The European Aspects of Global Financial Developments

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THE EUROPEAN ASPECTS OF GLOBAL FINANCIAL DEVELOPMENTS

VIRÁG ILONA BLAZSEK

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ABSTRACT

What is the position of Europe—and specifically the European Union (EU)—on the world map of global finances in 2017? This comment seeks to answer this question by focusing on three key issues. First, it analyzes Europe’s post-2008 bank bailouts, its sector-wide rescue packages, and its consequential sovereign-debt crisis. Second, it considers the role of the international credit rating agencies and asks why Europe does not have a large rating agency of its own. Third, it assesses the EU’s major recent regulatory developments related to the financial sector. There is no doubt that Europe is in a sustained economic and political crisis; the question of interest is whether the EU is responding by adopting reforms that will make it economically stronger and more united. This comment concludes that some of the EU’s post-2008 reforms—such as enhanced consumer protection, stress testing and stricter prudential requirements—have been in

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line with international regulatory tendencies, but that slow and expensive decision-making, member states’ failure to compromise on fundamental issues, and misguided rules for bank resolution and supervision have harmed the EU’s global competitiveness.

I. EUROPE ON THE WORLD MAP OF GLOBAL FINANCES

According to the March 2017 Global Financial Centres Index, there is only one European city among the top ten financial centers of the world: London (ranked first).1 Zurich dropped to eleventh place, whereas in the previous years it ranked among the top ten financial centers.2 World Bank data, in turn, indicates that the United States has the highest national gross domestic product (GDP), with China second.3 This does not mean that Europe—and particularly the EU—would be less important, because the GDPs of the United Kingdom, Germany and France also rank high, following the United States and China.4

Europe has strong economic ties with both the United States and China; its relationship with those regions can be characterized as a partnership rather than competition-based.5 Most U.S. foreign investments take place in Europe, and the EU is also one of China’s most important export partners. According to the most recent data, Chinese investments have increased by 30% in the EU.6 As far as the United States-EU economic and commercial ties are concerned, in case of the successful completion of the ongoing negotiations of the Transatlantic Trade and Investment Partnership (TTIP), the biggest free trade area of the world would be created by the participation of the United States and the EU member states, which alone would represent 30% of the world trade.7

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2 Id.
4 Id.
5 EU-Kína kamara: egyre súlyosabbak a kinai túltermelés következményei [EU-China chamber: the consequences of over-production in China are increasingly severe], INFÓRÁDIÓ (Feb. 22, 2016), http://inforadio.hu/gazdasag/2016/02/22/eukina_kamara_egyre_sulyosabbak_a_kinai_tultermelies_kovetkezményei/.
6 Id.
However, economic growth has slowed significantly in EU member states since late 2008 and it has not yet returned to its pre-crisis rate.\textsuperscript{8} This tendency has been even stronger in the Central and Eastern European\textsuperscript{9} segment of the EU because those economies grew mostly from foreign investment between 1990 and 2008.\textsuperscript{10} At the same time, the aforementioned statistics indicate that, even with all these economic difficulties and problems, the EU and the European region are significant participants in the global economy. Europe tends to forget about this.

Before turning to the three narrower issues that are the focus of the present comment, it is important to underline that from the point of view of economic growth, the following factors are important: long-term success and global competitiveness of a region; an efficient, relatively stable but also flexible legal-regulatory environment; the rule of law; labor market conditions (particularly the costs and the level of the skills and qualifications of the work force); innovation; and research and development. In the EU and Europe, the educational level and qualification of the work force, innovation, and research and development are very competitive on a global scale.\textsuperscript{11} However, the 500 million residents of the twenty-eight EU member states represent only 7% of the world population.\textsuperscript{12} Still, the EU contributes 30% of research and development worldwide.\textsuperscript{13}

In order to realize the region’s full potential, the EU member states should join resources and develop a long-term, common economic policy. In this respect, the legal reforms related to the financial sector can be mentioned among the few positive examples; at least in that area, there has been a common strategy and action towards enhanced coordination. It is natural that there are conflicts...
of interest among the member states of the EU, but it would be important to gain strength from remembering the tragic historic events that led to European integration and build towards more solidarity among the member states, because of the fact the European states together can, if unified, better represent the interests of their residents and achieve economic strength.

The remainder of this comment addresses three issues related to Europe’s economic outlook: the enormous governmental interventions in the financial sector since 2008 and the consequent increase in sovereign indebtedness, the importance of the international credit rating agencies, and finally, the impact on Europe’s global competitiveness because of the 2008 financial crisis.

