The 11th Annual European Financial Services Conference

Reshaping Europe's Financial Markets

Executive Summary

John Houston, Senior Partner at Kreab Gavin Anderson, welcomed the 450 participants before the conference launched into a far-reaching debate on the state of the financial services sector. There was a clear focus on the European Union's moves towards a banking union, beginning with agreement on a single supervisory mechanism; the importance of restoring consumer confidence in the financial sector; and the broader international regulatory context.

Pedro Solbes Míra, former European Commissioner for Monetary Affairs and Spanish Minister of Economy and Finance, and Currently a Senior Advisor to Barclays, delivered introductory comments ahead of the keynote address by European Internal Market & Services Commissioner **Michel Barnier.**

Europe is facing a defining moment for the future of its financial system, Mr. Solbes stated. The crisis has forced a rethink of the way European Monetary Union is being constructed, with a wide realization that greater central oversight of the financial sector is needed. Although the reaction of euro-zone governments and the European institutions has shown that the euro is irreversible, the legal framework required to make it successful clearly needs to be revised, Mr. Solbes added.

Europe's response to the crisis has been criticised but Mr. Solbes told the conference the complexity of the EU decision-making process had not prevented governments overcoming their differences to make substantial progress. As examples, he highlighted improvements in budgetary monitoring and control, implementation of macro-economic surveillance mechanisms, the creation of the European Stability Mechanism and the expanded role of the European Central Bank.

The decision to launch the banking union was essential and results so far have been encouraging, notably decisions to set up the Single Supervisory Mechanism and revise the European Banking Authority's statutes. More key steps are needed however - notably the need for an agreement on bank recovery and resolution, progress on the single rule book and work on deposit guarantee schemes, Mr. Solbes said. He praised the European Commission's proposals on resolution as a major step towards the goal of a resolvability solution that does not depend on taxpayer support.

In conclusion, Mr. Solbes said financial regulation should maintain the competitiveness of the euro-area banking sector while defending the efficiency and integrity of the single market. The risk of taxpayers' money being used to support the financial sector should be removed and priority given to facilitating long-term financing to regain the confidence of consumers.

Commissioner Barnier warned that despite the improved financial climate that was evident at the World Economic Forum in Davos this year, the crisis is far from over and the moment is certainly not right to relax the drive for better financial regulation. Although Europe has gotten over the peak of the financial crisis, the wider economic problems and the breakdown of growth cannot be forgotten, particularly given the rise in populist and protectionist sentiment that threatens the single market and European integration. He recalled that after recession in 2012, growth in the euro-zone was likely to be near zero this year and unemployment stands at 11.8 percent.

Growth cannot come without financial stability, Commissioner Barnier told the conference. He recalled how slack regulation led to irresponsible behaviour in the financial world which triggered the crisis. Regulation, he said, would help restore confidence in the sector.

The banking union, he said, was a key step to restoring confidence in European banks. The Commissioner went into detail on the workings of the Single Supervisory Mechanism. He explained how all banks will be supervised by the European Central Bank - with direct supervision for the around 200 judged to be systemic. The SSM should be up and running by 1 March 2014, he added.

Supervision however is only the first step. Commissioner Barnier is hoping for rapid progress this year on bank resolution and on a deposit guarantee scheme. He rejected suggestions that banking union could undermine the single market. Instead, he insisted it would counter the threat of fragmentation for those within, while preserving the integrity of the single market through the single rulebook that will apply to all 27 EU countries.

Turning to the issue of consumer confidence, the Commissioner called for action within the G20 framework to restore public trust which has been undermined by the use of taxes to bailout banks. An orderly resolution system that protects consumers and avoids taxpayer costs is essential. He also pointed to recent Commission proposals to increase consumer protection through improved information on mortgages and packaged retail investment products (PRIPs); tighter regulation on undertakings for collective investment in transferable securities (UCITS); and efforts to create a level regulatory playing field for different types of operators in insurance markets. Beyond that, Commissioner Barnier wants legislation to make it easier for people to open bank accounts and to change banks.

On the global level, the Commissioner said the EU was moving fast to adopt its Capital Requirements Directive IV in line with the Basel III agreement and it is essential that the United States, Brazil, Russia and others also apply the rules decided at the G20. Other areas where trans-Atlantic progress is needed include shadow banking and bank structure reforms, he said.

