EU IMPLEMENTATION OF BASEL III IN THE SHADOW OF EURO CRISIS

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Abstract

This article examines the implementation path of Basel III reforms within the European Union ("EU"). Basel III is the most recent version of the Basel global standards for bank regulation, adopted in response to the 2007/2008 financial crisis. Several EU Member States, as well as the EU Commission and the European Central Bank, participated in the design of the Basel III reforms. The greater part of these reforms is packaged in the so-called Fourth Capital Requirements Directive and Regulation, or CRD IV. It is the European sovereign debt crisis, and not the 2007/2008 financial meltdown, which dominated the mind of the EU legislator—and as a result European faithfulness to Basel III has attenuated. This article identifies two species of EU departures from Basel III: (1) treating a Basel III norm as a fixed obligation and not as a minimum standard; and (2) selective adoption of Basel III norms (Basel à la carte). It then discusses the future of Basel III in the EU as the Eurozone approaches a banking union.

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I. Introduction

This article examines the implementation of the post-crisis Basel III reforms within the European Union ("EU"). This article traces two fairly distinct phases, each with its own particular character and regulatory trajectory. It also looks forward, to an eventual Eurozone banking union where an even greater part of European banking regulation will be vested in European institutions (foremost of which will be the European Central Bank ("ECB")).

The two phases of Basel III implementation tracked here are:

1. EU and Member State participation in the Basel III reform process undertaken in the wake of the 2007/2008 financial crisis ("2007/2008 Crisis"), followed by the initiation of the implementation of these reforms through the EU legislative process. The larger part of these reforms was incorporated in the so-called Fourth Capital Requirements Directive and Regulation ("CRD IV") legislative package.[1]

2. The subsequent impact of the European sovereign debt crisis ("Euro Crisis") which placed the current arrangements within the Eurozone under perilous stress and which in turn has set in motion tectonic shifts in the regulation of banking in Europe.

During the unfolding of these developments, various debates opened; since then, some of these controversies have closed or were

[1] CRD IV is comprised of a regulation and a directive. Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation 648/2012, 2012 O.J. (L 201); Directive 2012/36/EU of the European Parliament and of the Council on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, Amending Directive 2002/87/EC, 2002 O.J. (L 35) and Repealing Directives 2006/48/EC, 2006 O.J. (L 177) and 2006/49/EC, 2006 O.J. (L 177).

overtaken by the rush of events.[2] Institutional and constitutional parameters have shifted. CRD IV may, in the end, be a mere way-station on the road to EU-wide (or at least Eurozone-wide) banking regulation directly administered by European institutions. EU law has been sandwiched between Basel-sourced norms and Member State activation; this position will change as the EU (and especially the ECB) undertakes an enhanced role in the supervision of banks.

Europe has a history of faithful, if not mechanical, implementation of the global banking standards promulgated in Basel.[3] The EU's implementation of the current Basel III system is proving to be a break from past practice. In part, this new, more selective approach simply reflects new concerns presented by the Euro Crisis, a development not fully anticipated during the creation of Basel III.[4] It is the Euro Crisis, and not the fading 2007/2008 financial meltdown, that dominated the mind of the EU legislator during most of the CRD IV legislative process.[5] But the Basel III implementation story also demonstrates the maturation of EU-level politics. Several of the controversies "settled" in the Basel process were re-opened for contest during the negotiation of CRD IV.[6] The European Parliament in particular refused to apply a rubber stamp to

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[2] The need for quick action in solving the Eurozone's economic crisis has fueled this rush of events and has loomed in the back of legislators' minds throughout the debate process. As George Osborne, Britain's Chancellor of the Exchequer, pointed out, "The euro zone leaders know that time is running out, that they need to deliver a solution to the uncertainty in the markets." Stephen Castle, *Meetings on European Debt Crisis End in Debate, but Little Progress*, N.Y. TIMES (Sept. 18, 2011), http://www.nytimes.com/2011/09/18/business/global/meetings-on-european-debt-crisis-end-in-debate-but-little-progress.html. *See also* Rebecca Christie & Caroline Connan, *EU Eyes March 22 Deadline for Basel Law to Avoid Delays*, BLOOMBERG (Feb. 26, 2013, 5:42 AM), http://www.bloomberg.com/news/2013-02-25/eu-eyes-march-22-deadline-for-basel-law-to-avoid-delays.html (reporting on the press for time to hit the EU's January 2014 target date to implement the Basel III Accord).

[3] *See* Frank Dierick, Fatima Pires, Martin Scheicher & Kai Gereon Spitzer, The New Basel Capital Framework and Its Implementation in the European Union, EUR. CENT. BANK OCCASIONAL PAPER NO. 42, at 20–23 (Dec. 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=807416 (acknowledging that the EU rules are to a large extent based on the texts of the Basel Committee).

[4] *See* discussion *infra* Part IV.A.

[5] *See* discussion *infra* Part IV.A.

[6] *See* discussion *infra* Part III.B.

the CRD IV package brought back from Basel.[7] As Europe's financial stature grows, so too may Europe exercise greater range to pick and choose those elements of the Basel program which best suit its internal interests.

The recent course of European banking reform has played out alongside the Euro Crisis. Europe has now implemented much (but not all) of Basel III package of reforms in CRD IV.[8] But CRD IV will hardly complete the restructuring of European banking regulation. The Euro Crisis has triggered a re-evaluation of the design and functioning of the European banking system, particularly within the Eurozone. The Euro Crisis has also further divided the Eurozone Member States from those EU banking powers outside the Eurozone (chiefly the United Kingdom and Sweden).[9] The force of the Euro Crisis will propel Europe (and especially the Eurozone) away from the global consensus struck in Basel, and this divergence has particular implications for London.

This article explores EU departures from the Basel III undertakings. The first is EU's treatment of many Basel III norms as fixed obligations, and not as minimum standards.[10] And, in certain instances, the EU has resisted a Basel III result and elected a studied course of non-implementation.[11] This new discretion is described here as "Basel à la carte."

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[7] *See* discussion *infra* Part IV.B.

[8] *See* Press Release, Eur. Comm'n, CRD IV/CRR—Frequently Asked Questions 5 (Mar. 21, 2013), *available at* http://europa.eu/rapid/press-release_MEMO-13-272_en.htm [hereinafter CRD FAQ I].

[9] *See Making the Break*, THE ECONOMIST (Dec. 8, 2012), http://www.economist.com/news/briefing/21567914-how-britain-could-fall-out-european-union-and-what-it-would-mean-making-break ("The euro-zone crisis has exposed the lack of dynamism in much of Europe (though Britain itself is hardly booming) and the British also feel sidelined, as countries that use the single currency are pulled more tightly together.").

[10] *See* CRD FAQ I, *supra* note 8, at 5 ("For the first time a single set of harmonised prudential rules is created which banks throughout the EU must respect. EU heads of state and government had called for a 'single rule book' in the wake of the crisis. This will ensure uniform application of Basel III in all Member States . . . .").

[11] *See id.* (recognizing that "[t]here are two reasons why Basel III cannot simply be copy/pasted into EU legislation," and therefore, a faithful implementation of the Basel III framework shall be assessed having regard to the substance of the rules).

EU banking regulation will have a European character and will reflect the realities of European politics. Basel III will also serve—in a way perhaps unintended by the European officials who took part in the Basel III process—as the foundation for substantive rules applied to Eurozone banks within the emergent European banking union.

II. Basel and Brussels

A. Basel and Basel II in European Law

Basel, a historic city on the Rhine, is Swiss of course: it sits outside the territory of the EU.[12] Yet it is a quintessentially European city, with neighborhoods spilling into adjacent France and Germany.[13] Basel's chief international institution—the Bank for International Settlements ("BIS")[14]—was established to serve a multilateral purpose: the processing of post-World War I reparation payments by Germany.[15] Basel the city has become global in its reach and influence. Indeed, Basel's two multinational pharmaceutical firms—Roche and Novartis—rank among the top

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[12] *Basel Region Location/Climate*, BASEL-VIRTUELL, http://www.basel-virtuell.ch/en/basel_region/basel_city/location_climate (last visited Jan. 16, 2014).

[13] *Id.*

[14] *See BIS History: Overview*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/about/history.htm (last visited Jan. 16, 2014) [hereinafter *BIS History*].

[15] *Id.* The BIS was established in Basel after World War I in order to administer the payment of war reparations. *Id.* These were, by-and-large, payments owed by Germany to its victorious European neighbors, France and the United Kingdom. *Id.* While this function long predates the establishment of the EU, it reflects the use of Basel as a locus for coordinating financial relations among the chief European powers. In modern times, the BIS has evolved into the major forum for coordination among central bankers and bank supervisors. *Id.*

Timothy Canova has argued that the BIS in its current role as a forum for central bankers and bank supervisors has served to promote the conventional model of an autonomous or independent central bank, removed from the control of the elected branches of national government. *See* Timothy A. Canova, *Banking and Financial Reform at the Crossroads of the Neoliberal Contagion*, 14 AM. U. INT'L L. REV. 1571, 1614–15 (1999); Castle, *supra* note 2.

five health care companies in the world.[16] The mandate of the BIS has similarly expanded to a global scale.[17]

Basel also provides the name of a system for the international coordination of national banking regulation, sponsored by the Basel Committee on Banking Supervision ("BCBS"), which is "hosted" by the BIS.[18] The major European banking powers have been active participants in the formulation of Basel rules.[19]

Basel norms had been enthusiastically embraced by Brussels in recent years.[20] Basel provided an external motive for greater harmonization of banking law in Europe: harmonization, which, in turn, furthered the European project.[21] Each succeeding Basel agreement functioned as a mandate for consistent European banking

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[16] *See Top 15 Pharma Companies of 2013*, GENETIC ENG'G & BIOTECH. NEWS (July 29, 2013), http://www.genengnews.com/insight-and-intelligenceand153/top-15-pharma-companies-of-2013/77899860/?page=2.

[17] *See The BIS and the Pursuit of Global Financial Stability*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/about/global_financial_stability.htm (last visited Jan. 16, 2014) ("In 1999, the Financial Stability Institute (FSI) was created to promote dissemination of the work undertaken by the supervisory community, and to provide practical training for financial sector supervisors worldwide.").

[18] *Basel Committee on Banking Supervision*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/ (last visited Jan. 16, 2014) [hereinafter *BCBS*].

[19] The current Basel edition—Basel III—is formally promulgated by the Basel Committee on Banking Supervision. *See International Regulatory Framework for Banks (Basel III)*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/basel3.htm (last visited Jan. 16, 2014) [hereinafter *Basel III*]. The Basel Committee includes representatives from EU member states Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden, and the United Kingdom. *Id.* Basel III received its political blessing—and much of its mandate—from the Group of Twenty, which includes EU member states France, Germany, Italy, and the United Kingdom, as well as representatives from the EU. *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, A BRIEF HISTORY OF THE BASEL COMMITTEE 1 (2013), *available at* http://www.bis.org/bcbs/history.pdf [hereinafter BASEL COMM. HISTORY].

[20] *See* Dierick et al., *supra* note 3, at 20–23.

[21] *See* Bryan J. Balin, Basel I, Basel II, and Emerging Markets: A Nontechnical Analysis 1 (May 10, 2008) (part of unpublished graduate thesis, Johns Hopkins University), *available at* https://jscholarship.library.jhu.edu/bitstream/handle/1774.2/32826/Basel%20I%2c%20Basel%20II%2c%20and%20Emerging%20Markets%20a%20Nontechnical%20Analysis052008.pdf?sequence=1.

reform within the bounds of that agreement.[22] The Basel-induced functional harmonization of Member State law created an opportunity for the Brussels-level institutions to operate as a coordination mechanism, and thus expanded their competence and influence.[23] Note, however, that Member States were able to anticipate the content of the harmonization program prior to its enactment.[24] The EU Member States could directly observe the incipient norms by examining the Basel instruments themselves.[25]

Basel II, for example, was faithfully transmitted to the EU Member States through a series of EU directives.[26] These directives mandated observance of Basel II's rules but permitted wide areas of discretion to be exercised by Member State authorities.[27] These earlier Capital Requirement Directives served as the basis for EU-wide harmonization of minimum bank capital levels.[28] Perhaps more importantly, they transmitted much of Basel II's self-regulatory spirit (which came to function as a regulatory "soft-touch") into Member

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[22] *Id.* ("Through quantitative and technical benchmarks, both accords have helped harmonize banking supervision, regulation, and capital adequacy standards across the eleven countries of the Basel Group and many other emerging market economies.").

[23] *Id.* ("Their goal, as stated in the Founding Document of the Basel Committee, is to . . . 'extend regulatory coverage, promote adequate banking supervision, and ensure that no foreign banking establishment can escape supervision' . . . .").

[24] *Id.* ("[A]s the Founding Document clearly states, the Basel Committee cannot enact legally binding banking standards. Therefore, it is up to the member states themselves to implement and enforce the recommendations of the Basel Committee.").

[25] *See id.*

[26] *See Progress on Basel II Implementation, New Workstreams and Outreach*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/publ/bcbs_nl11.htm (last visited Jan. 16, 2014) [hereinafter *Progress on Basel II Implementation*].

[27] Jaime Caruana, Governor of the Bank of Spain and Chairman of the Basel Comm. on Banking Supervision, Remarks at the Central Banks and the Challenge of Development Conference: The Implementation of Basel II 3 (Mar. 13, 2006), *available at* http://www.bis.org/review/r060531b.pdf ("Basel II is not a 'one size fits all' framework. Supervisors can adopt the framework on an evolutionary basis and use elements of national discretion to adapt it to their needs.").

[28] *See* Marianne Ojo, Basel II and the Capital Requirements Directive: Responding to the 2008/09 Financial Crisis 2–3 (Sept. 18, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1475189.

State law.[29] The very presence of a flow of Basel-level rules served to expand the role of EU law in coordinating banking law convergence in Europe.[30]

Basel itself is a coordinating mechanism. It results in loose agreements that do not rise to the level of legal engagements.[31] The countries participating in the Basel system do not formalize their mutual commitments in treaty obligations.[32] The various Basel undertakings are formally non-binding.[33] There is, as a result, no recourse to dispute settlement in the event a Basel signatory fails to carry out its Basel commitments.

As such, Basel agreements contrast with other international economic policy coordination mechanisms such as the World Trade Organization ("WTO") agreements.[34] That said, Basel certainly creates expectations of compliance by the countries engaged in its rule formulation—and compliance has been (at least with respect to national implementation) quite high throughout its history.[35] As soft law goes, Basel is fairly "hard." Further, Basel norms may be

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[29] Kern Alexander, *Global Financial Standard Setting, The G10 Committees, and International Economic Law*, 34 BROOK. J. INT'L L. 861, 876 (2009) ("As an international legal matter, the Basel Capital Accord and its amended version, Basel II, are not legally binding in any way for G10 countries or other countries that adhere to it. The Capital Accord has been analyzed and classified as a form of 'soft' law.").

[30] *See Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/publ/bcbs118.htm (last visited Jan. 16, 2014).

[31] *See* BASEL COMM. HISTORY, *supra* note 19, at 1 ("The Committee's decisions have no legal force.").

[32] *See* Alexander, *supra* note 29, at 867.

[33] BASEL COMM. HISTORY, *supra* note 19, at 1.

[34] *See* Alexander, *supra* note 29, at 867 ("In contrast to international economic organizations such as the WTO, or BIS, international standard-setting bodies are not entities with separate legal personality created by States, but rather informal associations of state representative and/or professionals that meet to address specific problems or to identify issues of concern.").

