

The influence of the ECB on the formation of prudential requirements for credit institutions: Analysis of key changes and challenges

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■ **Abstract.** The aim of the article was to examine the evolution of the powers of the European Central Bank and the correlation with the competences of national regulators in the European Union. The study used a set of legal analysis methods. The use of the comparative legal method allowed the identification of the main differences in the regulatory approaches of the European Central Bank and national banking supervisory authorities. The formal legal method was used to analyse the content of the main regulations and directives of the European Union. The systemic approach contributed to the consideration of the legal regulation of banking activity in the European Union as a complex phenomenon combining macro- and microprudential supervision. As a result of the study, it was established that the European Central Bank played a key role in regulating banking activity within the European supervisory mechanism. At the same time, national regulators retained powers over the supervision of medium-sized and small financial institutions, which created a need for clear coordination between these institutions. It was found that strengthening the interaction between the European Central Bank and the European Systemic Risk Board could contribute to a prompter response to financial imbalances, as confirmed by the analysis of existing regulatory mechanisms. The main directions for improving macroprudential supervision were identified, in particular through the expansion of the functions of the European Systemic Risk Board and the creation of joint platforms for information exchange between regulatory authorities. The results obtained could be used for further improvement of EU regulatory policy and the development of effective financial supervision mechanisms aimed at reducing systemic risks in the banking sector

■ **Keywords:** supervisory mechanism; national authorities; financial stability; regulatory coordination; banking risks

■ Introduction

The relevance of the study of the influence of the European Central Bank (ECB) on the formation of prudential requirements for credit institutions stemmed from the growing role of the ECB as one of the main regulators of banking activity in the European Union (EU). After the establishment of the Single Supervisory Mechanism (SSM) in 2014, the ECB received significant powers in the field of banking supervision,

which contributed to the harmonisation of banking sector regulation within the eurozone. At the same time, the strengthening of the ECB's regulatory functions sparked a number of discussions regarding the balance of powers between supranational and national regulatory authorities, as well as the impact of such centralisation on the sovereignty of EU member states in the area of financial supervision.

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Prudential requirements established within the framework of European banking legislation aimed to ensure the stability of the banking system, prevent crisis phenomena, and protect depositors' interests. However, the process of adapting international standards, such as the Basel Agreements, to the EU legal system sometimes generated controversies regarding equal competition at the international level, as well as posed challenges for national regulators and smaller banks. In this context, questions arose regarding the feasibility of differentiating prudential requirements depending on the size of banks, the possibility for national regulators to introduce additional restrictions, and the legitimacy of the ECB's interference in the internal management of private credit institutions.

Studies devoted to the impact of prudential policy on the banking system demonstrated significant attention to the effectiveness of macroprudential measures in various economic conditions. O. Akinci & J. Olmstead-Rumsey (2017) conducted an empirical analysis of the impact of macroprudential measures on the stability of the banking sector, establishing that such instruments as leverage limits and liquidity requirements effectively reduced risks in the financial system. At the same time, the authors emphasised that stricter regulatory requirements could negatively affect the availability of credit, especially during periods of economic instability.

The effects of macroprudential policy on credit growth dynamics were studied by A.M. Andrieş *et al.* (2021). The analysis showed that the ECB's approach to setting prudential requirements significantly affected the volume and structure of bank lending, particularly in countries with high financial openness. The authors noted the ambiguous impact of regulatory changes: on the one hand, strengthening capital and liquidity requirements contributed to improving the stability of banks, while on the other hand, it could limit access to financing for small and medium-sized enterprises.

The analysis of international prudential regulation practices indicated the importance of combining capital requirements with deposit insurance mechanisms. B.N. Ashraf *et al.* (2020) demonstrated that the introduction of strict capital standards in combination with deposit guarantee schemes could reduce the level of banking risks. However, during periods of crisis, the effectiveness of these measures depended on the specifics of the regulatory environment, particularly on the flexibility of the central bank in responding to shocks.

The relationship between macroprudential policy, economic growth, and banking crises was considered in the work of M. Belkhir *et al.* (2022). The research highlighted that macroprudential measures could play both a stabilising and a restraining role for

economic development. The authors drew attention to the fact that excessive regulation could limit the ability of banks to perform the function of financial intermediation, which was especially relevant during a recession. The issue of banking sector privatisation and the impact of state control on the level of banking risks was studied by N. Boubakri *et al.* (2020). The authors found that after privatisation, banks exhibited more aggressive risk-taking behaviour, which could affect the overall stability of the financial system. This raised the question of the appropriateness of the ECB's approaches to regulating banks that remained under partial state control.

The specificities of macroprudential policy in a competitive banking environment were studied by K.K. Chan *et al.* (2023). The authors concluded that the implementation of regulatory requirements could have different effects depending on the level of competition in the banking market. In cases where competition was high, banks were forced to adapt to new requirements by reducing the level of risky operations. At the same time, in less competitive environments, strict regulatory measures could lead to a reduction in lending volumes. The latest studies also focused on the impact of external shocks, such as the COVID-19 pandemic, on the effectiveness of banking regulation. I.R. Ganie *et al.* (2022) demonstrated that during crises, central banks had to balance between the need to maintain financial stability and ensure the availability of credit. The analysis showed that the ECB was forced to ease some prudential requirements during the pandemic, raising questions about the long-term effectiveness of such measures.

Overall, the analysis of academic publications indicated a number of unresolved issues regarding the effectiveness of the ECB's prudential requirements. Despite significant attention to the impact of macroprudential policy on the stability of the banking sector, gaps remained in the study of how banks adapted to new regulatory standards and the long-term impact on economic growth. This study aimed to partially fill these gaps by analysing key changes in the ECB's prudential requirements and assessing the consequences for the banking system.

The aim of the article was to analyse key changes and challenges in the legal regulation of banking activity in the EU arising from the implementation of ECB prudential requirements. The main objectives of the article were: to analyse the legal framework of the ECB's activity as a banking regulator in the EU; to examine the division of competences between the ECB and national regulators; and to propose ways to optimise the mechanism of interaction between the ECB and national regulators, taking into account modern trends in financial regulation and the need for harmonisation of banking supervision in the EU.