Session 1: EU Banking Union and the Single Financial Market

The first panel session was opened by a keynote presentation by **Vítor Constâncio**, Vice-President of the European Central Bank. The crisis has underscored the need for a stronger institutional framework for the eurozone, he said, and the banking union will be an important element of that framework. He explained the rationale for the different elements of the banking union and looked at the challenges for the ECB as it prepares for its new role through the Single Supervisory Mechanism.

The SSM will form the first pillar of a banking union that should safeguard financial stability and minimize the cost of bank failures. It should be implemented as soon as possible, together with the single rule book which will contribute to the creation of a level playing field across the single market, he said.

Mr. Constâncio set out the other key elements for the banking union: a Single Resolution Mechanism, sufficiently funded and able to resolve non-viable banks while minimizing the involvement of public money; a financial backstop able to directly recapitalise banks; and a common system of deposit protection. The banking union will become the most far-reaching reform since the creation of the euro, he predicted.

He insisted the SSM will work as a single system that combines the expertise of national supervisors with a strong decision-making centre. All 6,000 banks in the euro area will fall under the SSM's remit, he added, although the ECB's direct supervision will likely be limited to the 150 systemic banks who make up about 80 percent of the banking sector in Europe. The ECB Vice-President highlighted the importance of the bank's extensive set of micro and macro prudential powers given that the crisis had uncovered the extent to which risks at the macro and micro level can be mutually reinforcing. The ECB's monetary and supervisory functions would be clearly separated, he stressed.

Getting the SSM operational will be one of the ECB's top priorities this year. The tasks facing the bank as it sets up the SSM include ensuring it has sufficient resources and the correct level of cooperation with national authorities; harmonising risk assessment and reviewing the banks that will fall under direct ECB supervision, including through solvency analysis and identification of potential legacy problems.

To conclude, Mr. Constâncio said the agreement on the SSM showed Europe's resolve to strengthen the institutional framework of EMU. That momentum needs to be maintained as efforts progress towards the setting up of a Single Resolution Mechanism.

Moderator **Jeremy Anderson CBE**, Chairman, Global Financial Services, KPMG, kicked off the panel debate by paying tribute to the Commission and other authorities for moving ahead so rapidly with the SSM over the past year. That has created a position of strength, he said, but now is the time to ensure it can work.

From the Commission, **Nadia Calviño**, Deputy Director General at DG Internal Market & Services, pointed out that the work on banking union is not starting from scratch because considerable effort has already been put in over recent years on the single rulebook, setting out common rules on prudential requirements, supervisory powers, crisis management, etc. She stressed that the SSM is just a beginning and that a Single Regulatory Mechanism to protect taxpayers is a necessary second step. Finally, she emphasised the need for transition measures during the switch from national to European regulatory responsibility.

Matthew Elderfield, Head of Financial Regulation at the Central Bank of Ireland, represented national regulators on the panel. He said the SSM was a first step on the way to dealing with the heart of the problem: breaking the link between sovereigns and banks. One issue that now needs to be addressed is the sequence and timing of the other elements in the banking union - setting up the SRM and a European-level deposit guarantee scheme. He looked at three practical measures that need to be put in place. First, a clear division of labour between national authorities and the ECB with efficient decision-making procedures and accountability. Second, convergence towards a common approach on supervisory practices and procedures among the 17 national authorities in the euro area. Third, the development of a common supervisory philosophy covering such issues as the level of intrusiveness.

Koos Timmermans, the Vice-Chair at ING Bank, expressed appreciation of moves taken by the authorities to prevent a eurozone collapse and the ongoing efforts to increase competitiveness and make funding cheaper for bank clients. He gave full backing to the single rule book and efforts to alleviate concern over taxpayer-financed bailouts. There is still quite a lot of improvement to be made to the current level of supervisory cooperation, he said, with problems in areas such as the free movement of capital and liquidity. Banks need flexibility to ensure they can always address liquidity needs, he insisted. Problems relating to capital requirements at the subsidiary level also need to be addressed, he said. Mr. Timmermans insisted banks need clear guidance during the transition period. He pointed out the difficulties in setting out a "living will" - stipulating bank responses to crisis or collapse - while there is uncertainty over the bail in arrangements or the final shape of the banking union.

