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THE EUROFI FINANCIAL FORUM 2010

CONFERENCE REPORT - BRUSSELS, SEPTEMBER 27TH TO 30TH 2010

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THE EUROFI FINANCIAL FORUM 2010

Flagey Centre & Conrad Hotel

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Report

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About the Eurofi Financial Forum 2010

The Eurofi Financial Forum 2010 was dedicated to discussing the improvements required in regulation and supervision in the global context in the light of the upcoming G20 meeting and the European Commission's ongoing regulatory reforms. The event was organised by Eurofi in association with the Belgian Presidency of the EU.

More than 220 leaders from the financial industry and from EU and national public authorities, as well as several international regulators (from global organizations such as the Basel Committee, the IMF, IOSCO… and from the US and Brazil) took part in the interactive and informal debates of this Forum, that were attended by around 800 participants.

About Eurofi

Eurofi, the think tank dedicated to financial services in Europe, was created in 2000 and is a major platform for exchanges between the financial services industry and the public authorities on regulatory and supervisory issues. Chaired by **Jacques de Larosière** and **Daniel Lebègue**, this not for profit organization counts amongst its members many leading financial institutions active across Europe of different sizes (cross border and domestic), different sectors of the industry (universal and specialised banks, insurance companies, market infrastructures) and different statutes (commercial, cooperative, mutual).

Eurofi acts as a catalyst for the market and as a neutral go-between connecting diverse financial industry players and the public authorities. Eurofi addresses prospective and currently debated issues related to EU financial regulation and supervision in a global context, as well as industry trends and perspectives.

Our objective is to help industry and public decision-makers reach a common understanding of issues related to financial regulation and supervision and to open the way to regulatory or industry-driven solutions to ensure the safety and efficiency of EU financial markets, players and services.

Eurofi has two main types of activities conducted by **Didier Cahen**, Secretary General of Eurofi, **Jean-Marie Andrès** and **Marc Truchet**, Senior Fellows.

Research and mediation:
Assessments and proposals are prepared with the support of cross-sectoral working groups, comprising members and partners of Eurofi.
Our approach is to clarify the terms and issues of on-going or prospective debates and to work out operational and when possible consensual solutions with all the industry stakeholders concerned, taking into account their needs, constraints and economics. Regular interactions are organized with representatives of the public authorities, to discuss, test and fine-tune issues analyzed and proposals and when necessary with other stakeholders (e.g. consumer, issuer, investor representatives).

Events and communication:
Every year Eurofi organizes a major public international Financial Forum which is an opportunity for industry leaders, members and partners of Eurofi, and EU and non-EU legislators and political decision makers to interact informally and participate in high level discussions around on-going regulatory and industry-driven issues.
The Eurofi Financial Forum has become a landmark event in Europe for financial services attracting the key decision makers of the financial services area. The latest forums have been organized in association with the EU Presidency and attended by over 800 participants. These international events are organised with the support of **Christian Hawkins** of **Emcnet**.
Seminars and workshops are also organized regularly to facilitate exchanges of views between Eurofi members and partners and decision makers from the public authorities.

Executive summary

Eurofi's 2010 Financial Forum, in the year of its 10th anniversary, started with senior public policy figures reminding the gathered public and industry representatives of the financial sector of the costs of the financial crisis. Citizens remain angry about the austerity being forced upon them, as they see it, by the excesses of the finance sector.

The Forum covered two main topics:

- Improvements proposed to the prudential requirements, supervision and crisis management mechanisms of financial institutions to avoid future crises in the perspective of the upcoming G20 meeting
- Priorities of the EU legislative agenda in the global context

1. Improvements proposed to the prudential requirements, supervision and crisis management mechanisms of financial institutions to avoid future crises in the perspective of the upcoming G20 meeting:

Senior supervisory figures suggested that, it is time for the financial sector to show that it is part of the solution, not part of the problem. That includes paying for the cost of the crisis but also putting in place the mechanisms needed to avoid future ones. Profound reform of the financial system, including the new Basel III agreement, should indeed substantially improve the ability of banks to respond to crisis.

Speakers highlighted the huge range of challenges that the financial sector faces in the wake of the financial crisis. However, they were grouped under five main themes that remain relevant to the on-going reforms of financial regulation and supervision at EU and global level:

- The reform of prudential requirements following the recent Basel agreement and how they will be implemented
- The improvements that can be expected from the creation of the new EU regulatory and supervisory authorities and the conditions necessary for their success
- The importance for financial stability and growth of removing the disincentives to long term investment
- Developing a EU cross-border crisis management framework
- Prospects of future G20 discussions and expected impacts for the EU

The reform of prudential requirements following the Basel agreement and how they will be implemented

The public authority representatives strongly – and unanimously – defended the decisions that were made in Basel, explaining that there was a clear need to strongly increase prudential requirements to prevent a repeat of the excesses that led to the financial crisis. The overriding concern driving the Basel reforms is the determination that in the next crisis, taxpayers will not be left to pick up the bill – instead, industry stakeholders must be fully aware that they will have to bear the costs. "Moral hazard is embedded in the system so the important thing is to tell them they will not be protected but will be unwound".

The long phase-in period for the Basel requirements would enable banks to finance the increase required in capital mostly by retained earnings and cost reductions, which negated many of the industry's arguments that the changes would hurt consumers and economies around the world.

Regulators, supervisors and policy-makers also stressed the importance of a level playing field at the global level to avoid regulatory arbitrage and possible move of regulated activities towards non-regulated areas, which was one of the factors at the heart of the crisis.

Therefore, as well as focusing on the regulated sector, there will need to be increased scrutiny of the shadow banking system to ensure that it is not allowed to have systemic impacts again.

The need to define specific requirements for banks labeled as 'SIFIs' (Systemically Important Financial Institutions) was also discussed because of the potential moral hazard they represent in relation to the belief that they are 'too big to fail', which was demonstrated during the crisis.

Regulators also highlighted the potential benefit in helping to assess and reduce counterparty risk and possible contagion effects due to defaults that central clearing of eligible OTC derivative contracts and trade repositories could bring.

Industry representatives welcomed the extended implementation period for the Basel requirements while pointing out their potential negative effects. The industry expressed concern about the very significant tightening of the prudential requirements for banks resulting from the Basel recommendations. Combining the increase of Core Tier 1 from 2 to 7% with the restrictions imposed on the definition of Tier 1 equates to multiplying by 5 former capital requirements and by 15 requirements for trading activities, to which must be added extra requirements in terms of liquid assets held by banks. However, regulators noted that the costs are temporary while the benefits will be long-term.

The industry welcomed the staggering of the new requirements over a number of years in terms of reducing short-term macroeconomic impacts but most banks pointed out the potential negative effects of these measures Although most banks can probably reach the level of capital defined by Basel by the end of the timetable, by combining increases in retained earnings and productivity gains, the amount of capital to be raised will inevitably have economic impacts and the phased approach will not sufficiently reduce impacts on financing capabilities. Indeed, some observers consider that each additional point in the core tier one ratio could lead to an increase in the global industry's capital of €500 billion. Banks may not be able to increase their productivity sufficiently to absorb the required increases in capital charges, which would lead them to raise prices or reduce lending as a consequence.

The increase in prudential requirements will probably trigger changes in banks' activities, in business models and in the amount of focus on different types of customer segments that are difficult to anticipate at present but that will have an impact on the volume and cost of credit. Some warned that this could lead banks to focus on the most profitable customer segments, which would penalise small and medium-sized businesses and less wealthy retail customers.

The Basel reforms are expected to have a higher impact in the EU than in the US since banks finance 80% of Europe's economy. Moreover, European banks store the credits in their balance sheets as they lack the substantial support of Government Sponsored Entities (GSEs: Fannie Mae and Freddie Mac). Large European banks also have an essential role in the financing of SMEs, while US banks do not.

The notion that large banks should require more capital because they represent an additional threat to the financial system was robustly challenged. Large banks are not dangerous per se – it all depends on their business model, said bankers. Large banks that have well diversified activities and whose funding is largely deposit-based are probably less risky than smaller investment banks which have portfolios of risky investments and positions and rely on wholesale markets for their funding. A selective approach by national supervisors is of the essence.

A strong case was also made by some industry players to reflect the fact that many large institutions had a diversified exposure through their geographic presence and product lines, and so were resilient in the face of the crisis. The effectiveness of Pillar 2 in recognizing individual firm risk was also put forward.

In the same way the concept of a non-risk weighted leverage ratio was rejected by some players on the grounds that the portfolio of activities and the business model should be taken into account when defining such ratios.

In addition some insurance industry figures pointed out that the crisis did not affect all sectors in the same way and suggested that prudential measures should be adapted to each financial sector. The calibration of Solvency II should take into account that there is no need for a general increase of solvency requirements for all types of insurance activities, even if lessons from the crisis should be fully drawn (in particular regarding market risk).

The importance of strengthening supervision in parallel with prudential changes was also put forward. Prudential requirements on their own do not guarantee a genuinely sound system, pointed out a number of industry representatives. The quantitative measures must go hand in hand with risk management and transparency requirements, as well as improved supervision, so that new risks

resulting from financial innovation or the possible transformation of each financial institution's business portfolios, for example, can be identified as early as possible. Micro-prudential supervision also makes it possible to better adjust prudential requirements to the actual risk profile of large financial institutions in particular, which would reduce the possibility of a credit crunch as well as pro-cyclical consequences.

Supervision can more efficiently detect systemic weaknesses in financial institutions than the multiplicity of regulations or rules which often turn out to be imperfect since they can be circumvented and need to be constantly reviewed to follow evolutions and innovations in the market. A number of bankers suggested that intrusive, on-site supervision – by national supervisors rather than European authorities – could reduce the need for additional capital requirements.

Nonetheless, there was a strong commitment from both the public authorities and the industry to find ways to make the financial system more resilient while minimizing the impacts for customers and the economy.

The following conclusions were drawn.

Since the effects of the measures decided in Basel on the financing capacities of financial institutions and on the structure of the industry are difficult to evaluate at this stage and given the timeframe decided for their implementation, it is important to set up global and regional observatories in order to ensure appropriate monitoring of these reforms. These observatories could measure the consequences of the prudential reforms on the activities and business models of banks, analyze the positive and negative impacts of the reform and propose possible adjustments over time in the calibration and architecture of Basel 3, based on their observations.

Stronger supervision should play a larger part in the G20 agenda. To be effective supervision should rely on common principles and be hands-on and operational. This requires appropriate resources, skilled staff, authority, organization and processes. In addition supervisors should have a clear and unambiguous mandate, operational independence coupled with accountability and a relationship with industry that avoids “regulatory capture”.

The transposition of Basel 3 must be synchronised in the various regions around the world and factor in the impacts on lending highlighted by the observatories presented above.

Given that the insurance industry weathered the crisis, capital requirements for the insurance industry currently proposed in the QIS 5 should be reviewed so as to let the insurance sector play its traditional role in stabilizing financial markets and acting as a long-term investor.

Lastly, a review could be carried out to facilitate the development of sound securitisation and alternative financing mechanisms in Europe, to help the most vulnerable customers by facilitating access to the capital markets for European SMEs, by deploying guarantee and deposit mechanisms, etc..

The improvements that can be expected from the creation of the new EU regulatory and supervisory authorities and the conditions necessary for their success

The decision to set up the new EU supervisory authorities is the starting point for a fundamental change in European financial regulation and supervision towards more harmonization.

The new authorities will contribute to further convergence of regulation between Member States by developing common technical standards which are essential to bring about more integrated financial markets. They will also monitor how rules are being enforced by national supervisory authorities and be able to address breaches of Community law, which should lead to reinforced co-operation between EU supervisors.

To ensure the success of these authorities, they need strong leadership and appropriately skilled staff. They must be ready to use their new powers when required. In this respect the selection of the chairpersons in the coming months will be of the utmost importance. In addition, there must be an efficient dialogue to ensure a sharing of information not just between supervisors but also between the Authorities, the Member States, the ECB, the ESRB and the Commission.

The importance for financial stability and growth of removing the disincentives to long term investment

In the context of efforts to reduce public debt, private investments are increasingly required to finance long-term projects (e.g. infrastructures, new technologies, the needs of ageing populations…). The investments that can offer high long-term risk-adjusted rates of return should be stable but should also be sufficiently attractive to institutional and retail investors. In addition appropriate investment vehicles must be available.

At present, many investors are encouraged by the fiscal, regulatory and accounting frameworks (ie the emphasis on quarterly reporting, fair-value accounting, rules for capital and liquidity…) to adopt a short-term focus which is detrimental to long-term projects and to financial stability due to its pro-cyclical aspects.

For example representatives of the pension funds industry explained that prudential rules could in some cases lead them to reduce investments in equities, which would increase investments in bonds and short-term instruments providing less yield and which would provide lower returns to savers in the long term and lower pensions in the future.

Speakers at the forum proposed a range of options to reduce these disincentives to long-term investment, which included:

- Similar tax treatment for debt and equity financing
- An optional prudential and accounting framework for financial institutions that has specific valuation, prudential and reporting rules for long-term commitments
- An EU framework for financing PPPs (Public Private Partnerships)
- An EU framework for a long-term investment vehicle for households with specific redemption rules and appropriate investor protection for retail clients
- Rules to enable issuers to appropriately reward stable investors.

The development of these options requires political momentum. In order to prepare the basis for this, many speakers supported Eurofi's idea for a European plan to encourage long-term investment. Such a plan would comprise academic and economic evidence on the role played by long-term investment, identify and prioritise the present impediments to long-term investment, analyze best practices existing in Europe and around the world and make the appropriate recommendations.

Developing an EU cross-border crisis management framework

On the final day of the Forum, the message from the supervisory community was clear – all necessary measures will be taken to prevent taxpayers from paying for another bail-out. Crisis resolution was considered to be a major part of the improvements required alongside optimisations in the regulatory requirements, the supervisory architecture and deposit guarantee schemes.

Each member state – and every country in the world – should have a national resolution regime for conventional commercial banks according to the participants in the discussion. Yet few countries have such a regime, which was considered as a real gap in the architecture of the financial infrastructure.

Different components of a cross-border crisis management framework were pointed out.

Resolution regimes must be developed to be able to resolve the largest and most complex SIFIs, (Systemically Important Financial Institutions), seen as too big to fail and creating moral hazard, regulators said. In future, no company should be seen as too big to fail, the industry was warned, which involves developing cross-border resolution frameworks.
The basic resolution toolkit needs to be extended beyond the banks to holding companies, affiliate companies and non-bank financial institutions with systemic importance, which is what Dodd-Frank does in the US and should be considered it in Europe according to some speakers.

Other proposals for dealing with the cross-border aspects of systemic institutions were also discussed. Colleges of supervisors were considered to be crucial because they will be in a position to facilitate crisis frameworks quickly and can help to define the triggers for intervention. The present limits of colleges with regard to dealing with burden sharing and home / host conflicts of interest where however pointed out. Removing impediments to cooperation between supervisors is also essential as

well as limiting national discretions and avoiding ring-fencing. A new cross-border resolution framework should nevertheless not weaken existing national resolution schemes, according to one of the supervisors on the panel in order to preserve the interests of minority shareholders of subsidiaries and of host countries and cope with the characteristics of national markets.

Some industry figures suggested that effective resolution schemes could be a way to reduce fear among regulators that capital may be insufficient. Some also suggested considering mutual guarantee schemes as an alternative in some cases.

Regulators have to be able to write down the claims of unsecured creditors and convert their holdings into equity (bail-in), some regulators suggested. Contingent capital will be another important tool, but the triggers for conversion must be clearly defined and understood, regulators asserted. Such tools have already been used in countries such as Sweden and they allow supervisors to make it clear to shareholders that they may lose the bank if excessive risk is taken.

Several regulators and industry players insisted on the importance of living wills since regardless of the amount of effort that goes into the resolution framework, there will still be a need for lots of planning on a case by case basis, which is where living wills come in.
The living will defines crisis situations, the drivers for those situations and the actions that can be taken in those circumstances. They help to improve the understanding of where vulnerabilities lie for both the institution and the regulator and facilitate the access to this information. In addition, they give supervisors detailed information about the relationships between the company's entities, the market and other institutions. Viable living wills however rely on statutory national resolution regimes, regulators added.

Prospects of future G20 discussions and expected impacts for the EU

This closing session of the Eurofi Forum gathered several public decision makers from the EU and other major G20 countries (China, Brazil, India, US). The above-mentioned regulatory processes cannot be purely inward looking according to several speakers in the panel. While there was an impressive display of unity from the EU and the US during the Forum, a number of participants highlighted the need to include views from other regions of the world, particularly emerging markets, which have often come through the crisis in better shape than the developed economies. The role of the G20 in containing the crisis and promoting economic recovery was recognized. Some speakers also pointed out that countries outside the G20 should not be forgotten and that the respective role of different multilateral organizations should also be more clearly and consistently established.

At the global scale, economic imbalances represent a crucial threat to an effective increase of financial stability – while there is widespread acknowledgement of their existence, answers to the problem of how to reconcile mutually incompatible goals are less evident.

Regulators, supervisors and policymakers speaking in this closing session of the Forum reiterated their belief that capital requirements would make the financial system more resilient, reliable and safe but asserted that the reforms must not be an excuse for protectionism that may reverse the benefits that competition has brought (in particular to the EU). The first priority is to ensure that the commitments already made with the Basel III framework are implemented. Other priorities including SIFIs, cross-border and national resolution frameworks, OTC derivatives and market integrity were also put forward. Improving the supervision of rating agencies was also proposed, as well as reviewing the role they play in regulatory processes and decisions.

Competition, openness, transparency and consistent implementation were proposed as guiding principles. A level playing field should be ensured across countries and also across financial sectors to guarantee consistent regulation of all financial products including the shadow banking system.

While it was acknowledged that much needs to be done, the determination to continue reform remains high, it was stated. Moral hazard remains embedded in the system, and it must be removed, the Forum heard.

2. Priorities of the EU legislative agenda in the global context

The progress made with the main on-going reforms on the European legislative agenda was also discussed during the Eurofi Financial Forum as well as topics which may require legislative action at EU level in the future.

A clear agenda that will cover the main on-going directives and initiatives of the Commission was needed. The review clauses of FSAP 1 (the Financial Services Action Plan) as well as the ongoing programme of reforms as part of the G20 programme make up a de facto FSAP 2 which should be put in place in the coming years, according to several speakers in the Forum.

Now that the decision has been made to set up a new architecture of financial supervision in the EU, the main priorities of the Belgian Presidency of the EU are to complete the reform of the supervisory system, hammer out a compromise on alternative investment funds and define options for a European banking fee. The need to revive the EU/US dialogue and to redefine the role of Europe in international fora was also pointed out.

EU securities infrastructures and OTC derivatives:

Cash instruments:

- The MiFID Directive came under scrutiny and while it was seen to have improved competition and reduced costs for cash equity trades, work remains to be done on improving transparency through the consolidation and availability of post-trade data in particular. Yet it was also suggested that MiFID had increased fragmentation and that the total costs of executing trades [including post-trading] had not really diminished. This is thought to have an impact on investors but also on issuers.
- Technical changes in the trading area have produced mixed results for customers, some speakers believe, with many institutions moving to dark pools and the OTC markets, possibly in reaction to the advent of high-frequency trading but also with the objective to achieve best execution. There was a suggestion that deregulation and technology may have gone too far, and that limited monopolies are not a bad thing when it comes to liquidity or mitigation of investment risk. OTC markets were however defended by some speakers for providing good liquidity and being another tool in the toolbox for investors to use to achieve their investment objectives.
- Interoperability of central counterparties (CCPs) is considered to be an effective tool to increase efficiency but several participants pointed out that it was difficult to achieve in practice because of the competitive nature of the clearing market. Making interoperability mandatory was suggested. The importance of transparent pricing and of well-established risk management principles was also pointed out.
- Cost differences in settlement between the EU and US could be explained mainly by difference in scale suggested some industry leaders. Cross-border business is hindered by the regulatory and legal barriers which are in the process of being removed. T2S also needs a strong push towards harmonization to be a success. The project of legislation on CSDs which could help to clarify their role and obligations in particular was also welcomed by some players, although the possible unintended consequences of such a legislation e.g. forcing businesses into areas of lower regulation and transparency were also pointed out.

Derivatives:

- A transatlantic consensus and similar approach on the need to impose the clearing of eligible OTC derivatives and the registration of all derivatives trades in trade repositories was highlighted but it was recognized that the increased volume of activity this would entail for clearing houses has the potential to make these institutions systemically important, which means they must be bolstered to ensure they are “able to withstand financial Armageddon”. Central clearing also requires transparent and liquid markets and an efficient pricing mechanism.
- Transparency is also vital in derivatives which were an important contributor to the financial crisis, and this could come from bringing some OTC trades onto regulated exchanges or electronic trading venues, the Forum heard, as adopted in the US. This could also reduce risks for clearing houses some believe. This question should be addressed in the EU in the upcoming MiFID review. However, exchange and electronic trading is not necessarily a prerequisite for transparency according to some speakers who argued that the recent proposals made by CESR on transparency for example referred to all types of trades.

- As much consistency as possible on measures applying to derivatives is needed on the global level since capital and risk know no geographical barriers. One of the most important requirements for global regulation to work is that there should be global access to information. EU and US regulators insisted that the necessary data should be made available to mitigate risks.

AIFM Directive implementation and depositary rules:

- One of the main pieces of outstanding EU legislation is the AIFM Directive (AIFMD), where the third country rule continued to divide opinion among member states. Although the EU authorities continue to press for a regime based on “same rules, same rights”, a stance supported by many in the industry, oppositions still had to be solved with some industry players and countries considering that granting EU passports to third country funds would lead to selling these funds to retail investors over time, which could risk damaging the UCITS brand over time. The fact that the AIFMD covers many types of funds, some of which are quasi UCITS, was also pointed out in this context.
- Regarding depositaries the requirements for Alternative Investment Funds are meant to be applied to UCITS funds, once the AIFMD has been adopted policy makers said. Depositories must not be left to bear all the risks in the system, particularly those over which they have no control industry figures stressed, otherwise prices will have to be readjusted. This is the case for example of negligence or fraud of unaffiliated sub-custodians, where the depositary could not have been expected to discover such fraud or negligence through reasonable due diligence. Depositories cannot be isolated from the other players in the value chain and some industry players believed that in some limited circumstances investors [institutional ones at least] may be the appropriate people to bear losses and seek recovery of them if no alternative seemed possible.

Financing of corporates and SMEs:

- The importance of companies and particularly SMEs for economic growth was stressed, but meeting their financing needs was considered to be a challenge both at Member State and at EU levels. Since SMEs are by definition local it is also difficult to adopt a Europe-wide approach to the sector, speakers said, although a coordinated approach to SME financing across Europe seems necessary.
- Companies remain worried about the limited willingness of banks to lend, particularly to small companies, although they were cheered by better than expected growth in Europe and the positive outcome of bank stress tests, meaning that instability risks were limited. The difficulty to borrow money pushes businesses towards raising money on capital markets but SMEs are put off pursuing this avenue by the cost and the information requirements. A banking representative however pointed out that the number of loans rejected was the same after the crisis as before and that the issue was not so much the shortage of funds as less dynamism in the industry.
- Companies that are looking to raise money on the public markets want stability, not volatility and “large open windows”. They are also generally suspicious of over-regulation.
- Speakers stressed the need for companies to consider several ways of raising financing. Alternatives to be explored are private equity and the creation by governments of funds to help SMEs.

Improving securitization processes:

- Well functioning securitization was considered to be an important way of channeling money from savers to borrowers.
- The tentative return of the securitization market was noted, but for it to happen the confidence of investors needs to be regained by the industry and stricter conditions need to be applied according to regulators. This requires simpler, more transparent and easily comparable products than were available in the run-up to the crisis and greater disclosure by originators. More standardization and much greater scrutiny are needed. The new rule that originators must retain 5% of any securitization products could also limit the creation of potentially toxic products that banks would not wish to have on their books, policy-makers believed.
- Ratings will also have to be used with much more caution than previously and as opinions about the likely course of future events. Disclosures on the criteria and assumptions used to produce ratings will also be improved by rating agencies to help investors in their due diligence processes.

Retail investor protection:

- Consumers have not always been well served by financial markets, public authority figures said, yet the onus is increasingly on the consumer to organise their own affairs as the industry becomes ever-more complex. The role played by customer protection in systemic risk mitigation was also highlighted.
- Consumers want and deserve transparency, simplicity, value and choice, it was suggested, and consumer representatives added they should not have to be experts. They want providers to keep their promises and treat them fairly. A supervisor however considered that the necessary actions should be put in place for investors to understand investment products and their risks.
- The importance of achieving consumer confidence and safety was put forward which required consumer 'engagement' on the part of the industry, some industry players suggested. This involved appropriate advice, disclosure early in the sales process, information to compare products and a better understanding of risks and of fees.
- EU Commission spokesmen explained their projects in this field. The PRIPs (Packaged Retail Investment Products) initiative, which was still a priority for the Commission, was proposing to improve pre-contractual product disclosure and rules concerning advice and selling practices through a horizontal approach applying to all products defined in the scope [ie investment funds, unit-linked life insurance, retail investment product]. The objective is that investors understand all products. While the objectives of the initiative are straightforward, the legislative phase is not easy. A horizontal approach could probably be envisaged for pre-contractual disclosure but the right mix needed to be found for selling rules based on the different features of MiFID and the IMD, policy-makers said.
- Industry representatives insisted that this approach should take into account product specificities and that the whole value chain should to be examined in order to define the range of actions needed, including financial education for example.

