INSTITUTO ESPAÑOL DE ANALISTAS DESDE 1965
FUNDACIÓN

The trend towards financial regulatory fragmentation and how to tackle it. A pragmatic approach.

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Abril 2023

Documento de Trabajo N.º 30

ISBN: 978-84-09-50951-5
Depósito Legal: M-17449-2023
Edita: Instituto Español de Analistas
Imprime: Reimpventa

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FOREWORD

Since the pandemic and subsequently exacerbated by the invasion of Ukraine, there has been much debate about whether a new phase of deglobalization of the world economy has begun. While the positive effects of globalization in terms of lower prices and greater accessibility to a wide range of goods and services are generally acknowledged, an increasing number of academic studies point to the excesses of globalization and the need to correct them.

Within this broad concept, one of its components is that of financial deglobalization. While there is some unanimity on the desirability of moving towards economic deglobalization, there are more doubts about its financial component. In this area, while there is no clear evidence of a general financial deglobalization, we are observing a certain withdrawal of global banks. The reason for this retreat may lie in the tightening of financial regulation in the wake of the Global Financial Crisis of 2007-2008 and the establishment of barriers to foreign bank operations to limit contagion in domestic business from abroad.

This report raises the question of whether regulation has been a determining factor in this process of financial fragmentation, analyzing four impor-

tant areas: (i) prudential regulation in the home and host countries of the world's large banks, (ii) the incorporation of sustainability into the financial regulatory agenda, (iii) the emergence of BigTechs in the financial industry and (iv) the recent growth of the crypto-asset industry.

Three experts (Santiago Fernández de Lis from BBVA, Gloria Hervás from Banco Santander and Francisco Uría from KPMG) have participated in this report and I would like to thank and congratulate them for their excellent work and for their dedication and support for this initiative, which we hope will be of interest to its readers.

Lola Solana

Presidenta Instituto Español de Analistas

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EXECUTIVE SUMMARY

The trend towards deglobalization in the world economy over recent years has affected also the global financial system. This article focuses on whether regulation has been a factor behind this financial fragmentation process. We analyze four areas: prudential regulation, sustainability, the role of BigTechs and cryptoassets.

In prudential regulation, both home and host authorities have introduced regulation that penalizes international banks vis-à-vis domestic players. In the case of host countries, the main motivation is to avoid contagion from abroad. In the case of home countries avoiding contagion is a factor, but there are other elements, like a mechanistic application of consolidated regulation and supervision. We concentrate in extraterritoriality created by home regulation, partly because it is less well known than fragmentation created by host regulations and partly because it is the main problem for international banks like the Spanish ones that manage capital and liquidity in a decentralized way because of their subsidiary model. We present some examples of EU extraterritorial regulation that penalizes EU banks when operating abroad.

The progress in introducing sustainability in the financial regulatory agen-

da has been impressive over recent years, allowing banks to be better prepared to contribute to climate change targets. However, the traditional order of the financial regulation process (first international standards, later regulation in each jurisdiction and finally supervision) has been altered in this case. National regulation is advancing without international standards, and supervisory tools (like stress tests) are being developed without a proper regulatory framework. The EU is being particularly active. This direction of travel can promote fragmentation, creating inconsistencies, credibility issues and unlevel playing field problems.

The irruption of BigTechs in the financial industry is creating a debate on the most adequate regulation of their activities. From the competition viewpoint it is increasingly clear that ex post sanctions are insufficient, and some modality of ex ante regulation is necessary. The involvement of different authorities (financial regulators, competition authorities, data protection agencies or those in charge of cybersecurity, *inter alia*), combined with the global reach of these companies, complicates the debate. A consensus is emerging on the need to combine entity-based and activity-based regulations, with the former ideally being developed by the home authority and the latter by the host authority. In the absence of action by the home authority, however, some modality of entity-based regulation by the hosts might be needed, although at the risk of fueling fragmentation trends.