■ Literature Review

The influence of the ECB on the formation of prudential requirements for credit institutions and the implementation in different Eurozone countries was an important topic for research. Although many authors had paid attention to the role of macroprudential policy, there were certain gaps in understanding the specific influence of the ECB that remained unaddressed in previous studies. In this context, reviewing the findings of other authors allowed for an understanding of how different approaches to macroprudential regulation interacted with national and international economic factors.

T.T. Le *et al.* (2022), in the work, studied the impact of the COVID-19 pandemic on default risks in Vietnamese commercial banks. The authors emphasised the importance of income diversification for banks to reduce default risks, especially during global shocks. The researchers also pointed out the significance of macroprudential policy in maintaining the stability of the banking sector under uncertainty. However, one of the key limitations of this study was the lack of analysis of the direct influence of the ECB's macroprudential policy on the banking systems of Eurozone countries. This reduced the universality of the conclusions regarding the effectiveness of such measures in the European context.

Financial crises and diversification strategies became the subject of analysis in the study by D.K. Pham *et al.* (2021). The researchers concluded that adjusting diversification strategies helped reduce risks for banking institutions. At the same time, the study did not consider the ECB's role in shaping these strategies at the Eurozone level. This indicated a certain limitation in understanding how the ECB's macroprudential requirements might affect the banking sector. The authors emphasised the need to adapt banking strategies to economic changes, but the research did not cover the interaction between regulatory requirements and banks' diversification approaches within the European Union.

The topic of the ECB's macroprudential policy was also addressed by T. Poghosyan (2020), who analysed the effectiveness of credit restriction measures in EU countries. The author noted that such restrictions helped reduce financial risks, especially during crises. The study also highlighted the need to improve coordination mechanisms between the ECB and national regulators. An important aspect was that the work did not take into account socio-economic differences between Eurozone countries, although these factors could significantly affect the effectiveness of macroprudential policy. Furthermore, the author did not analyse the influence of other regulators on the EU banking system, which could have broadened the understanding of the overall effectiveness of regulatory measures in the region.

P. Tseng & W. Guo (2022) focused on banking risks in mixed oligopolies, examining the role of state-owned banks in this process. This research was interesting because the authors focused on the impact of state-owned banks on financial stability, highlighting the importance of the functioning in conditions of limited competition, where the banking services market was controlled by both private and state institutions. The authors showed that the presence of state-owned banks could have both stabilising and destabilising effects on the market, depending on political and economic conditions. However, a significant limitation of this study was the lack of analysis of the ECB's role as a regulator in the context of the Eurozone banking sector. The authors did not consider the specific regulation of banks carried out by the ECB, as well as its prudential requirements for banks operating in the Eurozone. The absence of a comparison between private banks subject to ECB norms and state-owned banks in a mixed oligopoly significantly limited the ability to draw conclusions about how the ECB's general macroprudential requirements might affect financial stability in a mixed market environment. This created a gap in understanding the effectiveness of the ECB's policy regarding banking stability and risks across the entire Eurozone.

An equally important study was conducted by Z. Venter (2022), who analysed the adaptability of macroprudential policy under economic uncertainty. The author presented theoretical foundations suggesting that macroprudential policy should be adaptive to effectively respond to changing conditions and new challenges in financial systems. However, although the work provided a theoretical basis for understanding the flexibility of macroprudential policy, it did not consider specific mechanisms used by the ECB to regulate banking activities under real economic crises. The study did not include practical examples of applying these principles in real situations, such as global financial crises or other macroeconomic shocks faced by the Eurozone. This significantly reduced the practical relevance of the findings for EU banking systems, as the findings did not cover the actual mechanisms by which the ECB could influence the stability of banking institutions during economic shocks.

The work of E. Meuleman & R.V. Vennet (2022) was dedicated to analysing macroprudential policy, monetary policy, and banking risks in the Eurozone. The authors examined the impact of various macroprudential policy instruments on the financial stability of banks under changing economic conditions, emphasising the importance of integrating macroprudential and monetary instruments to reduce risks in the banking sector. The authors highlighted the need for coherence between ECB policies and those of national regulators to effectively manage banking risks under conditions of global economic instability.

In Ukraine, research on macroprudential instruments was presented in the works of authors such as O. Antnonyuk (2020), L. Zherdetska & M. Kambur (2021). These studies focused on adapting macroprudential policy to national conditions, particularly on the use of instruments aimed at maintaining financial stability in Ukraine. V.V. Kovalenko & N.V. Radova (2019), and O.M. Oliynyk (2019) emphasised the importance of implementing appropriate macroprudential measures to prevent banking crises and ensure the stability of the financial system. However, most of these works did not consider the influence of European regulators, such as the ECB, on Ukraine's national policy. The analysis of the basic principles of financial system stability generally did not focus on the specifics of the prudential requirements applied by the ECB to Eurozone banks. This significantly limited the relevance of the findings for studying the integration of the Ukrainian banking system into European financial stability standards.

■ Materials and Methods

The study of the legal status and evolution of the powers of the ECB as a regulator of banking activities in the European Union was carried out based on a combination of general scientific and specialised legal methods, which ensured a comprehensive approach to the analysis of the legal aspects of the ECB's activities and its interaction with national regulators. The method of legal modelling was used in the study, which allowed for the assessment of the prospects for improving the EU's regulatory policy in the field of banking supervision, particularly in enhancing the effectiveness of the European mechanism for the financial recovery of banks and combating money laundering.

