The 10th Annual European Financial Services Conference

The Financial World Tomorrow

Executive Summary

After **Stefano Micossi** (Director General, Assonime), welcomed participants, the 10th anniversary conference launched into a wide-ranging debate on the state of the financial services sector in Europe bringing in experts from the industry, the European institutions and specialists from across the Atlantic. Against the backdrop of Europe's sovereign crisis, the conference focused in particular on the impact of the European Union's raft of new and upcoming legislation as well as the broader international context.

The keynote addresses were delivered by **Olivier Guersent**, Head of Cabinet for European Internal Market Commissioner Michel Barnier, and **Michael Dithmer**, Permanent Secretary of State for Business and Growth in the Danish Government, who spoke for the EU Presidency.

Mr. Guersent stood in for Commissioner Barnier, who was called away talks with the Spanish government. He started by recognizing the serious situation in which Europe finds itself in. The sovereign crisis coming on the heels of the 2008 financial crisis has led some to predicting a return to 1930s-style depression. However, he chose to take a more optimistic approach, highlighting the positive steps that have been taken at an EU and G20 level.

The European Union, he said, had succeeded in filling many of the regulatory gaps revealed by the financial crisis. Areas brought under new rules include alternative investment fund managers, credit rating agencies, short selling, credit default swaps and bankers' remuneration. He lauded the work of the new European Systemic Risk Board, European Banking Authority and other recently created supervisory bodies. The Commission will be coming forward soon with the remaining key legislative proposal - on bank resolution mechanisms - when the political and market conditions are right. In all Commissioner Barnier has put forward 29 legislative proposals in 20 months, he recalled.

His next point was to insist on the need for the Basel III agreement to be implemented both inside and outside the EU. He was hopeful the European Parliament and Council will be able to reach agreement to that end by the summer. An agreement on the Solvency II regime for insurance companies should also be concluded under the Danish presidency so it can come into force as scheduled in 2013, he said. Another important step was the setting up of a high-level expert group on structural issues headed by Bank of Finland Governor Erkki Liikanen.

Looking ahead, he said Commissioner Barnier would be focusing on two key areas in the two remaining years of his mandate: shadow banking , and international cooperation to strengthen the global regulatory reform effort.

Michael Dithmer outlined the Danish presidency's priorities in financial services. He said the presidency will be dominated by the need to confront the sovereign crisis through fiscal consolidation and renewed growth. Strengthening financial stability and revitalizing the single market can play a key role, he said.

Given that insufficient regulation of the financial sector up to 2008 as one of the causes of the financial crisis, he said the Danish presidency would make it a key priority to push for reforms that will strengthen financial services supervision and regulation. He also outlined steps taken so far, such as the creation of European supervisory authorities and the European Systemic Risk Board, the regulation of credit rating agencies, hedge funds, short selling and the limitations on bank remuneration practices. However, he recognized that the presidency still faced an enormous task in pushing forward the proposals still on the table.

The top priority is agreement on the CRD IV (Capital Requirements Directive) proposal before the summer. Another priority is to ensure that the EU lives up to its G20 commitments in derivatives trading, he said, stressing the importance of an early agreement on the European Market Infrastructure Regulation, or EMIR (which was in fact agreed later that day.)

The presidency also hopes to reach agreement before June 30 on deposit guarantee schemes and investor compensation, along with a deal on the Omnibus II Directive, which will set the implementation date of Solvency II. Other dossiers which the presidency aims to push forward include the revised credit rating agency regulation; the revised transparency directive; and the mortgage credit directive. As for MiFID (the revised Markets in Financial Instruments Directive), he recognized that the complexity of the dossier and differences among member states and MEPs meant that it was unlikely to be completed under the Danish presidency. The Danish presidency is hoping the Commission will soon table its crisis management and resolution regime proposal so it if relevant can be discussed at the Ecofin ministerial in May. He said the presidency is open to discussions on a Financial Transaction Tax.

He concluded by rejecting criticism that the EU is moving too fast with its legislative programme, saying laying a strong foundation of financial stability is a key condition for sparking a return to economic growth in Europe.

Session I: Finance: renewal or retrenchment?

Moderator **Jonathan Moulds**, (Bank of America Merrill Lynch. President, Europe & CEO, Merrill Lynch International) introduced the debate, insisting that a strong banking sector is a prerequisite for a strong economy. He warned that the lack of consistency in global regulation runs the risk of undermining efforts to achieve a strong, well-regulated and well-managed financial sector capable of leading a return to growth. He stressed the need for bankers to have a greater dialogue with their clients, regulators and governments on the way ahead. Basel III must strike the right balance between creating a stable regulatory and capital framework while still allowing economic expansion and future wealth generation, he said.