[35] *See id.* at 873 ("To ensure that its standards are adopted, the Committee expects the IMF and World Bank to play a surveillance role in overseeing Member State adherence through its various conditionality programs. In addition, because most G10 countries are members of the European Union, they are required by EU law to implement the Capital Accord into domestic law.").

followed by states outside its formal membership.[36] Basel norms are considered best practices by many national bank regulators.[37]

Basel has grown alongside the WTO and the EU[38]—and has been inspired by each.[39] Like the WTO, Basel dominates a field of important international economic activity. Basel is concerned with international competition, the avoidance of trade barriers created by regulatory divergence, and the facilitation of cross-border exchange.[40] But Basel differs from much WTO law in that it affirmatively directs the form and content of national law (and in this, Basel resembles EU law).[41] Most WTO law, in contrast, simply sets limits on national action;[42] WTO law, in spirit, is largely deregulatory.[43]

EU law inspires Basel law in its use of harmonization as its principal technique.[44] That is, all Basel participants, including the EU, enjoy considerable latitude in the manner and means of their

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[36] *See id.* at 875.

[37] *See id.* at 868 ("These committees have examined many important economic policy and financial regulatory issues, as well as elaborated and promulgated best practices in supervision and regulation, the functioning of payment, settlement systems, and the overall operation of financial markets.").

[38] The BIS established the Basel Committee in 1974. *See* BASEL COMM. HISTORY, *supra* note 19, at 1. The Basel Committee has included the chief bank regulators (central bank governors and bank supervisors) from the world's major banking centers. *Id.*

[39] *See* Alexander, *supra* note 29, at 866.

[40] *See id.*

[41] *See id.* at 876.

[42] *See Understanding the WTO*, WORLD TRADE ORG., http://www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm (last visited Jan. 16, 2014) [hereinafter *WTO*]. TRIPS is the exception within the WTO arrangements that proves the rule. *See Overview: The TRIPS Agreement*, WORLD TRADE ORG., http://www.wto.org/english/tratop_e/trips_e/intel2_e.htm (last visited Nov. 8, 2013). TRIPS mandates that each WTO member implement a system of intellectual property protection. *Id.*

[43] *See WTO*, *supra* note 42 ("At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations. These documents provide the legal ground rules for international commerce. They are essentially contracts, binding governments to keep their trade policies within agreed limits.").

[44] *See generally* JUNJI NAKAGAWA, INTERNATIONAL HARMONIZATION OF ECONOMIC REGULATION (2011).

implementation[45]—although this discretion may be narrowing as Basel norms become more specific over time.

No point of Basel law is "directly effective" (to borrow a concept from EU law).[46] This is certainly true from a "Basel perspective," in that the Basel rules do not pretend to have any automatic application. And even the most extremely monist nation would be unlikely to directly apply Basel law without some form of national transcription, given Basel's informal legal status.[47] After all, Basel norms are neither treaty commitments nor customary international law.[48]

Rather Basel law serves, much like a European directive, to guide national implementation. The form of national implementation—whether by statue, regulation, guidelines or whatever—is left to national discretion.[49] Basel law does, however, speak directly to the banks and other financial institutions that are the ultimate object of its strictures.[50] Banks anticipate the ultimate application of Basel norms in the various jurisdictions in which they operate; as such, there is considerable practical effectiveness directly exerted by Basel norms.[51]

The EU has quite loyally transmitted the Basel undertakings into EU law.[52] It is little exaggeration to state that Basel has been a major determinant of trans-European banking regulation.[53] Many of

[45] Alexander, *supra* note 29, at 874.
[46] "Direct effect" is a principle of EU law according to which provisions of Union law may, if appropriately framed, confer rights on individuals, which the courts of Member States of the EU are bound to recognize and enforce. *See* Eur. Comm'n, *The Direct Effect of European Law*, EUROPA.EU, http://europa.eu/legislation_summaries/institutional_affairs/decisionmaking_process/l14547_en.htm (last visited Jan. 16, 2014).
[47] *See supra* notes 27–33 and accompanying text.
[48] Alexander, *supra* note 29, at 869.
[49] *Id.* at 874.
[50] *See* Balin, *supra* note 21, at 2.
[51] Alexander, *supra* note 29, at 875.
[52] *See* Eur. Union, *The Taking-Up and Pursuit of the Business of Credit Institutions*, EUROPA.EU, http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_banking/l24234_en.htm (last visited Jan. 16, 2014) ("Directives 2006/48/EC and 2006/49/EC have transposed into Community law the Basel II rules on measuring own funds and capital requirements agreed by the G-10.").
[53] The Second Banking Directive is an example of an important EU banking law with no Basel roots. It famously allocated regulatory authority among

the central EU directives in the banking sector—the earlier Capital Requirements Directives—are largely European implementation of Basel engagements.[54] In a curious way, Basel has been used to support and legitimate Brussels-level exercise of competency in harmonizing Member State bank regulation.[55] Of course, neither Basel nor Brussels exhausts national competency in bank regulation.

We might usefully attribute the various sources of EU Member State banking regulation into three parts:

1. Brussels-Mandated Regulation Implementing Basel Norms. The EU-level Basel commitments, once reduced to EU-wide legislation (such as CRD IV), enjoy supremacy over conflicting Member State norms.[56] By terms of the basic EU treaties, that part of the CRD IV package that takes the form of a regulation becomes directly applicable to the Member States.[57]

2. Brussels-Mandated Regulation Exercising Discretion Within Limits of EU "Constitutional" Treaties. For example, the provisions of CRD IV that comprise a directive require the Member States to undertake implementing national legislation.[58] This national legislation must follow the design of the directive[59] and cannot

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the Member States and de facto harmonized the range of activities open to EU banks.

54 *See, e.g.*, Council Directive 2006/48/EC, 2006 O.J. (L 177) 1, 4; Council Directive 2006/49/EC, 2006 O.J. (L 177) 201, 201–03.

55 *See supra* notes 21–23 and accompanying text.

56 Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Mar. 30, 2010, 2010 O.J. (C 83) 01 [hereinafter Consolidated TEU and TFEU].

57 *See* Consolidated TEU and TFEU art. 288 (explaining in Article 288 of the Treaty on the Functioning of the European Union (TFEU) that a regulation "shall have general application" and "be binding in its entirety and directly applicable in all Member States").

58 *See* Directive 2013/36, *supra* note 1, at 1 (requiring the authorities to institute arrangements in accordance with the general requirements of the Regulation).

59 Article 288 of TFEU further provides that "[a] directive shall be binding, as to the result to be achieved, upon each Member State to which it is

be inconsistent with the directive.[60] The Second Banking Directive ("SBD"), a central piece of EU banking law, is a further example; SBD allocates regulatory authority among the Member States.[61]

3. <u>Member State Regulation in Residual Discretionary Zone Within Treaty Limits.</u> There remains an important zone of action open to Member State national authorities. Under current constitutional arrangements, the EU Member States, including the Eurozone Member States, enjoy substantial residual authority to set banking policies.[62] For the Eurozone Member States, however, this authority may be substantially reduced by the eventual emergence of a Eurozone banking union.[63]

How much European banking regulation falls within each of these categories would be difficult to quantify. That said, the expansion of

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addressed, but shall leave to the national authorities the choice of form and methods." *Id.*

[60] Similarly, the recent transfer to the ECB of supervision of Europe's largest banks is an example of Brussels' exercise of newly expanded powers. *See* George S. Zavvos, Legal Advisor, Legal Serv.—Eur. Comm'n, Towards a European Banking Union: Legal and Policy Implications, Address at the 22nd Annual Hyman P. Minsky Conference: "Building a Financial Structure for a More Stable and Equitable Economy" 4–7 (Apr. 18, 2013), *available at* http://www.levyinstitute.org/conferences/minsky2013/Zavvos_speech.pdf.

[61] Second Council Directive No. 89/646/EEC of 15 Dec. 1989, arts. 3–7, 1989 O.J. (L 386) 1, 4–5.

[62] *See* Katja Langenbucher, *Bausteine eines Bankgesellschaftsrechts: Zur Stellung des Aufsichtsrats in Finanzinstituten* [*CRD IV and Corporate Governance of Banks–A New Discipline in the Making*], 176 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT 652, 652–55, 662 (2012) (Ger.). Germany, for example, is exercising its residual authority in reforming the corporate governance features of its national banking law (*Kreditwesengesetz*). *See id.*

[63] *See* Emilios Avgouleas & Douglas W. Arner, The Eurozone Debt Crisis and the European Banking Union: A Cautionary Tale of Failure and Reform 25 (Oct. 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2347937.

Basel norms through the three "generations" described here—the 1988 Basel Accord, Basel II in 2004, and now Basel III—has resulted in the withdrawal of more and more matters from a zone of discretion that had previously been enjoyed either freely at the Member State level or exercised through Brussels-level competence.[64] While the collective EU and Member State freedom of action has been curtailed by Basel, Brussels has gained new authority at the expense of the Member States.[65]

CRD IV's "Single Rulebook" largely departs from the Basel transmission process.[66] The new approach reflects both the wider scope of Basel III (in comparison with Basel II) as well as the deeper integration created by the adoption of the euro.[67] Basel III will

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[64] *See* Stefan Ingves, Chairman, Basel Comm. on Banking Supervision, Welcome and Keynote Address at a Symposium to Mark 25 Years of the Basel Capital Accord: 25 Years of International Financial Regulation: Challenges and Opportunities 3 (Sept. 26, 2013), *available at* https://www.bis.org/speeches/sp130926.pdf (celebrating Basel Committee's expansion and evolution into an international standard-setter and a peer reviewer of members' compliance with their agreements).

[65] Gareth Jones, *Germans Distrust Brussels, Want UK to Stay in EU: Poll*, REUTERS (Sept. 17, 2013, 10:09 AM), http://www.reuters.com/article/2013/09/17/us-germany-eu-survey-idUSBRE98G0P220130917 (reporting the results of a German poll that said one in two want Brussels to devolve more powers to EU member states).

[66] *See The Single Rulebook*, EUR. BANKING AUTH., http://www.eba.europa.eu/regulation-and-policy/single-rulebook (explaining what the Single Rulebook is and why it is important); *see generally* Nicolas Véron, *A New Era for Global Financial Standards*, VOX (Mar. 17, 2012), http://www.voxeu.org/article/new-era-global-financial-standards. The EU's implementation of Basel III changes the Basel transmission process in an important way. While the current legislation is known as the Capital Requirements Directive IV, the descriptor of "directive" is no longer precise. The earlier Capital Requirements Directives were, by and large, directives: commands to EU member states to enact national legislation consistent with the directive's design. LINKLATERS, COMPARISON BETWEEN CAPITAL REQUIREMENTS DIRECTIVE IV AND BASEL III 2 (Benedict James & Andrew Forde eds., 2011), *available at* http://www.linklaters.com/Publications/Comparison-Capital-Requirements-Firective-IV-Basel-III/Pages/Index.aspx. In Contrast, CRD IV prominently features a regulation, containing much of the new "single rulebook" that will apply directly and uniformly throughout the EU territory. *See id.*

[67] *See Adopting the Euro*, EUR. COMM'N, http://ec.europa.eu/economy_finance/euro/adoption/ (last visited Jan. 16, 2014).

control more aspects of the European banking regulation—and will do so more directly and with greater specificity.[68] Basel (and less so Brussels) has thus become the ultimate source for a significant portion of EU banking law.

The 2007/2008 Crisis has accelerated the growth of the Basel domain. In responding to the crisis, the major banking powers, including the EU, have accorded a considerable thickening of Basel law. Basel III—the post-2007/2008 Crisis generation of Basel norms—significantly expands the mandates for harmonized national regulation.[69] These new disciplines—intermediated by Brussels—are reflected in new and more complex harmonizing legislation that is imposed on national authorities for eventual implementation and administration.[70] They will serve as the foundation for the substantive rules to be administered by the ECB in supervising the Eurozone's largest banks as part of the newly established Single Supervisory Mechanism ("SSM").[71]

The operation of various European banking directives has created conditions for the operation of the European "banking passport"—the regulatory notion that, once having met the standards of a single Member State banking regulator, an institution may operate throughout the European territory.[72] For the moment (and this is about to change with regard to Europe's largest banks), a banking institution is supervised by the relevant authorities of its home Member State with respect to its activities throughout the EU

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[68] *See* Véron, *supra* note 66.

[69] *Basel III*, *supra* note 19 ("'Basel III' is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision[,] and risk management of the banking sector.").

[70] *See Implementing Basel III Europe: CRD IV Package*, EUR. BANKING AUTH., *available at* http://www.eba.europa.eu/regulation-and-policy/implementing-basel-iii-europe (last visited Jan. 16, 2014).

[71] Eur. Comm'n, *The EU Single Market: Financial Supervision*, EUROPA.EU, *available at* http://ec.europa.eu/internal_market/finances/committees/ (last visited Jan. 16, 2014).

[72] Eur. Comm'n, *The EU Single Market: Banking*, EUROPA.EU, *available at* http://ec.europa.eu/internal_market/bank/index_en.htm (last visited Jan. 14, 2014) ("These policies are based on the principles of mutual recognition and the "single passport," a system which allows financial services operators legally established in one Member State to establish/provide their services in the other Member States without further authorisation requirements.").

territory.[73] This principle—known as "home country control"—is provided by the SBD.[74]

Basel rules generally constitute floors, not ceilings.[75] As such, a national banking authority may implement stronger prudential rules than required by Basel.[76] Brussels has converted the Basel norms into exhaustive rules that strip away the ability of Member States to take stronger action (presumably in the interest of eliminating regulatory differences within the European territory).[77] At least in the realm of banking, there is an increasing insistence within Europe not merely on harmonization but on uniformity of regulation.[78] Institutional centralization—such as the SSM—will likely increase the demand for a Single Rulebook that will not permit departures, even in the direction of stricter regulation.

There is no formally recognized "international" or "global" banking passport by which compliance with a particular nation's banking regulation gives rise to a right to operate within another nation's territory.[79] For example, current US banking law requires the approval of the Federal Reserve before a foreign bank may establish

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73 REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS IN THE NAFTA COUNTRIES 106 (George M. Von Furstenberg ed., 1997).
74 *Id.*
75 *Fed Chairman Bernanke: Basel III Rules "Floor, Not Ceiling"*, BANK CREDIT NEWS (July 23, 2013), http://bankcreditnews.com/news/fed-chairman-bernanke-basel-iii-rules-floor-not-ceiling/11658/.
76 *See id.*
77 *See Czech Governor Slams One-size-fits-all Regulation*, CENTRAL BANKING (Aug. 28, 2013), http://www.centralbanking.com/central-banking/news/2291374/czech-governor-slams-onesizefitsall-regulation.
78 *Basel III Implementation Assessment Programme*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/implementation.htm (last visited Jan. 16, 2014) ("The Committee believes that full, timely and consistent implementation of the globally agreed rules are fundamental to raising the resilience of the global banking system, maintaining market confidence in regulatory capital ratios and providing a level playing field . . . . The assessment programme is intended to provide further incentive for member jurisdictions to fully implement the standards within the agreed timelines.").
79 *See* HAL S. SCOTT & ANNA GELPERN, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION 353 (Robert C. Clark et al. eds., 19th ed. 2012) (explaining harmonization among countries and that "the host country retains the right to regulate branches or the cross-border provision of services to the extent that doing so is necessary to protect the public interest").

a branch within the US.[80] Federal Reserve approval, in turn, requires a finding that the foreign bank is "subject to comprehensive supervision or regulation on a consolidated basis" by its home country.[81] This finding is more likely to be met if the home country national banking regime is Basel-consistent.

Basel compliance greatly contributes to the ability of multinational banks to operate across borders.[82] A bank established in and supervised by the authorities of a Basel-compliant country will likely have a far easier time obtaining operating authority in other Basel-participating countries. Thus, states hosting banking institutions with global ambitions have an interest in carrying out Basel mandates.