II. BANK RESCUE PACKAGES AND THE SOVEREIGN-INDEBTEDNESS

Starting in 2008, there has been a large degree of state intervention in the economy on both sides of the Atlantic. Contrary to the initial popular misconception, in the United States, the various bailout measures have been repaid with interest.\(^4\) The TARP reports\(^5\) reveal that the U.S. federal government has, through charging of interest and strict control and supervision, recovered more money than it lent to financially distressed banks between 2008 and 2009.\(^6\) After the collapse and bankruptcy of Lehman Brothers, one of the biggest market players of the financial sector, the government rescued all systemically-important or too-big-to-fail financial institutions.\(^7\) These were mainly investment banks and giant corporations operating in the area of home loans and mortgage securitization.\(^8\) After these ad hoc bailout measures, Congress created TARP to fulfill the requirement of democratic authorization and legality.\(^9\) This program became available for the whole banking system, which was important for antitrust reasons as well; if financial aid is available for all market players,

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\(^4\) TARP Tracker from November 2008 to December 2017, Total TARP Funds Outstanding, fig., U.S. DEPT. OF THE TREASURY https://www.treasury.gov/initiatives/financialstability/reports/Pages/TAR-Tracker.aspx (last visited Jan. 15, 2018); Jim Puzzanghera, *Bailout not so costly after all*, THE MERCURY NEWS, (Feb. 28, 2011), https://www.mercurynews.com/2011/02/28/bailout-not-so-costly-after-all/. This press article makes a reference to a Bloomberg poll of Fall 2010 in which sixty percent of respondents said they thought most of the TARP money would not be recovered. *Id.*


\(^7\) *Id.* at 448.


there is less distortion of competition on the affected market. Similar actions took place in Europe, where governments rescued failing banks and the European Commission, as the EU authority responsible for competition law and state aid, approved all such applications of the member states. There was a crucial difference between the financial status of United States and EU banks in 2008: U.S. banks were illiquid but solvent, while European failing banks were insolvent. Another difference between the U.S. and the EU bank bailouts was that in Europe, bailouts took place in a much longer time period, whereas U.S. banks were bailed out between 2008 and 2009 and repaid the financial aid by 2010. This temporal factor matters, and it is crucial for recovering investor confidence in a financial crisis.

The level of sovereign indebtedness in Europe, and particularly in several EU member states, has been traditionally very high, around fifty to sixty percent. But by 2011, sovereign indebtedness reached or exceeded 100% of the GDP. The IMF, the EU, and other international organizations assisted member states to fill holes in their public budgets. Other words, as opposed to the U.S., EU bailout expenditures never could have been recovered, and several European states became insolvent, particularly, Ireland, Portugal, Spain, and Greece. The sovereign-debt crisis has yet to be solved. A detailed analysis of this problem is beyond the scope of this article, but it is important to note that the problem has largely contributed to the design of the 2014 bank resolution system, which aims to protect taxpayer euros as much as possible and exclude

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23 Leavitin supra note 16.

24 See Infra Part II.


26 Id.

27 Id. at 34.

future bank bailouts through statutory provisions.\textsuperscript{29} The sovereign debt crisis was not only caused by the post-2008 bank rescue packages, but it significantly contributed to the same bailouts in Europe.\textsuperscript{30}

The EU introduced profound legal changes for the prevention and management of future financial crises, but nonetheless it has failed to adequately equip its regulators.\textsuperscript{31} Because of the sovereign debt crisis, the EU focuses primarily on the protection of taxpayers.\textsuperscript{32} One of the main elements of the new regulatory system is a prohibition on bank bailout packages by member states.\textsuperscript{33} Additionally, most elements of the new regulatory framework, such as a network of new bail-in funds and a somewhat, but insufficiently, reinforced EU-level deposit insurance system, will remain unavailable until 2024.\textsuperscript{34} In principle, the European Central Bank (ECB) has not utilized fully its available monetary tools to reduce sovereign debt level for fear of a domino effect.\textsuperscript{35}

In business-as-usual times, when financial failure does not affect a large number of financial institutions simultaneously, the detailed provisions of the 2014 Bank Resolution and Recovery Directive (bail-in tool, bridge bank, etc.) may function well, but the provisions do not provide sufficiently prompt and strong tools for future financial crises.\textsuperscript{36} This is primarily because of the European regulators’ main, underlying regulatory principle: instead of concentrating on recovering investor confidence, the primary aim of crisis management and bank bailouts in the U.S., they are focused on protecting taxpayer euros.\textsuperscript{37} Taxpayer financial security is also very important, but should be prioritized only after financial stability of sovereignities has been restored.\textsuperscript{38} This was well sensed by Ben Bernanke, the Chairman of the Federal Reserve from 2006 to 2014, but was missed by the European regulators.\textsuperscript{39}

Currently, the 2014 Bank Resolution and Recovery Directive is untested when it comes to financial crisis situations, and it will likely remain untested un-

