A Note on the Differences between European and International Methodologies of Banking Regulation and Supervision

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Abstract

Although monetary policy is the main tool for central banking in order to control inflation/deflation, micro- and macroprudential instruments are also essential for crisis management. In this paper, we aim to clarify the differences between European and international banking methodologies. The European approach as represented by the European Banking Union, is based on a harder legalistic approach, whereas the international approach implemented by the Basel Committee on Banking Supervision has a *soft-law* methodology. We propose two comparative standpoints: "uniformity" versus "diversity", and a "legislative" versus "principle-based" approach.

Keywords: *European Banking Union (EBU), banking regulation and supervision, Basel Committee on Banking Supervision (BCBS)*

JEL Code: E58 (Central Banks and Their Policies), F36 (Financial Aspects of Economic Integration), G28 (Financial Institutions and Services: Government Policy and Regulation)

1. Introduction: The Structural Background

This paper explores the varied experiences in Europe in harmonising banking regulations and supervision. Given the diverse banking systems and regulatory regimes, this is no easy task. The regulatory systems of the nation states in the European Union are differentiated. The European Banking Union (EBU)[1] is the centrepiece in the harmonisation of banking supervision in the Eurozone, in which the EBU has implemented two-thirds of its pillars.

[1] The first proposal on the EBU was unveiled by President of the European Council on 26 June 2012, getting towards a Genuine EMU (Economic and Monetary Union). European Council (The President). (2012). *Towards a Genuine Economic and Monetary Union, Reported by President of the European Council, Herman Van Rompuy*, Brussels 26 June 2012, EUCO 120/12, PRESSE 296, PR PCE 102.

After the inauguration of the 2012 Banking Union project[2], the Single Supervisory Mechanism (SSM) was established in November 2014[3] and has, since then, accumulated experience over 9 years. One purpose of the SSM is to avert fragmentation of the supervisory methods in the Eurozone. The SSM aims to prepare countermeasures for financial crises in advance. The Supervisory Review and Evaluation Process (SREP)[4] shows how far supervisory methods differ among the 20 Eurozone countries' actual supervisory operations.

In contrast to the SSM, the Single Resolution Mechanism (SRM)[5] takes a fundamentally *ex-post* approach coping with failing banks through efficient and orderly resolution during a crisis. The SRM seeks to harmonize methodologies among member states for tackling plausible future financial crises, with an effective blueprint of recovery and resolution planning. The SRM was launched in January 2015 and became a full-fledged system since January 2016. The SRM is headquartered in Brussels, not Frankfurt.

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[2] The European Commission's communication on 12 September 2012 discussed planning the project from then onwards. European Commission. (2012). *Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union*, Brussels, 12.9.2012, COM (2012) 510 final. Especially, the EBU has been put in place to assure the unity of European single market. *Ibid.*, p. 4.
[3] European Union. (2013). Council Regulation (EU) No 1024/2013 of 15 October 2013, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, *Official Journal of the European Union*, L 287, 29.10.2013. As for relation between the ECB and the National Competent Authorities (NCAs), SSM Framework Regulation was stipulated in April 2014. European Union. (2014). Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014, establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation), ECB/2014/17, L 141, *Official Journal of the European Union*, 14.5.2014.
[4] Regarding the SREP, the recent publication in January 2021 is informative. European Central Bank/Banking Supervision. (2021). "ECB asks banks to address credit risk and improve efficiency", *Press Release*, 28 January. In 2020, the ECB assessed four factors: (1) credit risk, (2) internal governance, (3) business model, and (4) capital adequacy. The 2021 priorities of the SREP were as follows: (1) credit risk, (2) capital strength, (3) business model sustainability, and (4) governance.
[5] European Union. (2014). Regulation (EU) No 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) No 1093/2010, *Official Journal of the European Union*, L 225, 30.7.2014.

The harmonisation of deposit guarantee schemes (DGSs)[6] in the Eurozone, called the European Deposit Insurance Scheme (EDIS)[7], remains under discussion[8], but is the last pillar of the EBU to be completed. The EDIS faces strong opposition from Germany, especially from the Deutsche Bundesbank[9]. However, to complete the EBU, the EDIS must be implemented, to strengthen the legislative framework of EBU.

In an international context, the Basel Committee on Banking Supervision (BCBS) has coordinated international banking activities; since its establishment in December 1974, the BCBS has provided regular meetings of the G10 plus Switzerland and an international Conference of Banking Supervisors (ICBS), open to countries throughout the world[10]. After the global financial crisis (GFC) in 2008, the Financial Stability Board (FSB) was strengthened by the promulgation of the Financial Stability Forum (FSF). The FSB can deal with cross-cutting issues beyond the sector of finance, namely, banking, investments (securities), and insurance. Internationally recognized institutions, such as the BCBS and FSB, supply essential resources for authoritative and academic international communication about cross-border banking regulations and supervision.

There are many, perhaps for some too many, acronyms in this field, so a listing of them follows (**Table 1**):-

[6] European Union. (2014). Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast), Text with EEA relevance, L 173, *Official Journal of the European Union*, 12.6.2014.

[7] European Commission. (2015). *Proposal for a Regulation of the European Parliament and of the Council, amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme*, Strasbourg, 24.11.2015, COM (2015) 586 final, 2015/0270 (COD).

[8] The European Commission published a review of the EDIS discourse, focusing on 22 national options and discretions (NODs). European Commission. (2019). *Options and national discretions under the Deposit Guarantee Scheme Directive and their treatment in the context of a European Deposit Insurance Scheme: Final Report*, A study prepared by CEPS in collaboration with Milieu Consulting SPRL for the European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, November.

[9] The Bundesbank insisted on prerequisites such as de-risking in the banking sector and harmonisation of individual solvency laws as well as the implementation of the BRRD (Bank Recovery and Resolution Directive). Deutsche Bundesbank. (2015). 'Deposit protection in Germany', *Monthly Report*, December.

