IN SEARCH OF THE GOLDEN BANK FLEECE: DOES THE US DEREGULATION WAVE BREAK THE EUROPEAN FINANCIAL REGULATION DAM?

EN BUSCA DEL VELLOCINO DE ORO BANCARIO: ¿ROMPERÁ LA OLA DESREGULADORA DE LOS EE. UU. EL MURO DE LA REGULACIÓN FINANCIERA EUROPEA?

Carlos J. Moreiro González

Professor of International Law. «Ad Personam» J. Monnet Chair of EU Law
Carlos III University. School of Law and Social Sciences

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Abstract: Two different legal regimes are being modelled up within the two main banking markets in the world: the deregulatory trends driven by the US administration and those regulatory policies enacted by the EU. Measures taken up to foster both liquidity and solvency, at an international level, the two cornerstones for the functioning and stability of the credit institutions are being analyzed throughout this geographical and unpeaceful two-folded legal framework. The study finalize with the confrontation between the two regional systems focusing the stability of the financial sector.

Keywords: financial regulation, financial stabilty, Basel III Agreement, banking desregulation, banking business, unconventional measures.

Resumen: Actualmente están configurándose regímenes jurídicos divergentes en los dos mercados bancarios más importantes del mundo: el proceso desregulador impulsado por la actual administración de EEU y las políticas reguladoras de la UE. Este estudio analiza la implementación de las reglas internacionales relativas a la liquidez y la solvencia de las entidades de crédito de ambos marcos normativos regionales controvertidos. Se realiza también una referencia al papel que desempeñan las organizaciones internacionales especializadas preservando la estabilidad del sistema financiero. Finalmente se confrontan ambos regímenes normativos regionales a la luz de la estabilidad del sector bancario.

Palabras clave: regulación financiera, estabilidad financiera, Acuerdo Basilea III, desregulación bancaria, negocio bancario, medidas no convencionales.

Sumario: I. Introductio. II. The banking sector, an unfinished regulatory symphony. III. Banking deregulation in the US and "the one-handed economists solutions". IV. The European banking regulatory framework: financial stability vs. sectorial efficiency. V. Final remarks.

I. Introduction

1. Currently, two divergent scenarios are opening up over a crucial part of the banking activity in the world, both in the United States and in the European Union. Actually, the real dichotomy arises among the deregulatory trends driven by the US administration and the regulatory policies of the EU[1].

[1] See the letter of the Systemic Risk Council (SRC) to G20 Leaders on Defending and Strengthening Key Pillars of the Global Reform Program, 27th February 2017, https://www.systemicriskcouncil.org, at 5-6.

This article addresses two areas of the legal regime of the banking activity, concerning the liquidity and solvency, which are essential requirements to ensure the proper functioning of credit institutions and the stability of the financial system as a whole. Nevertheless, they are focusing from different perspectives within the aforementioned context.

2. Firstly, I will briefly present the controversy between supporters and detractors of applying a regulatory or debugging framework to the banking activity. Against this background, a reference will be made to the reports of various international organizations specializing in the subject that identify current threats to financial stability.

3. Secondly I will address the confrontation between the deregulatory trend in the United States and the EU's regulatory policy.

II. The banking sector, an unfinished regulatory symphony

4. In his Preface to Pedigree (1957), Georges Simenon wrote about the book as a work where "everything is true but nothing is accurate". The arguments that are used to justify the deregulation and regulation of banking activity could be grounded in a similar truism. A dialectic that began after the financial crash of 1929[2], resurges cyclically in a sort of a "eternal return" where only some contextual factors change[3]. Most regulations were passed then attempting to upgrade bank safety by limiting competition and by restricting bank entry into non-bank financial activities[4]. This legislation determined the structure of the financial system in the United States that existed up until the passage of the Deregulation and Monetary Control Act in March 1980[5].

After more than fifty years, a radical regulatory change was driven through the Brady's Proposal for the reform of the US Financial System (February 1991).

The regulatory standards of the United States have been subject to various changes that reflect the aforementioned tension between regulation and deregulation[6]. How are these decisions then justified in each single case?; what are the determining criteria to choose the regulatory pattern?.

5. The prevention of negative externalities[7] and other market failures[8] should ground any regulatory policy for the sake of a sound financial environment[9].

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[2] See N. A. Lash, *Banking Laws and Regulations*, N.J. Prentice-Hall, 1987, at. 12. A century before following the financial crisis of 1825, a series of far-reaching reforms and regulations transformed the financial market in the United Kingdom, see Ch. P. Kindleberger and R. Aliber: *Manias, Panics and Crashes. A History of Financial Crises*, Palgrave McMillan, 6th edn, 2011.

[3] See R. A. Schotland, "An overview: New Myths and Old Realities" in *The Regulation of Banking and Securities Industries*, Lexington Books, 1979, at 20.

[4] Scholars pointed out the unsound activities of credit institutions as one of the main causes of the aforementioned financial crash. See, T.H.F. Cargill/ C. G. García, *Financial Deregulation and Monetary Control*, Stanford UP, 1982, at 9; M. Friedman and A.J. Schwartz, *A Monetary History of the United States: 1867-1960*, Princeton UP, 1967, at 311-12.

[5] The main legislative outcomes of the 1930s financial reform were the Banking Acts of 1933 and 1935. A major provision should be remarked in the Banking Act of 1933: the ring-fencing between commercial banking and investment banking.

The enactment of the Bank Holding Company Act in 1956 delivered full regulatory authority over multibank holding companies to the Federal Reserve System (Fed).

The Banking Act of 1935 extended the power of the Fed Board on credit controls, the discount rates of the district banks and the reserve requirements. On the other hand, some restrictions had been removed by the McFadden Act (1927) that provided that in states where state branching was allowed national and state bank members of the Fed would be allowed to operate branches within the city limits of the parent bank; see R. G. Raja and R. Ramcharan "Land and Credit: A Study of The Political Economy of Banking in the United States in the Early 20th Century", Journal of Finance, AFA66(6), 2011, 1985.

[6] See, N. Cetorelli/ L. S. Goldberd, "Banking Globalization, Monetary Transmission, and the Lending Channel", NBER Working Paper No W 14101, 14 July 2010, at. 5, 13-24.

[7] See, F. Lupo Pasini, *Theologic of Financial Nationalism*, Cambridge UP, 2018, at. 7-9.

[8] See, P. J. Wallison, "Why Do We Regulate Banks?, [Winter 2005-2006] American Enterprise Institute 14, at 16.

[9] See K. W. Dam, "The Subprime Crisis and Financial Regulation: International and Comparative Perspectives", 10 Chi. J. Int'l L. 581, 2009-2010, at 606-608.

Nonetheless, according to Jihad Dagher, financial regulation is procyclical: "it helps boost the expansion in credit an asset prices during booms and increase credit restrictions during the bust"[10]. Several studies underline also the lack of foresight and strong foundations of the banking regulatory frameworks adopted to date, arguing that they are either the response to financial crises[11], or just an outcome of bargaining between politicians and bankers[12].

6. Thus, most of the banking regulatory frameworks failed to anticipate and minimize the consequences of the global financial crisis[13]. In fact, the Basel III Agreement[14] was adopted after the 2008 financial crisis in order to strength the capital adequacy levels of banks. Relevant scholars like R. Posner have written that this regulation is as useless as closing the stable doors when horses have escaped[15].

7. Such a controversial assessment of the banking regulatory policy might lead us to the conclusion that deregulation is a more efficient choice, but there is not empirical evidence about the relationship between the policy of banking deregulation and the stability of the financial sector[16]. The advocates of deregulation agree that it drives forward the economic growth by boosting credit[17] and also sectorial competition by reducing the normative burdens and administrative costs[18]. However, in the medium term, this policy usually involves serious supervision failures that cause financial crises[19].

8. In fact, some reports from international organizations highlight the current risks for the financial stability, and pointed out as one of the greatest risks the lack of a banking regulatory framework at global level that can prevent the house collapsing[20]. According to the IMF, "an indiscriminate rollback

[10] "Regulatory Cycles: Revisiting the Political Economy of Financial Crises", IMF Working Paper No WP/18/8, January 2018, at 4. See also, M.H. Eken/ S. Kale/ H. Selimler, "The Evolution of Regulations in Banking: A Cycle Based Approach (2013) 2 Journal of Finance and Risk Perspectives, at. 16.

[11] See, K. Spong: *Banking Regulation. Its Purposes, Implementation and Effects*, Federal Reserve Bank of Kansas City, 5th edit, 2000, at. 5.

[12] See, Ch. W. Calomiris and S. H. Haber: *Fragile by Design. The Political Origins of Banking Crises & Scarce Credit*, Princeton University Press, 2014, at. 14-15. See also, R. A. Werner, "A lost century in economics. Three theories of banking and the conclusive evidence" (2016) 46 International review of Financial Analysis, at 374. Although as Anat Adminati and Martin Hellwing have pointed out, the banking industry fights aggressively against tighter restrictions on bank borrowing on the main ground that they harm economic growth. *The Bankers' New Clothes. What's Wrong With Banking and What to Do about It*, Brilliance Corp, 2013, at 4-6.

[13] See, H. Powley and K. Staton, "The Post-Crisis Approach and New Challenges to Banking Regulation", (2017) 1, Institute of Law Journal, at 79-80. Moreover, a post-crisis regulatory framework could drive a strong policy trend toward deregulation; see, C. Borio, C. Furfine and Ph. Lowe: "Procyclicality of the financial system and financial stability: issues and policy options", BIS Papers No 1, 2001, at 46-48.

[14] *Basel III: A global regulatory framework for more resilient banks and banking systems-revised version June 2011*, BIS, 1 June 2011.

[15] R. Posner. *The Crisis of Capitalist Democracy*, HarvardUP, 2010.

[16] See,¨Ö. Orhangazi: "Financial Deregulation and the 2007-08 US Financial Crisis", FESSUD Working Paper Series No 49, 2014, at 6-10.

[17] See, A. Abiad and A. Mody: "Financial Reform: What Shakes It? What Shapes It?", 95 (1) American Economic Review, 2005, at 67; see also H. M. Treasury, "Fixing the foundations: creating a more prosperous nation", Cm 9098, July 2015, at 12; etc.

[18] See, A. Mullineux, "Banking for the Public Good", 36 International Review of Financial Analysis, 2013, at 89; see also M. H. Eken et al. (n 10) at 14-15, etc.

[19] According to W. Chen, M. MrKaic and M. Nabar, stricter banking regulation in the precrisis years is associated with a lower probability of a banking crisis in 2007-08, in "The Global Economic Recovery 10 Years After the 2008 Financial Meltdown", *World Economic Outlook. Challenges to Steady Growth*, IMF, October 2018, at. 72. See, also R. Glick, X. Guo and M. Hutchison, "Currency Crises, Capital. Account Liberalization, and Selection Bias", 88 (4) The Review of Economics and Statistics, 2006, at 699-700; See also K. Spong (n 11) at 9-11.