\textsuperscript{29} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Id.
\textsuperscript{33} Id.
\textsuperscript{36} See generally BEN BERNANKE, THE COURAGE TO ACT, A MEMOIR OF A CRISIS AND ITS AFTERMATH (W.W. Norton & Company 2015).
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Id.
til the next system-wide financial distress occurs. In June 2017, the private bailout of the Spanish Banco Popular by Banco Santander was the first triggering of the 2014 Bank Resolution and Recovery Directive (the Directive). This case, in comparison with the earlier approval of the government bailout of the Italian bank, Monte dei Paschi di Siena, demonstrates that the bigger financial trouble a financial institution faces, the more likely the tools provided by the 2014 Bank Resolution and Recovery Directive will be insufficient. These cases, together with the 2016 decision of the Court of Justice of the European Union that is discussed in depth later in this article, indicate that in simultaneous, massive bank failures, shareholders and unsecured creditors will be unable to absorb all the losses without a loss of investor confidence and a loss of systemic stability. This means that government interventions and bank bailouts simply cannot be excluded realistically in the future. Political pressure on EU institutions also increases flexibility when it comes to the application of the Directive. Additionally, only after three years of its adoption, there is an ongoing legislative project to amend the Directive. So it remains partly uncertain, what will be exactly the new legal framework in the next financial crisis and how will it function.

Additionally, it is worth mentioning some of the anomalies of the new system; investors—who are expected to absorb losses along with unsecured creditors of the failing financial institution—include retail investors. Based on the Markets in Financial Instruments Directive (MiFID), investors have to be informed about the details of the characteristics and risks of the investment based on how sophisticated they are. Retail investors have to be provided with much more information as compared to institutional investors. So by this, the legis-

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45 Id.
tor aimed to protect retail investors and put all investors in a similar position, in other words, to cure different levels of information asymmetry. This approach might work in the traditional disclosure-based system, such as the U.S., but taking into consideration, that in the EU the legislator has been decreasing gradually the responsibility of retail consumers in order to increase consumer protection in the past decades, it can be assumed that retail investors will challenge the bail-in system at the court. This adds to future legal uncertainty for investors. Also, the possible responsibility of financial intermediaries is not taken into account in the 2014 Bank Resolution and Recovery Directive.\(^46\) It does not seem to be logical not to extend financial burden-sharing to financial intermediaries. They advise their investor clients and have a great influence on investment decisions, and their exclusion may make them more careless; in case of bank failure investors bear the burden, not financial intermediaries.

Finally, the Directive may discourage private sector actions (e.g. raising capital privately in markets), because a private buyer—such as Banco Santander in the above mentioned case—has a much better position in the frame of bank resolution; the private buyer does not need to get the approval of shareholders. Instead, the resolution authority (the Single Resolution Board) authorizes the institution to transfer the shares of its assets to a private purchaser without the consent of shareholders.\(^47\) This seriously affects the property rights of shareholders. In addition, the power to decide which liabilities to transfer out of a failing institution based upon the objectives of ensuring the continuity of services and avoiding adverse effects on financial stability may affect the equal treatment of creditors negatively. Under the Directive’s system, in case of approval of the Bank Resolution Board the private investor can buy the failing financial institution without the consent of the shareholders, as it happened with the shareholders of Banco Popular in the above mentioned rescue by Banco Santander. This further weakens the position of shareholders, and also weakens investor confidence in the European region. The U.S. Federal Deposit Insurance Corporation (FDIC) is authorized to exercise similar powers to the EU’s bail-in tool before

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receivership, but shareholders are not explicitly excluded from the decision-making process.\textsuperscript{48} The EU’s message is clear-cut and not favorable for investors.

III. THE ROLE OF THE INTERNATIONAL CREDIT RATING AGENCIES

Credit rating agencies did not prove to be good “gatekeepers” before the financial crisis, not only because of their failure to rate certain bonds adequately, but also because of their politically biased rating practices.\textsuperscript{49} Rating agencies did not give warning signs before the 2008 crisis, leastwise, not with sufficient emphasis.\textsuperscript{50} Investors and financial regulators followed their ratings and analysis almost blindly, which underlines their crucial role in international investment decisions.\textsuperscript{51} This is why it is surprising that there have not been substantial changes in terms of regulation as to credit rating agencies.

Credit rating agencies were created in 1975 in the U.S. and reformed in 2006.\textsuperscript{52} The Securities and Exchange Commission (SEC) has the authority to license “nationally recognized statistical rating organizations.”\textsuperscript{53} The SEC permits the use of their ratings for regulatory purposes.\textsuperscript{54} Financial liability for issuing inaccurate ratings, guarding against conflicts of interest, and reporting and disclosure requirements of the rating agencies have been increased since the 2008 financial crisis on both sides of the Atlantic; in the United States by the 2010 Dodd-Frank Act,\textsuperscript{55} and in the EU by the 2009 Credit Rating Agencies Regulation\textsuperscript{56} and the strengthened regulatory practices of the European Securities and Markets Authority (ESMA).

Since 2007, the SEC—the regulator of credit rating agencies in the United States—has been trying to create more competition on the market by licensing


\textsuperscript{49} See JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE, (2006); see also György László, Nem minősítette fel Magyarországot a Fitch [Fitch did not upgrade the country risk rating of Hungary], MOZGASTER BLOG (Nov. 23, 2015), http://mozgasterblog.hu/blog/nem-minositette-fel-magyarorszagot-a-fitch.


\textsuperscript{51} See FIN. CRISIS INQUIRY COMM., supra note 50, at xxv.