The recent growth of the crypto-assets industry, although still in its early stages, is also subject to a regulatory debate. International fora like the FSB and the Basel Committee are developing an incipient regulatory general framework, whereas some authorities are adopting regulation (in particular the EU with MiCA). In the US, origin of many crypto schemes, there is a lively debate in the wake of recent scandals, but so far little regulatory action. And China, home of some of the BigTechs most active in the financial sector (but mostly local) is adopting a distinctive approach, with a segregation of financial activities from the rest of the group. The challenge in this domain seems to be rather how to regulate activities that are not only decentralized but also de-localized, and relying on totally innovative infrastructures.

What can be done to address the fragmentation problems as a conse-

quence of the above-mentioned trends? A few suggestions are the following: (i) stick to the natural order of the regulatory process, with global standards being developed first, followed by national regulation and finally supervisory policies; (ii) avoid extraterritoriality, especially from the biggest home jurisdictions like the EU and the US; (iii) foster the use of equivalence and substituted compliance to ensure consistent cross-border treatment of international banks, relying more on existent exercises by international organizations (peer reviews, FSAPs…) and less on discretionary assessment by the home authorities; (iv) in new areas like ESG, BigTech and cryptoassets develop a regulatory approach that ensures cross-border consistency, redesigning global fora to the extent necessary to include all the authorities involved, beyond financial regulators and (v) that a competitiveness check is introduced as a goal when new regulations are defined or old regulations are reviewed, following the example of the UK, that has introduced it as a secondary objective.

Recent events have shown, once again, the importance of banking regulation and also the need to it to be consistently applied in all jurisdictions not to create the potential risk of regulatory arbitrage or unfair competitive advantages.

1. BACKGROUND AND CONTEXT

There has been a lot of debate over recent years on whether we are in the middle of a phase of de-globalization in the world economy, a component of which would be financial de-globalization. This trend would be a reaction to the previous process of globalization, a main component of which was the integration of China in the global value chain and its effects in terms of global deflationary forces and changes in relative prices and relative wages of skilled and unskilled labor in favor of the former (which in its turn accentuated inequality in industrial countries). At the same time, technological changes as a result of digitalization led to online access to an increasing number of services. Bigtechs with global reach (mostly from the US) moved to the top positions in the ranking of biggest world companies. Although the positive effects of these trends in terms of lower prices and greater accessibility for a wide array of goods and services are generally acknowledged, there is increasing literature on the excesses of globalization and the need to correct them[1].

Whereas there is little controversy on the economic de-globalization trend, there is more debate around its financial component. There is a certain

[1] See Rodrick (2012); *The Globalization Paradox: Democracy and the Future of the World Economy.*

consensus on the idea that, although there is no clear proof of overall financial deglobalization, there is much more evidence of the retrenchment of global banks[2]. This was partly a reaction to the Global Financial Crisis initiated in 2007-2008, which led to contagion from the initial problems in the US subprime securitizations market to other financial systems, with heavy banking losses in a number of countries which had to be absorbed in many cases by local taxpayers. This led to a reaction of regulators that included a tightening of financial regulation and greater barriers to the operation of foreign banks in order to limit contagion from abroad.[3]

It is somewhat paradoxical that this fragmentation took place at the same time as global international standards became more complex, elaborate, and detailed. The Covid crisis fueled some of these trends, triggering a greater emphasis on sovereignty, self-sufficiency, and a preference for reliance on local suppliers. The pandemic has also shown how determinant the changes introduced globally in the banking regulation after the global financial crisis, and notably, the Basel III agreements have been in keeping banks stronger and clearly as part of the solution and not (at all) part of the problem.