[20] See, IMF: *Global Financial Stability Report*, April 2020, Chapter 1, "The Sharp Tightening of Global Financial Conditions Significantly Increased Risks to Financial Stability", at 5, 8, 14-17. Never has the IMF's World Economic Outlook made such grim reading. In fact, the liquidity relief throught fiscal and monetary stimulus couldn't be enough to overcome financial risks, such as highly indebted companies and leveraged investors.

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of postcrisis regulatory reform and oversight-both domestically and internationally - could encourage excessive risk taking, leading to a further build-up of financial vulnerabilities”[21].

Most of these risks stem from inappropriate practices of the financial markets such as the fact that investors have moved into riskier asset classes is search of yield[22], the increasing of government and corporate debt in many countries[23], as well as the growing of the share of firms with low investment-grade rates in advanced economy bond indices[24], debt-at-risk[25], or funds increasing their holdings of illiquid assets[26].

9. The European Systemic Risk Board (ESRB) broadens the typology of risks that threatens financial stability focusing on risks arising through interconnectedness[27], from climate change, disruptions in critical financial infrastructures, a cyber incident[28], as well as those which might deriving of contagion across sectors and within the shadow banking system, that almost exceeds the regularized banking activity and avoids the control of the supervisors[29], and liquidity risks and risks associated with leverage among some kind of investment funds[30]. The destabilizing effects of shadow banking on the financial system are also underlined by the IMF[31], the BIS[32], and the ECB[33], on a recurring basis over the past few years.

10. Leverage is perhaps the greatest risk because it is not possible to measure it accurately from a global financial stability perspective[34]. Thus, leverage arising from the interconnectedness within the financial system is rising and the off-balance sheet funding of the systemic banks on Key Jurisdictions –U.S., U.K. and the Eurozone– is higher now than in 2007[35]. According to a BIS research, the leveraged

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[21] See IMF *World Economic Outlook. Challenges to Steady Growth* (n 19) at 22. See also IMF, *World Economic Outlook, April 2019. Growth, Slowdown, Precarious Recovery*, Chapter 1: Global Prospects and Policies, at 19-20.

[22] See, S. Çelik, G. Demirtas and M. Isaksson (2020), “Corporate Bond Market Trends, Emerging Risks and Monetary Policy”, OECD Capital Market Series, París, at 5-7.

[23] See, IMF, Fiscal Monitor, April 2020, Chapter 2, at 2-8; See, also BIS *Annual Economic Report*, June 2019, “Editorial”, underlying Contagion Risk in International Banking through price adjustments of CLOs, Collateralised loans obligations, a new Kind of structured products; at xi-xii.

[24] Debt owed by companies whose earnings are insufficient to cover interest payments, see IMF: *The October 2019 Global Financial Stability Report at a Glance*, at 25-34

[25] Íbid. at 39-42

[26] See, among others, Q. Chen, A. Filardo and F. Zhu, “Financial crisis, US unconventional monetary policy and international spillovers”, 2016, 67, Journal of International Money and Finance, 62 at 63-64; C. Borio and F. Zhu, “Capital regulation, risk-taking and monetary policy: A missing link in the transmission mechanism?”, 2012, 8 (4) Journal of Financial Stability, 236 at 250-251

[27] See, ESRB General Board 36th regular meeting, 19 December 2019 (Press Release).

[28] Moreover, financial tensions could derived from sources of a different nature like cybersecurity breaches and cyberattacks on critical financial infraestructure, the rapid growth of crypto assets, geopolitical risk, etc. See also the point 3.1 of the *ECB Annual Report 2018*, April 2019 at 41-43. See also D. Nouy, “From a wish list to a to-do list: how supervisors can help banks prepare for crisis”, Brussels, 23 November 2018, ECB www.bankingsupervision.europa.eu.

[29] See the Letter of the ESRB Secretariat to the European Commission, “ESRB considerations regardig the AIFMD”, ESRB/2020/0015; Brussels, 3 February 2020, at 6-7.

[30] ESRB, *EU Shadow Banking Monitor,* No 3, September 2018, at 3-4. In order to assess how non-bank financial institutions can contribute to the build-up of Systemic risk, the ESRB proposes that macroprudential authorities should develope a “macroprudential toolkit”, taking into account the variety of business models and institutions within this sector; See ESRB, Reports of the Advisory Scientific Committtee, No 10. February 2020, *The Global dimensions of macroprudential policy, at 4.*

[31] See, IMF : *The October 2019* (n.24 *)*, at 47-50.

[32] See, “Statiscal release: BIS international banking statistics at end June 2019, 24 October 2019.

[33] According to a research from the ECB, recently published, increasing the supply of reserves reduces liquidity risk in the traditional banking sector, but fails to reach the shadow banking sector. Thus, when the former is large, the central bank can further stablilize asset prices by directly purchasing illiquid securities; see, A. D’Avernas, Q. Vandermeyer and M. Darracq Pariés: *Unconventional monetary policy and funding liquidity risk*, ECB/WPS, No 2350/January 2020, at 35-36.

[34] As M. Singh and Z. Alam have pointed out, typical leverage metrics, which include the ratio of total assets to capital or the ratio of risk-weighted assets to Tier 1 capital only rely on the aggregation of a bank balance sheet data. Therefore, they don’t include off-balance sheet items, nonbank funding to banks.

Although, the scope of the Basel III regulatory framework includes both leverage metrics, BIS databses and the IMF’s Financial Soundness Indicators (FSI) only include on-balance sheeet measures; *Leverage- A Broader View*, IMF Working Paper, WP/18/62, March 2018, at 4, 6.

[35] Íbid. at 16.

loan market is doubling in size over the past decade[36]. Moreover, the issuance of collateralized loan obligations (CLOs), that invest mainly in leveraged loans[37], and loose financial conditions[38], make more difficult the task of accurately weighing the current level of financial risks[39].

Beyond this point, regulators should apply additional scrutiny but given the existence of close connections across borders, banks should be scrutinized unevenly. Moreover, the current framework lets regulators look for the softest regulatory environment and there is a clear risk that "some countries might try to turn this into a business model"[40].

Basel III is the corner stone of the current banking regulation at the global level. It gathers several rules to enhance the resilience of banks in the case of a financial crisis. Banks have to hold more capital and of higher quality and furthermore to fulfil much stricter liquidity standards than before.

11. On the one hand, banks are required to maintain higher minimum levels of capital and improve its quality, Common Equity Tier 1 (CET 1). Thus, minimum Tier1 capital rises from 4% to 6%, and total capital 8%[41], while Global systemically important banks (G-SIBs) are subject to additional capital requirements under the so-called Basel "IV" framework[42].

12. On the other hand, Basel III establishes a leverage ratio for all internationally active banks that constrains the build-up of debt to fund banks' investment and limits on risk concentration. Under this requirement, the Tier1 capital must be at least 3% of the bank's on-and-off balance sheet exposures[43].

13. Moreover, this Global Framework sets up the liquidity Coverage Ratio LCR, that requires banks to hold liquid assets for 30 days during times of stress, and the Net Stable Funding Ratio, NSFR, for mitigating maturity transformation.

14. An assessment of the implementation of the Basel III framework does not offer a homogenous standard[44]. Concerning to CET1, all Group1 and Group2 banks (including the 30 G-SIBs) would meet the minimum capital requirement of 4,5% and the target level of 7%, including the G-SIBs surcharge, although currently CET1 ratios are higher in Europe than in America and the rest of the world.

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[36] See T. Goel "The rise of leveraged loans: a risky resurgence?", BIS Quaterly Review, September 2018, at 10-11.

[37] See S. Aramonte and F. Avalos: "Structured Finance then and now: a comparison of CDOs and CLOs", BIS QR, International banking and financial markets developments, September 2019, at 11-14.

[38] See, BIS QR, Easing trade tensions lift sentiment, December 2019, at 8-11.

[39] The September 2019 volatility in the US general colateral repurchase agreement market (GC repo), and the increasing segmentation of repo markets in the EU, could hamper the redistribution of liquidity; see P. Schaffner, A. Ranaldo and K. Tsatsaronis: "Euro repo market functioning: collateral is King", BIS QR December 2019, at 7-9.

[40] See, S. Lautenschläger, "Ten years after the crisis-risks, rules and supervision", Speech at the 13th ASBA-BCBS-FSI High Level Meeting on Global and Regional Supervisory Priorities in Nassau, Bahamas, 30 October 2018, www.bankingsupervision.europa.eu.

[41] CET1 consists of common shares, retained earnings and other reserves. In addition, when fully phased in, banks must hold a capital conservation buffer in the form of CET1 of 2.5%.

[42] The first phase of Basel III focused on the capital ratio calculation in the form of CET 1 of 2,5%, and the 2017 reforms on the risk-weighted assets RWAS. The capital ratio is the amount of regulatory capital, CET1+Add.T1 (capital instruments with no fixed maturity) + T2 (subordinated debt and general loan-loss reserves, divided by the amount of risk weighted assets. Each type of asset has different risk (i.e. mortgages, cash, securities and loans made to individuals, etc.). The greater the amount of RWAS, the more capital is needed. See, BIS, *Finalising Basel III. 2010, 2017 reforms*, December 2017, at 3-5.

[43] The leverage ratio limits any excessive build-up in leverage. The calculation of the 3% is the result of divide T1 capital by on-and off-balance sheet exposures (including derivatives, repos and other securities financing transactions). The 2017 reforms, Basel "IV", introduce a leverage ratio buffer for G-SIBs and set it at 50% of their weighted higher-loss abserbency requirements. Thus, a bank with a 2% risk-based buffer will have a 1% leverage ratio buffer and so will be expected to maintain a leverage ratio of a least 4%. See, BIS, *Finalising*.., (n 42) at 6.

[44] It consists of a monitoring framework on the risk-based capital ratio, the leverage ratio and the liquidity metrics using data collected by national supervisors in each country. Data were provided for a total of 206 banks, including 111 large internationally active ("Group 1") banks that have T1 capital of more than €3 billion, and 95 other ("Group 2") banks. See BIS, *Basel III Monitoring Report*, October 2018.

15. The leverage ratio has also grown, more in America than in Europe, 6,3%/5,3% (at end December 2017). Nevertheless, over 2018 it has increased by 0,2% in Europe while in America it remained constant.