\textsuperscript{53} Id. at sec. 101.

\textsuperscript{54} See FIN. CRISIS INQUIRY COMM., supra note 50.


ten new rating agencies, including two Japanese rating agencies,\(^57\) but it seems that the three big rating agencies—S&P Global Ratings, Moody’s, and Fitch—have conserved their market leader positions since about 2003 (earlier there were seven rating agencies in the United States). One can note similar tendencies in the European region. The EU has been trying to increase competition on the market of credit rating agencies, but without significant results.\(^58\) The European market of credit rating agencies is dominated by the three United States-based firms, S&P Global Ratings, Moody’s, and Fitch.\(^59\) Although the number of credit rating agencies has recently increased to more than twenty in Europe, the cross-border activities of the credit rating agencies are limited, and except for the three primary agencies, the size is small. The promotion of entry to the market of smaller rating agencies is a pointless policy aim in the author’s view because what is lacking is a large EU-based rating agency, which would create investor confidence on an international level. The reasons that there are only three large agencies requires further analysis\(^60\) as to whether this highly concentrated market structure is natural or whether it is a consequence of economic power. However, it is clear that credit rating agencies are crucial in the direction and flow of international investments. There are only a few—with the largest being U.S. institutions—and it would be beneficial to have a European credit rating agency of global influence to provide investors with more sophisticated information and analysis.

Another tendency on both sides of the Atlantic is that legislators and regulators have not intervened in the process that rating agencies use for their ratings. The U.S. legislature is more focused on disclosure and penalties than the European legislature, though both regulatory schemes are predominantly focused on transparency and disclosure.\(^61\) The Dodd-Frank Act specifically prohibits the SEC from regulating the methodologies that rating agencies apply.\(^62\) Article 8(3)


\(^{59}\) See id. at 9; see also List of agencies with CRA Authorisation, EUR. SEC. AND MKTS. AUTH. (last updated July 16, 2017), https://www.esma.europa.eu/supervision/credit-rating-agencies/risk.


\(^{61}\) Dodd-Frank Wall Street Reform and Consumer Protection Act, § 932(a)(8), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified at 15 U.S.C. § 78o-7(r) and § 78o-7(s)).

of the EU Credit Rating Agencies Regulation states that “a credit rating agency shall use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back testing.” The principle-based requirements of the Regulation do not impose the application of any specific methodology on credit rating agencies. The ESMA issued guidelines as to the methodology used by rating agencies—on international level a similar work has been done by the International Bank of Settlements—but these are soft laws that do not effectuate a substantial legislative or regulatory change as to methodology.

Another weakness of the existing regime under which rating agencies operate is that issuers frequently pay for the rating of certain bonds. This is true on both sides of the Atlantic. In the United States, the SEC began allowing this in the 1970s. The present issuer-pays model could be improved by alternative remuneration models, but these are hardly used at the moment in the United States and Europe. The United States also introduced a set of rules that aim to lessen reliance on rating agencies when banks calculate risks in their portfolio. But the Basel Committee has not introduced similar rules, so this approach lacks an international scope. The aim behind the United States’ rule has been to improve banks own assessments of the risks of loans when calculating capital requirements.

In sum, the fundamental issues that existed prior to the 2008 financial crisis as to rating agencies have remained substantially the same irrespective of the regulatory responses. Taking into consideration the amount of regulation that

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67 FIN. CRISIS INQUIRY COMM., supra note 50.
68 EUR. COMM’N, ECON. CRISIS IN EUROPE, supra note 50.
70 Report From The Commission To The European Parliament And The Council on alternative tools to external credit ratings, the state of the credit rating market, competition and governance in the credit rating industry, the state of the structured finance instruments rating market and on the feasibility of a European Credit Rating Agency, European Comm’n (Oct. 19, 2016), https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/1-2016-664-EN-F1-1.PDF. [hereinafter COMMISSION REPORT].
72 Caroline Binham, Banks Score Victory on Use of Ratings in Capital Calculations, Fin. TIMES (Dec. 10, 2015), https://www.ft.com/content/abc8f50a-9ea6-11e5-8ce1f6219b685d74?mhq5j=e5.
73 Id.
has developed over the past ten years, this is very surprising. It has to be re-
marked that the European Commission concluded in 2016 that creating a Eu-
ropean credit rating agency would only add costs but not value to the ratings.\textsuperscript{74} Instead of EU rating agency alternative tools—such as default swaps spreads and bond pricing information, accounting-based measures, OECD Country Risk classification—scorings by Central Banks, scorings offered by private compa-
nies and based on computational models are suggested by the European Com-
mission.\textsuperscript{75} In the United States, the Dodd-Frank Act also promotes alternative approaches (e.g. the use of definitions, regulatory models, and evaluation by third parties) and less reliance on rating agencies.\textsuperscript{76}

This comment does not argue that the EU or its member states should not organize, finance, or both to create a European big credit rating agency because such agency would not be credible. Countries wish to be highly rated and there-
fore, states are not impartial players on this market either. Rather, it is argued here that it is not beneficial for Europe because there is not a multi-state, private initiative for the creation of a big credit rating agency, which would enjoy investor confidence globally, or at least both on the U.S. and EU markets.\textsuperscript{77} The main problem with more reliance on alternative tools suggested by the European Commission is the lack of comparability on a global level.\textsuperscript{78} Without being comparable, those tools are largely useless for globally operating market players, and therefore, they will not be taken into account.