The first Basel Accord setting out a minimum capital standard was established in 1988.[83] The Basel Committee took this initiative in response to earlier efforts by the US and the United Kingdom to coordinate their respective capital standards.[84] The original participants included many current EU members.[85] The Basel Accord was a relatively simple harmonization initiative, designed to provide a common approach for specifying the minimum quantity of risk capital a bank must maintain, given its various

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[80] *Foreign Banks and the Federal Reserve*, FED. RESERVE BANK OF N.Y., http://www.newyorkfed.org/aboutthefed/fedpoint/fed26.html (last visited Jan. 16, 2014).
[81] Authority of Federal Reserve System, 12 U.S.C. § 3105(d)(2)(A) (2012).
[82] *See, e.g.*, Nicolas Véron, *Basel III: Europe's Interest Is to Comply*, VOX (Mar. 5, 2013), http://www.voxeu.org/article/basel-iii-europe-s-interest-comply (arguing that EU policymakers should enable "the adoption of a Capital Requirements Regulation that would be fully compliant with Basel III").
[83] *See generally* BASLE COMM. ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (1988), *available at* http://www.bis.org/publ/bcbs04a.pdf [hereinafter BASEL I] (establishing a global framework of capitalization standards for the first time); *BIS History*, *supra* note 14.
[84] *See* DALVINDER SINGH, BANKING REGULATION OF UK AND US FINANCIAL MARKETS 62–63 (2007) (discussing the United Kingdom capital standards and how Basel and the European Commission had "to amend their respective capital adequacy policies").
[85] *See* BASEL I, *supra* note 83, at 1 n.1. (noting that members included "Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, US").

activities (largely as reflected on its balance sheet).[86] The Basel Accord was crude, imprecise, riddled with exceptions, and easily manipulated.[87] As such, it may have accomplished little in bringing about any greater safety or stability to the banking sector.[88] But, importantly, it transferred an area of traditional national discretion into an international regulatory space.[89] That is, the Basel Accord brought concern for the soundness of multinational banks into a purpose-built international regime.

The first generation Basel Accord did not pretend to set out a comprehensive approach to national bank regulation.[90] Its focus was first and foremost harmonizing the amount of regulatory capital a bank should maintain, determined largely with reference to on-balance sheet items (loans, securities, and deposits in other institutions).[91] The dominating impetus for the adoption of the Basel Accord was likely securing somewhat even and transparent competition between banks from different home countries.[92] That is, the existence of disparities in the minimum amount of capital demanded by various national supervisors was viewed as engendering distortions.[93] The solution, provided by the Basel

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[86] *Id.* at 1–5.

[87] *See generally* David Jones, *Emerging Problems with the Basel Capital Accord: Regulatory Capital Arbitrage and Related Issues*, 24 J. BANKING & FIN. 35 (2000) (arguing that banks attempted to boost reported capital ratios through purely "cosmetic" adjustments, in order to comply with Basel Accord standards).

[88] *Id.*

[89] *See BIS History*, *supra* note 14.

[90] *See generally* BASEL I, *supra* note 83 (explaining that the committee worked to generally allow for consistent regulations and left it to national authorities to determine how to proceed).

[91] *See id.*

[92] Singh, *supra* note 84, at 61. According to Singh, "[t]he international move towards standardisation has been to provide some consistency and a level playing field within the international community so that banks, regardless of their regulator, are required to hold the same kinds of capital and levels of capital when competing with each other." *Id.* The US Congress mandated capital adequacy requirements on US banks in response to the Latin American debt crisis in 1983 and called on the Federal Reserve and the Treasury Department to pursue an international agreement on capital standards. *See* DANIEL K. TARULLO, BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION 46 (2008).

[93] *See* BASEL COMM. HISTORY, *supra* note 19, at 2 ("There was a strong recognition within the Committee of the overriding need for a multinational

Accord, was to fix a common level of minimum capital—and some accompanying methodology—to minimize these effects.[94] Less attention was paid to assuring that the common level attains a particular level of safety and soundness. Indeed, the basic Basel Accord target for minimum capital—8%—was reported to be a ball-park average of the various levels then applied by the major banking jurisdictions; it represented an expedient political target rather than a considered judgment on setting an optimal level of tolerated risk.[95]

The capital charge was to be applied to various categories of assets, with certain asset categories requiring less capital due to their apparent reduced risk.[96] Commercial loans required the full capital charge (i.e., 8%), whereas residential loans were subject to a 50% discount (effectively lowering the associated minimum amount of capital to 4%).[97] Securities issued by the Organisation for Economic Co-operation and Development ("OECD") nations—and deposits on OECD member banking institutions—effectively required no amount of minimum capital.[98]

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accord to strengthen the stability of the international banking system and to remove a source of competitive inequality arising from differences in national capital requirements.").

[94] *Id.*

[95] *See* SCOTT & GELPERN, *supra* note 79, at 557 ("[T]he [8%] level was not the product of scientific consensus on the size of capital cushion needed to make banks and financial systems 'safe' . . . . Rather, 8% was the product of pragmatism and competition: it was the level that leading international banks could achieve over the four-year transition period.").

[96] *See generally* BASEL I, *supra* note 83 (discussing throughout the qualities of different assets and how the level of risk corresponds to the amount of capital required).

[97] *Id*. at 11–12 (discussing residential loans risk).

[98] *See* David Jones, *supra* note 87, at 40–41. This nondiscriminatory feature introduced by the original Basel Accord is partly responsible for the Euro Crisis. Under current rules, a German bank may hold Greek or Spanish state obligations as if they were risk-free. *Id.* As Timothy Canova points out, the sovereign debt market has become much more speculative, and much more volatile, since the time of the original Basel Accord. *See generally* Canova, *supra* note 15 (discussing the international banking and finance industries and increased volatility, particularly regarding the US and Mexico). New instruments, such as credit default swaps, make it much easier to bet against the valuation of the debt instruments of OECD nations, such as Greece, Ireland or Spain, perceived to be in distress (relative to more solid Eurozone Member States). *Id.* at 1635.

It is difficult to reconstruct the process by which the initial Basel Accord asset categories and their respective weights were determined—though undoubtedly the European countries participating in the discussions were able to obtain valued concessions.[99] Banking institutions were given a substantial incentive to hold national debt instruments given the non-application of risk capital requirements to these assets.[100] Other categories (e.g., mortgages) may not have been a major item of interest at the time of the Basel Accord, but grew into substantial product lines in partial response to the incentives structured within the Accord.[101] And some of these assets (again, mortgages, for example) became much riskier due to shifts in underwriting standards.[102]

The Basel Accord also contained provisions designed to pick up certain risks associated with off-balance sheet items, but these rules were primitive and failed to anticipate the ensuing prevalence and complexity of securitization practices, leading into the 2007/2008 Crisis.[103]

The second generation of Basel, Basel II, adopted in 2004, was a major expansion of the Basel Accord.[104] Basel II significantly enhanced the requirements for addressing credit risk and added unprecedented coverage for measures addressing market risk and

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[99] For a discussion of the dangers of risk-based capital requirements, see Timothy Canova, *Financial Market Failure as a Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model*, 3 HARV. L. & POL'Y REV. 369, 380–82 (2009).

[100] *See id.* at 377.

[101] *See* David Manning, *Mortgage Lenders and the New Basel Capital Accord*, HOUS. FIN. INT'L 13, 13 (Autumn 2002).

[102] TARULLO, *supra* note 92, at 83.

[103] See SCOTT & GELPERN, *supra* note 79, at 569–71, for a discussion of the Basel Accord's treatment of off-balance sheet items. For a discussion of the impact of the deregulation of the derivatives market, see Timothy Canova, *The Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295, 1348–49 (1995).

[104] *See generally* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK COMPREHENSIVE VERSION (2006), *available at* http://www.bis.org/publ/bcbs128.pdf [hereinafter BASEL II] (enumerating a comprehensive framework for regulating the capital standards required from internationally active banks).

operational risk.[105] With this ambitious expansion of scope, the Basel regime began to resemble the outline for a comprehensive program of bank regulation.

In its design, Basel II reflects major shifts in regulatory philosophy. Rather than providing for common levels of capital across countries and institutions, Basel II provided a mechanism that would, at least for the largest and most sophisticated banks, permit institution-specific outcomes.[106] Banks were directed to develop their own risk management programs—national supervisors would then review the robustness of these protocols (as opposed to directly reviewing the solvency of the bank).[107] Assets would still be assigned to categories or "baskets," but within each basket capital charges would be determined according to the particular risk profile assigned (directly or indirectly) by credit rating agencies.[108]

The net effect of Basel II was likely to reduce the amount of required capital, at least with respect to the large multinational banking institutions.[109] In Europe, where Basel II was implemented, capital levels dropped to about 2%.[110] In the US, where Basel II implementation was postponed, capital levels remained about 8%.[111] The "even playing field" goal of the Basel Accord was replaced by more complex, less transparent methodologies that rewarded those banks with the most advanced internal systems of risk management.[112]

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[105] *See generally id.*
[106] *See id*. at 33.
[107] *Id*. ("The Committee permits banks a choice between two broad methodologies for calculating their capital requirements for credit risk. One alternative, the Standardised Approach, will be to measure credit risk in a standardised manner, supported by external credit assessments. The other alternative, the Internal Ratings-based Approach, which is subject to the explicit approval of the bank's supervisor, would allow banks to use their internal rating systems for credit risk.").
[108] SCOTT & GELPERN, *supra* note 79, at 576–79. According to Scott and Gelpern, the result of Basel II was "a hybrid method that has neither the administrative simplicity of risk buckets, nor the risk-sensitivity of good internal models." *Id.* at 579.
[109] SHEILA BAIR, BULL BY THE HORNS: FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF 27–31 (2012).
[110] *Id.* at 258.
[111] *Id.* at 259.
[112] *See* TARULLO, *supra* note 92, at 150–52.

Basel II did not cause the 2007/2008 Crisis—national authorities had just begun to implement it when the crisis hit.[113] Basel II did serve as a template for certain pre-crisis internal EU banking reform—the relevant implementation was reflected in amendments to the EU's Capital Requirements Directive.[114]

B. EU and European Participation in the Negotiation of Basel III

The 2007/2008 Crisis (and its continuing aftermath) focused attention on Basel—and drove a far more extensive package of reforms now referred to as Basel III.[115] Basel III reflects the "education" acquired by the major banking centers, including the European Commission, of the causes and responses to the 2007/2008 Crisis. That education—which of course may or may not be correct in any ultimate sense—included a thorough reappraisal of the design of the Basel rules.

The Basel Committee, at least for a limited period of time, conceded its primacy with more powerful, purpose-built institutions.[116] As the 2007/2008 Crisis brought arcane matters of bank regulation to the attention of national political leaders, the locus of debate shifted from technical networks of bank regulators to higher levels of transnational dialog. The Group of Seven, involving heads of government of the economic powers, was abandoned in favor of the somewhat dormant Group of Twenty, which had been established in 1999 to address the 1997 Asian financial crisis.[117] The Group of Twenty conveniently included a larger number of countries, including China and India, emergent superpowers that had not previously participated in Basel initiatives or other efforts involving the global financial system.[118]

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[113] *See* Jeffery Atik, *Basel II: A Post-Crisis* Port-Mortem, 19 TRANS. L. & CONTEMP. PROB. 731, 731–32 (2011).
[114] *Id.* at 734.
[115] *See Basel III*, *supra* note 19; *see generally BIS History*, *supra* note 14.
[116] Chief among these are the Group of Twenty and the Financial Stability Board. *See infra* notes 117–21 and accompanying text.
[117] *See* G-20 RESEARCH GROUP, THE GROUP OF TWENTY: A HISTORY EXECUTIVE SUMMARY 5 (2008), *available at* www.g20.utoronto.ca/docs/g20history.pdf (giving a history of the G-20, its objectives, and evolution).
[118] *See id.* at 8–9.

The Group of Twenty held a number of summits in order to coordinate and provide direction for post-crisis banking reform.[119] Though its meetings were sporadic, it provided an institutional facility by which political actors could command results.[120] The Group of Twenty created the Financial Stability Board, composed of treasury ministers and central bankers of the Group of Twenty members, which was tasked with devising post-crisis reforms.[121] As such, there was some overlap between the membership of the Financial Stability Board and the Basel Committee (many central bankers serve on both), but the Financial Stability Board's inclusion of finance ministers could have been expected to lead to broader economic considerations and more direct political responsiveness.[122]

The Financial Stability Board in turn directed much of the design and spirit of Basel III, although the formal proposals resulted from the Basel Committee.[123] Basel III can be read as an implicit

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[119] *See The G20: Its Role and Legacy*, RUSS. G-20, www.g20.org/docs/about/part_G20.html (last visited Jan. 16, 2014).

[120] *See id.* (listing previous G-20 Leaders' Summits).

[121] *See* PHILLIPP HÄRLE, MATTHIAS HEUSER, SONJA PFETSCH & THOMAS POPPENSIEKER, MCKINSEY & CO., BASEL III: WHAT THE DRAFT PROPOSALS MIGHT MEAN FOR EUROPEAN BANKING 3 (2008), *available at* ec.europa.eu/internal_market/bank/docs/gebi/mckinsey_en.pdf ("The Financial Stability Forum (now the Financial Stability Board, or FSB), a global group of regulators and central banks, started developing recommendations on regulatory reform as early as the fall of 2007. Its first findings were published in April 2008, six months before Lehman Brothers failed. Since then, the FSB has continued to develop its recommendations, which are regularly endorsed by the G20 governments.").

[122] *See* G-20 RESEARCH GROUP, *supra* note 117, at 14 n.18 ("International regulatory and supervisory bodies are represented by two representatives for each of the Basel Committee on Banking Supervision, IOSCO, and the IAIS, and one member from each of the Committee on Payment and Settlement Systems and the Committee on the Global Financial System.").

[123] *See generally* BASEL COMM. HISTORY, *supra* note 19 (discussing how the need for fundamental strengthening of Basel II framework led to a capital and liquidity reform package).

> The Basel Committee issued Principles for sound liquidity risk management and supervision in the same month that Lehman Brothers failed. In July 2009, the Committee issued a further package of documents to strengthen the Basel II capital framework, notably with regard to the treatment of certain complex securitization

critique of much of the design philosophy embedded in Basel II—motivated in no small part from the "education" derived from the 2007/2008 Crisis.[124] Indeed, the turn to reliance on credit rating agencies is largely reversed in Basel III,[125] and the substantial latitude conceded to large international banking organizations to conduct their systems of risk management is largely withdrawn.[126] It is an open question as to whether the Basel II "birth defects" contributed to the 2007/2008 Crisis, even though, as noted above, Basel II was in the early stages of implementation when the crisis struck.[127] That said, events surely overwhelmed Basel II (as well as the pre-crisis faith in the banking system's inherent soundness). Reform was both a legal and technical necessity.

Basel III represents a substantial change in policy that will have major effects on European banking practices. Among its central features is a return to the use of strict capital ratios.[128] The overall quantity of capital is substantially increased (from 4 to 6% for Tier 1 capital).[129] The definition of qualifying Tier 1 capital has been narrowed, thus increasing the quality of the assets held by banks as a

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> positions, off-balance sheet vehicles and trading book exposures.

Id. at 4.

[124] *See* PHILLIPP HÄRLE ET AL., *supra* note 121, at 5 ("In addition, banks will be subject to a capital charge for mark- to-market losses, called the credit value adjustment (CVA) risk. This risk had not been covered under Basel II at all, but was a source of great losses during the crisis.").

[125] Dodd-Frank effectively bans the heavy reliance on credit rating agencies. Basel III follows this determination.

[126] *See* BASEL COMM. HISTORY, *supra* note 19, at 5 ("These tightened definitions of capital, significantly higher minimum ratios and the introduction of a macroprudential overlay represent a fundamental overhaul for banking regulation.").

