Standard Approach

nb: 100 % risk weight – capital requirement of 8 %

	A <sup>+</sup>	A	A <sup>-</sup>	A <sup>+</sup>	A	A <sup>-</sup>	A <sup>+</sup>	A	A <sup>-</sup>	B <sup>+</sup>	B	B <sup>-</sup>	B <sup>+</sup>	B	B <sup>-</sup>	B <sup>+</sup>	B	B <sup>-</sup>	B <sup>+</sup>	B	B <sup>-</sup>	Belo w	Unrated d	Past due		
Corporate	20%		50%		100%		150%		100%		150%		100%		150%		100%		150%		100%		150%			
Sovereigns	0%		20%		50%		100%		150%		100%		150%		100%		150%		100%		150%		100%			
Banks	20%		50%		100%		150%		50%		150%		50%		150%		50%		150%		50%		150%			
Banks, based on their country of incorporation	20%		50%		100%		150%		150%		100%		150%		100%		150%		100%		150%		100%		150%	
Retail			75%																						150%	
Residential mortgages			35%																						100%	
Commercial real estate mortgages			From 100% to 50%, according to national supervisors																						150%	

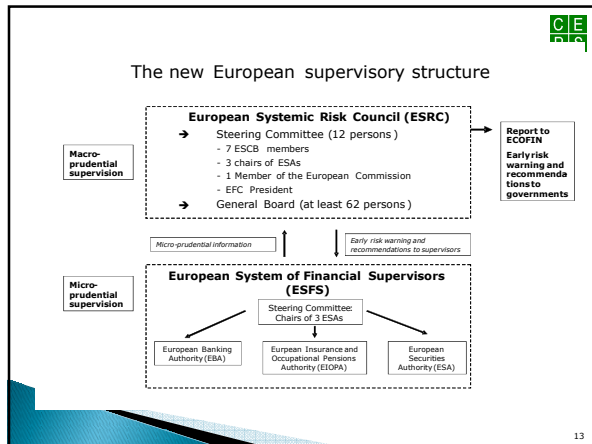
11

## 3. What's on today?

- ▶ Regulatory tsunami
  - **Credit rating** agencies regulation
  - **Basel epidemic** (CRD II, III, IV)
    - 5% for securitisation
    - More capital in trading book, rules on bonuses
    - Min leverage ratio, capital buffers, dynamic provisioning, ...
  - Tighter **conduct** regulation (e.g. short selling, executive remuneration, MiFID review)
  - More **product** regulation (hedge funds, private equity, deriv's)
  - Review of deposit protection schemes
- ▶ Changes in supervision
  - Financial Stability Board (FSB) at centre at global level
  - Larger role for ECB in macro-prudential in ESRB
  - Creation of EU System of Financial Supervisors

3/10/2010

12



- CEPS
- ## EU Supervisory Authorities
- ▶ 3 new authorities with legal personality
  - ▶ Task:
    - 'single rulebook';
    - enforcement;
    - supervising the supervisors (!);
    - participation in supervisory colleges and supervision of financial infrastructures (CRAs, and maybe CSD's, CCP's);
    - coordination in crisis situations;
    - central European **database** and exchange of information
- 14

- CEPS
- ## ESRB\ESFS outstanding issues
- ▶ ESRB:
    - Main problem is of **conceptual and institutional** nature: when is risk systemic?
    - Better to have it as "consultative only" committee,
      - reduces conflicts with central bank (and supervisors)
      - difficulty of predicting systemic risks
      - Where will powers end, and ESFS begin?
      - Will supervisory data be sufficiently detailed?
  - ▶ ESFS:
    - Enormous workload ahead: main problem is of **organisational and operational** nature
    - Will member states accept supervisory powers?
    - Mediation in colleges has fiscal implications
- 15

- CEPS
- ## 4. Comparing EU and US debate
- ▶ US:
    - Debate mainly **in the hands of Congress** and focused on Fed, White House proposals initially disappointing
    - Agreement on systemic risk council and consumer protection agency (almost)
    - House adopted Wall Street Act on 11 December 2009
    - No action on state aids?
  - ▶ EU:
    - Debate mainly focused on ESFS, supervisory problems
    - No formal increase in powers of ECB, maintains clear distinction btw. supervisory and monetary
    - Could over time lead to **more unified structure**, but maintains too much of a functional approach (where are consumer protection issues?)
    - Enormous regulatory agenda
- 16

- CEPS
- ## 5. In sum...
- ▶ Crisis stabilised thanks to enormous state support – how to organise exit?
  - ▶ EU has managed to extend powers, notwithstanding limited initial leadership
  - ▶ Enormous regulatory agenda, overkill?
  - ▶ Will single market be repaired?
- 3/10/2010 17