



Financial reform in Europe

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Following the publication of the Commission's Work Programme, which contained a hefty agenda on financial reform, industry stakeholders have been keen to discuss with policymakers the policies of the new executive.

As the global regulators and politicians take stock of the IMF recent paper on suggested topics, Europe has been left somewhat on the sidelines thanks to a combination of national initiatives as well as the global coordination at G20 level. This is reinforced by the debate on a possible transaction tax, thrown-out by the IMF, but which remains popular in the both Commission and Parliament. The new Commissioner for the Internal Market, Michel Barnier will be keen to reclaim a collective voice for Europe in the debate when he puts forward proposals on a resolution scheme in June, to feed into G20 discussions in Canada later in the month. Everyone is agreed that a new deal between financial services and society needs to be re-established, but to what extent can Europe play a role in this?

Barnier has stressed that financial services must serve the needs of the real economy and citizens. The Frenchman, who has been in the spotlight since his arrival in Brussels, looked to stress that he does not want to see protectionism or populism overtake common sense, saying that this would spell the end of the internal market. The Commission is determined to make 2010 a year of coordination and implementation, although it is still keen to drive forward further proposals to reform financial markets.

As Europe grapples with such a difficult agenda, there remain some key challenges on which the Commission will struggle on which to gain broad consensus. Firstly, how can a crisis resolution fund – one of Barnier's priorities – be structured in a way that avoids the moral hazard of giving banks the comfort of a bail-out fund? Moreover, if there were harmonisation of supervision across borders and sectors, would a homogenous FS industry not fall foul to a herd mentality? Striking the balance between preventing a future crisis and not squeezing innovation out of financial markets remains an uphill struggle. This trade-off could threaten all industries, not just banking. Indeed, the insurance sector is rightly showing concern that the different business model it uses in comparison to the banks will be not represented in a new regulatory regime – the recent IMF paper which would propose a levy on all financial institutions will certainly have done nothing to quell this fear.

Developments at a glance

- **Supervisory Package:** The Commission continues to push for agreement on the dossier so that a regime can be in place by the end of the year. The Parliament is considering amendments to the Rapporteur's reports. ECON vote: 4 May; Plenary vote: 15 June
- **Alternative Investment Fund Managers:** The issue of passports for third country managers and funds remain contentious with Jean Paul Gauzès' new compromise currently being discussed. ECON vote is now expected to take place in mid-May with a plenary vote expected before summer recess.
- **Capital Requirements:** The Commission's consultation on CRD 4 closed in April, with opinion being sought on liquidity standards, defining capital, leverage ratios, counterparty risk, counter-cyclical measures, systemically important banks, and a single rule book. It is due to hold a public hearing on 3 June with a formal proposal expected by the end of the year.
- **Derivatives:** The Parliament is voicing its support for the mandatory clearing of standardised contracts through central clearing counterparties (CCPs) through an own initiative report from Werner Langen MEP. The Commission, which is expected to bring forward a proposal on derivatives in the summer, will be under pressure to clarify where CCPs should be located and how best to regulate credit default swaps.

Further difficult questions remain unanswered: will the proposed European Supervisory Risk Board – which will be tasked with spotting potential crises across the financial markets – be given adequate data from industry to make it effective? Will a single rule book have detrimental effects on smaller firms? Faced with the unenviable task of finding answers to these questions, the Commission is not in the mood for taking its foot off the gas, and is keen that all the perpetrators of the meltdown pay their fair share in preventing a repeat. David Wright, Deputy DG for the Internal Market, has said, for example, that it will be incumbent on industry to cooperate with the proposed ESRB, as it has to admit fault for the part it played in the crisis. There is also a consensus building that shareholders also need to accept a degree of responsibility. Wright has mentioned that big shareholders “should examine their consciences” when referring to the role that they have to play in holding banks to account. An upcoming Green Paper on Corporate Governance, expected in July, will be hotly anticipated by institutional investors.

The Commission also continues to place emphasis on a speedy adoption of its supervisory reform package. Wright has noted that the executive is anxious to get agreement on its proposed supervisory structure within the next two months, stressing that the Commission’s role in crisis management would be the bed rock of all other regulatory reforms. Citing Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, he has said that Europe must be able to ensure that it can wind up one or more institutions effectively, the foundation to a successfully de-centralised supervisory regime in Europe, on which other aspects can be built – a single rule book, safe infrastructure and the ability to resolve disputes.

With the push from the Commission to cement its place in the world as a leading regulator, there is an obvious risk that new proposals will be rushed and unbalanced – epitomised by the AIFM Directive which Barnier accepted was “far from perfect” in its original form. The Commissioner has talked about the European Union changing its role in financial services from one of fire-fighter to architect. The danger for European policymakers and industry alike is that both are unprepared for the next (and potentially bigger) crisis, of sovereign debt which is looming large. Navigating the direction of these policies, and striking the right chord between the quality and speed of reform have never been more important; against this backdrop, it is business-critical for industry to make its voice heard in Europe.

- Corporate Governance: There has been much emphasis recently on shareholders and institutional investors taking their share of responsibility for the behaviour of financial institutions. A Green Paper on Corporate Governance is expected in June.

- Insurance: Technical specifications for the fifth Quantitative Impact Study (QIS5) which stress tests proposed solvency requirements have been released. They have gone some way to easing industry fears of overly conservative capital requirements, as was the case under QIS4. QIS 5 is likely to be run from November 2010 ahead of the 2012 deadline for entry into force for the rules.

- Deposit Guarantee Schemes: A revision of the current legislation is predicted before the summer

- Accounting: The IASB and FASB’s next progress report on improving convergence in international accounting and reporting standards is due in July.

- Pensions: The Commission will publish a Green Paper on Pensions policy in mid 2010, which will consider the need for legislation to take account of the ageing society, a possible review of IORPs and better understanding investor risk.

- Crisis resolution schemes: Barnier is set to propose a common European approach towards a resolution scheme in June, ahead of the G20 meeting in Canada. He will also develop ideas for a ‘polluter pays’ crisis co-operation framework in a policy paper, expected in October.