Even if most big institutional investors have their own research units and conduct independent risk analysis—and overleverage and the concentration of risk was perceived before 2008—the voice of rating agencies is more domi-
nant.\textsuperscript{79} For example, risk factors were identified and listed in the Goldman Sachs 1999 IPO prospectus (e.g. possibility of economic downturn, overleverage, concentration of risk, etc.),\textsuperscript{80} but most investors did not pay attention to those warnings. However, there were some market players in 2008 (e.g. John Paulson and later Goldman Sachs) who did identify and profit from the crash.\textsuperscript{81}

The regulation of credit rating agencies is an area where further development of international regulation is possible and likely in the future. The lack of a sufficiently significant European private initiative for creating a big credit rating

\textsuperscript{74} COMMISSION REPORT, supra note 70.
\textsuperscript{75} Id.
\textsuperscript{76} John Sorouhan, Credit Ratings in Financial Regulation: What’s Changed Since the Dodd-
Frank Act?, OFFICE OF FINANCIAL RESEARCH (Apr. 21, 2016), https://www.financialresearch.gov/brie-
iefs/files/OFRbr_2016-04_Credit-Ratings.pdf.
\textsuperscript{77} Id.
\textsuperscript{78} Binham supra note 72.
\textsuperscript{79} Id.
\textsuperscript{80} GOLDMAN SACHS, http://www.goldmansachs.com/investorrelations/financials/archived/other-
\textsuperscript{81} FIN. CRISIS INQUIRY COMM., supra note 50.
agency based in the EU, but of global effect, is a matter that cannot be remedied by legislation or regulation. It is an interest that should be recognized and acted upon in the EU by private actors.

Solidarity among EU member states has been stronger on some issues than others. As a consequence of the financial crisis, there was less solidarity and weaker cooperation when some of euro area members (namely Ireland, Portugal, Spain and Greece) were under severe pressure during the recent crisis. Neither the ECB nor the other, more fortunate members of the euro area were able to act as promptly and efficiently as the Federal Reserve did in 2008–2009 in order to lend a helping hand. An example of their failure is the rejection of the issuance of Euro Bonds—or as the European Commission calls them later, Stability Bonds—(mainly by Germany and by some other smaller EU member states) in the early years of the recent financial crisis, and the belated and limited application of monetary policy tools by the ECB. In contrast, the Federal Reserve adopted a generous policy during the crisis, including by acting as the lender of last resort, which enabled it to gain control over the crisis and limit its duration. In short, the ECB did too little, too late.

Within the EU there have been significant differences among member states’ country risk ratings, and a massive issuance of Euro Bonds might have led to a ratings downgrade of some of the member states. For example, the rating of Germany has been the best, AAA, but Spain’s rating is only BBB+ and Portugal’s is even worse, at BB+. The three big international credit rating agencies

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employ somewhat different ratings methods; the S&P Global Ratings (formerly Standard and Poor’s) sovereign rating scale employs, for example, eight categories, from AAA to CC.\footnote{S&P Global Ratings, supra note 88.} Country ratings are crucial for many reasons. First, the institutional ratings of banks and financial institutions depend on it; a bank’s rating cannot be higher than that of the country in which it operates. Second, under a certain rating level, a bank is not able to issue certain types of bank guarantees for its clients, preventing it from offering a service that is used in some of the biggest and most important business transactions.\footnote{Sovereign & Supranational, Moody’s, https://www.moodys.com/researchandratings/markets-segment/sovereign-supranational/-/005005/005005/-/0/0/-/-/-/en/global/pdf/ra (last visited July 5, 2017).} Third, country ratings also directly influence the interest rates, costs, and other contractual conditions related to obtaining credit for both retail and corporate clients in the country.\footnote{Id.} In general, the lower the country rating, the more expensive bank credit becomes.\footnote{Default, Transition, and Recovery: A Look at Ratings Behavior and Default Probability, Standard & Poor’s Ratings Services (May 29, 2015), http://www.spratings.com/documents/20-184/774196/A+Look+At+Ratings+Behavior+And+Default+Probability/89c2d8b1-2a02-4f5e-a9ed-36fb4e757a66.} This has far reaching effects on the country’s entire economy and rate of economic growth.\footnote{Id.}