[10] For a further detailed exploration of this issue, see Sato, H. (2023). "The Bank of England and the UK Banking Supervision from the Mid-1970s to the Early 1980s: The Relationship between the UK's and Basel's Methodologies", in Mastin, J.-L. and Touchelay, B. (eds.) *Des Banques sous Surveillance? Pour une histoire du contrôle bancaire depuis le XIXe siècle*, Presses universitaires du Septentrion.

Table 1: Acronyms

Acronym	Nomenclature
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CMU	Capital Markets Union
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DGS	Deposit Guarantee Scheme
DI	Differentiated Integration
EBA	European Banking Authority
EBU	European Banking Union
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EEC	European Economic Community
EIOPA	European Insurance and Occupational Pensions Authority
EMU	Economic and Monetary Union
ESAs	European Supervisory Authorities
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board
FSF	Financial Stability Forum
FU	Financial Union
G10	Group of Ten
G20	Group of Twenty
GFC	Global Financial Crisis
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
ICBS	International Conference of Banking Supervisors
IFD	Investment Firms Directive
IOSCO	International Organization of Securities Commissions
Kas	Key Attributes of Effective Resolution Regimes for Financial Institutions
MREL	Minimum requirement for own funds and eligible liabilities
NCAs	National Competent Authorities
NCBs	National Central Banks
NPLs	Non-performing loans
PEPP	Pandemic Emergency Purchase Programme
RRF	Recovery and Resilience Facility
Sis	Significant institutions

SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SREP	Supervisory review and evaluation process
SSM	Single Supervisory Mechanism
TLAC	Total loss-absorbing capacity

2. Research Framework

Research Methodology and Contribution

This paper makes two points on the methodology of research. First, it notes how the integration of financial regulation and supervision is *per se* difficult because of the members states' financial diversity. With different financial institutions, financial markets, and political structures being diversified it becomes harder to harmonise the prudential policies, distinctly different from the current integration of the European monetary framework after 1999. Secondly, we provide comparative analysis between European integration and international harmonisation. We contrast European uniformity with the much larger number of member states within an international institution such as the BCBS. However, these two categories are interactive, noting that the initial establishment of the BCBS in December 1974 stemmed from a European group. This research motivation aims to explore the interplay between European and international methodologies on banking regulation and supervision.

Literature Survey

Several publications cast light on the harmonisation of banking supervision. Ferran and Babis (2013) analyse the legal aspect of the SSM and explore the role of the EBA with regard to maximum harmonisation"[11]. Faia, Hackethal, Haliassos and Langenbucher (2015) provide a myriad of "-provoking viewpoints[12]. Krahnen and Moretti (2015) detail various types of 'market-friendly' bail-ins[13]. Tröger (2015) discusses how the SSM focused on the relationships between the ECB and NCAs

[11] Ferran, E. and Babis, V.S.G., 2013. "The European Single Supervisory Mechanism", *Journal of Corporate Law Studies*, 13:2, 255-285.
[12] Faia, E., Hackethal, A., Haliassos, M. and Langenbucher, K. eds. (2015). *Financial Regulation: A Transatlantic Perspective*, Cambridge University Press.
[13] Krahnen, J.P. and Moretti, L. (2015). 'Bail-in clauses' in Faia, E., Hackethal, A., Haliassos, M. and Langenbucher, K. eds. *op. cit*.

(National Competent Authorities)[14]. Goodhart (2000) describes the originally differentiated supervisory structure of the NCBs (National Central Banks) from country to country earlier than the proposal of the EBU[15]. Busch and Ferrarini (2015, 2020) explore the legal aspect of the EBU, including an insightful combination of "Single Supervision and Capital Requirements Directive (CRD) IV," "Single Resolution and the Bank Recovery and Resolution Directive," as well "MREL (Minimum Requirement for own funds and Eligible Liabilities) and TLAC (Total Loss-Absorbing Capacity)" from the UK perspective[16]. Regarding the EMU (Economic and Monetary Union), Amtenbrink and Herrmann (2020) compile a number of articles on EU law[17]. Delimatsis and Herger (2011) discuss a collection of papers analysing the response to financial crises[18]. Hüpkes (2011) reviews critical points in effective crisis management[19]. Krahnen and Schmidt (2004) describe the German financial structure, which is still critical on the completion of European harmonisation in this field and, namely, the EBU[20]. Fischer and Pfeil (2004) focus on German banking regulations, including the historical path of the deposit guarantee scheme, considering how to reach agreement on the EDIS[21]. Beck (2012) expands the EBU's ideas on a multitude of relevant issues[22]. Beck and Casu (2016) cover multifaceted aspects of European banking, based on individual member states' banking systems[23]. Carletti and Leonello (2016) describe the regulatory and supervisory reforms including capital requirements and liquidity requirements[24]. Hanada (2021) discusses the non-Eurozone member states which could involve an opt-in (or reluctant) strategy for joining the EBU through the lens of Differentiated Integration (DI)[25]. Howarth and Quaglia (2020) present an informative discourse on the feasibility for the