16. Both, LCR and NSFR decreased by almost 1.0 percentage point for Group1 banks (at end December 2017)[45].

According to a recent report, there are some Key structural shortcomings in the market risk framework that have to be addressed, such as foreign currency risk positions from foreign exchange capital requirements, equity prices or investments in funds.[46] Although they are subject to the revised standardized approach at a global level[47], regulatory autonomy at the national and regional levels may entail uneven implementation of the supervisory standards[48].

III. Banking deregulation in the US and "the one-handed economists solutions"

17. The deregulatory policy is being promoted by the current US administration, and it's also being supported by the legislative power, the Fed, and other regulatory agencies of the financial sector. According to a Presidential Executive Order signed in February 2017, the regulatory framework of the financial sector has to be tailored[49].

18. Although it did not mention the Basel III framework, it sought to dismantle the implementation of the Dodd Frank Act[50], which enshrined many of the above remarked global criteria for banking business.

19. The Dodd Frank Act addressed the roots of the 2008 financial crisis through the most far-reaching overhaul of the banking regulatory framework in the US since the 1930s[51]. It entails the introduction of higher prudential standards[52], and the requirement to develop, maintain and file a resolution plan ("living will") with the Fed and the Federal Deposit Insurance Corporation (FDIC), for large bank

[45] Ibid, 18-75.

[46] See BIS-Basel Committee on Banking Supervision, *Explanatory note on the minimum capital requirements for market risk*, January 2019, at 4-11.

[47] The revised standardised approach has three components the sum of which determines the overall capital requirement: (i) sensitivities-based method, than addresses the change in the value of an instrument given a small movement in a risk factor that affects its value. Banks must scale up their "sensitivities" to each risk factor based on the prescribed risk weight to estimate losses if a shock was to happen to the risk factor; (ii) Standardised default risk capital requierement, that allocates all credit and equity positions to default risk bucket categories (including corporates, sovereigns and local governments, municipalities); (iii) Residual risk add-on, that provides a conservative capital requirement for any other risks not addressed by the main risk factors included in the other two components. See BIS-Basel Committee on Banking Supervision. *Explanatory note...* (n 46) at 9-10.

[48] It must be underlined that the Basel Committee is not a supranational authority. Thus, the implementation of the Basel standards depends on the adoption of internal regulations in each jurisdiction. Such is the case of the *Consolidated Basel Framework* that have to be implemented by January 2022. Although it reorganizes all the existing global standards, it doesn't introduce any amendment to them; see Basel Committee on Banking Supervision: *Launch of the consolidated Basel Framework*, December 2019, at 4-10.

[49] The White House, "Presidential Executive Order on Core Principles for Regulating the United States Financial System", 3rd February 2017, https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states.

[50] Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L.111-203), H.R.4173, July 21, 2010.

[51] See, E."Ed" Towns: "On the Dodd-Franck Act", 1(1) Harvard Business Law Review, 2011, at xi-xii. Nonetheless, it has been critized on the main ground that it over-regulates the financial system and creates more bureaucracies; see J.C. Coffee, Jr.: "The Political Economy of Dodd-Frank: why Financial Reform tends to be frustrated and Systemic Risk Perpetuated", 97 Cornell Law Review 2012, 1020 at 1079-1082. See also J.R. Macey and J. P.Holdcroft: "Failure Is an Option: An Ersatz-Antitrust Approach to Financial Regulation", Faculty Scholarship Series, 2011; 3874; at 1381-1383.

[52] See, N. Baily, A. Klein and J. Schardin: "The Impact of the Dodd Frank Act on Financial Stability and Economic Growth", 3 (1) The Russell Sage Foundation Journal of the Social Sciences, 2017, 20 at 22-23.

holding companies (BHCs) and Foreign banking organizations (FBO) with total global consolidated assets of $50bn or more[53].

20. Nonetheless, the standards of the Basel III Framework were implemented through the provisions of the Revised Capital Framework[54] that sets forth, among others, the minimum risk-based capital ratios for CET1, including an additional capital surcharge for US banking organizations which are G-SIBs[55], market risk capital charge and Risk-weighted assets[56], and a minimum leverage ratio[57].

21. Up to date US regulators have not yet issued proposals to implement the 2019 Basel standards in the United States.

22. These regulations were completed in 2014 with the U.S. Liquidity Coverage Ratio (U.S.LCR)[58], while in 2016 it was proposed a Net Stable Funding Ratio (NSFR) that has not yet been adopted[59].

23. The trend towards the deregulation of the U.S. financial industry is also being driving thanks to some legislation that has repealed or revised certain provisions of the Dodd-Frank, like the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)[60] that reduced regulatory requirements for banks holding less than $250 billion or more in consolidated assets, exempt from the requirement of a "living will" to BHCs with assets of less than $100 billion, and exempts some banks from the Volcker Rule (VR)[61].

This deregulatory wave could dismantle many other regulatory controls if the Financial Choice Act would be enacted[62]; first, it will enforce a general repeal of Title II of Dodd-Frank, the Orderly Liquidation Authority (OLA), which allows the Federal Government to step in if a bank is near collapse and provide a backstop to ensure the bank's failure is not to spread to the rest of financial sector[63], and

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[53] The "living will" must detail the bank's strategy for rapid and orderly resolution in the event of failure or financial distress. See, Dodd-FrankAct Title I (n 50).

[54] Federal Register Vol. 78, No 198, 11.10.2013, pages 62017-62291.

[55] A minimum risk-based capital ratios for CET1 (4,5%), Tier1 capital (6%) and total capital (8%), and, when fully phased in, a capital conservation buffer of CET1 of 2,5%, and the possibility to impose an additional countercyclical buffer of up to 2,5% that has not yet been imposed.

[56] The Revised Capital Framework improves the risk-sensitivity of the general risk-based capital rules including a market risk capital charge but, unlike the Basel Framework, do not rely on credit ratings to determine specific captial requirements for certain instruments not rely either on external credit ratings for the risk-weighting of assets, due to the prohibition in section 939A of the Dodd-Frank Act.

[57] It includes two separate leverage requirements, a 4% minimum leverage ratio (Tier1 capital divided by average consolidated assets, less deductions) and a 3% supplementary leverage ratio in the Basel Framework which only is applied to BHCs.

[58] Federal Register, Vol. 79, No 197, 10.10.2014, pages 61440-61541. This regulation requires banks to hold a prescribed ratio of high-quality liquid assets to withstand a 30 days stress-scenario for the BHCS, like that released by the Basel Framework, but included specific criteria for the largest banks that exceed $250 bn in consolidated assets or $10 bn in on-balance sheet foreign exposure.

[59] Dep. Of the Treasury/OCC, 12 CFR Part 50, Docket ID DCC-2014-0024, May 03, 2016. This proposal establishes a specified ratio of high-quality liquid assets to cover the outflows of a one year stress scenario.

[60] Pub. L. 115-174, S. 2155, May 24, 2018.

[61] Federal Register, Vol. 79, No 21, 31.1.2014, pages 5223-5228. The VR refers to §619 of the Dodd-Frank Act and prohibits banks from engaging in propietary trading, acquiring any ownership interest in, or sponsoring a hedgefund or private equity fund, and generally requires them to adopt an appropiate compliance programme. It's a key tool both, to prevent that banks use customer deposits for risky trading and to prevent conflict of interest between their retail divisions and their investment divisions. According to the EGRRCPA, banks that do not have and are not controlled by companies that have more than $10 billion in total consolidated assets and trading assets of more than 5% of total consolidated assets, are exempted of the VR.

[62] The Financial Choice Act of 2017, H.R. 10, 115th Cong. (2017).

[63] Title I, Subtitle A-Secc 111; See, A. J. Wallison, "Why Large Portions of the Dodd-Frank Act should be Repealed or Replaced", in *The Case Against Dodd-Frank: How the "Consumer Protection" Law Endangers Americans*, N.J. Michel ed., The Heritage Foundation, 2016, 11-30. This scholar argue that, as far as no financial crisis has threatened U. S. financial sector since the enactment of Dodd-Frank, this law has not yet been proven in action and is skeptical about its ability to prevent a crisis. Moreover, the implementation of Dodd-Frank create costs that outweigh the bank's benefits.

will tailored the scope of the competences of the FDIC, which would revert to having receivership authority only over commercial banks[64].

24. Last, but not least, the Financial Choice Act would repeal the VR and would also prohibit the Consumer Financial Protection Bureau (CFPB), that was created by Dodd-Frank, from being responsible for supervision of banks as well as market monitoring[65]. Thus, banks with high levels of capital will not be subjected to Basel III standards and will have the chance to avoid costly regulatory scrutiny, "heightened risks for investors and other stakeholders in large interconnected depository institution holding companies (DIHCs)"[66].

25. The Fed, along with other regulatory agencies, are considering to low the supervisory standards that have been implemented in the US banking sector after the last financial crisis, minimizing compliance burdens[67], tailoring living wills[68], giving a 20% reduction to the leverage ratios of the U.S.G-SIBs[69], establishing reductions on the capital buffers for large banks[70], or suggesting a tiered system for reduced liquidity requirements[71]. Foreign banks operating in the US would enjoy a similar regulatory relief[72].

26. This alignment of the main financial supervisory bodies with deregulatory policies can not be justified in the light of recent data from the banking sector of the U.S. For the first time since 2006, while in 2018 there was no bank failure[73], and in 2019 only four small banks have busted[74]; according to a Fed report, the banking sector is in strong condition, with robust economic performance, lending growth, fewer nonperforming loans and stable overall profitability[75]. Moreover, most of the U.S. G-SIBs

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[64] According to the Title I, Subtitle 8-Secc. 121, 122 and 123, the OLA should be replaced by a new bankrupcy process of the Financial Institution Bankruptcy Act of 2017 (FIBA)- H. R. 1667, 115th Congress (2017-2018).

[65] Title IX-Secc. 901 and Title VII, Subtitle A-Secc. 711 to 717 and Subtitle B-Secc. 721 to 719, respectively.

[66] See, B. B. Miller and H. R. Sutherland: "Déjà Vu: Model Risks in the Financial Choice Act", Harvard Law Shool Forum on Corporate Governance and Financial Regulatiion Ethics Metrics LLC Posted on June 25, 2017. These scholars pointed out that, with the repeal of the OLA and the FDIC's financial assistance or systemic risk program for large banks, the US banking industry would be backed up by only two resources: the FDIC's current maximum funding capacity of $958 billion and a bank regulatory oversight process that does not protect investors.

[67] See, Board of Governors of the Federal Reserve System: *Supervision and Regulation Report*, November 2018, at 1-2, 13-20. See also, US Government Accountability Office, GAO 20-40, a report to congressional requesters assessing Bank's Compliance Controls for Money Transmitter Accounts, December 2019, pointing out that the federal banking regulators backed alternative ways for risky borrowers to get loans, such as their cash flow.

