Speech by Sharon Bowles, Chair ECON at the Former MEPs Dinner

Financial regulatory landscape and the future of the Euro

I am pleased to address you this evening; our topics could keep us here all night.

It was suggested that I might speak on the future of the Euro, and I added in the financial regulation part not just because there are so many things going on but because there is a huge linkage between financial regulation, markets, sovereign debt and therefore the Euro. It is those linkages, and EU responses, that I would like to explore a little.

Sovereign markets have certainly been reawoken from comparative slumber and complacency. The issue of how they should be treated has also come to the fore; currently sovereign issuance has exemptions from MiFID and special treatment under the Capital requirements Directive. Do we need changes here?

For example, as recent events have shown Sovereign debt in Euro does not truly merit the no nominal risk assumption in the CRD - that would certainly be even clearer without ECB bond purchase and underlies the latest concerns over bank exposures - and the MiFID exemption means that in some member states there is no competition between trading venues for Euro Government bonds.

And in like manner to the impact of the financial crisis, the Sovereign crisis has undermined confidence in the capacity of the market to deliver in the public interest. As with financial regulation in general, it is essential that we analyse where this properly implies intervention, to protect public good and – if such a thing can be done - to protect markets from themselves.

This gives us big choices, including where we see ourselves in the world. But amidst the big decisions we have to keep clear who we are serving.

First and foremost - even more so when we are hungry and needy for growth - has to be to serve the real economy and create the conditions and confidence for investment and an entrepreneurial spirit. This is the case for Sovereign debt markets as well as the more general financial markets, and means restoring integrity and trust, at the same time remembering we must not remove choices and flexibility. Investors will not come to a market that denies them their proper role, which includes responsibilities.

And we can not afford to get it wrong! If we close ourselves to the world, shut ourselves off from sources of investment capital or have to pay over the odds in consequence, we will be left behind - and the casualty of that will be Europe's cherished social ethos as reflected in the collective social models of the member states.

So far our response has been far from optimal. In the context of sovereign debt, some of the more extreme and populist rhetoric that has been invoked relating to bond market movement goes so far as to suggest any moving of money to a safer position is speculation and must be stopped.

This denial of underlying fundamentals makes markets more nervous, not less. As I said at the Brussels Economic Forum, markets can sniff out excuses and inadequate responses like a pig hunting truffles. Markets will not be satisfied at us giving an aspirin for symptoms - be that ratings or spreads - when the underlying deficit problem is relegated to minor billing.

It is my personal view that all the declaiming of naked Credit Default Swaps on Greek bonds did harm because it was seen as an excuse, an indication to the markets that a scapegoat would be found rather than the truth be addressed.

However, when this notion of harmful speculation was raised, it was also totally unacceptable that European supervisors could not get swift and adequate access to all the necessary data from the US trade repository. The data now shows that the declaimed activity was actually far less than it was hyped up to be – something that was also pieced together from other reporting in London – but the matter could have been laid to rest much sooner if full information had been available promptly.

On the positive side, the deficiencies in access to information are being solved in the latest US legislation. More widely, use of central clearing for all kinds of derivatives, not just CDS, along with reporting to corresponding repositories is being established in legislatures around the globe. The ideal world as I see it would have one global repository per asset class so that an overall picture is available without having to seek combinations from regional repositories. With repositories for different asset classes in different regions, there will be incentive for cooperation in access, and its a safe bet that the EU would have its fair share of infrastructure.

There are various other proposals around concerning sovereign debt. One is to ban the selling of naked Credit Default Swaps, which is basically saying banning the selling of insurance on a bond unless you own the bond. That sounds logical, but how else do you insure interests that you have in the soundness of a state? I am sure that some creative synthetic index could be created, and my guess then is that it would also influence bond prices.

Moving on from CDS, what do we do about central clearing of sovereign issuance. Amid all the complaints against the financial industry has there been any coverage of the fact that dealers have been crying out for ages for central clearance of Greek bonds in Greece. First Greece did not want it, then they did, and eventually called in the LCH clearing house. Spain is the same story again - dealers have asked, the state has resisted.

