FINANCIAL STABILITY OF BANKS AND THE PRIVILEGE OF ZERO-RISK WEIGHT FOR EUROPEAN SOVEREIGN DEBT

Critical Comments in the Light of Art. 124 TFEU

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Zero risk-weight for European sovereign debt
Banking regulation – regulatory capital requirements

Art. 114 (4) CRR
“Exposures to Member States’ central governments … denominated and funded in the domestic currency of that central government … shall be assigned a risk weight of 0%.”

Art. 150(1)(d) CRR
Institutions may apply the Standardised approach for “exposures to central governments … of the Member States … provided … exposures to the central government … are assigned a 0% risk weight under Article 114(2), (4) or (5).”

Exposures to all EU Member States are considered risk-free.

- Risk-weight of 0%
- Risk weighted exposure = EUR 0
- No own funds requirement
- Low costs for credit institution

Result: Lower lending rate for EU sovereign debtors’.
Zero risk-weight for European sovereign debt

Resulting risks

Aim of CRR at risk

- No risk buffer against state insolvency
- *Home bias* not countered
- Risk-benefit analysis of investments influenced
- Carry-trades

Systemic risks

- Sovereign-bank nexus one of the main reasons for European sovereign debt crisis

Influence on political decisions
Conformity of legal privileges with EU primary law
TFEU Rules on Economic Policy

Asymmetry of competences

- Monetary Policy falls largely under competence of the European Union (as regards Eurozone Member States)  
  Art. 127 et seq. TFEU

- Economic Policy remains largely with the individual Member States  
  Art. 121 TFEU
  Only coordination by EU
Conformity of legal privileges with EU primary law
TFEU Rules on Economic Policy

Art. 126 TFEU: “Maastricht criteria”

Aim: budgetary discipline

Art. 123 – Art. 125 TFEU:
Market conditions for Member States’ borrowing

- Art. 123 TFEU: Prohibition of monetary state financing
- Art. 124 TFEU: Prohibition of privileged access to financial institutions
- Art. 125 TFEU: “No bail-out”

Conformity of legal privileges with EU primary law

Article 124 TFEU

“Any measure, not based on prudential considerations, establishing privileged access by Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, shall be prohibited.”
Conformity of legal privileges with EU primary law

Article 124 TFEU

― “any measure establishing privileged access‖

Art. 1 (1) Regulation (EC) No. 3604/93

▪ “any law, regulation or any other binding legal instrument adopted in the exercise of public authority which”
  ▪ “obliges financial institutions to acquire or to hold liabilities” of i.a. EU Member States or
  ▪ “confers tax advantages, which may benefit only financial institutions or financial advantages which do not comply with the principles of a market economy, in order to encourage the acquiring or the holding by those institutions of such liabilities”.  

Prohibited are all measures granting the public sector an advantage over the private sector and that cannot be regarded as consideration within the framework of the credit relationship.

▪ Zero-risk weight for European Sovereign debt, if this does not simply reflect superior creditworthiness
Conformity of legal privileges with EU primary law
Article 124 TFEU

“not based on prudential considerations“

Art. 2 Regulation (EC) No. 3604/93:
▪ “‘prudential considerations’ shall be those which underlie national laws, regulations or administrative actions based on, or consistent with, EC law and designed to promote the soundness of financial institutions so as to strengthen the stability of the financial system as a whole and the protection of the customers of those institutions.”

Core Assumptions

▪ Sovereign debt is virtually without risk
▪ Sovereign bonds have a very high liquidity
▪ Sovereign debtors’ are upright and sound debtors
▪ Recital 7 Regulation (EC) No. 3604/93: “… prudential considerations may justify departure from the principle of this [Art. 124 TFEU] prohibition; whereas laws … may not, however, under the cover of prudential consideration, be used to establish disguised privilege access”.

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Conformity of legal privileges with EU primary law
Article 124 TFEU

Thesis

- Credit-rating (or credit-worthiness) of Sovereign Debtor has to be accounted for
- However, such exceptions only conform to primary law if the creditworthiness of the debtor state can be taken into account, either explicitly or by way of interpretation.
  - Financial markets can still exercise disciplinary function (to some extent)
- Legal privileges granted uniformly to all EU Member-States notwithstanding the individual credit-rating endanger the stability of the financial system. They thus violate Art. 124 TFEU and are void
  - Therefore, the uniform and unilateral zero-risk weight of all exposures to EU Member States violates Art. 124 TFEU
- Public sector advantages due to “prudential considerations” remain possible, as long as creditworthiness of the debtor state is taken into account
  - i.e. zero-risk weight for sovereign debt, if sovereign debtor has an outstanding credit rating, although zero-risk weight for private sector debt does not exist
  - If the ECJ agrees with this view, there is a risk of considerable distortions on the financial and capital markets
Thank you very much for your attention

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