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A Centre Right Answer to the Political and Social Crisis: a Project for Europe

Round Table:

Financial Market Regulation: Need for Global Coordination and Consistent Implementation

Chairman: Othmar KARAS MEP, Vice-Chairman of the EPP Group in the European Parliament

Guest Speakers: Valentin IONESCU, former Rumanian Minister of Reform and Privatisation

Panellists:

Karel LANNOO, Chief Executive Officer, Centre for European Policy Studies (CEPS)

Fernando NAVARRETE, Director of Economics and Public Policy department, FAES Foundation

Hans Peter BURGHOF, Vice-Rector, Hohenheim University

Sorin IONITA, Public Policy Advisor, European Economic and Social Council (EESC)

Rapporteur: Ansgar TIETMEYER, Delegate of the Management Board for EU Affairs, Deutsche Bank

Introduction by the Chair, Othmar Karas:

The current crisis consists of a (i) Financial market crisis and (ii) a sovereign debt crisis. Both are closely related and interconnected. EU Members States are working together to create more financial stability and improve market integration in the EU. "We don't have the United States of Europe" (KARAS). There are still too many national interests involved in the attempt to find answers to the current financial crisis. But the EU needs to speak with one voice what regards the different key regulatory initiatives. Karas underlined the need for global coordination and consistent implementation, on G20 level and especially on the EU/US level, as this market accounts for the largest share in the whole-sale sector. Karas opened the panel with three questions:

1. Is there an efficient implementation of regulatory proposals under G20?
2. Is there a political will for closer international regulatory integration?
3. What will be the future responsibilities of the G20?

Key Messages from the Round Table

- *Huge interest of the audience to discuss issues on how to make financial markets more resilient and how to improve regulation of financial institutions.*
- Coordination and implementation of the G20 regulatory suggestions needs to be improved.
- Impact assessment of cumulative effects of the different regulatory initiatives must ensure that regulation does not lead to unintended consequences, especially for the real economy.
- More competition between and less reliance on CRAs.
- Regulation needs to be implemented in a consistent way across borders, to avoid arbitrage. EU should only move ahead if US follows.
- With an international resolution scheme, less need for additional capital charges for G-SIFIs.
- Too much inter-governmentalism in the EU. More federalism and federal principles needed.
- FTT will not provide more financial stability and may lead to distortive effects (fiscal arbitrage). Costs will have to be borne by the consumers.

1) Lack of organisational structure to ensure consistent international regulation:

There are many different international organisations with the aim to closer coordinate international politics. In the field of banking, institutions like G20, FSB (Financial Stability Board) or BIS (Bank for International Settlement) have been strengthened, as policy makers identified the need for a more cooperative approach in financial market regulation. However, these bodies have no legislative or regulatory powers or responsibilities. Implementation of regulatory measures and enforcement remain at regional or national level. There is currently a tendency in the EU to more national regulation as a response to the crisis, based on political motivation. The fact that the EU has recently established new supervisory authorities for banking, insurances and securities (EBA, EIOPA and ESMA) was welcomed. These bodies need to become strong, well staffed and independent supervisors. IONESCU voiced concerns that there are too many regulatory bodies, which would be harmful and lead to high costs of coordination. He suggested more regulatory powers should be given to the independent ECB, a message that was not echoed by the panel. Discussion also focussed on the role of G20. It was criticized that there is a lack of implementation of what has been suggested by this body so far. The G20 would have to deliver better. What is the function of the G20 and what will be its future in the field of regulatory implementation?

2) Need for international convergence of many different regulatory measures:

There was general agreement that better and more efficient regulation is needed. It should focus on “preventive measures” (e.g. Basel III, MiFID, AIFMD), which lead to more transparency and more resilient markets, as well as on “corrective measures” (resolution, crisis management), which should avoid costs for the tax-payers in case of a bank failure. Although there are large differences regarding the implementation of the different G20 suggestions in the EU and US, LANNNOO was of the view that both sides are quite close in implementing the measures and sticking to the timetable. Focus must be on the EU/US as the transatlantic area, which brings 60% of total assets together. Panellists warned against “too burdensome” regulation. An impact assessment is a precondition to identify the cumulative effects of all different regulations and avoid unintended consequences. Taking a different view compared to the other speakers, who were rather in favour of more harmonised international regulation, BURGHOFF called for more competition in regulation, as too much harmonisation would not allow taking into account regional divergences.

