



DE-RISKING THE FUTURE OF EUROPE

REFORMING THE MACROFINANCIAL ARCHITECTURE

European financial market integration
and the need for European financial
supervision

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#deriskingEU 
#deepeningEMU

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The eternal return of the same problem?

- EU Financial market integration precedes integration of financial market supervision
 - This was done by the European Commission partially for ideological reasons (belief in regulatory competition); for expediency (problems of coordination and negotiation)
 - Related to the resistance of member states to cede powers in regulation and supervision (first and foremost UK, but also Germany, NL etc.); argument: fiscal liabilities and supervision need to be at the same level (moral hazard)
-
- European system of financial regulation develops first incrementally (review procedure) and then in leaps, following crises
 - These crises themselves are aggravated/caused by European financial architecture: can we avoid this dynamic?

Political economy literature on European financial market integration

- For at least 20 years (Story and Walter 1997), the literature has noted the tendency for regulatory competition in the EU
- Even though/despite common Basel I rules for banks, there has been competition around
 - A. the implementation of Directives
 - B. national regulatory forbearance
 - C. active industrial policy for finance

Lessons drawn from the crisis in EU: Why was Europe hit so hard by financial crisis?

- Global European banks evading the rules in shadow banking (global in life, national in death): need for recovery mechanism
- Regulatory competition and regulatory forbearance in the context of the creation of European banking market facilitated this development: need for SSM (Veron 2013)
- For better resilience and faster recovery: need for more non-bank based shadow banking: CMU

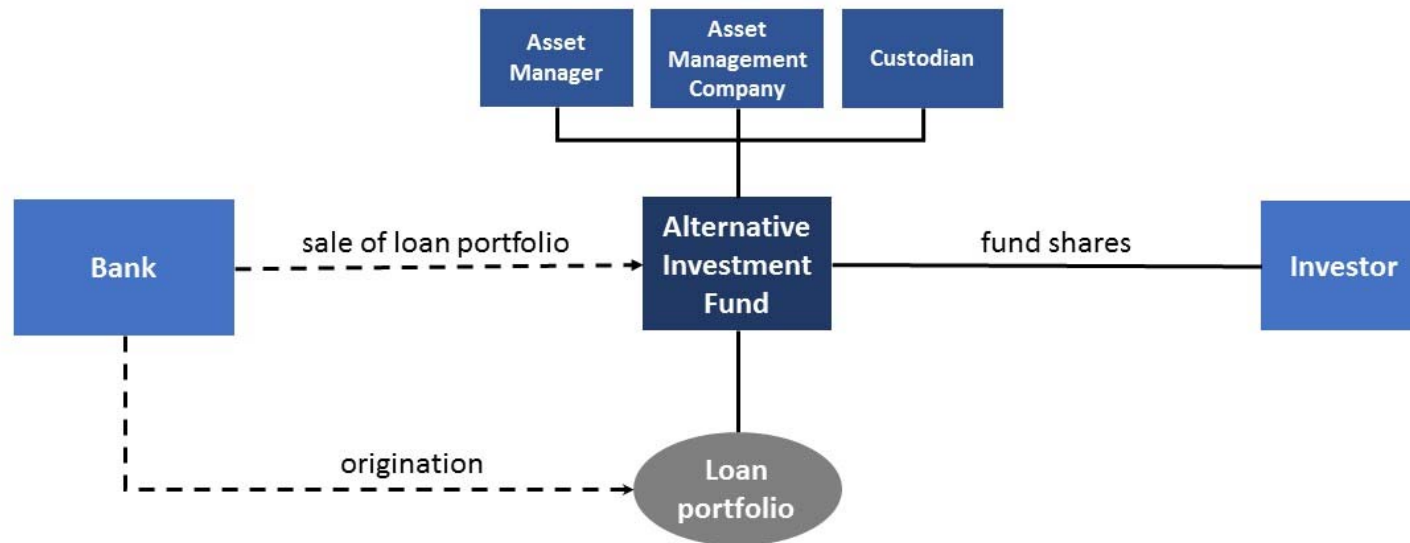
Reactions to crisis empower the EU level

- move from directives to common regulation
- From Lamfalussy process to Delarosiere report: empowerment of European Supervisory Agencies (ESAs)
- 2012 June European Banking Union
- → EU to a certain extent becomes more like a state with respect to its financial system, in particular its banking system