The three big international credit rating agencies are all American institutions.\footnote{Shankar Ramakrishnan & Philip Scipio, Big Three in Credit Ratings Still Dominate Business (May 4, 2016), https://www.reuters.com/article/uscorpbonds-ratings/big-three-in-credit-ratings-still-dominate-business-idUSL2N17U1L4.} In Europe, the idea of creating a European credit rating agency was on the table several times in the past, last time in 2008, but has not become a reality.\footnote{Marc Rothermund & Maria Gerhardt, The European Credit Information Landscape, European Credit Research Institute, http://aei.pitt.edu/33375/1/ACCRSurvey_FinalReport_withCover.pdf.} The argument for having a European credit rating agency is that, besides the traditional, economic aspects, non-economic and political elements have been gradually and explicitly included in the practice of the three big rating agencies and the influence of those factors has increased, especially during the most difficult months of the recent financial crisis.\footnote{The Credit Rating Controversy, Council on Foreign Relations, https://www.cfr.org/bakground/credit-rating-controversy (Feb. 19, 2015).} Also, observers have argued that the rating agencies failed in the years leading to the crisis partly be-
cause they included political factors in their analysis, and that their failure largely contributed to the gravity of the recent financial crisis.98

The agencies publish country ratings twice per year on previously announced dates.99 For example, in 2017 S&P Global Ratings published Hungary’s country ratings on February 24th and August 25th.100 Investors pay close attention to these publications, as these ratings directly affect the flow and direction of capital in global financial markets.101 The publication of Hungary’s BBB- rating on September 16th, 2016, was particularly interesting, as macroeconomic indicators had improved consistently in the country for a long period, and the European Union had ended its excessive deficit procedure against Hungary in mid-2013.102 Yet, the rating agencies did not raise Hungary’s rating for more than two years.103 This could be explained by the harsh and massive governmental interventions in the economy and banking sector after 2008.104 Forty percent of the financial sector was nationalized in Hungary—similar events took place in some other EU member states, such as in Spain, or in the U.K. but under very different circumstances—and an unprecedented level of crisis tax was introduced specifically for the financial sector.105 In April 2016, Hungary paid back the standby credit it received from the IMF in 2008.106 Sovereign indebtedness in Hungary is still at high levels similar to those in other EU member states and the U.S., and it can only be reduced gradually; however, it has dropped recently and generally conflicts with trends within the EU.107

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98 FIN. CRISIS INQUIRY COMM, supra note 50. “In assessing sovereign risk, CRAs highlight several risk parameters of varying importance: (i) economic; (ii) political; (iii) fiscal and monetary flexibility; and (iv) the debt burden.” UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, CREDIT RATING AGENCIES AND THEIR POTENTIAL IMPACT ON DEVELOPING COUNTRIES, (Jan. 2008), http://unctad.org/en/docs/osgdp20081_en.pdf.


100 Id.

101 S&P GLOBAL RATINGS, supra note 88.


103 Id.


106 László György, Miért fontos, hogy visszafizettük az EU/IMF hitelt? [Why is it important that we have repaid the EU/IMF loan?] (Apr. 12, 2016), http://mozgasterblog.hu/blog/miert_fontos_hogy_visszafizettuk_az_eu_imf_hitelt.

107 General government gross debt of GDP, annual data in 2015: 74.7% in Hungary (74.1% in 2016), 89.0% in the United Kingdom (89.3% in 2016), 99.8% in Spain (99.4% in 2016), 71.2% in
Because of the central importance of international rating agencies, and the fact that the American agencies have, since 2008, been considering factors besides traditional economic indicators, there is a strong argument in favor of the creation of a European rating agency. This would create more competition in this market and better service quality for investors. Even though the EU Commission has recognized the risk and the lack of feasible alternatives of reliance on external credit rating agencies in the EU, unfortunately, the desirability of a European credit rating agency has not been recognized with sufficient emphasis so far, and no action has been taken in this respect.

IV. REGULATORY COMPETITION, COMPETITIVE REGULATION AND ITS IMPORTANCE FROM THE POINT OF VIEW OF ECONOMIC DEVELOPMENT

Before tackling the issue of regulatory competition, it is important to recognize that there are influences that run counter to a global or even EU cooperation on financial regulation. In the European region, the exit of the U.K. from the EU (Brexit) is the latest and most significant among those influences. London is the main financial hub in Europe and globally (together with New York). Because of Brexit, there has been competition to clear houses between the U.K. and France; at the moment, Paris is trying to attract clearing houses that are in London. In general, uncertainty around Brexit does not favor the European region: whether the U.K. or the EU—or none of them—will benefit from the process in the short-run depends on the outcome of this ongoing regulatory competition, and on the regulatory arbitrage that banks might engage in in order to seek the loosest regulatory environment (London may seek to retain banks this way after Brexit). Another influence against global regulatory advance-

Germany (68.3% in 2016), and the EU (28 countries) average is 84.9% (83.5% in 2016). EUROSTAT, GENERAL GOVERNMENT GROSS DEBT – ANNUAL DATA (Jul. 5, 2017), http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=teina225.

FIN. CRISIS INQUIRY COMM., supra note 50. “In assessing sovereign risk, CRAs highlight several risk parameters of varying importance: (i) economic; (ii) political; (iii) fiscal and monetary flexibility; and (iv) the debt burden.” MARWAN ELKHOURY, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, CREDIT RATING AGENCIES AND THEIR POTENTIAL IMPACT ON DEVELOPING COUNTRIES (2008), http://unctad.org/en/Docs/osgdp20081_en.pdf.

