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Banking Regulation After the Financial Crisis has Made Banks Safer

Andrew Rizk[1]*

[1]LLM Corporate Finance Law, University of Westminster School of Law, London. E-mail: andrew98rizk@gmail.com

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Abstract

In 2008, the world financial system experienced its worst crisis in at least a century, arguably the worst collapse in the history of finance capitalism. Specific national financial crises have been more severe in the past, such as the collapse of the United States banking system between 1929 and 1933. But what makes this crisis unique is that severe financial problems have erupted simultaneously in a number of countries, and that its economic impact was felt throughout the world as a result of the global economy's heightened interconnectedness. Deregulation of banking sectors in numerous geographies, particularly in advanced economies, defined the decade leading up to the crisis. The advent of the crisis ushered in a period of extensive banking reregulation, with a number of efforts put in place to rectify the flaws which became evident throughout the crisis. Yet, the dilemma persists: did post-financial crisis bank regulations actually make banks safer?

Keywords: *Financial crisis, Deregulation, Dodd-Frank act, European system, Financial supervision*

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1. Introduction

Financial systems are prone to periodic breakdowns, with at least one significant financial crisis occurring almost every decade of the 20th century.[1] Banking crises often uncover weaknesses in the design and implementation of bank regulation and supervision. The latest 2007-2009 global financial crisis was not different, and it has sparked a heated discussion on the lessons to be learned and how to design efficient and safer banking systems.[2]

It is not surprising that governments everywhere seek to regulate financial institutions, both to avoid crises and to make sure a country's financial system efficiently promotes economic growth and opportunity. Striking a balance between freedom and restraint is difficult. Financial innovation inevitably exacerbates risk, while a tightly regulated financial system hampers growth. When regulation is too aggressive or too lax, it damages the very institutions it is meant to protect.[3] One clear outcome of the 2008 financial crisis has been a period of intense regulation, with several initiatives put in motion to address the flaws that were revealed during the crisis.

[1] Gerard, Caprio Jr., Ash Demirguc-Kunt. and Edward J. Kane. (2008). The 2007 Meltdown in Structured Securitization: Searching for Lessons not Scapegoats. The World Bank Policy Research Working Paper 4756 11.

[2] Deniz, Anginer., Ata, Can Bertay., Robert, Cull., Asli Demirguc-Kunt. and Davide S. Mare. (2019). Bank Regulation and Supervision Ten Years after the Global Financial Crisis. World Bank Group Policy Research Working Paper 9044 2.

[3] Gerard, Caprio Jr. *et al.* (2008). *op. cit.*.

* *Corresponding author: Andrew Rizk, LLM Corporate Finance Law, University of Westminster School of Law, London. E-mail: andrew98rizk@gmail.com*

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As a result, the aim of the following chapters is to examine post-crisis banking regulations in order to assess whether they have actually made banks safer. In order to do so, the paper first offers a brief overview of banking regulation prior to the financial crisis. Second, the paper examines post-financial crisis regulations, focusing on those enacted in the United Kingdom, the European Union, and the United States, as well as global initiatives taken by the G20. Although banking regulations have strengthened at national level, the paper concludes that globalized financial markets still exist, and unless regulations can become more globalized as well, a future financial crisis beckons.

2. An Overview of Banking Regulation Pre-Financial Crisis

This section will examine the years leading up to the global financial crisis, focusing on the "Great Depression of the 1930s" and the "Deregulation Period (1980-2008)." First, this section begins with a brief description of the depression that occurred about a century ago. Why? Because of the lessons that may be drawn from a comparable situation. Second, section 2.2. presents a summary of the "Deregulation Period". The goal is to show how financial market liberalization and deregulation almost invariably end in market bubbles.

2.1. The History of Banking Regulation

2.1.1. The Great Depression of the 1930s

The Great Depression was a global economic depression that began in 1929 and ended in 1939. Despite the fact that the Depression began in the United States, it led in sharp declines in output, massive unemployment, and severe deflation in practically every country on the planet.[4] Many explanations have been proposed throughout the years, but there is no single, widely accepted explanation as to why the Great Depression occurred.[5] Nonetheless, there is no denying that the 1929 stock market crash set off a chain reaction of panic throughout the world's population. The stock market in the United States saw significant development during the 1920s.[6] Investing in the stock market became a national pastime for those who could afford it, as well as those who could not. The latter borrowed money from stockbrokers to fund their investments.[7] The epic boom, however, ended in a catastrophic bust, which eventually led to the Great Depression.