[68] See, Board of Governors of the Federal Reserve System: "Statement on Proposals to modify Enhanced Prudential standards for Foreign Banks and to Modify Resolution Plan Requirements for Domestic and Foreign Banks by Governor Lael Brainard", April 8, 2019. Under the proposal, the eight U.S. G-SIBs would file living wills every two years, BHCs file full plans every three years, banks with $250 billion to $700 billion in assets only once every six years, and most domestic banking organizations in the range of $100 to $250 billion in assets are no longer required to file a living will.

[69] See, Board of Governors of the Federal Reserve System: "Rule proposed to tailor 'enhanced supplementary leverage ratio' requirements" April 11, 2018.

[70] By combining the "stress capital buffer" with the non-stress capital requirements, banks will need to meet 8 capital requirements instead of the current 13; See the Fed statement of March 4, 2020 regarding the adoption of a rule on stress capital buffer (SCB).

[71] See, Fed, FDIC and OCC, "Proposed changes to applicability thresholds for regulatory capital and liquidity requirements", October 31, 2018, at 12-26.

[72] According to a proposal of the Fed, foreign banks Fed with $100 billion or more in US assets would be sorted of increasingly stringent requirements based on several factors, extending also liquidity rules to their US branches, not just to their US subsidiaries; see, 84 FR 21988, (doc. N. 2019,-07895). Nonetheless, regulators have dropped it recently, see: *Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements 84 FR 59230,* October 10, 2019, and Fed: *Prudential Standards for the Large Bank Holding Companies Saving and Loan Holding Companies, and Foreign Banks Organizations*, 84 FR 59302.

[73] See, FDIC: "Bank Failures in Brief", January 23, 2019.

[74] According to a survey carried out by the New York Federal Reserve, this is not a relevant number if we take into account that currently 4700 Federally insured lenders are operating in USA; See Federal Reserve Bank of New York: *Quaterly Report on Household debt and credit, 2019: Q3, November 2019, at 30.*

[75] *Supervision and Regulation Report* (n 67) at 3-8. The average risk-weighted common equity ratio of the BACs increased from about 7% in the years preceding the financial crisis to about the 13% as of the end of 2017. Nevertheless, the federal

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passed the first round of the 2019 stress tests and would be well-positioned in the context of a severe global recession[76].

27. Against this background, the Fed and the FDIC keep on watering down the implementation of the Basel III regulatory framework voting to leave the counter-cyclical buffer at zero[77], or issuing rules excluding community banks from the VR regulations and loosening the standards that ban banks from engaging in proprietary trading[78]. Furthermore, R. K. Quarles, Vice Chair for supervision of the Fed, stated before of the U.S. House of Representatives that they'll not increase overall capital levels at US banks[79].

28. This policy that is weakening bank capital rules has been criticized by prominent economist[80] and several Institutions like the systemic Risk Council of the U.S. pointing out that as far as the economic cycle is approaching to the end, lending standards tend to loosen and asset values peak, so capital requirements should be raised rather than being reduced[81]. The recent emergence of a "black swan" –the Covid 19 pandemic– is hitting the credit quality of the US banking sector. Among the most severe risk, we can cite the collapse of the oil prices, which has reached a negative level for the first time in history[82], impacting the four main commercial banks that have an exposure to the energy sector on average of 15% of their regulatory capital[83].

29. We have also to pointing out the area of consumer credit, since the confinement of the population in their homes restricts private consumption to basic subsistence goods. This circumstance will make banks lose part of their most profitable business, since the financing of the consumption of various goods and services had increased in recent years given the high interest rates applied to consumer

banking agencies –FR, FDIC and OCC– have proposed a rule to limit the interconnetedness of large banking organizations and reduce the impact from failure of the largest banking organizations. Accordingly, GSIBs would be required to hold additional capital against substantial holdings of their total loss-absorbing capacity (TLAC), the debt that are required to issue in order to be used to recapitalize them during bankruptcy or resolution; see, Board of Governors of the Federal Reserve System: "Agencies propose rule to limit impact of large bank failures", April 2, 2019.

[76] See, Board of Governors of the Federal Reserve System, *Dodd-Frank Act Stress Test 2019: Supervisory Stress Test Results*, June 2019, at. 1-4, 21-48.

[77] See, Board of Governors of the Federal Reserve System: "Federal Reserve Board votes to affirm the Countercyclical Capital Buffer (CCyB) at the current level of Opercent", March 6, 2019. See also the arguments to support this decision from the speech of Vice Chair for Supervision R.K. Quarles,"Frameworks for the Countercyclical Capital Buffer", Spring 2019 Meeting of the Manhattan Institute's Shadow Open Market Committee, New York, March 29, 2019. The CCyB is a tool to bolster banks' strength against financial stability risks. According to the Revised Capital Framework of 2013 above remarked (note 40), 2013, G-SIBs should have an additional CCyB of up to 2,5%.

[78] See, Board of Governors of the Federal Reserve System, Final Rule of July 9, 2019, 12 CFR Part 248 [Docket No. R-1643] RIN 7100- AF33. See also the Inter Agency Final Rule approved by the Board of Directors of the FDIC on August 20, 2019, 12 CFR Part 351 RIN 3064-AE67.

[79] See, Statement by R. K. Quarles before the Committee of Financial Services, U. S. House of Representatives, December 4, 2019, at 5,6.

[80] According to A.R. Admati, regulation requiring more equity helps create beneficial commitments for banks to avoid the temptation of excessive borrowing; see, "Towards a Better Financial System", Economics for Inclusive Prosperity (econfip), Policy Brief 2, February 2019, http://econfip.org.

[81] See the letter of Sir Paul Tucker, on behalf of the systemic Risk Council to the chair of the Board of Governors of the Federeal Reserve System and the Chair of the OCC of August 8, 2018, "Comments regarding the e SLR and VR", www.systemicriskcouncil.org. See also Lael Brainard, a Fed Governor, dissenting on the central bank's deregulatory trend stating that "at a time when cyclical pressures have been building and bank profitability has been strong, it might be prudent to ask large banking organizations to fortify their capital buffers, which could subsequently be released if conditions warrant"; "Assesing Financial Stability over the Cycle", speech delivered at the Peterson Institute for International Economics, Washington, DC, December 7, 2018, http://www.federalreserve.gov>speeches.

[82] US oil sank 305% when the May futures for the West Texas barrel were trading at minus $37.63 on April 20, 2020 while the futures trading for June only went up to $14 on 27 April 2020.

[83] According to Haynes &Boone, as for early April, 215 oil producers have filed for bankruptcy involving more than $129 billion in aggregate debt: see, Haynes & Bone, LLP: "Oil Patch Bankruptcy Monitor", April 6 2020.

loans[84], although they have been included in public guarantees to cover bank risks that stem from the Covid-19 pandemic[85].

30. The global assessment of J. Yellen, the former Fed chair, seems to be conclusive when she states that US should deal with the deterioration in the standards of corporate lending instead of focusing on deregulation[86].

31. Th. Adorno said that we live in a time in which nothing true can be harmless. Although the banking regulatory framework established after the financial crisis could mean higher costs and fewer corporate profits, it is a guarantee for financial stability[87].

32. Meanwhile, well founded warnings arise to prevent the deregulatory wave from crossing the borders of the U.S. and sliding towards the EU which could lead to a financial system that is even less resilient that the one before the crisis[88].

The US deregulatory trend seems to be as unrealiable as the "one handed economists solutions" advocated, long time ago, by H.S.Truman.

IV. The European banking regulatory framework: financial stability vs. sectorial efficiency

33. The cornerstones of the normative framework of the EU are Directive 2013/36/EU of the European Parliament and the Council of 26 June 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms[89], and Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013, on prudential requirements for credit institutions and investment firms[90]. These tools are essential to achieve the complex goal of implementing Basel III objectives within the fragmented normative environment of the EU at a national level.

34. This framework aims at one hand to prevent and mitigate macroprudential and systemic risks while at the same time ensuring that it does not harm the functioning of the internal market[91].

35. Regarding to capital standards, credit institutions shall maintain, in addition to the CET 1, a capital conservation buffer of CET 1 equal to 2.5% of their total risk exposure amount although for G-SIBs this amount shall be of up to 2% of their total systemic risk exposure[92].

[84] Neverhteless, nonbank lenders such as Private equity firms and hedge funds now dominate cosumer loans because the implementation of The Dodd-Frank Act limited bank's ability to take risks in lending; see, T. Spangler: *One Step Ahead-Private Equity and Hedge Funds After the Global Financial Crisis*, Oneworld P., 2016, at 10, ss.

[85] The Federal Reserve Board established a "Commercial Paper Funding Facility" (CPFF) and the "Primary Dealer Credit Facility" (PDCF) on March 17, 2020, to support the flow of credit to households and businesses, that directly finance auto loans, mortgages as well as liquidity to meet the operational needs of a range of companies.

On March 18, 2020, the Fed established the "Money Market Mutual Fund Liquidity Facility" (MMLF), and on March 23, 2020, the Fed established the "Term Asset-Backed Securities Loan Facility" (TALF), that broaden its program of support for the flow of credit to households.

[86] Interview with the Financial Times, October 25, 2018.

[87] According to some analysts familiar with the matter, rising levels of corporate debt as well as the leveraged loan explosion, are posing risks to the financial system, but US regulators lack a toolkit to prevent a castrophic financial event; E. Ludwig: "US regulators ill prepared for next downturn", Financial Times, June 11, 2019. Nevertheless, two states have adopted proposals to oversight financial services providers currently underregulated as well as to protect consumers; See New York Governor: *State of the State 2020*, January, 2020, expanding protection for NY (consumers of financial products or services); see also state of California: *Governor`s Budget Summary 2020-2021*, January 10, 2020, at 13.

[88] S. Bair, former chair of the FDIC, "The US must hold firm on bank capital rules", Financial Times, October 2, 2018.

[89] OJ L 176/338 of 27.6.2013.

[90] OJ L 176/1 of 27.6.2013

[91] See P. Aghion, A. Bergeaud, G. Cette, R. Lecat and H. Maghin: "Financial constraints and productivity growth: An inverted-U relationship", 26 CEPR Policy Portal, 13 September 2019.

[92] Article 129(1) and 131 (5) of Directive 2013/36/EU (n 69), respectively. See also the Article 136 (4) of the Directive 2013/36/EU.

36. Moreover, Member States of the EU may introduce a systemic risk buffer of CET 1 of at least 1% based on the banks' exposures. This buffer could be upgraded to a 5%[93]. The EU requires also higher standards regarding to the own funds of the credit institutions[94].