Solvency II and pension funds:

- Solvency II, the biggest reform of the insurance sector in 30 years, continues to worry the industry, which insists that the implementation of the directive with its proposed calibration would have serious consequences on long term investment, on their capability to answer customers' needs and on the legibility of the actual solvency of insurers. However, supervisors said Solvency II was structurally sound. The Commission admitted that there must be further review to see how the industry will be impacted by Solvency II and asked for ideas to answer issues that had been on the table for some time.
- Demographic changes mean that a pensions crisis looms for Europe, it was suggested, but there was no unanimity on the idea that the answer is a cross-border market for pensions as the ordinary citizen has no interest in cross-border pensions and pension schemes are part of domestic social and labor laws in national contexts combining diverse multi pillar approaches. However as greater transparency and a common approach to pension promises is required across Europe, Solvency II principles could be a good starting point as far as the new prudential framework is up to the challenge to channel liquidity back into long-term assets that enable to pay for pensions .

SEPA

SEPA Governance

- The EPC has led the way toward SEPA so far, but with the creation of the SEPA Council -- and regulation on the way from the European Commission -- policy makers are moving from incumbents toward various additional actors.
- The Council's goals are to realize the vision of SEPA, promote its use and foster product innovation to meet the needs of end-users.
- However for the banks that have invested in new systems, the issue regarding SEPA is how to get users to migrate to what the industry has created. In that respect the SEPA Council's key contribution may be communication and giving end users a chance to have a say in the project and to feel invested in it.

SEPA end dates

- At present the migration rate toward SEPA instruments (SEPA Credit Transfer) stands at 9%. This level does not match the appropriate critical mass.
- The reasons are low awareness by end-users and insufficient clarity on phasing-out of national schemes. This situation means that first movers suffer significant financial burdens that lead some banks or end users to delay their investments. This illustrates the fact that the switch from the current payment system to SEPA cannot be market driven.

- Currently divergent opinions between DG MARKT and DG COMP are delaying the publication of the proposal for setting an end-date for moving from legacy payment systems to SEPA instruments, industry speakers said. The main divergence between the two Directorate Generals of the European Commission relates to the opportunity to regulate the use of an interchange fee for direct debit or not. DG COMP takes the view that the proposal for a Regulation on an end-date brings the opportunity to introduce an article on interchange fees for SEPA Direct Debits.
- According to the European Commission, the way to implement end-dates is to develop a set of standards and essential requirements that should be respected by all payment schemes.
- The publication of the draft regulation is now expected for later this year.

Eurofi 10th anniversary Debate

New challenges to EU integration raised by globalisation and the financial crisis

Writer and Journalist **Peter Norman** outlined the session's objectives and described them as forward-looking. As moderator, he added that, together, the topics would outline a route for financial services in Europe.

1. Objectives and drivers for achieving the single EU financial services market

Didier Reynders, Deputy Prime Minister and Belgium's Finance Minister, acknowledged the need for European governments to work towards balanced budgets in the member states, while emphasising the need to support "growth and jobs" across the EU.

The de Larosière recommendations have made it easier for all parties to have the same goals, he said. The European Commission's recommendations were in line with those of the de Larosière task force and it is now vital to have a clear commitment from all parties so that deadlines can be met.

Reynders welcomed the fact that there was close to unified agreement about the new structure of regulation that will see the creation of three new supervisory bodies. From 2011, this new structure will improve regulation at a European level, at the cross-border level and will be a barrier to the advent of further financial crises. Describing this reform as a "new and fundamental change in the architecture", Reynders welcomed the decision to have the President of the European Central Bank (ECB) in charge for the first five years of the ESRB (European Systemic Risk Board) and he wanted to see progress in the further control of hedge funds and "short-selling" operations in particular. Reynders, called for better performance on supervision at the European level compared to that achieved nationally. Emphasising the need to finish the job, Reynders insisted on a clear agenda that will cover the main on-going directives and initiatives of the Commission.

Former EU Commissioner for Competition **Frits Bolkestein** looked at the big picture and stressed that the heart of the EU is the internal market. Now, with monetary union in place, governments must tighten the rules and, the Basel III proposals go in this direction. Comparing the US and the EU, Bolkestein saw the former as Keynesian whereas European governments tend to favour more government expenditure. He favoured the European view. Looking back to the inability of EU governments to stick to the agreements of the Stability and Growth Pact, Bolkestein said that raised serious doubts about the effectiveness and credibility of future EU legislation. Bolkestein saw a bleak financial future for Greece and acknowledged that some observers feel that Greece should leave the EMU. He did not see that happening but he had harsh words for the mistakes made by ministers and the European Commission in allowing Greece into the euro area on false premises.

Ending with a warning, Bolkestein reminded the audience that President of the European Council Herman Van Rompuy has called for greater growth ("double" the current rate), adding that this will depend on everyone agreeing that the party is over. Everyone will have to work longer and there is no more time for "gesture politics".

Lucas Papademos, Former Vice-President, European Central Bank, stated that the sovereign debt crisis has shown that stability is needed in the financial system. The new supervisory framework is a milestone, he said, and the framework and the Basel III proposals must be implemented immediately in a practical manner. Papademos then highlighted the disfunctionalities in several markets caused by the financial crisis. He said the priority is to correct the spill-over effect from the sovereign debt market on banking systems and argued that fiscal adjustments are necessary.

Pedro Solbes, Former Minister of Finance, Spain and Chairman of EFRAG Supervisory Board, said further discussions are needed. He agreed that new instruments are available and that the G20 is proving to be a good initiative; however, Solbes was not sure that EU positions came across well in the G20. He was sure that more integration is required at the European level – so that customers can benefit from better products and competitive markets. Solbes was not certain, though, that such consolidation is required at a global level. Solbes wanted to avoid global convergence, as he wanted to "concentrate international efforts where they are clearly needed." Solbes concluded that the crisis has put into question the ability of markets to self-regulate. He therefore wanted the new regulations to

enforce market stability and enhance transparency in the overall process. That is crucial to the future of financial services, he said.

Thierry Francq, Secretary General, Autorité des Marchés Financiers (AMF), stressed that the new regulations will define the financial landscape of the future. He asked whether rules leading to an increase in the number of intermediaries were a good thing. As a supplementary question, Francq questioned on how the single market could help the needs of SMEs. He underlined that the EU institutions should now not only repair the regulation by filling the gaps but also built robust structures towards sustainable markets.

Euroclear Chairman **Nigel Wicks** argued that the disparities in competition, between the Eurozone member states were as serious as the divergences in their budgetary positions, and in some ways were more difficult to remedy. Indeed, remedies involved changes in innovation, labour market, and a host of other policies concerning the efficient working of the Single Market. Such policies went well beyond the remit of finance ministers and central bankers, and warranted the attention of a high-level political forum. “It is a broad landscape and one that demands a holistic approach,” he said. “It deserved the concentrated attention of the presidents, chancellors and prime ministers assembled in the European Council,” Wicks added.

Eurofi Co-President **Daniel Lebègue** asked if, despite all the work that has been done and the undoubted achievements, the economies of Europe have been improved and if access to finance has improved for SMEs and young people? He also wondered about the image of financial institutions and the objectives of financial regulation. Regulation and supervision must be improved but so must professional standards of governance, he said, welcoming suggestions as to how that could be realised. Finally Lebègue called for the dialogue among financial actors to be extended to include entrepreneurs and innovators.

Responding to **Wicks**, **Bolkestein** said that the EMU had acted as a “sleeping pill” on several countries – most notably in the Mediterranean area – and he argued that a “one size fits all” approach does not work for countries that had a different economic structure. **Papademos** felt that many of the comments he had heard were related to past events rather than to the future. He preferred to look ahead and argued that the current reforms in Greece (wages and pensions, etc.) will lead to more open markets, more competition and a new culture in Greece. Similar changes were taking place in Portugal, Spain and other Mediterranean countries, he added.

2. Evolutions of EU legislative tools and processes with the implementation of the new regulatory and supervisory architecture

Eurofi Co-President **Jacques de Larosière** – described by **Norman** as the “father of the new architecture” – was insistent that “great leadership” will be needed to chair the various committees defined in the new structure. Acknowledging that some people have said that the new authorities should have been given greater powers, he said that they should start by using the powers granted. Furthermore, de Larosière said that there must be more exchange of information between supervisors if cross-border institutions are to be effective. He reminded the conference that this package is the embryo of a fundamental change in supervision and regulation. In the process that has been agreed, he highlighted the logical outcome which is the unification of the rules. This could lead to the creation – eventually – of common Europe-wide rules. Much will depend, de Larosière added, on inspirational leadership.

Norman suggested that if competition standards had been tighter, then there might have been more chance of a level playing field in recent years. **Joaquin Almunia**, EU Commissioner for Competition looked at lessons from the crisis and said that the mindset had changed from a paradigm of deregulation and “light touch” supervision before the crisis to stronger regulation and improved supervision. In order to avoid a further major financial crisis, Basel III should be transformed into regulations via a new capital requirements directive; furthermore, the Commissioner saw the need for agreement on unified accounting rules and called for progress on the new initiatives in the area of derivatives, hedge funds, private equity, etc.

The Commissioner also focused on the issues of competition and, specifically, on state aid. With the rules on state aid now being more rigorously enforced, he said there is work to be done, not just in the Mediterranean states, but also in Germany, Ireland and in the UK, for example. Almunia also turned to a related issue that was to figure prominently throughout the conference – the need for a Europe-wide

resolution framework that is consistent in the way in which a bank will be wound down if it is found to be no longer viable. He insisted that this cannot just be done using state aid frameworks and taxpayer money. Concluding with a call for further integration of financial services – which is essential – Almunia insisted that all players must follow the same direction, with the same priorities and at the same speed.

Alexandre Lamfalussy welcomed the broad acceptance of the de Larosière recommendations in the areas of regulation and supervision but wanted to go further in the integration of the financial services market. Looking back to his eponymous process in the area of regulation, Lamfalussy acknowledged that it had run into difficulties at level 3. That had to be resolved and he hoped that the new architecture would achieve that improvement. Authorities with enforcement powers should be able to do what the existing committee could not do.

Lamfalussy, however, had two main concerns. Firstly, while he thought that the new architecture was a breakthrough, he did not think that the implementation will be "plain sailing" as the new bodies may not act decisively in all cases due to national priorities.

He added that more efficient markets do not necessarily lead to enhanced stability taking the example of more cross-border interconnected infrastructures. Improving co-operation between supervisors in prudential matters in order to discourage crisis breeding inclinations and encourage crisis-resistance capability must be a political objective pursued in parallel with the improvement of the efficiency of the single market.

Giving an industry viewpoint, **Edmond Alphandery**, Chairman of the Board, CNP Assurances, felt that the move to more supervision and regulation meant that there is a danger of slow growth in the European economy. While accepting that the new de Larosière architecture has advantages, there is a need to avoid creating a risk aversion bias in Europe.

Secondly he emphasised the need for greater diversification in risk appraisal, especially at times of crisis. Finally, he called for more transparency in capital markets, adding that stress tests should be conducted on a regular basis with the results being made public. "This will bring more confidence in the financial system," he said. There must be better – rather than more – regulation; this implies that all actors involved must be fully responsible for their actions. This will bring enhanced corporate governance and it must be backed by the availability of top quality information.

Turning to prudential reform, Alphandery looked at the banks and insurance companies. With the G20 about to address the "too big to fail" issue, he spoke against an equity capital surcharge on the biggest banks ie systemically important financial institutions (SIFIs). Instead, the potential costs of systemic risk should be internalised within the financial institutions. As for insurance companies, he argued that Solvency II was a superior framework but he did not want Europe to become the most risk-averse region in the world and he called for the Ecofin Council to look again at the directive.

David Wright, Former Deputy Director General, DG Internal Market & Services, European Commission, was content with the progress being made on the supervisory package but he felt that it was essential to find people of the highest calibre to chair the new committees. He also highlighted the need to build links between the various players: the new authorities the European Commission, the ECB, other central banks and national supervisors. Wright then stressed the importance of the work of the European Systemic Risk Board (ESRB) and asked how the private sector could help in the identification of risk in the global financial system. Above all, Wright did not want the new authorities to be overloaded at an early stage. "Credibility for the new authorities will come from successful progress on the ground," he said.

He agreed with Almunia on the need to move from rules to regulations in Europe. "There must be a move towards a single rulebook to avoid the problems caused by 27 interpretations; there must be consultation and transparency," he asserted. Looking to the future, Wright welcomed Commissioner Barnier's agenda that would look at issues such as short-selling and he wanted to know if heavier sanctions are necessary – today's sanction regimes are not a deterrent, he said. The need to implement Basel III, together with the reform of MiFID and other actions give the EU "a big agenda," he said. "2011 will be the acid test to see if the G20 is fully in tune with the Financial Stability Board."

Pervenche Berès, MEP, Special Committee on the Financial, Economic and Social Crisis, European Parliament, agreed that speed is necessary but it must be accomplished in a steady manner. Like several other speakers, she welcomed the work of de Larosière group but wanted to go further. The present text was not completely in line with the original de Larosière report. Berès wanted the right people and the right tools to be in place and she wanted more sanctions to be available. Noting that the European Parliament has always preached for regulation, Berès warned against the possibility of cherry-picking, insisting that implementation must be consistent. She had no problem with financial innovation as long as it is introduced in the goal of helping financial markets to play their role of financing long-term investment and creating jobs. Finally, Berès warned that the EU will not benefit if its citizens are not in employment.

Carlos Tavares, Chairman, Committee of European Securities Regulators (CESR), responded to the comments of Wicks and Commissioner Almunia by adding that he was somewhat "lost" by the lack of progress at a national level, based on his experience of sitting on the Competitiveness Council. Tavares wanted the new authorities to have even more powers and especially for the committees to have binding technical standards without the need to have European Commission agreement. However, he stressed that the new authorities should use what powers they have and exercise them fully. All member states have to be willing to take up their new responsibilities and a lot depends on the European Commission representatives as they have to endorse technical standards. The aspects of consultation and collaboration are also essential.

Michael Heise, Chief Economist, Allianz SE, reminded the conference that the global economy and the level of global financial wealth has not yet returned to the levels of 2007. He saw huge challenges for pensions and old age provision as well as fierce competition of financial centres in the years ahead. An effective ESRB that helps prevent new bubbles on financial markets also by regulatory means could be a real breakthrough. Next to regulation on the micro-level, macroprudential issues contribute a lot to explaining the financial crisis: An effective ESRB could therefore give a unique advantage to the European financial markets, helping Europe in a harshly competitive world.

Bolkestein also felt the new regulations do not go far enough and he wanted a single European regulator. Acknowledging that the UK disagrees with such a direction, he still felt that this could be achieved with the existing regulations via a system of "reinforced co-operation." **Berès** felt that a single regulator, if the position existed, would put even more emphasis on monetary rather than on economic union.

De Larosière said the result will "not be too far from a single EU regulator" with authorities having the power to fix technical standards. The creation of a single European regulator was not included in the original package as, at the time, it did not seem achievable. However, he wanted to differentiate between regulation and supervision. While arguing that the powers of the new authorities will bring a situation that is closer to having a "single regulator", de Larosière agreed that supervisory powers will still be delegated to the member states, with the attendant problems. De Larosière did not totally reject the possibility of making progress with "reinforced co-operation" among supervisors. He added that the UK has no problem with a common rulebook; they have more issues with surveillance and enforcement on the EU level.

Responding to Berès, de Larosière agreed that economic and monetary policies have deviated in terms of competitiveness. The crisis was a wake-up call and the amount of adjustment, in for example Greece, has gone far beyond what could have been imagined – as the correct levels of economic governance had not existed,

3. Prospects for EU Securities and Payments Infrastructures

Gertrude Tumpel-Gugerell, Member of the Executive Board, European Central Bank (ECB), argued that the crisis had intensified the EU participation in the global debate. The ECB certainly supported infrastructure integration and there is still more to be done, she said. Clearing & settlement rules are based on national systems and self-regulation has had limited success. Integration by common platforms needs more co-ordination. Compared to the US, pan-European processing must be improved to cut settlement costs – here, she stressed the importance of the UK's role.

The Payment Services Directive was a massive piece of work – integrating 32 markets – but so far only one-tenth of the credit transactions actually followed the new standards. She therefore called for a proposal from the European Commission, in the near future, with regard to debit cards to ensure

safety in payments in cross-border transactions. Finally, she reminded the audience that the 'wise men' (Lamfalussy Report) had been right when they called for better cooperation between national supervisory authorities already 10 years ago. The new supervisory authorities should also hire experts who are able to challenge mainstream thinking.

Tavares said that three lessons have been learned: the regulatory gaps must be closed, transparency is required in all markets and systemic risks are no longer limited to banks. Adding a fourth lesson, he warned there should also be concern when markets rise excessively.

Putting a large share of the blame for the crisis on OTC markets, Tavares welcomed the various European Commission actions and proposals and hoped they would become regulations as soon as possible. Tavares also said it is essential that the market abuse directive is extended to cover OTC derivative markets. He concluded with a look at the MiFID review, where he saw real opportunities for reform: for example, by extending the scope of transaction reporting, by ensuring the best execution principle is implementable and enforceable, and by reducing opportunities for regulatory arbitrage.

Norman acknowledged the difficulty in bringing all the different stands together.

Wicks noted that his company, Euroclear, had set out on the path to harmonise and integrate securities settlement and related market infrastructure services even ahead of the ECB's various initiatives. While he favoured competition as a general principle, competition in clearing and settlement, could, at least initially, lead to fragmentation. He had originally been of the opinion that inter-operability of central counterparties (CCPs) was the way forward, but was no longer certain about the implications for financial stability. Interoperability could lead to competition on margin levels, which could lead to a problem of under-collaterisation. In addition, , there is the danger of a "domino effect" with interconnected CCPs using different risk management and margining rules which could cause problems. So the dilemma between competition and concentration will continue to be the subject of debate for some time to come.

Wicks said that the European Securities and Markets Authority (ESMA) would succeed if it acted as a European institution rather than as a collection of national regulators. Progress in establishing harmonised market practices across Europe would reduce costly market inefficiencies and stimulate competition and might in the longer term lead to consolidation,. Wicks said that of course he was not opposed to EU legislation for CSDs. But when legislators prepared such legislation, they should beware of unintended consequences. This had been the lesson of MiFID which had had unintended consequences for trading platforms giving incentives to move business from highly regulated and transparent venues It would be counterproductive if CSD regulation had the same effect in the post-trading space.

Wright said that inter-operability is effective and useful in, for example, telecommunications. In response, EuroCCP CEO **Diana Chan** argued that there are already many examples of inter-operability in place in different industries such as the telecom industry or cash distributors. She said it is not technically difficult but that there are many commercial issues to be solved due to the interests of different parties. Some elements of regulation are needed for this to be solved. She added that there is a greater need for CCPs to have access to trade feeds and that this is largely a commercial problem. Competition created by interoperability is not an end in itself according to her but a transitory situation leading to consolidation. **Norman** felt that this might "concentrate risk on a large scale" and Chan agreed that common safety standards are needed for all CCPs.

The final speaker, **Peter Ayliffe**, President and Chief Executive Officer, Visa Europe, gave his total support to SEPA "as there is a fundamental need to have a European payments system". However, Ayliffe wanted more than a common card; he wanted new innovative features for end-consumers. Consumers want a fast system, working across all channels, that is hassle-free and safe. Here, Ayliffe argued that Europe is the envy of the world due to its chip-and-pin technology, its Europe-wide infrastructure with investments from the European banks and, finally, due to its progress on a business model based on "merchant indifference".

Sadly, he added, progress is stalling. Ayliffe said the core premise of having a card that works across all borders is being challenged along with the need to build on existing technology. He was optimistic but he wanted agreement on the overall objectives and more actions that leverage the current architecture. **Almunia** added that there is work in progress at the European Commission to solve the problems and issues raised by Ayliffe.

Legislative priorities of the Commission

Opening of the Forum - Priorities of the Belgian Presidency of the EU in the financial services area

Eurofi's aim is to develop a better understanding between policymakers and the industry on key financial issues to help solutions to emerge to common challenges, said **Didier Cahen**, Secretary General, Eurofi, opening the first session of the Eurofi 2010 Forum.

The financial crisis showed the consequences of governments pursuing reckless policies, regulators overlooking risky practices and traders pursuing bonuses irresponsibly, said **José Manuel Barroso**, President of the European Commission, in the opening session of Eurofi's 2010 Financial Forum.

In response, Europe has delivered an overhaul of the governance of EU economies, he said. "We first took action to support the banks, then member states struggling with sovereign debt. Now we are fixing the gaps and weakness in our regulation that were highlighted in the de Larosière report."

The European Systemic Risk Board (ESRB) sets a global standard and will help to deal with the challenge of dealing with Systemically Important Financial Institutions (SIFIs), those that are deemed too big to fail, for which a framework should be layed out in the coming weeks.

At the same time, the sovereign debt crisis has exposed weaknesses in surveillance that cannot continue, he added. "The time has come to complete monetary union with economic union. Alongside regulatory reform, we need an overhaul of our economic governance tools."

However, the Commission is not interested in bashing bankers or fund managers, he said. "Our aim is a thriving financial sector – but no one should underestimate the anger that people feel."

The Commission has implemented balanced solutions to get the economy back to growth, Barroso asserted. "It is time for the financial sector to show it is not part of the problem but part of the solution."

Didier Reynders, Deputy Prime Minister & Finance Minister, Ministry of Finance, highlighted Belgium's priorities for its EU presidency.

There has been progress on financial markets reform and the creation of a new supervisory structure by the end of the year. "Unanimity in the Ecofin Council has made it possible to set up a new architecture of financial supervision," Reynders said. "It was vital that all member states supported this."

This was hailed by **Wolf Klinz**, Chairman, Special Committee on the Financial, Economic and Social Crisis, European Parliament, for "completing a rather complicated dossier rather quickly".

Reynders outlined the priorities of the Presidency: 1) Supervisory package: the challenge of the new EU Authorities will be to prove that the EU level is more relevant to detect crises. 2) AIFM: difficulties around the concept of third country regime – for which the Presidency has granted the EU passport – but France still needs to be convinced. Main changes deal with private equity and depositary. 3) Credit Rating Agencies: the Presidency supports supervision by ESMA – which should have powers of investigation and to impose penalties. 4) Basel III: there is a need to find a political agreement, by taking into account the various effects of reforms. The cumulative effects of the reforms were being considered as well as ways to preserve growth. On taxation of the banking sector, to be discussed at the 30th of September ECOFIN, the objective is to make the financial sector aware of its responsibility. The ambition is to reach an agreement with the European Commission by the end of the year.
He also said banks should contribute to the cost of clearing up the financial system. "A European banking fee will avoid social losses and make banks aware of their responsibilities," he said.

Klinz highlighted two other important areas – the revival of the EU/US dialogue and the need for the EU to redefine its role in international fora. "Europe should increasingly speak with one voice and be represented by one person," he said.

The crisis has created a unique momentum for “profound reform of the financial system,” added **Guy Quaden**, Governor, National Bank of Belgium. He hailed the Basel III agreement, which he said “should substantially improve the ability of banks to respond to crisis situations”.

While many in the banking industry have complained that the rules will make lending more expensive and reduce the amount of credit available, “regulators believe that the length of the transition period will significantly reduce the cost so that it is very small relative to the long-term benefits of reducing the possibility of another banking crisis”.

Gertrude Tumpel Gugerell, Member of the Executive Board, European Central Bank (ECB) outlined her priorities: 1) Basel III is a fundamental step and phasing-in and transition arrangements are realistic. She urged for a swift implementation. On the supervisory package, the ECB will provide analytical, statistical, logistical and administrative support to the ESRB. 2) Market infrastructures: it is crucial that the decision to grant access to central bank liquidity remains entirely subject to central banking discretion, given the direct monetary policy implications. Given that CCPs are subject to various types of regulation, oversight and supervision, the cooperation between various authorities is crucial. She called on ESMA to cooperate closely with the European System of Central Banks on all oversight-related matters. She called for convergence in the field of global standards for financial market infrastructures. 3) SEPA: a migration end date shall be set by EU legislation. This issue shall receive high priority and due attention.

The cornerstone of the system will be recovery and resolution plans, or living wills. Financial institutions will have to specify the decisions they will take in the event of severe stress without recourse to public money.

Jean-Paul Servais, Chairman, the Banking Finance and Insurance Commission (CBFA), highlighted two challenges for regulators – to complete the reform of the supervisory system but also to manage their new powers at a time when systems are not yet harmonised.

In an example of the EU/US dialogue that **Klinz** highlighted, **Gary Gensler**, Chairman, Commodity Futures Trading Commission (CFTC) told the forum that his organisation is working in partnership with the EU on bringing the clearing of OTC derivatives into central clearing organisations. “OTC derivatives were meant to lower risk but in some cases they heightened risk,” he said. “They were part of the crisis”. Capital and risk know no geographical boundaries meaning that as much consistency as possible was necessary in rules at the global level.

The Dodd-Frank Act passed by Congress in July included three important priorities, he said. “It brings comprehensive regulation to OTC derivatives dealers; it requires standardised derivatives to be cleared by regulated clearinghouses; and it requires standardised derivatives to be traded on transparent exchanges or swap execution facilities. EU proposals were consistent with US plans, he said. “We will have some differences but it is important that we are as consistent as possible.” He pointed out that central counterparties will need to have more robust risk management standards because so many more trades will in future be transacted through them.

One of the most important requirements for global regulation to work is that there should be global access to information. “We must work to ensure the necessary data are available,” he pointed out.

Dodd-Frank is also explicit about the need to write business conduct standards to lower risk, Gensler said. While the EU’s proposals do not use the same language, they have the same aim.