[127] *See supra* note 113 and accompanying text.

[128] *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, BASEL III: INTERNATIONAL FRAMEWORK FOR LIQUIDITY RISK MEASUREMENT, STANDARDS AND MONITERING 9 (2010), *available at* http://www.bis.org/publ/bcbs188.pdf ("The standard requires that the value of the ratio be no lower than 100% (i.e. the stock of high-quality liquid assets should at least equal total net cash outflows). Banks are expected to meet this requirement continuously and hold a stock of unencumbered, high-quality liquid assets as a defence against the potential onset of severe liquidity stress.").

[129] *See* PHILLIPP HÄRLE ET AL., *supra* note 121, at 6.

buffer.[130] New countercyclical buffers are to be introduced, which will require even greater set-asides during periods of economic expansion ("booms"), with the dual aim to provide additional cushion for periods of stress (the resultant "bust") and to discourage overheated lending.[131] Basel III introduces new requirements with respect to liquidity, further assuring an institution's ability to survive liquidity shocks such as those experienced during the 2007/2008 Crisis.[132] Finally, Basel III imposes the application of an overall leverage ratio as a central indicator of bank health.[133]

The Group of Twenty, at the Seoul summit in November 2010, approved the general outline of the Basel III reforms.[134] Specific changes to the Basel structure were left to the Basel Committee.[135] Proposals were then released for comment before formal adoption.[136] The resultant package of reforms, Basel III, has been available for adoption by the relevant authorities of those jurisdictions participating since January 1, 2013.[137]

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[130] *Id.* at 4 ("However, the proposal makes several adjustments to core Tier 1 capital, e.g., excluding all hybrid forms of capital, such as perpetual securities and silent participations, which are viewed by the BCBS as economically equivalent to subordinated debt; deducting "intangible" assets such as deferred tax assets; and no longer considering minority interests as core Tier 1.").

[131] See RAFAEL REPULLO & JESUS SAURINA, THE COUNTERCYCLICAL CAPITAL BUFFER OF BASEL III: A CRITICAL ASSESSMENT 2 (2011), *available at* ftp://ftp.cemfi.es/pdf/papers/repullo/Repullo-Saurina%20Final%20R.pdf.

[132] PHILLIPP HÄRLE ET AL., *supra* note 121, at 6 ("The Basel Committee has also outlined new requirements for funding and liquidity management, embedded in two regulatory metrics: the liquidity coverage ratio (LCR), which is dedicated to improving banks' resilience against short-term liquidity shortages[;]" and "[t]he net stable funding ratio (NSFR), which looks at banks' long-term funding.").

[133] *Id.*

[134] *G-20 Endorses New Reserve Rules for Banks*, N.Y. TIMES (Nov. 12, 2010), http://www.nytimes.com/2010/11/13/business/global/13basel.html (reporting the G-20 Summit meeting in Seoul on November 12, 2010).

[135] *See generally id.*

[136] *See Basel III*, *supra* note 19.

[137] *Implementation of the Basel III Framework*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/press/p121214a.htm (last visited Jan. 16, 2014) ("The Basel committee has been actively monitoring on a continuing basis the progress of members in implementing the Basel III package of regulatory reforms, as well as the implementation of Basel II and Basel 2.5.

For Europe, implementation involved a complex process that exhibited considerable contentiousness. There remains significant authority exercised by Member State officials in overseeing European banking institutions under the EU "single-licensing" scheme.[138] Banking regulation was already largely harmonized, of course, and so implementing Basel III involved replacing existing EU banking directives with the new Basel III-compliant EU banking directive and regulation comprising CRD IV.

While CRD IV followed the traditional lawmaking track, with the various EU institutions discharging their legislative roles,[139] there were some significant departures from the spirit of prior implementation of Basel rules. The content and structure of the regulatory program set out in CRD IV was not a pure matter of European autonomous action. Basel III, which underlies CRD IV, resulted from a global process in which both the EU institutions and some (but not all) EU Member States participated.[140] As such, the content of Basel III cannot be said to reflect the democratic will of the broader EU membership (except by accident). That is, Basel III, and hence CRD IV, incorporated concessions to the views and demands of the other (non-EU) states participating in the Basel process.

Basel III entered the Brussels "sausage manufactory" with both advantages and disadvantages when compared to ordinary European initiatives. On the one hand, Basel III enjoys the imprimatur of a geographically broader process. It reflects Europe's important role in hosting and supporting the global financial system. As such, it may be "received" with more reverence than would a homegrown reform package. And intra-Member States conflicts (such as those which repeatedly flair up between the United Kingdom and the France-Germany axis in matters of financial

. . . The number of member jurisdictions that have published the final set of Basel III regulations effective from the start date of 1 January 2013 is 11.").

[138] *See generally* EUR. CENT. BANK, RECENT DEVELOPMENTS IN SUPERVISORY STRUCTURES IN THE EU MEMBER STATES (2007-10) (2010), *available at* www.ecb.europa.eu/pub/pdf/other/report_on_supervisory_structures2010en.pdf (detailing supervisory powers of various European Member States).

[139] *See generally id* (outlining efforts to increase supervisory authority at both the EU level and the national level in response to the financial crisis).

[140] *See* NAKAGAWA, *supra* note 44, at 216–17; *see also* BASEL COMM. HISTORY, *supra* note 19, at 1.

regulation)[141] are less likely to emerge, given the joint interest in faithful European implementation by the Americans, Japanese, Swiss, and other powerful states. On the other hand, the mere fact that Basel III contains approaches, solutions, and innovations that are "foreign" to the European imagination, and which may not command any substantial European support, made the progress of implementing legislation problematic.

The European lawmaking institutions likely recognized Basel III as if it were a "directive."[142] By analogy, Basel III creates a legislative mandate for the EU that is "binding as to the result to be achieved."[143] The European Commission launched the program for a revision of the existing Capital Requirements Directives that concluded with CRD IV.[144] CRD IV inevitably contained more detail than do the more general Basel III mandates. Thus, one will observe a winnowing of discretion (and an increasing concreteness of design) as a notion passes in two steps: first, from Basel to Brussels, and then from Brussels to the individual EU Member States.

The relevant European-level law—CRD IV—is an intermediate formulation between the Basel III provisions and the eventual Member State regulation.[145] This process of intermediated

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[141] For example, and within the context of CRD IV, the United Kingdom has taken a contrarian position with respect to bancassurance capital rules and limits on compensation. See *infra* Part III.B, for a discussion of the bancassurance controversy and compensation limits.

[142] Article 288 of TFEU provides that a directive "shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods." Consolidated TEU and TFEU, *supra* note 57; *see also* EUR. BANKING AUTH., EBA CONSULTATION PAPER ON DRAFT IMPLEMENTING TECHNICAL STANDARDS ON DISCLOSURE FOR OWN FUNDS BY INSTITUTIONS 5 (2012), *available at* http://www.eba.europa.eu/documents/10180/38225/EBA-CP-2012-04--CP-on-ITS-disclosure-for-own-funds-.pdf.

[143] EUR. BANKING AUTH., *supra* note 142, at 5.

[144] *See* NICOLAS VÉRON, THORSTEN BECK & SYLVESTER C.W. EIJFFINGER, BANKING UNION: THE SINGLE RESOLUTION MECHANISM 17 (Pol'y Dep't Econ. & Sci. Pol'y, Eur. Parliament ed., 2013), *available at* http://www.europarl.europa.eu/document/activities/cont/201304/20130422ATT64861/20130422ATT64861EN.pdf [hereinafter SINGLE RESOLUTION MECHANISM].

[145] *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, BASEL III REGULATORY CONSISTENCY ASSESSMENT (LEVEL 2) PRELIMINARY REPORT: EUROPEAN UNION 1, 5–6 (2012), *available at* http://www.bis.org/bcbs/implementation/l2_eu.pdf.

transmission is unique to Europe; in most other contexts, Basel III norms speak directly to the implementing national authorities.[146] As to the US, for example, Basel norms proceed directly.[147]

European courts frequently look to directives as sources for interpretation of the national measures that give effect to those directives.[148] It is an open question whether European courts will penetrate one additional level, in order to consider the Basel-level inspiration for the European-level directive mandating a Member State measure.

The CRD IV legislative process has been far more deliberative—and far more critical of Europe's Basel III undertakings—than have earlier European exercises in Basel implementation.[149] Recall that the European Commission represents the EU within the Basel Committee and within the Group of

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[146] *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, REGULATORY CONSISTENCY ASSESSMENT PROGRAMME (RCAP): ASSESSMENT OF BASEL III REGULATIONS IN BRAZIL 5 (2013), *available at* http://www.bis.org/bcbs/implementation/l2_br.pdf; BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, REGULATORY CONSISTENCY ASSESSMENT PROGRAMME (RCAP): ASSESSMENT OF BASEL III REGULATIONS—CHINA 4–5 (2013), *available at* http://www.bis.org/bcbs/implementation/l2_cn.pdf; BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, REGULATORY CONSISTENCY ASSESSMENT PROGRAMME (RCAP): ASSESSMENT OF BASEL III REGULATIONS—SWITZERLAND 3–5 (2013), *available at* http://www.bis.org/bcbs/implementation/l2_ch.pdf; BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, BASEL III REGULATORY CONSISTENCY ASSESSMENT (LEVEL 2): JAPAN 5 (2012), *available at* http://www.bis.org/bcbs/implementation/l2_jp.pdf.

[147] *See, e.g.*, Regulatory Capital Rules: Regulatory Capital, Regulatory Capital, Implementation of Basel III, Capital Adequacy, 78 Fed. Reg. 62,018 (Oct. 11, 2013) (to be codified at 12 C.F.R. pts. 3, 5, 6, 165, 167).

[148] *See* Dr. Robert Schütze, *The Indirect Effect(s) of European Law* 2 (Centre for Eur. Legal Studies, Working Paper, Nov. 2011), *available at* http://www.cels.law.cam.ac.uk/cels_lunchtime_seminars/SCHUTZE_WorkingPaper_cover.pdf.

[149] *See* EUR. BANK COORDINATION "VIENNA" INITIATIVE, WORKING GROUP ON BASEL III IMPLEMENTATION IN EMERGING EUROPE 4 (2012), *available at* http://www.imf.org/external/region/eur/pdf/2012/030112a.pdf [hereinafter VIENNA INITIATIVE] ("Establishing this working group was motivated by a concern that the new prudential rules of Basel III . . . may have certain unintended negative consequences on both future and market development and cross-border relationships that are crucial to emerging Europe.").

Twenty.[150] Several prominent EU Member States also participate in their own right.[151] The Commission is, of course, but one of the central EU institutions and (together with the European Court of Justice) remains fairly removed from the European populace.[152] The Commission is frequently criticized for elitism, distance, technocratic arrogance, and want of democratic legitimacy.[153] These "attributes" are more evident when Europe participates in international fora.

The more democratic European institutions—the Council and the Parliament—can exercise their voices only when treaties are returned for ratification and translation into the European legal order.[154] If the past experience with Basel has been one of a collective rubber stamp by the Council and the Parliament, the enactment of CRD IV has revealed a very different practice. The Council and the Parliament have shown much less willingness to defer to the accord reached with the Commission's approval in Basel.[155] Overall, the CRD IV implementation process has revealed three important new types or styles of debate as to the extent and manner of EU adoption of Basel III norms.

The first debate involved the resolution of a peculiarly European dilemma. Note that by its terms Basel III sets out

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150 *Id.*

151 *Id.*

152 *See, e.g.*, Judy Dempsey, *E.U. Elites Keep Power from the People*, N.Y. TIMES (Aug. 22, 2011), http://www.nytimes.com/2011/08/23/world/europe/23iht-letter23.html (discussing the popular movement for more democracy in the European institutions in the context of the Euro Crisis).

153 *See id.*

154 *Treaties and The European Parliament*, EUR, PARLIAMENT, *available at* http://www.europarl.europa.eu/aboutparliament/en/00b82c7869/Treaties-and-the-European-Parliament.html (last visited Jan. 16, 2014) ("The European Parliament, Council, Commission, Court of Justice and Court of Auditors exercise their powers in accordance with the Treaties . . . . When a new Treaty is to be created, or an existing Treaty amended, an Intergovernmental Conference (IGC) is set up in which the governments of the member states meet. Parliament is consulted and gives its opinion on the Treaty as it is shaped and developed.").

155 *See* Riva Froymovich, *EU Races to Meet Basel III Deadline*, WALL ST. J. (Nov. 12, 2012), http://online.wsj.com/article/ SB10001424127887323894704578114351244793668.html ("[S]ome officials in the U.S. and U.K. have complained that the rules are too complex, and some banks have described the proposals as overkill.").

minimum standards for adoption by its participants; as a general principle, countries retain the freedom to exceed Basel requirements.[156] Both the US and Switzerland have augmented Basel III in their national legislation.[157] But retaining a faculty to exceed Basel III is not an obvious result within the EU, where internal harmonization presents its own logic. Should CRD IV be a source for a common minimum standard for EU member states or should CRD IV provide one-size-fits-all mandatory rules?[158] This latter approach has largely been adopted in CRD IV. In the legislative debates, the EU's implementation choice is referred to as "maximum harmonization" or the "Single Rulebook."[159] In other words, CRD IV fixes a common set of standards, which are both ceilings and floors. Member States wishing to apply a more rigorous standard ("race to the top" or "gold-plating") than that provided within CRD IV will largely be barred from action.[160]

The second form of debate encountered in the EU implementation process is whether Basel III by its nature permits selective implementation, or Basel à la carte. Recall that Basel III is not a treaty—it does not create any formal international legal undertakings that must be followed.[161] That said, Basel III, like Basel II and the Basel Accord before it, clearly establishes expectations of

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[156] *See Making the Break*, *supra* note 9.

[157] *See* BASEL COMM. ON BANKING SUPERVISION, REPORT TO G20 LEADERS ON MONITORING IMPLEMENTATION OF BASEL III REGULATORY REFORMS 25 (2013), *available at* https://www.bis.org/publ/bcbs260.pdf.

[158] *See* Nicolas Véron, *The European Debate on Bank Capital Is Not Just About Europe*, VOX (May 4, 2012), http://www.voxeu.org/article/european-debate-bank-capital-not-just-about-europe (summarizing the two main unresolved issues of CRD IV/CRR).

[159] Press Release, Eur. Comm'n, Capital Requirements—CRD IV/CRR—Frequently Asked Questions 5 (July 16, 2013), *available at* http://europa.eu/rapid/press-release_MEMO-13-690_en.htm?locale=en [hereinafter CRD FAQ II]; ECON. & FIN. AFFAIRS, EUR. COMM'N, CRD IV: OVERVIEW AND ISSUES AT STAKE 8 (2012), *available at* http://ec.europa.eu/commission_2010-2014/barnier/docs/20120502_crdiv_overview_en.pdf (PowerPoint on capital requirements).

[160] *See* VIENNA INITIATIVE, *supra* note 149, at 48 ("A single rule book is a fundamental prerequisite for an effective European banking supervision. Nevertheless, lack of upward flexibility in applying prudential requirements might create a potential for imbalances between the powers and responsibilities of the national authorities.").