37. Liquidity requirements and the leverage ratio should be harmonized by 2015 and 2018, respectively[95]. The bank liquidity was subject to a specific and extraordinary supervision of the ECB in 2019 and the result elicited serious reluctance: only eleven banks reported a survival period shorter than two months under the extreme shock scenario but the number of banks that manage to resist for at least six months in this scenario is reduced to twenty six[96].

38. The adoption of the banking package in May 2019 has already updated these provisions, although it has just included some of the rules agreed by the Basel Committee in December 2017, those regarding the leverage ratio and the leverage ratio buffer[97]. The new framework also addresses the requirements to maintain a capital conservation buffer and to maintain a systemic risk buffer[98], and provides for new standards on additional own funds requirements[99].

39. It is forecast that the entire implementation of Basel III package should have the result of pushing forward mergers between the largest banks in the EU[100]. According to SCOPE, there are, however, certain elements suggesting that cross-border bank M&A in Europe will not be implemented in the short-term, such as digital challenges, product commoditization, the assessment of non-parametric risks like money laundering, climate-change risks or cyber risk, the persistence of excess capacity, and the scarce creation of synergies between their investment and their retail and commercial networks, among others[101].

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[93] Article 133(1) and 133(13-4) of Directive 2013/36/EU, respectively. It must be underline that, as a matter of fact, the European rules could make banks more susceptible to changes in the economic context due to their procyclical effect. Nevertheless, the Covid19 crisis has forced the central banks of these 9 eurozone states to authorize the release of countercyclical capital buffers to ease the financing of banks loans to companies.

[94] According to Article 92(1) of the Regulation (EU) 575/2013 (n 70), credit institutions shall at all times satisfy a CET 1 capital ratio of 4,5%, a T1 cr of 6% , a total cr of 8%.

[95] Recital 18 of the Regulation (EU) 575/2013.According to Article 412(1) of this Regulation, credit institutions shall hold liquid assets so as to ensure that they maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of thirty days. The leverage ratio shall be calculated in accordance with article 11(2) and 429 (2) of this Directive.

See also "Consultation Paper on CEBS' Guidelines on Liquidity Cost Benefit Allocation" (CP 36) March, 2010, CEBS archive/EBA, https://eba.europe.eu/cebs-archive.

[96] 103 banks were involved within a new stresst test risk profile focused on short-term liquidity risk which is not included in EU-wide stress test (e. g. EBA 2018); ECB, *Banking Supervision: Sensitivity Analysis of Liquidity Risks-Stress Tests 2019*, Final results, 7 October 2019, at 14. Furthermore, in an adverse scenario with limited liquidity outflows or a downgrade of a credit rating step, half of European banks would not resist six months. This time reference is taken into account because it is what lasted 43% of the liquidity crises analyzed by the ECB.

The EBA had planned to carry out along this year the assessment of 51 European banks against the most extreme pos-Brexit scenario, incluidng a decline in EU GDP by 4.3% between 2020-2022, but it had to be postponed to 2021 due to the Covid 19 pandemic; see, *EBA launches 2020 EU-wide stress test exercise*, 31 January 2020; see, also, EBA, EU-wide stress test postponed to 2021 to allow banks to prioritase operational continuity, 19 March 2020.

[97] The leverage ratio is set at 3% of Tier 1 Capital, according to article 1 (52) of Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU, OJ L 150/253 of 7.6.2019. See the ECB critical observations on this issue in its Opinion of 8 November 2017 (CON/2017/46).

[98] See articles 1(46), 1(47) and 1(49) of Directive (EU) 2019/878, respectively. The combined macroprudential buffer requirements in the euro zone are range between 2,5% to 5,75%, but only five countries have activated the systemic risk buffer and just countries have activated the counter cyclical capital buffer; See scope (Financial Institutions): "AT1 quaterly: where are bank capital requirements heading?". 10 February 2020, at 1-2.

[99] See Paragrap 4 of article 1(33) of Directive (EU) 2019/878. See, nonetheless, the Recomendation of the European Central Bank of 7 January 2019 on dividend distribution policies (ECB/2019/1), which establishes a stricter calculation of capital ratios with regard to credit institutions paying dividends.

[100] See, Scope Rating Gmbh: " Could new G-SII indicators facilitate cross-border bank mergers in Europe", 11 June 2019.

[101] See Scope Insights: "Cross-border bank mergers in Europe: not such a grand idea", 7 February 2020, at 1-4.

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40. In the meanwhile, European banks will be subjected to a 24.4% increase in their minimum capital levels[102]. But, according to European regulators, these capital increases will not be enough, arguing that, if risks are confined to one particular credit sector a specific capital buffer would not guarantee bank resilience[103]. The need to reinforce capital buffers has been underlined in various statements by members of the ECB, either on the ground that there is still some scope to have a higher share of capital in the form of releasable buffers[104], or pointing out that the current composition of CCyB have to be rebalanced in order to give this buffer a more prominent role[105].

41. These remarkable progress towards regulatory harmonization has not been yet completed through the creation of a standardized supervision[106].

42. Despite the existence of various supranational bodies, the supervision of the EU's banking framework is uneven. The establishment of the European Banking Authority (EBA) that is carrying out key tasks on this field[107], does not prevent the implementation of any further measure taken by the Member States[108].

43. Moreover, along with the supervisory differences, banks in Member States remaining outside of the euro area are also subject to resolution and financial backstop arrangements which are aligned at national level[109], whilst banks belonging to the euro area are subject to the supranational rules established by the Single Supervisory Mechanism[110], the Single Resolution Mechanism and the Single

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[102] See, European Banking Authority (EBA): "EBA advises the European Commission on the implementation of the final Basel III framework", 5 August 2019, and, "Call for advice on Basel III implementation: Key findings from the impact assessment and policy recommendations", Public Hearing, 2 July 2019, at 4.

Among the elements of the reforms that are still missing, it could be mentioned the Fundamental Review of the Trading Book, which includes the "out put floor", a limit to the capital benefit a bank can gain from relying on internal models rather than on the Standardised Approach (SA). The EBA strongly recomends that the SA should be implemented; see EBA: "Policy Advice on the Basel III Reforms: Output Floor", EBA-OP-2019-09c, 2 August 2019.

[103] See N. Jahn and M. Pirovano: "Understanding the specific features of the CC y B and the SCC y B-evidence from the 3D DSGE model", ECB Macroprudential Bulletin, 16 September 2019.

[104] Remarks by L. de Guindos, Vice-President of the ECB, at the ECB Forum on Banking Supervision, Frankfurt am Main, 6 November 2019.

[105] See, "Opportunities and chalenges for the euro area financial sector", Opening Speech by L. de Guindos, Vice-President of the ECB, at the 22nd Euro Finance Week, Frankfurt am Main, 18 November 2019.

[106] According to a report of the IMF, in euro zone, banks loss-absorbing buffers, have not been fully developed by some national authoties and there is a risk that banks' stronger links to sovereigns in countries with high goverment debt along with potential losses on nonperforming loans could hit to capital for some banks; see IMF: *Global Financial Stability Report. Vulnerabilities in a Maturing Credit Cycle*, April 2019, at 7-8 and 21-29.

[107] See Article 1(5) of Regulation (EU) 1093/2010 of the the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Banking Authority), OJL 331/12 of 15.12.2010. The EBA is part of the European Systemic Risk Board responsible for macro-prudential oversight across the EU's financial system, according to Regulation (EU)1092/2010 of the European Parliament and of the Council of 24 November 2010, OJ 331/1 of 15.12.2010, as well as Regulation (EU) 2019/2176 of the European Parliament and the Council of 18 December 2019 amending Regulation (EU) No 1092/2010, OJ L334/146 of 13.12.2019

[108] See Title VII (Prudential Supervision) of the Directive 2013/36/EU. See F. Mazzaferro and F. Dierick: "The ESRB and macroprudential policy in the EU", Focus on European Economic Integration Q3/18, Osterreische National Bank, 131 at 139-140

[109] See Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms, OJL 173/190 of 16.2.2014. The implementation of the Directive is uneven. Although for the euro area has been established a single resolution mechanism anchored in the Single Resolution Board, there are divergences in incentives and practices of Member States in the treatment of creditors of banks under resolution and in the bail out of failing banks; On the other hand, this Directive does not avoid the taking of inconsistent decisions on the resolution of cross-border groups and does not prevent different approaches for national financial arrangements; see, European Commission, Report on the application and review of Directive 2014/59/EU and Regulation 806/2014, COM(2019) 213 final, Brussels, 30.4.2019, 5-7.

[110] See, Council Regulation (EU) 1024/2013 of 15 October, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJL 287/63 of 29.10.2013. This Mechanism guarantees that the prudential supervision and the single rulebook for financial services is applied in a coherent manner to banks in the euro area, either centrally by the European Central Bank or by the national competent authorities. Although Article 7 of Regulation

Resolution Fund[111]. It is foreseeable that the operation of these Mechanisms would be updated in the coming years[112].

44. The Banking Package also included amendments to certain provisions to the Bank Recovery and Resolution Directive[113] and to the Single Resolution Mechanism Regulation[114]. While they introduce changes to the calibration, eligibility criteria and group allocation of the rules concerning the Minimum Requirement for own funds and eligible Liabilities (MREL)[115], a key element of the resolution framework[116], there is still missing a harmonized framework on insolvency regimes in the EU[117]. This current status could be changed because the European Parliament is considering to present a proposal to the European Commission to establish a unitary regime that should lodge in the SRB the competences on the matter, drawing the new regime from the US experience of the FDIC[118]. It is unavoidable to establish such a regulatory framework given the serious damages caused by the implementation of different criteria regarding either to the type of banks affected by a resolution procedure or by safeguarding different interest within the Eurozone States themselves. Thus, the Financial Stability Board (FSB) has pointed out, on the one hand, that progress in resolution policies is uneven; for example, there are no

(EU) 1024/2013 provides that Member States whose currency is not the euro could establish a "close cooperation" to participate in the mechanism, none of them had joined it up to date. See, Decision of the European Central Bank of 31 January 2014 (ECB/2014/5), and the Report from the Commission on the Single Supervisory Mechanism, COM (2017) 571 final, Brussels, 11.10.2017.

[111] See, Regulation (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) 1093/2010, OJL 225/1 of 30.7.2014. See also, European Commission, COM (2019) 213 final (n 109) at 12.