There may be some differences between the US and the EU in the way transparency is promoted. In the US standardised derivatives will be required to be traded on transparent exchanges or swap execution facilities. Options are not yet defined in Europe but this topic will be picked up in MiFID. Transparency is vital both in trade and post-trade, he said. “The more transparent a market is, the more liquid it is and the better the pricing is.”

Gensler concluded by saying that the process was due to be finalized in the US by the 16th July 2011 after thorough consultation with the public, with the FED and the SEC and other regulators around the world.

AIFM implementation and adaptation of UCITS depository rules

The AIFM (Alternative Investment Fund Managers) Directive is one of the most contentious pieces of reform the EU is trying to push through at the moment. It will affect many funds and have a significant impact on the structure of the industry, said **Jean-Paul Servais**, Chairman, the Banking Finance and Insurance Commission (CBFA), moderating the session.

The Commission had hoped the directive would have been adopted by now, said **Ugo Bassi**, Head of Unit Asset Management, DG Internal Market & Services, European Commission, but many technical and political problems remain. “Non-adoption is an issue,” he added. “It is time for everyone to show some flexibility. The Commission, the Council and the Parliament have to find a way for the text to be adopted.”

The directive has three main aims, he added. Firstly, to improve the capacity of national supervisors to monitor systemic risks, second to enhance investor protection and third to improve the internal market in this sector.

The main stumbling blocks are private equity and the third country regime. While a breakthrough seems likely on private equity the prospects for the third country regime remain unclear but “since the directive is one of the main elements of the Commission’s response to the G20 agenda and since this is a global industry, we firmly believe that there should be a true level playing field”.

The key principle of the regime should be: “Same rules, same rights”, **Servais** said, adding that the directive for the first time creates a real solution.

The returns that hedge funds generate can help Europe to return to growth so costs should not be driven up by excluding part of the industry, said **William Douglas**, Managing Director and Head of Hedge Fund and Business Consulting, Goldman Sachs International. “Regulation has to be proportionate to the risk it seeks to control,” he pointed out.

Pension funds and other investors should not be denied the opportunity to invest in products from outside the EU, added **Anthony Byrne**, Global Head of Securities Lending and European Co-Head of Prime Finance, Deutsche Bank.

However, having the same rights for EU and non-EU funds would damage the brand of EU AIFs and ultimately UCITS, claimed **Stephane Janin**, Director, Head of International Affairs Division, AFG (French Asset Management Association). He indeed considered that granting EU passports to third country funds would lead to selling these funds to retail investors over time, which could risk damaging the UCITS brand over time. The fact that the AIFMD covers many types of funds, some of which are quasi UCITS, was also pointed out.

It is important that depositaries operate under the same rules across Europe, said **François Marion**, Chief Executive Officer, CACEIS, and depositaries should not be left to bear all the risks in the system. “Depositaries cannot be isolated from other actors in the value chain. We understand the liability regime for depositaries will be reviewed and that, eventually, depositaries will have to bear more responsibilities”, he said. “This is acceptable if the rules are the same for everyone. It is, however, our opinion that effective investor’s protection requires that the risks are identified and managed all along the value chain, not only through the “deep pockets” of the depositaries. Another issue to take into consideration is the fact that the prices of service will have to adjust to the new environment

The problem arises from the loose definition of depository responsibilities in UCITS IV, said **Paul Bodart**, Executive Vice President, The Bank of New York Mellon, which meant the translation into national rules has been very diverse. “We need transparency and harmonisation.”

Depositories are being asked to underwrite risks over which they have no control, said **Byrne**. This will give smaller institutions with lower capital a significant advantage, which will increase systemic risks.

Depository rules are a key issue for prime brokerages, which are likely to retain many of their depository functions as sub-custodians to the depositories, said **Douglas**. “We do not believe it is appropriate for depositories to be strictly liable for negligence or fraud of unaffiliated sub-custodians where the depositary could not have been expected to discover such fraud or negligence through reasonable due diligence. In those limited circumstances, investors are the appropriate people to bear losses and seek recovery of them.”

Otherwise, the depositories effectively become financial guarantors of sub-custodians, which would either stop the bigger banks from providing the service or drive up costs for investors, he suggested.

The conditions for prime brokers to exercise due diligence and the ‘unforeseeable events’ referred to in the Directive over which depositaries have no control need to be clearly defined to assess whether these proposals are workable, he said.

Depositors and financial institutions can manage risks and market uncertainty, but they need a solid set of rules to act within, which they do not yet have at present, said **Stefano Pierantozzi**, Head of European Fiduciary Oversight & Research, Global Transaction Services, Citi. As a result, institutions are postponing their business development plans until they know what is going on.

Answering the financing needs of Corporates and SMEs

Moderating the session, **Pierre Delsaux,** Director, Free Movement of Capital, Company Law, Corporate Governance, DG Internal Market & Services, European Commission, stated that meeting the needs of corporates and SMEs is a challenge for all member states, and is equally challenging at a European level.

Business Europe's Director General, **Philippe de Buck** saw better than expected growth in Europe and he welcomed the fact that the stress tests of the banks had shown a limited risk of instability. However, he said that banks are not willing to lend to companies, which must be improved, and the sovereign debt crisis had led to a tightening of credit conditions that has hit companies' finances. The health of public finances will have a major impact on company finances – so he reasoned that Europe was "still skating on thin ice". De Buck said Europe faced four challenges:

- How to move on after the recovery measures?
- How to put in place smart consolidation measures, especially in the public sector?
- A need for a balanced agenda of financial market reforms
- A need for alternative sources of financing for companies.

Herman Daems, Chairman of the Board, BNP Paribas Fortis, focused on SME funding and argued that the type of company is important, as innovative SMEs in particular may be short of funds for some considerable time. As for SME strategies, Daems argued that with Europe set to experience a period of slow growth, there is a need to think about exports outside of Europe. Daems also felt that many SMEs are unhappy to be publicly listed due to the amount of information that must be provided, and the low volumes of trading and analyst activity. In addition, Daems preferred the government to stimulate the creation of funds to help SMEs.

Jean-Pierre Delwart, CEO, Eurogentec & President of Solvac, argued that companies want stability not volatility in the markets and they want "large open windows". They also need banks with strong balance sheets, together with credibility and stability. He felt that Basel III would affect the cost of lending but not dramatically, while **Daems** called for a stable tax environment. Daems made the case for private equity funding for SMEs as it gives smaller companies some much-needed advice on management structure.

Better regulation, not more, is what is needed, said **Carmine Di Noia**, Deputy Director General, Assonime. SMEs looking to raise money need a simple system suitable to their size and resource level.

The definition of SMEs also varies from country to country, and they have widely differing requirements, said **Ronald Kent**, Head of International Listings, NYSE Euronext. **Hans-Ole Jochumsen**, President NASDAQ OMX Nordics, Nasdaq OMX Group, stressed the importance of SMEs to society and argued that there must be several ways of raising finance. Jochumsen also stressed that SMEs are local and that a European market for SMEs is not required. However, he did see the need to define main and alternative markets across Europe as rules vary from country to country.

As for European SMEs, **Kent** had five points on his wish list:

- stability in capital markets
- banks with strong balance sheets
- costs of funds at attractive rates
- large open windows when capital could be raised
- plentiful funds to be available for investing companies.

With banks and "business angels" struggling to lend, Kent felt the solution lay in the public capital markets, but those markets need help, he said.

Many SMEs feel that it is too expensive to publicly list their company due to the amount of regulation, said **Philippe Lambrecht**, Director, Secretary General, Federation of Enterprises in Belgium. The final result could be that only blue chip companies are listed. Lambrecht did not see “one size fits all” as a good solution and he called for the European Commission to analyse the current situation as small companies should be allowed to grow. They need more ways to access funds as it is currently too complex for listed companies.

With 20 million SMEs in Europe, **Hugh Morgan-Williams**, Chairman, Canford Group plc, argued that it is vital that such companies have access to funding if growth is to be achieved. Starkly, Morgan-Williams described the banking relationship across Europe as being “broken”. SMEs are still seen to be risky and new ones tend to have no assets; one problem is that it is difficult to value intellectual property and entrepreneurial minds. Morgan-Williams was against over-regulation as many SMEs do not have the resources to deal with it – there is certainly a need for innovative solutions in many areas.

Gerassimos Thomas, Director, Financial Operations, Programme Management and Liaison with the IFIs, DG Economic and Financial Affairs, European Commission, said SMEs are drivers for the economy and said that it is essential to have a co-ordinated approach to SME financing across Europe.

Delsaux was concerned about over-simplification as this could have an impact on, for example, taxation and investor protection. He added that the European Commission is working on these issues. De Buck agreed as it was never certain what the outcome of simplification might be. He added, however, that it had always been difficult to provide SMEs with adequate funding.

Jochumsen wanted more investments by private individuals, while Daems reminded the conference that the number of loans rejected before, during and after the crisis, were the same – it is not so much a shortage of funds as a matter of less dynamism. **Kent**, though, argued that the current regulatory framework was put in place pre-crisis, but now Solvency 2 and Basel III are suggesting there should be a move from equity to debt. He suggested that major directives might need to be re-opened.

Main regulatory projects at the EU legislative agenda

Improving securitisation processes

Securitisation is an important way of channelling money from savers to borrowers, but it was one of the most high-profile casualties of the financial crisis, said moderator **Malcolm D. Knight**, Vice-Chairman, Deutsche Bank Group, as he set the scene for the debate. What is needed to increase securitisation flows and encourage sustainable growth, he asked?

A well-functioning securitisation market is essential for the resilience of the financial system, said **René Karsenti**, President, International Capital Market Association (ICMA).

The recovery of the securitisation market is important, agreed **Michel Stubbe**, Head of Division, DG Market Operations, European Central Bank (ECB), but for that to happen, the industry has to be able to regain the confidence of investors. Key requirements for this are simplicity and standardisation.

Investors must be able to do due diligence on products, so they must be easy to compare, simple to understand and transparent. This transparency must extend to post trade and there must be price transparency so investors are confident they can sell the products if necessary.

Investors will also be more confident if originators retain a portion of the products**, Karsenti** added, and they will also need enhanced disclosure about the underlying asset pool.

The main strength of securitisation is also its main weakness, said **Mario Nava**, Head of Unit, Banking and Financial Conglomerates, DG Internal Market and Services, European Commission. “There is extreme customisation on both the supply and demand side. If deals are done with little transparency and poor quality assets, then this can become a problem. If products are customised well, then you get the right product to the right client, but if you get the right product to the wrong client, then it becomes toxic.”

Perhaps the answer is to have more standardised structured finance products that can be publicly traded, allowing investors to make more informed decisions, said **Eddy Wymeersch**, Former Chairman, Committee of European Securities Regulators (CESR), a view that Michel Stubbe concurred with.

The new rule that originators must retain 5% of any securitisation “impedes the creation of products that banks do not wish to have on their books,” said **Nava**.

The toxic deals of the crisis have not gone away, pointed out **Eric Wragge**, Executive Director, Securitised Products, JPMorgan. “There are €2 trillion of securitisation products out there and something will have to be done with them eventually.”

There were clearly problems with the models used to rate structured products in the past that were not appreciated at the time, said **Ian Bell**, Managing Director European Structured Finance, Standard & Poor's. “Ratings of some structured finance products behaved abominably,” he said. However, he pointed out, “investors relied on ratings thinking they were something they were not”.

Ratings are opinions about the likely course of future events and it is unavoidable that at some point the future will surprise us, he added. S&P’s reaction to the crisis has been to strengthen its disclosure on the criteria and assumptions it uses to come up with its ratings, giving investors the ability to do their own due diligence to see whether they agree.

Despite all the problems, investors are returning to the market. Economic need – and investors’ need to generate yield – will drive the securitisation market, Bell added.

“The last two to three weeks have been the busiest in European markets since the securitisation markets shut,” **Wragge** pointed out, with deals from RBS, Fiat, VW and Aegon among others.

To ensure any recovery is sustainable, securitisation must take place under much stricter conditions than in the past, asserted **Wymeersch**. S&P’s move to greater disclosure needs to be mirrored by originators – much greater detail is needed about the underlying assets that are being securitised.

The apparent risk reduction benefits of diversity were overplayed and misled investors, he added. “If you have student loans, mortgages and other products securitised together, no-one can determine risk.”

Furthermore, most of the transactions took place outside the purview of supervisors. “I think this has to be stopped. More information should be available to investors and to supervisors.”

However, **Bell** warned of the cumulative effect of the numerous regulatory changes that each address very specific lessons from the crisis. **Stubbe** countered that there is a great deal of co-ordination both within and between jurisdictions, starting with the top-down approach that comes from the Basel Committee.

Can the market ever be as big as it was, asked **Bell**? “There was a market funding the real economy and then there was a huge arbitrage market. The arbitrage market has gone and won’t be back for decades, but you cannot determine the size of the market with reference to structured finance,” he suggested. “You have to ask how much leverage you want in the system, what are banks for and how big do you want them to be?”

Improving retail investor protection

Jean Paul Servais, Chairman, the Banking Finance and Insurance Commission (CBFA) introduced the panel and looked forward to a high-level debate about improving retail protection in the post-crisis era. The first speaker, **Jacqueline Minor**, Director, Consumer Affairs, DG SANCO, European Commission, placed the debate in context by stating that she was interested in how markets, and especially financial ones, performed for consumers. In her opinion, those markets had not performed well for consumers in the past: they were complex and constantly changing. Minor was concerned that responsibility for financial planning now lay much more with individuals themselves and, unfortunately, financial literacy had not kept pace with those requirements. Placing the emphasis on information, Minor said the Key Investor Document (KID), part of UCITS IV, was a good step forward.

Minor added that studies showed that financial advisors admit to being incentive-driven and that people do not act rationally when faced with having to make financial decisions in such situations. The European Commission is undertaking more investigations in this area and Minor added that the results will be available in November.

Explaining his responsibility for Packaged Retail Investment Products (PRIPs), **Ugo Bassi,** Head of Unit Asset Management, DG Internal Market & Services, European Commission, said that it is still a priority for the European Commission even though it had been overtaken by events linked to the financial crisis. Bassi outlined the progress on two work streams: pre-contractual disclosure of information for investors and rules concerning advice and selling practices. On the former, Bassi said the result could be a new horizontal directive that would apply to all products defined in the scope [i.e. investment products with some element of engineering such as investment funds, unit-linked life insurance, retail structured products] – the aim being to ensure that investors understand all products. On the latter work stream, Bassi said the benchmark is the MiFID directive, currently under review, but he stressed the importance of the Insurance Mediation Directive (IMD); requirements for advice will be based on both directives. While the objectives are straightforward, the legislative phase is not at all easy, he concluded. A consultation will be launched by the Commission in the weeks following the Forum.

Malcolm Harbour, MEP and Chairman, Committee on the Internal Market and Consumer Protection, European Parliament, reasoned that much work has been done in the area of consumer protection in different sectors but that the lessons learnt are perhaps not being heeded in the current work in the financial area.

For Harbour the key is consumer confidence as much as protection; furthermore, it is essential not to duplicate existing legislation, such as the Unfair Commercial Practices Directive (UCPD). He was also concerned about standards to protect consumers, which differ from country to country and it is not yet clear what standards are needed across Europe. Furthermore, if standards are recognised internationally, then they must be policed effectively at a market level. Harbour also saw the need for a "team effort" - on education, standards and advice – so that consumer confidence can be generated. Legislation is only part of a package to increase confidence.

While many regulations exist, the financial crisis revealed that the situation is far from perfect, said **Jean-Paul Mazoyer**, Chief Operations Officer, Amundi. There is still a lack of coherence in legislation between different product categories. Overall, retail investors want transparency, liquidity, simplicity and in some cases capital protection. Currently, products are still too complex and there is a lack of comparability for consumers. The risk return is difficult to evaluate for example. Making the difference between capital guarantees of investment funds and structured products is also difficult. The crisis had shown that there had been irresponsible selling of products and that must be avoided in the future. This requires looking at the qualification and competency of sales advisors also.

Consumers are not being well served, agreed **Robert Higginbotham**, CEO - Europe, Fidelity International, Fidelity International. He therefore saw an opportunity to focus more on "consumer engagement" so that they feel more protected and secure. Higginbotham's four pillars were transparency, simplicity, value and choice, which he said were "basic consumer rights".

Looking at the work to be done in bringing together the requirements and proposals in the areas of MiFID, IMD and PRIPs, Higginbotham stated that disclosure had to be strengthened in 4 areas:

- information and advice for investors to choose the right product and disclosure of the nature of the advisory relationship
- disclosure provided early enough in the process
- information that will allow products to be compared
- understanding of the components of the price paid.

Speaking on behalf of consumers, **Monique Goyens**, Director General, The European Consumers' Organisation (BEUC), argued that individuals should not need to be experts – they merely want to feel safe and confident and have information that is understandable and comparable. She was pleased to hear talk of financial advisors sticking to their principles, avoiding conflict of interest and disclosing links with product producers, but Goyens wanted to know why this had not happened before. Looking to the need for a fifth pillar, [in addition to the four mentioned by R. Higginbotham] she wanted "fairness" of marketing practices and no mis-selling. She also bemoaned the fact that products are so complex; she wanted a consistent approach to financial services products.
Concluding on enforcement, Goyens said consumers had to have the possibility of redress – there must be tools to protect consumers.

Emmanuel Constans, President, Comité Consultatif du Secteur Financier (CCSF), Banque de France, agreed on the need for more better regulation to improve investor protection and, hence, consumer confidence. He also called for asome new legislative texts for instance, in the context of PRIPs, at national and European levels. In addition, he wanted more "soft law" and codes of conduct both public and transparent.

He also argued that the financial crisis had shown that protection must be at the centre of any action and that means supervisors have a vital role to play. The French government had reorganised supervisory authorities – with the ACP – in order to bring increased protection for consumers in both banking and insurance sectors. Finally, he called for the simultaneous consultation of all actors in the field – both public and institutional – with the aim of getting consensus.

Timothy Hailes, Managing Director & Associate General Counsel, Structured Products Practice, JP Morgan, wanted consumers to have a better understanding of what they buy but he insisted that this also means having a better understanding of risk. He agreed on the need for a sound regulatory framework and supported the European Commission's work on PRIPs. While understanding the need for greater consumer confidence, Hailes stressed that products can be both "complex and risk-safe". Therefore consumers must have a better understanding of risk. In the area of PRIPs, Hailes wanted a greater differentiation between the two families of products: collective PRIPs (i.e. investment funds) and contractual PRIPs (i.e. warrants and securities) particularly for pre-contractual disclosure.

The first issue is to define a PRIP and then ask if there should be different rules for products sold directly or those sold through an intermediary, said **Karel van Hulle**, Head of Unit Insurance and Pensions, DG Internal Market & Services, European Commission. This would be done in the context of a review of the IMD [for unit-linked life insurance products]. He did not see why there should be differences in the information available for different types of investment products answering similar investment needs and those sold through direct or through an intermediary. In the area of selling practices, given the different features of MiFID and the IMD, finding the right mix is important. Van Hulle said, and the IMD and MiFID should be built on to the benefit of the consumer.

The whole value chain must be examined, including the need for additional consumer financial education, the quality of the information and advice provided to clients and there is a need to deal with different dispute resolution schemes, said **Xavier Cognat**, Head of Brussels Office, Economic, Finance and International Affairs, Fédération Française des Sociétés d'Assurances (FFSA). Cognat also stressed the need for a cooling-off period and warned about the introduction of "soft laws" which may not be suitable in the world of insurance. Looking at what is done in all sectors is necessary to favour a level playing field.

Victoria Raffé, Head of Prudential Insurance Policy, Financial Services Authority (FSA), gave a different view. While she was familiar with the arguments about transparency, simplicity and choice, Raffé argued that consumers simply want firms to keep their promises and, above all, to be treated fairly. She added that the key priority was for the ESAs (European Supervisory Authorities) to develop their own consumer protection strategy, so the market works better for consumers. Raffé added that "conduct risk" was a reality - enforcement and fast redress are what is needed to deliver credible deterrents.

Károly Szász, President, Hungarian Financial Supervisory Authority, made a plea for consolidated supervision – with one body being responsible for prudential and conduct matters and also for consumer protection. He also argued for some self-regulation as only satisfied consumers will remain as long-term investors in the market. It was therefore the interest of the industry for consumers to have confidence in the market.. Szász added that consumers sometimes have to be protected from themselves when they place themselves deliberately in a risky situation which is more difficult to achieve.

Having investors in the first place was the issue before protecting them according to **Thierry Francq**, Secretary General, Autorité des Marchés Financiers (AMF). He reasoned that investors see the financial world as a jungle, so there must be more confidence; for Francq, therefore, MiFID has a major role to play. Disagreeing strongly with the previous remarks that investors do not need to understand products, Francq wanted investors to understand and manage the risk as well as the drivers of the performance of the products they are buying. Otherwise, they may as well act truly conservatively and put their money into a bank savings account. One should not be 'over-conservative'. Making a case for complex products, Francq said the key is for understandable information and advice to be available for consumers. A coherent system such as PRIPs is needed, he said; however, many differences exist. He also called for the same level of protection to be available throughout the EU internal market.

Bernard Coupez, Head of Regulatory Affairs, BNP Paribas Investment Partners, backed the work of the European Commission and agreed that comparability of products is essential. However, he warned that products can be hard to compare, especially when there are cross-border issues. For example, Belgium, France and Luxembourg all have different words for the same things. Coupez advised that such practical problems should not be forgotten and suggested putting together a glossary of terms that could be used e.g. in pre-contractual information.

Protection must be the watchword in all activities and regulations, urged **Carlos Tavares**, Chairman, Committee of European Securities Regulators (CESR), and it must go further than MiFID – all regulations are important so that supervisors can protect investors. Tavares said the new authorities would have a leading role in introducing transparency, simplicity and fairness in the field. Systemic risk is now an issue that encompasses markets and products and it is no longer limited to banks and insurance companies.

ESMA has looked at the progressive distribution of complex products to retail clients; these products were previously distributed to professional clients only. This could lead to the distribution of systemic risk (by promising very high rates of return), he said. This requires a thorough assessment of products by financial institutions, a full disclosure of information possibly beyond the KID and, in some cases maybe not allowing certain products to be distributed to retail investors, such as leverage reverse ETFs. Over the long term, consumer education will be vital. The level of education varies across countries and it will be necessary to educate both the buyers and the sellers.

EU securities infrastructures in a global context

Cash instruments (equities, fixed income)

It is very difficult to know what the priorities in these complex matters are, but the panel included representatives from all the interested parties, said **Peter Praet,** Executive Director, National Bank of Belgium, moderator of the session on securities infrastructure for cash instruments.

Trading:

The debate kicked off with **Maria Velentza**, Head of Unit Securities Markets, DG Internal Market and Services, European Commission, asking whether MiFID had been a success. In terms of increasing competition and bringing costs down, it had, she concluded. However, work remains to be done on transparency and the availability of post-trade data, she said. Data facilitation has not really happened because of a lack of standards and because "there was no stick to make the industry comply," she said.

This lack of information is important, she stressed. "The CDS crisis showed us that regulators do not always have sufficient information to take action."

Adolfo Garcia Perez, Manager Securities Forums, Grupo Santander, highlighted the benefits that MiFID has brought to his home market, particularly for cross-border institutions such as his that operated in so many other markets. "It has led to a big improvement in efficiency," he said.

Reforms to the bond and derivatives markets will close an important regulatory gap, allowing the extension of supervision to markets that played a major role in disseminating the risks that caused the financial crisis, said **Carlos Tavares**, Chairman, Committee of European Securities Regulators (CESR)

Denzil Jenkins, Director of Regulation, Chi-X Europe Limited, asserted that MiFID had cut trading tariffs by nearly 10 times and reducing FTSE 100 trading spreads by 75%.

However, **Andrew W. Douglas,** Head of Public Affairs Europe, Depository Trust & Clearing Corporation (DTCC), asserted that "fragmentation leads to costs that are higher than necessary". "We are trying to make markets safer and more transparent but we must not lose sight of the fact that they must be competitive," he added.

At first sight, it seems clear that investors have benefited from MiFID, said **Kay Swinburne**, MEP, Committee on Monetary and Economic Affairs, European Parliament, "but when you look at the technical changes that have happened at the same time, why has the overall cost of executing a trade stayed the same or risen? Why have investors gone to dark pools?" she asked.

Phillip Hylander, Managing Director and Global Head of Principal Strategic Investments, Goldman Sachs, suggested the move to dark pools was a reaction to the move towards high frequency trades, which implies smaller individual lots and more difficulty in trading large blocks of shares, and was also the result of an effort to achieve best execution.

Yet at the same time, much greater transparency is needed in post-trade data, **Swinburne** said. It is impossible to make a judgement on whether high-frequency trading is a good thing or not because "the lack of data is shocking".

Indeed, the big winner from the opening up of competition was the OTC market, claimed **Thierry Francq**, Secretary General, Autorité des Marchés Financiers (AMF) and the trend towards an increase of OTC trades needs to be reversed.

Judith Hardt, Secretary General, Federation of European Securities Exchanges (FESE), agreed, suggesting that there should be a threshold for OTC trades, which make up 40% of the market in Europe at present but only 17% in the US. "This should be a wake-up call for Europe that we need to safeguard price disclosure."

Yet **Vincent Remay**, Adviser to the Chairman, Viel & Compagnie, suggested that perhaps the reason investors were using the OTC market was because they are finding good liquidity and price disclosure. "Maybe the OTC markets are not the devil," he added.