[161] *See supra* notes 31–34 and accompanying text.

compliance.[162] The EU had taken great pride as a faithful adherent to the Basel system in its prior incarnations, bringing most of their terms into European law.[163] It might be said that the EU had taken the fundamental norm of *pacta sunt servanda* most seriously.[164] In CRD IV, in contrast to the EU's past practice with respect to Basel obligations, Europe appears to be exercising some meaningful selectivity, choosing (or so it now appears) to give effect to much, but not all, of Basel III.[165] European politicians argue that it is the "spirit" of Basel III that need be implemented, and not the letter.[166]

The third style of debate revealed in CRD IV involves a different kind of á-la-carte-ism: the introduction of idiosyncratic norms that are not found within Basel III. Indeed, these may have been European proposals that failed to find favor in Basel, but remain popular in Europe. These non-conforming additions to CRD IV shall be described here as "Basel III Plus." The insertion of Basel III Plus norms into CRD IV represent a "second look" by the EU's legislative bodies at reform features rejected by the broader Basel

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[162] *See* Ingves, *supra* note 64, at 2.

[163] *See* Dierick et al., *supra* note 3, at 20–23.

[164] Latin for "promises must be kept," an expression signifying that the agreements and stipulations of the parties to a contract must be observed. 7 WEST'S ENCYCLOPEDIA OF AMERICAN LAW 347 (Shirelle Phelps & Jeffrey Lehman eds., 2d ed. 2005).

[165] The US's selective implementation of Basel II exemplifies how a Basel Committee member country may implement only certain aspects of Basel III and/or impose the requirements on only certain institutions. *See* William Wright, *When It Comes to Regulation, US Banks Have a Selective Memory*, FIN. NEWS (July 23, 2013), http://www.efinancialnews.com/story/2013-07-24/financial-regulation-us-banks-uneven-playing-field-comment?ea9c8a2de0ee111045601ab04d673622 (arguing that US banks did not implement Basel II in 2006 and have ignored Basel 2.5). A set of studies issued by the Basel Committee on October 1, 2012, found that neither the proposed regulations being considered in the US nor in the EU would fully implement Basel III. *See* BASEL COMM. ON BANKING SUPERVISION, BASEL III REGULATORY CONSISTENCY ASSESSMENT (LEVEL 2) PRELIMINARY REPORT: US OF AMERICA 5–6 (2012), *available at* http://www.bis.org/bcbs/implementation/l2_us.pdf.

[166] *See* CRD FAQ II, *supra* note 159, at 5 ("The new rules therefore respect the balance and level of ambition of Basel III. However, there are two reasons why Basel III cannot simply be copy/pasted into EU legislation and, therefore, a faithful implementation of the Basel III framework shall be assessed having regard to the substance of the rules.").

community.[167] The clearest example of Basel III Plus is the limits on banker compensation included in CRD IV.[168] Proposals to address compensation were defeated at Basel;[169] certain countries, the United States, perhaps, and the United Kingdom as well, viewed the matter to be settled. Not so, as it turns out; CRD IV contains significant limits on compensation.[170] Given the global structure of many banks, CRD IV's compensation limits will affect New York and Tokyo-based institutions, as well as banks based in London, Paris, and Frankfurt. Ultimately, CRD IV in its final form displays examples of this and other deviations from simple implementation of Basel III. They mark the emboldened force of the Council and the Parliament, giving voice (respectively) to the urgings of Member State governments and the broader European populace. As such, the passage of CRD IV can be seen as an example of a maturing democracy at the European-level.

Certainly, European implementation of Basel III has emerged as a second chance for opponents of particular international bargains to strike out against those policies and positions. This new field of contest was hardly lost on the lobbyists that represented European banking interests after the release of Basel III and during the run-up to CRD IV.[171] Moreover, certain critical elements of Basel

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[167] *Id.* ("What are the new, additional rules introduced by CRD IV?").

[168] *Id.* ("CRD IV essentially carries over the existing provisions of CRD III relating to remuneration. It also introduces additional transparency and disclosure requirements relating to the number of individuals earning more than EUR 1 million per year.").

[169] Gabriele Steinhauser, Tom Fairless & Neil Maclucas, *EU Reaches Deal to Curb Bank Bonuses*, WALL ST. J. (Feb. 28, 2013, 6:58 AM), http://online.wsj.com/news/articles/SB10001424127887323293704578330814285107262 ("Bankers' pay wasn't part of the Basel agreements, but lawmakers in the European Parliament insisted on limiting payouts linked to short-term profits because they were seen as driving bankers to take excessive risks in the lead-up to the crisis.").

[170] CRD FAQ II, *supra* note 159, at 5.

[171] *See Bankers Warn Basel III Leading to Credit Crunch*, EUBUSINESS (June 8, 2012, 10:11 AM), http://www.eubusiness.com/news-eu/finance-economy.gy8/ ("The chief executive of French bank Societe Generale, Frederic Oudea, said it was hard for bank[s] to raise capital 'in this current environment when there is fear around Europe but more generally speaking, with all the uncertainty which surrounds the future business models of banks.' He said that in the Eurozone, the de-leveraging was hitting new lending as it was difficult to sell assets in the current situation.").

III appear within CRD IV as objects for further study;[172] as a practical matter, these mandates have been avoided by deliberate postponement. CRD IV—and its omissions and deviations from the Basel III blueprint—demonstrated that the future formation of European banking law will not take place in its entirety at the Basel-level, even if this were the desire of the Commission (or the ECB).

But there is a price to be paid here: these adjustments may give rise to a greater level of distrust of the Commission in future international dealings, in Basel or elsewhere. This nascent lack of reliability would not be the end of the world, of course. The United States has, in many different fora over a long period of time, troubled its treaty partners by negotiating terms bilaterally or multilaterally, and then effectively unwinding its commitment through action (or inaction) by a suspicious Congress waiting in Washington.[173]

Basel III is a system of minimum standards; countries are expected to comply with Basel III's requirements but are free to impose higher standards.[174] And several countries (Switzerland, for example) have decided to require their banks to maintain more regulatory capital than what Basel III demands.[175] The combination of common minimum standards with regulatory flexibility is familiar to the EU Member States: it is a feature of most EU-level regulation, known as "harmonization."[176] But in CRD IV, the EU followed

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[172] MICHAEL AUER, GEORG VON PFOESTL & JACEK KOCHANOWICZ, ACCENTURE, BASEL III AND ITS CONSEQUENCES: CONFRONTING A NEW REGULATORY ENVIRONMENT 3 (2011) ("While the political process is quite advanced in the EU, some aspects of Basel III need further discussion, such as the definition of 'high-quality liquid assets.' Other topics will be tested during the observation periods.").

[173] *See* Wright, *supra* note 165 ("A quick flick through the main thrusts of regulatory reform over the past few years shows how the US authorities have put American exceptionalism into practice with their reluctance to adopt international standards if this might have meant that US banks could lose any of their significant competitive advantage at home and abroad.").

[174] *See Making the Break*, *supra* note 9.

[175] *See* Nicolas Véron, *The Euro Crises: Collateral and Centralization*, FAIR OBSERVER (May 7, 2012), www.fairobserver.com/article/europe's-banking-supervision?page=2.html (reporting on Europe's Banking Supervision of CRD IV/CRR).

[176] *See* CRD FAQ II, *supra* note 155, at 7 ("Binding Technical Standards (i.e. Regulatory and Implementing Technical Standards—BTS) are legal acts which specify particular aspects of an EU legislative text (Directive or Regulation) and aim at ensuring consistent harmonization in specific areas.

maximum harmonization, a design where the Basel III standards set mandatory—not minimum—standards for the implementing EU Member States.[177]

One of the chief requirements of the Basel III reforms is to increase both the quantity and quality of "regulatory capital" banks must hold.[178] This capital is intended to operate as a financial shock absorber in the event of large losses—assuring a bank's continued solvency and sparing shareholders (and—in a worse case—taxpayers) pain.[179]

Basel III requires that national regulators impose a minimum capital requirement for so-called Tier 1 capital ratio of 8%.[180] By its terms, the Basel III framework permits countries to impose higher Tier 1 capital ratio requirements. But to permit each EU Member State to impose its own Tier 1 capital ratio requirement (so long as it exceeds the Basel III minimum) would introduce competitive and operational stresses within the somewhat unified European banking market. These concerns motivated EU officials to endorse "maximum harmonization," whereby all EU Member States would enact identical Tier 1 capital ratio obligations.[181]

Within Europe, there was considerable push-back from certain Member States. The United Kingdom and Sweden, for example, pressed their desires to impose higher capital ratios than

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BTS are always finally adopted by the European Commission by means of regulations or decisions and they are legally binding and directly applicable in all Member States.").

[177] *Id.* at 8 ("The Single Rulebook in banking regulation also comprises the BTS which are developed by the European Banking Authority, adopted by the European Commission and applied directly in all Member States. The Single Rulebook will ensure uniform application of Basel III in all Member States.").

[178] *Id.* at 13 ("Under the existing framework, banks and investment firms need to have a total amount of capital equal to at least 8% of risk weighted assets. Under the new rules, while the total capital an institution will need to hold remains at 8%, the share that has to be of the highest quality—common equity tier 1 (CET1)—increases from 2% to 4.5%.").

[179] *Id.* ("The purpose of capital is to absorb the losses that a bank does not expect to make in the normal course of business (unexpected losses). The more capital a bank has, the more losses it can suffer before it defaults.").

[180] *Id.*

[181] *Id.* at 4 (acknowledging that "applying the internationally agreed rules only to a subset of European banks would have created competitive distortions and potential for regulatory arbitrage").

what a common European standard would provide.[182] Requiring banks to have more capital reduces the likelihood of bank bailouts—and thus improves the creditworthiness of the home state. Note the United Kingdom and Sweden lie outside the Eurozone.[183] In contrast, Germany and France reportedly supported a mandatory single common standard.[184]

On May 15, 2012, EU finance ministers reached a tentative compromise on capital ratios, somewhat relaxing the demands of maximum harmonization.[185] EU Member States may, according to the May 15 understanding, impose capital ratios that exceed the Basel III minima by up to 300 basis points (that is, 3%).[186] Beyond this range, a Member State would need EU approval.[187]

III. CRD IV

A. Single Rulebook vs. Minimum Standards

On April 16, 2013, the European Parliament approved the packet of legislation known as CRD IV, which largely implemented

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[182] Morris Goldstein, *The EU's Implementation of Basel III: A Deeply Flawed Compromise*, VOX (May 27, 2012), http://www.voxeu.org/article/eu-s-implementation-basel-iii-deeply-flawed-compromise.
[183] *See* Eur. Comm'n, *The United Kingdom and the Euro*, EUROPA.EU (Apr. 11, 2011), http://ec.europa.eu/economy_finance/euro/countries/uk_en.htm; *see also* Eur. Comm'n, *Sweden and the Euro*, EUROPA.EU (July 8, 2012), http://ec.europa.eu/economy_finance/euro/countries/sweden_en.htm.
[184] *See* Eduardo Porter, *Why Germany Will Pay Up to Save the Euro*, N.Y. TIMES, June 27, 2012, at B1 (reporting on why Germany fights to save the euro); *see also France, Germany Want to Keep Debt-Stricken Greece in the Eurozone*, BUS. TODAY (May 16, 2012, 12:14 AM), http://businesstoday.intoday.in/story/france-germany-want-to-keep-greece-in-euro-zone/1/184571.html ("[N]ew French President Francois Hollande and German Chancellor Angela Merkel have voiced their support for the debt-stricken nation to remain in the euro zone.").
[185] Press Release, Council of the Eur. Union, Bank Capital Rules: General Approach Agreed Ahead of Talk with Parliament (May 15, 2012), *available at* http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/130264.pdf.
[186] *Id.*
[187] *Id.* ("Member states would be able to apply systemic risk buffers of up to 3% for all exposures and up to 5% for domestic and third country exposures, without having to seek prior Commission approval.").

the Basel III banking reforms.[188] This approval completed the political phase of the European legislative process—formal adoption of CRD IV by the Council of Ministers occurred on July 17, 2013.[189] Following consultations on the form of detailed regulations ("technical standards"),[190] CRD IV became law effective January 1, 2014.[191]

CRD IV implements Basel III—and does more. The term "CRD IV" signals that this is the fourth generation of the EU's Capital Requirements Directive. The name is no longer precise: CRD IV is comprised of a regulation (law that is uniformly applied throughout Europe) and a directive (which requires national implementation and permits a certain degree of variation).[192]

CRD IV increases the quantity and quality of regulatory capital a financial institution must hold.[193] In most cases,

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188 Press Release, Eur. Parliament, Parliament Votes Reform Package to Strengthen EU Banks (Apr. 16, 2013), *available at* http://www.europarl.europa.eu/news/en/news-room/content/20130416IPR07333/html/Parliament-votes-reform-package-to-strengthen-EU-banks.

189 Press Release, Eur. Comm'n, Legislation on Capital Requirements for the Banking Sector to Enter into Force (July 17, 2013), *available at* http://europa.eu/rapid/press-release_MEX-13-0716_en.htm?locale=en.

190 CRD FAQ II, *supra* note 159, at 36 ("Article 4a of the draft SSM regulation as reflected in the agreement reached between the European Parliament and the Council on 19 March 2013 allows: 1) national competent or designated authorities to act on own initiative to apply macro-prudential tools; 2) the ECB to impose higher requirements or to act in consultation with the relevant competent authority in each participating Member State; 3) a reciprocal consultation process to ensure that both the national authorities and the ECB act in a consistent and coordinated manner.").

191 EUR. COMM'N, Draft Implementing Technical Standards with Regard to Supervisory Reporting of Institutions According to Regulation (EU) No 575/2013, at 12, *available at* http://ec.europa.eu/internal_market/bank/docs/regcapital/implementing/140108_act_en.pdf.

192 CRD FAQ II, *supra* note 159, at 6 ("The new framework divides the current CRD (Capital Requirements Directive) into two legislative instruments: a directive governing the access to deposit-taking activities and a regulation establishing the prudential requirements institutions need to respect.").

193 *Id.* at 2 ("In this regard, the G-20 Declaration of 2 April 2009 conveyed the commitment of the global leaders to address the crisis with

transitioning to CRD IV requirements will place pressure on European banks to retain earnings, raise additional equity capital, dispose of assets or change their respective asset mixes.[194] Under the existing version of the Capital Requirements Directive (which was adopted immediately prior to the onset of the 2007/2008 Crisis), many European banks reduced their capital to extremely low levels.[195] Reportedly some European banks had leverage ratios of nearly forty to one—that is, maintaining less than 2% of effective capital.[196] Many of these same banks remain in crisis now—a problem that in turn has infected the balance sheets of several EU Member States.[197] CRD IV acknowledges the insufficiency of bank capital during the financial crisis.[198] The new requirements are complex—and involve a stack of charges and buffers.[199] A minimum of 8% capital will now be mandated, computed with regard to a bank's risk-adjusted assets.[200] Left undetermined for the time being is the overall leverage cap—it is this simple metric that may prove to be the most meaningful limit on a bank's leverage.[201]

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internationally consistent efforts to, among others, improve the quantity and quality of capital in the banking system . . . .").

[194] *See id.* at 12–15.

[195] *See* Adrian van Rixtel & Gabriele Gasperini, *Financial Crises and Bank Funding: Recent Experience in the Euro Area* 4 (Bank for Int'l Settlements, Working Paper No. 406, 2013), *available at* http://www.bis.org/publ/work406.pdf.

[196] *Id.* at 24.

[197] *Id.* at 6, 25.

[198] Gareth Gore, *Leverage Shift Hits European Bank Plans*, REUTERS (Aug. 5, 2013), http://www.reuters.com/article/2013/08/05/banks-leverage-graphic-idUSL6N0G61X720130805 ("'We always said it was going to be tough, and that is one reason why there is a phased-in transition . . . . But it is designed to make sure banks can't leverage up the way they did before the last crisis.'").

[199] CRD FAQ II, *supra* note 159, at 25–27 (requiring capital buffers for a capital conservation buffer, countercyclical buffer, global systemic institution buffer, other systemically important institutions buffer, and systemic risk buffer).

[200] *Id.* at 13 ("Under the existing framework, banks and investment firms need to have a total amount of capital equal to at least 8% of risk weighted assets.").