Following the 1929 stock market crash and the initiation of the New Deal, the Roosevelt administration responded by expanding regulation in the United States. The state attempted to establish a regulatory framework to prevent the recurrence of circumstances that may lead to another bubble and subsequent catastrophic meltdown.[8] The Glass-Steagall Act was one of the most important pieces of legislation enacted at the time. Essentially, the Glass-Steagall Act restricted many commercial banks' activities and essentially prohibited commercial banks and investment banks from merging their businesses. The aim of this legislation was to safeguard depositors' money held by commercial banks from investment bank risks.[9]

Eigner and Umlauft identify three major factors that contributed to both the Great Depression and the Global Financial Crisis: (1) Both crises were preceded by a rapid rise in real estate prices and rising household indebtedness, as homeowners became increasingly leveraged and mortgages became increasingly risky; (2) In both historical situations, the period leading up to the crises was marked by high inequality and, most likely, high indebtedness; (3) In both crises, the bursting of the bubble had a severe impact on a vulnerable banking sector.[10]

As will be discussed in the next section, the experience of finance's evolution after the 1930s, through liberalization and deregulation, demonstrates that the issue is not so much enacting legislation immediately after a financial collapse as it is ensuring that safeguards are maintained when memories of the collapse fade and an appetite for risk returns.[11]

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[4] Christina, D. Romer. (2003). Great Depression. The University of California Berkeley, https://eml.berkeley.edu/~cromer/Reprints/great_depression.pdf. Accessed on December 21, 2021.

[5] David C. Wheelock. (2021). The Great Depression: An Overview. Federal Reserve Bank of St Louis, https://www.stlouisfed.org/~/media/files/pdfs/great-depression/the-great-depression-wheelock-overview.pdf. Accessed on December 21, 2021.

[6] The Editors of Encyclopaedia. (2021). Stock Market Crash of 1929. *Encyclopaedia Britannica*, https://www.britannica.com/event/stock-market-crash-of-1929. Accessed on December 21, 2021.

[7] Leslie, Kramer. (2021). What Caused the Stock Market Crash of 1929?. Investopedia, https://www.investopedia.com/ask/answers/042115/what-caused-stock-market-crash-1929-preceded-great-depression.asp. Accessed on December 21, 2021.

[8] Ioannis, Glinavos. (2014). *Redefining the Market-State Relationship: Responses to the Financial Crisis and the Future of Regulation*, 75, Routledge.

[9] David, Adams. (2019). Banking and Capital Markets, 5. College of Law Publishing.

[10] Peter, Eigner. and Thomas, S. Umlauf. (2015). The Great Depression(s) of 1929-1933 and 2007-2009? Parallels, Differences and Policy Lessons. Working Papers in Crisis History No. 2.

[11] Ioannis, Glinavos. (2014). *op. cit.*, 76.

2.1.2. The Deregulation Period (1970-2008)

Deregulation is the decrease or elimination of government power in a certain industry, which is generally implemented to raise competition. The battle between proponents of regulation and proponents of no government interference in the banking industry has transformed market conditions throughout history.[12]

Neoliberalism's theoretical support for financial deregulation is a crucial component. Neoliberalism is a strategy for addressing and developing human society's problems via the use of competitive markets. Competitive markets are supposed to be efficient and just, with the objective of maximizing consumer choice.[13] Financial markets, according to this argument, must be left to their own devices in order to function correctly. Since the 1970s, policymakers, regulators, and mainstream academics have viewed financial regulation as a barrier to job creation and economic growth.[14] As a result, as part of the wave of liberalization that marked the 1980s and 1990s, several nations opened their capital accounts and liberalized their domestic financial markets.[15]

The increasing growth of multifunctional universal banks characterized the transformation of banking between 1990 and 2008. A number of previously imposed restrictions on the combination of mainstream commercial banking and securities activity were gradually lifted.[16] The capital and client base of the commercial sector would feed the investment and advising operations of the investment banking arm, allowing these universal banks to profit from economies of scale and reap synergies.[17] The upshot was the US Financial Services Modernization Act of 1999 (or Gramm-Leach-Biley Act) which totally repealed the Glass-Steagall Act.[18] The Credit Institutions Directive 2000/12/EC and its predecessor, the Second Banking Directive 89/646/EEC, were designed to liberalize banking services in the European Union. If authorized to issue securities in their home state, banks might participate in such activities across the European Union through branches. This put pressure on Member States that did not allow their banks to engage in such activities since they would be at a competitive disadvantage otherwise.[19]

The ideology of neoliberalism lost its power after the financial crisis of 2008 and the Great Recession. The approach to politics, global trade, and social philosophy that characterized an era resulted in total disaster rather than limitless prosperity. "Laissez-faire is finished," stated French President Nicolas Sarkozy. In testimony before Congress, Federal Reserve Chairman Alan Greenspan conceded that his ideology was defective.[20]

The 2008 Global Financial Crisis and the damage it left in its wake are textbook examples of deregulation's disastrous consequences. It's a monument to what occurs when society's laws and regulations are torn away, replaced by a supposedly "self-regulating market" benignly steered by the profit-maximizing "free-hand".[21]

2.2. The Causes of the 2008 Financial Crisis

In addition to the role of deregulation, many factors contributed to the global financial crisis of 2007-09. Economists cite as the main culprit the collapse of the subprime mortgage market, which led to a credit crunch in the global banking system and a precipitous drop in bank lending.[22] But, in fact, the reasons are more complex. According to a 2011 report by the Financial Crisis Inquiry Commission, the Great Recession was an avoidable disaster caused by widespread

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12 Will, Kenton. (2021). Deregulation, Investopedia, https://www.investopedia.com/terms/d/deregulate.asp. Accessed on December 26, 2021.