Perhaps we have simply been too innovative when it comes to encouraging competition in the financial sector, suggested **Ludwik Sobolewski**, Chief Executive Officer, Warsaw Stock Exchange. “When it comes to liquidity or mitigation of investment risk, limited monopolies are not a bad thing,” he said

Hylander also warned against too much competition in clearing, because of its quasi-utility status. Too much competition could create a race to the bottom in risk management, he said.

Antonio J. Zoido, Chairman and Chief Executive Officer, Bolsas y Mercados Españoles, claimed that MiFID was a product of a bygone era “that assumed that benign conditions would continue and that competition would improve that situation”. The directive sought to take a less intrusive approach to regulation that has since been shown to have significant risks. “The regulated market concept is a winner. MiFID may have created competition for incumbents, but it also led to a lack of transparency,” he added.

In addition, it increased fragmentation to the detriment of listed companies. “Companies want to list their shares in markets where they find adequate regulation, where they feel comfortable with the cultural environment and that are most conducive to their needs,” Zoido said. “Fragmentation that offers nothing in financial and economic terms is a serious issue. It is highly unfair to a company to see its shares being traded in a venue not of its own choice in unfamiliar trading conditions and subject to unforeseen risks.

“Companies should be able to grant or deny permission for their shares to be traded on platforms where they are not listed.”

Erik Thédéen, President, Nasdaq OMX Stockholm, wondered why there should be transparency in equity markets but not in non-equity markets. “Transparency was introduced for consumer protection reasons and now it is about stability. The argument for not having transparency in non-equity markets has gone,” he said.

Tavares highlighted the Commission’s rules on short-selling, which he hailed as well-balanced, along with proposals for a new settlement regime that will end the deliberate failure to settle. “These rules will allow us to distinguish between what is genuine speculation and what is market abuse and manipulation, which must be banished.”

The view from outside Europe is not one of universal admiration, suggested **Maria Helena de Santana,** Chair, Brazilian Securities and Exchange Commission. Emerging markets such as Brazil worry about having only one exchange and a vertical monopoly, “but at the same time, we look at the consequences of the moves in the US and Europe and we do not see solutions there”.

Post-trading:

Alain Closier, global Head of Securities Services, Société Générale argued that at post trading level, where unification of actors should have been fostered to benefit from economies of scale, the number of infrastructures has increased and the unification of systems by implementing interoperable links has failed. Additional competition among CCPs favoured by MIFID has allowed reduction of clearing fees but the latter has actually largely been balanced by the increased fragmentation and induced complexity of the sector. He warned regulators to adopt a very cautious approach regarding systemic risk – when dealing with interoperability.

Interoperability [among CCPs] is one tool to make the system more effective, said **Douglas**, and it has been shown to work in the US. “If interoperability is not in the system to drive control, then what are the alternatives?” he asked.

But **René Maatman**, Board Member, Netherlands Authority for Financial Markets (AFM), said that the first experience of interoperability had not been very encouraging. “It will be very difficult to achieve in practice. We have major obstacles to overhaul and we are far from what we are aiming for.”

Zoido also sounded a warning on interoperability, which he said should be approached “with extreme caution because we do not know what systemic risk lurks in the various different layers of legislation.”

Patrice Colle, Chief executive Officer, BNP Paribas Securities Services (BPSS) added that interoperability can add risk. He favours a few big and strictly regulated CCPs, which woud have the ability to draw on central banks.

Transparency of pricing and well-established principles of risk management are important for interoperability, "and we have to be cognisant of the risks, particularly the network risks," said **Mark Garvin**, Chairman, Treasury and Securities Services International, JPMorgan, adding that he was supportive of the route being taken by the UK and Switzerland. However, he said that while he was in favour of interoperability for cash equities, he was cautious about applying the principle to derivatives.

Why would any institution open up its doors to competition voluntarily, asked **Satvinder Singh,** Managing Director & Head of Direct Custody and Clearing, Citi? "We will not see interoperability unless it is mandated," he added. "One of the drivers of interoperability is to improve efficiency and lower costs. The market is trying to react to what its users want."

Europe's problem is that it suffers from HSV, said **Patrick Pearson**, Head of Unit Financial Markets Infrastructure, DG Internal Market and Services, European Commission, by which he meant Horizontal models, Spaghetti models and Vertical silos. These structural issues are expensive, he pointed out, with cross-border trades 2 to 6 times more expensive than domestic trades and even domestic clearing twice the cost of clearing in the US. The total cost of all these inefficiencies comes to €28bn, he added.

Cross-border sales of securities in Europe do not work, suffering from legal uncertainties brought about by the EU's 27 different legal systems. "It is not clear what investors own and how they can exercise their rights. We have to harmonise to achieve greater legal certainty in Europe," he said.

Furthermore, regulatory differences and legal or de facto monopolies create barriers to cross-border business. "It is not 27 different systems – it is one system that should be made to work."

However, Singh pointed out that many institutions are taking a back seat because the interplay of all the regulations has caused confusion.

Colle highlighted his bank's support for CSDs, which he said are "key market infrastructure and crucial to market stability so he recommended that they should not take on any extra risk other than operational risk." BNP Paribas welcomes the legislation on CSDs as a clarification of their precise role and a way to ensure that there is access for all CSDs to central bank money.

Eric Derobert, Head of Public Affairs, CACEIS, also supported the initiatives on CSDs and the prudential objectives behind the review. "We expect the debate to focus on what is central to the role of CSDs. Once you define what is central, it will be easier to define the rights and obligations of CSDs."

CSDs operate well at the domestic level, said **Joël Mérère**, Executive Director, Euroclear. Cost differences in settlement between the EU and US could be explained mainly by difference in scale, suggested some industry leaders. But cross-border business is also hindered, and thus made more expensive, by regulatory and legal barriers, which therefore need to be removed. T2S also needs a strong push towards harmonization to be a success. The project of legislation on CSDs which could help to clarify their role and obligations in particular was also welcomed by some players, although the possible unintended consequences of such a legislation e.g. forcing businesses into areas of lower regulation and transparency were also pointed out. Consolidation will not come overnight, he explained. First there will be a period of competition, although he wondered "to what extent this competitive landscape is compatible with the need for stability?"

T2S will be a limited success if it is not accompanied by a big push towards harmonisation, asserted **Jean-Michel Godeffroy**, Director General, Chairman of the T2S Programme Board, European Central Bank. "We are going to follow those who have committed to deliver on harmonisation and those who have not done so," he warned. "To make T2S a success, we need Europe to be united."

Adolfo Garcia Perez, manager Securities Forum, Grupo Santander added that on top of MiFID and the T2S initiative, fiscal consolidation would also be important.

Derivatives

Derivatives were an important contributor to the financial crisis, as the need to bail out AIG demonstrated, said **Gary Gensler**, Chairman, Commodity Futures Trading Commission (CFTC). Regulators have better transparency in the US because of the Swap Data Depository, but there is a need for greater transparency to the public as well, he said. “Transparency of trading is so important to promote transparency of the market. The more transparent a market is, the more liquid it is and the more competitive it is, lowering costs for those trading and reducing risks for clearing houses.” The Dodd-Frank Act calls for real-time reporting as soon as technically practicable, he added.

A consensus is emerging on the need for some kind of post-trade transparency for derivatives, **Velentza** asserted. “OTC reporting needs to be established across the board.”

The Commission’s proposals for a clearing house regime look very similar to the US system, Gensler said. “We are working very much in parallel.”

Many were caught out by the fact that the US and the EU reached agreement, suggested the moderator, **Jeremy Grant**, Editor, FT Trading Room, Financial Times. “How did you get to agreement?” he asked. “It seemed like it happened very quickly.”

Gensler and **Pearson** agreed that communication was the key, while the crisis had focused the minds of legislators. “We seemed to just agree on many issues. We come from different regulatory systems but we have ended up on the same page,” said Pearson.

For the Commission, Pearson said “this is probably the most complicated regulatory cocktail I have ever shaken and with the most volatile ingredients”. With the introduction of a law requiring standardised OTC trades to be cleared, it will be important to have clear standards for OTC derivative components so there is enough volume to make clearing of different products practicable.

Common standards consistently enforced at global level will be key in ensuring stability in a consistent way across jurisdictions. This is very important, especially for global markets. In this respect there are some concerns about detailed US and EU legislations inconsistent between themselves and with CPSS-IOSCO, said **Daniela Russo**, Director General Payments & Market Infrastructure, European Central Bank (ECB).

Roland Bellegarde, Group Executive Vice-President and Head of European Execution, NYSE Euronext, explained why clearing increases the resilience of a market. “What the market needs to clear a product is an efficient pricing mechanism. You cannot have a price unless you have a third party to challenge the price agreed by the two trading parties.”

CCPs need a transparent and liquid market, **Thédéen** said. “If you don’t have transparency, what price is the market going to be prepared to pay?” This implies a greater need for pre-trade transparency – ie exchange trading. Europe needs a flexible system like the US’s but it remains unclear what will happen, he said.

He also suggested that it is not possible to have a totally opaque underlying market and a fully transparent derivatives market, but this was challenged by **Gensler**, who said that “often, the derivatives market was where fair prices came from and they made the underlying market more transparent”.

But the US has recognised that not every asset will be sufficiently liquid to be exchange-traded, said **Hylander**. “The US has recognised that it cannot predict exactly where there will be a successful order book, but it removes the impediments to this happening,” he said. He added that exchange and electronic trading is not a prerequisite for transparency since CESR’s recent proposals are venue-agnostic and will provide post-trade transparency nonetheless.

“We will subject any OTC contract that is not cleared to rigorous rules,” **Pearson** warned. “It is in the interests of many to keep parts of this industry as opaque as possible,”

However, **Athanassios Diplas**, Global Head of Systemic Risk Management, Deutsche Bank, warned that “as you turn the transparency dial up, people’s behaviour changes. If you have to disclose when you reach a certain level, then people will start trading in smaller blocs.”

The structure of the new rules is such that they will come into effect as soon as they are agreed – they will not need to be transposed into national law as directives are. It is in the transposition process that differences normally emerge, pointed out **Paul Bodart**, Executive Vice-President, The Bank of New York Mellon. “The fact that this will be a regulation will ensure there is a lot of alignment between member states.”

CCPs will become increasingly central to the financial system as a result of the reforms, so they “must be able to withstand financial Armageddon,” **Pearson** said.

“These are systemically important institutions,” agreed **Garvin**. “We have to be careful not to create new potential points of failure.”

Grant also suggested that they will need access to central bank funding but **Russo** while agreeing that access to central bank funding is important and CCPs which have access to central bank funding are “safer” than CCPs which do not have such access, countered that “central banks should not be forced to automatically provide credit to any entity. Monetary policy is a “public good”, not a tool to ensure stability of CCPs. CCPs should be highly liquidity resilient and the central bank has to be totally independent in deciding which organisations to give money to and when”. In the case of the ECB/Eurosystem, this independence is recognised by the Treaty.

Nonetheless, she recognised that the crisis had shown there are scenarios when even a well-capitalised CCP could run into trouble. “There was some liquidity herding and CCPs could have been in a position where they could not address their own needs because banks refused to provide liquidity.”

It is an issue that the Commission is addressing, **Pearson** said. “There is a framework, but it is not as well-developed as it should be.”

In the US, the Financial Stability Oversight Council will be able to designate some clearing houses as systemically important, Gensler pointed out.

There are fears that these organisations, which will have increasing potential to be systemically important, are facing increasing pressure to compete, said **Grant**. “We are already seeing competition on margins.”

Both **Gensler** and **Pearson** were quick to say that clearing houses should not compete on margins, with Gensler pointing out that “we will be addressing key risk management features and there will be uniform criteria on clearing”.

Hardt asked whether the EU and the US have started to look at what a mutual recognition agreement might look like for clearing houses, given that EMIR defines third-country access to EU markets. “For clearing houses, will there be the same access to the US market?” she asked. “I know it was difficult for exchanges to gain access to the US cash equities market.”

Both Europe and the US are open to foreign clearing houses as long as they are well-regulated, **Pearson** and **Gensler** added.

Insurance and pension funds

Solvency II

Karel van Hulle, Head of Unit Insurance and Pensions, DG Internal Market & Services, European Commission, moderated this session and referred to Solvency II as the "biggest reform in the field of insurance in the last 30 years". With the focus firmly on implementation measures, van Hulle wanted to hear about "facts not theories".

Henri de Castries, Chairman and Chief Executive Officer, Axa Group, focused on four principles: reality, responsibility, conformity and uniformity. De Castries stated that the industry wants a constructive dialogue with supervisors and authorities at this critical phase of implementation. Highlighting four key principles, de Castries stated that:

- *reality:* the insurance industry had resisted well during the crisis and did not need more capital
- *responsibility*: the suggested implementation measures could have dramatic consequences on the industry – by reducing growth and increasing unemployment
- *conformity*: fewer than 30 insurance companies have had problems in the last five or six years – there had to be better insight about risks but the goal should be "the right capital for the right risk"
- *uniformity*: there has to be a level playing field with the same rules applied everywhere in a consistent framework.

Jozef De Mey, Chairman, Ageas, agreed that Solvency II will change the industry dramatically. However, he added that it is difficult to foresee when the impact on the industry will be felt. Solvency/capital ratios will be more volatile, De Mey said, and this, coupled with the possible need for more capital would lead to higher prices for consumers. The Solvency II requirements will also have a major impact on insurance companies as institutional investors. Describing Solvency II as a risk-based approach based on models, he reminded the conference that, by definition, models are complex – so the overall solution must be "as complex as necessary and as simple as possible". De Mey was also worried about the resources needed to manage the Solvency II framework, especially for small companies. Given the various areas of concern, he felt that it was unlikely that Solvency II would be settled by 2012.

Gabriel Bernardino, Chairman, Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), agreed with the two industry speakers to an extent but reminded them that the "devil is in the detail of implementation". While arguing that Solvency II has a sound framework, Bernardino insisted on the need to reinforce risk management, transparency and supervision. However, he acknowledged that Solvency II will not be perfect. For Bernardino, the most important word in Solvency II was risk, together with understanding the reality of risk behaviour before taking decisions. QIS5 would show how SMEs could deal with Solvency II, he said.

In the post-crisis world, solvency ratios will be different between QIS4 and QIS5, he argued, so if "risky" businesses need capital, that is normal but overall there will be no increase in capital. Implementation must be balanced and timely, starting in 2013. Transitional measures might be required, but Bernardino did not think that Solvency II would be too difficult to implement. Overall, implementation must be consistent, especially across the various sectors and across countries – the new authorities will play a key role in implementation.

Van Hulle suggested four topics for the various speakers: the impact of the financial crisis on Solvency II, the impact of Solvency II itself on the economy, what messages should be passed to MEPs and what messages should be given to the supervisors. He added that words about solutions would be welcome.

The impact of the crisis on Solvency II

Pervenche Berès, MEP, Special Committee on the Financial, Economic and Social Crisis, European Parliament, reminded the panel that Solvency II had been developed pre-crisis and said that it did not take full account of the financial crisis in its proposals. She wanted it to take a more long-term view, which she said is vital as savers, such as insurance companies, are the ones likely to embark on long-term investments.

Bart De Smet, President, Assuralia & Chief Executive Officer, Ageas, conceded that Solvency II was created pre-crisis, but he was in favour of its implementation as it will replace a system built in the 1970s. De Smet did not see the financial crisis having too much of an impact on the Solvency II proposals, except that some asset classes could be reviewed, such as sovereign debt. While backing this new direction, he warned about being too prudent. **Christian Collin**, Chief Financial Officer, Groupama, supported the transitional phase as a too rapid implementation could lead to price increases. There must be a smooth transition over at least six years to ensure fair competition between banks and insurance companies. **Peter Skinner**, MEP, Committee on Monetary and Economic Affairs, European Parliament, called for a balanced approach – qualitative and quantitative – and he wanted a better quality of supervision across Europe. He thought the Solvency II approach was right and now is the time to try it out in practice.

The impact of Solvency II on the industry

Jo Swyngedouw, Deputy Director, Prudential Policy – Banks and Insurance, Banking Finance and Insurance Commission (CBFA), argued that although the insurance sector had weathered the crisis, it would not necessarily be immune to problems in the future.

Victoria Raffé, Head of Prudential Insurance Policy, Financial Services Authority (FSA), was not convinced that the insurance business had sailed through the financial crisis calmly and she shared Swyngedouw's concern about future crises. She added that the UK is concerned about the calibrations for the standard formula in QIS5; this "package" as defined will not deliver the right results and she argued that investors and policyholders will pay the price.

Jean-Luc de Boissieu, Secretary General, Groupement des Entreprises Mutuelles d'Assurances (GEMA) explained the reasons why Solvency II would change the business model of mutual companies. **Pilar González de Frutos,** President, Spanish Union of Insurance and Reinsurance Institutions, said that industry supports Solvency II but she added that that support depends on how tight the screw is tightened.

Messages for MEPs

Tom Wilson, Chief Risk Officer, Allianz SE, warned of unintended consequences and highlighted volatility and reasoned that long-term guarantees could be challenged.

Asmo Kalpala, Chairman and President, Tapiola Group, agreed that risks have increased and that the crisis is ongoing. The economy will remain unstable in the near future, which means self-regulation will be important. **Tommy Persson**, President, Comité Européen des Assurances (CEA), said that if the final Solvency II regime necessitates more capital, it will affect the European economy. To ensure a level playing field, Persson insisted that European companies must not have higher capital requirements than international competitors.

Berès argued that, above all, the crisis had shown that "self-regulation does not work". She again called for all stakeholders to be involved in discussions and she argued that the implementation of Solvency II could lead to higher prices for consumers. "The one year duration is an issue and we also need to articulate long term saving with long term investments. "I am afraid that the consequences will be on the macro level less long term investment and an increase in the cost of premiums for policyholders on the micro level. We also need to ensure that this piece of legislation does not jeopardise a significant part of the market represented by mutuals and cooperatives".

Although not a fan of self-regulation, **Skinner** reminded the conference that resources are somewhat scarce and that the final solution should rely on a balanced approach that involved such self-regulation and the application of principles.

De Mey argued that there will be "no free lunch" and somebody will have to pay if there is volatility in the marketplace and higher capital requirements. **Kalpala** supported Solvency II as long as it has the right calibration. However, he reasoned that the large quantities of technical information that Solvency II will involve will be impossible for SMEs to manage unless there is a transition period.

Jean-François Lequoy of the Fédération Francaise des Sociétés d'Assurances (FFSA) warned that because discretionary powers lay with local supervisors, this could lead to an uneven playing field and distortion of competition. **Wilson**, however, wanted to dampen out inconsistencies in markets, adding that the supervisor's job would certainly become more challenging.

Bernardino disagreed with those who said that Solvency II will bring volatility to the marketplace; he argued that volatility had always existed and that Solvency II will simply add transparency and the ability to understand the volatility. He stated that the framework of Solvency II allows supervisors to look at a range of situations; furthermore, they can agree plans with companies to enable them to recover from problems.

Raffé did not want the system to be weakened but she felt that now was a good opportunity to be pragmatic about implementation. Firstly, simplification, if appropriately balanced with additional prudence, could be a real help not only to small companies but also others according to their "nature, scale and complexity". Secondly, she favoured a transitional phase in certain areas providing that it was more than a delaying tactic: transitionals should particularly focus on helping firms move progressively towards full compliance with the Directive. Swyngedouw felt that Solvency II could cause instability and that supervisory colleges should be backed by CEIOPS' monitoring in order to guarantee cross-sectoral convergence..

Summing up, **van Hulle** said that of the negative consequences that had been identified, a number had been on the table for some time. There must be further review to see how the industry will be impacted by Solvency II. Adding that the European Commission has asked for ideas, van Hulle confirmed that it is a time for creativity and innovation. The overall aim is to support consumers.

Pensions

Karel van Hulle said that the European Commission has issued a green paper and is asking for comments with a view to deciding how the IORP directive could be amended.

Michael Heise, Chief Economist, Allianz SE, predicted a "retirement crisis" heading for Europe as both public and private pension systems have been affected by the overall financial crisis. A recent study showed that gross financial assets have not yet reached the levels of 2007 and there is a challenge for the industry to channel liquidity back into long-term savings – in order to pay for pensions. However, there is a good chance of this happening as people are fully aware of the impending "retirement crisis." Heise wanted Eurofi's ideas and action plan to be implemented so that disincentives to long-term savings can be removed. He also wanted a market for pensions to be developed across the EU, despite national differences. In addition, Heise wanted the portability of pensions to be improved, via the so-called 28th regime; he wanted assurances of a level-playing field and EU legislation to protect clients in the case of an insolvency of a pension provider.

The Commission is too pre-occupied – in its green paper – with the need to enhance the internal market, suggested **Willem Handels,** Pension Strategy Adviser, Shell Pensions Fund, Royal Dutch Shell plc. The ordinary citizen has no interest in cross-border pensions and a genuine internal market for pensions may not be needed, he said. Occupational pensions are not seen as products in the Netherlands but more as part of the social and labour law framework. Handels highlighted some areas that the Directive should prioritise:

- A focus on sustainability and adequacy by promoting multi-pillar approaches which will spread risk across more parties.
- Any review must respect national choices in regard to retirement provision.
- International accounting rules must not jeopardise pension funds.
- There must be risk-based, well-balanced, transparent, proportionate, flexible and practical rules.

Handels did not reject a Solvency II-type regime for pensions, but he said the timeframe was difficult to define as Solvency II was experiencing problems. He added that it is difficult, but not impossible, to have something implemented consistently across Europe due to the differences in member states.

Georg Fischer, Director, Social protection and Integration, DG Employment, Equal Opportunities & Social Affairs, European Commission, stated that the green paper took a holistic view on pensions as they must be adequate, sustainable and safe. Referring to the huge demographic shift that is taking place, Fischer commented that the green paper also asks for ideas as to how the EU could help member states, which had the ultimate responsibility for pensions provision.

Noting the increase in funded private pension schemes, he suggested that reducing public debt might be a better solution – in state schemes – than such a reliance on public-private schemes. Fischer argued that the biggest increase in funded schemes had been not in occupational ones but in privately-funded schemes, in countries such as Italy and the UK. Occupational schemes can be less costly and more efficient, he said.

Fischer said that the green paper had 14 questions only but it emphasised gender issues and it dealt with the three broad issues: pension strategy, mobility issues arising from the dynamic labour market and, lastly, the safety and security of pensions.

De Mey welcomed the idea of a directive that would create an internal market for pensions. He wanted reliable information, safe pensions and the same rules to be applied across the marketplace, but not competition on the wrong issues. Even though pensions and insurance are not the same, De Mey felt that the principles of Solvency II could be applied.

Bernardino called for more consistency and with the trend from defined benefit to defined contribution, he acknowledged that there is an open debate as to whether the Solvency II principles should be applied to pension funds. Future generations need more professionalism, greater transparency and a common approach to pension promises across Europe, he said.

Several speakers pointed out the differences in the various member states, including **Philip Neyt**, President, Belgian Association of Pensions Institutions. In Belgium, for example, he stated that the "pension promise" was part of social and labour law. **Ángel Martínez-Aldama**, President, European Association for Retirement Provision (EFRP), said the green paper's holistic approach, with its interaction between the first and second pillars, is interesting but he called for a multi-pillar approach to be implemented before strict rules are imposed. **József Banyár**, Senior Counsellor, Hungarian Financial Supervisory Authority (HFSA), wanted the EU to support funded pension systems as the free movement of employees makes it impossible to support the old-style "pay as you go" systems.

Berès said that minimum social standards on retirement must be defined, including the "right to a pension". Historically, pensions had either been "funded" or "pay-as-you-go" and both types of pension were affected by the crisis, she said. Both are needed in the future and there must be equilibrium between them. Mobility is a reality for the rich and the poor and "I have no problem with the so-called 28th regime," she said. However, she did not want the whole system designed to cater for mobile people. Berès also called for the Occupational Retirement Provisions directive (IORP Directive) to be re-examined – as soon as possible - as it was drafted under Solvency I "and the world has certainly changed since then". "When reopening the IORP directive, we will need to look at portability but also at the corporate governance and the investments strategy of these funds to make sure workers' voice and long term strategy is taken on board.

Wilson stressed the need to cater for an ageing population, with the Solvency II principles as a good starting point for resolving the problems linked to pensions across the EU. De Franssu was struck by the size of the pension review task and suggested that a step-by-step approach might be more suitable. De Franssu highlighted some of the issues and themes under discussion: the 1st, 2nd and 3rd pillars, an ageing population, economic, social and financial issues, the impact of the financial crisis and a number of conflicting views.

De Franssu called for the existing pension gap to be closed through actions that cover all of the three pillars. However, there are national issues and progress will have to be steady. He described UCITS as a major success that has become a complete pan-European project. However, he concluded that a less ambitious and step-by-step approach might work better for Solvency II. **Van Hulle** argued that pillar 2 and pillar 3 already exist in the pension directive but they have not increased the amount of cross-border products.

The green paper offers a comprehensive, holistic view of pension policy, said **Chris Verhaegen**, Secretary General, European Federation for Retirement Provision (EFRP). Any review of the IORP directive must clarify the definitions of the three pillars across Europe, Verhaegen said, and an ambitious approach is preferable to a step-by-step method.

Lequoy called for Solvency II principles to be applied to pensions to ensure a level playing field. He also wanted the IORP directive to be reviewed in a timely fashion.

Neyt envisaged a world with people living longer and working longer; the only solution is one that offers short-term solvency and long-term continuity. There will be another major financial crisis and a collapse of the financial system if these existing pension issues are not resolved, he said.

Fischer added that the current pension situation is not particularly positive and he felt the panel had been a bit too complacent on the matter. The green paper had set out the issues and he hoped for many contributions.