[14] Tröger, T.H. (2015). 'A political economy perspective on common supervision in the Eurozone' in Faia, E., Hackethal, A., Haliassos, M. and Langenbucher, K. eds. *op. cit*.
[15] Goodhart, C. ed. (2000). *Which Lender of Last Resort for Europe?* A collection of papers from the Financial Markets Group of the London School of Economics, Central Banking Publications.
[16] Busch, D. and Ferrarini, G. eds. (2015, 2020). *European Banking Union: First Edition and Second Edition*, Oxford University Press.
[17] Amtenbrink, F. and Herrmann, C. eds. assisted by Repasi, R. (2020). *The EU Law of Economic and Monetary Union*, Oxford University Press.
[18] Delimatsis, P. and Herger, N. eds. (2011). *Financial Regulation at the Crossroads: Implications for Supervision, Institutional Design and Trade*, Wolters Kluwer.
[19] Hüpkes, E. (2011). "How to Deal with Global Financial Institutions in Crisis', in Delimatsis, P. and Herger, N. eds. *op. cit.*
[20] Krahnen, J.P. and Schmidt, R.H. eds. (2004). *The German Financial System*, Oxford University Press.
[21] Fischer, K.-H. and Pfeil, C. (2004). "Regulation and Competition in German Banking: An Assessment", in Krahnen, J.P. and Schmidt, R.H. eds. *op. cit.*
[22] Beck, T. ed. (2012). *Banking Union for Europe: Risks and Challenges*, Centre for Economic Policy Research.
[23] Beck, T. and Casu, B. eds. (2016). *The Palgrave Handbook of European Banking*, Palgrave Macmillan.
[24] Carletti, E. and Leonello, A. (2016). "Regulatory Reforms in the European Banking Sector", in Beck, T. and Casu, B. eds. *op.cit.*
[25] Hanada, E. (2021). "Differentiated Integration: The case of the European Banking Union," *Australian and New Zealand Journal of European Studies*, Vol. 13 (3).

harmonisation of the Deposit Guarantee Scheme (DGS)[26], following an analysis of German reluctance related to moral hazard, legal challenge and the Sparkassen (Howarth and Quaglia 2014)[27].

Reviewing international cooperation on banking supervision, Goodhart (2011) elaborated on the historical path of the BCBS by citing informative archival records from 1974 to 1997[28]. Capie (2010) delineated the trajectory of banking legislation as related to the Banking Act 1979 regarding UK banking supervision[29]. In the context of European and international perspectives on prudential policies, Kapstein (1974, 2008) provided a comprehensive overview of international cooperation for central banks' supervision[30]. In a recent study Schenk (2020) discusses "the changes in regulation and the geographic pattern of international banking activity" and focusses on the period from 1975 to 1990[31].

3. Current Status of European Banking Supervision

A discourse on the difference between supervision and regulation

Capie (2016) noted as follows: "There is a difference between supervision and regulation. The first implies some overseeing and possibly some suggestion of appropriate behaviour. The second carries the clear implication of policing and disciplining and would have to carry the threat of penalty to be effective."[32] The European banking prudential field can be divided into two bodies: the ECB's SSM as banking supervisor and the European Banking Authority (EBA) as banking regulator. **Figure 1** shows

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[26] Howarth, D. and Quaglia, L. (2020). "The difficult construction of a European Deposit Insurance Scheme: a step too far in Banking Union?" in Howarth, G. and Schild, J. eds. *The Difficult Construction of European Banking Union,* Routledge.

[27] Howarth, D. and Quaglia, L. (2014). "The Steep Road to European Banking Union: Constructing the Single Resolution Mechanism", *Journal of Common Market Studies*, Vol. 52, Annual Review.

[28] Goodhart, C.A.E. (2011). *The Basel Committee on Banking Supervision: A History of the Early Years 1974 - 1997*, Cambridge University Press.

[29] Capie, F. (2010). *The Bank of England: 1950s to 1979*, Cambridge University Press.

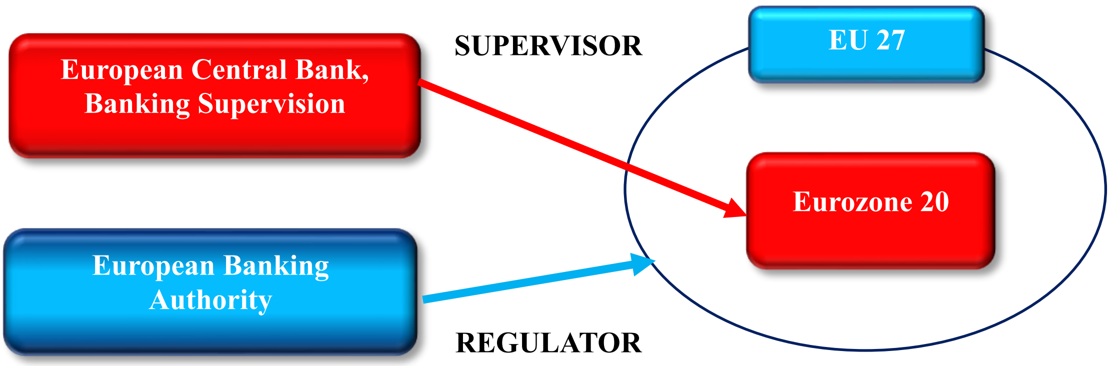
[30] Kapstein, E.B. (1994). *Governing the Global Economy: International Finance and the State*, Harvard University Press, Kapstein, E. B. (2008). "Architects of Stability? International Cooperation among Financial Supervisors", in Borio, C., Toniolo, G., and Clement, P. eds. *Past and Future of Central Bank Cooperation*, Cambridge University Press.

[31] Schenk, C. R. (2020). "Regulatory foundations of financialization: May Day, Big Bang and international banking, 1975-1990", *Financial History Review*, 27. 3, Cambridge University Press on behalf of the European Association for Banking and Financial History.

[32] Capie, F. (2016). "Central Banking", in Cassis, Y., Grossman, R.S., and Schenk, C. R. eds. *The Oxford Handbook of Banking and Financial History*, Oxford University Press, p. 356.

these two bodies' differences in their respective roles and targets. The ECB plays a pivotal role in directly supervising significant institutions (SIs) in the Eurozone and Bulgaria, together with the national competent authorities. As of 1st of November, 2023, the ECB has reportedly supervised 113 SIs (ECB 2023)[33]. The EBA is an important regulatory institution and one of the European Supervisory Authorities (ESAs) as proposed in the *de Larosière Report*, as is subsequently discussed. The essential responsibility of the EBA is to establish a single rulebook and set up numerous regulatory technical standards for banking supervision, resolution, and DGSs.