[112] There are several aspects within the Single Supervisory Mechanism that have to be addressed by the EU legislators. Such is he case of the macroprudential stress test of the largest banks of the euro area. The Results of 2018 indicate substantial resilience of more than 90% of them at the crurent juncture; see EBA: *2018 EU-Wide stress test*, 2 November 2018; see, also K. Budnik: "A bird's-eye view of the resilience of the European banking system: results from the new macroprudential stress test framework", ECB/Macroprudential Bulletin, March 2019, Issue 7. Nonetheless, a Special Report of the European Court of Auditors pointed out different features of the EU-wide stress test that should be improved. For example, that they have been conducted according to the bottom-up approach –where banks produced the results yielded by the shock scenario– rather than rely on a top-down approach; that key decisions at the EBA during the various phases of the stress test are taken by representatives of national supervisors; or that the EBA does not currently have the resources it needs to exercise full oversight, among others; see European Court of Auditors: *EU-wide stress test for banks: unparalleled amount of information on banks provided but greater coordination and forms on risks needed*, Special Report 10/2019, Luxembourg, 10.7.2019, at 9-12 and 107-117.

[113] Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive (EU) 2014/59, OJ L 150/296 of the 7.6.2019.

[114] Regulation (EU) 2019/877 of the European Parliament and the Council of 20 May 2019 amending Regulation (EU) 2014/806, OJ L 150/226 of 7.6.2019.

[115] See article 1(17) of Directive (EU) 2019/879 and article 1(6) of Regulation (EU) 2019/877.

[116] Recital 44 of Directive 2014/59/EU and Recital 58 of Regulation 806/2014/EU, establish the Principle that the competent authority may conclude on grounds of public interest, that when a bank is failing or likely to fail, must be put under resolution, rather than applying insolvency under national law. Thus, the resolution framework establishes several resolution tools, like to use the sale of business tool, to create a bridge bank, to carry out bail-in, etc.; and it must ensure that share holders and creditors effectively support losses. While article 129 of Directive 2014/59/EU and article 94 of Regulation 806/2014/EU require the European Commission to review the application of the resolution framework that includes the MREL. According to a Single Resolution Board (SRB) Position Paper, banks headquartered in the Banking Union and their subsidiaries which will maintain significant business or operational activities in the UK post Brexit, are expected to consider issuing instruments, which are intended to be eligible to meet the MREL target, under the governing law of one of the EU 27 Member States; See *Single Resolution Board expectations to ensure resolvability of banks in the context of Brexit*, 15 November 2018, at 3.

[117] The EU framework only provides some harmonisation on grounds of article 108 of Directive 2014/59/EU, establishing a ranking of deposits in insolvency hierarchy, and of Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017, amending Directive 2017/59/EU as regards the ranking of unsecured debt instruments in solvency hierarchy, OJ L 345/96 of 27.12.2017.

[118] See European Parliament : *An Effective Regime for Non-viable Banks: US Experience and Considerations for EU Reform-Banking Union* Scruting, EGOV, Dir. Gen. for IP of the Union, PE 624.432, July 2019, at 53. The scope of the Competences that should be lodged in the SRB will be the almost 3.900 "less significant" credit institutions which are not subject to the single supervisory mechanism of the ECB, because the performance of these tasks belongs to the national competent authorities (see Case C-450/17P, EU:C:2019:372).

references of the resolution plans for local and regional banks, and there remains a gap in adopting institution specific cross-border cooperation agreements[119]. On the other hand, the chairman of the Supervisory Board of the ECB has stated that there is no supranational capacity to safeguard the implementation of the European framework within some Member States of the Eurozone, instead of adopting internal decisions that protect shareholders and investors, bailing out their national banks with public money[120].

45. As remarked above, the post crisis regulatory framework of the EU has increased the resilience of credit institutions although the other side of the coin are the costs meant for the banking business, especially those stemmed from tighter leverage and capital requirements and from unconventional monetary policies and the policy rate path adopted by the ECB.

46. Although a global trend seems to consolidate that shows the progressive lack of profitability of the banking sector, the gap is also widening between the US and European banks; thus, while the average return on equity of the former was 16% in 2018, the return for the latter was 6.5%[121]. Moreover, recent official data show that a quarter of the European banks has a profitability of less than 3% when the cost of capital is 10%[122], and in the Eurozone banks have to face a persistent low profitability in recent years with around 75% of significant banks generating returns below the 8%benchmark returns demanded by investors for holding bank equity[123].

Thus, a hyper-regulated monitored sector[124] with high operating cost could hardly be efficient[125].

47. This circumstance should be carefully considered, since, for example, according to independent research the implementation of this regulatory policy is improving the bank solvency within the eurozone[126].

48. Banks blame sector hyperregulation of creating unintended consequences and demand some steps forward of the EU Institutions to overhaul the current framework[127].

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[119] FSB: *2019 Resolution Report, Eight Report on Implementation of Resolution Reforms*, "Mind the Gap", Basel, 14 November 2019, at 8-12 and 20-22.

[120] European Parliament, "Public hearing with Andrea Enria, Chair of the ECB Supervisory Board", ECON on 12 December 2019.

[121] According to McKinsey, "the global industry approaches the end of the (economic) cycle in less than ideal health, with mearly 60% of banks printing returns below the cost of equity"; see, McKinsey & Company: *Global banking annual review 2019: The last pit stop?. Time for bold late-cycle moves,* October 2019, Report.

[122] Speech by M. Delgado, Deputy Gov. of the Bank of Spain delivered at the Club Diálogos para la Democracia, Madrid, 14 January 2020.

[123] Opening speech by L. de Guindos, Vicepresident of the ECB, at the 22nd Euro Finance Week, "Opportunities and challenges for the euro area financial sector", Frankfurt am Main, 18 November 2019.

[124] Along with the above remarked supranational bodies, macro-prudential oversight of the credit institutions-mainly those qualified as G-SIIs or other systemically important institutions (O-SIIs) can be implemented by the national competent authorities. Complicance with the EU framework could afford that the latters apply stricter national meassures in several fields like the requirements for large exposures or the capital buffers; see, for example, the Opinion of the ESRB of 9 March 2019, (ESRB/2018/3).

[125] Such could be the case of the implementation of Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, OJ L 337/35 of 23.12.2015, (PSD2), which allows access to the financial data of customers who expressly consent to other competitors. This can mean a significant loss of business for the european banks because competitors, (including fintech, and other companies), could offer their customers digital media for payments, alternative to the use of their credit cards, as well as every kind of financial products and services that shall weak the bank's intermeditaion links with their customers. Moreover, according to Accenture, in order to protect the economics of their payment businessess, banks will need to define strategies about scale technology and differentiate themselves by adding value in a low marging, high volumen business; see, Accenture: "Two ways to win in Payments, Banks can add value in the world of Instant, Invisible and Free payments via scale and differentiation" Accenture Global Payments Pulse Survey, September 2019, at 8-10.

[126] The AXIS Corporate ranking of the European States, taking into account the non-performing loan (NPL) ratio on banking balance, shows that there are only two Eurozone States Greece (49%) and Cyprus (39%) with high levels of risks; see, Axis Corporate Report: *Assets Under Management: Trends in European Non-Performing Loans Market*, May 2019. It should be underlined that banks with high stocks of NPL lend less than banks with better credit quality.

[127] See, Board of the European Banking Federation (EBF): "Banks call for improving Europe's Global economic competitiveness in upcoming EU policy cycle", 10 May 2019, availble at www.ebf.eu. Among the adverse effects of the implementation

49. A Report of the Advisory Scientific Committee of the ESRB reaches similar conclusions, stating that while regulation can limit the diversity of business approaches and constrain competition and innovation, excessively complex regulation contributes to increased systemic risk[128]. However, it also underlines that neither complex nor simple financial regulations are able to address the challenge of maintain cost-efficiency and adequate risk-sensivity[129].

50. In the meanwhile, the European banks are relying heavily on unreliable financial tools to capture liquidity with low costs, like the issuance of EUR 93.5 bn on Covered bonds in the first half of the last year[130], or the outstanding growth of the Collateralized Loan Obligations (CLO) –a toxic typology of corporate loans very similar to the Collateralized Debt Obligations (CDO)– that has reached the record figure of EUR 220 bn along the 2014-2018 period[131]. Nevertheless, the EBA is trying to mitigate this type of financial risk through different actions. Such is the case of the adoption of the Opinion on the Regulatory Treatment of Non-Performing Exposing securitizations[132] (NPEs) and the adoption of the Final draft Regulatory Technical Standards on mapping of derivative transactions to risk categories, on supervisory delta formula for interest rate options and on determination of long or short positions in the standardized Approach for Counter party credit Risk under Article 277(5) and Article 279a (3) (a) and (b), respectively, of Regulation (EU) No 575/2013 (CRR2)[133]. While the former focuses the risk for investors stemming from the fact that the assets in the NPEs securitizations are already defaulted or deemed as defaulted, the latter establishes a method for the allocation of derivative transactions to one or more risk categories[134].

51. As regards the policies of the ECB, the last deposit facility (DFR) at -0,40% implied a cost for the eurozone banks of EUR 7.5 bn a year[135]. Thus, Eurozone banks argued that, in contrast to that DFR system, which treated all excess reserves in the same manner, a tiered system akin to those in place in Japan, Denmark, Sweden or Switzerland, would imply no cost for them up to a certain threshold of

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of this framework, banks underlined that the significant increase in capital requirements for European banks –up to 20%– could lead to a severe reduction in the funding available for lending, while also placing them at a competitive disadvantage with US banks. However, the focus on these effects should be more nuanced as it is argued by another analysis; see Scope Insights: "Questionable assumptions make European Banks' profitability look worse than it is", 20 July 2019.

128 Systemic risk could be transfered though the encoragement to transfer risks to institutions outside the regulatory perimeter; because a wide array of regulatory tools can make policy responses convoluted, or because it can hamper the accountability of regulators and supervisors, among others; see, Reports of the Advisory Scientific Committee: *Regulatory complexity and the quest for robust regulation*, 8 June 2019, at 2 and 32-33.

129 According to this report, current financial regulation should be complemented by a set of rubustness principles: adaptability (to the evolution of the financial system); diversity (preserve the variety of institutions and business models); proportionality (set regulation in proportion to the importance of market imperfections); resolvability (do not regulate to avoid failure, but ensure failure is not disruptive); systemic perspetive (ensure the continous provision of critical financial services, not the survival of individual institutions); information availability (to allow for timely identification of vulnerabilities and contagion channels); and non-regulatory discipline (ensure market discipline, good governance and managed ethics as complements to regulation); see, *Regulatory complexity and the guest for robust regulation*, (n 128), at 35-36.

130 This data makes 2019 the strongest first half for eight years (2011-2019) according to Scope Ratings, "Covered Bond Quaterly: maintaining the pace of issuance looks challeging", 10 July 2019.

131 See, Banco de España (BdE): *Informe de Estabilidad Financiera*, Primavera 2019, at 40-41. These Kind of loans can spread contagion risk through the financial system; see, G. Covi, M. Montagna and G. Torri: "Economic Shocks and Contagion in the euro area banking sector: a new microstructural approach", ECB, Financial Stability Review, 1, May 2019, at 10-12. When the market for these bonds seizes up, banks can get stuck holding the risk, weighing donw their balance sheets.