SEPA

SEPA Governance

The panel on Sepa governance dealt with the governance mechanisms that are needed -- but not yet clearly defined -- to reconcile the differing interests of providers, diverse end-users and policy makers. The governance debate is about who is responsible for designing Sepa and sets the objectives, said **Gerard Hartsink**, chairman of the European Payments Council, in opening the panel. "We believe we did what we were asked to do by self regulation," Hartsink said. "But what about the customers?"

The EPC has led the way so far, but with the creation of the Sepa Council -- and regulation on the way from the European Commission -- policy makers are moving from incumbents toward various additional actors. More precisely the newly created Council has at least brought public administrations -- the biggest users -- into the conversation for the first time, Hartsink said.

The Council's goals are to realize the vision of Sepa and promote its use, according to Hartsink. He said that another goal that remains to be taken up by the Council is to "promote product innovation to meet the needs of end-users."

However for the banks that have invested in new systems, the big question hanging over Sepa remains how to get users to migrate to what the industry has created. In that respect the Sepa Council's key contribution may be communication and giving end users a chance to have a say and feel invested in the project, said **Elemer Tertak**, Director, Financial Institutions, at the Commission's DG Internal Market and Services. The communication task isn't easy because customers don't personally perceive tangible benefits from the promises of macroeconomic efficiency, Tertak said.

SEPA end dates

At present the migration rate toward SEPA instruments (SEPA Credit Transfer) stands at 9%. This level does not match the appropriate critical mass. The reasons are low awareness by end-users and insufficient clarity on phasing-out of national schemes.

This situation means that first movers suffer significant financial burdens that lead some banks or end users to delay their investments. This illustrates the fact that the switch from the current payment system to SEPA cannot be market driven. Therefore increasing the communication towards payment system users is crucial. Moreover in this context all participants agreed on the need to set an end-date in order to provide end-users with sufficient time to be convinced and to adapt.

Currently divergent opinions between DG MARKT and DG COMP are delaying the publication of the proposal for setting an end-date for moving from legacy payment systems to SEPA instruments, industry speakers said. The main divergence between the two Directorate Generals of the European Commission relates to the opportunity to regulate the use of an interchange fee for direct debit or not. DG COMP takes the view that the proposal for a Regulation on an end-date brings the opportunity to introduce an article on interchange fees for SEPA Direct Debits.

According to the European Commission, the way to implement end-dates is to develop a set of standards and essential requirements that should be respected by all payment schemes. These requirements should take into account the concerns of the end-users without imposing too many details so as not to stifle future innovation. The European Commission is still considering this way forward, in order to appropriately reconcile wishes of the industry and end-users. The publication of the draft regulation is now expected for mid / end of October.

SEPA keynote address

Peter Ayliffe, President and Chief Executive Officer, Visa Europe, focused on the payments system and its vital role in the economy. “If we get it wrong it can be a real barrier, if we get it right it can be a great facilitator,” he said. “Maybe that is why the European Union is calling for a fully-compliant SEPA card scheme.”

The ECB wanted banks to take a long-term view of governance and how much control of their cards they wanted to retain, he said, and more than 4,000 European banks decided Visa Europe should be completely owned and managed from Europe. “They wanted a direct proprietary interest in the European payment system.”

While the rest of the Visa world sought a listing in the second-biggest IPO ever, the European banks “did not take the easy decision. They wanted Visa Europe to remain a separate entity and this organisation is the best vehicle for a SEPA world,” he added. “They want cost-effectiveness, security and choice.”

Visa Payment is the only SEPA-compliant card on the market, he pointed out. “Through their ownership of Visa Europe, 4,000 banks have already ticked all the boxes for a SEPA system.”

The underlying business model must be palatable for regulators and retailers alike and the card’s prevailing rate is one of the lowest in the world – 10 cents for a €50 transaction, which is 50 times lower than the cost of using cash, he claimed. “Retailers get an incredibly good deal.”

The EU is worried about national card schemes being at risk of extinction, Ayliffe claimed, but he cited the case of the Netherlands, one of the largest card markets in the bloc. Visa Payment cards are no more expensive than national schemes, even though they are more flexible, “as you would expect from a not-for-profit business”. One of the benefits of SEPA is a more open and competitive system, he said. “I welcome competition – all we ask is a level playing field.”

Europe should have its own payment system and it should retain control of the governance of that system. “European retailers and consumers should not be subject to a second-rate payment system,” he concluded.

Is a new EU financial services action plan in a global context required?

In his keynote speech, **Adair Turner**, Chairman of the Financial Services Authority, said that while there are a huge number of issues to deal with post-crisis, "it is crucial we ensure that we focus on the issues which are most vital."

The causes of the crisis included "those on which popular attention often focuses" such as absurd bonuses for excessive risk taking, "an explosion of exotic product development whose impact we did not fully understand" and failures in risk management practices.

"But underlying all of these problems, and far more fundamental, were prudential rules and an entire philosophy of market regulation – embraced by policy makers throughout the world – which failed to identify and adequately address the dangers of excessive leverage and maturity transformation, and which too confidently relied on supposedly efficient and rational markets always to produce good results," he said.

Of the many reforms that have been put in train, some are more important than others, he said.

Rules to address bonuses that lead to excessive risk-taking "in themselves will not transform the build-up of risk in the financial system". Lehman's top management lost huge amounts in deferred bonuses, after all.

Regulation of credit rating agencies (CRAs) is also important, but will not remove the fundamental problem of pro-cyclical credit risk assessment and credit supply, he said, while hedge funds, another focus of popular concern, did not play a large role in the crisis. However, they may play an important role in a future crisis, so regulators must be able to gather information on hedge funds "and if necessary, to extend regulation to them".

More serious was the fact that "in the two decades before the crisis we failed to see that the shadow banking system – broker/dealers, money market funds, SIVs and conduits – had become systemically important". "We need to guard against any such mistake in future," he added. Some of the most high-profile issues, such as hedge fund passports, are of secondary importance.

The core issues should not be muddied by tangential, anti-competitive or political issues, he added. "Getting OTC derivatives as much as possible on to CCP systems is very important; the argument that clearing in euro-denominated instruments must be cleared in some sense physically 'within the Eurozone' has no basis in good prudential risk management, and it is on good prudential risk management that we should focus."

The most important issues, he said, are:

- Higher capital and liquidity standards – more buffers to absorb volatility in the financial system and economy
- Prudential and other measures which address the problems of banks perceived as 'Too Big to Fail'
- The need for macro-prudential analysis and policy tools to spot and lean against excessive credit growth.

Higher capital and liquidity standards are essential – pre-crisis, the global banking system was simply running with too small buffers of capital and liquidity to absorb shocks, Turner asserted. Basel III "is therefore central to future stability – combining a more robust definition of risks, a higher quality definition of capital, higher minimum ratios, and capital conservation and counter-cyclical buffers which will help guard against pro-cyclicality".

"The key priority for Europe now – more important than what we do on bank bonuses or hedge fund marketing passports – is developing a Capital Requirements Directive which translates this agreement fully and robustly into EU law."

But Basel III must be combined with measures to deal with systemically important financial institutions (SIFIs), the institutions seen in the past as 'too big to fail'. "We need to create real market discipline – so that future taxpayers do not have to bail out banks" and losses can be imposed on debt as well as equity holders," he stressed. This means that SIFIs should have buffers that go beyond the Basel III

requirements. However, we need to look beyond Basel III and rules on SIFIs because “the nature of financial risks continually evolves, with new institutions and activities emerging”.

As well as reforming the rules, there must be macro-prudential analysis and tools that will enable regulators “to take away the punch bowl just when the party gets going”.

While this will be important in the UK, it will arguably be even more important in the eurozone, he said. In a system with such different economies and banking systems, “the ability of interest rates alone to address financial stability issues is even lower than in a nation with its own currency and monetary policy.”

This macro-prudential analysis and policy cannot be conducted on an entirely national basis because one country’s actions – and the behaviour of cross-border institutions – will have implications in others. The European Systemic Risk Board (ESRB) is essential, therefore.

The Icelandic banking crisis forced the UK to realise that “a European single market in retail banking, with banks free to operate across borders in branch form, is dangerous if not combined with pan-European mechanisms to ensure strong bank regulation and supervision in all countries of the European Economic Area.”

“This crisis has been so harmful to the lives of ordinary people across Europe, through lost income, lost employment and public debt burdens for the future – that we owe it to them to ensure our policy responses focus on the key changes which will prevent it happening again,” he concluded.

Europe already has a de facto Financial Services Action Plan 2 (FSAP2), said **Sharon Bowles**, MEP and Chairwoman, Committee on Economic and Monetary Affairs, European Parliament, in answer to the question posed by the title of this session of keynote speeches, a fact that she pointed out a year ago at the Eurofi Forum in Gothenburg.

This is because most of the elements of FSAP 1 had review clauses which are now falling due, on top of which the financial crisis has highlighted some of the main issues with FSAP 1 and there is an ongoing programme of reforms as part of the G20 programme. “In the next 18 months, we have scheduled three times as much legislation as in the whole five years of the previous Parliament,” she said, and no doubt that will be followed up by a number of mopping up exercises “where we have not got it quite right or not linked up with everyone else quite right”.

Bowles also recalled that in Gothenburg she had said she would like an impact assessment of all the various bits of legislation that were in train. With claims that the cost of FSAP 1 was about 0.5% of GDP the fact that new regulation is likely to have a bigger impact “is quite worrying”.

“I wonder whether we are in danger of making our regulation seriously over-correlated in some ways,” she added.

Yet she warned of the “huge mistrust” between the US and Europe on accounting standards. “If we do not resolve it, some of our efforts on issues such as Basel III will not happen as we would like”.

She also expressed disappointment that, while there has been much focus on the links between US and EU regulation, “no-one has a map of how we are doing with other countries, particularly those that are going to be bigger than us and have more spare money to invest than us. It sends out a terrible message to Asia,” she said.

“I do question whether we are being sufficiently serious about global co-operation,” she continued. “I wonder if we are hiding behind our own sophistication as a form of protectionism.” She cited discussions about international colleges where the only concerns expressed were about confidentiality rather than exploring how “we could make the colleges a serious player in the global system”.

The EU has experience of this approach with its own national supervisors, she pointed out. “I hope we have grown up in Europe about this, but we need to grow up with regard to our dealings with the rest of the world. Sometimes we say we want consensus as long as it is our model of consensus.

“We cannot look down on other markets, many of which have withstood this Western crisis much better than us and by using the same sort of macro tools that we are now thinking might be a good idea.”

The aim of FSAP 1 at the turn of the century was to build a single market in financial services, said **Henri de Castries**, Chairman and Chief Executive Officer, AXA Group. “It has created some convergence in some areas, particularly accounting standards and asset management but it is difficult to say it has significantly hastened the integration of financial markets.”

In looking towards a FSAP 2, one must remember that such a plan is much easier during a period of deregulation rather than the climate of reregulation that now prevails, he added.

The financial crisis was a crisis of the banking sector, he added, not of the insurance sector although some weaknesses in the institutional framework were revealed at the European level. But the crisis has held back the cause of financial integration – the reaction to the situation came from national governments acting alone rather than within a European framework.

In reacting to the situation, policymakers need to decide where they want be on the continuum from risk to stability. The idea that you can deal with all the risk issues by increasing capital requirements is a very big mistake, he stated. “Capital has a cost, so if you have no risk, capital will be very expensive.”

A differentiated approach is needed to acknowledge the fact that different financial actors have different characteristics. “You have to recognise and foster diversity. You do not have stability by pushing everyone into the same business model. Different models have to co-exist,” he said. Forcing everyone to adopt the same business model, attitude to risk and risk horizon leads to a low cost, high risk monoculture with extreme volatility. “The medicine has to be adapted to each patient,” he pointed out.

The new regulations must apply equally to all parts of the sector and everyone should face up to their responsibilities, de Castries added. “Whatever the business model or risk horizon, the same risk taken by different actors should have the same cost of capital.”

The EU needs to wake up to the fact that if it gets its regulatory framework wrong “we will not be followed by the US and Asia and this will create major competitive distortions. Capital will move, jobs will move.”

Solvency II is at a critical stage and regulators need to find the right balance between now and mid-2011, he asserted. “If we get it right, it will make Europe more competitive. If we get it wrong, it will create more problems down the road.” Insurers, he said, had not asked for taxpayers money and continued to produce returns throughout the crisis. “You should not ask them to commit more capital, you should ask how can regulation fit better with their business model and use their business model as an element of their stability.”

The original FSAP, which tied in with the launch of the euro, was aimed at strengthening market integration in the EU because it was felt that financial integration lagged other sectors and the regulatory framework was patchy, said **Jonathan Faull**, Director General, DG Internal Market and Services, European Commission. “Subsequent events have shown that it was very far from being enough.” The Commission’s comprehensive reform agenda is aimed at correcting poor risk management, he pointed out.

International co-operation and convergence remain critical, he added. “All that we do must be and is properly co-ordinated with our international partners.” Some people fear that the push for international consensus will lead to weak domestic rules, but he highlighted the fact that the G20 agenda “very much corresponds with the approach of the EU framework”.

“In a world of global capital markets, there would be no sense at all in reforming in isolation,” he went on. “Financial markets move quickly and we are aware of the need to move swiftly to ensure a safe and sound European financial system.”

But he added that the Commission counts on “strong policy commitment from the member states”. The EU is taking actions for meeting the commitments of the G20, making this a “kind of FSAP”, with the G20 objectives being the roadmap.

There are a few fundamental goals for a new FSAP in a global context, said **Tommaso Padoa-Schioppa**, President, Notre Europe and Chairman, Europe Promontory Financial Group. It must foster the competitiveness of the European financial industry; improve the regulatory and supervisory framework of the EU and make a decisive contribution to a better and more consistent set of global rules.

While the EU was less affected by the flaws at the origin of the crisis, it has been worse hit by the crisis itself and it is in danger of being the main victim of the upheaval, he averred. This is because its response to the crisis was fragmented, and was not only ineffective but actually produced more fragmentation. “The first victim was the single market and the second – almost – was the single currency.

“In a crisis that requires support and protection, when the response is fragmented, protection becomes protectionism and support becomes the privilege of national champions,” the former Italian finance minister said.

One key lesson from the crisis is that “the system is indeed a system and to segment this system is a fundamental mistake. The Greek crisis shows that the idea that every country should pay for its own mistakes and that will preserve the others is not true.”

Another lesson is that co-operation and co-ordination have fundamental limits, not least when supervisors keep secrets from each other and as a result lose trust in their counterparts.

The goal of creating a large internal market has been the exclusive aim of the EU for 25 years, he said. “The objective was excellent, but the exclusiveness was probably unfortunate.” Integration was costly and resulted in inadequate supervision and little influence on international reforms – Basel II, for example, contained 15-20 different sets of rules that made it impossible for cross-border banks to have one avenue of complying in all EU jurisdictions.

Removing impediments to such integration is a task that comes up against resistance from organised interests in financial institutions, their clients, public authorities and policy makers, he pointed out. Supervisors hold a great deal of influence in an industry that is so heavily supervised that companies are reluctant to speak out and ministers are captive to local administrative structures. However, there is some hope, he suggested, as politicians are now having to pay attention because they have to go to national parliaments asking for taxpayers’ money for rescue packages.

Nonetheless, the new European Supervisory Authorities will be run by colleges bringing together the very supervisors that have been so reluctant to change over the last few years.

Finally, **Daniel Lebègue**, Co-President, Eurofi, issued a plea for the industry to raise standards in terms of corporate governance, risk management, remuneration, ethics and customer service. But he also worried that, following a crisis caused by the complexity of financial products, techniques and markets “we may be preparing a new “crisis of complexity” – this time of rules, processes and systems?” How can we manage this enormous set of rules on matters ranging from accountancy to remuneration, he asked?

European priorities for the incoming G20 meeting

IAS 39 accounting reform

Tomaso Padoa Schioppa, Chairman of the IFRS Foundation, coming back to 2001, reminded that despite it was contrary to its history to set common standards by Directives the EU decided to appoint IASB as standard setter in particular because the European Commission had no clear idea on ways to develop its own standards. Then he stressed two major challenges now lying ahead for EU. The first challenge is the appointment of the future chair of IASB. Even though it is not its task the Monitoring Group has been involved in the process. The second challenge is the evolution of the fair value concept. Were the US to maintain their extreme version of the fair value, one might abandon the objective to share single global standards and move towards regional ones.

Stefan Cooper, Board member of th IASB said that the IASB proposal on classification and measurement has been very well received. The proposal should be finalized soon. On impairment, following discussions with the European Banking Federation, the BIS, the ECB…five different models are now on the table. Therefore, the IASB may well have to re-expose. On hedge accounting, the difficulty is to avoid being too restrictive, in order to reflecting banks' business model without being to loose. The objective is to put for comments by the end of the year, and to finalize IFRS 9 by 2011. If IASB gets hedge accounting wrong, they might have to re-expose. On offsetting, the IASB considers that the US model offers too much flexibility, and will be reluctant to move to their model.

Etienne Boris, Director General, PricewaterhouseCoopers, insisted that the IASB should worry about financial stability, and reminded that investors do ask for a mix-measurement model reflecting the business model. He also pointed out that transparency is about understanding performance, cash-flows and risks. As risk assessment requires forward-looking information, he suggested the introduction of a "risk statement" as a new primary statement addressing the legitimate risk transparency expectations.

Impacts of prudential requirements on public and private financing capacities

John Berrigan, European Commission, DG ECFIN, welcomed the work of the Basel Committee and the long transition period that will allow banks to appropriately adjust to the regulatory changes and combine financial stability and economic growth. Although the costs of the prudential reform are not negligible, they should be weighted against the benefits in terms of stability. Anyway, banks are expected to cope, especially given the transition period. However he recognised that implementing the regulatory package will be challenging for the European banks and discrepancies between member states will certainly emerge in the way the banks will adapt (increasing lending rates, reducing dividends …). Back to the impact assessment provided by FSB and BCBS John Berrigan stressed that it is highly dependent of underlying assumptions e.g. markets may demand more capital or quicker transitions, there is also a risk of crowding out sovereign issuers etc. The Commission will conduct an impact assessment on the CRD 4 proposal, but it will not cover all ongoing regulatory reforms, as requested by the European Parliament. The Commission has room for maneuver to adapt the Basel agreement to EU specific circumstances t.
The level playing field will also be a key challenge for the coming years, underlined **Peter Praet**, National Bank of Belgium. He also stressed that "one must remain vigilant that massive transfer of activities from the banking sector to the non-regulated sector is avoided.

Amit Goel, Senior Analyst, JP Morgan, referred to a study by JP Morgan in February on the original Basel III proposals, which revealed that USD 220 billion in additional capital would be required and core capital would be cut in half. Further study after the July amendments revealed that the amendment was especially beneficial to EU banks. Generally speaking markets still under appreciate the impact of the proposals, e.g. only very recently did markets understand the potential impact of the treatment of credit valuation adjustments (CVAs). He stressed that the results of the QIS are highly sensitive to the assumptions. For example the economic impact depends on the increase of credit the effect of which is hard to anticipate.

Jordi Gual Sole, Chief Economist, La Caixa, claimed that the Basel long term QIS is flawed. It cannot be assumed that the new framework will decrease the frequency and scope of crises, as there is a possible move to under regulated sectors and some business models are penalized. Nor it is taken into account that markets will require quicker compliance. The main reasons for the crisis (lack of transparency, poor risk management/models, bad supervision) are not tackled. The focus is too

strongly on capital rather than on RWAs. **Peter Praet** reacted that the problem was also that capital was not sufficiently loss absorbing and that this is tackled through the definition of capital. Jordi Gual Sole reacted that it would be better to raise the minimum requirement than to change the definition of capital that raises a risk of regulatory arbitrage.

Although the overall assumption is that the costs of capital will be reduced in the long term, the package does not warrant that the risks will be reduced hence preventing a new crisis. The new regulation ends up punishing business models that were less exposed to risks. The retail banks will be hit violently by the new regulation. **Maria Abascal**, regulatory affairs, BBVA, supported the view, and raised the competition issue- as tackled by all other Spanish banks, and underscored by Peter Praet.

María Abascal, BBVA,, said that the impact of the proposals remains hard to assess given the lack of detail. Furthermore, market expectations are hard to foresee. Prudential requirements are only part of the story - a cumulative assessment is necessary, including also bank taxes, treatment of systemically important financial institutions, crisis management. **Mr Praet** added that there is a need for additional capital and liquidity requirements as there is too little market discipline in the absence of an adequate resolution regime.

Malcolm Knight , Vice Chairman, Deutsche Bank said that a financial crisis has a huge impact on the economy, so the benefits of stability should not be underestimated. But there should be no disproportionate increase of costs for banks. Given the differences between the conclusions of the IIF and Basel Committee/BIS impact assessments, they should both be treated with caution. There is a great risk of unintended consequences given the various important regulatory measures under development at the same time - therefore, to the regulators' decision to postpone implementation of the long-term liquidity ratio (the Net Stable Funding Ratio) and to phase-in enhanced regulatory requirements over a sufficiently long transition period was a good one. A longer transition period is also required as the amount of capital available in the system is limited, so it will be hard to absorb increased capital requirements. **Mr Praet** mentioned that the data provided for the QIS will be disclosed but the format has not yet reach an agreement by the supervisors.

Improving Corporate Governance and risk management

Christopher Towe, Deputy Director, International Monetary Fund, stressed that the crisis illustrated that risk management, both by firms and supervisors, fell far short of that needed to protect either the interests of individual firms or systemic stability. He noted the that the 2008 Corrigan and Senior Supervisors Reports pointed to the isolation of the risk management function in many firms, the over-reliance on quantitative indicators, inadequate involvement of senior management and boards, and shortfalls in the boards' own actions. And these problems were compounded by compensation practices that encouraged risk behaviors—bonuses were too linked to short-term profits and too tightly linked to the success of the individual employee. Towe argued this experience illustrated the need to bolster market discipline, but at the same time stressed that the events of recent years warned that it was probably unlikely that market discipline alone could adequately protect either the interests of individual firms and or systemic stability.

The public policy implications were similar to those of industrial pollution: supervision needed to be more proactive, skeptical, and intrusive in enforcing minimum standards for risk management and new compensation guidelines, and there was also strong arguments for systemic risk charges that helped firms internalize the risks they posed for the rest of the system**.**

Antonio Garcia del Riego, Managing Director, Head of European Corporate Affairs from Banco Santander, highlighted that "Self regulation can be a good complement of standard regulation." In addition, self regulation should be challenged by high quality supervision, he said.

Good governance depends on the quality of the relationship between the board of directors and the general management said **Jérôme Brunel,** Head of Public Affairs, Crédit Agricole s.a. To his view, four main conditions are necessary to get the relationship right:

1) A clear distinction of responsibilities between the board of directors and the general management
2) A true willingness from the general management to help directors to understand for each business line what is broadly at stake and the main risks involved.

"What is the best fit between the bank and its customers?" This is the question directors must answer, in collaboration with the general management. To find the right answer, the board needs to be composed of directors with a diversity of social and cultural backgrounds.
3) A quite high frequency of board meetings –or board specialized committees-. At the end, it does contribute to a better understanding of the group activities, its business objectives and its overall strategy".
4) Transparency in particular regarding risks and remuneration. Aligning remunerations with the bank medium/long term interest is indeed key for the financial stability. Remuneration policy must also be in line with the bank's risk culture. In this perspective, the FSB guidelines should be applied with the level playing field to be monitored.

Speaking on behalf of FEAM – Forum of European Asset Managers, **Irda Levine** mentioned that there are structural constraints on what shareholders can achieve. It is the regulators who have the front-line responsibility for prudential regulation of financial institutions, including monitoring strategic direction, governance and risk. The regulators are the only ones with unlimited access to the often non-public information necessary to review these sensitive areas; if investors are privy to material non-public information, they are no longer free to trade for their clients.
Fund managers, do not act as principals and have a fiduciary duty to clients to act in their best interests. Although fund managers often are long-term investors – and not traders, this can sometimes mean that they decide in their clients' best interests to sell a stock or bond instead of sticking it out and engaging with a company to improve its governance and risk management practices – this is reality and must be factored into the equation.
However Levine insisted on that investors have an important role to play to improving companies' governance, in particular by voting and engaging them in. But solutions must be practical and recognize the roles of the Board and of the Management and facilitate closer interaction between the Investors and the Board.

Levine made also two key points when it came to defining stewardship responsibilities.
1) "we would favour a "code of conduct" she said using a "comply and explain" approach responding to the principles in the code. He supports this approach for 2 reasons:
- This would accommodate the different types of asset manager and breadth of investment styles in the industry – e.g.. fixed income managers, "quants" etc.
- Prescriptive rules could have unforeseen consequences, and should not be set in stone – this gives some time to see what works best.

2) Answering the Commission request for opinions on measures that could encourage shareholders to engage more effectively and strengthen corporate governance he proposed 2 changes:
- Uniform toolkit across EU embracing best practices – e.g. vote on major transactions, advisory vote on remuneration.
- "Safe harbour" from "acting in concert" rules for institutional investors – particularly in relation to mandatory bid thresholds – that would allow investors to engage collectively without any chilling effect.

Implementing the de Larosière agenda

Opening the session, **Patrick Jenkins**, Banking Editor, The Financial Times, said that a debate on the de Larosière agenda is timely because it comes just a week after the three new supervisory authorities have been given the go-ahead. “Now is a good time to be debating what this means in practice,” he said.

The de Larosière proposals will create a real competitive advantage for Europe in the long run, said **Séverin Cabannes**, Deputy Chief Executive Officer, Société Générale, but it must be accompanied by the implementation of a worldwide level playing field.

