



**Eurofi 2008 -
Thursday 11/09/08**

**Session [1A] - TAKING INTO
ACCOUNT INNOVATION IN
THE EU INVESTMENT FUND
REGULATORY FRAMEWORK:
Keeping up with innovation
in secured conditions**

**through potential evolutions in the product or distribution
framework of investment funds.**

The Panel

Moderator: **André Villeneuve**, Chairman, Liffe

Panellists: **Ariane Obolensky**, Director General, French Banking Federation

François Villeroy de Galhau, Head of French Retail Banking, BNP Paribas

Guiseppe Zadra, Director General, Italian Banking Association and Chairman, European Banking Federation Executive Committee

Jacques Maire, Director of European Affairs at AXA

Richard Britton, Consultant to the International Capital Market Association

The Debate

André Villeneuve, the chairman of derivatives exchange Liffe, said his role as moderator stemmed from another function, as chairman of the City of London European Union Advisory Group. The group, amongst other things, was working on EU priorities for 2010-2015. Writing priorities now, he said, you sometimes had the impression you were writing the same priorities as you did five years ago for the present Commission. Though a great deal had been achieved in building the single market, there was a sense of déjà vu. It would be interesting to hear from the audience and the panel "whether there isn't something a bit more ambitious we should be thinking about," he said. "This is the time you can think radically, before the sober assessment of what actually can be done happens in the lead-up to the new Commission."

The good functioning of credit markets was "absolutely critical" to EU growth, and to all the other ambitions, including the Lisbon agenda on EU competitiveness. The City of London sought a "level-playing field," not just within the EU, but also across the Atlantic and globally. The City group had, in very close consultation, with Paris Europlace, and practitioners had discovered with satisfaction that they had a great deal in common

with regard to views on market regulation, legislation and so on. Other countries were welcome to contribute.

He hoped the panellists would outline their three chief priorities for 2010 and 2015; suggest what could realistically be achieved over the next five years to develop a single market for retail business, and what institutional evolutions would be desirable. "Do we need more supervision, a different sort of supervision, better supervision?" he asked.

Ariane Obolensky, Director General, French Banking Federation, said 2010 was in less than two years time – a short term. Her major objective was the completion of a real European financial market. That meant to do "what hasn't been done, up to now" to put in order the post-market elements that were lacking. This shortcoming impaired the competitiveness of markets and firms. "We cannot stay with such a fragmented market on these activities, we must move towards something which is more connected," Ms Obolensky said. Was interconnection the answer? A study was urgently needed to answer the question, because interconnection was very costly, and might not be efficient. What mattered was that users should have a choice of where to buy the service they wanted to pay for.

But to complete the European financial market would also require more efficient regulation and supervision at a European level – essential for the competitiveness of the continent's market, economies, banks and intermediaries. It was also essential for security, she said, and in particular for crisis regulation. The final necessity was more effective convergence with other areas such as the US. This should begin with a "real and rich" dialogue within Europe. Ms Obolensky was "thrilled" by the constructive talks between the City and Europlace – a real step towards convergence. Accountancy norms were a big issue: the priority was not "to have the same system everywhere, but to have a good and sound system for everybody".

François Villeroy de Galhau, Head of French Retail Banking, BNP Paribas, said Europe had the beginning of Euro-providers, but asked whether we yet had Euro-consumers. Banks such as HSBC, BNP Paribas in Italy and Central Europe, Santander and Unicredit were now "more or less" pan-European in retailing. But consumers in retail remained "very domestic". Yet technology could change this, notably the internet, "a very powerful pan-European retail tool". So his priorities would be mainly non-financial regulation.

Firstly, he wished for the extension of the Euro-zone, especially to Central Europe. The Euro had been not only a political success, but also a practical step towards a level retail financial playing field for the consumer. It made prices comparable, stable, and probably lower, due to lower interest rates. His second priority would be regulatory changes to remove obstacles.

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Internet regulation was a problem. At Cetelem, a BNP Paribas consumer finance arm he previously ran, internet sales were developing fast and had reached 20 per cent of the total. But in some countries – notably Italy and Germany – internet retailing was less developed because of legislation regarding electronic signatures. Development of the internet under consistent regulation would be “a very powerful accelerator” for the retail financial market.

House purchase mortgages were another victim of legislation. Europe needed property regulations in each European market, which were “protective of the consumer and clear for the providers”.

