

# REGULATORY DEVELOPMENTS IMPACTING CENTRAL BANKING

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# Expanded mandates

- Upwards – relations with Government
  - Monetary policy and content of the delegation - CBI
  - Accountability, legitimacy and populism
- Downwards – relations with the banking & financial system
  - Bankers' bank, ELA/LOLR, Supervision and regulation, Resolution
  - CBI from the market – Regulatory capture 'overt' and 'subtle'
  - Whither next in financial regulation?
    - **Inconsistent rules across jurisdictions and regulatory arbitrage** – Example - [Nordea's](#) decision to relocate from Sweden to Finland puts the Nordic region's only global SIFI inside the euro zone. Nordea estimates it will save it as much as \$1.3 billion in regulatory costs...
    - **Banking Union** - missing pillars and challenges

# Matching objectives and functions

## Brief historical overview

### Twin mandate

- **Monetary stability** relies on one main instrument, monetary policy (interest rate policy) and is conducted by one authority (the central bank)
- **Financial stability** relies on many instruments, including MP, LOLR, regulation, supervision and crisis management, even fiscal policy and involves other authorities (co-existing with other goals).

### CBI before after the crisis – instrumental nature

- From the Bundesbank model of independence (Tinbergen rule) to the Fed model of independence and how the law adapts

### Evolution of money and new challenges – VC and impact on CB

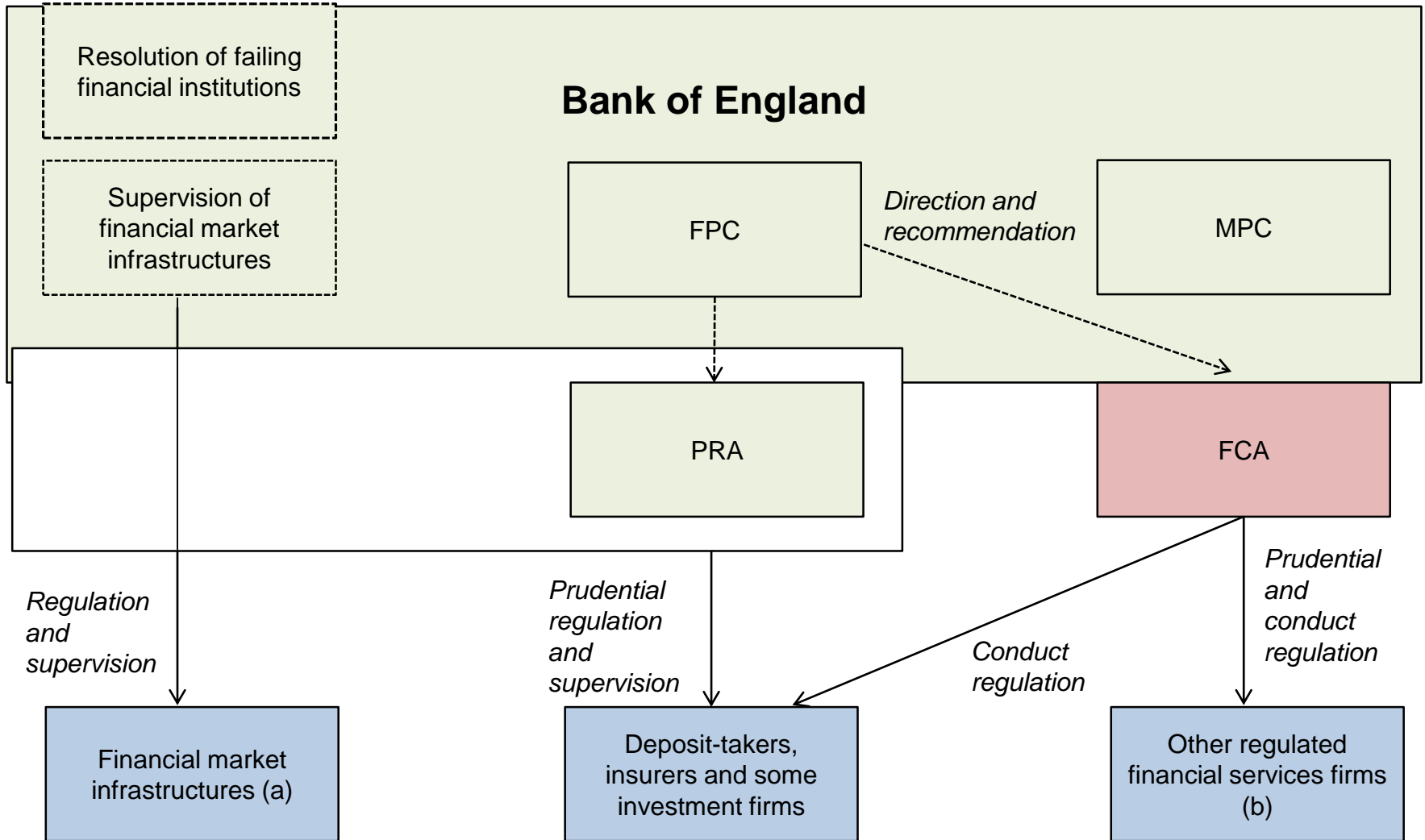
# Understanding Accountability & Legitimacy