Koos Timmermans, (Vice-Chair, ING Bank) responded that some things have gone right since 2007, notably that banks have in general been able to recapitalize while keeping lending at reasonable levels. He cautioned however that lending will fall over the next few years. That need not necessarily be so bad, he said, since debt-to-GDP needs to go down, however he warned that regulators needed to take into account that capital increases should be more gradual to avoid cutting off lending. On the question of bail ins, he expressed concerns that with covered bonds becoming a more eligible instrument with underlining securities, there is a risk of subordination of senior debt holders.

Emil Paulis (Director - Financial Markets, DG Internal Market & Services, European

Commission) said there is a natural reaction among companies and states to retrench in times of crisis, but the current lack of confidence among external investors about investment in Europe goes beyond that and was a major concern of the Commission. Restoring that confidence so that the EU's internal market can fulfil its huge potential to create growth is therefore a major Commission priority. Building a solid foundation of financial stability is key to achieving that, he insisted. Only then can the EU build on the potential of its single market of 500 million consumers. He agreed with Mr. Timmermans that the market, rather than regulation, will be the main driver of change.

Gabriele Galateri di Genola (Chairman, Assicurazioni Generali) focused on the insurance sector and the impact of the Solvency II Directive and Basel II. He complained that rules are far from uniform between Europe and the United States, or even within the EU. The Solvency II proposals run the risk of placing too many burdens on insurers seeking to buy financial instruments, which in turn threatens to produce a negative impact on growth. He also warned about the disconnect between Basel III and Solvency II and appealed for regulators working on them to better coordinate their work in order to avoid such discrepancies. The longer-term nature of insurers' assets and liabilities meant that they needed different treatment than banks, he added.

From the European Parliament, **Sharon Bowles** (MEP, Chair of the Committee on Economic and Monetary Affairs) said US and European legislators were working more closely than ever, but she acknowledged that mismatches remained between new rules on either side of the Atlantic. Europe, she added, should also be focusing more attention on working with financial centres in Asia. It is important to remember that the measures being introduced in Europe are being taken against the backdrop of the sovereign crisis and should be seen as a package, she stated, adding a warning about delays to setting up adequate firewalls against contagion.

In the panel discussion and question-and-answer session, issues covered included the different role that banks play in Europe and the United States and the need for Basel III to take that into account. The panel also discussed whether the Basel rules risking being too tight for Europe in the current crisis and assessed the potential cumulative impact of all the new European regulation.

Session 2: Re-thinking the trading landscape

Anthony Belchambers, (CEO, Futures & Options Association) moderated the session. In his introduction, he cautioned that while there is a broad understanding of the need for regulatory repair in the aftermath of the finance crisis, there are concerns that the pursuit of market safety is being purchased at the expense of functionality and choice. He referred to the recent European Commission decision to block the merger between Deutsche Börse and NYSE Euronext, noting regulators will increasingly have to balance competition at a regional level with the need for Europe to have major global players. Mr. Belchambers also raised concerns that the lack of international agreements was leading to a proliferation of regional and domestic infrastructures which could be very difficult to sustain.

Markus Ferber (MEP) explained that the MiFID review was an important step towards much-needed transparency in European markets. As rapporteur on the MiFID proposal, he hopes to be able to publish his report at the end of March, opening negotiations with the Council before the summer and three-way talks bringing in the Commission in September. The Parliament wants the revised rules to reduce systemic risk, create more transparency, guarantee financial market stability and provide protection for investors and consumers. Among the issues the Parliament is looking at with particular attention are the proposed Organized Trading Facilities, algorithmic trading, consumer protection and cohesion with US and other non-EU regulators.

Verena Ross, (Executive Director, ESMA) focused on ESMA's role and responsibility relating to risk analysis, in particular its systemic aspects. She highlighted work the authority has already done on automatic trading, MiFID transparency and the wider European and global context. Although MiFID is still under review, the authority feels it needs to ensure that ESMA can respond quickly to any risks that might occur. On automatic trading, she underlined the guidelines proposed by ESMA to make sure markets can monitor and, if necessary, restrict the order flow coming through their systems. The MiFID review is expected to generate a huge workload for EMSA in the area of transparency. One key challenge there will be to calibrate requirements to take into account all the different types of instruments. She emphasised that ESMA will be working hand-in-hand with national authorities within the EU and around the world.

Dan Waters (Managing Director, ICI Global) explained that ICI Global represents the long-term investor on the buy side and therefore has a strong interest in ensuring that markets are highly competitive, transparent and efficient. He focused on three issues relating to the EU legislative proposals: algorithmic and high-frequency trading; the benefits and costs of transparency for long-term investors; and third-country issues affecting global investors in European markets. He welcomed EU efforts to prevent abusive practices in automated trading but expressed concern that the current MiFID proposals do not address the specific requirements of long-term investors. While supporting the general principle of transparency in capital markets, he stressed the importance of protecting certain fund orders for long-term investors from exploitation.

