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Past and Future of Prudential Regulation in Europe in the aftermath of the Global Financial Crisis

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Roundtable Session (#080) on Prudential and Banking Regulation at the European Level
Organized by
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25 June 2013, 4:00 to 5:45 PM - Room Oudemanhuispoort C123

Presentation

The financial crisis that started in the summer of 2007 and morphed into the Euro-zone crisis in 2009 revealed brutally the longstanding deficiencies of the regulatory framework for banking supervision in Europe and elsewhere. The creation of a common European frame for financial services weakened the national regulatory frames without being accompanied by the creation of a common process of prudential supervision. In this way, national banking regulators were exposed to regulatory capture in a fight for national champions.

Different accounting standards for banking conglomerates in Europe aggravated the problem, as they further impeded policy convergence and consistent enforcement, inducing a dynamic of regulatory exemptions that was most visible in the shadow banking sector. Since 2005, international accounting standards issued by the International Accounting Standards Board were introduced as a common European accounting framework. However, these standards introduced new elements of volatility, opacity and structuring opportunities into banking regulation, most notably because of the flaws involved by fair value accounting. These standards also threatened the national collaboration between accounting regulators and banking regulators, while national accounting frameworks used to be established in order to possibly serve the prudential goals of banking regulation.

In the aftermath of the global financial crisis, the European Union is on a new path to create a financial architecture which can correct this misalignment between the European general interest and national particular interests, by creating a structure of European-wide supervision. Suggested solutions include widening the powers granted to the "Council of European Banking Supervisors," to a European Banking Authority, or to the European Central Bank. However, in light of the recent crisis, several issues need to be addressed in order to disentangle the past preventing it to repeat itself. The new regulatory framework for banking may impose increasing compliance costs on banking conglomerates. Regulatory elusion and displacement of activities into the shadow banking sector, which were widespread before, become thereby even more likely. This process requires deepening our understanding of the interaction between European accounting standards and their local accounting practices, together with their linkages with banking regulation. The European level of regulation shall be confronted and accommodated with the National dimensions of its application and the existence of trans-national banking conglomerates.

The discussion may address the following themes:

- Given such a great impact of accounting standards not only on banking regulation, but also on the behavior of banking conglomerates, should accounting standard-setting take these effects into account in its rule-making efforts?
- The business model of banking conglomerates is so fundamentally different from business models in other industries (i.e., regarding the role of leverage and the use of debt instead of equity), should banking conglomerates be subject to the same accounting standards?
- What should the cooperation between the Accounting Standards Setter and a European banking and prudential regulators look like in the future European financial architecture?
- Given the intensive national connection between financial market regulators and banking regulators, professional auditing bodies and accounting standard setters, should this collaboration be reproduced on the European level? Which role should the subsidiarity principle play? How can the European regulation benefit from the local knowledge of national banking regulators and industry bodies without being captured by (and remaining powerless facing) national special interests?

Participants

This roundtable on the Future of Prudential Regulation in Europe addresses these questions, benefitting from the expertise of practitioners in the field, namely the President of the French Accounting Standards Setting Body, Mr. **Jerome Haas**, and the former chair and former supervisory board member of the Bundesbank, Professor **Hans-Helmut Kotz**.

Professor **Stephany Griffith Jones**, Director on Financial Regulation of the Initiative for Policy Dialogue (Columbia University) will speak on the need to have comprehensive regulation and the pitfalls one needs to overcome in order to make it possible, in particular the collection of data from financial markets. She will elaborate on the implementation of the new regulations in the derivatives market (EMIR) and in how far they address the problem of information asymmetries.

Professor Dr. **Yuri Biondi** will speak about the transformations of the European accounting framework and the damages involved by the adoption of a fair value accounting model especially for banking conglomerates and the financial market price formation.

Dr. **Matthias Thiemann**, whose PhD thesis dealt with regulatory issues related to the shadow banking system in different European countries, will provide input on the infrastructure needed to address regulatory arbitrage in this realm. He will explain the kind of collaboration between banking regulators, accounting standard setters and industry bodies he found to be effective in containing regulatory elusion in the European shadow banking sector before the crisis.

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