Global Counsel

The decline and fall of regulatory empire-building

Blog post by Adviser Tom White, 01 December 2016

Global Counsel hosted an interesting seminar with Nicolas Véron of Bruegel recently about the future of international standards for financial regulation. This assessed the EU's appetite for designing its rulebook to be attractive for other jurisdictions, and more specifically whether this might help the UK agree some form of 'super-equivalence' that could provide regulators with confidence to allow continued cross-border trade. Yesterday's failure in Santiago to agree global standards for capital requirements highlighted one of our reasons for scepticism: that EU interest in global standards has weakened considerably since the high point of promoting Solvency II for insurers in 2012. With the incoming US administration promising more 'competitive' regulation of the financial sector by amending the post-crisis Dodd-Frank legislation and showing little interest in maintaining the G20 as a policy-making forum, and with carve outs for large Asian markets from FSB standards, it is worth considering why the largest players have retired from the competition to set universal standards.

The main cause is that policy priorities since the crisis have been stress-testing, risk identification and resolution planning, rather than enabling growth of the sector. This is partly a cultural consequence of central banks taking responsibility for supervision, and partly a consequence of banks themselves focussing on domestic markets as they cut costs. A further cause is that politicians have only been able to defend the exceptional taxpayer support for individual banks based on their provision of capital and liquidity to non-financial businesses, primarily domestic business customers. The original motivations for securing extra-territorial adoption of EU standards - preventing regulatory arbitrage and securing financial services export opportunities – are therefore much weaker, as banks have retreated from internationalisation. There is also a question of the EU's self-confidence and credibility as a successful shaper of financial markets, with continued evidence of bank weakness in the largest Member States.

The most obvious short-term consequence will be institutional, with the Financial Stability Board (FSB), the Basel Committee and even the G20 starting to question what their role should be in future. They may move further in the direction of fairly bland sharing of best practice, or stretch their mandate into other areas where demand for global action is greater, such as climate change. In the medium term, advocates of liberalisation in international financial services trade – such as Switzerland, the UK or Japan – will find the absence of common standards a barrier to their exporting ambitions and an opportunity cost of being unable to introduce effective group-level supervision. Finally, in the longer term it may also serve to slow down some of the expected technology-driven structural transformation of the sector, with tech start-ups finding it harder to exploit their profitable niches at a global scale and consequently struggling to justify some of their high valuations.

One of the policy questions for Brussels and Frankfurt as they look to consolidate Banking Union, and inject life into Capital Markets Union, is therefore how to secure some control and understanding of how the largest international institutions are regulated outside their immediate jurisdiction, if we indeed see a reversion to the old WTO GATS norms of subsidiarisation, regulatory divergence and very limited cross-border service provision. They will also want to identify where scale and common standards within the EU27 can be harnessed to deliver gains in productivity and innovation. The decisions by the Commission in November to simultaneously launch a review of equivalence and create a fintech task mean there will be important choices for politicians about the balance between control and opportunity in this next phase. They will almost certainly not restart the ‘empire building’ the EU aspired to in the early 2000s, but should present politicians with options for economic opportunities.