13 Heikki, Patomaki. (2009). Neoliberalism and the Global Financial Crisis. *New Political Science,* 31(4), 433.

14 Frank, Van Lerven. (2019). Setting a Dangerous Precedent: What Can Finance Teach us About the Risks of Deregulation?. New Economics Foundation, https://neweconomics.org/2019/03/deregulation-and-finance. Accessed on December 26, 2021.

15 Joseì, Antonio Ocampo., Shari, Spiegel. and Joseph E. Stiglitz. (2008). *Capital Market Liberalization and Development,* 1, Oxford University Press.

16 Ross, Cranston., Emilios, Avgouleas., Kristin, van Zwieten., Christopher, Hare. and Theodor, van Sante. (2017). *Principles of Banking Law*, 8, 3rd Edition, Oxford University Press.

17 David, Adams. (2019). *op. cit.,* 5.

18 Julia, Kagan. (2021). The Gramm-Leach-Bliley Act of 1999 (GLBA). Investopedia, https://www.investopedia.com/terms/g/glba.asp. Accessed on December 26, 2021.

19 Ross, Cranston *et al.* (2017). *op. cit.,* 9.

20 Ganesh, Sitaraman. (2019). The Collapse of Neoliberalism. *The New Republic,* https://newrepublic.com/article/155970/collapse-neoliberalism. Accessed on December 24, 2021.

21 Frank, Van Lerven. (2019). *op. cit.*

22 Anne, Field. (2021). What caused the Great Recession? Understanding the Key Factors that led to one of the Worst Economic Downturns in US History. *Business Insider,* https://www.businessinsider.com/what-caused-the-great-recession?r=US&IR=T. Accessed on December 26, 2021.

failures, including government failures and risky behavior by financial institutions.[23] Three main causes are touched upon briefly in this section: (1) Sub-Prime Mortgages; (2) Securitization; and (3) Credit Rating Agencies. However, this list is not exhaustive as other factors have also contributed to the crisis, such as corporate governance, remuneration practices, capital buffers and so on.

2.2.1. Sub-Prime Mortgages – Low Interest Rates and Loose Lending Standards

By early to mid-2000s, the US housing market was booming. This housing boom, combined with low-interest rates at the time, prompted many lenders to offer home loans to individuals with poor credit.[24] These risky loans are called subprime mortgages. The meaning of 'sub-prime' refers to a section of the housing market in the US that consisted of people purchasing properties with questionable ability to repay the associated loans.[25] Lenders did so by providing teasers like minimal or zero down payment, and low introductory adjustable-rate mortgages, as well as lax documentation and credit checks.[26]

Easy housing credit resulted in higher demand for homes. This contributed to the run-up in housing prices. Eventually, the mortgage payments became quite a large share of personal disposable income, finally reaching the point that the cost of homeownership was as high enough that it began to dampen the demand for new houses.[27] As a result, supply started to outpace demand which meant house prices spiralled. Given the decline in house prices, it became apparent that the amounts owed under the mortgages were greater than the value of the houses.[28] In the foreclosures that inevitably followed, it was usual for lenders to obtain much less than the original mortgage value when the time and expense of the resale process had been taken into account. However, the originators of the loans had sold them on using complex structured financial derivatives.[29] This brings us to the next topic of our discussion, "Securitization".

2.2.2. Securitization — Collateralized Debt Obligations (CDOs) and Credit Default Swaps (CDS)

Along with issuing mortgages, lenders found another way to make money off of the real estate industry, particularly, by packaging subprime mortgage loans and reselling them in a process called securitization.[30] Securitization means selling securities whose principal and interest payments are exclusively linked to a pool of legally segregated, specified, cash flows (promised loan payments) owned by a Special Purpose Vehicle (SPV). The cash flows were originated by a financial intermediary, which sold the rights to the cash flows to the SPV.[31] Instead of bankers having to hold onto and support every loan they originate until it matures or defaults, securitization allowed risks to be stripped from the loans and disbursed beyond the traditional geographical areas in which a particular lender had been operating to investors in any country of the world.[32] The legitimate purpose of securitization is for financial institutions to spread and place risk into the hands of large numbers of investors. However, from 2003 to 2007, the main purpose of securitization was not to share risks with investors, but to make an end run around capital-adequacy regulations.[33]

Additionally, securities, known as CDOs, made up of bundles of asset-backed bonds, had been created. The CDOs were sliced and diced into different elements, known as tranches, each with its own risk levels suitable for different types of investors.[34] To make matters even more complicated, banks used CDS, another financial derivative, to insure against

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[23] The Financial Crisis Inquiry Commission. (2011). The Financial Crisis Inquiry Report. U.S. Government Publishing Office.

[24] Will, Kenton. (2021). Subprime Meltdown, Investopedia https://www.investopedia.com/terms/s/subprime-meltdown.asp. Accessed on December 27, 2021

[25] Ioannis, Glinavos. (2014). *op. cit.*, 86.

[26] Michael, Mah-Hui Lim. (2008). Old Wine in a New Bottle: Subprime Mortgage Crisis—Causes and Consequences. Levy Economics Institute of Bard College Working Paper 532.