Figure 1: Supervisor vs. regulator: EU's classification and targets



Source: Author.

The de Larosière Report for All EU Member States

After the GFC, European experts promptly published a report in response to the crisis. In February 2009, *de Larosière Report* proposed a trans-European supervisory mechanism for banking, securities, and insurance[34]. The ESAs consist of the EBA, The European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). These three bodies make up the European System of Financial Supervision (ESFS) from the perspective of microprudence. The ESFS embraces the European Systemic Risk Board (ESRB), which mandates macroprudence across the European Union. The EBA's headquarters was moved from London to Paris because the UK left the EU in 2020. The EBA operates the single rulebook for professionality,

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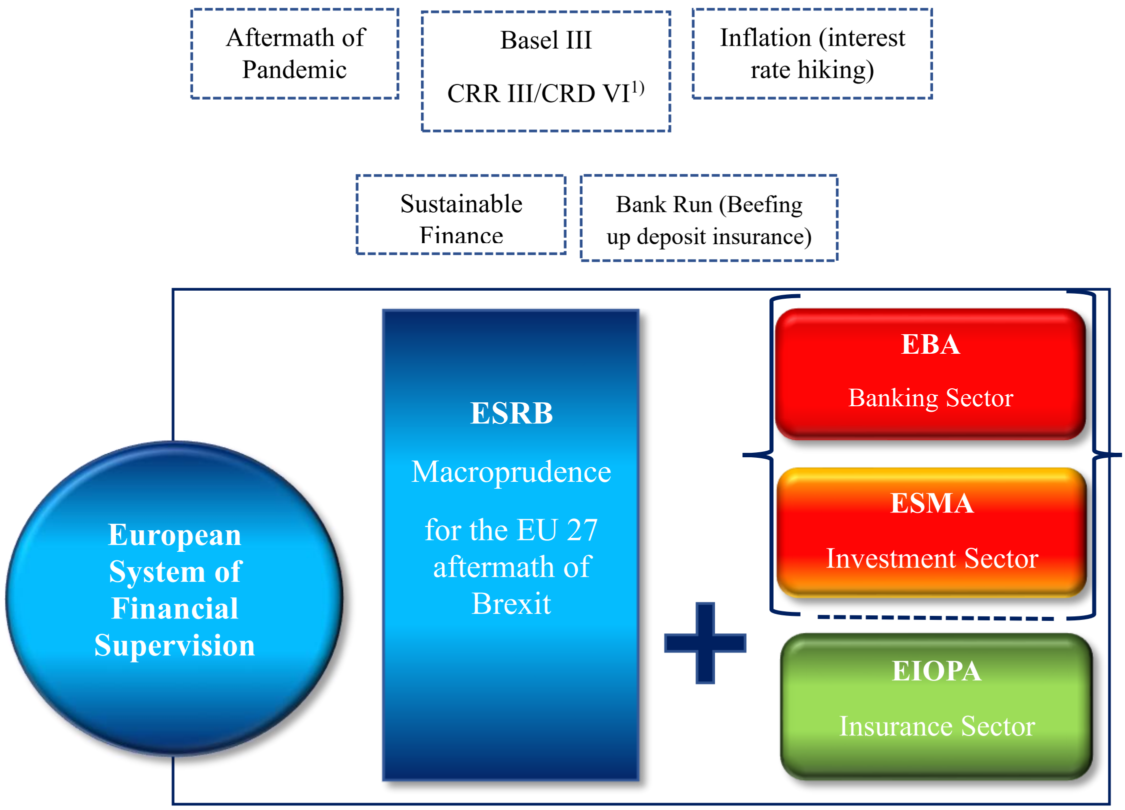
[33] European Central Bank/Banking Supervision. (2023). *List of supervised entities*, Cut-off date for changes in group structures, 1 November 2023.
[34] The High-Level Group on Financial Supervision in the EU (The de Larosière Group). (2009). *Report*, Brussels, 25 February.

which is the foundation of supervision, resolution, and deposit insurance. **Figure 2** outlines the ESFS, where ESFS = ESRB + ESAs.

Cooperation between the EBA and EBU is, and will be, vital in achieving both Capital Markets Union (CMU) and EBU. Financial Union (FU) is central to the EMU's progress in the 2020s, where FU = EBU+ CMU.

Figure 2: Macro- and microprudential EU policies: ***Risk Reduction and Risk Sharing***



Source: Author.

Note: 1) The CRR III/CRD VI were proposed on 27th of October 2021 related with the Basel III's implementation.

In the field of banking supervision, striking the right balance between risk reduction and risk sharing is necessary[35]. In terms of risk reduction, the SSM plays a crucial role in checking significant individual institutions and managing a reduction in non-performing loans (NPLs).

In contrast, the SRM is focused on risk sharing related to bank resolutions. A resolution usually involves an *ex-post* approach, even though respective banks' recovery and resolution plans are hammered out in advance. How to resolve failed and failing banks in an orderly manner has become ever more important after the experience of the GFC, and the role of the Single Resolution Board (SRB), whose headquarters is located in Brussels, is increasingly indispensable.