COMMISSION REPORT supra note 70.


Philip Stafford, Brexit threatens London’s Status as a Markets Hub: A Q&A, FIN. TIMES (June 30, 2016), https://www.ft.com/content/d3c6f9e8-3213-11e6-ad39-3fee5ffe5b3b.

The U.K. Will Make Concessions to EU Banks to Keep Them in London After Brexit, FORTUNE EDITORS & REUTERS (Dec. 20, 2017), http://fortune.com/2017/12/20/uk-boe-eu-banks-
ment has been the sharpened differences between the short-term economic interests of several EU member states (for example writing off part of the sovereign debt of Greece would jeopardize maintaining the AAA country rating of Germany), while recently the U.S. has been focusing on domestic economic interests rather than advancing international cooperation. This has led to new tensions in the U.S. and also in several member states of the EU, which simply run counter to a totally global financial regulatory system.

Notwithstanding, there is a reason to be optimistic, because in the past decades soft law-based global regulatory developments took place (primarily through the Recommendations of the Basel Committee on Banking Supervision—the Basel III criteria). Several significant jurisdictions opted for adopting those soft laws and made them hard law. The Basel III criteria are taken into consideration by the legislators and regulators globally. This committee of banking supervisory authorities issues recommendations on the area of risk management, capital, and liquidity requirements. The United States and European regulatory reforms have been designed in accordance with these global regulatory developments, so there is a possibility to coordinate banking regulation on certain areas, specifically, on capital and liquidity-related issues. Besides the bank-specific, micro-prudential regulations, these sector-specific, macro-prudential regulations are also highly relevant from the point of view of the stability of the financial sector.

In the past few years the EU has become a significant player in the area of international financial regulation. At the same time, U.S. regulatory solutions have influenced regulatory tendencies in Europe over the past several decades. This has been especially visible in the process of the elaboration of the EU Directives and Regulations and the operation of the European Commission


118 Id.
and the ECB. \footnote{For example, the IMF took part in the elaboration of the founding documents establishing the European Stability Mechanism (ESM) and the credit agreements of the ESM as an institutional advisor. \textit{EUR. STABILITY MECHANISM} (Jul. 5, 2017), http://esm.europa.eu/about/legal-documents/index.htm.} As a consequence of the 2008 financial crisis, the banking authority of the EU has been reshaped and strengthened.\footnote{\textit{Id.}} The ECB has become a “real” central bank for the euro area member states but not the entire territory of the EU.\footnote{\textit{Id.}} It makes monetary policy decisions, decides on the amount of Euros in circulation, and functions as supervisory authority for the banking sector.\footnote{\textit{Id.}} As a result, the former central banks of the euro area member states have basically become subsidiaries of the ECB, and execute its policy decisions.\footnote{\textit{Id.}}

Even in this new central-banking regime, supervision and direction is still partial.\footnote{\textit{Id.}} In non-euro area member states, the central banks continue to make monetary policy, and they have significant autonomy with respect to bank supervision and control. The members of the euro area must report more frequently to the ECB than non-euro area members.\footnote{\textit{Id.}} However, a certain level of coordination and supervision has become a reality over the entire territory of the EU in the area of banking in the form of the Single Supervisory Mechanism—one of the pillars of the European Banking Union.\footnote{\textit{Id.}} After 2008 the other pillar, the Single Resolution Mechanism, has been strengthened,\footnote{\textit{Id.}} and it will fully function starting on January 1, 2024, when the bank resolution funds, contributed by member states, will be fully available.\footnote{\textit{Id.}} This means that in case of bank failure, there will be a uniform resolution mechanism.\footnote{\textit{Id.}} The essence of the 2014 Bank Resolution and Recovery Directive is that in case of bank failure, banks could be recapitalized only through a bail-in tool described in the Directive (burden-sharing by shareholders and subordinated creditors, conversion or write-down of...}
subordinated debt), rather than being bailed out by the member states. However, the EU Court of Justice (the ECJ) held in the Kotnik Case in July 2016 that bank bailouts cannot be fully excluded, but can be used as ad hoc measures in severe crises after the exhaustion of the bail-in tool. This new system aimed to strengthen the financial sector and restore investor confidence in the European region, which weakened during the sovereign debt crisis, but it has failed to do so. There is still an ongoing economic recession or stagnation in the EU, and the prospect of an expensive bail-in imposed on shareholders and creditors does not make the European region more attractive for investors.

In preparation for future crisis situations, the euro area member states created the European Stability Mechanism (ESM) in 2012, which is basically a crisis fund for exceptional situations. Besides the above mentioned twin pillars of the forming banking union and the ESM, the deposit insurance schemes of member states also contribute to systemic stability. Although these schemes have been operating for decades, their function is limited to the indemnification of depositors. Meanwhile, in the United States the FDIC also fulfills substantial systemic stability-related functions, such as acting as receiver in the resolution of failed banks and being available for bailout purposes in financial crises.

