POST CRISIS MANDATES FOR CENTRAL BANKS: REGULATORY AND INSTITUTIONAL CHALLENGES

Banking Structural Reform – an EU post crisis regulatory initiative

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All views expressed are those of the author and do not necessarily represent the opinions of and should not be attributed to the National Bank of Romania.

1. EU financial sector prior to the crisis

- Strong development of cross-border banking groups
- High capital inflows in Eastern Europe
- Very profitable trading activities in developed markets
- Rapid expansion in shadow banking sector
- Low volatility on financial markets
- Strong financial innovation
- Broad usage of external credit ratings

2. Regulatory caveats brought at surface by the crisis

- Cross border banking groups vs. local supervision
- Home – host issues
- Regulatory arbitrage
- Pro-cyclical bank capital requirements
- Financial stability not at the center of financial regulation framework
- No robust bank resolution framework
- Lax or no regulation for shadow banking sector
- Conflict of interest in rating assessments

3. EU post crisis regulatory initiatives. A change of paradigm?

- Amendments to the Directive on Deposit Guarantee Schemes
- Amendments to the Capital Requirements Directive
- Regulation of credit rating agencies
- Regulation of alternative investment funds (hedge funds)
- EMIR
- MiFID
- Banking Union
- **Banking Structural Reform (BSR)**

3. EU post crisis regulatory initiatives. A change of paradigm?

- Much more emphasize on financial stability
- Higher financial integration within EU (move the focus from entity to group supervision)
- Single Supervisory Mechanism paves the way for less micro-prudential supervision and more macro-prudential supervision at local level
- Longer term perspective embedded in financial regulation (less pro-cyclicality)

4. Banking Structural Reform

Objectives:

- Cut the direct link between trading and bank deposits
- Prevent systemic crisis/ Enhance financial stability
- Safe public funds
- Facilitates resolution of systemically important institutions

Scope:

- EU banks assessed as global systemically important institutions
- Any bank/banking group that for a period of 3 consecutive years has total assets ≥ EUR 30 billion and trading activities ≥ EUR 70 billion or 10 per cent of its total assets

4. Banking Structural Reform

Measures:

- Prohibition of proprietary trading (starting with January 2017)

  Derogation: EU government securities, securities issued by international financial institutions (IMF, EBRD, IBRD, EIB), cash management

- Potential separation of certain trading activities (market making, lending to venture capital and private equity funds, sales and trading of derivatives etc.) (starting with July 2018)

  Decision: competent authorities, following a comprehensive risk assessment

4. Banking Structural Reform

Regulatory challenges:

- No regulatory arbitrage within EU, but risk of regulatory arbitrage with other jurisdictions (globalization)
- EU Commission discretion (possible conflict with Treaty of European Union)
- Both micro and macro approach
- Correlation with other EU regulations (BRRD, DGS, MiFID, EMIR, CRD IV, SSM)
- Possible negative impact on financial markets liquidity

4. Banking Structural Reform

Institutional challenges:

- Home-host cooperation (joint decision or consultation/ consolidating supervisor has the leading role)

  Smaller countries ask for joint decision between home and host supervisors in case of significant banks to preserve local financial stability

- Banking Union (one single supervisor)
- Macro-prudential authority
- Resolution authority

5. BSR implications for Romanian banking sector

- 5 G-SIIs are present in Romania (based on BIS list published in November 2013)
- No Romanian bank holds assets amounting at least EUR 30 billion;
- Over 80% of banking sector owned by foreign institutions → a few other banks may enter under the scope of regulation if the banking groups fulfill the regulation criteria
- Proprietary trading activity in Romania is dominated by government securities

5. BSR implications for Romanian banking sector

- Low direct benefits for financial stability

    Low proprietary trading activity

    Low other trading activities, either

    Possibility for proprietary trading to migrate to small banks that do not fall under the scope of BSR regulation; still the competent authorities may decide to apply the proprietary trading ban to other banks

- High indirect benefits for financial stability

    Local banking sector sensitive to external developments

    BSR enhances the robustness of EU banking sector and diminishes the negative consequences of cross-border spill-overs

Thank you very much for your attention!

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