[201] *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, CONSULTATIVE DOCUMENT: REVISED BASEL III LEVERAGE RATIO FRAMEWORK AND DISCLOSURE REQUIREMENTS 2 (2013), *available at* http://www.bis.org/publ/bcbs251.pdf [hereinafter BASEL III LEVERAGE

The core content of CRD IV—the Basel III minimum capital requirements—is for the first time expressed in a regulation.[202] As an EU regulation, these norms are automatically and directly binding on the more than 8000 banks operating within the EU; the regulation component of CRD IV will not require any implementing legislation by the various EU Member States.[203]

CRD IV—or at least those parts of it dealing with capital requirements—reflect a re-orientation of EU banking law. As a regulation, the reformed EU capital requirements will be uniform.[204] This shift is described as the creating of a "Single Rulebook" throughout Europe—eliminating the differences and gaps that plague the current Capital Requirements Directive.[205] In an important deviation from uniformity, CRD IV permits Member States (such as the United Kingdom and Sweden) to impose optional additional capital requirements (known as "systemic risk buffers") beyond the levels set by the "Single Rulebook."[206] Other provisions of CRD IV, such as the controversial new limits on banker's compensation, are contained in the directive component; these will be implemented by Member State rule-making.[207]

RATIO] ("The Basel III leverage ratio is defined as the Capital Measure (the numerator) divided by the Exposure Measure (the denominator), with this ratio expressed as a percentage. The basis of calculation is the average of the three month-end leverage ratios over a quarter.").

[202] CRD FAQ II, *supra* note 159, at 7 ("While Member States will have to transpose the directive into national law, the regulation is directly applicable, which means that it creates law that takes immediate effect in all Member States in the same way as a national instrument, without any further action on the part of the national authorities.").

[203] *Id.* at 4 ("Furthermore, while the Basel capital adequacy agreements apply to 'internationally active banks,' in the EU it has applied to all banks (more than 8300) as well as investment firms.").

[204] *See id.* at 7.

[205] *Id.* at 5.

[206] *Id.* at 26 ("Each Member State may introduce a Systemic Risk Buffer of Common Equity Tier 1 for the financial sector or one or more subsets of the sector, in order to prevent and mitigate long term non-cyclical systemic or macro-prudential risks with the potential of serious negative consequences to the financial system and the real economy in a specific Member State.").

[207] *Id.* at 29 ("[CRD IV] introduces additional transparency and disclosure requirements relating to the number of individuals earning more than EUR 1 million per year . . . . For performance from [January 1,] 2014 onwards, the variable component of the total remuneration shall not exceed 100% of the fixed component of the total remuneration of material risk takers.").

The application of the CRD IV "Single Rulebook" is broad: it includes those Member States that have not adopted the euro and is applied to all EU banks (not only large internationally active banks) and to securities firms as well.[208] This extended coverage has in turn introduced some inconsistencies between CRD IV and the Basel III rules.[209]

CRD IV also reflects the influence of the European Parliament. For example, CRD IV's capital adequacy rules include a reduction in the risk weights of loans of small and medium size enterprises ("SMEs").[210] The SMEs possess a mystique in European political culture not unlike that exercised by the "family farm" in the United States.[211] Loans to SMEs are discounted (by a factor of 0.7619 to be precise) for purposes of setting the CRD IV minimum capital.[212] Effectively, a bank may hold a greater quantity of qualified SME loans given a particular quantity of capital.[213] This should have the effect of encouraging lending to SMEs—both in terms of total funds advanced and in lowering the interest rate charged.[214] This rather transparent instance of credit allocation reflects on-going political concerns about the health of the European economy. Left unstated, however, is the implicit greater toleration

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Exceptionally, and under certain conditions, shareholders can increase this maximum ratio to 200%. *Id.*

[208] *Id.* at 4 ("Furthermore, while the Basel capital adequacy agreements apply to 'internationally active banks,' in the EU it has applied to all banks (more than 8,300) as well as investment firms.").

[209] *Id.* at 25.

[210] *Id.* at 24 ("The Regulation applies lower conversion factors to trade related off-balance sheet items than those initially provided in the Commission's initial proposal. This intends to mitigate the impact of the leverage ratio on trade finance operations and lending to SMEs.").

[211] *See* John M. Brewster, *The Relevance of the Jeffersonian Dream Today*, *in* LAND USE POLICY IN THE US 86 (Howard W. Ottoson ed., 2001) ("Jefferson's devotion to the family farm stemmed from his belief in a 'causal relationship between [family] farming and the political system of democracy.'").

[212] CRD FAQ II, *supra* note 159, at 35 ("Article 501 of CRR introduces a reduction in the capital charges for exposures to SMEs—up to EUR 1.5 million—through the application of a supporting factor equal to 0.7619, thus providing credit institutions with an appropriate incentive to increase the available credit to EU SMEs.").

[213] *See id.* at 35.

[214] *Id.*

for bank failure,[215] which is how the Europeans got into the current Eurozone mess in the first place.

B. Basel III à la Carte

European implementation of the earlier versions of the Basel banking law regime proceeded rather mechanically. In prior cycles, the Europeans actively participated in the Basel II process, reached agreement with the world's other major banking powers, and then faithfully enacted the Basel II norms into EU law.[216] This has not been the case with the latest Basel product: Basel III. While Europe was once again a major force in the negotiation of Basel III, it has been decidedly less eager to give full effect to the global banking accord in EU legislation.[217] And the reason—it should be no surprise—is politics.

The link between Basel III and the European implementation (CRD IV) involves three levels of politics: global, European, and national.[218] The outbreak of European reluctance to carry out the Basel III mandates to the letter reflects the varying distributions of power at each level of the lawmaking game.

The case in point: so-called "bancassurance"—the peculiar continental financial conglomerates that are part bank, part insurance company.[219] France's Société Générale and Crédit Agricole are two prominent examples of bancassurance.[220]

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[215] Andrew Willis, *Europe Issues New Bank Guidelines*, BLOOMBERG (July 24, 2009), http://www.businessweek.com/globalbiz/content/jul2009/gb20090724_371057.htm ("'The specificity of the banking sector is the tolerance of bank failure,' said Mr. Lowe, pointing to government reluctance to let banks fail.").

[216] *See Progress on Basel II Implementation*, *supra* note 26.

[217] BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, BASEL III REGULATORY CONSISTENCY ASSESSMENT (LEVEL 2) PRELIMINARY REPORT: EUROPEAN UNION 11 (2012), *available at* http://www.bis.org/bcbs/implementation/l2_eu.pdf.

[218] *Id.*

[219] *Bancassurance: Success in the South*, THE ECONOMIST (July 24, 2003), *available at* http://www.economist.com/node/1948115.

[220] Press Release, Finaccord, Global Bancassurance: Strategies of the World's Top 125 Retail Banking Groups (July 18, 2013), *available at* http://www.finaccord.com/documents/press_releases/2013/press-release_global_bancassurance_strategies-of-the-world-top-125-retail-banking-

The treatment of bancassurance was a sticking point in the Basel III negotiations. The United States and others (including the United Kingdom, an EU member state) expressed concern about the "double counting" problem in bancassurance.[221] Basel III requires banks to maintain adequate amounts of high-quality (Tier 1) equity capital.[222] This capital acts as a loss-absorbing buffer, protecting depositors and other bank creditors from risk in the event of financial hard times.[223] In a similar spirit, insurance regulators demand that insurers maintain adequate equity to protect policyholders in the event insurers experience losses.[224]

The banking business and the insurance business share many common characteristics: both take in capital (from depositors and policyholders, respectively), both invest capital, and both pay out capital (upon maturity or insured event, respectively). But the businesses also are quite distinctive. Banks lose money through improvident lending and other investments; insurance companies lose money through poor underwriting or unexpected casualties. Characteristically, banks invest over a shorter time horizon than insurance companies. While in theory these distinctions might make banks and insurance companies good financial complements (or not), the practical outcome has been that banking and insurance have

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groups.pdf (ranking Crédit Agricole and Société Générale at first and seventh, respectively, by premium value).

[221] *See* INT'L MONETARY FUND, FRANCE: FINANCIAL SECTOR ASSESSMENT PROGRAM—DETAILED ASSESSMENT OF OBSERVANCE OF BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION 12 (2013), *available at* http://www.imf.org/external/pubs/ft/scr/2013/cr13180.pdf [hereinafter FRANCE: FINANCIAL SECTOR]; *Bancassurance: Success in the South*, *supra* note 219 (stating that the US's regulatory history may provide a partial explanation for why bancassurance has not caught on in the US).

[222] BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS 12 (2011), *available at* http://www.bis.org/publ/bcbs189.pdf [hereinafter A GLOBAL REGULATORY FRAMEWORK] ("Common Equity Tier 1 must be at least 4.5% of risk-weighted assets at all times. Tier 1 Capital must be at least 6.0% of risk-weighted assets at all times.").

[223] *See* FRANCE: FINANCIAL SECTOR, *supra* note 221, at 2.

[224] *See*, *e.g.*, INT'L MONETARY FUND, FRANCE: FINANCIAL SECTOR ASSESSMENT PROGRAM—DETAILED ASSESSMENT OF OBSERVANCE OF INSURANCE CORE PRINCIPLES 16 (2013), *available at* http://www.imf.org/external/pubs/ft/scr/2013/cr13181.pdf.

remained mutually exclusive lines of business, separated by regulation, in many jurisdictions (the US through most of its history, for example).[225] In other jurisdictions (France, for example), mixed companies—the bancassurance—have thrived.[226]

Basel III addressed bancassurance—and though it did not ban the business model, Basel III did make it more difficult to carry off.[227] In order to avoid "double-counting," Basel III requires banks to deduct, from what otherwise would have been qualifying Tier 1 capital, the capital serving as "reserves" for the purpose of meeting the mandates of insurance regulation.[228] And there is a certain amount of appeal to this result: capital protecting bank depositors cannot simultaneously protect insurance policyholders.

The bancassurance issue was hardly a major Basel III issue—but is an enormously important issue to the French bancassurance industry.[229] While the Europeans were unable to

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[225] Thomas E. Wilson, *Separation Between Banking and Commerce Under the Bank Holding Company Act—A Statutory Objective Under Attack*, 33 CATH. U. L. REV. 163, 165–68 (1983) ("The historical separation between banking and commerce has meant that banks have not been authorized to engage in most insurance activities.").

[226] *Bancassurance: Success in the South*, *supra* note 221 ("[C]ountries in which bancassurance has been a success have some traits in common. In Italy, Spain, and, to some extent, in France and the Benelux countries, local banks are powerful, labour laws are rigid, there are too many bank branches and insurance products are simple.").

[227] *See* FRANCE: FINANCIAL SECTOR, *supra* note 221, at 55.

[228] *See* BANK FOR INT'L SETTLEMENTS, BASEL III: INTERNATIONAL FRAMEWORK FOR LIQUIDITY RISK MEASUREMENT, STANDARDS, AND MONITORING 24 (2010), *available at* http://www.bis.org/publ/bcbs188.pdf ("Amounts should also be net of Level 1 and Level 2 collateral, to the extent that this collateral is not already counted in the stock of liquid assets, in line with the principle in paragraph 53 that items cannot be double-counted in the standard."); *see also* BASEL COMM. ON BANKING SUPERVISION, REVISED BASEL III LEVERAGE RATIO FRAMEWORK AND DISCLOSURE REQUIREMENTS 3 & n.10 (2013), *available at* http://www.bis.org/publ/bcbs251.pdf. ("[T]o avoid double counting of exposures between entities in the scope of consolidation of the leverage ratio framework . . . banks may offset the on- and off-balance sheet exposures of these entities in order to calculate their Exposure Measure . . . . For example, most investments in the capital of financial investees are deducted from Tier 1 capital and therefore may already be deducted from a bank's exposure measure elsewhere in this Framework.").

[229] *See* FRANCE: FINANCIAL SECTOR, *supra* note 221, at 13.

protect these bancassurance interests in Basel (conceding that double-counting would not be permitted), this did not end the game.[230]

Rather, the issue of the treatment of bancassurance returned to prominence during the EU legislative process that created CRD IV. Here, Germany and other EU member states joined France in eliminating the Basel III provision with respect to bancassurance, thus protecting Société Generale, Crédit Agricole, and others.[231] The United Kingdom, in response, argued that Europe was abandoning its past practice of faithfully implementing its global Basel commitments.[232] On the other side, some Basel participants (most notably the United States) had displayed a certain looseness in the past, implementing Basel norms selectively, keeping those they liked and ignoring others.[233] Given the political and economic climate, slavish implementation of Basel III suddenly seemed naïve, if not foolish.

Under any theory, the CRD IV process has certainly revealed Europe's new stance as a selective adherent to Basel III. In the end, the EU may implement more of Basel III, in a more faithful spirit, than will other countries. It is too early to tell, as most other Basel III parties are less advanced in the implementation track.[234]

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[230] *See* CRD FAQ II, *supra* note 159, at 17.
[231] *Id.* ("The CRR allows an updated version of the Financial Conglomerates Directive (FICOD) approach, which allows consolidation of banking and insurance entities in a group, to continue to be used as an alternative to the Basel III deduction approach. The alternative approach is allowed because consolidation is considered to prevent double counting of capital as well.").
[232] *See, e.g.*, Letter from Simeon Djankov, Minister for Fin., Bulg. et al. to Michel Barnier, Comm'r for Internal Mkt. & Servs., Eur. Comm'n & Olli Rehn, Comm'r for Econ. & Monetary Affairs, Eur. Comm'n (May 19, 2011), *available at* http://www.secure-finance.com/analyses/1110.pdf; STEPHEN BOOTH, CHRISTOPHER HOWARTH, MATS PERSSON & VINCENZO SCARPETTA, OPEN EUROPE, CONTINENTAL SHIFT: SAFEGUARDING THE UK'S FINANCIAL TRADE IN A CHANGING EUROPE 20 (2011), *available at* http://www.openeurope.org.uk/Content/Documents/PDFs/continentalshift.pdf (arguing that CRD IV's less ambitious and less faithful implementation of Basel III may have adverse effects on the UK's economy).
[233] *See* Wright, *supra* note 165.
[234] *See* BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, PROGRESS REPORT ON IMPLEMENTATION OF THE BASEL

Yet Europe's recalcitrance as to the treatment of bancassurance reflects a newly emboldened European-level field of political action.[235] It is no longer the case that when Brussels returns from an international negotiation such as Basel with a result, slavish implementation will follow. Rather, ordinary political forces will continue to play—and new results are possible.

A narrower interpretation of the bancassurance story is also tenable: the special treatment reflects European realities. The EU points to an existing European special regime for assurance of the adequate capitalization of bancassurance.[236] In other words, CRD IV's treatment of bancassurance can be seen as a special regime applied to a limited circumstance, and hence a less than significant departure from the spirit of Basel III. That said, the affected institutions are important players at the global level, and it will be argued that CRD IV unfairly favors them.[237]

Further EU resistance to Basel III can be seen with respect to two key innovations: the requirement of an overall leverage ratio and the maintenance of a long-term liquidity buffer.[238] In each case, CRD IV postpones (and hence effectively avoids) implementation.[239]

Basel III requires the imposition of an overall limit on leverage.[240] The leverage ratio supplements the long-standing use of

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REGULATORY FRAMEWORK 1 (2013), *available at* http://www.bis.org/publ/bcbs263.pdf.

[235] *See* Steven Erlanger, *Euro Debt Crisis Is Political Test for Bloc*, N.Y. TIMES, Feb. 6, 2010, at A1.

[236] CRD FAQ II, *supra* note 159, at 7 ("A regulation is subject to the same political decision making process as a directive at European level, ensuring full democratic control.").

