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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

# New Course in U.S. Banking Regulation will Have Consequences for Europe

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Jan Krahenen: A withdrawal from a stability-oriented policy in the U.S. would endanger the regulatory debate in the EU



The re-assessment of the regulatory reform impetus, that we saw in the aftermath of the financial crisis, is currently a hot topic. Not only in the U.S. but also in Europe there are calls for thorough impact analyses. Which consequences has the new regulation on an insolvency law for banks (BRRD) for consumers, companies and savers? Which effect have these reforms on financial stability?

If there is one big lesson from the years after the crisis, then it is the following: Every regulation has to be assessed with respect to their implementation, the detail work that is usually heavily influenced by lobby groups. The sharp change of direction that can be interpreted from the U.S. Financial CHOICE Act and, in

parts, also from the Mnuchin report announces a policy change in banking supervision away from stability orientation towards growth and risk orientation.

This change of direction will not necessarily be of disadvantage for the U.S. Here, the big financial institutions are positioned in an oligopolistic market structure, very profitable and endowed with high equity and subordinated debt ratios. In addition, the important role of the Federal Reserve Systems as central supervisory and rescue authority in case of a crisis leads to a firm and consequent supervisory policy. Bank lenders can well guess how the regulator will act in a crisis situation, and they can adapt to and rely on a strict policy before a crisis and a lenient attitude during a crisis.

However, the new policy in the U.S. can have consequences for Europe where the situation is quite different. On average, banks are less profitable here and their capital base – equity and subordinated debt – is comparably weak. Supervisory and liability competences fall apart: Although large institutions are centrally supervised by the SSM, national competencies still play a role in case of a crisis. This leads to tensions that leave their mark on the work of the national authorities – even if they work closely with the SSM. If European politicians follow the call e.g. of the Financial CHOICE Act and reduce the importance of the newly established supervisory and resolution mechanisms SSM and SRM without, at the same time, increasing capital requirements, immense stability risks in Europe would have to be expected.

Therefore, a new course in the U.S. regulatory policy will have more severe consequences for Europe than for the United States. This is also because one can expect the U.S. to cut back their interest in international standards in financial regulation as well as their engagement in the Basel Committee. This will result, sooner or later, in a weakening of the stability orientation in EU banking regulation. National authorities in Europe will certainly greet less pressure from the U.S. towards a higher capital base in order to strengthen their own “national champions”. For the entire system this is bad news.

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