His final priority was supervision. This was clearly the main problem at present for Euro-providers. “Sometimes, the real nightmare is how to deal with so many different supervisors.” I would wish for a very strong dialogue between the legislator, the supervisors, and the accountants, and closer links between supervision and accounting. “This is probably the core of the financial crisis.” Failure to tackle this would lead to pro-cyclical effects that could be very perverse.

Guiseppe Zadra, Director General, Italian Banking Association and Chairman, European Banking Federation Executive Committee, recalled an analysis by the European Banking Federation on the obstacles to integration compiled in the autumn of 2007. He had gone back to see what had changed. “Of the whole list, probably one item has been performed,” he said, that being modification of Article 16 on cross-border mergers, a problem now solved. “All the others are still alive.”

He agreed with Ms Obolensky that the first priority was to do what was really needed to complete the single financial market. Too little had been done to complete integration. Euro-producers should be able to reach their customers easily, wherever they were. Producers were able to reach anyone with information, but not with contracts or guarantees.

Mr Zadra said retail market integration was essential, because the retail market was more than 50 per cent of the European financial market. The Commission was pursuing noble ideals, but the Commission was a “prisoner of the Council” and national authorities were very reluctant to demolish barriers, both in political terms, but also because they knew that even if they reached agreement “they will never be able to implement it in the national countries”.

European countries’ real estate and property legislation was often more than a century old. “To change this kind of stuff is really a problem,” said Mr Zadra. When governments went to Brussels and encountered such proposals they were scared “and I would be too, in their place”. Returning to their countries, they knew they would meet opposition. So his wish was that the Commission would focus on implementation, and give up on integration. Instead, they should “follow lines like consumer protection, and competition.” That would improve the quality of the 27 markets.

His second point was that the current financial crisis had been born in non-banking markets, in securitised loans, collateralised debt obligations (CDOs) and derivatives traded in informal markets. They grew to the point that it blew up, but many in the audience would remember that central banks were wondering “where these CDOs and swaps were ending up five or six years ago”. Nobody knew where they were and yet people had accepted that this “pyramid was growing out of the control of anybody”. The authorities had made a mistake in accepting data from the rating agencies, instead of “real” information. Regulated markets were needed to put together and provide information.

Thirdly, he said, “we need a much more solid European financial market, not only in retail banking, but also in respect of institutional investors, so that unit and mutual funds could be offered throughout Europe, favouring necessary economies of scale. Europe was too small, in terms of institutional investors, and was linked to inadequate market capitalisations, widespread in Europe.

Jacques Maire, Senior Vice-President, Head of European & Public Affairs, AXA, said he too saw the linkage of accounting and regulation as essential. His dream, as an insurer, was that in, say, three months time Solvency II would be adopted, leading to integrated supervision for the European financial sector. “I think the five years to come will mostly be dedicated to managing the consequences of the transfer of responsibilities from local to global levels” with benefits for the consumer.

He also suggested three changes that were desirable. The first was consistent implementation of Solvency II at Level 2. What was important for consumers was financial innovation, yet the directive said nothing about that. In pensions, AXA had been providing variable annuities in the US market for a decade. Pensions with assets were invested in equities, backed by a hedging strategy to match the downside in the market. But this product was not recognised by most supervisors in Europe. “The impression we have is that there is a certain gap in knowledge and skills between the banking and insurance supervisors about risk transfer systems and financial innovations,” said Mr Maire. If Europe wanted an efficient system capable of providing the benefits of innovation to both insurers’ balance sheets and consumers, that problem must be addressed.

His second priority was the issue of pension funds. “It shouldn’t be an issue.” Solvency II covered the prudential regulation of insurers, creating a gap between pension funds and insurers that didn’t previously exist. Pension funds needed, and deserved, the same treatment, in terms of impact studies, and so on. Consumers deserved the same level of safety, whether they bought a pension through an insurer, or through a pension fund. This was an important issue for markets such as the UK, the Netherlands, and France.

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Mr Maire's third point was that there should be convergence of insurance guarantee funds. Regulators must address "extreme situations" such as the winding-up of an insurer. The first trans-national case was certain to raise concerns, he said. It would be much more efficient to have some kind of European Union "pool" to protect consumers.

Richard Britton, Consultant to the International Capital Market Association, said he agreed with much of what Mr Zadra had said, but contested Mr Zadra's views on CDOs. Though regulators had worried these would be bought by insurance companies, the liabilities had actually stayed on the books of the banks. "Under Basel I, legally it was off the books, but as we saw, as soon as they hit trouble, for reputational reasons the banks have used up all their liquidity bailing out something that under regulations they had no responsibility for." Risk had stayed with the entities central banks were supposed to be regulating.

