

Reinforcing Supranational Bank Regulation, Supervision, Support and Resolution in Europe: Introduction

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A decade on since the outbreak of the worst international financial crisis since the late 1920s, the effective design of EU bank regulation, supervision, support and resolution remains hotly contested, in both academic and policy-making circles. European Banking Union (BU), one of the most important developments in European integration since the Maastricht Treaty and the launch of Monetary Union, still ranks very high on the European Union's reform agenda (see Howarth and Schild 2018; Mayes 2018). Some reform proposals, such as the creation of the European Deposit Insurance Scheme (EDIS), have been placed on the backburner given German government concerns regarding the state of bank balance sheets in some euro area member states — and, specifically, bank holdings of nonperforming loans — and that incentives for future risk-taking have not been sufficiently reduced (Howarth and Quaglia 2018). Other reforms affecting all EU member states have met the determined opposition of a number of national governments and powerful bank interests, including the Commission's proposal for a regulation on Bank Structural Reform (BSR), which was dropped by the Commission in late 2017. However, there are also a range of other legislative and institutional

reforms designed to reinforce EU bank regulation and supervision which have either been proposed and / or adopted. The main objectives of these reforms are to make banking safer—and specifically to diminish the systemic effects of losses resulting from high risk bank activities — and to reinforce the ability of supervisory authorities to monitor effectively bank activity.

The first two articles of this special issue deal with regulatory issues (Andrés, Reig and Vallelado on bankers' remunerations and Endrejat and Thiemann on bank structural reform), the next three articles look at supervisory issues and shift the attention from grand debates on institutional design to concrete questions of the day-to-day working of the new system of supervision and consultation — Gren on two-level supervision in the SSM, Salter on the European Banking Authority, and Lettanie on the ECB's consultations as prudential regulator. The sixth article of this special edition focuses upon European level financing of bank resolution and specifically the debate over the creation of a common financial backstop for the Single Resolution Fund (SRF).

The European regulation of bank executive compensation, a highly visible and prominent item on the EU's reform agenda in the aftermath of the international financial crisis, provides us with an interesting example of the unintended consequences of these reforms. In their contribution on European bank's executive remuneration under the new EU regulation, Pablo de Andrés, Rodrigo Reig and Eleuterio Vallelado, point to the possible negative impact of this attempt to reduce the risk-taking incentives of paying out very high bonuses. The reform might lead to an adverse risk selection as the best-performing managers might leave EU banks and work in jurisdictions without limits to variable pay. A strong increase in the share of fixed to total remuneration changes the incentive structure, the worst performing managers being attracted by banks working under a regulatory framework that leads to high fixed

remunerations. The bonus cap introduced by this reform indeed increased the share of fixed compared to overall remuneration in EU member states, but least so in the UK where the overwhelming majority of high earners are currently located. And as it is likely that UK banks will not be affected by this reform once the UK has left the EU and lifted the bonus cap, the unintended (and unforeseeable) consequence of this reform might be to help the UK to attract the best managers to the disadvantage of the EU's banks and their long-run performance.

Endrejat's and Thiemann's contribution to this special issue examines how the European Commission watered down its own proposal for Bank Structural Reform (BSR). The initial proposal aimed at making banks more resilient and facilitating their resolvability through the separation of riskier trading activities from deposit-taking. The Commission framed the BSR as a balancing act between financial system stability on the one hand and market liquidity and growth on the other hand. Shifting its emphasis increasingly towards growth in order to bolster flagging support for the reform, the Commission finally dropped its proposed regulation altogether in October 2017. Focusing on the European Commission's regulatory discourse, Endrejat and Thiemann retrace the Commission's discursive framing of structural reform in terms of the benefits of market making, liquidity and growth in the context of a supposed stability-growth trade off. The authors argue that this Commission effort to get the balance right undermined progress on the draft legislation (Endrejat and Thiemann, this issue).

Contributions three and four to this special issue focus upon the problematic operation of the EU's two supranational supervisory bodies — the ECB and the EBA — arguing the need for further reform. In his contribution, Jakub Gren looks at the co-existence of the ECB direct supervision for large and systemically important banks (currently 119) and its indirect supervision of small and medium-sized banks via its oversight of the national supervisors'