The final speaker on the panel, **Darcy Bradbury**, Managing Director at D. E. Shaw Group, stepped back to the fundamental question of why the banking union was needed. She answered by pointing out that 20 European banks have a liability base equal to or greater than their country's GDP. Since it is unfair to ask the taxpayer to support them, a cross-border solution is needed. She welcomed the SSM, but said it was only a first step and a resolution authority is also needed. Investors know what the rules are and what is the funding mechanism behind them. The Lehman Brothers experience showed the need for regulators to work together internationally and the value of clearly explained and stable rules to maintain market confidence.

The issues of sequencing and timing during the transition to banking union and concerns about the fragmentation of liquidity and capital also came up during the Q&A session. Other questions looked at legacy debt, the current lack of a single rule book, levels of investor return and the role of competition policy in banking union.

Session 2: Restoring Consumer Confidence

After a brief introduction from moderator **Pierre Francotte**, Professor at Solvay Brussels School of Economics and Management, former CEO at Euroclear and currently a Senior Advisor to Kreab Gavin Anderson, the panel discussion began.

Paola Testori-Coggi, Director General at the Directorate-General for Health and Consumers, European Commission, spoke of the need to ensure consumers know their rights and be fully informed so they can avoid potentially catastrophic financial decisions. The DG is working to get the right laws and to ensure that those laws are properly enforced, she explained, giving the example of the Consumer Credit Directive where enforcement action has greatly increased respect for the rules. Currently, her department is working with Commissioner Barnier's Internal Market and Services Directorate General on new proposals to ensure transparency on bank fees and lift barriers to switching bank accounts. She pointed out that financial services rank bottom out 20 sectors rated in a consumer scoreboard, with the public often unable to understand what's on offer. Improved education is crucial to broadening understanding of financial markets, she concluded.

Prof. John Kay, Visiting Professor of Economics at the London School of Economics, went further. He suggested that British consumers' opinion of banks would be unprintable. It seems sometimes that the basic function of banks to take in money and lend it back to consumers and business has been forgotten, he contended, as the low supply of credit holds back the economy. Too often, the financial sector holds debates in self-referential terms, ignoring the interests of the users, he said, adding that equity markets are essentially non-existent as a source of finance for British companies. In the past decade, Prof. Kay argued, savers, investors and taxpayers have all done badly while market participants have thrived. That situation, he warned, is not sustainable politically or economically.

German Green MEP **Sven Giegold**, a member of the European Parliament's Economic and Monetary Affairs Committee, said there was something deeply rotten in the basic market structure from the consumer point of view since those giving advice were not paid by those receiving it, but by those who constructed the products on offer. That needs to change so that those giving advice to consumers are on the consumers' side. He said Europe needs to get more serious in dealing with complex and risky products that are a danger to consumers and to financial stability, criticizing a number of European regulatory efforts as ineffectual. Mr. Giegold said he'd launched a competition to find the most dangerous financial product and planned to ask the European Securities and Markets Authority to ban the winner.

Curt Hess, the CEO of Europe Retail and Business Banking at Barclays, assured the conference that banks are aware that consumers and businesses are deeply affected by the economic crisis and that many people had lost confidence in the banks. He acknowledged banks have made mistakes and need to change. Barclays, he said, is on a journey to rebuild public trust, including through a new purpose statement and a new set of values to set out what it wants to do to serve its clients. That will include making products more simple and transparent and granting easier access for clients to the information they need. Banks need to get the basics right and to use modern technology to reach out to clients, he said. Achieving the necessary changes won't happen overnight, but the sector has recognized the challenges facing it and is cooperating with policy makers to make things work, Mr. Hess concluded.

The need to rebuild trust in the financial system was the main theme of the presentation by **David Wright**, Secretary General of the International Organization of Securities Commissions. He agreed that there is wide public distrust directed at political and business leaders, largely because ordinary people have paid the price of the crisis.

Mr. Wright warned that without the trust of society there was a risk of capitalism breaking down. There is no option but to work hard to rebuild trust and counter the damage to the financial sector's image from ponzi schemes, money laundering and other scandals. Key issues that still need to be dealt with include the delivery of finance reforms to stabilize markets on a sustainable basis; ethical changes within the industry; tougher sanctions on those who misbehave; stricter product regulation; and mandatory financial education in schools.