While a single European authority to supervise the banking industry “should still be the target”, it is probably too ambitious an aim and there are too many execution risks in getting it up and running quickly, he added. The intermediate solution that has been reached is pragmatic and a good first step but for it to work, each supervisor must be given the same type of powers and expertise. “The legal competencies of regulation should be harmonised in a short period of time.”

Cabannes indicated that in his view, successful implementation in Europe will rely on three elements:

1) Give each supervisor power and expertise and harmonize practices,
2) Develop cooperation and trust amongst regulators and supervisors, and clearly establish the role of the home supervisor;
3) Provide technical, human and financial means.

Maria Abascal, regulatory affairs, BBVA, said the macro-prudential framework must be very well-defined, with clear boundaries between national and European supervisors to avoid overlap. “We need to move from words to action – to implementation,” he added. “I hope supervision will be kept at domestic level for the next three years because domestic supervisors are in the best position to look at institutions – they are very close to them.”

While supervisors’ colleges could play a valuable role, it would be useful to further clarify their interaction with the ESRB, he continued.

There must be more co-operation and trust between supervisors, Cabannes pointed out, while a single European rulebook is also necessary.

The creation of this rulebook will be one of the main functions of the three new supervisory authorities, said **Vítor Constâncio**, Vice-President, European Central Bank (ECB). The authorities will also have the power to monitor implementation, to mediate if there are conflicts and then arbitrate if necessary.

Constâncio also mentioned that from 2012 onwards, reporting will be the same in all Member States. Colleges will be the forum to try to co-ordinate the thorny question of burden sharing. There are now 31 colleges in the EU, they will soon be 43. He personally believes that an EU resolution fund should be built on a network of national resolution funds. On the ESRB, he advised that warnings and recommendations be concrete enough, and some should be public to create real pressure.

Co-ordination and supervision are linked, said **Antolín Sánchez Presedo**, MEP, Committee on Economic and Monetary Affairs, European Parliament, and the single rule book is essential. “We are moving from a fragmented to an integrated system. Harmonisation is common ground but we recognize there is room for national differences.”

There will be 43 colleges of supervisors for different financial groups by the end of the year, which is a big step forward, Constâncio added.

The European Systemic Risk Board (ESRB) is another crucial element of the new framework, and will enable the authorities to take action when needed. While the general regulatory overhaul will address many of the concerns related to macro-prudential supervision, certain issues such as capital buffers and impairments require judgement about when to intervene. “The ESRB’s effectiveness will depend on the timeliness and the quality of its interventions,” he pointed out. On the ESRB, he advised that warnings and recommendations be concrete enough, and some should be public to create real pressure.

The crisis management of cross-border institutions remains a very thorny subject, he added. “The only real solution is to have a European Resolution Fund created out of the network of national resolution funds the Commission has recently proposed.”

There has been much talk about the transition costs of the Basel III proposals, said **Juan María Nin Genova**, President and Chief Executive Officer, La Caixa, but “the transition periods seem to be long enough to avoid the potential adverse effects that we and others warned of months ago”.

To make the financial system more resilient, it is not enough to revise the regulatory framework, he added. “We need better supervision and we need to go further than just checking compliance.”

The only way to judge if an institution is being managed well is close supervision, he argued. “Supervisors need to be independent, depoliticised and strong enough to prevent the survival of zombie institutions. Supervision needs to be strict, intrusive, on-site and co-ordinated at international level but flexible enough to deal with national circumstances.”

This plea was backed up by his compatriot **Adolfo Garcia del Riego**, Director European Corporate Affairs, Grupo Santander, who said that supervisors need very close knowledge of the institutions being supervised and that such close supervision could avoid the need for additional capital requirements. “National supervisors should have the flexibility to apply principles according to their deep knowledge of institutions. By doing this, capital surcharges for large institutions could be avoided.”

Abascal said that it is crucial to define what SIFIs are “and it needs to be looked at on a dynamic basis – looking only at size makes no sense. You have to look at other issues such as maturity mismatch.”

Cabannes agreed that “there is still big concern in the industry about minimum capital requirements for systemic institutions.

Koos Timmermans, Chief Risk Officer and Member of the Board, ING Group, pointed out that the Basel process will proceed slowly and warned that counter-cyclical measures are “a bit of a crude measure”. Certain sectors grew in an unhealthy way before the crisis and it will be up to the ESRB to make recommendations about certain sectors of the economy when necessary.

Solvency II will produce a larger degree of harmonisation than in other parts of the financial sector, said **Denis Duverne,** Deputy Chief Executive Officer, AXA Group. “The Solvency II process gives a lot of power to Level 2 regulators and it is important that supervisors take a balanced approach,” he added.

He also highlighted the scope for further harmonisation through the Financial Conglomerates Directive. Basel II puts limits on banks with holdings in other sectors – insurance companies with bank holdings should be treated in the same way.

There are obvious costs associated with harmonisation, Nin pointed out, including reduced flexibility for supervisors and the market to adapt to local preferences and different local frameworks “so we need to look at how far harmonisation should go. There are some cases where national discretion is appropriate.” He cited the example of La Caixa’s holdings in local utilities, which would be affected by new rules affecting the exclusion of minority stakes and non-banking services. “No doubt this is a reaction to SPVs, which led to under-capitalisation. But our holdings are low-risk.”

However, **Sharon Bowles**, MEP and Chairwoman, Committee on Economic and Monetary Affairs, European Parliament, reposted that “it is vital to get away from the cult of national exemptions with carve-outs and holes. I would be very sad if we created incentives for more carve-outs by creating national rulebooks.”

She also questioned whether there were the resources to undertake more intrusive and hands-on supervision. “Where is the capacity to supervise large banks?” she asked.

Sven Giegold, MEP Committee on Economic and Monetary Affairs, European Parliament, said there must be sufficient budget to ensure the new supervisors can attract quality staff. “We must not create a tiger without teeth.”

The single rulebook does not mean uniform rules regardless of national circumstances, said **Axel Weber**, President, Deutsche Bundesbank. Supervision will still mostly remain with national supervisors, but the options for national discretion must be removed. “It will be challenging to find a balance between the new powers on the one hand and the day-to-day responsibilities of national authorities on the other.”

Weber also warned: “We need to keep a focus on the fact that we are deeply embedded in the international system. Europe is not an island. While I value the pan-European approach, the more important work is the G20 work on the pan-global system.”

This was backed up by **Jonathan Faull**, Director General, DG Internal Market and Services, European Commission, who said that in the G20 and Basel processes, European countries of all different sizes – and the EU itself – all came together in a very easy way “because there is a common European outlook and we face a common European challenge”.

Yet given the lack of a global state, there will only be minimum standards at global level, so there is a danger of lowest common denominator solutions, warned Giegold. On the other hand, there is no “one size fits all” solution for Europe, he said.

The new arrangements have the potential to produce fundamental change, but there are many uncertainties, said **Tommaso Padoa-Schioppa**, President, Notre Europe and Chairman, Europe Promontory Financial Group. There are two possible scenarios, he added. The first is that the potential will be exploited to the full “and we will have a highly integrated system of regulation and supervision”. The second is that “not much will change except that the core committees will now be called agencies”.

The Lamfalussy process ended in disappointment, he asserted, because the policy was not fully realised. “This time the ambition is higher, but risks remain because the decision-making bodies will be the same institutions that did not meet the potential of the Lamfalussy framework.”

Not all member states want to introduce the de Larosière agenda, pointed out **Sylvie Goulard**, MEP, Committee on Economic and Monetary Affairs, European Parliament. “In our negotiations with the Council, we found that some member states have put obstacles in the way of the new authorities.” **Jean-Paul Servais**, Chairman, the Banking Finance and Insurance Commission (CBFA), called for qualified majority voting “to force national authorities to implement the new rules”.

Stephen Cooper, Board Member, International Accounting Standards Board (IASB), focused on the need for a provisioning model that is more forward-looking and based on expected losses. However, he pointed out: “Dynamic provisioning means different things to different people. If it means something that is quicker to respond, that is good. But sometimes, it is seen as under-providing in the bad times and over-providing in good times and that is not something we intend to introduce.”

The architect of the reforms, **Jacques de Larosière**, Co-President, Eurofi, conceded that the structure that has been agreed is not ideal. “It is not a single federal authority, but it is the creation of authorities with very significant powers, which is fundamentally different form the vision of the Lamfalussy process.”

But he warned: “The show is not finished. This is something that is going to have to evolve over time.”

Like Padoa-Schioppa, he also envisaged two possible scenarios – that bad habits and bureaucracy prevail, that information remains secret and “that government influences seep into the organisation. If that is the case, we will not be that far from where we are now.” However, there is another way “that I believe will happen. The authorities will use to their full extent the powers bestowed on them by the EU.” The key to success will be the staffing of the new authorities, he said.

In the past, the regulators had been “not one step behind but 100 steps behind the industry, so the industry paid no attention to them. We need to get the regulators at the most one or two steps back. To do that you need to find the right people, people from the private sector, people who are taken seriously by the industry.”

This will be “the beginning of the end of this monstrous game of fragmentation, these exceptions and exemptions, this gold-plating and the like”.

De Larosière welcomed the idea of the Parliamentary shortlist, with the Parliament looking at the candidates for key positions in the new authorities. “It might help the selectors to be a bit careful to choose people who are not exactly those who the present structures would have liked,” he suggested.

Finally, he warned that member states must play by the rules. “If this is all lip service, if countries are determined to keep things as they are and not pay attention to the very deep consequences of this, it is going to be very difficult.”

Developing a long term investment perspective favouring financial stability and growth

Eurofi has presented a paper that raises some issues concerning the impediments to long-term investment and makes proposals about how they could be addressed, which would provide for a good debate, said moderator **Malcolm D. Knight**, Vice-Chairman, Deutsche Bank Group. A number of industry players complained that regulation was stifling long-term investment, starting with **Jean Azéma**, Chief Executive Officer, Groupama.

Financial markets show little appetite for long-term investment in equities, even though Europe's saving rate is high. "Investors prefer low-risk assets such as government bonds rather than equity," he stated. Furthermore, the appetite for long-term investment has fallen over time, with the average length of holdings falling from seven years to below a year.

Insurers have a positive impact on business activity through their impact on long-term investment and their ability to absorb financial volatility and they are major players, with $20 trillion AUM, second only to pension funds. "However, certain key principles in the present Solvency II reform, such as the one-year horizon, are more likely to impair insurers' strategy than help it," he claimed.

European insurers have sold €700bn of equity already in anticipation of the new prudential requirements but also the new accounting standards, he said.. He called for a study of the impact of the regulation on long-term investment and said it should include a refined treatment of certain long-term holdings "to better match the requirements of our long-term business and the duration of our liabilities". He also said that the implementation of Solvency II should be phased in over a six-year period so the industry can adapt to the new rules "otherwise there will be serious disruption".

Angel Gurria, Secretary General, Organisation for Economic Co-operation and Development (OECD) pointed out that the EU had a lower appetite for venture capital than the US. The first requirement for long-term investments is that banks are well-capitalised, well-run and well-regulated, he said. This is still "work in progress" at present however. And while it is clear that there was a massive regulatory and supervisory failure, it should not be forgotten that there was also a massive failure of corporate governance and risk management, he added.

There is also much work to be done on the macro-framework level in order to find a new balance between recovery and conservation Gurria concluded. Trade and investment protectionism must be fought against as well as risk averse biases.

Governments need to mobilise investment to sustain economic activity and fight against unemployment at a time of high public debt that will restrict their ability to finance projects from public funds, pointed out **Antoine Gosset Grainville**, Deputy Executive Officer, Caisse des Dépôts et Consignations. At the same time, the financial sector is not in much of a position to help. "How do we finance today the growth drivers of tomorrow – infrastructure, innovation, research and development?" he asked.

When a group of investors created the Long-Term Investors' Club, the Caisse des Dépôts et Consignations is part of, three years ago, the concept was unknown or ignored, he said. The club has created two of the largest infrastructure funds in the world, the Marguerite fund and the Inframed fund but "there is still much to be done to encourage long-term investment, particularly through the regulatory framework".

A gap remains between the need for long-term investments and the ability to meet the demand that is the result of "an accumulation of short-term preferences," he added.

Mark-to-market accounting standards mean that at certain times, long-term investments show massive losses, which limits insurers' ability to invest. The EU should increase pressure on the IASB to introduce accounting criteria that distinguish between different types of investment, Gosset Grainville urged.

Some parts of the industry have started to argue that Solvency I was more robust and provided a better basis for long-term investing than Solvency II because of the latter's one-year time horizon, pointed out **Thomas Steffen**, Chief Executive Director of Insurance Supervision, (Bafin).

Yet **Karel van Hulle**, Head of Unit, Insurance and Pensions, DG Internal Market and Services, European Commission, pointed out that Solvency II was developed by all stakeholders and that the Commission has lowered a number of requirements from the recommendations of the technical experts, from 45% to 39% for listed equity and from 55% to 45% for non-listed equity. “This is not unreasonable,” he said. “These are risky assets.”

Pension funds have the longest investment horizon of all, claimed **Philip Neyt**, President, Belgian Association of Pensions, and “the average maturity of our liabilities will increase. People will retire later and live longer.” Currently about 40% of pension fund investments are in equities but if Solvency II was introduced tomorrow, pension funds would have to sell €1 trillion to €1.5 trillion of assets, on top of what insurance companies would need to sell.

These sales would not only result in huge swings in equity markets but the cash would need to be allocated to other asset classes, which would likely be short-term instruments and bonds. “These are all the ingredients of the next crisis, as well as locking investors into low expected returns and reducing the incomes of pensioners,” he asserted.

Jordi Gual, Chief Economist, La Caixa recalled the impact of accounting standards, as the fair value accounting introduces incentives for short term. Accounting rules and tax policy should take account long term investments.

“What are the alternatives to fair value?” asked **Stephen Cooper**, Board Member, International Accounting Standards Board (IASB). “None seem particularly attractive.” The IASB had considered the approaches in Eurofi’s paper on the subject and rejected them, he said. It’s all very well having expert judgements, but which experts?

“Maybe fair value can give problems at certain times, but to allow individual companies to make a judgement about what they feel is the value of an asset is not something we feel is appropriate,” he stated. “We have taken lots of steps to deal with fair value in illiquid markets where you do have to resort to a more mark-to-model approach but it is very difficult to see how you can produce something that reflects economic circumstances better than market prices.”

Mario Monti, Former EU Commissioner for Competition, for Single Market & Financial Services, for Tax Policy and current President of Università Bocconi, declared that he largely subscribed to the Eurofi paper, but in themselves the proposals would not be sufficient, he said.

The key basis for growth in the EU is the single market, but “what does the single market mean from a long-term perspective?” he asked. There has been a wave of economic nationalism and the emergence of small parties that reject integration, he said. “Unless there are some bold political initiatives, the single market might not be there in the long term.”

At the heart of financial stability is economic governance and the Stability and Growth Plan, he said, but there is a tendency to satisfy the hunger for discipline that has to be followed up to generate stability. Sanctions were introduced to encourage that discipline but then they were put aside by large member states, he pointed out.

Short-term behaviour was not invented by bureaucrats in Brussels, added **Pierre Delsaux**, Director, Free Movement of Capital, Company Law, Corporate Governance, DG Internal Market & Services, European Commission. “Why are long-term investors not active when they invest in companies?” he asked. There is a need to look at asset managers’ remuneration, which must be based on short-term profits, not long-term factors, he said.

There is no lack of finance, but there is competition for finance, pointed out **Philippe de Buck** Director General, Business Europe. There is also a great deal of regulation and reform being introduced. “We have to put everything in place, but what is important is that we know in advance that it will work,” he stated. “There should be an impact assessment of everything that is on the table.” He made a plea to all financial companies not to forget their customers.

Yet before discussing regulatory and supervisory instruments, “the industry should ask itself if it is still willing to provide society with long-term products and whether it goes along with long-term investing,” said Steffen.

“We need capital markets with windows of opportunity as wide open as possible and without excessive volatility,” added **Pascal Hubinont**, Executive Vice-President General Manager Group, Treasury – Solvay. The financial crisis led to a substantial flight to quality that effectively closed the capital and debt markets for lower-rated borrowers, he added.

“We need banks with a strong balance sheet and the incentive to make that available to the corporate community,” Hubinont continued.

But **Jozef Kortleven**, Counselor General, Belgian Ministry of Finance, pointed out that while much of the focus has been on the availability of credit to the financial sector and the problems of public debt, “not so many people seem to know that corporate debt has also gone through the roof in the last 10 years”.

After the 2001 recession, corporate debt levels fell for 3-4 years and there could be a similar deleveraging this time, he added. “To finance investments, you need projects to invest in.”

Uli Fricke, Chair, European Private Equity and Venture Capital Association (EVCA), pointed out the long-term nature of private equity investing, where the average holding is five years, while for venture capital it is eight years. “There is a very clear alignment between the fund and the investor and between the fund and the companies it invests in.” The capital requirements for private equity seem disproportionately high. This is just one instance among many that shows that a one size fits all approach towards regulation can hinder long term investments in companies.”

Wolfgang Mansfeld, Member of the Executive Board, Union Asset Management Holding, highlighted the need to link household savings and long-term finance. There are no suitable instruments for doing this currently, he said. UCITS products have to be highly liquid to provide constant redeem ability, so only liquid instruments are eligible. But with private investors increasingly on the look-out for lower volatility, there should be products regulated to UCITS standards but with longer-term assets such as real estate and restricted redemption windows, he argued.

Paul-Henri de la Porte du Theil Chairman of the Association Française de la Gestion Financière (AFG) also supported the development of long term instruments. In his view, a pan European savings regime could ensure the transferability of investments made on the basis of UCITS, and should be portable on a cross-border basis.

Volatility has been fuelled by banks using their asset management subsidiaries to shore up their balance sheets, said **Jean-Baptiste de Franssu**, President, European Fund and Asset Management Association (EFAMA), and the volatility of flows into UCITS are two-three times higher than for US mutual funds.

One requirement for long-term investment is more long-term products, van Hulle said and **Franco Bassanini**, President, Cassa Depositi e Prestiti, highlighted President Obama’s project bonds as a possible example to emulate, along with EU bonds to fund renewable energy projects. “The premium would come from the EU’s endorsement and the quality of the issuers could cut the cost of issuance. This could create an asset class that could attract investors from all over the world,” he said.

Antoine Lissowski, Chief Financial Officer, Executive Board, Member, CNP Assurances, said that the insurance sector is a natural long-term investor but its capacity to do this is being hindered by the plethora of regulations, such as accountancy regulations and Solvency II, and the way that they interact with each other.

“We have to rebuild the European economy and its capacity to be competitive. The initial target of financial stability could be mitigated by having better conditions for long-term investments,” he added.

It is also important that there is a well-functioning Eurozone government bond market, said **Maurice Thompson**, Vice-Chairman and Head of Public Sector, Citi EMEA. Given recent volatility, total cohesion in the Eurozone and total government support for reform mechanisms is essential to improve market sentiment and bring private investment back to government bond markets, he stated.

“We face a contradiction between our long-term needs and our decreasing ability to meet them,” said **Jean-Jacques Bonnaud**, Independent Director, Board Member, Eurofi. One thing that would help is the restoration of regional decision-making powers. “There has been a tendency to centralize

decision-making," he pointed out. The creation of regulatory ratings organizations would help small and medium-sized businesses and there is also a need to look at non-financial issues such as the quality of management.

Eurofi's activity on long-term investment may become its most important contribution to the public debate, said **Tommasso Padoa Schioppa**, President, Notre Europe and Chairman, Europe Promontory Financial Group. "It addresses one of the deep factors behind the crisis and one that has received virtually no attention in attempts at post-crisis reform," he added. "Short-termism is a pervasive element of the mindset in which we live today and it affects government, the financial sector and business."

It is the job of public policy to correct this distortion, although that is difficult when the legitimacy of governments is questioned every two weeks, he suggested. Nonetheless, "we need to correct perverse tax incentives but we also need to accept that if there is no risk, there is no return. We have to accept mistakes as the price of a longer-term view. This is precisely what policymakers do not do now."

Regulation, taxation, budgets and ownership by governments should be used to encourage long-term investment. While privatization had been seen as a panacea, that view should be reviewed, he added.

He also warned against confusing pro-cyclicality and short-termism. "The pro-cyclicality debate puts together all things that go up and down but the logic of cycles is very different from the logic of bubbles."

Defining a common regulatory and supervisory basis to achieve resilience, growth and competitiveness

Financial stability regulatory agenda (Basel Agreement)

At the start of a marathon display of moderating, Co-President, Eurofi **Jacques de Larosière** looked forward to several "interactive sessions". He wanted reactions to the main speakers rather than "speeches" from the floor. With that he introduced the first speaker, **Jean-Paul Chifflet,** Chief Executive Officer, Crédit Agricole SA, who said the financial industry must continue to support the real economy, which means regulation should avoid a "one size fits all" scenario, taking into account the bank-insurance and cooperative business model. Instead of focusing on capital requirements to regulate risks specifically for large cross border organizations, Chifflet said there should be room for better prudential supervision, adequate corporate governance, market infrastructure improvements and well-co-ordinated crisis prevention tools.

Although Credit Agricole welcomed the Basel III framework last adjustments , Chifflet felt it would be a challenge for banks to fulfil its requirements. Improvements are, therefore, required in four key areas:

- Concerns remain about the prudential treatment of insurance participations which penalises groups
- The introduction of a complex counter-cyclical buffer on top of capital requirements ~~is~~ seems inappropriate
- The short-term liquidity ratio is based on excessively conservative stress hypotheses and the range of elegible instruments remains too limited
- The long-term liquidity ratio must be the subject of an in-depth review.

Reforms are clearly necessary, Chifflet said, but improvements are still needed and he called for the European Commission to conduct a thorough analysis of the cumulative effect of all forthcoming reforms to meet the needs of the development of the EU's economies.

Michel Pébereau, Chairman, BNP Paribas, agreed that the strength and quality of capital must be improved, but argued that Basel III is bringing in many measures that could harm Europe's economy. The calibration is harsh for European banks that have met the recent stress tests. Furthermore, Pébereau felt that Basel III would harm economic growth and the amounts of capital required might not be found in European markets despite the 8-year transition period. The introduction of Basel III will mean banks having to reduce flows of credits and be stricter with clients, Pébereau said. He warned European SMEs will suffer first, as the US market which relies less on financing by banks will be less impacted by Basel III . He warned European policymakers not to rush their decisions and called for more work to be done on crisis management. In particular, a specific administrative resolution regime shall be considered for financial institutions in distress and posing a systemic risk. Such regime shall pursue three objectives: to restore the solvency position, subordinated debts shall be converted into equity; the central bank shall provide funding assistance to keep the institution alive, and it shall enable the restructuring, or possibly the sale of activities to ensure the viability of the firm.

Pébereau also highlighted the importance of macro-prudential supervision. Most national supervisors will have to upgrade their resources and take appropriate steps, in order to be fully equipped to properly control banks under their jurisdiction. financial stability is first and foremost a combination of intimate work between supervisors and the banks under their supervision. .

Axel Weber, President, Deutsche Bundesbank, argued that the financial system had been fragile and lessons had to be learnt. Financial reforms will not prevent all crises but they will lessen the frequency and dampen the impact. Weber felt that micro-prudential supervision and stricter requirements for the quantity and quality of capital are key. The transition period will be essential, he said but he did not feel that Basel III would affect the economic recovery – its introduction is manageable and it will bring long-term benefits.

Weber added that systemic risk cannot be resolved by micro-prudential supervision alone. Supervisors need to make both qualitative and quantitative judgements on large institutions, and assess the risk profiles and business models of institutions. Priority should be given to global financial institutions that most need a level playing field – in that way, supervisors can assess which organisations need attention first. It is vital to complement micro-prudential supervision by macro-prudential oversight so that a global view can be taken, Weber said.

Tommaso Padoa-Schioppa, President, Notre Europe and Chairman, Europe Promontory Financial Group, argued that there is no need for a rule for each business model. Instead he called for general rules that are "neutral" to business models and to business strategies. In response, de Larosière, added that a rule could have different options depending on the types of risks.

Peter Skinner, MEP, Committee on Monetary and Economic Affairs, European Parliament, added that on the macro side, supervisors should work holistically through the "joint committee" – better co-ordination is needed from the ESAs. **Malcolm D. Knight**, Vice- Chairman, Deutsche Bank Group, called for regulation to be extended to all institutions and markets that could have similar types of risks as to those of regulated commercial banks. He explained that money-market mutual funds (in the US) and other "risky instruments" (off balance sheet) should have similar capital and liquidity requirements as banks. Knight added that the aggregate positions of hedge funds should be available to supervisors so that risks to the market can be avoided.

Karl-Peter Schackmann-Fallis, Executive Member of the Board, German Savings Bank Association (DSGV), understood the need for enhanced capital requirements but he saw hidden risks for bank on the asset side as, he argued, the Basel III committee has addressed the wrong side of the balance sheet. As an example, Schackmann-Fallis said that higher equity ratios could slow down lending to all groups, including loans to SMEs, a problem that he had not seen with Basel II.

Denis Duverne, Deputy Chief Executive Officer, AXA Group, spelled out the differences between insurance and banking. On the banking side, Basel III was a comprehensive framework but Solvency II was defined pre-crisis and Duverne did not believe there was any drive towards global harmonisation in the insurance world. He added that he was fearful about a knee-jerk reaction that would lead to excessive capital requirements in the insurance world. Duverne said that group supervision should be strengthened but not without in parallel a harmonised approach to insurance guarantee schemes. Here, he called for the European Commission to come forward with a proposition. Duverne also called for the Financial Conglomerates Directive to be updated so that consistent rules can be applied to the banking and insurance world, where appropriate.