[27] Ben, S. Bernanke. (2012). The Federal Reserve after World War II. (March 22 2012) College Lecture Series at George Washington University School of Business.

[28] John, V. Ducka. (2013). Subprime Mortgage Crisis. Federal Reserve History, https://www.federalreservehistory.org/essays/subprime-mortgage-crisis. Accessed on December 27, 2021.

[29] Alexander, Davidson. (2009). How The Global Financial Markets Really Work: The Definitive Guide to Understanding International Investment and Money Flows, Kogan Page 3.

[30] Anne, Field. (2021). *op. cit.*

[31] Gary, Gorton. and Andrew, Metrick. (2012). Securitization. National Bureau of Economic Research Working Paper 18611 3.

[32] Gerard, Caprio Jr..*et al.* (2008). *op. cit.*

[33] Viral, V. Acharya. and Matthew, Richardson. (2009). Causes of The Financial Crisis. *Critical Review,* 21(2-3), 196.

[34] Anu, Arora. (2014). *Banking Law,* 26, Pearson Education.

defaults on CDOs. Banks and hedge funds started buying and selling swaps on CDOs in unregulated transactions. Also, because CDS transactions didn't show up on institutions' balance sheets, investors couldn't assess the actual risks these enterprises had assumed.[35]

To make investment assessment for the investor even harder, credit ratings for financial institutions were inaccurate. In addition, although regulation favored the widespread use of credit ratings, it also limited the contestability of the credit-rating market.[36]

2.2.3. Weak Watchdogs – Credit Rating Agencies

For many years, rating agency ratings have been very important to investors. Corporate bonds are very difficult to sell without ratings; securitization securities, such as subprime securities, are impossible to sell without ratings.[37] However, there is a broad consensus that credit rating agencies contributed to the current financial crisis. It was believed that credit rating agencies provided ratings that were too positive, leading to bad investments. Part of the problem was that despite the risk, the agencies continued to give mortgage-backed securities AAA-ratings. These ratings led many investors to believe that these investments were very safe with little to no risk.[38]

Furthermore, rating agencies advised the originators of mortgage-backed securities on how to arrange sophisticated financial instruments, such as CDOs, while also rating these same products. As a result of the enormous fees they gained by advising clients, the rating agencies were subject to conflicts of interest. As such, ratings were drastically exaggerated, allowing complicated financial products to be sold that were far riskier than investors realised.[39]

It is unsurprising, against this backdrop, that a heated debate emerged about the rating process, prompting calls by politicians for greater regulation of credit rating agencies.[40]

3. Banking Regulation Post-Financial Crisis

Following the financial crisis of 2008, the banking industry underwent significant regulatory change with the intent of enhancing the financial system's resilience.[41] Systemically important banks have become substantially more robust as a result of the post-crisis regulatory regime.[42] This comprises stricter rules for bank capital adequacy and liquidity, as well as structural constraints and tighter supervision that limit bank activity. Special resolution regimes have also been introduced by recent bank regulations, with the aim of averting major bank failures in order to minimize systemic disruption or the need for a costly public rescue.[43]

The first section of this chapter will focus on some of the international regulatory responses to the financial crisis, specifically those of the United States, the European Union, and the G20. Following that, in Section 2.2, this paper will delve deeper into the regulatory response in the United Kingdom. The purpose of this chapter is to present a basic, yet informative, overview of the policy measures used by the major financial centres in order to assess if these regulations made banks safer following the crisis.

3.1. International Regulatory Frameworks

3.1.1. The United States Regulatory Response

Although both the Bush and Obama administrations enacted short-term measures to stabilize the financial system during the financial crisis, policymakers pursued more extensive reform initiatives to improve long-term financial stability

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[35] Anne, Field. (2021). *op. cit.*

[36] World Bank. (2019). *Global Financial Development Report 2019/2020: Bank Regulation and Supervision a Decade after the Global Financial Crisis.* World Bank Publications.

[37] Claire, Hill. (2010). Why Did Rating Agencies Do Such a Bad Job Rating Subprime Securities?. University of Minnesota Law Review, 71, 585.

[38] Denise, Finney. (2021). A Brief History of Credit Rating Agencies. Investopedia, https://www.investopedia.com/articles/bonds/09/history-credit-rating-agencies.asp#citation-15. Accessed on December 28, 2021.

[39] Frederic, S Mishkin. (2012). *The Economics of Money, Banking and Financial Markets*, 194, Pearson Education.

[40] Siegfried, Utzig. (2010). The Financial Crisis and the Regulation of Credit Rating Agencies: A European Banking Perspective. Asian Development Bank Institute Working Paper Series 188.

[41] Andrea, Sironi. (2018). The Evolution of Banking Regulation Since the Financial Crisis: A Critical Assessment. Bocconi University Department of Finance Working Paper 103.

[42] Daniel, K. Tarullo. (2019). Financial Regulation: Still Unsettled A Decade After the Crisis. *Journal of Economic Perspectives,* 33(1), 61-80.

[43] Ross, Cranston. *et al.* (2017), *op. cit.,*10.

and prevent future crises.[44] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, known as the Dodd-Frank Act, is at the center of these initiatives.