More recently the war in Ukraine accelerated geopolitical fragmentation and increased the mistrust on global financial infrastructures like Swift, which were the vehicle used to impose sanctions on Russian interests. Emerging markets reacted with particular concern to these trends, with many voices advocating for a resurgence of capital controls.[4]

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[2] McKinsey Global Institute: *The new dynamics of financial globalization,* August 22, 2017 | Report.
https://www.mckinsey.com/industries/financial-services/our-insights/the-new-dynamics-of-financial-globalization

[3] See Financial Stability Board (2019): FSB Report on Market Fragmentation, 4 June 2019.
https://www.fsb.org/wp-content/uploads/P040619-2.pdf
See also Boer and Ekberg (2023): How Fragmentation is Continuing to Challenge the Provision of Cross-Border Financial Services: Issues and Recommendations, IIF.
https://www.iif.com/portals/0/Files/content/32370132_iif_scer_market_fragmentation_vf_03_02_2023.pdf

[4] Ghosh, Jayeti: *Financial Deglobalization Must Come Next,* Dec 19, 2022.
https://www.project-syndicate.org/commentary/international-capital-markets-fragmentation-financial-deglobalization-by-jayati-ghosh-2022-12

2. PRUDENTIAL REGULATION

There are many aspects of financial fragmentation, but in this article we are concerned about a particular modality affecting international banks: fragmentation as a result of prudential regulation adopted by authorities that are home or host of global banks. As mentioned above, host authorities reacted to the Global Financial Crisis with a series of measures to protect the local market from the contagion of crises abroad. These measures included the obligation to set up holding companies in the host country subject to strengthened regulation and supervision, like the Bank Holding Company regulation in the US, which was followed by the Intermediate Parent Undertaking regulation in the EU (seen by most as a retaliation to the former). Focus on the resolvability of banks included the prepositioning of the loss-absorbing capacity of banks with a centralized model (the so-called Single Point of Entry model), with the ensuing cost for the parent bank.

The restrictions because of Host country regulations have been subject to some debate and intense advocacy actions by the affected banks. Less well known are the restrictions emanating from Home authorities, partly because they affect a smaller group of international banks with a decentralized business model, in particular Spanish banks. These restrictions also

pretend to avoid contagion (in this case from the host to the home market) but are as well the result of a mechanical application of consolidated rules to banks whose decentralized structure renders some of these regulations redundant, unnecessary, or inappropriate. Many of these regulations can be grouped under the general label of extraterritoriality, the origin of which lies overwhelmingly in the US and the EU, which are the Home of most global banks and have legislation that tends to extend its requirements abroad. A few examples in the case of the EU are the following:

- New definition of default, which sets a 1% threshold in terms of the net present value change that triggers a default. This threshold is much more demanding in geographies with traditionally higher inflation and interest rates, as is the case in most emerging market economies (EMEs).

- Guidelines on loan origination from the EBA, which imply requirements difficult to be met by EMEs as well.

- The prudential treatment of sovereign debt denominated in domestic currency normally enjoys a zero-risk weight. Its application to foreign subsidiaries is however subject to an equivalence decision by the Home authority. In the case of the EU this equivalence very often requires a regime that mimics the European one. But in some aspects it makes little sense to require Host countries to have a framework identical to the European one. For instance, in terms of capital requirements some of the Host countries lack a market for AT1 or T2 capital, which implies that EU rules cannot be transposed in a mechanical way. The implication of a country being denied the equivalence is that the local sovereign debt receives a higher RWA at the consolidated level of the global bank, with the ensuing loss of competitiveness of EU banks when operating abroad.

The above are only a few examples of extraterritoriality that affect in a negative way EU banks with a decentralized business model and present in EMEs. This implies that they compete with local players with the disadvantage of a more demanding regulation. Furthermore, some of these effects tend to curtail the financial inclusion process in EMEs, complicating the access to financial services of the lower and middle income population.

Other restrictions create operational fragmentation, limiting the free flow of data or the use of cloud services, as well as limits on outsourcing (even intra-group) or the cross-border use of technology and infrastructure. All these limitations preclude global banks from exploiting synergies that lie at the heart of their business model and increase the cost of financial intermediation in an artificial way.

As a result of all the above, global banks are retrenching from external markets. This process is affecting more European banks and those with a centralized business model[5]. Banks with a decentralized business model (like the Spanish banks) are better adapted to a fragmented world, but are still suffering from the effects of regulatory fragmentation, especially those created by extraterritorial Home regulations.