Kay Swinburne, MEP, Committee on Monetary and Economic Affairs, wanted to know if Basel III would be implemented in its entirety, in all areas of importance and in all geographic jurisdictions - especially as this has not happened with Basel II. Secondly, she asked, "from a global viewpoint, will there be more effective work from the College of Supervisors?".

Marisa Lago, Assistant Secretary for International Markets and Development, US Treasury, said she believed that the G20 heads of state would endorse the Basel III committee's recommendations in Seoul and that the US regulators are committed to a full and timely implementation. **Pébereau**, however, argued that Basel II had not been implemented in the US and he added that if it had been implemented, then the crisis might have been of a different nature.

Lloyd C. Blankfein, Chairman and Chief Executive Officer, Goldman Sachs Group, said the investment banks – not the commercial banks – were regulated by the SEC and come under the remit of Basel II, and that includes Goldman Sachs. He added that Lehman Brothers had also been on Basel II, so it had not been a panacea. **Pébereau** said that while (commercial) banks had been under the control of the Federal Reserve, the SEC had effected control through "leverage ratios" which did not prove to be effective and were eventually suppressed. **Blankfein** added that he was sympathetic to Basel II principles. However he argued that the real problem was that people had not realised they were taking excessive risk and that in that case a properly constructed leverage ratio may have been an appropriate back-stop against a possible mistake in risk assessment.

Lago offered clarification, saying that 17 US banks that account for 70 % of the market were subject to Basel II. Looking forward, she backed Weber in looking not just at the quantity but also the quality of the capital.

Richard Meddings, Group Finance Director and Board Member, Standard Chartered Bank, said that Asian banks are in somewhat better shape than those in Europe. Their economies have high levels of capital in a macro-prudential system, making the banking sector more resilient. The challenge for Basel III is that some issues such as the trading book and double liquidity have not yet been fixed. Turning to the crisis, he said that in the case of UBS, for example, a leverage cap would have helped but he was against one leverage ratio for the whole market.

Stefan Walter, Secretary General, Basel Committee Banking Supervision, argued that the crisis had built up under Basel I as the US had implemented the legislation with an incomplete trading book and this was followed by an incomplete Basel II implementation by US banks. Leverage ratios were not applied across the board in some firms and that had caused problems. He said the quality of capital should be improved and the gaping hole of trading should be filled; he regarded leverage ratio as a backstop.

De Larosière argued that not all banks had run such risks, by trading dangerous products, and he did not think it was fair to impose rules – such as leverage ratios - on those that had been prudent. He suggested that it would have been better to get supervisors to really look at the risks. In Europe, many banks managed the crisis well and he felt the responsibility fell with supervisors and CEOs rather than the imposition of a one-size-fits-all solution across the board.

Weber agreed with those comments and added more comments to the mix. Leverage ratios should be part of the risk management approach. Weber said the discussions about leverage ratios in the Basel Committee led to a comprehensive dialogue about off-balance sheet items exposure in risk management; He called for more consistency in global accounting standards – otherwise this would all be "a wasted endeavour". That work might be necessary but it must be achieved without impeding the banks ability to lend. **Knight** reasoned that the fact that commercial banks in the US were not on Basel II had been a major negative contributor to the crisis: huge amounts of off-balance sheet vehicles were sponsored without capital buffers that were adequate to absorb losses. This led **de Larosière** to add that he was reluctant to see prudent banks treated in the same way as those that had not been so wise.

Athanasios Orphanides, Governor, National Bank of Cyprus, looked at the issue from a different angle. Rather than focusing simply on financial stability, he wanted more attention to be paid to minimising the consequences of failures 'if they happened'. Orphanides argued that credible resolution mechanisms are needed to give the supervisors much more confidence in an organisation. Their existence would avoid the use of taxpayers' money and, he added, there would be less pressure to build up capital reserves. The moderator agreed and noted that the US had been much more efficient in this regard, although it is only a single country.

Stanislaw Kluza, Chairman, Polish Financial Supervision Authority, looking from the vantage point of the emerging economies in the EU, stressed that all economies have different business cycles; for example, in the Baltic States, the boom had led to consumption rather than investment. He wanted buffers to be applied at the country level. Financial institutions are not the problem, but rather financial situations, he said, and thus systemic risk must be viewed on a country basis.

All economies have different business cycles, argued **Károly Szász**, Chairman, Hungarian Financial Supervisory Authority. For example, in the Baltic states a boom led to consumption rather than investment. Financial institutions are not the problem, but financial situations, so systemic risk must be managed on a country basis.

Basel III "is here to stay", said **Sharon Bowles**, MEP, Chairwoman, Committee on Economic and Monetary Affairs. She said there are lessons to learn from markets such as Asia and she wanted a flexible system somewhere between pillars 1 and 2. Bowles felt that the systemic risk boards might help as they would trigger signs of problems automatically – possibly across member states.

Andras Simor, Governor, National Bank of Hungary, spoke out against a standardised approach, pointing out that in smaller countries such as Hungary, liquidity is more of a problem than capital. Macro-prudential supervision is the first line of defence but there is an enormous amount of work to be done, Simor said, in terms of tools and the various powers available.

There must be more security for ordinary taxpayers, said **Sven Giegold**, MEP, Committee on Economic and Monetary Affairs. Having heard industry representatives saying that more regulation would affect loans, he wanted to know why bonuses had been paid post crisis, as this money could have been used to build buffers. The industry has not fully understood the impact of the crisis, he said.

Christopher Towe, Deputy Director, International Monetary Fund (IMF), emphasised market discipline. He thought that the industry should be able to cope with the impact of Basel III in the transitional years. He added a caveat though, as those banks depending on intangibles might suffer.

Towe said that while the Financial Stability Board (FSB) might be working on peer reviews the IMF would make monitoring mandatory.

Séverin Cabannes, Deputy Chief Executive Officer, Société Générale, argued that the length of the phase-in period is vital to allow banks to adapt their business models. He also pointed out several remaining problems in the Basel III proposals; more attention must be paid to liquidity risk management and he did not believe the long-term ratio to be appropriate. Some countries already have more advanced liquidity management schemes in place

Weber did not want "shadow banking" to be forgotten, otherwise parts of the industry would simply migrate. Any resolution regime must have a global impact and coverage and it must be a harmonised initiative across the EU that can be looked at by the European Parliament.

Eurofi Co-President **Daniel Lebègue** emphasised the need for better day-to-day co-operation between the public authorities and industry, backed by improved professional standards. J**ean Guill**, Director General, Commission de Surveillance du Secteur Financier (CSSF) Luxembourg & Vice Chairman of CESR, agreed that irresponsible behaviour had led to the crisis and that public intervention is key. Pébereau agreed on the need for more regulation but he insisted that it is industry's duty to explain the consequences. For example, increasing the level of capital required fourfold would lead to less credit being available.

De Larosière noted that Weber had backed the need for capital buffers in the banking system and that the rise to 7% is not "lip service" but is a fundamental change to the banking system. He argued that 80% of Europe's economy depends on the banks willingness to give credit. He added that the situation is totally different in the US as only a quarter of its economy is dependent on banks.

The role of supervision in supporting the enforcement of prudential requirements

Meddings said that too much attention is being paid to capital and that improving supervision must be a priority. One size fits all is not the answer – supervision worked well in many areas of the globe, such as Asia, where certain products had been banned. Meddings felt European regulators and supervisors have not kept pace with such progress, although in the UK the FSA has increased its resources. In the past, too much time has been wasted on checking minutiae rather than focusing on emerging risks. Meddings wanted more emphasis on sharing information and on hiring supervisors with prior banking experience.

The staffing of the new authorities is vital, De Larosière said. "Tighter supervision, being alert to risks and innovation, would have reduced the magnitude of the crisis."

Self-regulation had not been effective and therefore more regulation is essential, said **Stanislaw Kluza,** Chairman, Polish Financial Supervision Authority. Regulation brings financial stability and the stability of nations, which is a public good, Kluza said. There must be a way of defining a model that prevents the taxpayer from paying. The final system must optimise costs and achieve the right balance.

Hans-Ole Jochumsen, President NASDAQ OMX Nordics, suggested that equity markets could become more important in terms of raising capital. Being concerned about insider trading, Jochumsen insisted that the monitoring must be close to the local marketplace – for several reasons, including that of language capability. He also raised the possibility that the exchanges could be responsible for real-time surveillance, i.e. act as supervisors for on-exchange equity markets. **René Karsenti**, President, International Capital Market Association (ICMA), emphasised the need for high-quality supervision, which requires the right people with the correct attitude and experience. They must use technology to monitor this complex area but there is a place for self-regulation, he said.

Antoine Lissowski, Chief Financial Officer, Executive Board, Member, CNP Assurances, explained that France had organised the supervisors into two bodies (banking & insurance, and market supervision) and he questioned why there are three bodies in the new European authorities (banks, insurance and the market). Lissowski was also concerned that the European level of supervision (so-called lead supervisor role) has been reduced and that multiple contacts still exist. He wondered how the level playing field would be enforced as many insurance companies have moved from one country to another in order to avoid regulation.

These comments led de Larosière to explain that many companies have three regulators and that it would have been premature to legislate for two bodies in all countries. He added that this could happen in the future. De Larosière reminded the conference that this lead supervisor approach has never been accepted; regulatory arbitrage is always available if all else failed.

Szász said there is more and more work linked to international activities but eventually, rules must be implemented in local markets. **Malcolm D. Knight**, Vice Chairman, Deutsche Bank Group, emphasised that the crisis had shown that regulation must go far beyond the supervised banking system, into the "shadow banking" world. The latter will be unsupervised, although in both Europe and the US hedge funds for example, would be registered and would need to provide appropriate data to regulators.

De Larosière added that the UK has a similar register for hedge funds and he agreed that the "macro-regulator" should look into such shadow banking areas. **Jean Paul Servais**, Chairman, the Banking Finance and Insurance Commission (CBFA), highlighted the importance of the new authorities being able to set up binding mandatory standards.

Yann Le Pallec, Head of Government Ratings for EMEA, Standard & Poor's, said the same criteria should be applied by supervisors across the globe, although he suggested that Europe is moving ahead of other regions in the field of regulation. Convergence will be the "acid test" but efficiency, comparability and, above all, resilience are also needed to bring confidence to the market. **Andrew W. Douglas**, Head of Public Affairs Europe, Depository Trust & Clearing Corporation (DTCC) and **Jean-Pierre Jouyet**, President, Autorité des Marchés Financiers (AMF), both pressed for clearing of OTC derivatives at the European level.

Giegold reminded the panel that in countries like Spain and Canada, higher standards of supervision had been applied intelligently and this had helped in the crisis. However the phase-in period must be applied intelligently so that the economy is not affected.

The challenges posed by implementing a new financial regulatory and supervisory framework in a global context

Blankfein, like many speakers before him, emphasised the need to co-ordinate the work of regulators and supervisors to avoid adverse consequences. If regulations are not co-ordinated globally, competitors will move to a location where capital can be raised more cheaply. Blankfein wanted a level playing field and he added that large organisations will find it easy to move resources to non-regulated areas, which was obviously not optimal. Many lessons had been learnt in the financial crisis:

- Institutions did not hold enough capital and not enough liquidity
- Major risks had not been on the balance sheet
- Quality of capital is just as important as quantity
- The market made judgements about what made good capital
- Principles are better than "hard rules" for global co-ordination
- There will be a challenge in future to avoid protectionism and provincialism.

Attention also had to be paid to unintended consequences of the current proposals regarding OTC derivatives, he believed. While he was highly supportive of clearing houses (CCPs) in order to reduce counterparty risk he suggested making sure that CCPs which are built to avoid "regular crises" do not increase risks in the context of "extreme crises". He also pointed out that while safety is an important goal, there is a cost associated to it and therefore policy makers, who should appropriately make decisions between safety and aggressiveness of lending, should publicly acknowledge the trade-offs to economy.

José Antonio Alvarez, Chief Financial Officer, Grupo Santander, wanted a global response to a global crisis. It is not just a matter of competition, however – there are also significant differences across G20 countries: different accounting rules and balance sheet instruments, a need to harmonise what is on/off the balance sheet and a need to discuss leverage ratios. Furthermore, there are many resolution regimes and different funding structures in different markets.
Focusing specifically on the EU and the US, Alvarez said the major difference is the treatment of the mortgage market on the balance sheet. And if the principle is to create safety in the industry beyond the banks, then it must be agreed who would be protected: tax payers, savers, retirees?

Marisa Lago, Assistant Secretary for International Markets and Development, US Treasury, said she had been struck by the need to ensure a level playing field, both cross-border and across sectors. And it is obvious that the focus cannot simply be on US-EU relations – it should also include the BRICS. Progress has been made at a financial level, Lago acknowledged, but the identified standards must be used in support of high-level principles. While the Basel III capital regime is global, Lago insisted that financial regulation is essentially a national responsibility with all countries working closely together. EU-US co-ordination has intensified recently, she said.

Critical areas of focus in the future include a need to identify areas where co-ordination is better than regulation for financial stability, as typified by the "Volcker Rule" in the US. She recognised that a different approach is likely to be required in Europe. Lago noted that the IMF wants all firms and institutions to be regulated. To this end the Financial Stability Oversight Council (FSOC) will meet to identify firms to be supervised by the Federal Reserve. The ESRB will perform a similar function in Europe with co-ordination at a senior level and Lago placed the emphasis on a frank dialogue between experts.

Henrique de Campos Meirelles, Governor, Banco Central do Brazil, stated first that clearing houses should not only have solid margins but also risk assessment. This is the way it works in Brazil and Meirelles argued that firms should welcome regulatory reform as it will give them confidence in counterpart dealings. He did acknowledge, however, that in this perspective a possible regulatory arbitrage is a nightmare.

Meirelles emphasised the need for a global co-ordination of principles, especially on the quantity and quality of capital and the definition of liquidity. Even if at the end of the day regulation is a national prerogative, Basel requirements help to go towards common rules. In addition, he said coordination was particularly important for SIFIs (systemically important institutions).

Meirelles thought the prudential concepts should be broadened. He said that Basel III rules must be reinforced in particular by credible resolution regimes. It is also clear that more volatile countries from a macro-economic perspective will need stronger attention as there is an inter relation between countries and financial institutions.

Jochumsen called for US-EU co-ordination to be expanded to cover, for example, the interest rate equity swap market while Weber touched on unintended consequences, arguing that if CCPs have access to central bank liquidity, then this must be supervised. However non-standardised OTC products could become cheaper for consumers. He concluded on the differences of a capital-based US and a bank-based Europe. Compared to the US, capital market alternatives are not as readily available in the EU.

Stefan Ingves, Governor, Swedish Central Bank, highlighted the advantages of the IMF as peers tend to be "nice to each other". He also argued that it will be hard to destroy a system if macro-economic supervision is in place as most problems are due to excess leverage. Ingves added that country cycles are not co-ordinated and monetary policies are different across borders.

The IMF's **Towe** noted that the IMF was adapting its multilateral and bilateral surveillance to include lessons learnt from the crisis. There are two main challenges, he said; firstly, more attention needed on the activities of large complex financial institutions, given their importance for transmission of cross-border shocks, which was constrained by limited data availability; and secondly, just as the crisis had demonstrated the importance of national supervisors to be more intrusive, comprehensive and challenging, it was probably true that the same lesson needed to be applied by those involved in multilateral surveillance, he said.

A level playing field means regulating financial activities, warned **Hervé de Villeroché,** Assistant Secretary, Financial Sector Department, Ministry of Economy, Finance and Employment, but it is important that the result of more regulations should not be an increase in "shadow banking".

Alvarez said there had been a basic agreement on principles and the goal now is to implement the regulations without impacting the real economy. Blankfein was also optimistic saying the current progress on regulations is good for business. Meirelles wanted to broaden engagement to the private sector as there must be stability and a higher return for stakeholders. He was encouraged by the discussion on clearing houses but he was unsure about access to central bank funding.

Closing the debate, **de Larosière** asserted that the regulatory framework must encompass OTC derivatives and clearinghouses. He also stressed the need to look at resolution mechanisms and to make regulations globally consistent, if not identical. He liked the idea of taking a macro-economic view of risky countries (the Stability Board and the IMF could do that) but much more effort is required to ensure a consistency of approach.

Concluding Remarks

Jacques de Larosière introduced **Michel Barnier,** EU Commissioner for Internal Market and Services, who made the keynote address. The Commissioner said that we are living in uncertain times and that recent events have shown that the financial crisis is ongoing. This means that Europe must have the right monitoring tools and everyone must be vigilant. These are the principles behind the agreement reached in September by the Ministers of Finance and the European Parliament to create a new supervision architecture for Europe.

This agreement is the first step of an ambitious action programme that Barnier then described. Three levels of coherence were looked for: coherence in financial regulation; coherence in international actions; and coherence between financial regulation and economic policy.

With these new tools and structure, Barnier stated, “for the first time, Europe will have the means to react to urgent situations in the world of financial services. The Commissioner personally thanked Jacques de Larosière for his efforts in helping the financial sector to move towards a Europe that will be more solid, more integrated and more competitive. Noting that it is only the first step in a long and ambitious programme, Barnier called for coherence at every step – financially, internationally and between financial regulations and the world of politics.

Insisting that financial regulation must be seamless, Barnier said it should be based on two principles: a) all products and sectors must be included in the scope, and b) the new European authorities must be supported as much as possible without neglecting the essential role of national authorities. Barnier stated that the European Commission has recently started work on a system to trace derivative products, so that if a supervisor has doubts, he or she will be able to determine who has taken certain actions. The new supervisory agreements give Europe the possibility of restraining or banning certain short-selling operations if market conditions make this necessary. “Europe must have strong regulations but this only makes sense if that is part of a global framework,” he said.

Barnier wanted to avoid the disastrous consequences that had occurred because different regulatory bodies had been in competition; now, countries must follow the same objectives with equal determination. To this end, he stated that the US and Europe have a particular responsibility with their differing approaches: the US with the all-comprehensive Dodd-Frank law, as opposed to Europe’s case-by-case approach. Despite these differences, progress has been made on derivative products with coherent approaches put in place in the US and the EU, as pointed out earlier by G. Gensler, and plans are afoot to take action on short-selling. Barnier welcomed the US’s full involvement in the Basel negotiations as there could be no risk of divergence in the implementation of regulations; equally he wanted no divergence in accounting rules. Going further than this EU-US collaboration, Barnier looked forward to dialogue and co-operation with the emerging nations to create a truly global architecture.

Barnier returned to the European Commission’s policy of growth. This means the creation of a financial sector that supports the economy and a reform of the sector that will allow the EU to grow and move towards a more effective single market. This would make conditions better for citizens, shareholders and entrepreneurs. In conclusion, he called for a long-term strategy for the EU against protectionism, as that would be against the single market, and for stronger regulation and supervision that will improve stability in the economy. “These European ideas and ideals must be explained to all the nations of the world,” he said.

Henrique de Campos Meirelles, Governor, Banco Central do Brazil, explained that In Brazil, all kinds of institutions (all sizes and sectors) are included in the regulatory system and supervisors are moving towards a system of risk assessment and strong capital rules. He added that Brazil has rules that had allowed it to escape the impact of a crisis and that had led to higher employment levels and a more predictable economy.

Summing up, **Jean-Pierre Jouyet**, President, Autorité des Marchés Financiers (AMF), drew a number of conclusions:

1. The challenge, in the wake of prudential regulation overhaul, will be to avoid that stronger requirements push parts of the banking activity into the unregulated world, thus creating a new kind of "shadow banking system". The role of the macro and micro EU supervisors, who should look into this parallel financial system, will be crucial.
2. There is a risk of divergence and of potential systemic risk, associated with the flight of financial activities to less regulated countries. Allowing divergences of financial regulation at international level –leaving aside several new emerging markets - would be a terrible mistake. There must be global monitoring –at the at G20 or FSB level to ensure a level playing field.
3. At international level, the G20 and the FSB do not have the power to issue binding standards and rely too much on light-touch "peer-pressure" to promote the implementation of the common declarations. We need more mandatory decisions from international bodies to ensure real convergence.
4. The creation of ESMA and other agencies is fundamental but it is only a first step towards global regulation; A key role should be given, by the EU institutions, to ESMA to ensure coordinated enforcement with its sister counterparts of third countries.
5. The organization of financial markets should be at the heart of further reform movement because confidence in financial markets is key to sustain economic growth. Financial markets reform is still incomplete. It should be the priority of the next G20. .
6. Reforms since the crisis have corrected the most obvious failures (securitization, derivatives), efforts must now be pursued to cover all asset classes. Reforms must be accompanied by a global reflection on the organization of markets and their supervision.

Mr. Jouyet added that much work remains to be done but he wanted to remind the conference that a financial market must be organised for sustainable economic development.

Gala dinner

At the Eurofi 2010 Gala dinner, **Didier Reynders**, President of the Ecofin, Deputy Prime Minister & Finance Minister, Belgium, spoke of his pride that the Belgian Presidency was able to reach an agreement on a new architecture for financial supervision in Europe that was based on Eurofi co-founder Jacques de Larosière's report. It was only possible to reach an agreement because of Belgium's insistence on sticking to the proposals in the report.

The minister reiterated his determination that banks should contribute to the resolution of the next crisis through a bank levy but he conceded that "it may take some time to make progress on that". More difficult still would be to make progress on discussions about a tax on financial transactions. "Ten years ago, during the last Belgian presidency we tried to put a discussion on the table. Now we will try to organise the same pressure at the G20 meeting."

If other goods and services can be taxed, he said, "then why not financial services?"

The Belgian presidency would also attempt to introduce sanctions for countries that are not able to implement their own commitments, he added.

The financial crisis has "vividly illustrated the importance of effective financial regulation of economic activity," said **Elisse B Walter**, Commissioner, Securities and Exchange Commission, (SEC). "A balanced and dynamic regulatory sector guides the smooth running of the financial system. We have the opportunity and the obligation to take dynamic and rapid action.

"We have a chance to build a seamless regulatory structure that better protects our interests in a global age," she added. "There is a global opportunity to build procedures, transactions and relations to make a positive legacy of the crisis."

Today every matter is a global matter, the commissioner continued. The technical committee of IOSCO has released a set of principles for cross-border supervision in line with the recommendations of the G20, she said. "This type of co-operation is critical but we should also focus on more targeted efforts on regulatory reform," she added. "The US and the SEC are more prepared than ever to pursue this course. The Dodd-Frank Act recognises that the time when one can focus on one issue in one economy is past."

She stressed how important it is for the US and the EU to work together to eliminate the opportunity for regulatory arbitrage.

OTC derivatives, hedge funds and ratings agencies are particular focuses for the SEC, she said. There should be exchange trading for trades that can be cleared, so regulators should define which contracts can be cleared.

This year's forum takes place at a time of considerable progress on matters of financial regulation, said **Jean-Claude Trichet**, President, European Central Bank (ECB). "The establishment of the European System of Financial Supervision (ESFS), including the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities (ESAs) is a milestone."

The ESRB, which Trichet will chair, has the mandate of mitigating EU-wide systemic risk through macro-prudential oversight, he said. "At present, we hardly need to describe systemic risk in words: we can almost feel it. In all our economies, financial distress became so widespread that it impaired the functioning of the entire system to the point where economic growth and welfare suffered massively."

This financial crisis is not over, he stated, and the ESRB will pay particular attention to the way that risks can reinforce each other in highly detrimental ways. "It is therefore appropriate that the ESRB draws together the work of a broad range of EU institutions: central banks; our partners in the ESFS, including national supervisors; as well as the Commission."

But he stressed that the ESRB is separate from all these other institutions and it will not affect the functioning of any EU domestic central banks. The key strength of the new institution will be in the diversity of its members, he said.

The ESRB's main tasks are threefold, he said: "to identify and prioritise systemic risks; to issue early warnings when significant systemic risks emerge; and to issue policy recommendations for remedial action in response to the risks it identifies".

It will not focus on individual institutions, countries or macroeconomic issues, he said. "Interlinkages and spillovers should be key terms in its analysis." Its scope should be broad-based enough to cover the shadow banking system as well as the rest of the financial system.

Because it does not have binding powers, "it must convince through the quality of its work. To achieve credibility, it must ensure that warnings are well-timed and that recommendations are specific and well-targeted." It will also alert the Council and the European Parliament "when it judges that compliance is less than satisfactory".

The Basel III reform package "will be a cornerstone of the new regulatory system," Trichet said. Some commentators suggest that the agreements are too lenient while others argue that they are too tight, he added.

Those who argue that the package is too lenient say that the regulators have been too soft on the banking sector, basically giving in to its intensive lobbying efforts and allowing an implementation period that is too generous.

Those who argue that the agreements are too tight point to the risk to banks' lending activity and therefore to the recovery of the global economy, he said. "Despite the implementation costs, which are of a temporary nature, the new framework will benefit the global economy by enhancing financial stability through strong global standards and by contributing to avoid the massive economic and social costs of a major bust and deep recession."

The so-called Long-term Economic Impact study suggests that a 1% lowering of the yearly probability of a major financial crisis corresponds to an annual output gain of 0.6%. "Of course, these figures need to taken with a pinch of salt, but they suggest that the order of magnitude is very significant."

The Basel agreement is remarkable because of its global nature and because it has come up with tough standards, he asserted. With common equity requirements lifted from 2% to 7%, this is by a factor of 3.5 but with some institutions previously only having a level of 1%, they face a seven-fold increase. "Overall, I consider that our agreement strikes the right balance between the objective of strengthening the resilience of the financial sector and the need to avoid unduly severe implications for national banking systems, he added. "The transition arrangements will allow banks to meet the new standards while not endangering the progressive consolidation of the recovery."

