Atlantic Council Speech – Five Years in the Chair

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It is a great pleasure to be here today and I thank our hosts. I do not intend to replicate the work that has gone into the Dangers of Divergence report, but rather to give an account from my side of how things have been during this extraordinary period of new regulation.

I will not go into any detail, but how I became chair of the Economic and Monetary Affairs Committee of the European Parliament is a story in itself and something that happened to my surprise without my seeking it. There seem to be times when destiny just points its finger no matter by who or how many times it is told to point somewhere else.

So, when I became chair in July 2009, we were already well into the financial crisis. President Obama had taken office – something the world had waited for in order to coordinate its response to the crisis – and which took shape via the Pittsburgh G20 commitments to strengthen the international financial regulatory system.

In Europe the G20 commitments coincided with reviews of the original EU financial services action plan, and an appetite to expand and tighten all financial regulation within a more harmonised supervisory framework, leaving less discretion over implementation to the national supervisory authorities.

Another issue that was immediately on our agenda was the Greek sovereign debt crisis and the ensuing redenomination risk. This illustrates how, right from the start in Europe, we were wrestling not just with a financial crisis and new regulation but with the twin problems of that AND the Eurozone crisis, and they were inextricably linked through cause, rhetoric and banking regulation.

At the outset of the Greek sovereign debt crisis, much was made by the then Greek premier George Papandreou of the role of short selling of

sovereign credit default swaps. Unfair though it seems to make bets and gains on another's misery, the figures never bore this out as a substantive cause, but the anger and rhetoric against greedy bankers and hedge funds found a ready audience that influenced the attitude and legislation on issues such as the Alternative Investment Fund Management Directive - AIFMD which was about hedge funds and private equity - and even spawned a whole new piece of legislation on short selling.

We have had wave after wave of new legislation, and I will point to some of the main features but I can not be exhaustive because the statistics show we have adopted 63 pieces of legislation, produced 192 other reports, opinions and resolutions, I have chaired some 300 committee sessions and over 300 trialogue negotiation sessions – the equivalent of US conferences between the House and Senate to hammer out final legislative acts.

The first wave of legislation included the unfinished business of Basle 2 and 2.5 – in our parlance CRD3 – which dealt with the trading book and also our first round of reining in bonuses. This was accompanied by AIFMD, credit rating agencies and the new European Supervisory Framework.

Internally of the EU the supervisory framework was by far the most contentious and one where the Parliament pressed hard for, and won, a greater degree of power for the European Supervisory Authorities than was wanted by our co-legislators in the other European chamber, the council of finance ministers.

Externally, regulation of hedge funds and private equity caused a lot of noise and objection from a sector that had little understanding of how European legislation worked, whilst the overlap and consistency or otherwise of our credit rating agency legislation with that of the US also gave rise to a lot of agitation.

The AIFMD shows well how motives for legislation have many drivers. It had long been clear that regulation would happen someday. After the financial crisis it became inevitable. In France it transpired that hedge fund investments had found their way to inexperienced investors and the response was both to demand European legislation and to wish to block

inward selling – something that found its way into the legislative debate and was part of the political tussle of open markets versus the Prison Europe/Fortress Europe approach.
Private equity on the other had had different detractors, some seeing them as asset strippers that threw employees on the dustcart, others notably Germany , fearing for the takeover of their famed Mittelstand, or SME, sector through covert acquisitions. As with France not having consumer protection legislation, one could have blamed German low transparency provisions over share acquisitions and contracts for difference, but it was a whole lot sexier to have specific regulation at a time of high tensions and push back against Anglo-Saxon financial markets that seemed to have done nobody any favours.
To add to the problems the Commission's draft proposal was not its best piece of work. However I do recall telling everyone to calm down and that it would probably be all right on the night. It was a long and painful scrap, so painful that once we had an agreement in principle I did not let anyone leave the negotiating room until every word was signed off. But the end product was workable – even the third country regime – and already many are wondering what all the fuss was about.
The Second Wave of legislation included the European Market Infrastructure Regulation - EMIR – which was where we set up the rules for derivatives clearing through central counterparties and reporting to trade repositories. Along with some conduct of business rules done later within our revisions of the Markets in Financial Instruments Directive and Regulation - MiFID2 – this has been legislation that has commanded more transatlantic attention than anything else. The irony of much of it is that we knew at the time we did the legislation where some hot spots would be that were premature to decide, but one or another party – and it varied around institution and political spectrum as to which – would not back down.
We knew that there should be a possibility to exclude FX swaps and forwards. We knew that there would be technical difficulties in the frontloading. On these issues the Commission wanted to be tough and insisted, as it happens against the majority view of the Parliament. Suffice it

say that I have since had the European Securities and Markets regulator in my office asking how the Parliament might react to 'proportional' going all the way to zero and presenting almost verbatim the arguments that we put to the Commission in trialogue.