[237] Rym Ayadi, Emrah Arbak & Willem Pieter De Groen, *Implementing Basel III in Europe: Diagnosis and Avenues for Improvement*, POLICY BRIEF (Ctr. for Eur. Pol'y Stud., Brussels), June 27, 2012, at 1.

[238] *Id.* at 2.

[239] DEUTSCHE BUNDESBANK, MONTHLY REPORT: IMPLEMENTING BASEL III IN EUROPEAN AND NATIONAL LAW 61 n.10 (June 2013), *available at* http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2013/2013_06_basel_3.pdf?__blob=publicationFile ("The Implementation plan provides for a minimum LCR of 60% from 2015, to be increased annually in stages to 100% by 2018. Under the delegated legislation on the LCR, the European Commission can postpone full introduction until 2019.").

[240] BASEL III LEVERAGE RATIO, *supra* note 201, at 2.

regulatory capital as a check on a bank's overall exposure to risk.[241] Banks, which reduce or eliminate the amount of regulatory capital they maintain (by loading up on low-risk weight or zero-risk weight assets), must nevertheless comply with the demands of the leverage ratio.[242] There was considerable resistance in the European banking community to the imposition of the leverage requirement during the CRD IV debates.[243] Banks argued that de-leveraging would diminish the amount of credit they could make available, which in turn would confound efforts toward economic recovery in Europe.[244] In its final form, CRD IV does not define the eventual maximum leverage ratio, and it sets a vague timetable for its eventual effectiveness.[245]

Similarly, an important element of the new Basel III liquidity requirement is avoided in CRD IV. Basel III requires the setting of a New Stable Funding Ratio ("NSFR") limit, to minimize maturity mismatches and reduce liquidity risk.[246] Notwithstanding the severe liquidity crisis experienced during the 2007/2008 Crisis, CRD IV postpones consideration of a NSFR measure to no earlier than 2018.[247]

IV. The Shadow of the Euro Crisis

A. Banks in Europe

The implementation of Basel III in Europe has been conducted in the period spanning two banking crises. And the European banking reform has been haunted by two specters: a possible collapse of the Eurozone on the one hand; and an alternative blind leap into the deeper integration of a European banking union on the other.[248] Events have shown the first to be avoided—and the second embraced.[249]

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[241] CRD FAQ II, *supra* note 159, at 12.
[242] *See id.* at 14.
[243] *See* Ayadi et al., *supra* note 237, at 1.
[244] *Id.*
[245] Commission Regulation 575/2013, 2013 O.J. (L 176) 1.
[246] Ayadi et al., *supra* note 237, at 12.
[247] *See id.* at 14.
[248] *See* Floyd Norris, *Euro Survives, but Future Is in Doubt*, N.Y. TIMES, Oct. 25, 2012, at B1.
[249] *Id.*

The first crisis of course was the 2007/2008 global financial meltdown that led to significant bank failures in Europe and the US and costly public bailouts of many surviving banks.[250] The Basel III reforms were designed to prevent a recurrence of this kind of banking crisis, through various new mandates: implementation of much stricter capital requirements, new liquidity and leverage tests, and other innovations.[251] The Basel III response was negotiated within the Group of Twenty, where Europe had a substantial presence and an important influence.[252] Based on the past record of enthusiastic adoption of Basel norms by Europe, one might have expected the passage of the CRD IV legislative package to be largely a technical exercise. It has proven otherwise, due in part to the timing.

The complex European legislative process coincided with the outbreak of a second severe crisis, more specifically centered on Europe.[253] This second—and ongoing—crisis is the European sovereign debt crisis.[254] Initially involving Greece, the sovereign debt crisis spread to Italy and Spain, sharply raising borrowing costs of these seriously indebted countries and miring their respective populations into social misery.[255] Unemployment remains at merciless levels in Spain, while the Spanish government has had to reduce social spending as a result of European imposed austerity disciplines.[256]

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[250] Luc Laeven & Fabian Valencia, *Resolution of Banking Crises: The Good, the Bad, and the Ugly* 1 (Int'l Monetary Fund, Working Paper No. 10/146, 2010), *available at* www.imf.org/external/pubs/ft/wp/2010/wp10146.pdf ("present[ing] a new database of systemic banking crises for the period 1970–2009").

[251] *See* A GLOBAL REGULATORY FRAMEWORK, *supra* note 222, at 1–2.

[252] *See* G-20 Research Group, *supra* note 117, at 21.

[253] *See* Erlanger, *supra* note 235, at A1.

[254] *See generally* Jay C. Shambaugh, *The Euro's Three Crises*, BROOKINGS PAPERS ON ECON. ACTIVITY 157 (Spring 2012) (examining increasing investor concern about sovereign debt).

[255] *See* Landon Thomas, Jr. & David Jolly, *Despite Push for Auterity, European Debt Has Soared*, N.Y. TIMES, Oct. 22, 2012, at B8 ("Greece's ratio of debt to gross domestic product has hit a new high of 170 percent, and Portugal's has reached 120 percent."). At the same time, Ireland's ratio was 117 percent, and Spain's was 90 percent. *Id.*

[256] David Román & Ilan Brat, *Spain Jobless Rate Hits 26% Amid Austerity*, WALL ST. J. (Jan. 24, 2013, 4:11 PM), http://online.wsj.com/news/articles/SB10001424127887323854904578261911924194162.

The European sovereign debt crisis is in large part also a banking crisis, though with different features from the 2007/2008 Crisis. The Euro Crisis reveals the inherent weakness of the strange middle ground of the monetary structure of the current Eurozone: Eurozone countries share a common currency and somewhat coordinate monetary policies, but borrow euro-denominated funds in their respective sovereign capacities.[257] Moreover, they bear primary oversight responsibilities for the banks headquartered within their respective territories.[258]

The residual sovereign control Eurozone states maintain over their banks means that a bank in crisis will look toward its national authority (and its national authority alone) for deposit insurance coverage, bailouts, and eventual resolution procedures, which works well enough for those healthy Eurozone countries with large economies and small banks.[259]

Things are more challenging for those Eurozone countries with smallish economies and large banks; for these countries, the prospect of undertaking additional bank rescues may drive national accounts deeply into the red and precipitate a decline in the sovereign credit scores.[260]

A pernicious feedback loop has formed between the failing banks and the troubled countries charged with their supervision.[261]

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[257] Ashoka Mody & Damiano Sandri, *The Eurozone Crisis: How Banks and Sovereigns Came to Be Joined at the Hip* 1 (Int'l Monetary Fund, Working Paper No. 11/269, 2011), *available at* http://www.imf.org/external/pubs/ft/wp/2011/wp11269.pdf ("us[ing] the rise and dispersion of sovereign spreads to tell the story of the emergence and escalation of financial tensions within the eurozone").

[258] Jacob Goldstein, *A Baby Step Toward a US of Europe*, PLANET MONEY BLOG (June 29, 2012, 9:39 AM), http://www.npr.org/blogs/money/2012/06/29/155973136/a-baby-step-toward-a-united-states-of-europe ("In the eurozone today, each country regulates its own banks.").

[259] *See* Mody & Sandri, *supra* note 257, at 5.

[260] *See id.* at 7 ("The eurozone countries that had experienced a large appreciation of their effective real exchange rate had become competitively weak, and the pre-crisis buoyancy in some of them was not sustainable. The econometric results show, indeed, that countries with weaker competitiveness were prone to greater sovereign stress resulting from financial sector weakness. Thus, during this key phase, financial shocks translated into higher spreads especially for countries with lower growth prospects and higher debt burden.").

[261] *Id.* at 7, 22.

As the banks sink deeper, their shrinkage reduces their ability to make credit available, thus starving the real economies where they are active (usually their home countries).[262] As the creditworthiness of the banks declines, the prospect for further bailouts draws on national financial capacities, driving the home state creditworthiness downward (reflected in the increase in its euro-denominated borrowing costs).[263] Eurozone banks often maintain large holdings of the euro-denominated obligations issued by their home countries.[264] A Spanish bank holding Spanish notes will see its asset base decline as the value of the state obligations fall, causing the bank's financial status to deteriorate as a result.

The wide gap that opened between the valuation of Spanish and German euro-denominated sovereign debt, to give an example, did not necessarily suggest that the market was projecting a likelihood of Spanish default per se.[265] Rather the concern was the possible collapse of the euro.[266] An end to the euro would likely have caused outstanding sovereign obligations of Spain and Germany to be restated in restored pesetas and restored deutschmarks respectively, with the value of those obligations reflecting an implicit devaluation of the peseta against the deutschmark.[267] Of course, escaping the euro straightjacket would have restored to Spain the ability to work out its obligations by manufacturing new pesetas or by imposing other fiscal measures.

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[262] *Id.* at 22.

[263] REBECCA NELSON, PAUL BELKIN, DEREK MIX & MARTIN WEISS, CONG. RESEARCH SERV., THE EUROZONE CRISIS: OVERVIEW AND ISSUES FOR CONGRESS 9 (2012), *available at* www.fas.org/sgp/crs/row/R42377.pdf.

[264] *See* Neil Unmack, *Euro Zone Weakened by Banks' Sovereign-Debt Feast*, REUTERS (July 16, 2013, 2:06 PM), http://in.reuters.com/article/2013/07/16/idINL4N0FM1QO20130716.

[265] *See* MICHAEL PETTIS, THE GREAT REBALANCING: TRADE, CONFLICT, AND THE PERILOUS ROAD AHEAD FOR THE WORLD ECONOMY 119–24 (2013); *see also Rising Interest Rates: Spain Slips Further into Crisis*, SPIEGEL ONLINE (Apr. 16, 2012, 5:52 PM), http://www.spiegel.de/international/europe/as-spain-slips-back-into-recession-bailout-fears-return-a-827890.html.

[266] *See* Adam Davidson, *The Euro Crisis Is Back from Vacation*, N.Y. TIMES (Aug. 28, 2012), www.nytimes.com/2012/09/02/magazine/7-story-lines-to-watch-in-the-euro-crisis-this-fall.html?pagewanted=all&_r=0 (reporting on the collapse of the Greek economy and with it, the entire Eurozone and its decade-old currency).

[267] *See id.*

The collapse of the euro was one specter haunting European bank reform. The price of the euro's salvation may be the eventual establishment of a European banking union.[268] Such a banking union will likely involve (1) a unitary European-level regulator, (2) a common deposit insurance scheme, and (3) a unitary European-level resolution mechanism.[269] The consolidated Eurozone economy would stand behind all the banks within, thus eliminating the peculiar challenges faced by the smallish states with largish (and failing) banks.

A fundamental political question remains: is Europe ready for a banking union? For some Member States, this is going too far.[270] Sentiment in some Member States maintains that profligacy in Europe's margins (Greece, Spain) should not cost the more prudent core.[271] Member States may also fear losing the convenience (and lending focus) of truly national banks, serving the credit needs of their respective national economies.[272]

The other side of the banking union debate has been forcefully voiced by Germany: a banking union cannot be achieved without greater common fiscal integration.[273] This prospect truly

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[268] Rachel Epstein, *A European Banking Union Could Save the Euro*, U.S. NEWS (June 29, 2012), http://www.usnews.com/opinion/articles/2012/06/29/a-european-banking-union-could-save-the-euro ("The European Central Bank and [a] number of European policy makers have gravitated toward the idea of creating a European banking union to alleviate the ongoing debt and currency crisis. A banking union would put in place collective deposit insurance and bank resolution schemes. It would consolidate supervision, most likely in the European Central Bank.").

[269] *See* John O'Donnel, *Regulator Warns Banking Union Could Split Europe*, REUTERS (Sept. 19, 2010), http://www.reuters.com/article/2012/09/19/us-eu-eba-idUSBRE88I14W20120919 ("There are three major steps in a banking union: the ECB being given responsibility for monitoring all euro zone banks and others that sign up; a fund to close down and settle the debts of failed banks; and a fully fledged scheme to protect savers' deposits.").

[270] *See id.*

[271] *Id*. ("The close ties between governments and the banks they supervised and on whom they also relied to buy their debt, has dragged both ever deeper into crisis. A banking union would break this link by making the policing of banks supranational and establishing central schemes paid into collectively to cover the costs of closing failed lenders.").

[272] *Id.*

[273] *The Future of the European Union: The Choice*, THE ECONOMIST (May 26, 2012), http://www.economist.com/node/21555916 ("For people like

frightens the euro-skeptics.[274] Were this to happen, national leaders would lose much control of national budgets. [275] In other words, every Member State may find itself in the position of Greece or Spain, whose central economic destinies are now in the hands of Brussels.[276]

B. CRD IV and Eurodemocracy

The state of democracy has been frequently questioned throughout the European project.[277] From the start, euro-skeptics have viewed the EU (and the prior European Community) with considerable suspicion.[278] The European political apparatus has been dominated by elite technocrats, with little regard for the impacts their policies cause and less appreciation for the play of national cultures.[279] During various ensuing political reforms, the EU has

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Germany's finance minister, Wolfgang Schäuble, the single currency was always a leg on the journey towards a fully integrated Europe.").

[274] Francesco Capriglione, *European Banking Union: A Challenge for a More United Europe* 5 (Sept. 2, 2013), *available at* http://ssrn.com/abstract=2319297.

[275] O'Donnel, *supra* note 269 ("For banking union to work, it will require countries to surrender a degree of sovereignty over banking supervision, which has long been a national responsibility.").

[276] Both Greece and Spain had to adopt EU-imposed austerity policies as a condition for bailouts. *See* Melissa Eddy, *Greece Says It Is on Track to Repay Bailouts*, N.Y. TIMES (Nov. 22, 2013), http://www.nytimes.com/2013/11/23/business/international/greece-says-it-is-on-track-to-repay-bailout.html?_r=0; Raphael Minder & Stephen Castle, *Spain Plans New Round of Tough Austerity Measures*, N.Y. TIMES (July 11, 2012), http://www.nytimes.com/2012/07/12/business/global/daily-euro-zone-watch.html.

[277] JONATHAN BIRDWELL, SEBASTIEN FEVE, CHRIST TRYHORN & NATALIA VIBLA, BACKSLIDERS: MEASURING DEMOCRACY IN THE EU 11 (2013), *available at* http://www.socialistsanddemocrats.eu/sites/default/files/DEMOS_report.pdf (reporting that the financial crisis may have heightened antidemocratic trends in the EU and arguing that the EU, and the European Commission in particular, need to fully embrace their role as democratic protector).

[278] *Id.* at 10.

[279] *See* Robert A. Dahl, *Can International Organizations Be Democratic? A Skeptic's View*, *in* DEMOCRACY'S EDGES 19, 30 (Ian Shapiro & Casiano-Hacker Cordon eds., 1999) ("If popular control is formidably difficult

arguably become more democratic (illustrated by the ever-strengthening role of the directly-elected Parliament)—but to be more democratic is not necessarily to be democratic enough.[280]

International law also suffers a democracy deficit.[281] When nations adopt coordinated policies, their bargaining takes place removed from ordinary internal politics.[282] Indeed, other nations (and interests reflected in those nations' preferences) may have greater influence than do particular domestic constituencies.[283] Diplomats return to their national capitals with neatly wrapped legislative packages, concluded agreements which cannot be easily altered regardless of national politics.[284]

The implementation of the Basel III banking reforms in Europe demonstrates the operation of both the well-recognized European democracy deficit, as well as the international law democracy problem. Indeed, these two phenomena operating in concert seem to magnify the removal of law-making from the European peoples—testing the possibility that the reforms have any democratic legitimacy.[285]

Of course, the European implementation of Basel III and CRD IV are highly technical, and the more technical a legislative initiative, the more likely that the people will defer to technocrats. But not always—and particularly not so when the arrangements implicate structural changes to society. Complexity alone does not justify technocracy.