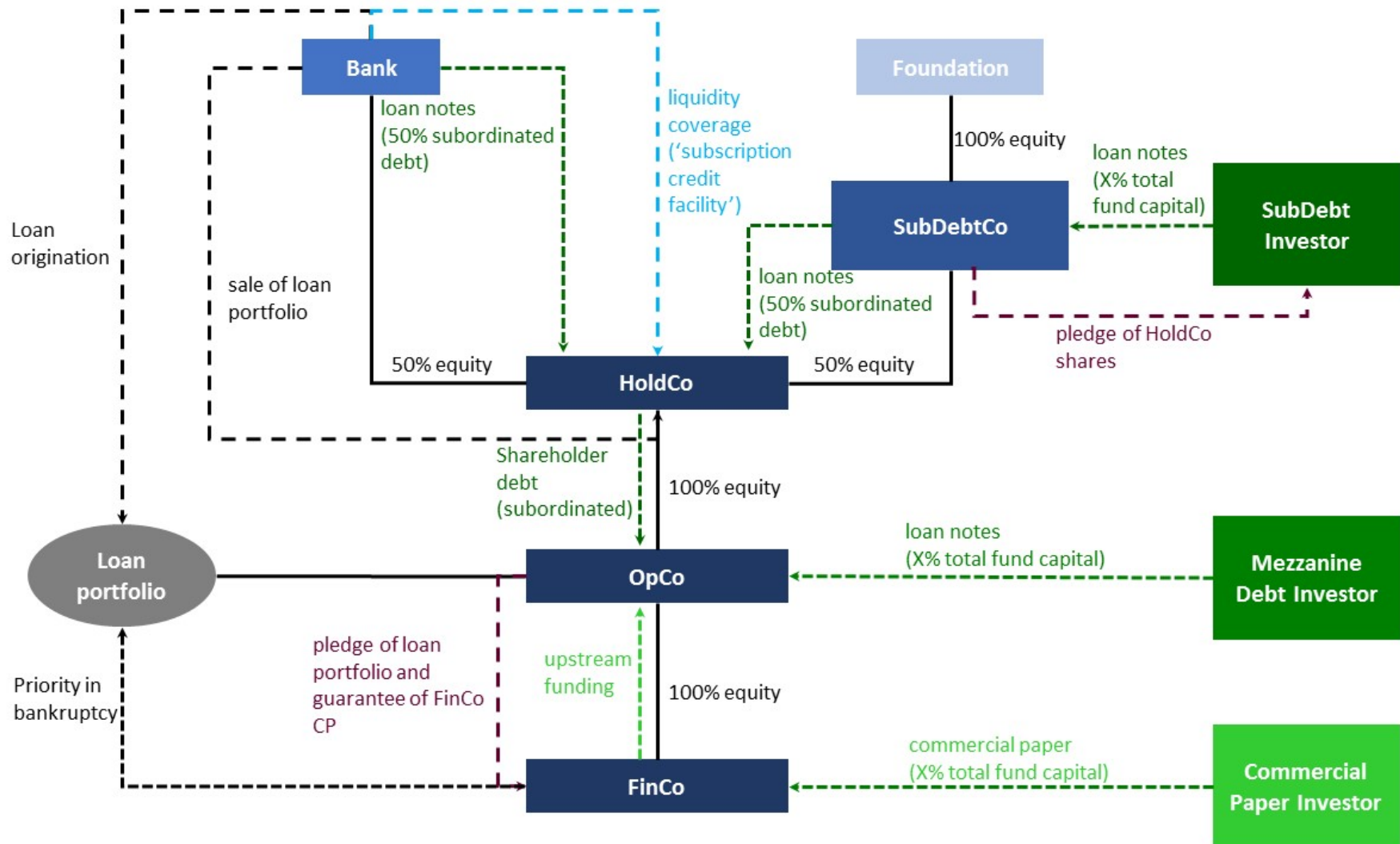
Changes in European financial market governance

- While there is a Europeanization of bank supervision, and despite an empowerment of ESAs post-crisis (ESMA for securities markets), there is still splintered supervision of non-banks in EU
- Are we doomed to repeat the same mistakes, now in financial market governance? (lax supervision and financial innovation)
- Context: Shadow Banking increasingly pushed outside of Banks and push for CMU: increase financial market integration to facilitate cross-border flows

Example 1: credit funds (2015)

