1. The Case for a Level-Playing Field

**Key Aim for Establishing the SSM**

- Ensure consistent supervision across all the banks in the participating countries.

**Research Questions**

1. May heterogeneities in prudential regulation across EU countries have contributed to differences – at national level – in bank risk-taking and financial stability?
2. To reduce bank distress probability, should the prudential framework be based more on rules or discretion?

2. Prudential Regulation in the EU

**Basel II/CRD** [Dir. 48/2006 & Dir. 49/2006]

The key principles were:
1. established at the EU-level through directives;
2. but implemented through national legislation.

Larger differences for banks in distinct countries

**Basel III/CRD4** [Reg. 36/2013 & Dir. 575/2013]

- Single Rulebook
- Still some national options and discretions
- Trend towards more uniform regulatory framework

3. A New Indicator for Prudential Regulation

**Focus on the CRD implementation**

- Two types of Options and Discretions (O&Ds)
  - General O&Ds: National Legislators determine the rules applying to all banks without additional assessment
  - Case-by-Case O&Ds: Supervisory Authorities conduct bank-specific assessment to authorise more favourable regulatory treatment.

**REGULATORY FLEXIBILITY**

- CEBS (now EBA) identified 152 O&Ds in the CRD
- We construct a quantitative indicator based on the CRD implementation by EU countries in all the areas.
- Higher value of the indicator = more permissive treatment for all banks (Regulatory Flexibility) or some of them (Supervisory Discretion)

4. Dataset

- Consider 696 banks in 17 EU countries (EU15, MT, CY) with at least 5bn € of total assets in the period 2000-2008
  - Bank balance sheet variables (Bankscope)
  - Bank-level measures of crisis support (Recapitalisations, Liabilities Guarantees, Asset Relief, Liquidity Facilities)
  - Country-level indicator of prudential regulation
  - Country-level macro variables

5. Empirical Analysis

- **Hypothesis:** Did banks established in countries with more flexible regulation and/or more supervisory discretion experience higher need for crisis public support?
- **Strategy:** Define a dummy for banks receiving support and estimate a logit model for the probability of receiving a government bail-out during the years 2008-2011

6. Baseline Specification: Empirical Results

**MARGINAL EFFECTS OF THE LOGIT ESTIMATION**

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>(LIQSUPP)</th>
<th>(RECAP)</th>
<th>(SUPP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Indicator</td>
<td>0.0000***</td>
<td>0.0000***</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Regulatory Flexibility</td>
<td>0.0000***</td>
<td>0.0000***</td>
<td>0.0000***</td>
</tr>
<tr>
<td>Supervisory Discretion</td>
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<td>0.0000***</td>
<td>0.0000***</td>
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<tr>
<td>GovSec/Total Assets</td>
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<td>0.0000***</td>
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<tr>
<td>LiqAssets/Deposits &amp; ST Funding</td>
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<td>0.0000***</td>
<td>0.0000***</td>
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<td>Loans/Total Assets</td>
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<tr>
<td>Equity/Total Assets</td>
<td>0.0000***</td>
<td>0.0000***</td>
<td>0.0000***</td>
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</tbody>
</table>

1. The Table reports the marginal effects of the logit estimation for the probability of:
   - any support (SUPP);
   - recaps/ReCAP (RECAP);
   - liquidity support (LIQSUPP).
2. Robust (bank-cluster) standard errors in parentheses.

*** p<0.01, ** p<0.05, * p<0.1

7. Bank Heterogeneity: Empirical Results

1. **Interaction with Liquidity** (Liquid Assets/Deposit & Short-Term Funding)

- A) Overall Indicator
- B) Regulatory Flexibility
- C) Supervisory Discretion

2. **Interaction with Government Bonds** (Gov. Securities/Total Assets)

- Regulatory Flexibility

8. Conclusions

1. Higher probability of crisis support for banks in countries with more flexible regulation or supervisory discretion.
2. **Rules versus Discretion**
   - Regulatory Flexibility may imply larger increase in the prob. of crisis support than Supervisory Discretion
3. **Heterogeneity across banks**
   - Larger increase in the support prob. for banks subject to laxer prudential framework if they are more financially fragile (subject to higher liquidity constraints).