According to some views, the retrenchment of global banks is not a big loss. It is interesting in this regard to recapitulate the role of global banks in the international financial system. The traditional literature identifies three main reasons for international banking: risk diversification, economies of scale, and following the corporate client. But this is the logic from the point of view of the bank itself or the home country. From the point of view of the host country, the entry of foreign banks offers competition and efficiency gains, compared to a purely domestic banking system. The Spanish experience is illustrative in this regard: the entry of foreign banks in the 1970s led to significant efficiency gains. In the case of emerging economies, an additional reason is the professionalization of risk management and the separation of the banking system from local industrial groups or "extractive elites", particularly important in countries with weaker institutional frameworks. An interesting example is Latin America, a region traditionally prone to financial crises and which, following the entry of international banks in the privatizations wave of the late 20th century and early 21st century, has shown remarkable resilience to the crises of recent years, partly thanks to the decentralized model of Spanish banks (in the terminology of banking

[5] Lund and Windhagen (2017): *As European Banks Retreat from the World Stage, China Is Stepping Up,* Harvard Business Review, September 25, 2017
https://hbr.org/2017/09/as-european-banks-retreat-from-the-world-stage-china-is-stepping-up

resolution, the so-called Multiple Point of Entry model, MPE), which has limited contagion.

If international banks bring advantages to the global financial system, especially in emerging countries, what can be done to avoid them being penalized by regulation? Among the lines of action that could address this problem, it is worth mentioning the following: (i) avoid extraterritoriality, especially the one generated in key jurisdictions such as the US and the EU, which makes banks from these countries subject to more demanding standards than their local competitors, especially when operating in emerging countries; (ii) in the process of granting equivalence to third countries, Home authorities should rely more on objective exercises carried out by international financial institutions like the FSB and the IMF (peer reviews, FSAPs, etc.…) and less on discretional assessments that are often mixed with diplomatic or geopolitical considerations; and (iii) clarify the scope of action of local supervisors according to the banks' business models, since supervision is often more relevant than regulation, something that is hardly recognized in the global standard-setting process.[6]

The aforementioned lines of action should help in the necessary simplification of international financial regulation, to correct the (somewhat paradoxical) trend towards increasingly detailed international standards and an increasing fragmentation of the global financial system, restoring a more balanced playing field between international banks and local actors. All this would reaffirm the relevance of the global standard setting process in Basel.

[6] See Fernández de Lis (2022): *Whither international banking regulation?* The International Banker, November 28, 2022.
https://internationalbanker.com/banking/whither-international-banking-regulation/

3 . SUSTAINABILITY

The debate around sustainability regulation is one of the newest and clearest examples of regulatory fragmentation. This section shares some reflections and concerns on how this debate is evolving and the challenges that financial entities face, including some suggestions to ensure that those challenges become opportunities.

We all agree on the need to have a regulatory framework that helps actors and sectors, and all countries, to contribute to the fight against climate change, ensuring an economic model that protects the environment, while ensuring social and governance objectives. Europe has taken a decisive role in this sustainability agenda, leading with ambition, and encouraging other jurisdictions to act as well. However, we believe that the way in which this framework is being defined, both in depth and speed, requires a further reflection.

Even though the sustainability agenda is quite broad, and it covers many sectors, the financial sector is by far one of the most regulated and supervised, which means that a huge amount of rules are being complemented and reviewed to include the sustainability angle.

Financial rules tend to follow a natural "sequence" of development that guarantees, or at least, provides the basis, to minimize the risk of regulatory fragmentation. The need to regulate and supervise additional issues not covered by the current regulatory and supervisory framework are always discussed first at global fora, being the Basel Committee the natural forum. In addition, the regulatory framework is usually discussed ahead of the supervisory framework, as the regulatory framework determines the supervisory powers, including its degree of discretion.

