Olivier Guersent

Keynote Speech

"The financial world tomorrow"

10th Annual european financial Services Conference

Brussels, 9 February 2012

Ladies and Gentlemen,

We are meeting against a sombre backdrop of financial crisis. Two crises are interacting with each other. The financial sector crisis of 2007-8 was not yet fully over – and the various safeguards to prevent a further such crisis not yet fully in place – when the sovereign crisis hit. Our European leaders have taken action to deal with the sovereign crisis, and global leaders in the G20 have laid down a clear roadmap for dealing with the financial crisis. But fears have been expressed that the severity of the medicine will take us back to the 1930s.

I will not take such a gloomy line today. I want to accentuate the positive, and stress how much we have achieved, and how much we are coordinating internationally to put coherent reforms in place.

Let me first of all, recap where we stand at present.

Our number one goal has to be to **prevent further collapses of financial institutions**, and failing that, find a way to organise bank failure in a way which prevents both massive taxpayer intervention – which in any case cannot be afforded another time – and a systemic chain reaction.

We all know that capitalism is cyclical, and it isn't going to change soon. We have to manage the cyclical nature of the financial system, to smooth out the peaks and troughs and better foresee them.

We have done a lot already, both in the EU and globally. We are well on the way to meeting our G20 commitments. Let me briefly run through some examples what's already in place, to illustrate this:

- We have three new European Supervisory Authorities in place and a European Systemic Risk Board. These have existed for over a year now and become part of the landscape. When the European Council decided that a temporary bank recapitalisation exercise was necessary, it was natural to entrust the oversight of that exercise to the European Banking Authority, which is a great accolade for such a young authority.

- We have filled a lot of gaps in the regulatory framework which existed before the last crisis. Alternative Investment Fund Managers, Credit Rating Agencies, Short-selling and CDSs – all these areas are covered by regulation now and previously were not.

- We have rules on remuneration in place. This does not cap remuneration or bonuses in absolute terms, but limiting the variable part as a percentage of the total, and ensuring that bonuses are reviewed over a period of time, with the possibility of clawback if they are not ultimately justified. This is not a populist measure, but designed to make banks safer by having a longer-term perspective.

- We have rules on short-selling and Credit Default Swaps in place in the EU, and we are very close to adopting legislation on central clearing and reporting of OTC derivative trades, another key G20 commitment.

So what's missing? Well, in the EU, there is obviously a major absentee, and that is an EU-level bank resolution mechanism. We have a proposal worked out, and are awaiting the most propitious moment, in both market and political terms, to call in the midwife and give birth to it. The Council and Parliament agenda is very full up, and the sovereign crisis is still in the middle of the radar screen. We want the proposal to come forth when ministers can give it their full attention, and the markets are not jumpy. But I can promise you that the proposal will soon be revealed, and will not be put back to the Greek Kalends.

Secondly, we need to get Basel III implemented in the EU (not to mention worldwide). The ongoing temporary recapitalisation exercise is no substitute for a permanent revised capital regime. We want to see Council and European Parliament adopt our legislative proposal on this by the summer. And we also need Council and Parliament to adopt the necessary decisions to allow the Solvency II regime for insurance companies to come into force on schedule in 2013.

Another thing which we need is an EU-level viewpoint on the structural issues in the banking sector. That is why Commissioner Barnier recently announced the creation of a High-level Expert Group on structural aspects of the EU banking sector, to be led by Governor of the Bank of Finland Erkki Liikanen. I have to say that the group will be independent and pan-European in its view. It will not necessarily be "Euro-Vickers" nor "Euro-Volcker", and the group is not obliged to recommend any structural reforms at all.

My own personal view, for what it is worth, is that you can go a long way with incentive management. The management of banks have to be incentivised to look at long term stakeholder value (I said stakeholder value, not shareholder value, as bondholders account for far more of a bank's balance sheet than its shareholders, and are involved with the bank for far longer on average). We also need to look again at the role which prudential authorities can play in M&A activity in the financial sector. We have a Directive on this, which is currently under review.

Enough of the past and present. What about the future? What about when this current wave of legislative activity has died down. What then?

Apart from the obvious activity of evaluation and review of the new regulatory framework, I would identify two key things to work on.

The first is the **interaction between financial regulation and investment in the real economy**. On the one hand, it is a knee-jerk reaction from financial institutions faced with new regulation to say "this will reduce our ability to invest in the real economy and be detrimental to growth". On the other hand, we as regulators, cannot ignore that argument simply because it is a knee-jerk reaction. We have to square the circle. Not "regulation or growth" but "regulation and growth".

How do we do that?

First, as I said, by making banks and other financial institutions take the long-term view, not behave like short-term speculators. New remuneration and corporate governance rules can contribute to this. We need to see what the Liikanen groups comes up with in this area.

Second, by facilitating the access to capital of SMEs. I'm sure you read carefully our action plan on this of last December, adopted in a package with our draft legislation on venture capital and socially-responsible investment funds. So I don't need to tell you how we have made it easier for SMEs to access capital markets, by lightening prospectus and transparency requirements.

Third, by making sure that bank deleveraging – which is inevitable to some extent – is the right kind of deleveraging, that is, exiting risky and non-core activities, thus preventing a credit crunch. That is a responsibility of supervisors everywhere.

Yes, we need to do more. We need to look at the impact of capital requirements and especially risk weights, not just for sovereigns but for real economy investments. We need to do it globally and cross-sectorally.

In this context let me say that in this year's upcoming review of legislation on pension funds, the effect on the real economy will be foremost in our minds. Pension funds can be a driver of the single market and growth. We will encourage that role not handicap it.

I mentioned two key things to work on. Growth was the first. The second is **international coordination**. This current regulatory reform programme is a global effort, decided in the G20 and coordinated in the Financial Stability Board. We have to work together to prevent regulatory arbitrage as a result of new legislation.

The second knee-jerk reaction of the financial sector when faced with new legislation (after saying it will hurt the real economy), is to say "we will move elsewhere". Of course, we don't believe them (and the number of hedge fund managers still operating in the EU shows that we are largely right not to believe them), but if we implement reforms in harmony we won't even allow them to force us to call their bluff.

The Financial Stability Board needs to be beefed up, to receive a permanent status and to undergo a governance review. The FSB is here to stay and it needs to have the tools and the mandate to do its job, which is pushing countries to meet their G20 commitments. Enforcement is becoming a key word.

We also need to make sure that our respective financial reforms don't lead to trade barriers and rolling back of trade liberalisation (such as it is). We all need workable and credible regimes for allowing third countries access to our financial markets, while allowing for essential prudential requirements to be met. Equivalence assessment systems need to be robust, and to be seen to be fair.

Let me say that we in the EU are working intensively with our key partners to ensure coherent implementation, avoiding overlaps and "underlaps" in our rules. One example: we are working closely with the US supervisors on OTC derivatives, where a transaction between and institution in the EU and one in the USA has to be subject to compatible requirements. And another example: we have agreed to start a formal dialogue with Switzerland, which so far was a notable gap in our bilateral network.

In **conclusion**, allow me to end on a note of optimism. I don't believe we are going back to the 1930s. I believe that in the EU, and globally, we have the means in place to tackle the macro and the micro issues which face us. Yes, there is going to be a tough adjustment, and probably a limited recession. But not a slump.

Financial regulation is not part of the problem, as some people would have us believe. It is part of the solution.

I hope that today's discussions can take us a step further towards demonstrating that.

1645 words