In the debate, **Mr. Francotte** raised the issue of deeper problems within the ethical culture of the financial sector and asked how it compared to other sectors which have faced public trust issues, such as pharmaceuticals or the agro-industry. Questions from the floor looked at investment in ethical products; the need to separate retail and investment banking; and the importance of instilling responsibility, accountability and knowledge in management across the sector including in smaller banks.

Lunch Session

Regional Integration and Global Markets: Regulatory divergences and mutual trust

Stefano Micossi, Director General, Assonime, introduced the lunchtime debate at which **Erkki Liikanen,** Governor of the Bank of Finland and Chairman of the High Level Expert

Group on Reforming the Structure of the EU Banking Sector, gave a keynote address. Later **MP Azevedo**, Deputy Director at the Office of Complex Financial Institutions (OCFI) in the US Federal Deposit Insurance Corporation (FDIC) presented the global perspective on regulatory issues.

Mr. Liikanen explained how the high level expert group he chairs considered two avenues towards reforming bank structure, eventually choosing to focus on immediate separation of retail banking and trading-related activities, rather than seeking to "do the trick" by asking for more robust capital for the banks' trading books.

He listed four arguments backing the separation route: the separated trading entity would be prevented from financing itself with insured deposits so the price of its funding will better reflect the true risks and therefore curb incentives to excessive risk-taking; separation will tackle bank complexity, making resolution easier; simpler structures also make it easier for the bank to be managed, monitored and supervised; separation would reduce the mixing of management cultures and restore the value of customer relationships.

This approach differs from the Volker rule in the United States by avoiding a complete split between propriety trading and market making and by keeping propriety trading within the regulated banking field, Mr. Liikanen said. Turning to the Vickers reforms in the United Kingdom, Mr. Liikanen said his proposals differ by having a broader concept of the activities of deposit banks to cover underwriting, and direct loans to householders, SMEs and big corporations. Vickers also proposes higher capital requirements for deposit banks, while Mr. Liikanen said his group believes the Basel requirements are sufficient.

Mr. Liikanen said regulators should have the right to impose deeper separation when banks cannot prove that their recovery and resolution plans are able to unwind high risk activities without harm. On bail ins, he said the key issue was that banks should have higher loss absorbing capacity, and both shareholders and creditors must take their responsibilities. To conclude, he hoped the debate ends with a harmonized European solution that also encourages reinforced global standards.

Ms. Azevedo focused on three themes: the constructive role government-led resolution can play in the orderly winding down of failed banks; the particular problems of Systemically Important Financial Institutions (SIFIs); and the role of international cooperation.

Contrary of the view of many in Europe, the FDIC's experience is that properly conducted resolution regimes tend to stabilize markets and build confidence among deposit takers. Resolution regimes however must be predictable, transparent and fair - meaning there are clear rules on when resolvers will step in, processes are based on law and regulation rather than discretion, and recovery is based on pre-established priorities that are fully understood by stakeholders

Ms. Azevedo explained how the FDIC deals with the resolution of normal banks over the course of a weekend, while SIFIs are more complex requiring advanced planning and special resolution strategies to deal with their affiliates around the globe.

This is covered by the Dodd-Frank legislation introduced in 2010, which sets out two distinct resolution-planning exercises - title 1 under which the banks set out in a "living will" how they would be resolved under normal bankruptcy and insolvency regimes, and title 2 where the FDIC devises a plan to show how it would resolve the firm in an orderly way avoiding systemic risk to the US economy and without resort to taxpayer-funded bailouts. The success of Title 2 resolution will be highly dependent on effective coordination among domestic and foreign regulatory authorities, she said, expressing confidence that ongoing bilateral and multilateral talks can lead to an adequate level of international cooperation being achieved.

Leading the debate, Mr. Micossi asked whether the high level of discretion foreseen in the Liikanen group's proposals on separation risked creating a regulatory nightmare. He also suggested the US is taking its own path less concerned with what the EU is doing.

Issues raised from the floor included the future of the Liikanen group's proposals in the face of opposition from France and Germany; cooperation between US and British regulators; SSM coverage for British banks with euro-zone subsidiaries; insurance sector regulation; statutory or discretionary bail ins; and the prospect of further restructuring reforms beyond the Liikanen proposals.