legwork. He analyzes the dynamic relations between the ECB and national competent authorities (NCAs) in banking supervision in terms of a principal-agent relationship. First, he looks at potential agency problems in this multi-level and decentralized setting of the ECB's indirect supervisory competence. Then he goes on to identify six *ex ante* and *ex post* control and accountability mechanisms at the ECB's disposal thanks to the SSM supervisory legal framework. These mechanisms allow the ECB to steer and monitor the NCAs' exercise of their supervisory tasks. Gren's analysis shows that the *ex ante* controls are more prominent than the *ex post* controls such as staff relocation or direct takeover of supervision by the ECB since the latter would enter into legally and politically highly sensitive areas. However, the asymmetry between ECB supervisory apparatus (the principal) responsible for the oversight and the NCA supervisory apparatus (the agent) responsible for actual supervision of small and medium-sized banks together with the soft, legally non-binding nature of the ECB's formulation of policy expectations on key areas of the NCA's prudential supervision casts some doubt as to the ultimate robustness of the current two-level and multi-actor system of ECB indirect supervision. Gren argues that the ECB is in a relatively weaker position in relation to the NCAs and may not always be able to guarantee their coherent and effective implementation of prudential supervision (Gren, this issue). Hence, he suggests a strengthening of the ECB's position in relation to the NCAs in future Banking Union reforms and points to some concrete reform options as to how this might be achieved.

John-Paul Salter (this issue) looks at the complex accountability structure surrounding the European Banking Authority (EBA), taking into account both formal-legal accountability to political principals as well as more fluid and more contingent forms of accountability to peers. Are these forms of accountability complementary or constraining of the EBA's autonomy? According to Salter, the EBA is accountable to four sets of stakeholders: EU institutions, its

fellow European supervisory authorities (the European Securities and Markets Authority and the European Investments and Occupational Pensions Authority), national competent authorities (NCAs) and market actors. The formal links to the legislative arena and the EBA's resource dependency on the NCAs create stronger EBA relations to these two types of actors compared to those with its fellow supervisory authorities and market actors. It is, above all, its resource dependency on the NCAs that limits the EBA's operational autonomy. This makes the maintenance of national specificities in regulatory regimes and supervisory practices more likely and suggests the need for reforms to the EBA's accountability structure in order to reinforce the harmonization of supervisory standards in the EU.

In the fifth contribution to this special issue, Ute Lettanie looks at the manner in which the ECB fulfils its legal obligations enshrined in the SSM regulation to organize public consultations in cases where it makes use of its limited regulatory powers when acting as a prudential regulator. Lettanie asks whether the ECB gains in terms of legitimacy thanks to the openness, transparency, inclusiveness, efficacy and judicial accountability of its practice of consultation. She identifies the lack of feedback given by the ECB to those who participate in the ECB's consultation procedure, the low participation rate beyond the group of actors from the regulated sector and the weak judicial review as constituting the 'Achilles' heel' of the ECB's consultation practice (Lettanie, this issue). Whereas she finds the openness and transparency standards to have been met, the judicial review *ex post* is still vague (Lettanie, this issue) and the inclusiveness criterion is hardly fulfilled. The latter comes as no surprise as well-organized sectoral interest groups are overrepresented, as to be expected in terms of Mancur Olson's logic of collective action. Overall, improving throughput legitimacy of the ECB's practice as a regulator turns out to be the crucial but complex challenge. The author identifies several mechanisms as to how to meet this challenge.

The sixth article of this special edition focuses upon European level financing of bank resolution and specifically the debate over the creation of a common financial backstop for the Single Resolution Fund (SRF). Brandt and Wohlfahrt identify four main principles in statements by national ministers of finance which must be respected in the design of a future backstop in order to ensure a sufficiently large coalition of support among member state governments. These principles include fiscal neutrality in the medium term; that the backstop be an instrument of last resort in order to minimize any recourse to public funds; the equivalent treatment across all BU member states; and the assurance that no costs will occur for non-Banking Union Member States. The authors argue that taking these principles into account significantly restricts the possible designs and available providers of a future common backstop.

Overall, these papers provide us with a number of valuable new insights with regard to the unintended consequences of accomplished reforms (banker's remuneration) and provide a telling example of a failed reform attempt in the case of bank structural reform. Curiously enough, the agenda setter, the Commission — according to Endrejat and Thiemann — reevaluated its own policy proposal once the worst challenges to the stability of the banking system appeared to be in the past and dropped its own policy proposal. Hence, business as usual prevails in terms of bank structures despite the worst international financial crisis since the late 1920s.

The articles in this special issue on the operation of the EU's two supranational bank supervisors and the article on the ECB's consultation practice are representative of the changing research agenda on EU bank regulation and supervision in light of the empirical

evidence that can be gathered despite the recent creation of the EBA and launch of the SSM. It is not surprising that the early operation of both the EBA and the ECB's bank regulatory and supervisory roles has highlighted a number of practical problems and thorny existential questions. All three contributions to this special issue that examine the EBA and ECB thus suggest proposals for further reform. Finally, the article by Brandt and Wohlfahrt points to the political difficulties inherent in the designing of a common financial backstop to the SRF. Policy evaluation, policy learning and reflections on a new cycle of reforms have already begun. This provides us with stimulating questions for future research on EU bank regulation, supervision support and resolution and, more specifically, on the design and operation of Banking Union. By shedding light on a number of difficult issues facing these topics, this special issue seeks to provide a contribution that is helpful to both academics and policy makers.

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