Mr Britton said his first priority for 2010-2015 was restoring investor confidence in the market. "I think it takes longer than you might think," he said, "which is why I think 2010-2015 is not a ridiculous agenda." And that was assuming "we can put the credit crunch behind us by the end of this year, or early next." Investors had long memories, especially when they had lost money. Investor cynicism had stayed high after the 1999-2000 dotcom bubble until very recently. The Dow Jones Index hit its all-time high in August 2007, "when the sub-prime crisis was already well under way". The securities industry was devoting large resources to improving investor confidence, as it needed to. Against this background, any new initiatives should be kept to a minimum, and thoroughly justified.

He also wanted a mindset among regulators and legislators that Europe needed a highly competitive marketplace, as French Finance Minister Christine Lagarde had recognised in her remarks the previous evening. But this view was "not yet universal".

Mr Britton said his third priority would be making the single European capital market a visible reality to all investors – a view he shared with Mr Zadra. Fragmentation was not a problem for institutional investors. "Technology can reconstitute data, and smart order routing ensures best-execution." But fund managers would have to pay for information that had previously been free. The retail market raised a bigger question. Europe lacked a common market system like that which had been under construction in the US for 30 years. "Quite frankly, MiFID enables only inefficient and ad-hoc tinkering." There was no mechanism to "put it all together in a way that really makes sense," he said.

He then added a personal fourth objective: "I'd like to see the UK join the Eurozone."

Mr Britton then made a passionate call for more uniform sanctions for law-breakers, and tougher enforcement to underpin the credibility of

securities markets across Europe. National sanctions were often too weak. Should the Commission have powers to impose more uniform regulatory standards and sanctions? In the 1980s, the UK had tried fragmented self-regulation, and it had not worked. Yet the fragmented structure of European regulation today resembled that prevailing in Britain a quarter-century ago. Eventually, the financial industry there had welcomed the creation of a single, strong, statutory regulator. Today, the industry supports the current regulatory framework in Europe. Yet frustrations were growing. "The industry view may change, and if it changes, when it changes, it will be radical, and very fast," Mr Britton said.

The chairman, Mr Villeneuve, then invited questions from the audience. A question was asked about banking consolidation facilitated by the credit crunch, and whether in future the industry might not displace policy-makers and take the lead role in shaping the evolution of the financial services industry. In the future wouldn't it be "about the market driving, and policy-makers responding?"

Mr Zadra responded that consolidation in Europe had been led by industrial "pushes", which sometimes generated the legislation the producers needed, but it was incumbent on legislators to produce a useable framework as soon as possible. Regulators could also anticipate consolidation. Mr Villeroy de Galhau said that broadly, he agreed with the questioner. It was probable the crisis would accelerate consolidation. The priority was not further regulation, but consolidation of supervision would not come only through market forces. "It is time we had one common currency, one central bank – we cannot remain with more than 27 regulators." But the biggest issue was probably accelerating the emergence of "Euro-consumers".

Mr Britton said that the Market in Financial Instruments Directive would impose huge but affordable costs on big players, and low costs on small ones. "It is the guys in the middle who are going to get squeezed." Medium-sized European banks with pan-European ambitions would have to take on the same costs as big global players, without having the necessary revenues. "They only have two choices: they either retreat as niche players in their markets, or they merge."

A questioner said SEPA had created a single instrument for European citizens, and those with homes in several countries were the nascent European consumers. Shouldn't such people be lobbying now on a focused set of integration issues? Ms Obolensky said this was a welcome dream, but the conflict between the banking industry and the Commission over multilateral interchange fees for SEPA showed that even planned initiatives were struggling. There was something wrong with the way European projects were conceived and constructed. Too little attention was being paid to building an integrated market. Mr Villeroy de Galhau

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said language remained a barrier for many European citizens, and at the same time, retail banking was “still a history of proximity”, even in the US, a relatively integrated market.

What other regulation was needed, a questioner asked? Mr Maire said the insurance industry had gone as far as it could in proposing change, but the real stumbling block was the fragmented nature of national regulation. Mr Zadra said lobbying was probably both inadequate and misdirected. The obstacles were not in the Commission, but in national authorities, especially allied to fears that integration was a threat to small banks – and those fears were quite well founded. Mr Villeneuve said the European agenda needed to be “owned” at much higher levels in the financial industry.

A Belgian banker highlighted the problem and costs of keeping three sets of accounts to different accounting standards within his bank, Fortis. He also highlighted the problem of double-taxation on shares arising from mergers. Mr Britton agreed that double-taxation was a pan-European problem.

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