The main research method was the comparative legal analysis, which was used to assess the compliance of the EU banking regulatory framework with international standards. Within this method, a comparison of European banking legislation with international documents regulating financial activities was conducted, particularly with Basel III (Bank for International Settlements, 2011). The main documents that were subject to analysis were the Stability

and Growth Pact¹, Treaty on Stability, Coordination and Governance in the Economic and Monetary Union², Regulations of the European Parliament and of the Council No. 575/2013 "On Prudential Requirements for Credit Institutions and Investment Firms"³, No. 806/2014 "On Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund"⁴, Directives of the European Parliament and of the Council No. 2013/36/EU "On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms"⁵ and No. 2014/59/EU "On Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms"⁶.

The formal legal method was applied to study the structure and content of the EU normative acts regulating the activities of the ECB, particularly its role as the central bank of the eurozone and the main banking supervisory body. Special attention was paid to the provisions defining the ECB's competencies in the field of prudential supervision of significant credit institutions, as well as the legal norms regulating mechanisms of cooperation with national regulators within the framework of the Single Supervisory Mechanism (SSM). Procedures of supervision, criteria for assessing the financial stability of banking institutions, capital and liquidity requirements, as well as the legal aspects of decision-making in preventing banking crises were analysed. Special attention was paid to the legal foundations of the ECB's interaction with other European and international financial institutions supervising the banking sector.

The system approach method allowed for an exploration of the institutional characteristics of the ECB's functioning in connection with national financial regulators, as well as in the broader context of economic governance in the EU. Mechanisms for coordinating powers between the ECB and national supervisory authorities within the Single Supervisory Mechanism were analysed, which allowed an assessment of the effectiveness of the existing banking regulation system. Furthermore, the impact of

¹ Stability and Growth Pact. (2011, December). Retrieved from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:stability_growth_pact.

² Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. (2013, January). Retrieved from [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:42012A0302\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:42012A0302(01)).

³ Regulation of the European Parliament and of the Council No. 575/2013 "On Prudential Requirements for Credit Institutions and Investment Firms". (2013, June). Retrieved from <https://eur-lex.europa.eu/eli/reg/2013/575/oj/eng>.

⁴ Regulation of the European Parliament and of the Council No. 806/2014 "On Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund". (2014, July). Retrieved from <https://eur-lex.europa.eu/eli/reg/2014/806/oj/eng>.

⁵ Directive of the European Parliament and of the Council No. 2013/36/EU "On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms". (2013, June). Retrieved from <https://eur-lex.europa.eu/eli/dir/2013/36/oj/eng>.

⁶ Directive of the European Parliament and of the Council No. 2014/59/EU "On Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms". (2014, May). Retrieved from <https://eur-lex.europa.eu/eli/dir/2014/59/oj/eng>.

the ECB's activities within the SSM on ensuring the financial stability of the eurozone was studied, particularly through the introduction of unified supervisory standards and the application of early response mechanisms to financial imbalances.

The case study method was applied to analyse specific cases of the application of bank resolution mechanisms in EU countries. The aim of this analysis was to identify the features of interaction between national regulators and the ECB in crisis situations, as well as to identify the factors influencing decision-making regarding the support or restructuring of banks.

In particular, the cases of the resolution of the Italian bank Banca Popolare di Vicenza and the Spanish Banco Popular (European Commission, 2017) were reviewed, which demonstrated differences in the approaches of national regulators and European institutions to managing financial crises. In addition, examples of national authorities' intervention in the early stages of banking risks were analysed – particularly in Finland (tightening of mortgage lending requirements), Germany (conservative risk assessment for local banks), as well as the general debate around the harmonisation of prudential requirements within the EU.

■ Results

The ECB as a regulator of banking activities in the EU: Legal basis and evolution of powers. The global financial crisis of 2008 posed a serious challenge for many European countries, leading to significant economic consequences, including the threat of bankruptcy for individual states. One of the causes of the crisis was the revealed deficiencies in regulation and supervision in the banking sector, as well as the inability of financial institutions and regulators to respond promptly to crisis situations. The crisis also exposed systemic shortcomings in the legal regulation of the financial sector of the European Union, resulting in a decline in trust in banking institutions and financial entities in general.

In response to these challenges, the EU developed a set of anti-crisis measures, which included both short-term and long-term strategies. The short-term measures aimed to stabilise the situation in financial markets and prevent the further spread of crisis

phenomena. This included the creation of special anti-crisis funds, such as the European Financial Stability Mechanism, the European Financial Stability Facility, and the European Stability Mechanism. These measures enabled EU member states' governments to provide the necessary refinancing of public debt and promote financial stability.

Long-term measures were aimed at eliminating structural problems that had contributed to the onset and spread of the crisis, as well as at developing new mechanisms for regulating the financial sector to prevent similar crises in the future. One of the main elements of these measures was the radical restructuring of the Economic and Monetary Union, initiated by the European Commission. A revised version of the Stability and Growth Pact¹ was adopted, which included six legislative acts aimed at strengthening oversight of budgetary discipline in the eurozone and introducing methods to prevent violations.

The next stage was the signing of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union², as well as the development of the “Blueprint for a Deep and Genuine Economic and Monetary Union” by the European Commission. One of the key proposals was the transfer of supervisory functions for large banks in the eurozone to the control of the ECB, with countries outside the euro area given the opportunity to join the “Single Supervisory Mechanism” on a voluntary basis.

These measures led to the creation of the European Banking Union, which became a new stage of integration within the European Monetary Union and was aimed at creating a centralised mechanism for applying banking rules at the EU institutional level. The goal of this mechanism was the formation of a transparent, unified, and secure banking market. On 4 November 2014, the ECB began to perform the functions of the main supervisory authority of the European Banking Union.

The structure of the European Banking Union includes three main components: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM), and the Single Rulebook and Standards, which include stricter capital requirements for commercial banks, deposit guarantee schemes, and rules to prevent bank bankruptcies (Table 1).

Table 1. Structure of the EBU

Component	Description	Functions and tasks
Single Supervisor Mechanism (SSM)	An integrated system of national banking supervisors, united under the auspices of the ECB	Ensuring centralised supervision of banks in the eurozone and non-eurozone EU countries to ensure financial stability

¹ Stability and Growth Pact. (2011, December). Retrieved from https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:stability_growth_pact.

² Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. (2013, January). Retrieved from [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:42012A0302\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:42012A0302(01)).

Table 1. Continued

Component	Description	Functions and tasks
Single Resolution Mechanism (SRM)	Mechanism for effective resolution of crisis situations in the banking sector through the Single Resolution Board	Preparation and implementation of bank recovery plans to prevent the bankruptcy and minimise the negative impact on the financial system
Uniform rules and standards	Legislation defining bank capital requirements, deposit guarantee guidelines, and bankruptcy prevention measures	Ensuring stricter capital requirements for commercial banks, creating deposit guarantee systems and mechanisms for protecting against financial crises

Source: compiled by the author based on Understanding the banking union and ESFS (2024)

The Single Supervisory Mechanism, one of the key components of the European Banking Union, was enshrined in Article 127(6) of the Treaty on the Functioning of the European Union¹. This mechanism granted the European Central Bank (ECB) exclusive powers to supervise significant banks within the euro area, as well as banks located in other EU Member States. The ECB was authorised to supervise credit institutions whose total asset size exceeded EUR 30 billion, as well as banks deemed significant for the economy of a particular Member State or those that had received financial assistance from EU institutions.

The introduction of the Single Supervisory Mechanism under the ECB's auspices became a determining factor in the transformation of prudential requirements for credit institutions in the European Union. The strengthening of regulation aimed to enhance the financial resilience of the banking system, minimise systemic crisis risks, and harmonise standards at the EU level. One of the most important reform directions was the increase in capital adequacy requirements. Within the implementation of Basel III (Bank for International Settlements, 2011), the ECB required banks to raise the Common Equity Tier 1 (CET1) to a minimum of 4.5% of risk-weighted assets, introduce capital buffers (the capital conservation buffer and the countercyclical capital buffer), which varied depending on the macroeconomic environment, and apply increased requirements to Global Systemically Important Banks (G-SIBs), including additional buffers to ensure the stability.

The adaptation of Basel III had varied effects on the competitiveness of banks in different EU countries. On one hand, large international banks such as BNP Paribas, Deutsche Bank, and Santander were better positioned to adapt to heightened regulatory demands due to broad asset diversification, access to global financial markets, and the ability to accumulate required capital. On the other hand, small and

medium-sized banks, particularly in countries such as Italy (Intesa Sanpaolo, UniCredit) or Spain (CaixaBank, Banco Sabadell), faced challenges in meeting new requirements due to limited financial resources and narrower market segments. In some cases, this compelled local banks to reduce lending to small and medium-sized enterprises, impacting regional economic development (Radojičić & Marinković, 2023).

It is also important to note the consequences of implementing Basel standards for banking institutions in Central and Eastern Europe, particularly in Poland, the Czech Republic, and Hungary. As the financial systems of these countries were largely oriented around subsidiaries of large Western European banking groups, the tightening of capital requirements could lead to a reduction in fund transfers between parent and subsidiary companies, affecting credit availability for national economies (Wang & Lin, 2021).

Another important aspect was the correlation between the adaptation of Basel standards in the EU and the implementation in other jurisdictions, such as the United States and the United Kingdom (McCann & O'Toole, 2019). While similar standards were implemented in the United States through Federal Reserve Rules², American banks enjoyed certain regulatory advantages due to differences in capital and liquidity calculation approaches. For example, more flexible risk management mechanisms were envisaged in the US, providing a competitive edge to American banks compared to the European counterparts. This could result in capital outflows from European financial markets towards the United States.

Guided by the provisions of Regulation of the European Parliament and of the Council No. 575/2013³ and Directive No. 2013/36/EU⁴, the ECB introduced stricter liquidity requirements for banks, including the liquidity coverage ratio (LCR) – ensuring that banks held sufficient high-quality liquid assets to cover potential cash outflows over a 30-day period ,

¹ Treaty on the Functioning of the European Union. (2009, December). Retrieved from <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12016ME%2FTXT>.

² Federal Reserve Rules. (2018, January). Retrieved from <https://www.federalreserve.gov/supervisionreg/reglisting.htm>.

³ Regulation of the European Parliament and of the Council No 575/2013 "On Prudential Requirements for Credit Institutions and Investment Firms". (2013, June). Retrieved from <https://eur-lex.europa.eu/eli/reg/2013/575/oj/eng>.

⁴ Directive of the European Parliament and of the Council No. 2013/36/EU "On Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms". (2013, June). Retrieved from <https://eur-lex.europa.eu/eli/dir/2013/36/oj/eng>.

the net stable funding ratio (NSFR) – aimed at ensuring stable funding sources for long-term assets, and the mandatory conduct of stress tests to assess banks' resilience in crisis situations. A significant change was the reduction of discretionary powers of national regulators. The uniform requirements introduced by the ECB limited the ability of Member States to apply the own, more lenient, criteria for assessing banking risks. At the same time, this remained a contentious issue, as some national regulators sought to retain the right to introduce additional requirements for banks, taking into account the local characteristics of the financial system, while there was also an ongoing debate about whether centralised regulation violated the principles of competitiveness within the European banking market.

Changes in prudential requirements also affected the mechanisms for resolving problem banks. According to Directive No. 2014/59/EU¹ and Regulation No. 806/2014², the ECB gained new levers of influence: clear procedures for early intervention in the activities of problem banks were established, bail-in requirements were introduced obligating shareholders and creditors to bear financial responsibility for the rescue of banks, and the SRM was implemented, providing for the creation of a common resolution fund for banks in the euro area. One of the most debated issues remained the stringency of requirements for small banks. It was argued that the existing rules disproportionately complicated the activities of small financial institutions that did not pose systemic risks to the market. The European Commission and the ECB considered the possibility of adapting standards to the size of the bank to avoid excessive administrative pressure.

Under the influence of the ECB, prudential requirements were significantly tightened to increase the resilience of the EU banking sector. At the same time, the centralisation of regulation triggered disputes among national governments, as it reduced the autonomy in the field of banking supervision. The further development of banking regulation in the EU

was likely to aim at finding a compromise between centralised control and the need to preserve a degree of flexibility for local regulators.

