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**Some aspects of economic and  
financial crisis**

*Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort*

**INSTITUTE OF CHARTERED ACCOUNTANTS IN IRELAND (ICAI) FINANCIAL  
SERVICES BREAKFAST SEMINAR**

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Ladies and gentlemen,

Thank you very much for inviting me to this breakfast seminar.

This morning I would like to discuss some aspects of the present economic and financial crisis.

### **Financial crisis**

Robust reforms are needed in Financial Markets to remedy known weaknesses and prevent the emergence of new vulnerabilities in the future.

There have been fundamental failures in the assessment of risk, both by financial firms as well as supervisors.

These pressures were not sufficiently contained by regulatory or supervisory policy.

### **A stronger, more reliable financial system**

The crisis has taught us some valuable lessons. We will emerge from this crisis with a stronger, more reliable financial and economic system.

We are proposing ambitious reforms of the European financial system - which will also set a clear course for the EU to lead and shape the process of global change.

Let me give you a number of concrete examples.

### **European supervisory architecture**

Based on the de Larosière report, we have proposed ambitious reforms to reinforce the European supervisory architecture. The European Council last week adopted strong conclusions supporting our approach to set up a European Systemic Risk Board and three Supervisory Authorities. We will bring forward legislative proposals by September.

### **Prudential requirements for banks**

In parallel, we will continue to strengthen the prudential requirements for banks. I have already made changes to how banks will handle securitisations in the future. I want banks to pay more attention to the loans they generate for onward securitisation. They will be obliged to keep 5% of any securitisation on their books. This should help improve lending standards. There are other changes I intend to propose as well.

I am particularly keen that we address the shortcomings of the capital requirements for the trading book. And our message is simple: if you want to hold a position on your trading you will need capital to back it. The current crisis showed that when times get rough the risk from the trading book is just as great as it is on the banking book.

And then of course, there are: complex re-securitisations. Our proposals aim to ensure that complexity is inspected, dissected and explained before a position is taken. And in any case there must be more capital going forward for the additional leverage that is created by re-packaging one securitisation into another.

To address short-termism and unconsidered risk taking, we now have recommendations in place on the remuneration policies of the financial services sector. We will also bring remuneration policies within the scope of prudential oversight. We are currently considering how best to achieve this within the framework of the Capital Requirements Directive.

Later this year, there will be further measures to help constrain the build-up of leverage in the banking sector, supplementing the present risk-based capital requirements. One thing I have learned from this crisis is that complexity makes it harder to manage risk. All these wonderful internal models drawn up by brilliant people with double doctorates were shown to be woefully inadequate in many cases. If the managers of the bank could not understand these models what hope is there that regulators can have a proper assessment of the risks that may be building up. It might be because I am getting older but I have a yearning for returning to more simple metrics. It may be crude but I believe we need to look at leverage ratios as a measure for determining acceptable levels of risk.

One of the follies shown up by the current crisis is the application of accounting rules to banks. I could talk all morning about this. But one example will do for now. Namely the prohibition on keeping reserves. If we don't fill up the grain sheds when the harvests are good how are we going to survive in the lean years? We must allow and then oblige banks to build up extra reserves when times are good. This will then cushion the system when economies turn for the worst. The Spanish thankfully ignored the accounting rules which has enabled their banks to withstand the initial shocks that the crisis has unleashed. Finding solutions to these procyclical tendencies in our rules and regulation is a priority.

### **CRA and AFIMs**

All relevant actors and types of financial instrument will now be subject to appropriate regulation and oversight:

- The conflicts of interest that existed in the Credit Rating Agencies have been amply demonstrated. This cannot be allowed to continue if we base so much of our regulation of risk around the ratings given by these agencies. With its new legal framework for CRAs, the EU has set an example to be followed and matched. I expect that the conduct of credit rating agencies will significantly improve, with clear benefits to the integrity and stability of the financial system.
- The proposal for a Directive on Alternative Investment Fund Managers has received a lot of comments both positive and negative. On the positive side many people believe that greater transparency and regulatory scrutiny is needed to ensure that risks are appropriately monitored and this is what this proposal offers. The proposal also for the first time gives a European passport for the marketing of alternative investment funds.
- Most commentators agree that alternative investments such as Hedge Funds and private equity were not the primary causes of the crisis. There has been however strong political pressure from all sides of the outgoing European Parliament for more regulation in this area. President Barroso on behalf of the Commission promised to bring forward legislative proposals and that is what we have done. They will now be examined by the Council of Ministers and the European Parliament. I would hope that in the debate ahead people on all sides would bear in mind that Europe is going to need all the investment it can get to move out of the crisis. We must not end up making Europe an unattractive place for investors.

## **OTC derivatives markets**

And we are closely monitoring the commitment of the OTC derivatives markets' industry to clear credit default swaps on one or more European central counterparties by the 31st of July.

If industry is unable to deliver on this commitment, we shall have to consider other ways to incentivise the use of CCP clearing for credit default swaps.

In the coming days we shall be publishing our findings on the functioning of the OTC derivatives market. In our paper we explore possible ways to reduce the impact of OTC derivatives markets on financial stability through increased transparency and improved counterparty risk mitigation. We shall consult on our findings and draw the appropriate conclusions after the summer.

## **Accounting**

As you all know, the role of accounting rules has become the subject of heated debate. But we remain convinced that the international standard-setting system is the best way forward. And this is not solely an EU view. It is also the view of the G-20.

Accounting rules did not cause the crisis but it is fair to ask did they amplify it? We need to look at what has happened and see if the rules need to be adjusted so as to strengthen financial stability.

I am pleased that at last the IASB plans to complete its fundamental revision of IAS 39 by the end of this year. This is an ambitious agenda for such a complex standard. I know there are many financial institutions in the EU who will want to have the revision of the impairment rules in place for the year end accounts. ECOFIN ministers have conveyed their intentions in this regard.

## **Auditing**

The crisis is also a challenge for auditors. Not only can we not afford the demise of another large firm after Arthur Andersen, we also need to encourage more audit firms to enter the market for international audits. The Commission therefore recommended to Member States a year ago to find a way to limit auditors' liability. I have also just launched a public consultation on whether it is workable for the EU to adopt International Auditing Standards or "ISAs". We will get the results in due course.

## **SEPA**

I would finally like to say a few words about SEPA, the Single Euro Payments Area. We need SEPA to complete monetary integration in the euro area and to provide us with an efficient and competitive system for euro payments. This is of particular importance for Ireland, a relatively small, export-orientated, economy located on the periphery of Europe.

The launch of the SEPA Credit Transfer last year has been a technical success, but since then, frankly the speed of migration to the new SEPA payment products has been too slow. We need to strengthen our collective commitment to SEPA. I plan to publish a SEPA Roadmap next month, clearly identifying the steps we need to take to move ahead.

## **Conclusion**

And while the situation today is extremely difficult, I am confident that the economy will rebound. The Ireland of today is light years ahead of where we were in the dark 70s and 80s. The knowledge, confidence, spirit of entrepreneurship and can-do approach that exists in the country today will enable us to go forward again.

In the end, I believe Ireland and the rest of Europe will emerge stronger and better prepared for the future.

Thank you. I look forward to your questions.