Meanwhile from the US side, definitions of swap-dealers and treatment of non-US persons for transaction level reporting requirements placed on non-US Swap Dealers – the famous footnote 513 – has caused not just agitation but real anger.

Likewise it has been clear since before we did EMIR, because the Parliament did a report, that we would be exempting corporates. It was clear in that report and from the legislative process for EMIR that when it came CRD4 –our Basle 3 – would be changed to follow suit. And it was. One of the reasons for this particular change is because of the collateral requirements of EU CCPs. And unfortunately there is no solution for this in sight, not least as the general thinking in the EU is that the systemic nature of CCPs is one of the biggest challenges to face us, and now is not the time for relaxing anything.

So I guess what I am saying here is that there was not sufficient joining up at an early enough stage and that in future there needs to be more thought about the differences that exist in markets because something went wrong.

As I said at the start, we were fighting twin problems and by this stage, sovereign bail-outs of Greece, Ireland and Portugal were bearing down heavily and there were also major legislative proposals on economic governance, the so called six pack – which tightened the budgetary controls in particular on Eurozone Member States. These and the follow up two-pack, and a plethora of new legislation on statistics and a budgetary oversight semester are intrusive and painful for EU countries: the external relevance was that shoring up the stability of the Eurozone was an issue of great international importance even if the minutiae of how it was done was not studied everywhere. Another relevant fact, just as with financial services, was that the European Parliament made substantive changes, forging a strong alliance with the European Central Bank on these issues.

The ECB had to know that the governance was serious in order to be confident in deploying its armoury, which has been crucial.
The third wave of financial services legislation included CRD4, our version of Basle 3, rapidly followed by revisions to Market Abuse and Markets in Financial Instruments legislation.
Of course Basle 3 is not finished because leverage and liquidity are still outstanding, yet a lot of the accusations hurled at the EU are about these issues. Well, my message is I do not think Basle or FSB first pronouncements are always perfect and we know that they change and modify as they work. Remember the time when the idea was that only sovereign bonds counted as 'liquid instruments'? Again it was the European Parliament that pushed strongly against this – after all it was absurd when we were in the middle of a sovereign debt crisis. I think we had an effect because Mario Draghi, then FSB Chair, said at a Brussels Economic Forum, yes Sharon, I know what you have been saying about liquidity and we are making changes. Mind you, I was sitting near him on the panel and I think he knew what was coming.
On leverage the EU banking system is full of mortgages, US has Fannie Mae and Freddie Mac. This radically changes for example the impact of leverage ratios. EU applies Basle to all its banks, not just the big ones, including specialised mortgage banks, so there have to be inbuilt provisions for proportionality. There is never political appetite to destroy mortgage institutions as the trouble trying to reform Fannie and Freddie in the US shows. This does not by any means mean that big banks will get away with using the legislative flexibility that is intended for small banks and the introduction of the ECB as Eurozone bank supervisor will make that all the more certain.
Basle 3 came up with some overly strong rules on trade finance, and backed strongly by colleagues, I was prepared to challenge on this so we changed it. The IMF and World Bank were on my side too. Now Basle has made amends on most of it. Would they if we had not challenged? When it comes to working out CVA charges, the other side of EMIR, this all relies on proxies and the situation is completely different in the US where there is

a strong corporate bond market and corporate CDSs. This is not replicated in the EU and the numbers come out silly, so again the Parliament was not prepared to tolerate that.

But I regard these as failures of Basle, failures to take account of realities, and failures of the EU to have got its act together at that stage too. So whilst there are serious reasons to look more to G20 and international organisations, there are serious reasons for better detailed feedback at an early stage. G20 can't do that much detail.

On MiFID there was much to do to update and establish comprehensive coverage, and have stricter controls on market structure. The issues that took highest profile were restrictions on algorithmic and high frequency trading and the establishment of a European regime for commodity position limits. There was also great contention over fungibility between CCPs and open access. But after much hard negotiation, again in the early hours of the morning, and a five year delay in implementation, in the end we do have both fungibility and access.