In the case of the sustainability agenda, and specifically referring to financial regulation, the debate is not following this traditional approach. This is the core element that explains the regulatory fragmentation we are witnessing. First, international authorities have not led the development of the framework from the outset. Even if now they are more involved in some specific issues, jurisdictions like the EU, the UK and now gradually more and more the US, have individually advanced quicker in designing new measures and new tools. Second, some supervisory authorities started to discuss, and even have already set supervisory expectations, on issues that have not yet been decided at regulatory level.

There are several regulatory discussions taking place that show this. One of the most relevant ones is the taxonomy – a classification to identify sustainable activities. The EU will count with a very comprehensive framework. It has already defined relevant elements of the green taxonomy and work is underway to finalize the definition of the other environmental goals. There is also a debate on whether a transition and social taxonomies could be necessary. Internationally there has not been any mandate or direction to follow. There are other countries such as UK or Brazil that are working on their own taxonomies, whereas the US has shown no indication of developing one. This means that the signals to investors regarding green investments and the classification of our exposures (whether they are green or not) will vary across countries.

Disclosure is another example. Apart from the EBA Pilar 3, we need more information, data, on how companies are approaching the transition. To that aim, the EU has given the mandate to the European Financial Reporting Advisory Group (EFRAG) to develop a set of European standards for climate and ESG disclosure. In addition, the International Sustainability

Standards Board (ISSB) is working with the same goal in order to develop a global baseline for sustainability disclosures, to overcome the existence of multiple and overlapping market standards. However, Europe started its work earlier, progressing faster and taking a broader approach. This may have significant unintended consequences for Europe, including a lack of comparability with non-European companies and introducing a layer of extra compliance burden on European businesses.

Related to the disclosure it is worth highlighting the Green Asset Ratio (GAR). This will be a major milestone to showcase how banks are progressing in green financing, linked to the EU Taxonomy. First, this is an obligation that only European banks will have to comply with. Second, the definition of the ratio will unduly penalize banks with significant exposures to SME customers, as well as banks with a significant presence outside Europe. SME and 'third country' counterparties do not, as of today, have any obligation to publish their alignment, so banks who are lending to them will not be able to include those volumes in their ratios. Additionally, since the GAR is a balance sheet metric, it will disregard green activity linked to capital optimization or de-risking strategies. As a result of both factors, the GAR as currently designed will not be an accurate representation of European banks' support for the green transition.

The capital requirements discussion is one of the most worrying debates. Imposing capital requirements will impair the ability of banks to support the economy to transition. It is good to see that there is currently no appetite at international level to impose capital requirements connected to certain exposures nor to modify the prudential framework to enable the integration of climate risks, which is appropriate to consider ESG risks (e.g., it already allows to adjust the value of the exposures and collaterals). However, at European level, there is a political mandate that has been given to the EBA to analyze whether the regulatory framework, and in particular, the Pilar 1 framework, should be modified. Any measures taken by Europe unilaterally penalizing European banks that are financing the transition, will only hamper our ability to realize a net zero economy.

The stress test situation is a particular debate and a source of high risk of regulatory and supervisory fragmentation as well. A study by the Institute of International Finance (IIF) stated that as of June 2021 there were

more than 25 regulatory climate scenario analysis exercises underway or announced, in 18 different jurisdictions. And each of them with its own scenario and methodologies. The lack of harmonization leads to a situation where entities that must build these scenarios and run these exercises have to apply different hypothesis to the same portfolio depending on the criteria defined by the authority leading the exercise.

All these rules are examples that create financial fragmentation, which leads to several consequences. The fact that European entities are subject to rules that that do not exist in other countries pose a competitive disadvantage, undermining the EU competitiveness by adding a significant extra compliance burden on European businesses, including the cost of compliance but also the supervisory scrutiny. It will drive up costs, divert resources and investment away from the delivery of core products and services to support the transition of the economy.