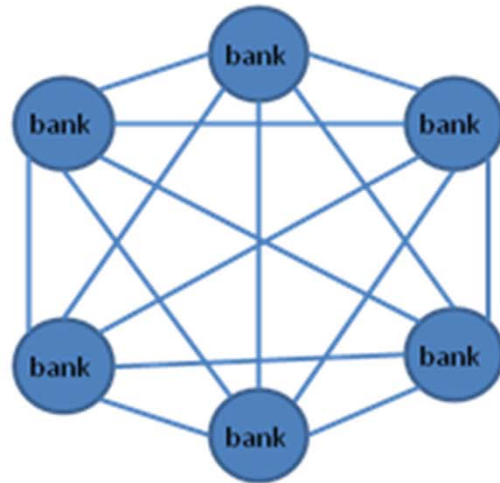


Credit funds 2019

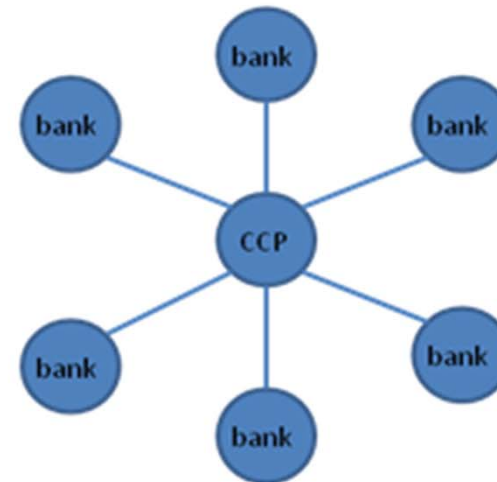


Example 2: CCPs

Bilateral clearing

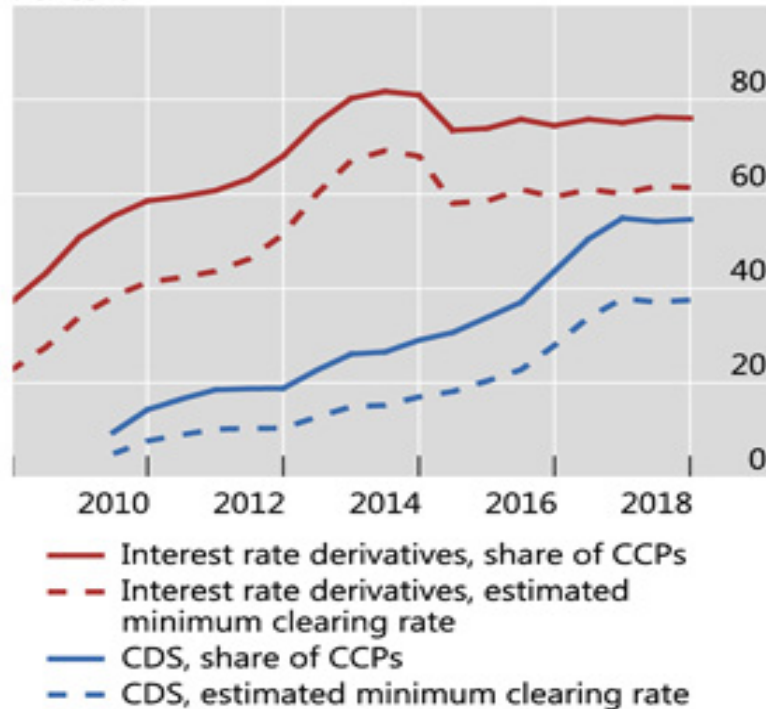


Clearing via CCP



CCPs experience strong balance sheet growth post 2012

Share of CCPs and estimated clearing rate
Per cent



Share of CCPs, end-December 2018
Per cent



Problem of competition among CCPs (financial market infrastructures)

- Low margin, high volume model
- Network effects: the larger the size, the more cross-margining possible
- Predatory margining (Pelizzon and Krahen 2016): to gain market share, you underprice risk
- Question is: do regulators play along?

Governance of rule enforcement: the national supervision of European rules

- European Market Infrastructure Regulation (2012): one European system of regulation
- General feedback from interviews: very well drafted and good rules (EMIR 2012), but problem with supervision (interview ECB supervisor 2016, former ACPR supervisor 2018)
- NCAs supervise their domestic CCPs and ESMA is a College of Supervisors, which can compare practices but at least initially has little to no capacity to intervene

Schizophrenia on supervisory arbitrage

- EMIR 2.2: how to re-order supervision of CCPs in Europe and vis-a-vis third country to avoid supervisory divergence and divergent compliance? European Council breaks development toward common intra-European supervision
- « Schizophrenic position » prevails, where third country divergence requires empowerment of ESMA, but domestic competition only requires enhanced cooperation between national supervisors



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