William Goodell (Chairman, Managed Funds Association) pointed out that, contrary to popular misconception, the majority of capital in his industry does not come from wealthy individual investors, but rather from pension funds, university endowments, labour unions, sovereign wealth funds and other non-financial institutions. He said MFA's members want well-functioning markets with open access and transparency along with safe and stable banks. He stressed four issues: the need for fair access internationally with a level playing field in line with G20 commitments; globally coordinated efforts to improve transparency while minimizing duplication in reporting requirements; maximum guidance from regulators on the scope of new rules to bolster legal and regulatory certainty: and, safeguards against leaks of sensitive information handed over to regulators.

Giovanni Prezioso (Partner, Cleary Gottlieb Steen & Hamilton LLP) had three main observations. He recognized that regulators are working at full capacity and are struggling to keep up with the burden of so much work. In the US, that means they have to focus on a limited number of priorities such as stability, the derivatives market, and market developments like the Flash Crash. He recognized that there is a great deal of attention being paid to the international dimension of those priority areas, but feared that too much focus there meant broader issues like mutual recognition and equivalence were being neglected. Finally, he said the enforcement landscape is changing through stronger international enforcement cooperation, but said care was needed to ensure this did not harm relations between regulated and regulators, or increase the risk of duplication.

In the Q&A session, issues raised included regulation of algorithmic trading, the need for consolidated tape in Europe, the impact of the Commission's blocking of the NYSE Euronext and Deutsche Börse merger on the MiFID and MiFIR discussions, the wisdom of regulators going after high-frequency trading and the difficulties in getting third-country equivalence with MiFID.

Lunch Session

The eurozone and global stability

This was moderated by **John Houston** (Senior Partner, Kreab Gavin Anderson). He introduced the remarks by US Treasury's Deputy Assistant Secretary for Monetary and Financial Policy **Mark Sobel** who offered a US perspective on international and regulatory developments.

Mr. Sobel stressed that there is more unity in the approach of US and EU regulators than is often assumed. He pointed to the swift action taken by the G20 and the work of the Financial Stability Board. That strategy is now transitioning from design to implementation, he said. Within the G20, he said the US this year is focusing on three priorities: capital, resolution, and OTC derivatives.

He said important work to ensure a level playing field on capital is being done through Basel III with no significant differences between the US and EU on the big picture issues, although there are important debates on technical points like liquidity run-off ratios and capital deduction measurements. On resolution, he pointed out that cross-border crisis management groups for the largest firms have already been established, and that cross-border cooperation agreements will be put in place, while recovery and resolution plans are being developed.

The US and EU are making progress on the complex issue of derivatives' regulation, backing global work on margins on un-cleared trades and developing a legal entity identifier system for financial contracts which will help monitor systemic risk, he said. However, he acknowledged that they still faced a "daunting agenda" on derivatives to avoid geographic mandates, meet G-20 timetables and seek global alignment of rules.

Beyond those three key areas, he mentioned work that is being taken forward on shadow banking; accounting convergence; non-cooperative jurisdictions; and reining in imprudent compensation structures. He expressed the hope that talks between the US Federal Insurance Office and the EU would address trans-Atlantic issues that have arisen on questions like reinsurance collateral and Solvency II. He noted the growing lexicon of approaches to managing cross-border cooperation, and emphasized the importance of developing and maintaining robust international standards even if implementation must necessarily vary by jurisdiction.

Questions to Mr. Sobel focused on capital ratios and gold-plating; effective equivalence and reciprocal market access; and how to work with China.

Christian Clausen (President, EBF, and CEO, Nordea) opened by quoting Formula 1 champion Mario Andretti who once stated that if everything seems to be under control, then you are not going fast enough. Mr. Clausen argued that things are going too fast and are not under control. New regulations facing the sector are a "big mountain to climb" he said, cautioning that new liquidity and capitalization regulations were a huge cost for the banks that will lead to structural deleveraging. He warned that failure to create a genuine level playing field, across the Atlantic and within Europe would risk creating conditions for more systemic risk.

Mickey Levy (Chief Economist, Bank of America) emphasized that while the ECB's aggressive bank lending program has successfully eased the short-term funding squeeze faced by banks and contributed to sharply lower government bond yields, it should only be considered a bridge loan by the central bank acting as lender of last resort, and is not a substitute for needed economic reforms and fiscal austerity. The economic outlook for Europe will remain grim unless reforms are pushed through to improve competitiveness, tackle labour market bottlenecks and reduce excessive regulation. Such reforms are just as important, if not more important, than fiscal austerity. Policymakers should not resort to temporary quick-fixes. Well-designed reforms will lift policymakers' credibility and build leadership. Since there is a lag between enacting needed reforms and achieving stronger sustainable economic activity, policymakers must manage the expectations of financial markets, the media and politicians.

Questions from the floor ranged from the need for short- and long-term liquidity; the role of the Liikanen group; and the financial sector's role in promoting growth and employment.