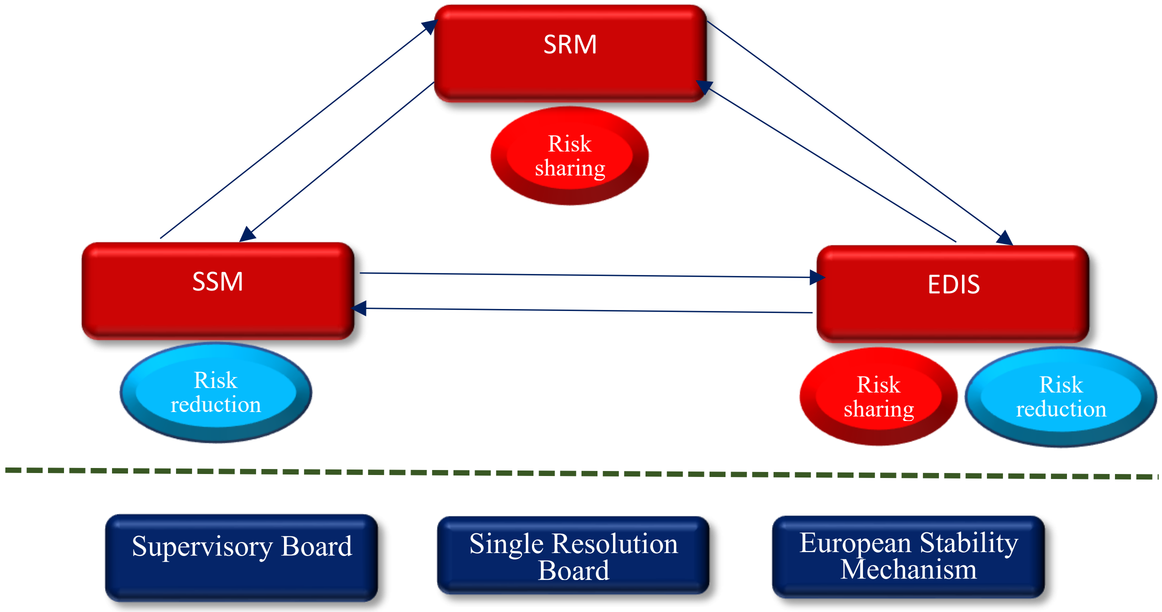
The EDIS remains under construction, which the EBU needs to complete and launch in order to integrate the member states' DGSs. Currently national DGS schemes are diversified among the member states, especially the German deposit protection scheme[36]. The DGS is *per se* an essential instrument – an essential safety net – to cover consumer deposits, reflecting the risk sharing in the Eurozone. The EDIS should contribute to risk reduction, as its common coverage (it currently covers at most 100,000 EUR) is integrated and provides a single yardstick for depositors (**Figure 3**). Micossi (2017) discussed the EBU proposal toward completion, including capital-strengthening measures[37]. Progress towards extending capital requirements, such as the Capital Requirements Regulation III and CRD VI, are currently under way.

[35] The authors thank M. Denis Beau, First Deputy Governor of the Banque de France, in October 2018 at Paris for insights on this point. On the historical and current aspects of European integration and supervisory issues, we are grateful for valuable meetings with M. Didier Brunnel, Honorary Director General of the Banque de France, since 2013.

[36] See the speech by Mr. Andreas Dombret (Member of the Executive Board). (2016). *Common supervision, common resolution, common deposit insurance scheme?* at the Bundesbank symposium "Banking supervision in dialogue", 1 June.

[37] Micossi, S. (2017). "A Blueprint for Completing the Banking Union", *CEPS Policy Insights*, No 2017/42, November.

Figure 3: Risk reduction and risk sharing: Three pillars of the EBU and key relevant European bodies on supervision

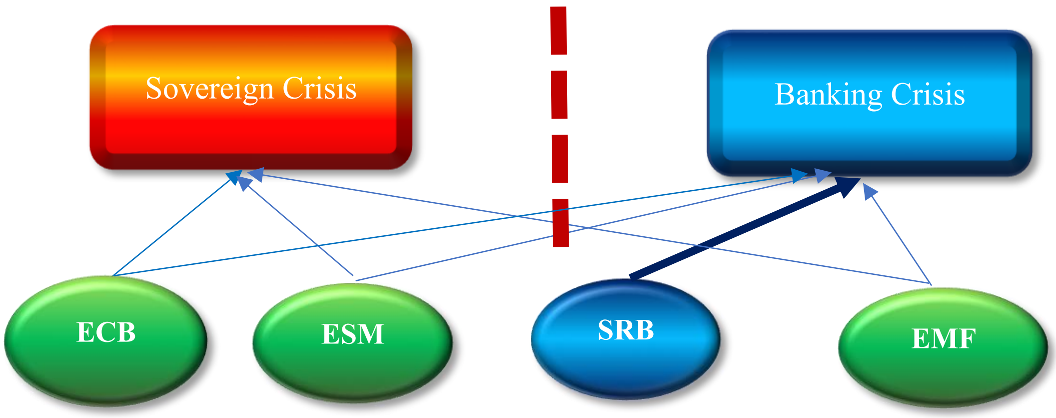


Source: Author.

Fundamental Necessity of Harmonisation of Supervision

The EBU, with its two pillars (SSM and SRM) was established to reduce sovereign and banking crises, Gual (2013) has underlined[38]. **Figure 4** shows how the Eurozone aims to handle these two intertwined crises.

Figure 4: Nexus of sovereign and banking crises in the Eurozone



[38] Gual, J. (2013). "Banking Union: made of concrete or straw?", *"la Caixa" economic papers*, No. 09, July. "la Caixa" Research Department.

Note: The establishment of the EMF has been proposed, but remains under, discussion.

Source: Author.

EBA and ESMA Line

The ESAs, the EBA and ESMA cooperate with each other, necessarily since the European banking system is based on a "universal banking system." The "separation" of deposit-taking institutions and extremely risky investments is problematical, since this may be a profitable banking strategy. The UK's Vickers Report and the USA's Dodd-Frank Act are firm about separating these two domains; however, the *Liikanen Report* did not insist on such separation[39]. Cooperation of each European supervisory authority is needed when it comes to cross-cutting issues. The EBA has to cooperate with the ESMA in the field of the Investment Firms Directive (IFD), related to governance for class 2 investment firms[40].