The Act's main purpose is to increase financial system accountability and transparency, end "too big to fail," safeguard American taxpayers by preventing bailouts, and protect the public from abusive financial services activities, among other things.[45]

The way to address the systemic fragility shown by the crisis was perhaps the most important topic in the financial reform legislation. The Dodd-Frank Act established the principle that prudential regulation should be tailored to the size and systemic importance of banking institutions.[46] Furthermore, Dodd-Frank formed the "Financial Stability Oversight Council (FSOC)," which has the authority to identify some financial firms as systemically significant and subject them, as well as any banks with more than $50 bn in assets, to more stringent prudential oversight.[47] Financial institutions were subjected to a specific resolution regime known as the "Orderly Liquidation Authority" under Title II of the Dodd-Frank Act. Following the 'too-big-to-fail' financial crisis, the government sought to save some of these institutions with over $1.7 tn in bailouts.[48] In light of these bailouts, Congress saw the necessity for a government body to provide for the effective liquidation of large financial firms and to prevent future government bailouts. As a result, the Orderly Liquidation provision gave the Federal Deposit Insurance Corporation (FDIC) receivership powers.[49]

Other notable aspects of Dodd-Frank addressed certain sectors of the financial system or specific classifications of market participants. Dodd-Frank required more derivatives be cleared and traded on regulated exchanges, that over-the-counter derivatives be reported, and that certain derivatives dealers and major traders register with competent regulators.[50] It introduced the "Volcker Rule," which prohibits banks from engaging in proprietary trading, which means that its agents or units cannot buy or sell securities, derivatives, commodity futures, or options in their accounts. New reporting and registration requirements were imposed on hedge funds.[51] The SEC Office of Credit Ratings was formed by Dodd-Frank. The office's mission is to ensure that credit rating agencies provide relevant and trustworthy credit ratings for the businesses, municipalities, and other entities they assess.[52]

Critics of the Dodd-Frank Act have claimed that "Dodd-Frank will harm competition in the financial services industry because its regulations fall hardest on small banks and credit unions which makes it harder for them to compete with their larger counterparts."[53] Furthermore, Jamie Dimon, CEO of JPMorgan Chase & Co., stated in an interview with a Citi analyst concerning Dodd-Frank that higher capital standards, Volcker, and OTC derivative reforms make it more expensive and difficult for smaller firms to enter the market in the long run, ultimately increasing JPMorgan's "moat."[54]

Finally, as a free-market advocate, Donald Trump promised to abolish Dodd-Frank when he was elected President in 2016, and in May 2018, the Trump administration signed a new law repealing substantial elements of it, through the Economic Growth, Regulatory Relief, and Consumer Protection Act.[55] It is yet unclear what the impacts of that Act will be. Nevertheless, past examples can provide insight into what to expect in the future. The Great Depression was followed by a series of deregulation and liberalization of the financial services industry, culminating in the financial crisis

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44 Aigbe, Akhigbe., Anna D. Martin. and Ann, Marie Whyte. (2016). Dodd-Frank and Risk in the Financial Services Industry. *Review of Quantitative Finance and Accounting,* 47(2), 395-415.

45 Dodd-Frank Wall Street Reform and Consumer Protection Act H.R. 4173.

46 Daniel K. Tarullo. (2019). *op. cit.*

47 Baird Webel. (2017). The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary. Congressional Research Service.

48 Dodd-Frank: Title II - Orderly Liquidation Authority.Legal Information Institute. https://www.law.cornell.edu/wex/dodd-frank_title_ii_-_orderly_liquidation_authority. Accessed on December 30, 2021.

49 Adam, Mayle. (2010). *Developments in Banking Law,* 30, Boston University School of Law Review of Banking and Financial Law 30.

50 Baird, Webel. (2017). *op. cit.*

51 Kelly, Anne Smith. (2020). How The Dodd-Frank Act Protects Your Money. Forbes, https://www.forbes.com/advisor/investing/dodd-frank-act/. Accessed on December 30, 2021.

52 Adam, Hayes. (2021). Dodd-Frank Wall Street Reform and Consumer Protection Act. Investopedia, https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp. Accessed on December 29, 2021.

53 House of Representatives Committee on the Judiciary "Dodd-Frank Act Effects On Financial Services Competition", (2012) 112-117 https://www.govinfo.gov/content/pkg/CHRG-112hhrg74976/pdf/CHRG-112hhrg74976.pdf. accessed on December 29, 2021.

54 Joe, Weisenthal. (2013).The 4 Things That Worry Jamie Dimon.... *Business Insider,* https://www.businessinsider.com/the-four-things-that-worry-jamie-dimon-2013-2?r=US&IR=T#ixzz2JwOrqfGg. Accessed on December 29, 2021.

55 Adam, Hayes. (2021). *op. cit.*

of 2008. As a result, as history has shown, every time regulation is lax, a financial crisis occurs. We will have to wait and see if that holds true this time.