132 Opinion of the European Banking Authority to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitizations, EBA-Op-2019-13, 23 October 2019.

133 EBA-RTS-2019-02, 18 December 2019.

134 According to financial reports, European banks loan lossprovisions could quadruple in the first quarter of 2020, and bank profits might decline by 50% along the whole year; MYM: *European Banks Prepares for Loan-loss Provisions,* 28 April 2020.

135 See, F. Rojas, F. Troiano and R. da Mota Guedes: "The potential impacts of changes to the ECB's deposit facility", Funcas SEFU, 8, 4 July 2019, 15 at 18.

liquidity with the ECB[136]. In addition, it weakened their position vis-à-vis US banks which, in 2018, got almost $36 bn from deposits in the Fed[137].

52. Moreover, according to a Position of the Association of German Banks, the relief provided by the introduction of a tiered system of interest rates for excess liquidity in October 2019, will not compensate for the renewed cut in the deposit rate from -0,4%to -0,5% in September 2019, because less than half the excess liquidity in the Eurozone is currently exempt from this negative deposit rate, while other central banks, such as the Bank of Japan, exempts up to 90%[138].

53. Empirical data shows, nevertheless, that the transmission mechanism of monetary policy has not been impaired by the implementation of the ECB's DFR, because the sound banks in the eurozone started to charge negative rates on corporate depositors after the introduction of the negative DFR in 2014, increasing their net wealth[139], and there were not clear evidences of the existence of a «reversal rate effect»[140]. In fact, a staff Report that has been delivered by the IMF states that the introduction of the above-mentioned tiered system for the bank's deposits in the ECB in the future will have minimum impact on their profitability[141].

54. Finally, it should be underline that the unconventional monetary policies of the ECB have also helped to improve the profitability of the banking business within the eurozone. Such is the case of the Targeted Longer-Term Refinancing Operations (TLTRO) –2014-2016, 2016-2018– that have spurred competition and stimulated bank financing[142].

55. The short period of time elapsed since the adoption of the last package of unconventional ECB measures, on 12 September 2019[143], does not allow for a weighted assessment of its implementation. Regarding the impact on the banking business, in addition to the afore mentioned new tiering system and the decreasing of the interest rate on the deposit facility by 10 basis points to -0,50%, it should be underlined the consequences of the new Targeted Longer-Term Refinancing Operation (TLTRO III), in the medium-term (4-7 years), because banks can borrow money for three years from the ECB at -0,5, and then deposit it for free.

[136] Ídem, at 17. See also, B. Poole's Scope Ratings Report 6 September 2019. Other side effects of the ultra low interest rate policy of the ECB have also been high lighted, such us keeping commercially non-viable firms alive; see, V. Acharya: "Creating zombies and disinflation: a cul de sac for accommodative monetary policy", 60 CEPR Policy Portal, 11 November 2019.

[137] According to the decision of the Federal Open Market Committee (FOMC) of June 19, 2019, the federal funds rate (FFR) is maintaingin in the target range at 2.25 to 2.50%. Thus, the Board of Governors of the Fed approved maintaining the interest rates paid on required and excess reserve balances at 2.35%. On the other hand, there is a differential shock induced by negative rates on high and retail deposit banks, because the latters are being pushed to increase their holdings of securities issued by private firms yielding higher returns, so they take higher risk in loans; see, J. Bubeck, A. Maddaloni, J. L. Peydró: "Negative monetary policy rates and systemic banks' risk-taking: evidence from the euro area securities register", ECB WPS No 2398, at 14-26 and 18-22.

[138] See, Bankenverband: "Strategy review of the European Central Bank", 13 January 2020.

[139] These banks have also increased their lending. See, C. Altavilla, L. Burlon, M. Giannetti and S. Holton: "Is there a zero lower bound? The effects of negative policy rates on banks and firms", ECB-WPS No 2289, June 2019, at 3-5, 12, 20, and 27-28.

[140] See F. Ducrozet and N. Gharbi: "The new limits of ECB policy", Pictet-Perspectives, 28 October 2019. According to M. Brunnermeier and Y. Koby, a «reversal rate» appears when rate cuts might lead to less lending by credit institutions; see, M. K. Brunnermeier and Y. Koby: *The Reversal Interest Rate¸*National Bureau of Economic Research, WPS, 2018, last version 30 January 2019, at 31-32.

[141] IMF Country Report No 19/2019, *Euro Area Policies*, July 2019, at 8-12 and 21-25.

[142] Features delivered by a reseach gathering data from 130 banks of 13 countries show that the banks that participated in the TLTRO expanded their credit offer thanks to the reduction of their financing costs; see, M. García-Posada Gómez: *El impacto de las TLTRO en las políticas de crédito bancario: el papel de la competencia*, BdE, Boletín Económico, 2, June 2019, at 2, 6-7.

[143] The Governing Council of the ECB took the following monetary policy decisions: (1) Cut its key deposit rate to -0,5%; (2) the interest rate on the main refinancing operations and the rate on the marginal lending facility will remain at their levels of 0,00% and 0,25 respectively; (3) Net purchases will be restarted under the asset purchase programme (APP) at a monthly pace of EUR 20 billion as from 1 November 2019; (4) the launching of a new series of quaterly Targeted Longer-Term Refinancing Operations (TLTRO III) according to different criteria; (5) the introduction of a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity will be exempt from the negative deposit facilty rate.

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56. But the transnational outbreak of the Covid 19 pandemic has forced central banks to adopt exceptional measures that enhance their unconventional policies and give some relief to the implementation of rules related to capital buffers and the assets rating of credit institutions.

57. The ECB has expanded its bond buying programme and agreed an unprecedent level of flexibility in its plan to buy €750 bn through the Pandemic Emergency Purchase Programme (PEPP)[144]. This program will be implemented in addition to the €120 billion of the TLTROs-III[145]. Given that, unlike the financial crisis of 2008, this time is not about bailing out banks, but to bail out big business, highly leveraged[146], as well as to give grants to small and midsized businesses and to protect citizens and consumers. Therefore, monetary policy has to keep the banking sector liquid[147] and ensure that banks can lend to all sectors[148].

58. Both tools were completed by decisions subsequently adopted by the Governing Council of the ECB[149] in the context of the launch of a new bank liquidity program, the non-target pandemic emergency longer-term refinancing operations (PELTROs)[150], consisting of seven additional refinancing operations –from May 2020 to September 2021– that will be carried out with an interest rate 25 basis points below the average rate[151].

59. The explosion of the Covid-19 pandemic has created volatility and squeezes on liquidity. In these circumstances, the ECB must explore the feasibility of every tool that could guarantee the flow of money to businesses and households, including the «shadow banking»[152], and must safeguard the

[144] Decision (EU) 2020/440 of the ECB of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) OJ L91, 25.3.2020, p. 1. According to articles 4 and 5 of this Decision, almost all constraints that applied to ECB's previous asset-purchase programmes can be removed, including the limit to buy no more than a third of any country's elegible bonds. The PEPP will remain in place until the Covid-19 is over.

[145] Decision (EU) 2020/407 of the ECB of 16 March 2020 amending Decision (EU) 2019/1311 on a third series of targeted longer-term refinancing operations (ECB/2020/13) OJ L 80, 17.3.2020, p. 23.

[146] Decision (EU) 2020/441 of the ECB of 24 March 2020, amending Decision (EU) 2016/948 of the ECB on the implementation of the corporate sector purchase programme (ECB/2020/18), OJ L91, 25.3.2020, p. 5.

[147] Banks account for two-thirds (€3.6 bn) of the Eurozone's corporate debt while US banks' debt amounts to only one-thrid of the corporate debt; see UBS Report, *Eurozone: Debt to surge*, April 2020.

[148] Along with the ECB measures to support liquidity conditions and money market activity, US regulators, like many others in the world, call on banks to offer "small dollar loans"; see, "Joint Statement Encoraging Responsible Small-Dolar Lending in Response to Covid-19", 26 March 2020; and "Two actions to support lending to households and businesses", 27 March 2020.

[149] The conditionas on the TLTROs-III have been further eased reducing their interest rate in operations from June 2020 to June 2021 to 50 basis points below the average interest rate on the Eurosystem's main refinancing operations prevailing over the same period; See, art 5 of the Decision (EU) 2020/614 of the ECB of 30 April 2020 amending Decision (EU) 2019/1311 on a third series of targeted longer term refinancing operations (ECB/2020/25); OJL 141/28, 5.5.2020.

Regarding to the above mentioned PEPP, purchases under this program will be conducted in a flexible manner across asset classes in any case, until the end of 2020; see, ECB, Press Release, 30 April 2020.

[150] Unlike TLTROs-III, which allow to request liquidity up to 50% of the loans provided, the PELTROs would let that banks could request as much liquidity as collateral they provide in each auction.

[151] The implementation of this program pursues that banks buy public debt from the peripheral States of the Eurozone, to avoid spreads soarings. In fact, the features of the PELTROs are very similar to those of the very long-term refinancing operations (VLTROs) that were launched by the ECB in 2011. However, given the special conditions of the PELTROs, Eurozone banks could only buy peripheral debt for one year, which would produce earnings of approximately 0.5% to 0.7%, depending on the issuing State.

[152] According to a research of the ECB, "opening emergency lending facilities to a broader set of institutions can be beneficial in reducing the fall of asset prices "(...) (although) it may generate moral hazard"; see, A. D'Avernas, Q. Vanderweyer and M. Darracq Pariés: "*The Growth of non-bank finance and new monetary policy tools*", ECB Research Bulletin, No 69, 15 April 2020, at 4/4. Since the post GFC framework have tightened banking regulation the *«shadow banking» has developed a key role in the financial sector and could help in easing liquidity stress beyond the banking channels.* Most of this type of financial entities have more flexibility than banks to lend to businesses and households because they are not bend by the strict regulatory and supervisory standards of the latters. As a matter of fact, the Fed has implemented several tools during the financial crisis of 2008 to relief liquidity pressures in the shadow banking sector; see speech by Vice Chairman S. Fischer, "*The Lender of Last Resort Function in the United States*", February 10, 2016.

implementation of all measures adopted in this context against whatever interference in the exercise of its competences[153].

60. Moreover, the ECB have required to credit institutions that, at least until 1 October 2020, no dividends are paid out and no irrevocable commitment to pay out dividends is undertaken by them and that they will refrain from share buy backs aimed at remunerating shareholders[154]. This Recommendation, that has been supported by the EBF, aims to shore up the capital base of the banking system, freeing up billions of additional loan capacity[155].

