European Commission

The relationship between financial services liberalization, the regulatory framework and financial stability: an EU perspective

Olivier SALLES, EC, DG MARKT

Internal Market and Services

26/06/2012

Summary

- *The 2008 crisis : a world effort to regulate*

- *The European path out of the crisis*

- *Regulation/Stability vs Liberalization/Development ?*

Two financial crises

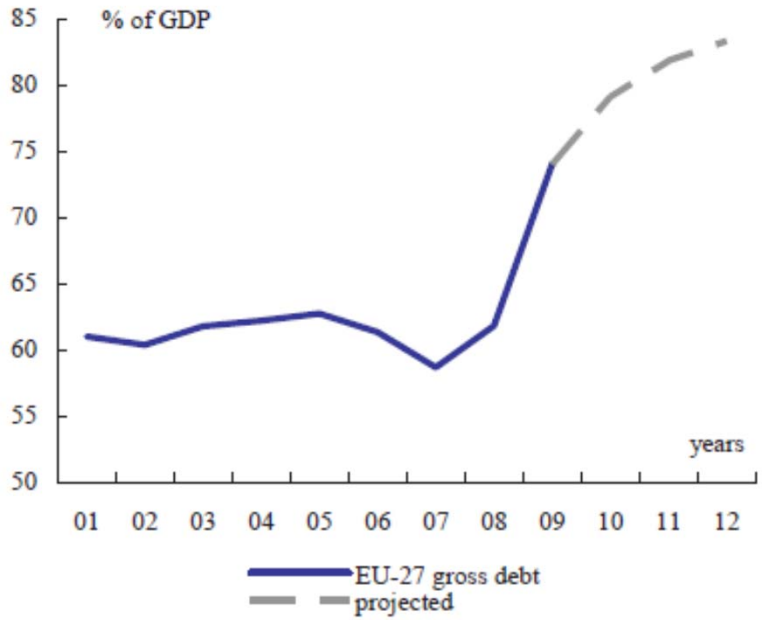
- **2007-08 financial shock**
  - Made in USA: subprime market and complex securitisation
  - Failure of monetary policy
  - Regulatory gaps and inadequate supervision
  - Weak corporate governance
  - Conflicts of interest in credit rating agencies

- **2010-11 sovereign weaknesses**
  - Made in Europe, various causes in different Member States:
    - Poor government financial management
    - Debt overhang from the past
    - Real estate bubbles
  - Negative feedback to financial sector via haircuts, reduced value of collateral, etc, then negative circle feeding financial instability

The 2008 crisis and its consequences

Economic effects of the crisis at a glance

EU27 debt to GDP evolution



Political response to the crisis :

- A world effort to regulate and stabilise Financial Markets and Global Economy

- Tackling financial issues at the global level (G20 agenda) : more robust institutions, secure and transparent financial markets, reducing dependency on specific actors such as CRAs

- Economic growth as an answer to the financial crisis : jobs creation (esp. for the young) and improved public finances balances

Key objectives

- **Financial stability**
  - Financial institutions must be robust enough to resist shocks
  - Financial markets must be secure and transparent
  - Consumers must be protected
  - Sovereign debt problems must be stabilised

- **Growth in the real economy**
  - Need to create jobs, especially for the young
  - Growth helps public revenue and debt repayment
  - The financial sector must contribute to this
  - Regulatory policy can help

Europe's regulatory path out of the crisis

The European Union has followed the most ambitious regulatory agenda among G20 members :

- A comprehensive agenda that covers all aspects of financial services

- International coordination of regulatory reforms (G20, FSB, bilateral relations, i.e. regulatory dialogues)

- Quickest implementation of reforms to be achieved by 2013

- Integration in an overarching economic policy in favour of growth and jobs

Key milestones in the area of financial services last year

PL Presidency

EU/Eurozone Summits

G20 Summit in Cannes

DK Presidency

G20 Summit in Los Cabos (June)

March

- **Directive on Mortgage Credit (COM adoption)**

June

- **DGS (General approach in ECOFIN)**

July

- **CRD IV / CRR (COM adoption)**

October

- **MIFID II & Market Abuse Directive (COM adoption)**
- **Accounting Directives & Transparency Directive (COM adoption)**
- **Omnibus II (General approach in ECOFIN)**

November

- **Credit Rating Agencies III (COM adoption)**
- **Audit (COM adoption)**
- **Investor Compensation Scheme (General approach in ECOFIN)**

December

- **Venture capital & Social Investment Funds (COM adoption)**

2012

- **Bank resolution**

Not to scale

The financial sector and stability

- Improve **supervision** – new structure of the European supervision (EBA, EIOPA, ESMA, ESRB)
- Strengthen **capital levels** of banks, insurers etc.
- Improve **corporate governance**, control **remuneration**
- Regulate previously **unregulated sectors** (rating agencies, hedge funds, in future also other areas of shadow banking)
- Control or sometimes ban the **riskiest transactions** (short-selling, naked sovereign Credit Default Swaps)
- Reduce the riskiness of **derivatives** (especially OTC)
- Improve functioning and **transparency** of markets (MiFID, MAD).

The financial sector and sovereign debt

- Latest **EBA recapitalisation exercise** for banks used «mark to market»
- **Restrictions on trading in naked sovereign CDSs**
- Special responsibility of the rating agencies requires **specific rules on sovereign rating**
- Global coordination on the **risk weighting** for sovereign exposures needed
- **Accounting rules** must be consistently applied on sovereign exposure

The financial sector and consumers

- Right to **basic bank account**
- Improvements to **deposit guarantee and investor compensation schemes**
- Better rules on design and selling of **retail investments**
- Better **protection for residential mortgage borrowers**
- **Single euro payments area** will be completed – and extended to e-payments

Europe's regulatory path out of the crisis : work in progress

- *CRD IV*
- *Crisis resolution*
- *coming : EU Deposit Guarantee Scheme*
- *coming : EU Supervision on Cross border banks*

➔ *Basis for possible Banking Union.*

Future work streams : consummer package, Shadow banking, Liikanen Group

Regulation vs Liberalization

Overall, Europe regulated but did not departed from a liberal conception of financial markets functioning :

- Numerous and significant regulations aim at covering formerly out-of-scope activities but not putting unbearable constraints (e.g. shadow banking, derivatives, alternative investment) = proportionality.

- European reforms followed an international agenda decided and implemented by all G20 members aiming at creating a world-wide level playing field.

- Overall, very few practices have been forbidden. Several have been stricktly regulated.

Regulation vs Liberalization

- Regulation + fiscal consolidation = key elements for predictability and stability.

- European regulatory agenda did not promote protectionism. On the contrary, Europe develops specific legal tools to facilitate international business (third country regime) and promote trade opportunities and agreements.

- Important consultations with stakeholders.

Conclusions:

- European regulatory reforms have been quite far reaching and will pursue in that way for the future : tough regulation is not opposed to liberal and smooth functioning of financial markets.

- Right balance between regulating and allowing financial actors to play their role.

- EU answer has been comprehensive and integrative, addressing different stakeholders.

➔ No evidence of contradiction between ambitious regulatory framework and liberalization/development.

Conclusions:

- No evidence it had so far a negative impact on international business and Trade. GATS rules provide stability and clarity.

- Financial carve-out has not been an obstacle.

- Still too early to draw some definitive conclusions. Very difficult to analyse the global impact (study from FSB).

- Need to futur analyse and monitor.

European Commission

:

THANK YOU

QUESTIONS ??