Division of competencies: Areas of responsibility of the ECB and national regulators. The introduction of the SSM significantly transformed the distribution of powers between the ECB and the national regulators of EU Member States. While the ECB assumed a key role in banking supervision within the euro area, national regulators retained a number of powers necessary to ensure the effective functioning of the financial system at the national level. Defining areas of competence and dividing responsibilities between these institutions was important for maintaining the stability of the banking sector and preventing regulatory gaps or duplication of functions.

The main competencies of the ECB included direct supervision of significant institutions (SIs) that met certain criteria, including asset size, systemic importance to the country's economy, and access to EU stabilisation mechanisms. In addition, the ECB was vested with exclusive powers in bank licensing, assessment of the suitability of managers and shareholders, monitoring compliance with capital and liquidity requirements, conducting stress testing of banks, and monitoring systemic risks.

National regulators, despite the strengthening of the ECB's role, remained key actors in banking supervision within the jurisdictions. The regulators oversaw less significant institutions (LSIs) not subject to direct ECB supervision, implemented macroprudential measures, monitored compliance with anti-money laundering legislation (AML/CFT), participated in bank resolution procedures, and cooperated with the ECB within joint supervisory teams (JSTs) (Table 2). Despite the formal distribution of functions between the European Central Bank and national regulators, in practice, the interaction between these institutions was accompanied by a number of challenges related to potential conflicts of competence, duplication of functions, and differences in regulatory approaches.

Table 2. Areas of responsibility of the ECB and national regulators in the field of banking supervision

Area of responsibility	European Central Bank (ECB)	National regulators
Banking supervision	Direct supervision of SIs that meet the criteria of asset size, systemic importance or receiving support from EU stabilisation mechanisms	Supervision of LSIs not under the direct supervision of the ECB
Licensing	Exclusive right to grant, revoke and restrict banking licences in SSM member countries	Implementation of procedures for national banks, but decisions are made in agreement with the ECB
Management assessment	Assessment of the suitability of owners and managers of significant banks	Similar functions for less significant banks

¹ Directive of the European Parliament and of the Council No. 2014/59/EU "On Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms". (2014, May). Retrieved from <https://eur-lex.europa.eu/eli/dir/2014/59/oj/eng>.

² Regulation of the European Parliament and of the Council No. 806/2014 "On Establishing Uniform Rules and a Uniform Procedure for the Resolution of Credit Institutions and Certain Investment Firms in the Framework of a Single Resolution Mechanism and a Single Resolution Fund". (2014, July). Retrieved from <https://eur-lex.europa.eu/eli/reg/2014/806/oj/eng>.

Table 2. Continued

Area of responsibility	European Central Bank (ECB)	National regulators
Capital and liquidity adequacy control	Monitoring compliance of significant banks with Basel III requirements (CET1, LCR, NSFR)	Establishing additional national requirements for less significant banks
Stress testing	Conducting annual stress tests together with the European Banking Authority (EBA)	Participation in stress testing led by the ECB, as well as conducting the own national tests
Systemic risk monitoring	Analysis of the financial stability of the banking system and development of macroprudential measures	Implementation of macroprudential measures at the level of individual states
Anti-Money Laundering (AML/CFT) Controls	General monitoring of financial system risks	Direct supervision of banks' compliance with AML/CFT regulations
Bank rehabilitation	Participation in procedures through SRM and Single Resolution Board (SRB)	Implementation of remediation procedures at the national level
Cooperation and coordination	Joint management supervisor teams	Participation in JSTs and interaction with the ECB within the framework of joint supervision

Source: compiled by the author

One of the key problems was the potential conflict between the unified regulatory policy of the ECB and the individual initiatives of national authorities regarding the implementation of additional macroprudential measures. According to Article 5 of Council Regulation No. 1024/2013¹, national regulators had the right to apply stricter macroprudential requirements than those established by the ECB, but the initiatives required approval from the European Central Bank. At the same time, Article 458 of Regulation of the European Parliament and of the Council No. 575/2013² allowed Member States to introduce additional restrictions on bank lending and liquidity, provided the necessity of such measures for financial stability was substantiated. In accordance with European legislation, Member States had the right to set stricter requirements for capital or liquidity for banks operating within the jurisdiction, if justified by economic circumstances. For example, the Netherlands introduced an additional capital buffer for systemically important banks pursuant to Article 458 of Regulation No. 575/2013, aimed at reducing risks of financial instability. France, in turn, set increased requirements for real estate lending, in particular restrictions on the loan-to-value (LTV) ratio, to reduce the risk of overheating the market. Estonia applied stricter macroprudential liquidity buffer requirements for banks with high reliance on foreign capital, since its financial system was more vulnerable to external shocks (Paravisini *et al.*, 2023).

However, such decisions could disrupt the balance in the European financial market, creating unequal conditions for banks operating in different Eurozone countries. For example, the introduction of higher countercyclical capital buffer requirements in one country compared to others could lead to a shift

of banking capital and lending activity to regions with less stringent regulation. This, in turn, could impact the overall resilience of the EU financial system.

The ECB applied unified risk analysis methodologies to all banks under its supervision, guided by Basel Committee standards and its own regulatory practices. At the same time, national regulators, who had a long-standing history of interaction with local financial institutions, often possessed a deeper understanding of the specifics of regional markets and potential threats. For instance, in countries with high levels of household debt or a large share of mortgage lending, local regulators might assess the financial stability of banks differently than the ECB, which potentially created discrepancies in supervisory conclusions. As a result, banks could face conflicting requirements regarding risk management, complicating the strategic operations.

The area of bank resolution also remained complex, particularly when it concerned significant financial institutions under the direct supervision of the ECB. In cases of financial instability of such a bank, decisions on its reorganisation or liquidation were taken by the SRM in coordination with the ECB and the SRB. However, the implementation of relevant measures directly depended on the involvement of national regulators, who might have the own views on priority actions aimed at protecting the interests of local depositors and the national economy.