Market Abuse rules have been tightened and modified not least in the light of the Libor and other scandals. We had very useful cooperation with the US on this. There are issues here that annoy the Parliament in terms of not being able to mandate high enough administrative fines because of the way it all interacts with criminal law which is still a new area for legislation at EU level. But we do have tougher than before minimum fines and criminal sanctions everywhere, with countries able to impose higher if they wish.

In the EU personal privacy is also a big issue, especially in some countries that have lived through the trauma of the Stasi secret police, a history of where family members have spied on family members and where personal liberties have been infringed well within recent living memory. This has made it hard to agree taping of phone trades made with private individuals rather than professionals for purposes of detecting market abuse. These sensitivities raise their head elsewhere and are not going to go away, so we have to work with them. However the NSA matter seems to make every case of suspicion as to what the US might do with data justified, and that of course spills over badly into plans for aggregated data repositories and the

like. It will take a lot of hard work from the US to make amends and the onus is upon them for that while Europe deals with the legacy of its traumatic past.

The final wave of legislation to mention – and it is not actually the last wave – takes us into territory where the EUs twin problems of financial services and Eurozone stability meet in the creation of the Banking Union. We have agreed to have the ECB as the direct supervisor of the largest Eurozone banks – not just giant ones, some 130 will be covered – and the ECB is the responsible supervisor for all banks so they can be called in if there are problems. The ECB will of course be applying the same rule book of EU legislation that covers those outside the Eurozone as well. Again the Parliament ruffled some feathers, this time including by negotiating a tough accountability regime to the ECON Committee for the ECB's bank supervision.

We have also just agreed new rules for bail-in for bank recovery and resolution following the FSB principles and in a move mirroring the ECB as the common supervisor for the Eurozone we have also agreed - after a final 16 hour overnight trialogue to 7 am - legislation for a Single Resolution Mechanism and Authority. The decision procedure has been made a lot simpler than finance ministers had agreed, so it can operate over a weekend. A joint resolution fund has also been created that provides the working capital and liquidity for resolution processes in the Eurozone. It takes a few years to be running at full mutualised capacity, but get there it does. The European Parliament played a big part in getting the Single Resolution Mechanism into a much more workable state, again finding major support from the ECB.

Looking to the future, I think there is still a lot to learn about the interconnection of banks and sovereigns and how to address the lack of flexibility that monetary union creates. Indeed we are always reducing flexibility, whether that be through budgetary controls or the additional rules present in the Single Resolution Mechanism for the Eurozone compared with the options in the Bank Resolution and Recovery Directive.

Some suggest that absence of the ability to depreciate the currency may mean that there are limits to the size of banking sector that can be absorbed in the event of crisis. It has already been mooted in finance minister circles, with controversy, with regard to whether small Eurozone countries can sustain large international banks and banking sectors. Others are even wondering whether to some extent this applies to the Eurozone as a whole: that it is impossible to absorb a systemic banking crisis with a large banking sector if there is not the ability to use the full range of monetary tools that inevitably lead to devaluations. We all expect that the agreed rules on bail-in resolve many of these problems, and in the limited way in which this has already been tested in the EU there are reasons to be optimistic.

The final outstanding wave of legislation includes shadow banking, benchmarks, money market funds and bank structural separation. These will now be left to the next Parliament to pick up and complete although some pointers have been left.

So that is an overview of some of the key legislation and flash points, of course there are more, but in reality it is quite extraordinary how coherent the US and EU have been. However, there is room for improvement at the international level and room for TTIP to help that process at the EU-US level. The more I think about it the more a framework is needed to ensure much earlier engagement, working together before even international positions have been taken.

So to conclude, my time in the chair has been extraordinary. The effects of the financial crisis cannot be under-estimated. Sub-prime mortgages and overly complex securitisation is one thing; miss-selling, interbank lending rate scandals, insider-dealing and forex investigations quite another.

The response from regulators and legislators has been to try and rebuild public trust by a comprehensive overhaul of rules. Anyone responsible for anyone else's money has to have the right levels of governance and accountability - maybe ***more*** than the right levels - for that trust to be restored.

This has all been done in the excruciatingly tense backdrop of an existential crisis for the Euro and profound responsive measures in which the ECON committee had a key role.
It is an era where the Parliament has left its mark more than ever before and I am proud of my colleagues and the work that we have done.