



In search of stability, but at what price?

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While plans to overhaul the welfare state have been the headline announcements from this week's Conservative Conference, the debate threatening to dominate proceedings is that of the Party's stance on Europe. The Shadow Chancellor George Osborne today shed more light on how the Conservatives plan to curb state spending, including a rise in the state retirement age for men to 66 from 2016. Following some mixed messages about City excess from senior Party figures so far this week, Osborne's speech was an opportunity to start to rebuild the confidence of industry on the back of yesterday's announcement to stimulate start-up business growth through national insurance tax breaks. The Europe question is however intrinsically linked to rebuilding this confidence, particularly given the crucial policy developments currently taking place in Brussels.

With Irish voters having backed the Lisbon Treaty last week, embracing greater European cooperation in the wake of the financial crisis is catching on. The Eurofi forum, which brings together EU financial services policymakers and stakeholders, is always a good indication as to where the EU views its priorities in financial services. While there was no shortage of self-congratulation for the cooperative and decisive efforts taken in the last year to avoid a banking meltdown, few are under any illusion that the clean-up will not be just as important a task and one that will require an unprecedented level of harmonisation between member states. For business, this signals the challenge of ensuring that regulatory outcomes are not overly restrictive at a time when economic growth is vital.

The theme of stability ran throughout the conference – whether in banking, insurance or asset management, there is now an evident understanding in Brussels that ensuring the long term health of financial markets must take precedent in the development of policy. As Sharon Bowles MEP, Chair of the Economic and Monetary Affairs Committee put it; stability is the new S in FSAP.

Dominating the political agenda is the Commission's proposed financial supervisory package which will see the creation of two new layers of supervision covering macro and micro prudential issues. The broad principles of the package: to improve regulators' ability to identify risks in the market as a whole and to better coordinate the supervision of cross border institutions have received broad support, including from Treasury Minister Lord Myners. Indeed the conclusions may pave the way for improvements to existing legislation such as the now defunct Group Supervision provisions in Solvency II as well as spilling over into new areas such as the expected proposals on living wills in cross-border banks. That is not to say however that the reforms have been met with whole-hearted praise.

Developments at a Glance

- › **The Commission will consult on cross-border bank crisis management in October**
- › **The financial supervisory package will not be passed through Parliament this year, despite political pressure for speedy implementation**
- › **AIFM Directive continues to draw widespread criticism. ECON Committee will undertake an impact assessment of the proposals this year. Parliament approval not expected before July 2010**
- › **Commission proposal on derivatives and clearing legislation expected in October**
- › **A review of MiFID will begin next year. Focus will be on bringing more OTC derivatives onto exchanges**
- › **New legislative proposals on post trading are expected from the next Commission**



Over-interference of the Commission in supervisory matters, the impact of a single rule book on different institutions and member states and the involvement of the ECB in non-eurozone members' regulation are just some of the concerns which policymakers cannot expect to go away quietly.

The political will behind the package in Brussels is however unquestionable. It represents a potential success story for EU leaders and not least the Commission which has endured a difficult period since the credit crunch began two years ago. With efforts to deliver a global response to the crisis, the Commission is keen to demonstrate the EU as a global standard-setter and the blueprint for worldwide reform. The push to implement the proposals next year are however contentious, with parliamentary procedures ensuring that the Parliament will not rubber-stamp the dossier by the end of the year.

The controversial Directive on Alternative Investment Managers also continues to be one of the most talked about proposals in Europe with all stakeholders now in agreement that the current Commission proposals need to be amended.

Criticism is rife about the broad scope of the proposal, unintended consequences on existing legislation, uncertainty around the role of prime brokers and depositories and the potential Trojan horse of the third country passport. With the Council currently working on a compromise paper, Sharon Bowles confirmed that the ECON Committee would be undertaking an impact assessment of the proposals before giving parliamentary approval, not now expected before July 2010.

Sir James Sassoon, currently advising George Osborne on the Conservative's financial regulatory reform plans, raised a number of concerns about the direction of policy being debated in Brussels including the lack of emphasis on bank business models' ability to meet retail consumer needs and their impact on competition. While Glass-Steagall appears to have fallen off everyone's wish-list, Sassoon highlighted that a bank's size should be reflected in capital buffers given the reality that large institutions require large sums of taxpayer money when they fail. Finally, he was one of the few speakers throughout proceeding to identify the potential conflict between increasing bank liquidity in the name of stability on the one hand and the need to restore lending to businesses to aid economic recovery on the other. To the majority of speakers who were singing off the same hymn sheet for most of the proceedings, Sassoon's contribution confirmed that a Conservative Government would challenge much of the conventional thinking in Brussels on financial market reform. With pressure mounting on the Conservatives to elaborate on their stance on the Lisbon Treaty following Ireland's approval, their credibility and effectiveness in future Council negotiations are likely to be compromised.

While stakeholders appear to be in agreement on the broad principle which should drive EU efforts to learn from the crisis, the challenge for industry remains a substantial one. Legislative proposals are in the pipeline that will shape capital market structures for decades. At the same time the political pressure is pushing these through at unprecedented speed and at a critical time in the political cycle. With an incoming Commission due in the New Year, a new Parliament (75% of ECON members are new) and political change in the UK imminent, industry's arguments for balancing financial stability with economic growth need to resonate.