In addition, some rules have an extraterritoriality impact, as previously commented in section 2. There are many rules that apply at consolidated basis, that means that European entities must apply those at the parent level (based in the EU) but also at group level, and therefore, at each of the subsidiaries that belong to the group. The taxonomy is an example. European banks have to classify their exposures according to the EU taxonomy. That means that to be able to obtain information, if clients are not obliged to disclose info (that is underway in the EU but not in other geographies), banks have to reach out to their clients and ask information. This is not always well understood by the clients, and in those jurisdictions where there are no similar rules that must be adopted by local players, this kind of requests can harm the relationship with the client. Extraterritoriality intensifies the unlevel playing field for international groups competing with local peers. We are not subject to the same rules nor to the same level of supervisory scrutiny.

Because of the lack of data, on many occasions it is necessary to engage with clients and ask information, as highlighted before. Contacting clients with similar but not the same requests generate confusion and goes against the relationship and the credibility of the exercises. It also leads to the risk of overburdening customers with overlapping requirements. In addition, in a context such as the current one, with significant gaps in the

necessary climate data, with methodologies still very incipient, generating different views of climate impacts for the same portfolio poses a great risk to the credibility and comparability of the results.

To address these challenges, ensuring that the sustainability regulatory agenda allows financial entities to play a role, given the global nature of climate change and the sustainability transition, it is essential that the debates take place internationally. Only in this way we will be able to ensure competitiveness of business and avoid fragmentation. It is true that some of these debates go beyond financial entities, as they apply to all sectors (e.g., Taxonomy, disclosure, …) and therefore accentuate the challenge as there is not a unique or even, not clear authority, in charge of those topics. However, to the possible extent, a discussion should take place at international level.

We should try turn these challenges into opportunities. We all, financial entities, Governments, regulators, NGOs, companies, and the different stakeholders might differ on the details on how to reach the goal, but we all agree on the goal.

Given the depth and speed in which the regulatory framework has been developed, we would encourage European policy makers to reflect on the progress achieved to date and refrain from defining any new initiatives until the ones adopted or in the pipeline have been fully implemented. It is key to agree, together with the financial sector, with a global perspective, what the specific goals are and the tools to meet them. There are multiple discussions running in parallel, sometimes with no clear cohesion amongst them, and the issues (e.g., transition plans) are being discussed in different regulatory pieces. Policymakers and regulators should carefully consider the coherence of the framework as a whole, including its sequences, to ensure that it is meeting its main goal to channel investment to meet sustainable objectives.

Particularly relevant is that European authorities do not anticipate Basel's ongoing work to assess the right prudential framework for climate risk and that they recognize that penalizing European banks that are financing the transition will only hamper banks´ ability to realize a net zero economy, as well as to help developing economies in their transition. The provision of

finance is vital to ensure that businesses that have the capacity to improve their carbon emissions are able to access the financing needed to make necessary investments and adaptations to their business. Penalising or de facto preventing financing of businesses that have a role to play in the transition and which are currently important to ensure energy security will prevent banks from providing this financing which is essential to support the EU's climate ambitions. We must green the industry. Much of the industry is not green – it is a variety of shades of grey through to brown. These businesses require support – and lending – to help them make the transition.

Finally, sustainability goals should go hand in hand with competitiveness goals. In the UK, the Chancellor of the Exchequer, announced in December the introduction in the regulatory framework of new secondary competitiveness objectives. That means that regulators will have a duty to facilitate the international competitiveness of the UK economy and its growth in the medium to long term, subject to aligning with relevant international standards.

The European green deal industrial plan recently published has introduced a competitiveness check on all new regulation to ensure that all potential competitiveness impacts are addressed. As the European Commission explains, a simple, predictable, and clear regulatory environment is key to promoting investment. This is a fundamental step that should be replicated in all the different regulatory initiatives.

4. THE NEW DIGITAL ECONOMY: BIG TECHS AND THE RISE OF CRYPTO ASSETS

The third global trend in the banking services industry that the regulation needs to face is how to respond appropriately to the new risks created by the new technologies and how to regulate the new financial services providers that have appeared in recent years using them.

To that end, we will focused on two different topics that have been a recent concern for the regulators globally: the first is about how to regulate the Big Techs once they are starting to provide some financial services and the second is related to the appropriate regulatory response to the new risks and opportunities created by the growing crypto economy.