Specifically, national financial supervisory authorities might oppose ECB decisions on bank resolution if the authorities believed such decisions posed a threat to the regional banking system. For example, in 2017 Italy, through its national regulator Banca d'Italia, opposed the ECB's decision to liquidate Banca Popolare di Vicenza and Veneto Banca, insist-

¹ Regulation of the Council of European Union No. 1024/2013 "On Conferring Specific Tasks on the European Central Bank Concerning Policies relating to the Prudential Supervision of Credit Institutions". (2013, October). Retrieved from <https://eur-lex.europa.eu/eli/reg/2013/1024/oj/eng>.

² Regulation of the European Parliament and of the Council No. 575/2013 "On Prudential Requirements for Credit Institutions and Investment Firms". (2013, June). Retrieved from <https://eur-lex.europa.eu/eli/reg/2013/575/oj/eng>.

ing on the necessity of state intervention to protect local depositors and creditors (European Commission, 2017). This was especially relevant in countries such as Italy, Spain, and Greece, where banks played a key role in financing small and medium-sized enterprises, providing a significant share of lending to this sector. Furthermore, in France and Portugal, banks often held a substantial share of government debt, making the stability critically important for the financial stability of these countries. In such cases, potential contradictions could arise between the ECB's supranational approach to resolving financial crises and national regulators' intentions to minimise negative impacts on a specific country's economy.

Thus, while the mechanism for the distribution of competencies between the ECB and national regulators was generally well-defined, in practical terms it remained a subject of discussion and potential conflict. Differences in approaches to macroprudential regulation, risk assessment, and bank resolution procedures required further coordination between European and national bodies to ensure the effective and stable functioning of the EU banking sector.

The policy of the Netherlands demonstrated an example of the application of local macroprudential instruments: De Nederlandsche Bank (DNB) initiated an increase in countercyclical capital buffer requirements and liquidity ratios for local banks in response to high household debt levels, particularly due to mortgage lending. However, these measures were not always consistent with the ECB's overall policy, which created tensions in the relationship between the national regulator and the supranational authority (Kuvshinov *et al.*, 2022).

Similarly, in Finland, the local financial regulator (Finanssivalvonta (FIN-FSA)) applied stricter capital requirements for banks engaged in high-risk mortgage lending, citing the threat of a "real estate bubble". The ECB, in turn, called for greater harmonisation of such measures at the EU level to avoid unequal conditions for financial institutions in different countries (Laeven & Valencia, 2020). The ECB applied unified risk analysis methodologies to all banks under its supervision, guided by Basel Committee standards and its own regulatory practices. At the same time, national regulators, who had a long-standing history of interaction with local financial institutions, often possessed a deeper understanding of the specifics of regional markets and potential threats.

In Germany, the Federal Financial Supervisory Authority (BaFin) traditionally adopted a conservative approach to risk assessment, particularly concerning medium and small banks (Sparkassen and Volksbanken), which played an important role in lending to the real economy. BaFin believed that the risks inherent to these institutions were not always accounted for in the ECB's standard models, which

could lead to incorrect conclusions about the financial resilience (Matos *et al.*, 2024).

A notable example was the case of the Italian bank Banca Popolare di Vicenza, which faced bankruptcy in 2017. The ECB deemed the bank "failing or likely to fail" and referred the case to the SRM (Bilotta, 2017). Meanwhile, the Italian government, with the support of the national regulator Banca d'Italia, decided to use €4.8 billion of public funds to support the bank to avoid negative consequences for the local economy. As a result, the bank was transferred to Intesa Sanpaolo, and a significant portion of its non-performing assets were placed in a special fund for gradual resolution. This decision was criticised by the ECB and the European Commission as it contradicted the principles of the single resolution mechanism, but was ultimately accepted as an exceptional measure due to socioeconomic risks.

Another similar example was the situation with the Spanish Banco Popular, which was declared insolvent in 2017 and transferred for resolution within the framework of the Single Resolution Mechanism. In this case, the Spanish regulator Banco de España was forced to act in accordance with the ECB's decisions, despite some differences in the views on the bank's rescue strategy (López Gómez & Matea, 2020). Given these challenges, further development of cooperation between the ECB and national regulators required a comprehensive approach aimed at improving the effectiveness of joint supervision, reducing regulatory discrepancies, and strengthening financial stability in the euro area.

One of the key areas for improvement was the optimisation of the joint supervision mechanism through strengthening the role of JSTs. JSTs consisted of representatives from the ECB and national competent authorities (NCAs) and were responsible for the direct supervision of significant banking institutions. It was important to ensure clearer regulation of decision-making procedures within JSTs, enhanced information exchange between the ECB and national regulators, and expanded JST powers in the field of macroprudential regulation.

An additional step towards optimising banking supervision was the improvement of regulatory approaches to small and medium-sized banks, taking into account the specific nature of the operations. The current ECB supervision system was primarily focused on large systemically significant institutions, while the regulation of small banks largely remained under the competence of national authorities. However, the tightening of Basel agreements and stricter reporting standards created excessive burdens for smaller institutions, potentially limiting the competitiveness. In this context, the ECB could introduce proportionate regulation, providing more flexible requirements for small banks, including simplified

reporting mechanisms and reduced administrative burden, while not compromising financial stability.

Another important area of reform was the creation of the Anti-Money Laundering Authority (AMLA), which was to centralise oversight of compliance with anti-money laundering and counter-terrorist financing regulations. Currently, the responsibility for supervision in this area was assigned to national authorities, leading to heterogeneous standards and fragmented regulatory approaches. The planned establishment of AMLA would allow harmonisation of anti-financial crime rules at the EU level, enhance the monitoring of suspicious transactions, and introduce unified requirements for banks and non-bank financial institutions.

