Coordination Among Supervisors

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Coordination is Necessary

- The Lehman Group comprised 2,985 entities in 50 countries
- A liquidity problem at Fortis arguably spiralled because national authorities could not coordinate
- Icelandic banks generated most of their profits outside Iceland. It was hard for local supervisors to get a clear picture of the banks' operations, and yet local taxpayers bore the costs of failure in several countries

Basic Problems and Frameworks

- Externalities
- Race-to-the-bottom
- Big picture

- Two supervisory problems:
  1. Oversight of the going-concern firm
  2. Dealing with the financially distressed firm

Single Supervisory Mechanism

- Rapid progress on need for, and specifics of, SSM
- SSM has little to say about the distressed firm, and nothing to say about deposit insurance
- This is a source of heterogeneity: a potential source of inefficiency, even in a world without supervisory competition and rent-seeking
- If the ECB were to attempt to correct for the heterogeneity then it would likely run up against accountability requirements

RULES AND REGULATIONS

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- Exclusion from SSM is not an attempt to resolve heterogeneity
- Relationship between ECB, as the SSM supervisor, and the EBA is unclear
- Whichever institution prevails, some interim confusion may be inevitable
- ECB direct supervision will be pretty clear. Indirect ECB supervision can be fixed via direct instruction
- EBA regulations will be implemented by local supervisors. They may generate a range of interpretations, even if they are concerned entirely with aggregate surplus
- Even in a world without rent-seeking we wind up with unpredictability

De Facto Supervisor Competition

- In practice, we have evidence that supervisors are subject to incentives that are non-communautaire
- Supervisors have skewed intervention incentives in cross-border institutions. Intervention less likely when lenders are foreign and more likely when equity-holders are overseas
- Bankers seek the lowest cost supervisor: supervisors appear to alter their behaviour to attract bankers and the fees that they bring with them
- The complexities of the ECB/EBA relationship may render this type of behaviour more likely and easier

Resolution

- Absence of a single resolution regime seems like a serious impediment
- Already argued that a variable ECB approach is unlikely to take up the slack
- Coordination and information-sharing problems with local finance ministries
- Could capital requirements achieve this? If so, how can capital regulation be harmonised?

Informational Problems

- Too-complex-to-manage and possibly to-supervise problems
- Limitations on activities?
- Local supervisory information and its transmission to the ECB
- Moving institutions in and out of the "significant" category
- Staffing challenges

Regulatory Arbitrage

- The SSM doesn't cover non-banks
- Will we encounter the "boundary problem"?

Conclusion

- Three excellent papers
- The SSM addresses important problems: M&A, coordination, free-riding, race-to-bottom effects
- But it is weakened by heterogeneity in resolution regimes
- The rather complicated nature of Europe's new bank supervision arrangements makes matters worse than it need be
- And both bankers and supervisors respond to incentives:
  - Supervisors tailor their approach to financial distress to the liability structure of their banks
  - Supervisors may tout for business
- Quite apart from resolution problems, there will be serious informational, organisational, and jurisdictional challenges