61. International and supranational banking supervisors have also contributed to the creation of liquidity, freeing credit institutions of some regulatory requirements on solvency[156]. Regarding to Basel III, the measures endorsed by the BIS comprise, among others, the following changes: the implementation timeline of the Basel III standards finalized in December 2017 has been deferred by one year to 1 January 2023; the accompanying transitional arrangements for the output floor has also been extended by one year to 1 January 2028;; the implementation date of the revised market risk framework finalized in January 2019 has been deferred to 1 January 2023, as well as the implementation of the revised Pillar 3 disclosure requirements[157].

62. At a European level, the EBA has decided to postponed to 2021 the EU-wide stress test, this will allow banks to focus on their core operations, and have encouraged National Competent Authorities (CAS) to make full use of the flexibility already embedded in the existing regulatory framework (the implementation of Pillar 2 Guidance on the LCR, the management of non-performing and forborne exposures, etc.)[158], and has established that, in case of debt moratoria, there is no automatic classification in default or forborne of IFRS 9 status[159]. The European Commission has adopted also a banking package to facilitate lending to EU households intended to encourage banks to make full use of the flexibility embedded in the EU's prudential and accounting framework[160]. These decisions would help to free up an estimated €120 billion of extra bank capital, which can support lending capacity by European banks.

[153] See the statement of the Governing Council of the ECB , "*ECB takes note of German Federal Constituional Court ruling and remains fully committed to its mandate",* Press Release, 5 May 2020. The ECB comes to the step of a controversial decision of the German Court that considers that the Public Sector Purchase Programme (PSPP), launched by the ECB on 4 March 2015 as part of the Expanded Asset Purchase Programme (EAPP), a framework programme of the Eurosystem for the purchase of assets on financial markets, may lack sufficient proportionality considerations and could amount to an exceeeding of its competences. Although this decision expressly states that "does not concern any financial assistace measures taken by the EU or the ECB in the context of the current coronavirus crisis", it could nevertheless hamper their implementation; see, German Federal Constitutional Court Judgements of 5 May 2020, 2 BvR 859/15, 2 BvR 980/16, 2 BvR 2006/15, 2 BvR 1651/15.

[154] Recomendation of the ECB of 27 March 2020 on divided distributions during the Covid-19 pandemic and repealine Recommendation (ECB/2020/1) (ECB/2020/19), OJ C102I, 30.3.2020, p. 1.

[155] EBF letter to ECB/SSM in context of actions to fight Covid-19 pandemic, 27 March 2020. Keeping this capital in the banks will increase its T1 capital by €30 billion, therefore, assuming a 75% charge applicable to loans to companies, it would be equivalent to €300 billion in loans.

[156] See, IMF: *Global Financial Stability Report*, April 2020, Chapter 1, "Banks Could Act as an Amplifier should the crisis Deepen Further", at 19-22 and 27-30.

[157] B.I.S: *Governors and Heads of supervision announce deferrall of Basel III implementation to increase operational capacity of banks and supervisors to respond Covid-19*, 27 March 2020.

[158] *EBA statement on actions to mitigate the impact of Covid-19 on the EU banking sector*, 12 March 2020.

[159] In particular, generalised payment delays due to legislative initiatives do not lead to any automatic classification in default, forborne or unlikeness to pay; see, *EBA provides clarity to banks and consumers on the application of the prudential framework in light of Covid-19 measures*, 25 March 2020.

[160] European Commision, *Proposal for a Regulation of the EP and the Council amending Regulations (EU) 575/2013 and (EU) 2019/876 as regards adjustments in response to the Covid-19 pandemic*, COM (2020) 310 final, Brussels, 28.4.2020, and *Commission Interpretative Communication to the EP and the Council on the application of the accounting and prudential frameworks to facilitate EU banking lending,* COM(2020) 169 final, Brussels, 28.4.2020.

The implementation of the Proposals after their foreseable approval next June by the EP and the Council would affect to various Key rules of current banking regulations, such as the relaxation of the IFRS 9, concerning on bank's provisions to afford expected credit loss (ECL), the prudential requirements on the classification of non-performing loans (NPLs), and the postponement of the implementation of the late Basel III framework.

63. The instrumentalization of European banks as drivers of the money supply have been boosted through various decisions of the ECB that temporarily relax the implementation of some criteria on solvency and liquidity. We can first pointing out to the Decision on the valuation haircuts[161]. Through this exceptional tool, the ECB expands the type of loans that banks can use as collateral to attend liquidity actions, making additional valuation hair cuts applied to specific types of marketable assets, and reducing their previous threshold of €25.000 for domestic use of credit claims to a minimum size threshold of € "O".

64. This decision may contribute to the mobilization of a substantial part of the deposits of European banks in the ECB, since at the beginning of April 2020 they amounted to €250.850 billion, which, means that the European banks only lent €6000 billion during the past month of March, despite of the ECB's adoption of the PEPP Program[162].

65. The ECB adopted two decisions subsequently, one regarding to the temporary relief for capital requirements for market risk[163] and the other one regarding to the loosening of collateral rules[164]. Both decisions should preserve the bank's ability to provide market liquidity[165].

V. Final Remarks

66. The current threats to international financial stability largely match with the challenges of the banking business model at a global level: the exponential growth of the so-called "shadow banking" that escapes the scope of supervisors; the decentralization of money and the creation of alternative payment systems through digital currencies, driven by large technology companies; the depletion of financial profitability due to the introduction of the negative interest rates which spur the trading of new typologies of risk assets[166]; etc.

It is estimated that, once in force, these acommodate relief measures would ease lents for almost €30 billion which would be capable of mobilizing resources up to € 450 billion.

[161] Decision (EU) 2020/56 of the ECB of 7 April 2020 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework and guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework (ECB/2020/20).

[162] The total amount of the ECB's stimuli currently reach the figure of €869.175 billion; see, ECB: *Consolidated financial statemet of the Eurosystem*, 3 April 2020.

[163] This decision leads to a reduction of the Qualitative Market Risk Multiplier which is used to compensate for the possible underestimation by banks of their capital requirements for market risks, and responds to the extraordinary levels of volatility recorded in financial markets in the context of the Covid-19 pandemic; see, ECB-Banking Supervision, Press Release, ECB Banking Supervision provides temporary relief for capital requierements for market risk, 16 April 2020.

[164] This decision aim to ensure that banks have assets that they can mobilise as collateral to participate in the liquidity providing operations. Therefore, the elegibility of marketable assets and the issuers of such assets that fulfilled minimum credit quality requirements will be grandfathered: BBB-for all assets, and currently eligible A- as long as they remain at or above BB+. The temporaty grandfathering will last until september 2021; see, ECB, Press Release, ECB takes steps to mitigate impact of possible rating downgrades on collateral availability, 22 April 2020. It would prevent that a possible downgrade of the sovereign debt of any Eurozone State could hamper its use as collateral to grant access of the banks to the ECB liquidity bar. According to the OECD, about $275 bn of non financial corporte bonds culd become "fallen angels" during the whole 2020. This data were published before the Covid-19 crisis; see, OECD: *Corporate Bond Market Trends, Emerging Risks, and Monetary Policy*, 18 February, at 5-7 and 35-47.

[165] The coronavirus crisis has drained the liquidity of Eurozone banks, constrained by the obligation to preserve European regulatory standards. This circumstance did not allow them to efficiently inject into the economy the money of the liquidity bars of the ECB, such as PEPP. The Fed has successfully implemented similar tools, such as accepting the purchase of "Hight Yield"assets; see, Board of Governors of the Fed, *Federal Reserve takes additional actions to provide up to $2.3 trillion in loans to support the economy*, April 9, 2020.

[166] The adverse impact have been stronger for small banks than for large banks because the former have been able to mitigate the negative effect through hedging, lending diversification and by swithching from interest to non-interest oriented business models; see, P. Molyneux, A. Reghezza, R. Xie: "Bank margins and profits in a world of negative rates", 107 Journal of Banking and Finance, 2019, at 16; see, nonetheless, J. A. Lopez, A. K. Rose and M. M. Spiegel: *Why have negative nominal interest rates had such a small effect on bank performance?,* WP 25004, NBER-WPS, Cambridge, MA, September 2018, at 4 and 28-29.

67. On the other hand, the gradual implementation of Basel "IV" rules from 2021 to 2025[167] will hit to the G-SIIs with higher increases of capital requirements[168]. The temporary inapplication of Basel III due to the Covid-19 pandemic, does not question the international consensus of financial regulators on its necessary implementation[169]. Moreover, although public institutions have provided much of the cash, banks have worked as the transmission mechanism to ensure support to households and companies; another proof that the Basel III reforms have left the system strong enough to survive.

68. The banking sector has to tackle all these challenges while is transiting from an almost secular pattern of doing business toward a new one of financial disintermediation.

69. Thus, it's foreseeable that only systemic banks will survive in the new environment. In that oligopolistic context financial earthquakes could be devastating. Banking regulation at a global level is more important than ever before.

70. Nevertheless, a threat of fragmentation is being driven by the current deregulatory trend in the US, and could shift away of international co-operation the shaping of Key standards of the banking framework like capital requirements and solvency ratios.

71. Such nationalist refocusing of banking activity hampers free competition, promotes protectionism and discriminatory practices and does not guarantee financial stability.

72. The European Union has to avoid the contagion risk of this regulatory backlash and must stick to the commitments of the Basel framework. Despite some deficiencies that have already been underlined, the implementation of the banking package guarantees a resilient banking, protects the financial interests of the Member States against bankruptcy situations and contributes to the profitability of the banking business.

73. These achievements are especially valuable in times of economic uncertainty and growing geopolitical tensions as they contribute to financial stability.

[167] See Bis-BCBS: *Sixteenth progress report on adoption of the Basel regulatory framework*, 31 May 2019.

[168] While EU banks would have to run down about €0'8 trillion to meet the capital requirements an increase to 60-80% from the current standards, US banks would be less affected increasing about 1-3% because they already have 100% standardized floor under section 171 of the Dodd-Frank Act; See McKinsey & Company: *Basel "IV: What's next for banks? Implication of intermediate results of new regulatory rules for European banks*, Global Risk Practice, April 2017, at 9-11.

[169] See, *Statement by Christine Lagarde, President of the ECB, at the forty-first meeting of the International Monetary and Finacial Committee*, IMFC, 16 April, specially when the states "(the) current measures imply using the flexibility that is built into the existing framework in order to help the banking sector weather these difficult economic circunstances. We remain committed to fully implementing the Basel standards under the revised timeline. We are by no means back tracking on the progress in the strenghening the regulatory and supervisory framework that has been made since the previous finacial crisis".