3.1.2. The European Union's Regulatory Response

The EU's economy was hit hard by the financial crisis of 2007-2009, owing to large European financial institutions adopting roughly the same business model as those functioning in the US prior to the crisis. Because most of the US securitized debt was created with the intention of being dispersed to European institutions and investors, the speed with which the financial impacts on the EU were felt was not surprising.[56] In the aftermath of the crisis, the EU took charge in a robust regulatory response. The EU agreed to a thorough revamp of the financial sector's regulatory and supervisory architecture.[57]

Nonetheless, since the global financial crisis began in 2007, European legislators have sought to make the EU's financial system safer and more sound. One of the actions taken was the establishment of a European System of Financial Supervision, which included the establishment of three European Supervisory Authorities, including the European Banking Authority (EBA).[58] The EBA is a specialist EU body created to promote a more coordinated approach to banking supervision across the EU. One of its main tasks is to develop a unified set of standards that apply uniformly to all EU banking institutions.[59]

However, when the crisis evolved and turned into the Eurozone debt crisis in 2010-2011, it became evident that a more comprehensive and integrated solution is required for countries who share a currency. This is why, in June 2012, EU Heads of State and Government agreed to a banking union.[60] As a consequence, the banking union is built on a new regulatory framework with common standards for banks in all Member States, outlined in a "single rulebook."[61] The banking union will accomplish consistent implementation of the common standards of prudential supervision for Member States that use the Euro as their currency through the Single Supervisory Mechanism (SSM). The European Central Bank (ECB) has been designated as the ultimate prudential supervisor of all banks in the Eurozone under this SSM.[62]

The Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR) were at the forefront of the capital requirements legislation package that implemented Basel III. The financial crisis exposed flaws in banking system regulation and supervision at the European and global levels. Institutions entered the crisis with insufficient capital in terms of both quantity and quality, and governments in many countries were forced to offer extraordinary support to the banking industry in order to maintain financial stability.[63] Many of these issues, such as the quantity and quality of banks' capital and liquidity resources, were addressed by the capital requirements package. More recently, CRD V included additional measures aimed at better harmonizing micro- and macroprudential supervision and increasing prudential requirements proportionality.[64]

In addition, governments have had to pump public money into banks and give guarantees on an unprecedented scale in order to preserve crucial financial services available to citizens and businesses. The European Commission authorized €4.5 tn in state aid to financial firms between October 2008 and October 2011.[65] To avoid this in the future, a standard framework has been established to recover or resolve the bank, i.e., to wind it down in a controlled manner. This framework is primarily contained in the Bank Recovery and Resolution Directive (BRRD).[66]

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56 Walter, W. Eubanks. (2010). The European Union's Response to the 2007-2009 Financial Crisis. Congressional Research Service.

57 European Union Committee Fifth Report. (2015). The Post-crisis EU Financial Regulatory Framework: Do the Pieces Fit?. Parliamentary Publications https://publications.parliament.uk/pa/ld201415/ldselect/ldeucom/103/10302.html. Accessed on January 1, 2022.

58 Matthias, Haentjens. and Pierre De Gioia-Carabellese. (2015). *European Banking and Financial Law,* 94, Routledge.

59 European Banking Authority. (2016). The European Banking Authority At A Glance, https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1401372/e8686db2-6390-4c52-ad06-bc8d24b7aeb5/EBA%20AT%20A%20GLANCE.pdf?retry=1. Accessed on January 1, 2021.

60 European Commission. (2014). A Comprehensive EU Response to the Financial Crisis: Substantial Progress Towards a Strong Financial Framework for Europe and a Banking Union for the Eurozone. MEMO/14/244.

61 European Banking Authority. *The Single Rulebook,* https://www.eba.europa.eu/regulation-and-policy/single-rulebook. Accessed on January 1, 2022.

62 Matthias, Haentjens. and Pierre, De Gioia-Carabellese. (2015). *op. cit.,* 95.

63 European Commission. (2013). Capital Requirements - CRD IV/CRR – Frequently Asked Questions. MEMO/13/690.

64 Bank of England. (2020). Capital Requirements Directive V (CRD V). Consultation Paper 12/20.

65 European Commission. (2012). New Crisis Management Measures to Avoid Future Bank Bail-outs. Press Release, https://ec.europa.eu/commission/presscorner/detail/en/IP_12_570. Accessed on January 1, 2022.

66 Matthias, Haentjens. and Pierre, De Gioia-Carabellese. (2015). *op. cit.,* 94.

Furthermore, the Liikanen Report recommended that proprietary trading and other substantial trading operations be transferred to a distinct legal entity, akin to the Volcker Rule created in the US. This ensures that trading operations beyond a certain threshold are conducted independently from the deposit bank.[67] Other notable legislation reforms include the amended Deposit Guarantee Scheme (DGS) Directive, which endorses a widely accepted deposit guarantee of up to €100,000 per depositor (and per bank) safeguarded at all times and everywhere in the EU.[68] The Markets in Financial Instruments Directive II and accompanying Regulation (MiFID II/ MiFIR) is another piece of legislation worth mentioning. In essence, the regulation (MiFIR) addresses transparency and access to trading venues, whereas the directive (MiFID II) governs trading venue authorization and organization, as well as investor protection.[69]