Those are both complex fields, in which regulators need to find a proper balance between the guarantee of a level playing field amongst competitors, avoiding competitive advantages for the non or less-regulated institutions, consumer protection, financial stability and not to hamper financial innovation. Making all those relevant objectives compatible is not easy at all.

This is also a territory in which banking regulation has deep interlinks with other parts of the legal framework, as personal data protection, consumer protection or competition law, none of them harmonized at global level.

The risk of fragmentation is, in this particular case, even more evident that in the two previously analyzed in this paper, but the question is that, maybe it wouldn´t be negative to face some fragmentation on this topics if that allows to advance on having some regulation when the alternative, to wait for a global regulation to be settle, could mean waiting for years, not really knowing if this is going to be really the case.

With a European perspective, the big question is to consider if the strong regulatory approach we have already taken in those topics (including privacy and competition law) could create a competitive disadvantage for the European economy contributing to explain the gap we have with other regions in everything related to financial innovation.

Anyway, we have to recognize that international financial regulatory bodies have already taken the decision to explore the possibilities to advance in some kind of global standards (may be the establishment of some very general principles to guide specific regulatory actions at regional or local level).

4 .1. BIG TECHS

On the Big Techs´regulation, a recent speech by Agustin Carstens, General Manager of the Bank for Internal Settlements[7] has explained the problem in a very simple and clear way: "Big Techs reach extends across a wide range of industries, with existing core business grounded in e-commerce and social media, among others. From this base, they have expanded to finance".

This irruption creates, in his opinion (and ours) new challenges for policymakers that are listed as: data governance, competition, financial stability and, inside this one, one concern centered on Big Techs potential systemic importance, a second around the risks from substantive interdependencies inherent to Big Tech activities and third around the role of Big Techs as providers of critical services.[8]

[7] BIS conference "Big Techs in finance – implications for public policy". Basel. Switzerland, 8-9 February 2023.

[8] Some of the key ideas for the future debate can be traced in the "Occasional paper" N° 2 from

Reality is this that Big Techs activity has developed, until the moment, in a very fragmented, scarce, and differentiated regulatory context in key areas as competition law or privacy law to put only the main two examples. The way in which supervisors respond to the provision of financial services (lending, payments…) in the different geographies is also completely different.

Correcting this fragmentation and deciding which global authority could be potentially entitled to regulate Big Techs are certainly not easy tasks at all. A consensus is emerging on the need to combine entity-based and activity-based regulations, with the former ideally being developed by the home authority and the latter by the host authority. The Bigtech ecosystem is also very special in that there are only a few home jurisdictions (basically the US and China, but in the latter case with mostly domestic business models). In the absence of action by the home authority, some modality of entity-based regulation by the hosts might be needed, although at the risk of fueling fragmentation trends.

Indeed, a pragmatic approach, as already suggested, would be to recognize that to advance globally on this regulation could be a "too far bridge" and some level of fragmentation, connected with the different principles and priorities that the different legal frameworks currently present, is probably impossible to avoid.

Mr. Cartens has just intensified the discussions on a debate that will be probably long and tough, but the reality is that, even if the regulatory action is confined to the financial services area, the establishment of global standards won´t be easy.

The alternative approaches that are to be explored: the restrictive approach, the segregation approach and the inclusion approach are only the starting point of the debate to start.

From this paper we would like to support this proposal and the efforts that

the Financial Stability Institute (BIS) written by Johannes Ehrentraud, Jamie Lloyd Evans, Amelie Monteil and Fernando Restoy on October 2022. There is also a description on two of the three potential approaches to the new regulation ("segretation and inclusion") included in Mr. Cartens speech.

will be made to make it real, including the future effective implementation of the regulation to come knowing that, as always happen, the devil will be in the details.

We agree with the abovementioned paper[9] from the Financial Stability Institute when it states that "A potential promising way forward could be to define a new framework for addressing the specific risks that originate from the unique business model of big techs that perform significant financial activities (big tech financial group (BTFG)").