The CRD IV stories repeatedly show resistance of various constituents to defer to the Basel result. In some instances, the resistance comes from particular "interests"—the interests of London as a financial capital, for example, or of the French bancassurance industry.[286] And, at times, the interests appear to be that of a broad

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within democratic countries, surely the problem will be even harder to solve in international institutions.").

[280] *See id.* at 32.

[281] *Id.* at 20.

[282] *Id.* at 32.

[283] *See id.* at 30.

[284] *Id.*

[285] *Id.* at 34.

[286] Jeffery Atik, *European Politics and the Regulation of Bank/Insurance Firms*, SUMMARY JUDGMENTS (Aug. 6, 2012), http://llsblog.lls.edu/faculty/2012/08/european-politics-and-the-regulation-of-bankinsurance-firms.html.

and ill-defined people, suspicious of banks, suspicious of bankers, and protective of the familiar and the local.[287]

The story begins with Basel III—where Europe was represented by the European Commission, as well as by national representatives of the largest Member States.[288] By numbers, this suggests a number of routes to advance European desires. Basel III involved other voices, however, such that the outcome hardly reflects a European consensus on banking reform, given the inevitable influences of the United States, Japanese, Chinese, Swiss, and other representatives participating in the Group of Twenty.[289] As a result, it may well be that Basel III contains substantive results that Europe entered into grudgingly.

The Euro Crisis has tested more than the viability of the current currency arrangements. The sovereign debt crisis affecting Greece, Ireland, Italy, and Spain has also tested the limits of broader European democracy. Ultimately, the pre-crisis status quo will likely be abandoned.

The EU and its predecessors began as a common market for goods and services.[290] A common European currency space is a more recent development—the euro serves as the currency of most (but

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[287] *See, e.g.*, Susanne Amann, *The Good Bankers: Battling the Financial Lobby in Brussels*, SPIEGAL ONLINE INT'L (Oct. 24, 2011), http://www.spiegel.de/international/business/the-good-bankers-battling-the-financial-lobby-in-brussels-a-793917.html ("[Financial Watch] is [an organization] backed by forty European organizations, including unions, consumer-protection groups, foundations and think tanks. And it has a single goal: to make financial markets more transparent and influence future legislation so that it serves the needs of society rather than the financial industry.").

[288] The Basel Committee on Banking Supervision's European representatives came from, among other countries, France, Spain, Italy, the UK, and Germany. *See BCBS*, *supra* note 18.

[289] *See supra* notes 118, 139–41 and accompanying text.

[290] The establishment of the European Coal and Steel Community (ECSC) in July 1952 was the first step towards a supranational Europe. *See generally* Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, 261 U.N.T.S. 140 (establishing the ECSC). The EEC Treaty, signed in Rome in 1957, brought together France, Germany, Italy, and the Benelux countries in a community whose aim was to achieve integration via trade with a view to economic expansion. *See generally* Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 (establishing the EEC).

not all) EU Member States.[291] Adoption of the euro has reduced trading costs and has led to more transparent prices.[292] The open question is whether the Euro Crisis will lead to deeper integration among the EU Member States (as an artifact of a euro rescue) or whether a collapse of the euro will signal a retreat from the past achievements of the European project.[293]

C. Toward an EU Banking Union

The Euro Crisis is first and foremost a sovereign debt crisis, initially affecting a handful of EU Member States running unsustainable deficits.[294] The sovereign debt crisis is itself an artifact of the establishment of the euro—neither Greece nor Spain would have been able to borrow as much in their former currencies (or on such favorable terms) as they were able to using the euro.[295] Prior to the Euro Crisis, the financial markets valued all euro-denominated obligations of Eurozone Member States similarly.[296] As the crisis developed, lenders became far more discriminating, demanding much higher euro interest rates from weaker Member States (such as Greece and Spain) than from others.[297]

For those grossly indebted Member States, there is no simple escape from these much higher borrowing costs—absent assistance

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291 Eur. Comm'n, *The Euro*, EUROPA.EU, http://ec.europa.eu/economy_finance/euro/ (last visited Jan. 16, 2014) ("The euro is the single currency shared by (currently) 17 of the European Union's Member States, which together make up the euro area. The introduction of the euro in 1999 was a major step in European integration.").

292 *See id.*

293 *See The Future of the European Union: The Choice*, *supra* note 273.

294 Jill Schlesinger, *Europe Debt Meltdown: How Did We Get Here?*, CBS News (June 8, 2012), http://www.cbsnews.com/8301-505123_162-57449818/europe- debt- meltdown-how-did-we-get-here/.

295 *Id*.

296 *Id.* ("[A]fter the euro was introduced, the cost of borrowing evened out, which allowed weaker nations to borrow more money and banks in the larger economies to boost their earnings by lending money to the weaker ones.").

297 Eur. Comm'n, *Loans*, EUROPA.EU, http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/access-to-finance-indicators/loans/index_en.htm (last visited Jan. 16, 2014) ("Hungary, Romania, Bulgaria, Greece and Cyprus have the highest interest rates of all the countries for the third quarter of 2012.").

from more solvent Member States. And healthier Member States, such as Germany, have resisted intervention.[298] Austerity has been bandied about (indeed, it has been "imposed" on Greece), but there is a point of distress beyond which austerity measures alone cannot generate the budget surpluses needed for a country to dig its way out of debt.[299] The better answer may be devaluation, which effectively resets a nation's debt, but this path is not presently open to a country participating in a currency union such as the euro.[300]

Devaluation could have taken two forms. One or two countries could have exited the euro and re-adopted a (devalued) national currency. The remaining euro countries would continue to practice the monetary union. Or the euro could have shattered entirely—with all countries returning to their historic currencies: a new old world of francs, lire, and deutschmarks. But rampant revaluations of post-euro national currencies (upward and downward, in various cases) would dramatically affect intra-European trade—and would reintroduce risks and costs the euro had seemingly eliminated.[301]

It now seems that the euro has been saved.[302] All that was needed was the political will to do so. As a technical matter, the rescue of the euro involves replacing the arrangements that now permit each euro-participating country to issue euro-denominated notes with a collective facility that would enjoy the confidence of the

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[298] *See* Sumi Somaskanda, *Germany Resists Calls to Give More to $657B Eurozone Bailout*, USA Today (Jan. 30, 2012), http://usatoday30.usatoday.com/money/world/story/2012-01-26/european-debt-crisis-eurozone-bailout-fund/52874640/1.

[299] *See* John Cassidy, *It's Official: Austerity Economics Doesn't Work*, THE NEW YORKER (Dec. 7, 2012), http://www.newyorker.com/online/blogs/comment/2012/12/austerity-economics-doesnt-work.html ("Austerity policies are self-defeating: they cripple growth and reduce tax revenues.").

[300] *See* Jeremy J. Siegal, *Devaluation: The Last Option to Save the Euro*, FIN. TIMES (May 22, 2012, 9:54 AM), http://www.ft.com/intl/cms/s/0/8626a02e-a35d-11e1-988e-00144feabdc0.html#axzz2C22pfqqX.

[301] *See id.* (discussing the possibility of devaluation in Europe and its possible consequences).

[302] Jörg Asmussen, Board Member, European Cent. Bank, The Economist's Bellwether Europe Summit (Apr. 25, 2013), *available at* https://www.ecb.europa.eu/press/key/date/2013/html/sp130425.en.html ("The euro is already 'saved.'").

financial markets.[303] Access to the facility would be disciplined in a manner that would prevent "excessive" borrowing.[304] Put another way, it would remove the ability of Eurozone Member States to run deficits—deficits that could have allowed the maintenance of desired levels of government services (such as education, health care, and pensions).[305]

It may be a democratic inevitability that people want high levels of government services but are unwilling to accept the constraints that accompany fiscal discipline. And, at times, austerity is simply the wrong prescription.[306] Be that as it may, these democratic urges are real and (at times) irresistible. If the "periphery" (in Europe, a term with both financial and geographic significances) is to be included, its European expectations must be satisfied. And this will cost the center (think Germany).

Germany has a proud history of generosity—within its own borders (recall the integration of the East) and beyond. But there seems to be something that offends a German popular sensibility in bailing out sunnier and more profligate Member States in the Euro Crisis.[307]

Germany and other core euro states must stand behind the euro to save the euro—and that means, both now and in the future, standing behind the sovereign borrowings of all euro states. Going forward, the only way to preserve the euro is to increase the authority of the central European institutions to regulate the Member States—moving sooner, rather than later, toward a fiscal union. Doing so, however, has a democratic cost associated with it.[308] National capitals will have far less say in determining national economic conditions in a fiscal union. EU-level politics are already viewed as

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[303] *See* Mario Draghi, President, Eur. Cent. Bank, The Future of the Euro: Stability Through Change (Aug. 29, 2012), *available at* http://www.ecb.europa.eu/press/key/date/2012/html/sp120829.en.html.

[304] *See id.* ("For fiscal policies, we need true oversight over national budgets. The consequences of misguided fiscal policies in a monetary union are too severe to remain self-policed.").

[305] *Id.*

[306] *See* Siegal, *supra* note 300.

[307] *See Merkel Launches New Pro-EU Campaign in Germany*, EUBUSINESS (Aug. 23, 2012), http://www.eubusiness.com/news-eu/finance-public-debt.i2i ("With all eyes on Germany, Europe's effective paymaster, to solve the eurozone debt crisis, surveys have shown Germans are increasingly weary of bailing out debt-wracked countries such as Greece.").

[308] *See* Dahl, *supra* note 279, at 34.

distant and elitist, and these tendencies would only increase with fiscal union.[309] The other direction—abandonment and retreat—promises more responsive governance, but with a loss of prosperity and a reintroduction of greater divergence of economic performance in Europe with the accompanying tensions.

V. Conclusion

European bank reform in response to the 2007/2008 Crisis commenced with European participation in coordinated global efforts—by participation in new and newly energized institutional formulations (such as the Financial Stability Board and the Group of Twenty). These efforts included both responsive measures as well as forward-looking reform. The outcome of these global banking initiatives was the concordance of the latest generation of Basel norms: Basel III.

Moreover, European bank reform has taken a constitutional turn, with the relocation of substantial regulatory authority from the European Member States to the ECB—at least with respect to supervision of the largest banks headquartered within the Eurozone.[310] A full banking union within the Eurozone will likely follow this bold move toward federalization. This is a surprising outcome of reform efforts that earlier had seemed to follow more traditional design. Post-crisis EU bank reform commenced at the global level, through participation by the EU and certain large EU member states in the establishment of the Basel III reform package.[311] Once Basel III had been concluded, Europe embarked on Member State implementation mediated by harmonizing EU law in

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[309] *See generally* Christopher J. Anderson, *When in Doubt, Use Proxies: Attitudes Toward Domestic Politics and Support for European Integration*, 31 COMP. POL. STUD. 569 (1998) (finding, *inter alia*, that "satisfaction with democratic institutions translates into higher levels of support for European unification," and therefore, "those who are dissatisfied with the working of political institutions . . . display higher levels of dissatisfaction with European institutions").

[310] *See* James Kanter, *European Lawmakers Expand Power of Central Bank over Top Lenders*, N.Y. TIMES, Sept. 12, 2013, at B3 ("European Union legislators overwhelmingly approved a law on [September 12, 2013] that puts about 130 of the euro zone's largest banks under the direct scrutiny of the European Central Bank.").

[311] Basel II, *supra* note 104, at 1.

the form of CRD IV.[312] The EU legislative process revealed continuing tensions among various Member States and a new willingness by the EU to be a somewhat less faithful adherent to the Basel III blueprint.[313] The Euro Crisis has knocked the CRD IV harmonization train off its tracks.

Based on past practice, it appeared Europe's efforts would focus on the straightforward implementation of the requirements of Basel III through a mix of Member State-level and Brussels-level measures. Yet it soon appeared clear that the 2007/2008 Crisis would be used to justify deeper European harmonization of banking regulation. In part, this was driven by the weaknesses revealed by major recent events—the cross-border effects of bank failures in Ireland and the United Kingdom.[314] There may well have been some opportunism in play, as well—crises after all create unanticipated occasions for institutional reshuffling. That is, the 2007/2008 Crisis created an opportunity for further deepening of the single market for financial services and a shifting of greater influence from London to the Member States participating in the euro.

And so the earliest versions of the European legislative implementation of Basel III—CRD IV—significantly increased the degree of harmonization within Europe. Harmonization discourse in Europe typically has both horizontal and vertical aspects. The vertical discourse, of course, is the debate as to how much harmonization is truly needed in a particular policy space—and these conclusions wax and wane over time. But there is a certain inevitable resistance to new areas of harmonization (constitutionally enshrined in the subsidiarity principle).[315] In banking matters, resistance to

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[312] CRD FAQ II, *supra* note 159, at 1.

[313] *See supra* notes 167–72 and accompanying text.

[314] Philip R. Lane, *The European Sovereign Debt Crisis*, 26 J. ECON. PERSP. 49, 55 (2012) ("Cross-border financial flows dried up in late 2008, with investors repatriating funds to home markets and reassessing their international exposure levels . . . . This process disproportionately affected countries with the greatest reliance on external funding, especially international short-term debt markets. Inside the euro area, Ireland was the most striking example: the high dependence of Ireland's banking system on international short-term funding prompted its government at the end of September 2008 to provide an extensive two-year liability guarantee to its banks . . . .").

[315] *See* Eur. Comm'n, *The Principle of Subsidiarity*, EUROPA.EU, http://europa.eu/legislation_summaries/institutional_affairs/treaties/lisbon_treaty/ai0017_en.htm (last visited Jan. 16, 2014).

harmonization, uniformity, and centralization has a particular cast, given the fracture between those Member States participating in the Eurozone and those remaining outside.[316] The most vocal outsider states—the United Kingdom and Sweden—instinctually resist harmonization as it weakens national economic control within their respective currency areas. [317] In contrast, the German-French axis pulled for greater harmonization, if not uniformity, resorting to the frequently articulated slogan of the Single Rulebook.[318]

The horizontal debates are squarely substantive quarrels between Member States as to the content of harmonized norms.[319] Here, the debates often involved the residual exercise of discretion permitted by Basel III.[320] Real contrasts in the structure of the existing banking sectors of various Member States generated important conflicts over regulatory content.

Both the vertical and horizontal conflicts engaged all three of the principle EU institutions involved in lawmaking: Commission, Council, and European Parliament.[321] CRD IV was an example par excellence of the more complex play of politics in Europe, with the most varied and often subtle opportunities for interested parties to exert influence on regulatory design.[322] The end result of a provisional CRD IV in mid-2012 was a set of compromises mediating both vertical and horizontal tensions. But CRD IV quickly passed from the spotlight as the Euro Crisis deepened.

The Euro Crisis presented its own imperatives—and created its own set of institutional possibilities. The Euro Crisis pitched CRD IV into obscurity: CRD IV formally will harmonize Member States in their residual authority over the many smaller banks in Europe. But CRD IV will not (as such) become the relevant set of rules guiding the ECB in its oversight of the Eurozone's largest banks—but it will likely inspire ECB regulation in the short run. In the

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[316] *See Making the Break*, *supra* note 9.
[317] *See supra* notes 182–84 and accompanying text.
[318] *See* Porter, *supra* note 184, at B1.
[319] *See supra* notes 176–84 and accompanying text (analyzing the European policy of maximum harmonization and the ensuing disagreement among Member States regarding the content of such norms).
[320] *See supra* note 62 and accompanying text.
[321] *See supra* Part III.A.
[322] *See supra* notes 218–35 and accompanying text (citing the dispute over treatment of the bancassurance industry as an example of divergent European interests during the formation of CRD IV).

longer run, should a European banking union fully develop, the mere size and complexity of the European banking space may precipitate further distancing from Basel.