4. International Harmonisation of Banking Supervision

The BCBS plays an essential role in harmonising international regulatory methodologies and has provided the opportunity for discussion of common problems. Goodhart (2011) described the antecedents of the BCBS, especially the *Groupe de Contact*[41]. During the early period of the BCBS, the majority of its members were European. Such European approaches as the UK's Banking Act 1979 and the EEC (European Economic Community) First Banking Directive 1977 provided an initial background to the BCBS. Kapstein (1994) has described how UK-US cooperation in the middle of the 1980s was also formative in reaching the first Basel Accords[42]. Walker (2001) explored the trajectory of the legal, political, and practical aspects of such banking regulatory issues[43]. Goodhart (1995) placed financial regulation in the context of financial system in several relevant separate notes/chapters[44].

[39] High-level Expert Group on reforming the structure of the EU banking sector, Chaired by Erkki Liikanen. (2012). *Final Report*, Brussels, 2 October.
[40] European Banking Authority. (2021). *Annual Report 2020*, p. 44.
[41] Goodhart, C.A.E. (2011). *op. cit.*, Chapter 2.
[42] Kapstein, E.B. (1994). *op. cit.*
[43] Walker, G.A. (2001). *International Banking Regulation: Law, Policy and Practice*, Kluwer Law International.
[44] Goodhart, C.A.E. (1995). *The Central Bank and the Financial System*, MIT Press.

BCBS' Core Principles of Banking Supervision

The BCBS published the "Core Principles for Effective Banking Supervision (The Basel Core Principles) in 2012, which was crucial in forging common acceptance[45]. This consists of 29 key principles providing the essence of harmonisation, as shown in **Table 2**. From Principles 1 to 13, the publication proposes "supervisory powers, responsibilities, and function." In contrast, Principles 14 to 29 clarify "prudential regulations and requirements." The BCBS has many member states, not only advanced economies but also emerging markets[46].

Table 2: 29 Core Principles of international effective commonalities on banking supervision

Supervisory powers, responsibilities, and functions	
Principle 1	Responsibilities, objectives, and powers
Principle 2	Independence, accountability, resourcing, and legal protection for supervisors
Principle 3	Cooperation and collaboration
Principle 4	Permissible activities
Principle 5	Licensing criteria
Principle 6	Transfer of significant ownership
Principle 7	Major acquisitions
Principle 8	**Supervisory approach**
Principle 9	**Supervisory techniques and tools**
Principle 10	**Supervisory reporting**
Principle 11	Corrective and sanctioning powers of supervisors
Principle 12	Consolidated supervision

[45] Basel Committee on Banking Supervision. (2012). *Core Principles for Effective Banking Supervision*, September.
[46] The BCBS member states are as follows: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxemburg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

Principle 13	**Home-host relationships**
Prudential regulations and requirements	
Principle 14	Corporate governance
Principle 15	Risk management process
Principle 16	**Capital adequacy**
Principle 17	Credit risk
Principle 18	Problem assets, provisions, and reserves
Principle 19	Concentration risk and large exposure limits
Principle 20	Transactions with related parties
Principle 21	Country and transfer risks
Principle 22	Market risk
Principle 23	Interest rate risk in the banking book
Principle 24	**Liquidity risk**
Principle 25	Operational risk
Principle 26	Internal control and audit
Principle 27	Financial reporting and external audit
Principle 28	Disclosure and transparency
Principle 29	Abuse of financial services

Source: The Basel Committee on Banking Supervision. (2012). *Core Principles for Effective Banking Supervision*, September (the authors highlighted in bold the more significant principles).

The BCBS was set up in December 1974. Its launch was an international cooperative response to the Herstatt crisis in 1974[47]. The original member states were Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Switzerland, the UK, and the USA. Obviously most of the membership structure was comprised of European countries; the others were Canada, Japan, and the USA. Chairman Blunden stressed the EEC's ability to motivate harmonization, for example via the *Groupe de Contact*, namely, the Dondelinger Committee (Blunden, 1977)[48]. This Dutch initiative was intended to harmonize various banking supervision systems.

By and large, these G10 countries, plus Switzerland, led international cooperation on banking supervision, especially through the UK's initiative. Sato (2018) focused on the UK's Banking Act 1979 by exploring the British approach to banking supervision[49]. For further research, Sato (2019) explored the Bank of England's leadership during the Basel process[50]. Gardener (1986) also reported on the UK's banking supervision in terms of progressive path, practice, and related issues, including capital adequacy and deposit insurance[51].

Concrete Points of the Core Principles

The latest version of the Core Principles published in September 2012, states that "the importance of applying a system wide macro perspective to the microprudential supervision of banks to assist in identifying, analysing and taking pre-emtive action to address systemic risk"[52] needs to be recognized. As of September 2012, four years after the GFC, a macroprudential viewpoint for addressing microprudential issues needed to be used.

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[47] As related to the Herstatt Crisis in July 1974, Mourlon-Druol (2015) elucidated in detail the development of the crisis. Mourlon-Druol, E. (2015). "Bank Crisis and its Implications for International Regulatory Reform", *Business History*, Vol. 57, No. 2, pp. 311-334, Routledge.
[48] Blunden, G. (1977). "Control and Supervision of the Foreign Operations of Banks", in Wadsworth, J.E., Wilson, J.S.G. and Fournier, H. eds. *The Development of Financial Institutions in Europe, 1956-1976*, A.W. Sijthoff – Leyden, p. 194.
[49] Sato, H. (2018). "UK Banking Supervision and Regulation through a Historical Approach: Implications for the European Banking Union", *Discussion Paper Series*, Faculty of Economics and Management, Kanazawa University, No. 46, pp.1-30.
[50] Sato, H. (2019). "The UK's Initiative on International Banking Supervision in the 1980s: Basel Process and International Cooperation on Prudential Policies", *Discussion Paper Series*, Faculty of Economics and Management, Kanazawa University, No. 50, pp. 1-21.
[51] Gardener, E.P.M. ed. (1986). *UK Banking Supervision: Evolution, Practice and Issues*, Allen & Unwin.
[52] Basel Committee on Banking Supervision. (2012). *op. cit.*, p. 2.