In this context, it was advisable to initiate amendments to the EU regulations governing the ECB's activities within the Single Supervisory Mechanism (in particular, Council Regulation No. 1024/2013¹), in order to more clearly delineate areas of responsibility between the supranational and national levels. This implied the introduction of flexible regulatory frameworks for national regulators in supervising small and medium-sized banks, alongside strengthening the ECB's coordination function. To reduce the fragmentation of prudential supervision, it was also worth considering the creation of a single electronic platform for the exchange of supervisory information between the ECB and national competent authorities. The combination of these measures would contribute to maintaining the necessary balance between centralised control and the preservation of institutional autonomy of Member States within the framework of financial regulation.

Thus, the banking supervision system in the European Union remained complex and multi-levelled, driven by the necessity to combine supranational and national regulation. The ECB oversaw the largest financial institutions and coordinated European banking supervision policy, while national authorities ensured the implementation of regulatory requirements for less significant banks and performed macroprudential functions. The further evolution of the distribution of competences would largely depend on the European Union's ability to adapt the regulatory system to contemporary challenges of financial stability and changes in the global banking environment.

■ Discussion

The research findings confirmed the key role of the ECB in regulating banking activity in the eurozone, which partially aligned with the findings of other authors. The study by H.A. Ahmed &

M.W.R. Khan (2022) demonstrated that the dynamics of short- and long-term interest rate spreads significantly affected risks in the banking sector and the yield curve. The legal analysis of the ECB's activities in this study aligned with the conclusions on the importance of macroprudential regulation in managing risks in the financial system. At the same time, it was established that the ECB's regulatory policy was stricter than that of other regulators, which could have both positive and negative consequences for financial market stability.

The results of the study by M. Ampudia *et al.* (2021) emphasised the considerable role of macroprudential policy in preventing financial crises, highlighting the need for proactive regulation to reduce systemic risks. The researchers found that timely intervention by regulators in financial processes contributed to the resilience of the banking sector, preventing the build-up of imbalances in capital allocation. Similarly, in the present study, it was established that the ECB's legal regulation played a critically important role in ensuring financial stability in the eurozone. However, existing coordination mechanisms between the ECB and national regulators were found to be insufficiently developed. In particular, although the ECB focused on macroeconomic risks, insufficient consideration of specific regional characteristics could reduce the effectiveness of its policy. In this regard, the study confirmed the conclusions of M. Ampudia *et al.* (2021) regarding the need to strengthen coordination mechanisms, especially in the area of credit risk regulation and liquidity supervision.

B. Clark & A. Ebrahim (2022) examined the issue of regulatory arbitrage and its impact on banking risks, noting that differences in regulatory approaches between countries could create incentives to move capital to less regulated jurisdictions. The study showed that such processes could exacerbate risk asymmetry in the financial system and complicate the maintenance of stability. The results of this study partially aligned with the conclusions of B. Clark & A. Ebrahim (2022), as the identified legal aspects of the ECB's activities demonstrated the existence of potential risks associated with differing interpretations of regulatory norms among EU Member States. This confirmed the hypothesis that even within a single regulator, contradictions in the interpretation of requirements could exist. Such discrepancies could hinder the process of harmonising the regulatory environment and create additional challenges for financial stability, aligning with the conclusions of other researchers.

¹ Regulation of the Council of European Union No. 1024/2013 "On Conferring Specific Tasks on the European Central Bank Concerning Policies relating to the Prudential Supervision of Credit Institutions". (2013, October). Retrieved from <https://eur-lex.europa.eu/eli/reg/2013/1024/oj/eng>.

C. Cantú *et al.* (2020), in the work, found that specific characteristics of banks had a significant impact on the credit policy. This study confirmed that the ECB's supervisory powers were of key importance for maintaining a unified lending policy and reducing asymmetry in access to financing. However, it was established that the extent of the ECB's influence on banks' credit policy significantly depended on the structural features of financial institutions in different Member States.

C. D'Avino (2024) conducted a thorough analysis of the internal capital markets of global banks and the localisation strategies, highlighting the impact of the regulatory environment on the effectiveness of financial flow management. The author emphasised that banks operating in multiple jurisdictions adapted the capital strategies to local regulatory requirements, which could lead to uneven distribution of financial resources. In this context, author's noted the critical role of the ECB in coordinating financial flows between EU Member States, which was important for maintaining financial stability. In this context, the findings of this study were consistent with the conclusions of C. D'Avino (2024) regarding the need to unify the regulatory environment, which would reduce risks associated with imbalances in the distribution of financial resources.

The results of this study were consistent with the conclusions of F. Franch *et al.* (2020), who examined the transnational effects of prudential regulation. The authors established that the introduction of control measures in one country could impact the financial system of other states through mechanisms of cross-border banking intermediation. This confirmed the need for effective coordination between the ECB and national regulators to reduce potential risks of regulatory fragmentation. Similar conclusions were drawn in this study regarding difficulties in coordination between the ECB and national regulators, confirming the need to develop more effective mechanisms of intergovernmental interaction.

J.E. Galán & M. Lamas (2023) analysed credit standards and regulatory arbitrage, establishing that increased regulatory requirements could lead to changes in the structure of risks. This aligned with the conclusions regarding the need for closer coordination between the ECB and national regulators to minimise potential risks associated with legal uncertainty. P.J. Morgan *et al.* (2018) analysed the use of Loan-to-Value (LTV) policy as a macroprudential instrument. Within the present study, it was confirmed that the application of such mechanisms could reduce risks in the banking system, although the effectiveness largely depended on the degree of coordination between the ECB and national regulators. It was found that LTV policy required adaptation to national market specificities to achieve optimal outcomes.

J. Kelly *et al.* (2019) studied risk clusters in the European residential property market, focusing on changes since the 2008 financial crisis. The results confirmed that regulation of the financial sector, particularly the ECB's supervision of bank lending, played a key role in containing systemic risks. Within this study, it was established that the ECB's regulatory policy did indeed contribute to strengthening control over bank lending in the mortgage finance sector. At the same time, the analysis revealed that the effectiveness of these measures was uneven due to significant differences between national property markets, which aligned with the findings of authors.

