

# CSFI

## CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

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**Brussels for breakfast (36): A breakfast discussion on EU regulatory issues, with Donald Ricketts (Fleishman-Hillard) and Graham Bishop (grahambishop.com) held on Thursday, April 24, 2008, at the City Marketing Suite, Basinghall Street, London, EC2P 2EJ, from 8:30-10:15am.**

The whole issue of financial regulation in Europe was at an inflection point, the first speaker said. The combination of the devastating impact of the global crisis – now likely to cost \$945bn according to the IMF – and the imminent changes at the European Parliament and Commission had put everything into play. In particular the “fragile consensus” under McCreevy’s commissioner was in danger of unravelling.

This consensus has four core principles. The first was risk-based policy making. There was a feeling that too much had been delegated to professionals who may not have been up the job and that much of those responsibilities should be brought back to policymakers – especially now taxpayers were picking up the tab and banks asking for bailouts. Second was the better regulatory agenda and the ideas that the industry could be given time to come up with solutions to market failure. Questions are being asked about how far one can trust the industry to clear up its own mess. Even Liberal MEPs such as Roman’s former finance minister Daniel Daianu are ridiculing this.

Third was the acceptance of the benefit of the financial markets and innovation to the economy. There is a strong feeling that innovation has created embedded leverage and that the financial engineering has been to the benefit of the engineers. Fourth; the idea that open and competitive financial markets are the way forward is under challenge. France and Germany see an opportunity to push a more *dirigiste* agenda and this will be applied in areas such as sovereign wealth funds.

The potential spill over effects are many. Examples include the debate about systemic risks from over-the-counter versus exchange trading; the future of the credit default swap industry; CESR reviewing its advice on non-equity transparency; the debate on private equity and hedge funds and even Solvency II. Overall it is not a question going from sunshine to night-time but there will be a pronounced change in the mood music.

The second speaker said Internal Market Commissioner Charlie McCreevy has laid out his response to the turmoil in an address to the economic and monetary affairs committee on April 1. He said the issues were well-known: weak internal valuation models; opaque securitization process; business models that were built upon disproportionate maturity mismatches between assets and liabilities; weak internal controls; and poor disclosure standards. He called for enhanced transparency for investors, markets and regulators; improved valuation standards; reforms to banks’ incentives structure; and a targeted revision of certain aspects of the Capital Requirements Directive.

The speaker agreed there was a clear feeling from politicians that something should be done. Ieke Van Den Burg, the Socialist firebrand, had called for a European regulator with oversight of the whole market, a view that was gathering supporting along the spectrum. The likelihood of a more interventionist approach was highly likely.

The informal Ecofin on April 4, while mouthing the usual concern over the financial crisis, appeared to pull back from previous ministerial. It said the three committees, CESR, CEBS and CEIOPS, should not be given a new legal basis. The speaker said there was a clear pull-back from October's recognition of the need for burden-sharing – working out who paid in the case of a bailout. Ecofin said that was tied to the issue of the home-host issue - reconciling the demands of regulators in countries that host branches of the banking group with those of the centralised group regulator in the home domain. Members said the issue had been parked in the “too difficult” box. Ecofin also invited Member States to give a European mandate to national supervisors and signed a Memorandum of Understanding committing all signatories to co-operate across border, both in normal times, and in crisis situations.

The Financial Stability Forum submitted its recommendations on enhancing stability to the G7. One member said it would boost the hopes of Mario Draghi, the chair, to become the next ECB president. The 11-page executive summary included an array of detailed proposals on prudential oversight, enhancing transparency, credit ratings and authorities' responsiveness to risks. It also called for greater use of international colleges of supervisors. The second speaker said that this was a signal to the EU to ensure its colleges fitted with an international framework. The first speaker said reactions from financial trade bodies had strongly argued against imposing extra regulations.

On accountancy it seemed hopes of getting a new international standard by 2011 would be extremely difficult. The FSF had tasked the IASB to come up with proposals on fair-value accounting but the idea of measures on off-balance items was “irretrievably broken”. The second speaker said everyone acknowledged the risk of pro-cyclicality of mark-to-market but did not want to change the rules at half-time. Nicolas Veron of Bruegel had argued that fair-value was the least-worst option and that reducing transparency would be a mistake.

The second speaker summarised by returning to the core theme. McCreevy had been seen as the “do nothing” commissioner and other DGs were not working round and under him to move into his space in areas such as mortgages and Consumer Commissioner Meglena Kuneva's scoreboard on pricing costs. There are many areas under McCreevy's watch that will have to be taken by the next Commission when anyone with a slightly greater interventionist stance will have a prime opportunity. None of this is in the media, but there is now doubt that in Brussels it is all change.