The Core Principles include recognition of the need for an effective resolution. The FSB published, in 2014, the Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs)[53]. Even before the publication of the FSB's KAs, the BCBS's Core Principles stated that "the increased focus on effective crisis management, recovery and resolution measures in reducing both the probability and impact of a bank failure."[54] The latest version pointed out the magnitude of the audit to secure public disclosure and transparency through financial reporting and an external audit[55].

FSB: Transnational Governance Coping with Cross-Cutting Issues

The FSB was launched in April 2009, strengthening the prior FSF. The FSB's headquarters is also located in Basel, underpinned by the BIS. However, augmenting the BCBS, the FSB plays a key role in maintaining a level playing field over banking, securities (investment banking), and insurance. After the GFC, the mandate of the FSB has been to focus on cross-cutting issues. For example, the rise of shadow banking needs to be covered by international standard-setting bodies because it could cause a financial crisis and lacks stringent regulations.

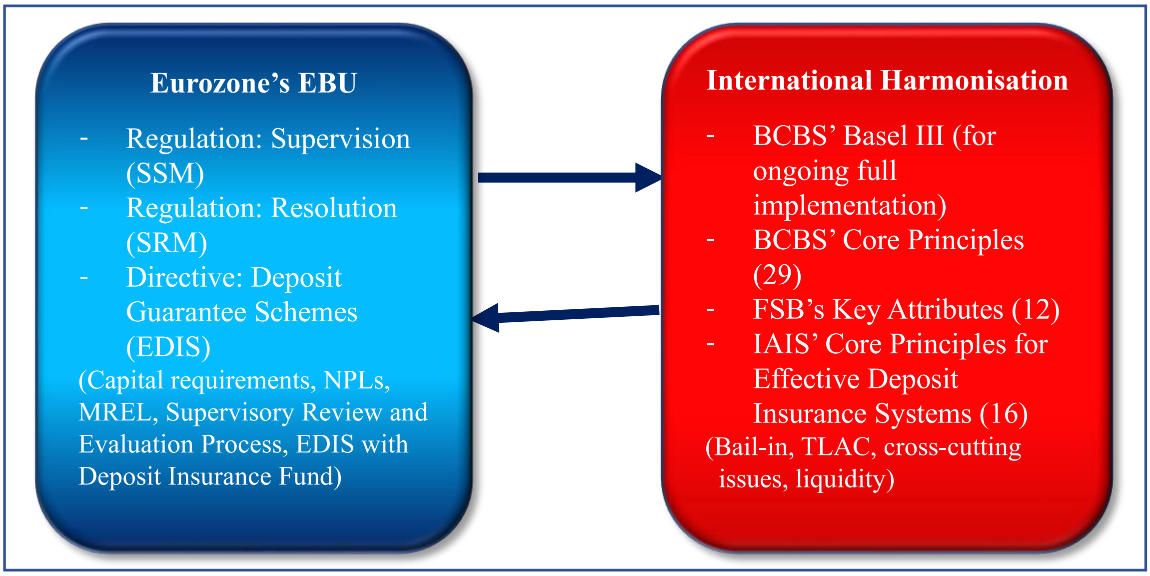
The FSB also makes proposals to the G20 for regulatory measures to be agreed by G20 member states. This powerful institution is dedicated to nurturing appropriate frameworks for international commonalities. Although such proposals frequently adopt a "*communique*" form, this approach is easily recognized as *soft pressure* to abide by the *de facto* regulations. Since its transition from forum to a formal body, the FSB has become an essential centre for managing financial crises and preventing potential crises.

5. Comparative Analysis

Figure 5 shows the difference on prudential issues (through a comparison of methodologies), between European and international institutions. Two key issues arise.

[53] Financial Stability Board. (2014). *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 15 October.
[54] Basel Committee on Banking Supervision. (2012). *op. cit.*, p. 2.
[55] *Ibid.* An effective external audit becomes more essential and pertinent to effective banking supervision through the lens of impartial inspections.

Figure 5: Interactive relation between the EBU and international harmonisation



Source: Author.

Notes: The numbers on the right hand are key standards and principles in international harmonisation.

First, the focus is on "uniformity" versus "diversity". The desire for European integration drives the need for "uniformity". Since the Treaty of Rome in 1958, European integration has progressed via *hard law*. Numerous stringent regulations, directives, and communications support the robustness of the European system. Since the introduction of the Euro as a single currency, the EU – especially the Eurozone – strengthened its uniformity, even through several financial crises. By and large, the European legalistic approach, as reinforced by the European Commission, provides impartial and unambiguous rules in the fields of banking supervision, regulation, and resolution.

In contrast, the harmonisation approach in the international arena has maintained a "diversity." It is rational for international standard-setting bodies, such as the BCBS, FSB, and International Monetary Fund, to develop a number of systems through relatively discretionary yardsticks. The methodology focuses on the *de facto* standard implemented through *soft law* rather than (hard law) legislation. The BCBS applies peer pressure to forge a "common recognition," including capital adequacy stipulated by the Basel III (BCBS 2011, BCBS 2021)[56]. The FSB also supplies standards for liquidity,

[56] Basel Committee on Banking Supervision. (2011). *Basel III: A global regulatory framework for more resilient banks and banking systems*, June (the original version was published in December 2010). The documents on

namely, the TLAC (FSB 2015)[57], which is in line with the KAs as previously mentioned (FSB 2011, 2014)[58]. This has also been kept flexible enough to comply with the diversity of member states' individual regulatory and supervisory structures.