3) More competition between Credit Rating Agencies (CRAs) needed:

There was a large interest from the audience regarding the role of CRAs, especially in the context of the sovereign debt crisis. LANNNOO mentioned that ESMA needs to deliver as so far only 10 CRAs have been accepted in the EU. None of them is one of the “big three” international CRAs. Panellists agreed the reliance on CRAs must be reduced in a systematic manner.

4) More and better capital (Basel III)

Banks must have enough capital and liquidity to face possible financial crisis. Both sides of the Atlantic should implements Basel III rules, to avoid regulatory arbitrage. “We must put pressure on US authorities and US institutions to apply Basel III” (BURGHOFF). Europe should not apply Basel III as long as it is not clear that the US will follow in time.

Panellists agreed that more capital is needed (including special capital buffers), but also warned about the cumulative effects, if every capital measure was introduced at the same time. Therefore the phasing-in foreseen in Basel III was welcomed. However, markets put pressure on financial institutions and request to immediately comply with the new capital and liquidity rules. LANNNOO warned that Basel III is far too complex and more simplification is needed.

5) A response to the G-SIFIs and too-big to fail issue can be “effective resolution”:

“We need to define what G-SIFIs are. We need to determine activities and not institutions.” There is a reason to hold more capital for more risky activities. The danger is that an additional layer of capital for the SIFIs (surcharge) creates competitive distortions and leads to a squeeze in credit-supply to the real economy (NAVARETTE). However, BURGHOFF underlined that a list of G-SIFIs is needed to identify those international institutions which have an implicit state guarantee.

Discussants agreed, that an international harmonised bank resolution scheme needs to be urgently implemented, as a kind of “public safety net” and as a “last resort” (NAVARETTE).

Although an international resolution system would be preferable it is difficult to achieve and the EU must start with an effective European crisis management toolkit. Such a resolution scheme with effective living wills would respond to the too big-to-fail problem and reduce the need for additional capital charges for G-SIFIs.

6) Economic Governance

LANNOO warned that there is “too much inter-governmentalism in the EU – we must pay attention to more federalism and federal principals”. This was echoed by BURGHOFF: “Nations have their own interest”, which leads in many cases to short-sighted responses to the financial and sovereign crisis, undermining the achievements of EU financial market integration. There are too many disagreements between EU states which also weakens the EU position and strength in the G20 dialogue. The recent work of the Council and Parliament on the six-pack on economic governance was welcomed. Member States must agree on clear principles like the “no bail-out clause” or central bank independence (BURGHOFF), so far the enforcement of laws by the EU is still very limited. Better economic governance with improved enforcement mechanisms will help the EU foster political integration (IONITA).

The panel agreed that monetary integration will only survive if further political integration is ensured. This may only be achieved at a higher price for some countries giving up certain national competences or via fiscal transfer. IONESCU mentioned that there is no need for a single fiscal policy, especially no further integration on taxes, as Member States need flexibility to respond to different economic situations. But he called for setting up a limit on public debt (‘debt-break’). There was unanimity about the role of “market forces” in the EU. This would also apply for Greece, where structural adjustments are urgently needed.

7) No commitment to Financial Transaction Tax:

Responding to a critical request from one participant, that an FTT would be needed to reduce speculation, provide more transparency and avoid competition trading, panellists rather warned against an FTT in the EU. It will not provide more financial stability and may lead to distortive effects (fiscal arbitrage), as certain business will then be offered off-shore. Especially such a measure would not at all lead to more transparency. On the contrary, costs will be passed-on to the final consumers. It is expected that London, where most of the final transactions are booked, will not support such tax. An FTT will lead to a huge net loss for the UK, as transactions will move off the city and be executed elsewhere (LANNOO).