Finally, one cannot give an overview of the EU-level regulatory framework without mentioning the role of international organizations, such as the IMF and the World Bank. Those organizations’ data collection recommendations and advisory activities have greatly contributed to the redesign of the regulation of the financial sector in Europe. For example, the recommendations of the IMF were explicitly included in the founding documents of the ESM.

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130 Id.
132 Id.
135 Id. at 6.
138 Id.
V. Conclusion

Are Europe and the EU still in crisis in 2017? I think that they are. Besides the economic and sovereign-debt crisis, there has been a political crisis as well. The EU has not been able to respond efficiently to any of the major economic and social challenges of the past several years. Crises are not extraordinary situations in Europe. The history and analysis of crises in modern capitalist economies are available in the literature, and regulators are in a fortunate position, as they can study the reasons, characteristics, and frequency of past crises, as well as the effectiveness of past crisis-management tools.\textsuperscript{140} Therefore, the important question is not whether there is a crisis in Europe. The important question is how quickly and thoroughly Europe will adapt to the changing economic and social circumstances, and whether it will be able to reinvent itself. As Winston Churchill said: “To improve is to change, so to be perfect is to have changed often.”\textsuperscript{141} From this point of view, the EU of the post-2008 era could not be further from being perfect.

There is a symbolic place in the heart of Manhattan; the library of John Pierpont Morgan (Morgan Library).\textsuperscript{142} It happened here, in the West Room that Mr. Morgan called together a group of bankers in 1907 to resolve the national financial panic which led to the foundation of the Federal Reserve.\textsuperscript{143} It is a symbolic place because in the United States, even the central bank was born as a consequence of organic cooperation between private and public entities.\textsuperscript{144} This culture of cooperation was also present in the 2008–2009 bank bailout cases. Europe would hugely benefit from having a similar approach, which apparently is much less present, if not lacking, in the old continent.

This comment focuses on three key issues: the bailout and sector-wide rescue schemes for failing financial institutions; the consequential sovereign-debt crisis; the crucial role of the international credit rating agencies, and the fundamental changes on the area of the regulation of the financial sector. This comment aims to answer two questions: First, how has the position and global competitiveness of Europe changed as the consequence of the 2008 global financial crisis and second, what are the possible consequences of those changes? Although sovereign indebtedness has reached unprecedented levels in most of the EU member states, this issue is not EU-specific. Rather, it is a global phenome-

\textsuperscript{140} Reinhart C. M. and Rogoff K. S., This Time Is Different: Eight Centuries of Financial Folly, Princeton University (2009).


\textsuperscript{143} Id.

\textsuperscript{144} Id.
non present in all capitalist market economies, including the United States, and it raises larger questions about the possible or necessary corrections in capitalist economies. This comment argues that instead of focusing on the protection of the public budget and taxpayers’ dollars, the EU should have put more emphasis on regaining investors’ confidence when reshaping the regulation of its financial sector. The EU has had slow and chaotic crisis management, along with the imposition of the financial contribution of shareholders and creditors in case of future bank failures. \[145\] Thus, the EU has failed to achieve this objective in recent years. \[146\]

It would be a positive development if a European credit rating agency of global influence arose to compete with the big three American rating agencies. Such development would enable investors to make global investment decisions based on more sophisticated and diverse information. Europe has, however, failed to organize such an institution, and as of 2017 this issue is no longer being considered. \[147\]

With respect to financial-sector regulation, Europe has been following the much more efficient and flexible U.S. regulatory tendencies for decades. Ironically, the outbreak of the recent financial crisis was largely caused by the inaccurate information about subprime mortgages and the related imprudent business practices of U.S. banks. Like the EU, the United States responded to the crisis with extensive regulation, the strengthening of consumer protection, prudential supervision, and stress testing. \[148\] Europe should be able to react much more quickly and efficiently to the recent economic and social changes. \[149\] Enhanced flexibility could be achieved through increased willingness among member states to cooperate and compromise, based on the common interests of Europe as a region. Unfortunately, in recent times one can see exactly the opposite trend. The United Kingdom is in the process of leaving the EU, and the lack of efficient EU-level solutions and the inability of even among the biggest


\[146\] Graph of the week: Investment in the EU, EUR. COMM’N (Jan. 27, 2017), http://ec.europa.eu/economy_finance/graphs/2015-01-12_investment_in_en_en.htm (“The main reason investment in the EU has remained weak is low investor confidence.”).


member states (the UK, France, and Germany) to compromise has led to frac-
tions within the EU. Most recently, the split has been between the EU’s Western
and Eastern segments.

Although the EU’s financial-sector regulatory reforms have been profound
and extensive since 2008, and they are also largely in line with global regulatory
trends, one can observe that the EU, by reacting with inadequate speed and
force, has failed to restore investor confidence. As a result, it is stuck at low lev-
els of economic growth and lagging in competitiveness.