Second, we distinguish between legislative and principle-based approaches. The EU, especially the Eurozone 20 countries and the EBU, is based on an essential legal framework. The *de Larosière Report*, an urgent response to the GFC, required the European Commission to set up a single rulebook to prevent similar future crises. Since 2020, the pandemic crisis has required emergency monetary responses, such as the Pandemic Emergency Purchase Programme (PEPP), which was initially set up with €750 billion in March 2020 (ECB 2020)[59] and expanded later during 2020 to €1,850 billion in total (Lagarde 2021)[60]. In May 2020, the European Commission published a proposal for establishing the Recovery and Resilience Facility (European Commission 2020)[61], amounting to €672.5 billion, consisting of €360 billion in loans and €312.5 billion in grants in the NextGenerationEU framework (European Commission 2021)[62]. This also allows for Eurobonds to be issued, which had, thus far, been deemed impossible. These initiatives by the European Commission could be further developed.

Meanwhile, international standard-setting bodies, such as the BCBS and FSB, have adopted a principle-based methodology. Harmonising diverse supervisory and regulatory systems among the nation states throughout the world needs much effort and perseverance. Because banking regulatory and supervisory issues are *per se* intricate, their convergence might be considered impossible. However, since the establishment of the BCBS in December 1974, it has played a crucial role in implementing informative discussions among not only advanced economies but also emerging markets. The first ICBS conference was held in London in July 1979, initiated by the Bank of England

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Basel III were integrated for updating. See the integrated version: Basel Committee on Banking Supervision. (2021). *The Basel Framework*, 22 January.

[57] Financial Stability Board. (2015). *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: Total Loss-absorbing Capacity (TLAC) Term Sheet*, 9 November.

[58] Financial Stability Board. (2011, 2014). *op. cit.*

[59] European Central Bank. (2020). "ECB announces €750 billion Pandemic Emergency Purchase Programme (PEPP)", *Press Release*, 18 March.

[60] Lagarde, C. (2021). "European Parliament plenary debate on the ECB Annual Report: Introductory statement", at the plenary session of the European Parliament, Brussels, 8 February.

[61] European Commission. (2020). *Proposal for a Regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility*, COM (2020) 408 final, Brussels, 28.5.2020 with Annexes 1 to 3 to the Proposal on the same date.

[62] European Commission. *Recovery and Resilience Facility*, Accessed on 22 February 2021.

whose chairperson was Peter Cooke. Cooke sought to harmonise member states' different supervisory schemes through a non-binding approach. The Bank of England and the BCBS shared a common standpoint for effectively cooperating with other authorities using a gradual methodology. To summarize, the soft-law, non-binding, discretional, and gradual methodologies were key features for the actual convergence to international prudential policies.

Concluding Remarks

In this note we have stressed the distinctions between the approach to banking regulation in the EBU as contrasted with that of the BCBS, with the former applying a much more legalistic version with the aim of achieving uniformity, whereas the latter has adopted a much more 'soft-law' standpoint based on some general principles, thereby accepting a degree of, (but not too much), diversity. In this final Section we seek to explain *why* this difference has occurred and what its implications are.

The key is that the issue of currency is, and always has been, normally[63] an aspect of sovereignty (see, for example, M. Hudson[64]). It follows from this that issues relating to the use of currency, for example in making loans and other credit relationships, notably in commercial banking practices, will come under the oversight of the sovereign. But which body is sovereign, and can such sovereignty be shared?

In many countries there are subsidiary states, (e.g. the States in the USA, the Lander in Germany, the separate members of the UK, provinces in many other countries, etc., etc.), but in most of such countries, the dominant executive and legislative powers, lie at the federal centre. In these cases the sovereign power to adjust monetary and financial conditions also lies at the federal centre of each country.

The BCBS, whose members are from Central Banks, (*not* political representatives), has no locus, or power, to require sovereign countries to do *anything*. All it can do is to propose principles of action,

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[63] The early monetary history of the United States, at least until the National Banking system was established in the 1860s, provides something of an exception.
[64] Hudson, M. (2023). *The Collapse of Antiquity*, ISLET.

notably on banking regulation and supervision, and hope that its member (and other) Central Banks can persuade their own legislatures and executives to put such principles into operation in their own countries. The BCBS does, however, have the further possible sanction that, if a country should not only refuse to abide by such principles, but also egregiously follow a different line, its banking and financial relationships with other BCBS members could be put at arm's length. Such a potential sanction has, in practice, been effective in persuading smaller countries to toe the principle line in the past. But it would be hard to get this to work if a major country, or significant group of countries, were unhappy with the principles adopted. So a degree of consensus is essential in establishing the principles to be adopted.

The status of monetary, and financial sovereignty, is different, indeed particular, in the EMU. In this latter case, the countries involved have agreed to share, indeed to give up, their sovereignty in a restricted, quite tightly defined, field of monetary, and some other financial, matters, while retaining sovereignty elsewhere, e.g. on defence, fiscal policy, social policy, etc. Such a (partial) abandonment of sovereignty needs a clear, specific, legal framework. This implies the need for procedural uniformity amongst the member states, backed by a clear legal framework.

The distinctions that we have emphasised between the methodologies of the EBU and BCBS are, therefore, primarily political in substance. In the EBU, monetary sovereignty amongst the member states is shared; in the BCBS, it is not.

In some respects the maintenance of the existing status of the EBU and its procedures are stronger than that of the BCBS. For a member of the EBU to refuse to accept the, previously agreed, legal position would not only invite immediate sanctions, but could threaten its whole shared position within the EMU, and even the wider EU. In contrast, should a major country, or group of countries, change its mind on the BCBS principles, it would not face such penalties or be forced to back down.

But by exactly the same token, an agreement by an EMU member state to some extension of shared sovereignty, for example on Capital Market Union or a common European Deposit Insurance scheme (EDIS) is much more of a binding commitment, than some change to a BCBS principle.

Thus the EBU is more rigid, whereas the BCBS is more flexible. Is the EBU sufficiently flexible to meet the various shocks that the future may hold? Is the BCBS sufficiently rigid to maintain a well-functioning (world) international banking and financial system? Time will tell.

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