E.J. Reite (2023) examined the issue of bias in mortgage lending, considering changes in house prices and LTV adjustment. Author's research demonstrated that macroprudential instruments, including LTV, were important for managing banking risks. In this context, the findings of this study confirmed that the ECB's policy aimed at regulating access to mortgage lending had a significant impact on financial stability. At the same time, it was established that the level of LTV constraint adaptation remained uneven across eurozone countries, creating potential risks for the financial market, in particular due to the possibility of regulatory arbitrage.

T.F.A. Matos *et al.* (2023) studied the role of market discipline and macroprudential policy in ensuring banking system stability. The authors proved that stricter supervisory measures contributed to reduced risk levels in the banking sector, although these measures could limit access to financing. Similarly, this study confirmed that the ECB's policy aimed to support stability, but its impact on access to financial resources depended on the specific features of individual financial institutions and the ability to comply with regulatory requirements. This highlighted the need for a flexible approach to regulatory policy, taking into account the structural characteristics of banks in different jurisdictions.

Thus, the findings of this study broadly aligned with previous works, confirming the importance of legal regulation for the stability of the EU banking system. At the same time, certain aspects requiring further research were identified, particularly regarding the harmonisation of regulatory approaches and elimination of legal fragmentation in banking supervision. Special attention should be given to the adaptation of ECB policies to national conditions in order to enhance the effectiveness of regulatory measures within the eurozone.

■ Conclusions

In the course of the study, a comprehensive analysis of the legal basis of the ECB's activities as a regulator of banking in the EU was carried out. It was determined that the regulatory framework for banking

supervision was based on a combination of European legislation and international standards, in particular the Basel principles. An analysis of legal norms demonstrated a significant degree of harmonisation of banking regulation at the EU level, although there was a certain fragmentation of the legal framework, which complicated the implementation of a unified supervisory policy in the euro area. It was established that the distribution of powers between the ECB and national regulators remained complex, which could lead to inconsistency in approaches to the regulation of the banking sector and create risks of legal uncertainty. Despite progress made in establishing a unified legal field, a certain degree of fragmentation in the regulatory framework for banking supervision was identified, which hampered the implementation of a standardised supervisory policy in the euro area. This was due to the fact that national regulators retained broad discretionary powers, and certain aspects of financial institution supervision remained within the competence, which could lead to differences in law enforcement practices. In particular, it was established that certain provisions of EU directives and regulations concerning banking supervision allowed for the implementation taking into account national specificities, which created risks of inconsistency in regulatory requirements across different Member States.

The study of interaction between the ECB and national financial market regulators showed that the introduction of the Single Supervisory Mechanism was an important step in the centralisation of supervision but did not eliminate all structural deficiencies in the EU's regulatory system. National regulators, while retaining significant powers, continued to play a key role in monitoring and controlling banking institutions, which in turn could cause divergences in the assessment of financial stability of individual banks. It was revealed that although the ECB supervised the largest systemically important banks, control over less significant banking institutions remained with national regulators, which could reduce the overall effectiveness of the regulatory mechanism in times of crisis.

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In view of current trends in financial regulation, the need was substantiated to improve coordination mechanisms between the ECB and national regulators, as well as to strengthen interaction between the ECB and the European Systemic Risk Board. This would improve the effectiveness of monitoring financial imbalances and timely response to potential threats to the EU banking system. Additional attention was required for the harmonisation of risk assessment procedures and the implementation of uniform banking supervision standards, which could increase transparency in regulatory processes and eliminate possible legal conflicts between European and national legal acts. Particular emphasis was placed on the importance of expanding the ECB's powers in supervising small and medium-sized banks, which would allow for a more comprehensive approach to banking regulation and strengthening of financial stability in the euro area.

The study's limitation lay in the fact that the analysis was based on the current regulatory framework, which might undergo changes in response to new challenges in the financial sector. Moreover, no empirical assessment of the effectiveness of the proposed regulatory mechanisms was conducted within the study, which requires further exploration in the context of applied economic and legal research. The results obtained may serve as a basis for further analysis of financial regulation mechanisms in the EU, as well as for the development of recommendations to improve banking supervision policy within the European legal framework.

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■ Conflict of Interest

None.

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Вплив Європейського центрального банку на формування пруденційних вимог до кредитних установ: аналіз ключових змін і викликів

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■ **Анотація.** Метою статті було дослідити еволюцію повноважень Європейського центрального банку та їх співвідношення з компетенціями національних регуляторів у Європейському Союзі. У дослідженні було використано комплекс методів правового аналізу. Застосування порівняльно-правового методу надало можливість визначити основні відмінності в регуляторних підходах Європейського центрального банку й національних органів банківського нагляду. Формально-юридичний метод було використано для аналізу змісту основних регламентів і директив Європейського Союзу. Системний підхід сприяв розгляду правового регулювання банківської діяльності в Європейському Союзі як комплексного явища, що поєднує макро- та мікропруденційний нагляд. За результатами дослідження було встановлено, що Європейський центральний банк виконує ключову роль у регулюванні банківської діяльності в межах європейського механізму нагляду. Водночас національні регулятори зберігають повноваження щодо нагляду за середніми й малими фінансовими установами, що створює потребу в чіткій координації між ними. Було виявлено, що посилення взаємодії між Європейським центральним банком і Європейською радою із системних ризиків може сприяти оперативнішому реагуванню на фінансові дисбаланси, що підтверджено аналізом наявних регуляторних механізмів. Було визначено основні напрями вдосконалення макропруденційного нагляду, зокрема через розширення функцій Європейської ради із системних ризиків і створення спільних платформ обміну інформацією між регуляторними органами. Отримані результати може бути використано для подальшого вдосконалення регуляторної політики Євросоюзу й розроблення ефективних механізмів фінансового нагляду, спрямованих на зниження системних ризиків у банківському секторі

■ **Ключові слова:** наглядовий механізм; національні органи управління; фінансова стабільність; координація регуляторів; банківські ризики