3.1.3. International Financial Regulation Reform – The G20's Response

Since the first leaders' summit in November 2008, financial regulation has been a main priority for the G20.[70] The G20 initiatives were created to address a number of significant flaws in the international standard-setting regime that emerged as a result of the global financial crisis. Some measures attempted to tighten current microprudential regulations in order to promote the stability of individual financial institutions, markets, and instruments. However, the G20 has urged regulators and supervisors to focus more on the macroprudential goal of tackling broader systemic vulnerabilities.[71]

The transformation of the Financial Stability Forum into the Financial Stability Board (FSB) was one of the first steps taken by the G20.[72] The FSB is an international body that examines and offers recommendations on the global financial system. It accomplishes this by bringing together national financial authorities and international standard-setting bodies to produce robust regulatory, supervisory, and other financial sector policies.[73]

Claessens and Kodres outline some of the significant reforms that have been finalized and are being implemented under FSB guidance. These include:

- Adoption of Basel III capital requirements, which include a countercyclical capital buffer and a surcharge for globally systemically important financial institutions, both of which are a first attempt at implementing a macroprudential instrument on a worldwide scale.
- Improvements to the "securitization model" by broadening regulation and oversight to include credit rating agencies and hedge funds.
- Some progress on reducing too-big-to-fail, with the identification of global systematically important financial institutions and domestically systemically important banks, higher capital adequacy requirements and more strenuous supervision, and some reforms of national resolution schemes to allow failing institutions to be resolved without causing further disruptions.
- Implementation of sound compensation practices principles in order to eliminate unintended incentives for risk-taking.
- Some reforms for OTC derivatives.[74]

While the scale of these reforms is remarkable, they do have some significant limitations. Despite the severity of the crisis, reforms have been gradual rather than drastic. Their implementation has also been delayed and unequal, with some key issues completely overlooked.[75] Furthermore, whilst the FSB's creation increased the framework of transnational cooperation, it has limited formal power and operates more as a network of networks in developing soft law whose execution is left to national authorities' discretion.[76]

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67 *Ibid.,* 83.

68 Francesco, Paolo Mongelli. and Gonzalo, Camba-Mendez. (2018). The Financial Crisis and Policy Responses in Europe (2007–2018). *Comparative Economic Studies,* 60, 531-558.

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4. Domestic Regulatory Framework — United Kingdom

4.1. Dealing with Failing Banks

Northern Rock, a British bank, had rapidly expanded in the years preceding up to the financial crisis, relying on international money markets to fund its fast expansion. However, when the sub-prime mortgage crisis in the US extended to Europe in 2007, this source of funding dried up. Northern Rock was left with a significant lack of liquidity. Northern Rock's precarious status was made public in September 2007, which prompted a run on the bank.[77]

The necessity for measures to deal with failing banks and building societies in a way that protects depositors and reduces the risk of financial crises was one of the first lessons learned from the financial crisis. As a result, the Banking (Special Provisions) Act, 2008, enacted in February 2008, gave the government temporary powers to deal with failing banks.[78] The Banking Act of 2009 superseded the Act, establishing a "Special Resolution Regime" (SRR) for dealing with distressed banks. The SRR is divided into two parts:[79]

1. **Pre-insolvency Stabilization**: The SRR contains three stabilization options, which are listed in terms of priority, which include the transfer of all or part of a bank (1) to a private sector purchaser; or (2) to a bridge bank wholly owned and run by the Bank of England; or (3) the temporary nationalization of the bank.[80]
2. **Banking and Administration:** The second part of the SRR comprises two new insolvency procedures: (1) a special Banking Insolvency Pprocedure (BIP); and (2) a bank administration procedure. Both procedures are modified versions of the Insolvency Act 1986's conventional insolvency and administration procedures.[81]

4.2. Ring-Fencing and Capital Loss Absorbency

The Independent Commission on Banking released its final report and recommendations on reforms to improve UK stability on September 12, 2011. In December 2011, the government responded to the final report, accepting nearly all of the Commission's recommendations. The Commission's main suggestion is to ring-fence financial institutions. The goal of ring-fencing financial institutions is to preserve deposit-taking activities apart from affiliate risks, as well as to prevent retail deposit-taking banks from moving capital to affiliates. The ring-fencing rule, known as the "Vickers Rule", applies to financial institutions with deposits in excess of £25 bn.[82] In addition, the Commission issued recommendations aimed at making banks better able to absorb losses and hence less likely to fail, as well as better equipped to manage losses even if they do not lead to failure. As a result of these recommendations, banks' loss-absorbency capital has improved.[83]

4.3. A New Regulatory Structure

Prior to the financial crisis, the Bank of England, the Financial Services Authority (FSA), and the Treasury shared oversight of the UK financial system. The Treasury Committee's investigation into Northern Rock's demise found that the tripartite authorities' communication system was deficient, and that a lack of cooperation between them led to the public's reaction, which resulted in the bank's run.[84] In response, the Financial Services Act, 2012 took effect in April 2013, removing the FSA and replacing it with a new regulatory structure that includes the Prudential Regulation Authority (PRA), which is responsible for microprudential regulation and supervision of banks, building societies, and investment firms, and the Financial Conduct Authority (FCA), which is responsible for day-to-day business conduct and consumer protection. In addition, the Financial Policy Committee (FPC), a financial stability body inside the Bank of England, was formed to oversee macroprudential supervision.[85]

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[77] Bank of England. The Financial Crisis – 10 years on: What Happened, and What has Been Done Since?. https://www.bankofengland.co.uk/news/2018/september/the-financial-crisis-ten-years-on. Accessed on January 3, 2022.

