

## **A Journey through Ruth Wandhöfer's Book: "Transaction Banking and the Impact of Regulatory Change", UK: Palgrave-Macmillan, 2014**

Ruth Wandhöfer was one of the lecturers at the first edition of the Jean Monnet Autumn School on "The Europeanisation of the Payment System. Learning from the past to address the challenges ahead", held at the University of Siena from 23 to 25 October 2014.

As academic coordinator of the Jean Monnet project I invited her to give a speech on the on-going developments of PSD and SEPA, as her first book dealt with European Payments Integration (Palgrave Macmillan, 2010), and her second volume, "Transaction Banking and the Impact of Regulatory Change" (Palgrave Macmillan, 2014), investigated the second Payment Service Directive draft within a wider international framework, analysing payment service regulation as one of several post-crisis regulatory measures. In the end, her speech was brilliant and held the audience's attention from beginning to end.

I am going to focus on "Transaction Banking and the Impact of Regulatory Change".

This book centres on the idea of "transaction banking". Actually, there is no regulatory definition to refer to. In the opinion of the Author, this is a wholesale form of banking, whose main clients are corporations, other banks, governments and financial institutions (for example, funds and broker dealers).

Transaction banking activities cover a combination of the following: i) payment and cash management, ii) trade finance, iii) custody, and iv) ancillary securities services. However, the most important feature of "transaction banking" seems to be the *network* dimension or, in other words, its *interconnectivity*: "Network banking, which is transaction banking, has a socially essential purpose and relies on (...) widespread interconnectivity" (page 58).

The book takes an international approach, making reference to relevant US, EU and UK regulatory initiatives where necessary, but the Author correctly refrains from a comprehensive analysis of post-crisis regulatory changes.

To assess the critical impact of some regulatory initiatives on transaction banking, the Author firstly overviews its banking and financial framework, pointing to the regulatory measures employed to improve financial stability (for example, MIFID rules or the Recovery and Resolution regime) and depositor protection, as well as the dialectical relationship between the increased level of harmonisation/standardisation on the one hand and the trend towards the "balkanisation of financial markets" on the other (page 9).

The Basel accord and payment services regulation, however, are examined in greater depth. Indeed, in chapter 4, Wandhöfer explains the basics of Basel I and what changes took place leading to Basel II and Basel III. In chapter 5, she critically focuses on the Payment Service Directive (or PSD) and the proposal for PSD2, drawing a comparison between the EU and US regulatory frameworks.

The real heart of the book, however, is to be found in chapters 6 and 7. Here, the Author critically examines the impact on the transaction banking model of Basel III regulation and argues her regulatory proposals.

On the premise that transaction banking does not seem to show major leverage or a higher level of speculation, the Author underlines how Basel III rules and regulations can reduce the “profitability of the bank’s treasury” and this, in turn, can “reduce the amount of money that can be passed on to the transaction bank”, thus influencing the level of infrastructure investments in terms of “safety of infrastructures”, “regulatory compliance” and “innovative systems”. In addition, further foreseeable consequences might be an increase in a bank’s fees to its corporate, public sector and FI customers as well as reduced interest paid on their accounts.

The mechanism seems to work as follows: the bank’s treasurer is entrusted with finding the best way to invest the available deposits in order to generate returns through the liquidity coming from transaction banking. However, the liquidity requirements set out by Basel III cut the bank’s treasury resources in terms of “the type of products, the duration, the risk profile and the degree of liquidity” (page 218).

Coming to the regulatory proposals, Wandhöfer points to the importance of the global network and connectivity on which transaction banking is based, which, in turn, supports the functioning of the global economy.

Having established this premise, she proposes, among the other things,

- To make a change to the regulatory approach: “Prescriptive rules alone may not be able to prevent the next crisis. Instead, we need banks to be incentivised to be transparent and give them sufficient freedom to do their business” (page 258)

- To keep the ring-fencing risk under control. Indeed, when the lawmakers oblige foreign banks to ring fence capital and liquidity domestically, the range of services offered to customers ends up being reduced, with negative consequences especially for small and medium enterprises (page 259)

- To control the “too-big-to-fail” syndrome, the Author points to international cooperation according to a model established as part of the G20 process and greater recourse to principles-based regulation. Indeed, she writes, “(...) the more prescriptive and detailed the rules, the more complex it will be to supervise banks’ compliance with these” (page 265).

- Finally, the Author suggested applying a bottom-up regulatory approach: “Having established harmonised accounting and reporting rules for large international banks all around the world and having improved the transparency of RWA measurements, my proposal would be to actually remove the Basel capital, liquidity and leverage ratio requirements and limitations altogether. Instead, large banks (...) should transparently disclose their capital and liquidity levels and their LRs according to the globally defined Basel III

formulas. (...) sufficient room for clarifying the different types of risks should be given as part of these disclosures” (page 266).

“Transaction Banking and the Impact of Regulatory Change” is far from being an academic book, and it does not claim to be. The bibliography and the book’s structure say a lot on the matter.

Rather, this volume - a useful informative text - is essentially a critical investigation of regulatory rulemaking from within the banking world. Its greatest merit is that it stimulates interest in side-based issues. To give just a few examples, one might question i) how transaction banking activities are referred to within the European legal framework and what degree of harmonisation has been achieved (apart from the provision of payment services), ii) how the institutional organisation of international economic governance has changed in the post-crisis framework or, iii) how the standardisation process among international economic players can raise antitrust issues and how the competent authorities deal with this.

Thanking Ruth Wandhöfer for this interesting read, I very much look forward to her next book.