"The new European supervisory system will not only strengthen oversight, it will also foster integration," he added. The new single rulebook will contribute to a level playing field in Europe and the ESRB could increase the confidence to engage in cross-border financial activities.

On the G20 agenda the ECB chief said: "Financial reform is a long and arduous process, and we have to keep the momentum." Particular areas of focus are to reduce the moral hazard posed by SIFIs, to develop tools to resolve the failures of such institutions without resorting to taxpayer money and to extend oversight to institutions that currently fall outside of regulation.

"In this respect I hope that rapid progress will be made with the Commission's legislative proposals on short selling and OTC derivatives, which address some important shortcomings of the current regulatory framework. We also need more work on credit rating agencies and hedge funds," he added.

Effective financial reform needs perseverance and determination, he continued. Global regulators took very dramatic action to avoid a depression but even so, the advanced economies still suffered the deepest recession since World War II. If we had to deal with the same crisis now, the probability that governments would mobilise 27% of their GDP as taxpayer risk to avoid a depression would seem to be meagre, he said. "So we won't have a recession, we will have the depression that we avoided this time through the rapid action of the authorities.

"Our economic environment remains very demanding. This is no time for complacency. It is a time to remain alert, vigilant and inflexibly determined," he concluded.

Developing an EU cross-border crisis management framework

Moderator **Peter Praet**, Executive Director, National Bank of Belgium welcomed **Paul Tucker**, Deputy Governor, Bank of England, to Brussels before Tucker introduced the session. Resolution is a domestic, EU and global issue and it is important that the EU is taking it seriously, said Tucker. "It is essential that each member state – and every country in the world – has a national resolution regime for conventional commercial banks. Not to have such a regime is a great mistake and can be a disaster, as the UK demonstrated in the case of Northern Rock," he stated.

Yet very few countries, including the UK until 18 months ago, have such a regime and "this is a real gap in the architecture of our financial infrastructure. One of the things the EU can do is to tell member states they must do this."

The global financial community must develop tools to be able to resolve the largest and most complex Systemically Important Financial institutions. "This is at the heart of the work to address the problem of institutions that are too big to fail," he said. "Unless we make progress on this, we won't bring back the market discipline on which all capitalism relies."

The goal of such resolution regimes is to be able to resolve these institutions without taxpayer support and avoid disruption to the essential flow of financial services, Tucker said. The need to avoid taxpayer support was a theme he returned to several times.

"As the crisis has demonstrated, we need to extend the basic resolution toolkit beyond the banks to holding companies, affiliate companies and non-bank financial institutions with systemic importance," he continued. "This is what the recent US Dodd-Frank legislation does and we should consider doing it in Europe."

Beyond that the authorities should also plan for being able to write down or "haircut" the claims of unsecured uninsured creditors and convert part of their holdings to equity, which is sometimes known as "bail-in". "This would only work where the size of the loss could be estimated in the run-up to resolution and the underlying franchise remains viable," Tucker pointed out. This is essentially the application of US Chapter 11 techniques in an accelerated way, but at the discretion of the resolution authorities rather than through negotiations.

"But even with the right set of tools, we must be able to cope with the cross-border element of a bank failure in the EU and regulators must take a very close interest in what is happening at a global level," he added. "Leaders will have to think about the extent to which they want to pool sovereignty in this area."

There is a decision to be made about whether to stress nationally-based solutions or to look for a European framework, said **Elisa Ferreira**, MEP, Committee on Economic and Monetary Affairs, European Parliament. "The Parliament's position is very clear. We ask the Commission to act and state the guidelines for intervention."

A multilateral binding treaty to put a single country in the lead role was likely to be out of reach, Tucker suggested, but there is scope for the removal of impediments to co-operation.

The authorities in the Nordic-Baltic region carry out cross-border exercises on resolution which revealed that the natural instinct is to talk about ring-fencing but that each jurisdiction loses less money if they co-operate, said **Stefan Ingves**, Governor, Swedish Central Bank. "However, to make that happen requires a quite different mindset so it will take a long time to figure these things out."

Regardless of the amount of planning that goes into the framework, there will still be a need for lots of planning on a case by case basis, which is where living wills come in. However, viable living wills rely on statutory national resolution regimes. "We want these tools because there is a policy of not rescuing banks in future," **Tucker** said. "I don't think there is an appreciation yet about the amount of data banks will have to hold."

We are used to thinking of central banks as the lender of last resort but that is not normally how it works in reality, said Ingves. "Governments are not being owners of last resort. They want it either not to happen at all or for it to take much longer to happen."

Living wills are now very important for institutions, said **Juan Guitard**, Director General of Internal Audit, Grupo Santander. “We have given very high priority to the preparation of our living will. It is something like a comprehensive self-portrait of the organisation taken from time to time. It is a very useful tool for both the regulator and the institution,” he explained.

The living will defines crisis situations, the drivers for those situations and the actions that can be taken in those circumstances. In addition, they give supervisors detailed information about the relationship between the entity, the market and other institutions. In a crisis situation, supervisors face two main enemies, he said – a lack of time and a lack of information. “Living wills help deal with these two enemies.”

Living wills are only useful when there is something to distribute, said **Lothar Blatt**, German Savings Banks Association (DSGV). There should be three lines of defence – fostering resilience through capital buffers; voluntary activities by the industry to avoid bank failures, such as mutual guarantee schemes and then, finally, resolution schemes.

The definition of crisis is that you do not know, added Ingves, “because if you knew you would have solved the problem in the past. Crisis management is about enormous uncertainty. The more guidance you have the better because it tells you how to take the next step.”

Colleges of supervisors will be critical in this regard because they will be in a position to facilitate crisis frameworks quickly, said **José María Roldán**, Director General of Banking Regulation, Banco de España. If the EU cannot organise an integrated, well-supervised market including resolution regimes then there is no hope for the global financial system, he added.

Living wills clearly improve the understanding of where vulnerabilities lie for both the institution and the regulator, added **Richard Meddings**, Group Finance Director and Board Member, Standard Chartered Bank. Standard Chartered illustrated the challenge there can be in gathering the necessary information – the bank operates in 70 countries, it has back offices in Chennai, Shenzen and Singapore and data centres based in Hong Kong, London and New York. “For us, this is less about financial exposure and more about the physical wiring of the organisation,” he said.

There is confusion in the debate between going concerns and gone concerns, Meddings asserted. A resolution framework would have spotted the problems at Northern Rock, but it would not have helped in the collapse of Lehman Brothers.

Dodd-Frank gives the US authorities more discretion to adjust the rights of creditors, which is important, said **Malcolm D. Knight**, Vice-Chairman, Deutsche Bank Group, but there is an element that needs clarification. “While the authorities should have increased discretion, it would be very bad if this allowed them to treat creditors who had exactly the same contractual rights in different ways.”

He also highlighted the importance of contingent capital when institutions get into trouble, “But what are the triggers?, he asked.

The triggers must be clear at the outset, said **Roldán**. “I want rules, not discretion,” he added.

This call for clarity was echoed by **Luc Everaert**, Assistant Director, Euro Area and EU Policies, European Department, International Monetary Fund (IMF). “The financial stability arrangements need to be very clear.” Regulation is “in a half-way house at the moment,” he added. “We are doing a lot on financial regulation and strengthening supervisors but resolution affects how banks are set up and how they behave. We need to move quickly on that front too so we have the entire suite of tools.”

“We must remember our master plan,” said **Piia-Noora Kauppi**, Managing Director, Federation of Finnish Financial Services, which involves a regulatory framework, a supervisory architecture and crisis resolution. “Without all three elements, we are lost.”

The crisis resolution framework is the missing link, agreed **Kerstin af Jochnick**, Managing Director, Swedish Bankers Association. “If we do not have good resolution schemes, there will always be a fear that we have not required enough capital from the banks,” she said.

Yet resolution is what happens “when you are in the last chance saloon,” said Tucker, “and the choices are utterly unpalatable. This is the point at which the rules have been exhausted and you are at the point where you have to exercise discretion.”

Sweden enforced government support to problem banks linked to equity conversions in 1993, **Ingves** pointed out. “There is nothing strange about it and this type of transaction can be an enormous incentive to shareholders to run the bank properly. You can design it in such a way that if they don’t behave they can lose the bank.”

Colleges of supervisors for SIFIs should help to create a dashboard that “should be the basis for development of a clear understanding of the triggers for intervention,” said **Ferreira**. “If we don’t have this system we will not be able to solve the problem of burden-sharing in Europe.”

The priority should be to have a clear roadmap, said **Maria Abascal**, regulatory affairs, BBVA.

With the 43 colleges that will be up and running by the end of the year, “how do you deal with that kind of complexity?” asked **Everaert**. “Do colleges really remove the conflict of interest between home and host country? Do they really deal with burden-sharing?” Would it not be preferably to have a European Resolution authority to deal with this issue?

Burden-sharing is down to the political will of Member states, said **Kauppi**, “but I think they are dancing around it. We have seen binding agreements like the no bail-out clause of the Maastricht Treaty dropped in a second.”

Resolution regimes are the most important focus for the Commission, said **Mario Nava**, Head of Unit, Banking and Financial Conglomerates, DG Internal Market and Services, European Commission. “There is a consensus that we need prevention, early intervention, an extension of the tools the authorities have at their disposal and a need for co-ordination. This must go beyond the supervisory circle – we need a resolution circle as well.” Yet, divisions remain on: where and when should the money be taken (ex ante or ex post model?), where should it go, and who should do what? The Commission announced that its communication on crisis management would come out at the end of October. A public consultation will be launched before the end of the year and a regulatory proposal is expected for spring 2011.

Resolution squares the circle of capital regulation, deposit guarantee schemes, supervision and regulation, he added. “It is the last piece of the puzzle.”

The role of the European Banking Authority is clear enough in the prevention phase, when it has a surveillance role, said **Giovanni Carosio**, Chairman, Committee of European Banking Supervisors (CEBS), but it is much more difficult to see what it should be doing during a crisis. “The EBA will have a role in defining what will be in recovery and resolution plans but there is a risk that at the crucial point it will be difficult to reach an agreement. Can the EBA step in at that point?” he wondered.

Carosio also pointed out the difficulties of co-ordinating bail-in triggers. “There is an obvious limit to all this, which is the fiscal sovereignty of the state,” he said.

This prompted **Elemer Tertak**, Director, Financial Institutions, DG Internal Market and Services, European Commission, to recall the statement that “big institutions are very international in life but national in death”. He also pointed out that the US’s early intervention system and resolution system were not enough and it still needed to bring in new powers.

There is no free resolution, he continued, and in the case of bail-in instruments, the costs would come from bondholders.

Nonetheless, bail-in instruments deserve serious consideration as they could enhance the loss absorbing capacity of financial institutions, said **Panagiotis Strouzas**, Head of the Financial Services Policy Division, European Central Bank (ECB). However, further work is needed on addressing several challenges such as triggers, definition of non-viability, pricing, availability of investor base. The possible impact from a financial stability perspective as banks and other regulated financial institutions could be potential investors needs to be assessed. In the same vein, the need for hedging against such risks may lead to new innovative products.

Consistency in the availability and use of tools by the authorities is needed, he added. “When it comes to the resolution funds, I am supportive to this idea as tool for crisis management. It is also important that a network of resolution funds at EU level is created in a more longer term to promote consistency and harmonization and address issues arising from cross-border banks. As to the levies as source of funding for resolution funds, their introduction should take due account the cumulative impact of all measures under way (Basel II, surcharges etc). .

The new system should not weaken existing national resolution schemes, pointed out **Stanislaw Kluza**, Chairman, Polish Financial Supervision Authority. While the new framework seems to meet the expectation of the largest banks, it disregards the interests of those who find it harder to present their interests, such as minority shareholders of subsidiaries, he said. These groups find themselves strongly marginalised or have seen their rights violated. “The interests of the host country must be protected as much as those of the home country,” he added.

Prospects of future G20 discussions and expected impacts for the EU

Jacques de Larosière, Co-President, Eurofi, welcomed an eminent international panel for the final debate of the forum by saying it was a great honour and privilege for Eurofi to have their presence, but it was also important because “we have been talking over the last few days of the importance of having a global view and implementation of the main rules that govern the supervision of financial institutions and their regulatory framework”.

Since the G20 was established two years ago, it has had four summits and come up with a series of important agreements, said **Song Zhe**, Ambassador, Mission of The People's Republic of China to the EU. “The G20 has played an important role in containing the crisis and promoting economic recovery,” he added. “As the crisis fades, we are now able to debate the future.”

The future direction of the G20 needs to be carefully managed, the ambassador said. The organisation represents a fair share of the international community in terms of population, GDP and trade and it should become a major platform for international co-operation. “The world economy still faces profound structural risks and has yet to resume the cycle of steady growth,” he pointed out. “We need a sense of urgency, not complacency.”

The G20 must not forget those outside the organisation, who represent 90% of countries and one third of the world’s population. “The G20 should listen to other countries and respect their views,” Zhe said.

The organisation must also establish its place among the other multilateral organisations, such as the UN, the WTO and the IMF. “We need to work out who does what. The G20 should not spread itself too thinly – it should focus on the reform and improvement of global economic governance and macro-economic financial issues,” he suggested. “The crisis made us see clearly the importance of financial regulation to maintain stability and prevent crises. The financial sector should be able to support, not burden the international economy.”

Zhe praised the EU multilateral approach for the way it ties in with the G20’s operations but highlighted the fact that the EU or its members hold a quarter of the G20’s seats. “The future of the G20 will shape to a large extent the future standing of the EU,” he said.

Enhanced competition, transparency and non-discrimination are critical to drive future growth, said **Mark Hoban**, Financial Secretary, HM Treasury, UK. These had been the objectives pursued in the EU. “The single market opens up trade, reduces costs for business and provides benefits for consumers.”

Events since 2007 demonstrate the need for a strong, well-regulated banking system, he continued. “High capital standards strengthen banks and protect taxpayers, but there is still work to be done to deliver on our G20 commitments.” But regulation must not raise barriers to market entry or help vested interests to reverse the benefits that competition has brought to the EU’s financial sector.

Hoban proposed 4 principles as future guidance: competition, non-discrimination, transparency and consistent implementation.

Competition drives further innovation and growth. This had been exemplified for example with the MiFID directive in the EU. The need to preserve openness of the Single Market is key.

“The G20 leaders have made clear that we need derivatives markets to be regulated in an internationally consistent and non-discriminatory way.” Transparency is key also, he said to help safeguard the interests of consumers and investor confidence. Better transparency should underpin future regulatory developments and is also vital to underpin supervisors’ decisions, Hoban asserted.
Finally consistent implementation will help to impose higher standards. He said “in the UK, we would like to see tough regulatory standards applied across the EU and the G20- to secure financial stability and avoid the fragmentation of financial services. This involves implementing the Common Rule Book. Nevertheless, the diversity of economic and market conditions means that national supervisors need to build on the common standards and retain a degree of national discretion.

“We need reforms that allow regulators and supervisors to exercise their judgement and be accountable for their decisions,” he concluded.

De Larosière added that the ability to go beyond minimum requirements is very important if you want a stronger and more accountable system.

Henrique de Campos Meirelles, Governor, Banco Central do Brazil said that assessing to what extent supervision is effective is important. There is a need for coordination and peer reviews in order to have consistent supervision and send similar messages.

Brazil's regulatory structures are already close to the spirit of Basel III, with capital requirements higher than normal, limits for large exposures in derivatives markets and provisioning rules that are forward-looking. In addition OTC trades are forced to go through central clearing and on and off-site supervision is enforced. "We have learnt from past banking crises," he said.

There are lessons in Brazil's experience for both home and host countries. "A clear approach to banking resolution rules is very important. Global institutions should be organised with subsidiaries with sufficient capital provisioning, rather than branches, he explained. "Guidelines should be applied in such a way that if there is a failure in the home institution, it should not necessarily be the same in the host country."

Basel III is balanced, robust and shows that the G20 can achieve improvements to financial architecture on a timely basis, he added, and the transition period is long enough not to hinder economic recovery.

Implementation will vary from country to country. Some regions want to deal more rigorously with areas such as hedge funds and some want to define priorities depending on the cost of the reforms, while others have different approaches to capital and liquidity reforms. Countries that faced more crises in the past already had more stringent regulations that helped them weather the crisis better, he thought. Those lacking sufficient regulation now want to move quickly to fill the gaps.

He concluded by saying that the level of economic recovery as well as economic development (i.e. the specificities of emerging economies) should be taken into account. These differences should not be brushed away. They must not impede either the progress towards a more efficient financial system with the timely implementation by all countries of the set of new rules.

Can the G20 continue to agree on concerted action now that the sharpness of the crisis has receded, asked **Jaimini Bhagwati**, Ambassador, Mission of India to the EU.

Governments are very keen to work together in the light of a crisis that caused at least 2% of global GDP – and probably much more – to disappear forever, he added. "We are very aware of global macro imbalances, but how do we work together to smooth the unwinding of these imbalances? he asked. To what extent are these imbalances driven by excesses created by leverage consumption in OECD countries and to what extent should growth be driven by savings?" The challenge for the G20 and others is to somehow reconcile these sometimes mutually contradictory short-term goals and aspirations and diverging situations, he stated.

Bhagwati outlined the position of India with regard to the main on-going reforms in the financial sector.

India has been following the Basel III process and will implement prudential regulations and capital requirements with country specific adaptations.

The country is also working to implement IFRS so that India has high-quality accounting standards, although he pointed out that in some cases, complying with IFRS would actually dilute existing standards.

However, membership of the IASB board has to be more representative, he said, "and we would like to see more convergence between IASB and FASB.

The compensation reform requires taking into account the fact that in India a substantial part of the financial industry is in the public sector with compensation decided by the government and private sector compensation levels are validated by the Central Bank.

Continued effort is needed at international level with the FSB and the IMF on SIFIs and cross-border resolution, he added. India has no provision to enable cross-border insolvency proceedings.

The importance of monitoring macro-prudential risks had also been widely addressed.

Lago highlighted the sheer volume of initiatives that have emerged from the G20. “In Washington, there was a 47-point action plan, in London 148 pages of working group papers and 23-page and 28-page communiqués from Pittsburgh and Toronto.”

She repeated Sir Howard Davies’ plea in a recent Financial Times interview for a focus on the core issues, which she called “the meat and potatoes” and defined as capital, SIFIs, resolution and OTC derivatives markets.

“Capital is the main course,” she stated. “In the lead up to the crisis, institutions held too little capital, used too much leverage and relied too much on short-term funding, which led to unacceptable costs for households, businesses and government – so we must have a more resilient financial system that is less prone to fail.” The US is fully committed to the Basel III agenda, she said.

The plan to address SIFIs has three key ingredients, she suggested. “Each jurisdiction should have clearly communicated policies on how it will deal with SIFIs and these should be internationally supportive so there are no mixed messages.” A core of minimum policies to underpin the SIFI strategies should include higher capital, stronger supervisory powers and workable resolution regimes.

The US Financial Stability Oversight Committee, which was due to meet the day after the Forum, has the ability to identify firms that should be supervised “to ensure that the most systematic firms will be supervised no matter what their form,” said Lago.

On resolution, “we start from the view that no firm should be too big to fail”. To reduce moral hazard each country must develop robust resolution systems. “Markets have to see and believe that there is a credible threat of failure for any firm, regardless of its size,” she stated.

One of the most contentious features of Dodd-Frank was the debate on how to plug the biggest resolution vulnerability – the absence of a mechanism to resolve non-bank financial institutions. “We are proud of the fact that we now have authority to resolve systemically important non-bank institutions in a manner that is as robust as the FDIC's time-tested bank resolution regime,” she said.

National resolution schemes are only the first step in dealing with cross-border resolution. “We have to create incentives for firms to reduce complexity,” Lago pointed out.

The build-up of risk in OTC derivatives markets was a major source of contagion, and US reforms now require clearing through well-regulated CCPs and exchange trading and extra margins on all non-CCP cleared products.

“The object remains to raise standards globally and to promote a level playing field that will prevent regulatory arbitrage which can create a race to the bottom and intensify risk throughout the financial system,” she said.

Global consistency in reforms is needed concluded Lago otherwise businesses will move to where standards are looser and expectations of government intervention higher.

“There is no doubt that we are in a period of transition and the regulation of the global financial system is going to be transformed in the years ahead,” said **Paul Tucker**, Deputy Governor, Bank of England. “The energy behind reform has not flagged as we confront enormous challenges posed by the crisis.”

The crisis was global, so while many national reforms are under way, “the essential programme is global in the G20,” he continued. The first landmark was the new Basel Capital Accord, which is a significant stiffening of the previous regime. It is important that the EU implements Basel faithfully, yet leaves flexibility for regulators and supervisors to make supplementary requirements. The specificities of institutions as well as cyclical features should be taken into account. The next step is a long overdue liquidity accord, he added.

Yet already there are people hard at work looking for the regulatory arbitrage opportunities in Basel III, he warned, “so we need the capability to adapt the system”.

Having SIFIs too large to fail is intolerable according to Tucker. Institutions that were too big to fail were very heavily involved and this situation cannot continue.

Tucker repeated that resolution regimes were essential. Many countries do not have one. This is not about enhanced supervision but about what should be done when an institution has failed and all other solutions have not worked. He added that if the EU could not solve the cross-border resolution problem this would be difficult to do on the global level.

At EU level, there needs to be much more intimate and trusting co-operation between home and host supervisors where there is currently reluctance to share information. “The EU can break down barriers locally,” Tucker said.

The issue of rating agencies was commented by several speakers.

Careful supervision of ratings agencies is needed to ensure that ratings are trustworthy reflections of the standing of a country, **Zhe** said.

Bhagwati said the existence of, effectively, a duopoly [of rating agencies] in a quasi-regulatory situation, was unhealthy and highlighted a situation where a sub-national bank was rated above India’s sovereign debt. “Work on ratings agencies has to be trans-national,” he said.

At a more local level, there will have to be revisions to the extent to which regulators use ratings agencies, said **Tucker** who chairs the FSB’s working group on this issue.. “We cannot express concern about agencies and at the same time bolt ratings into our regulations.”

The Dodd-Frank Act explicitly calls for an end to the reliance on rating agencies and the SEC is now looking at the multiple places that ratings are interspersed throughout the system, said **Marisa Lago**, Assistant Secretary for International Markets and Development, US Treasury.

It is desirable for every institution to make its own assessment of risk, while issuers must also be more transparent, said **Henrique de Campos Meirelles**, Governor, Banco Central do Brazil.

Hervé de Villeroché, Assistant Secretary, Financial Sector Department, Ministry of Economy, Finance and Employment, France was confident that good results will be achieved in Seoul. He outlined the future work that would be conducted under the aegis of the G20.
The first priority is to ensure that the commitments already made are implemented, he said. The most important is the implementation of the Basel III framework. It is very important to restore confidence.

“We need to broaden the scope of financial regulation to ensure consistent regulation of all financial products including in the shadow banking system,” he added. Yet tighter regulations for banks will increase incentives for more shadow banking (e.g. money market funds, hedge funds, SIVs in some cases), he said, so a level playing field is crucial among activities and not only across countries.

Market integrity and how to address new technologies such as high frequency trading, algo-trading, etc... is also a major issue. Market transparency needs to be promoted with a proper balance between competition and efficiency. The effects of high frequency trading on market structure and stability also need to be better monitored according to him.

Moving to the implementation of the commitments made at the G20, de Villeroché considered that the only way to deal with the moral hazard created by the existence of SIFIs is enhanced supervision, risk mitigation measures and specific resolution regimes. “There must be adequate mechanisms to organise the transfer of assets in connection with deposit guarantee schemes,” he said, but he warned that it is very difficult to say what a SIFI is. “It is more a relative than an absolute concept.” Flagging or creating a list of SIFIs has the risk of creating moral hazard.
Discrepancies between compensation mechanisms need to be reduced.
Regarding the clearing of OTC derivatives a clear process should be established to identify which contracts need to be cleared centrally. In terms of safety CCPs need to have access to central bank liquidity and be subject to market or banking regulation or both.

In the future, the G20 agenda could include the instability and excessive volatility of commodities markets, suggested **Daniel Lebègue**, Co-President, Eurofi. “The volatility of these markets could threaten economic recovery and the development process of less developed countries. What can be done in the framework of the G20 and other organisations?” he asked.

Mereilles agreed that the effect of short sellers and hedge funds on markets was an important issue. He also commented on the problem of currencies which needs addressing: i.e. flows of US $ to countries that have free floating currencies and the potential result for US policy.

Lago agreed that the focus should be on implementing what is already underway. Currency and commodities were part of future plans but she wondered what the right forum for these questions was and how they could fit in with the agenda of the G20 and of other global organisations such as the OECD or the UN.

De Villeroché was convinced that the present loopholes in commodity derivatives market regulation needed to be put on the agenda taking into account the specificities of markets and investors. This related to transparency, market integrity, market abuse issues in particular.

It is clear that we need a European system for unwinding cross-border institutions, which implies at the least an EU legal framework, a set of instruments and a set of rules on what to do in a college, **de Larosière** concluded. National systems should be under the aegis of an EU framework, which may require tackling issues with national bankruptcy law.

While this will be difficult, “we have to say this is as important as the 7% level of capital requirements,” he said. “The approach should not be to say that it will take years to remove barriers; it should be to say that we have six months to create a European system. That would be a great contribution to the stability of the system and help reduce moral hazard. “Moral hazard is embedded in the system so the important thing is to tell financial institutions they will not be protected in case of default but will be unwound. We have to organise this.”

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