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[80] Banking Act, 2009 s.11, 12 and 13.

[81] Banking Act, 2009 Part Two and Three.

[82] World Bank. (2019). *op. cit.,* 71.

[83] International Commission on Banking. (2011). Final Report Recommendations, 79, https://webarchive.nationalarchives.gov.uk/ukgwa/20120827143059/http://bankingcommission.independent.gov.uk///. Accessed on January 3, 2022.

[84] Anu, Arora. (2014). *op. cit.,* 137.

[85] Ross, Cranston. *et al.* (2017). *op. cit.,* 143.

4.4. Corporate Governance and Remuneration

Corporate governance measures have firmly established a central component of the prudential regulation framework in the post-2008 era.[86] HBOS's board and senior management failed to create a suitable strategy for the bank or question its poor business model, which contributed to the bank's collapse. Hence, it was difficult to hold failing bank executives accountable in the aftermath of the crisis.[87] As a result, Both Houses of Parliament appointed the Parliamentary Commission on Banking Standards (PCBS) to examine and report on professional standards and culture in the UK banking sector.[88] The Banking Reform Act of 2013 followed the PCBS Report, introducing a new "senior persons" regime and new powers for the PRA and FCA to impose regulatory sanctions on individual senior managers when a bank violates a regulatory requirement.[89] It also establishes a new regulatory crime of "misconduct" as well as a criminal regime for senior managers. Section 36 of the Financial Services (Banking Reform) Act, 2013 establishes a new "offence relating to a decision causing a financial institution to fail", which may be committed when a senior manager of a financial institution:

a) "takes, or agrees to the taking of, a decision by or on behalf of the financial institution as to the way in which the business of a group institution is to be carried on, or

b) fails to take steps that the senior manager could take to prevent such a decision being taken."[90]

Finally, the Executives' Remuneration Reports Regulations 2013 makes certain revisions to the existing remuneration regulations. The regulations' goal is to promote transparency in the remuneration of directors, boost shareholder accountability, and offer a more effective performance linkage. The company's approach to every facet of directors' remuneration, including recruiting and loss of office payments, must be outlined in the remuneration policy.[91]

5. Conclusion

In maintaining and enforcing financial discipline, regulators are set at a disadvantage. Regulation is best seen as an endless and unfair game of action and response. In this game, the regulated side is able to move more often and more quickly than the regulatory side can. Regulators inevitably find themselves trying to catch up with the regulated side.[92] Every move they make generates a series of new and creative moves by financial institutions who seek to minimize the burdens regulations ultimately place on them.[93] Their profit-making orientation ensures that the moves the financial institutions make are not only swifter, but also more complex and harder to anticipate than those of regulators.[94]

It is frequently claimed in the run-up to a crisis, the causes for apparent vulnerabilities are different from those of past incidents. Reforms, however, remain incomplete after a crisis.[95] One of the challenges in making overall progress is that crises tend to provide a push to evident flaws while ignoring the underlying root problems. Furthermore, reform procedures take time to implement, during which time public outcry for reform fades and financial sector lobbyists regroup to tone down policies they see threatening their profit margins.[96]

Are banks safer after the financial crisis? "We are safer, but not as safe as we should and could be," said Sir John Vickers, former member of the Bank of England's Monetary Policy Committee and chair of the UK's Independent Commission on Banking.[97] Despite the fact that a large amount of law and regulation were enacted in the aftermath of the financial crisis to make banks safer, there is currently no widely agreed-upon international body of rules and principles to regulate bank activities and financial markets. As a result of the interconnected nature of financial markets and the fragmentation of regulatory frameworks, a new financial crisis remains a possibility.

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[86] *Ibid.,* 103.

[87] Bank of England. (2022). *op. cit.*

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[90] Financial Services (Banking Reform) Act 2013 Section 36.

[91] Anu, Arora. (2014). *op. cit.,* 164.

[92] Gerard Caprio Jr. *et al.* (2008). *op. cit.*

[93] Edward, Kane. (1977). Good Intentions and Unintended Evil: The Case Against Selective Credit Allocation. *Journal of Money Credit and Banking,* 9(1), 57.

[94] *Ibid.,* 97.

[95] Stijn, Claessens. and Laura, Kodres. (2014). *op. cit.,* 30.

[96] *Ibid.*

[97] Thom, Wetzer., Jure Jeric. and Alexander, Zeitz. (2018). Ten years After the Financial Crisis: 'We Are Safer, But Not As Safe As We Should and Could Be. University of Oxford Faculty of Law, https://www.law.ox.ac.uk/business-law-blog/blog/2018/11/ten-years-after-financial-crisis-we-are-safer-not-safe-we-should-and Accessed on January 4, 2022.

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