- Definition of accountability. Lawyers' view and economists' view
- Primacy of Parliamentary accountability but....
- Judicial review to prevent an arbitrary and unreasonable exercise of discretionary authority is an important element of the rule of law.
  - In the USA, there is no mechanism to review the monetary policy actions and decisions of the Federal Reserve System, though the Fed's actions and decisions concerning supervision, financial stability and payment systems are subject to judicial review.
  - In the UK, the Northern Rock case led to a lively debate about discretion, financial stability and moral hazard with regard to the LOLR of the Bank of England.
  - In the EU, the role of supreme court judges in the formation of economic and monetary policy has become the subject of heated legal and political debate (Pringle, Gauweiler, Weiss)
- US Supreme Court Justice Stephen Breyer has argued that it is not possible to understand and evaluate what agencies do without having some sense of the regulatory policy as well.
  - If judicial restraint in monetary matters is advocated on the basis of [limited] technical expertise and qualifications of the judges adjudicating such matters, the counter-argument to not 'being equipped' is to actually equip judges. (*Goodhart and Lastra*)
  - **Hence the suggestion to have specialized judges or a specialized chamber in CJEU**

# Whither next in financial regulation?

- **What to regulate?** New rules for capital, liquidity, resolution, compensation, corporate governance, transparency, CPPs, etc and other measures such FTT. Standards: AML/CFT
- **Who to regulate?** ‘Widening the net’ to a wider range of institutions that are now central to the safeguarding of financial stability, such as clearing and settlement systems, credit rating agencies and auditing firms, and private pools of capital such as hedge funds and private equity funds. **SIFIs**
  - Boundary problem, shadows & loopholes (COST-BENEFIT ANALYSIS)
- **How to regulate?** Intensity of supervision and regulation. Macro-prudential policy.
- **Structural reforms** which aim to change the structure of the banking industry and the balance sheet structure of commercial banks and other financial institutions. Casino/utility. Change the legal form of banks from PLC/S.A.
- **Who regulates?**
  - **Sector-based model (US and EU) and Goal Based Model (UK) or twin peak**

# Twin peaks in the UK (regulation by objective)



(a) Excludes regulation of trading platforms, which is the responsibility of the FCA

(b) Includes asset managers, hedge funds, exchanges, insurance brokers and financial advisers

# EUROPEAN FINANCIAL ARCHITECTURE (REGULATION BY SECTOR)

Macro-prudential supervision



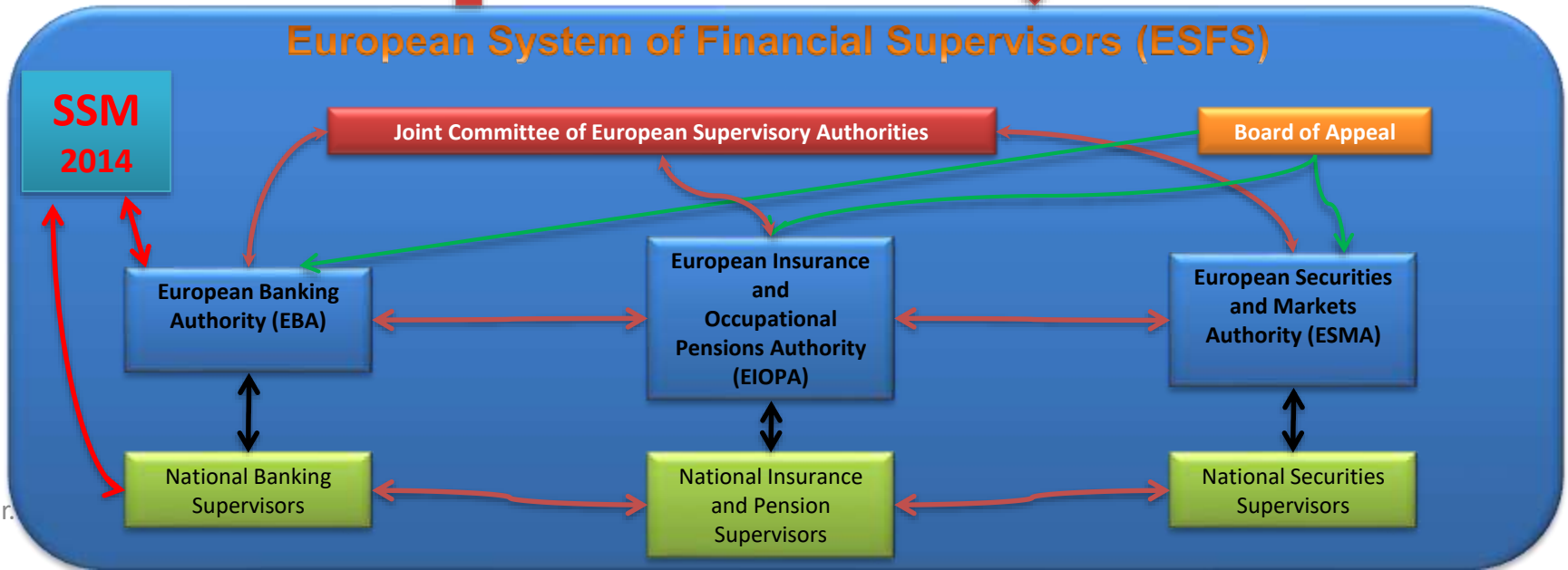
Early risk warnings and recommendations to governments



Micro-prudential information

Early risk warning and recommendation to supervisors

Micro-prudential supervision



# Banking union

This process replicates the experience of the Federal Reserve System and the Federal Deposit Insurance Corporation in the USA one century ago.

Establishment of the Single Supervisory Mechanism (SSM)  
Regulation of 15 October 2013  
Start – 4 Nov 2014