The recent crisis has also caused others to raise questions about rating of Sovereign debt. Here we should tread very carefully. We are in the maelstrom now of the consequences of some Member States not being as honest about debt as they should have been.

We also have history of Germany and France causing the stability and growth pact to be flexed to suit them. The Commission took them to Court in 2004 and won. Despite the optimism expressed by some of you at the time, this was a pyrrhic victory, since the council response even before the Court delivered its judgement was to start re-writing the Stability and Growth Pact and blocking any new powers for Eurostat. So I am not inspired by the notion of states having a say over their own rating, which could be the result if it is done by a public rating authority. Indeed my guess is the markets might be pretty dismissive too.

Turning to the future of the Euro itself. I still believe in it, warts and all, and that is still the dominant view.

Recently a momentous decision was reached to set up a European rescue fund in concert with the IMF. How much more effective would that have been if it had been done sooner, when first talked about. Instead we had weeks, no months, of the Commission and Council having to say that the Euro would be backed, but giving no detail. I can tell you I and many on my committee were left wanting by the various pronouncements and papers that really said very little other than 'we are fixing it'. I'd say we lost patience even sooner than the markets, so no wonder the market forced a showing of the hand.

And at last some details about how the special purpose vehicle -which is known since last Monday as *European Financial Stability Facility*- that will raise funds have been fleshed out this week, but there are still matters pending. The rating might only qualify for AA, not AAA, and the mechanism is more costly than it need be. It may even have knock on effect on the borrowing of other European Community institutions such as EURATOM or the EIB.

The Facility has been incorporated in Luxembourg, but it is far from finished despite Ministers claims that it was the final touch – and in the words of a former director of the Commission 'It is this type of blustering that creates the incentive for markets to test the resolve of EMU member

States resulting, more often than not, in an increase of the amount and cost of their interventions.' So I am not the only one that has noticed the negative effect of overstatement, and that it actually costs money, but at least we are on the way. Indeed, it is effectively the birth of Eurobonds and maybe it will lead to more examination of other Eurobond proposals.

This week has also seen some agreement on giving Eurostat more audit powers. The Parliament has pressed for this for a long time, from long before the crisis, and recently we have maintained strong pressure. It seemed to me that without such powers there was absolutely no point in Mr Van Rompuy's Task Force on economic governance: far more useful to have a grip on outturn than on promises.

Having got this important verification tool, work can progress on other surveillance measures. Ideas on the table include some kind of pre-budget coordination or verification, which may be difficult at least in detail, which is essentially acknowledged in Mr van Rompuy's press statement. Broader multi-annual and mid year objectives, with monitoring of real outturn and impacts look easier to achieve. Telling Germany to be less competitive in order to achieve macroeconomic balance looks challenging.

Turning specifically to Mr van Rompuy's press statement he says that members of the Eurozone were on a sleeping pill, with which I agree, but he then says we need to avoid a rude awakening by the market forces. With that I disagree. The market spotted the Eurozone was asleep, and it is right to wake it up to the reality of fixing deficits. Actually the truth is the markets were also asleep and larger bond spreads should have kicked in years ago; the fact that they did not was at least in part due to the capital treatment that I referred to earlier.

My final point is one with which you will empathise as former parliamentarians. At the end of the line there may be measures that come to the Parliament for codecision, such as multilateral surveillance. Unfortunately the Parliament is so far being frustrated and excluded from meetings and planning. No doubt at the end we will we told the results and expected to push things through quickly. At that stage I do not think we can be blamed if we take our time to think and investigate and debate in our turn.

It would be much more productive to let us do that in parallel: every week that we are not included in the loop means a week longer for us to reach a conclusion when it eventually comes to us.

There are of course many more issues that spread out from the points I have raised. But to end I return to my basic point, that there is no substitute for tackling deficits. No coordination in the world, no affordable amount of bail out will remove that responsibility. The future of the Euro depends on that understanding.