Nevertheless, we need to be realistic on this and recognize that the advance on this future regulation won´t be fast (and could finally become impossible) and to advance in providing some legal certainty -- although in a fragmented way -- where possible could be something easier to achieve. There are already some European initiatives such as the Digital Markets Act (DMA), Digital Operational Resilience (DORA) and Markets in Cryptoassets (MiCA) that address some of the risks that Bigtechs pose: accumulation of data, power of negotiation as technological services providers or the risk that they launch stablecoins and become critical.

4. 2. THE NEW CRYPTO ECONOMY

When we start a debate on the crypto world we need to distinguish, at least, three different elements that could require an specific regulatory approach for each one.

Those are: the DLTs and its potential for the operational transformation of the economy, stablecoins, and the "non-stable" cryptoassets. The concerns and risks inherent to these three different questions are different and the regulatory response to them could recognize this fact as the European regulation has already shown in the differentiation between MICA and the DLT regulations.

[9] See previous note, page 18.

What seems clear is that nearly fourteen years after the creation of Bitcoin the crypto economy is already a reality.

The number of existing crypto assets is exponentially growing globally and only a particular type of them, the non stable crypto currencies have been able to attract massive investment specially from retail customers raising concerns from a purely regulatory perspective (AML, Tax law, financial stability,,,) and also from the consumer protection point of view for their extreme volatility and inherent risks for retatil and less informed investors.

It is also true that the new financial global landscape, with the change in markets conditions and liquidity access have revealed part of the problems these specific assets and their intermediaries could bring, moving global regulators into an action that no so long ago they seemed to be reluctant to take.

Local regulators have moved between the recognition of the risks the investment in crypto assets could pose for retail investors, the concern by anti-money laundering and fiscal considerations and the will to take advantage of the possibilities the new DLT could bring to foster competition and efficiency in financial services.

The European Union took the first step to set up a cross border legal standard, with the still-not approved- MICA regulation[10] and, now this paper is closed, several initiatives have been announced for this year in IOSCO[11] and the BIS to advance in different regulatory proposals starting for setting up some global standards following the recommendations adopted by the Financial Stability Board.[12]

[10] Proposal for a regulation of the European Parliament and of the Council, on markets in crypto-assets and amending Directive (EU) 2019/1937, COM/2020/593 final.

[11] IOSCO is already working in the preparation of the future standards to be adopted this year within two different working groups one lead by the US SEC (on decentralized finance (DeFi)) and the other by the British FCA (specifically on crypto assets regulation, that could mirror the MICA regulation, to some extent).

[12] Report on crypto assets. Financial Stability Board. October 11, 2022.

This is urgent. To take advantage of the possibilities the new technologies bring for financial innovation and efficiency, legal certainty is essential.

The regulated banking industry could play a role to discipline part of the economic activities around the crypto assets but, again, it is impossible for them to act without the certainty that only regulation could bring.

Again, from this paper, we positioned ourselves as clearly favorable to an urgent global regulatory action to provide certainty for the development of the new crypto economy and the cryptoassets.

Although we can recognize that, even with the exponential growth of the investments globally made on these assets in last years, they aren´t still a significant challenge for global financial stability, there are a lot of reasons, including some related to the compliance with other parts of the regulation (anti-money laundering and investor protection as two key examples) that make advisable for global regulators to step in and to set up, at least, global standards that could provide the legal certainty that is already needed. An internationally harmonized prudential framework will ensure that banks in all jurisdictions are subject to the same rules and take advantage of the potential benefits in the same way. Cryptoassets are one of the major applications of blockchain technology in finance. Banks are able to foster the potential of digital finance while mitigating the risks using their current risk management internal controls and procedures. In that sense, the role of Banks should be making the benefits of crypto assets available and accessible to customers and businesses in a secure and convenient way, guaranteeing consumer and investor protection and combating money laundering and terrorism financing.

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Nº 1. Informe sobre el mercado hipotecario español. Febrero 2013.

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Nº 11. Debate sobre la evolución del Mercado del Petróleo y las Materias Primas. Junio 2016.

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