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Financial Turmoil: latest developments on policy response

ECON Committee

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Madame la Présidente, Honourable Members,

Ahead of the informal ECOFIN Council in Nice on Friday, I would like to brief you on some of the latest developments on the policy response to the financial turmoil and on the Lamfalussy supervisory issues. I will also say a few words on Solvency II, investment funds and the EU-US regulatory dialogue.

Financial turmoil

The financial turmoil has entered its second year. The situation in the international financial system remains difficult. Market sentiment deteriorated over the summer months. The bailing out of Fannie Mae and Freddie Mac emphasises the seriousness and depth of the crisis. The unfavourable economic environment is compounding to the fragility of the financial markets. It is getting harder for banks to recapitalise. Losses and write-downs, at around 350 billion EUR, of which 120 billion EUR in the EU, are not over yet.

The turmoil has exposed a chronic lack of private sector discipline and competence and some weaknesses in the global financial regulatory framework. We must strengthen market and institutional resilience. This is what the ECOFIN Roadmap of October 2007 is designed to do.

First, restoring trust amongst market participants by enhancing transparency. In July the industry published valuable data and statistics on the securitisation market. We have also received data on holdings of securitised products, enhancing our insight into the exposures of financial institutions. By the end of October the industry is expected to adopt guidelines which will promote consistent and comparable disclosures by firms when they publish their first quarter 2009 results. Industry initiatives aimed at strengthening investor information are progressing as well.

Second, the upgrading of valuation methods, in particular with respect to the valuation of illiquid assets. Work is being led by the Basle Committee and the International Accounting Standards Board (IASB), who have established a panel on fair valuation. Advice is expected by the end of the third quarter of 2008. The IASB is also working on off-balance sheet items with the key question being: when should an entity be brought onto another entity's balance sheet? The input received in these meetings will help the IASB in shaping its forthcoming proposals on reviewing consolidation rules under IFRS. Deliverables are expected in 2009. Proper due process must be carried out. I believe we need to look hard at issues such as dynamic provisioning – and how to account for prudential reserves built up by banks to buffer for bad times. It should not have escaped people’s attention that banks in Spain were better placed to withstand the turmoil because they had not yet adopted the relevant IFRS Standard. There is a lesson there that needs to be drawn.

On the changes to the Capital Requirements Directive (CRD), the Commission is on track to adopt two Comitology Directives and one Co-decision proposal. The changes to the CRD are targeted at:

- improving the management of large exposures;
- harmonising the treatment of hybrid capital;
- increasing the efficiency of the supervision of cross-border banking groups – both in going concern and in crisis situations;
- improving liquidity risk management, and
- addressing the shortcomings in the 'originate to distribute' securitisation business model.

In terms of process, two Comitology Directives, containing purely technical changes in line with Article 150 of the CRD, will be submitted for vote to the European Banking Committee on the 24th of September and then transmitted for scrutiny to the European Parliament. Adoption is foreseen for early 2009. The Co-decision proposal, covering issues related to crisis management, colleges, large exposures, hybrids, minimum capital for securitisation, liquidity, and waivers for banks affiliated to a central institution, is scheduled for adoption by the Commission in early October 2008.

The European Council has given its full backing to the project and has underlined the importance of striving for an agreement between the European Parliament, the Council and the Commission, by April 2009. Given the seriousness of these issues, I know I can count on this house to play its part and strive to have a good result before you break for elections next year.

Last week we completed the consultation on a proposal for a regulatory response to problems identified in relation to credit rating agencies (CRAs). Our proposal foresees the adoption of a set of substantive requirements CRAs need to respect for the authorisation and exercise of their activities in the EU. Under these forthcoming proposals, CRAs will have to register and become subject to supervision in the EU. How to deal with conflicts of interest, ensuring sound rating methodologies and increasing the transparency of their rating activities will all need to be dealt with.

Our legislative proposal will be tabled probably in October. I look forward to hearing the views of the Committee on this important project, and I recognize you have long requested this.

Supervision Roadmap

On financial services supervision, we all agree that there is a need for increased supervisory cooperation and convergence in the EU. To meet this goal, the Commission is swiftly proceeding with the implementation of a number of improvements to the functioning of the Committees of Supervisors.

Our short term priority is to revise the Commission Decisions establishing CESR, CEBS and CEIOPS. The Committees need to be given a clearer, comprehensive, more homogenous framework for their activities. We see a clear role for the Committees in mediation and consultation mechanisms. They should be involved in the exchange of information between supervisory authorities, delegation of supervisory tasks and the oversight of the operation of supervisory colleges. Monitor and report potential risks to the stability of the financial system. Develop a common supervisory culture.

These tasks could be further specified – where appropriate – in the sectoral Directives. When the Committees can play a useful role and contribute to the objectives of our directives, they should do so. I hope that satisfactory outcomes can be found also in the context of the Solvency 2 and CRD negotiations.

This enhanced framework should also be accompanied by improved working processes and strengthened accountability towards the EU Institutions. We are considering including in the Decisions the obligation to apply Qualified Majority Voting coupled with a "comply or explain" requirement. However, at this stage, the measures agreed by the Committees should in our view remain legally non-binding.

This approach was welcomed by the vast majority of stakeholders and Member States in the public consultation which my Services completed in July. Only a few representatives of the industry took the view that more radical changes to the current EU supervisory architecture could be needed. As a result we intend to proceed with the modification of the Commission Decisions to put the enhanced practical framework in place by the end of the year.

This being said, we are carefully following the debate that the Parliament is currently having on the future of supervision. I know that a vote on a draft report is taking place today in your Committee. I am looking forward to discussing the final report with you. Where possible, I will be ready to try to incorporate some of your recommendations into the Commission Decisions.

The debate on supervision in the months ahead will determine the structure of supervision in the EU for the period ahead. I have made no secret of my concern that improvements in supervision for the larger financial institutions are urgently needed. The decisions that will be taken on the proposal for colleges of supervisors for insurance companies in the Solvency II proposal and for banks in the forthcoming Capital Requirements Directive will be a test of the willingness to accept and make the changes that today's integrated EU Financial Market needs.

The increased role that we see for the Third Level Committees also necessitates appropriate financial support. We hope to table a proposal for a European Parliament and Council Decision soon which would establish a new Community funding programme in this respect – something I regard as particularly important.

Solvency II

On Solvency II, we have but a month to get political compromise on the main issues. There are some tough nuts left to crack. As well as group supervision, the capital charge for equity, minimum capital requirements, surplus funds, the pension overlap.

Peter Skinner and this committee have a tough job ahead. But let us not depart from the need to ensure a strong, balanced, risk-based prudential outcome. That will strengthen all the Member States and give us the best insurance framework which will be copied throughout the world.

Investment funds

On investment funds, the Commission has tabled its proposal - which has been generally well received. We are grateful about the commitment shown by the Presidency and the rapporteur Mr Klinz to move quickly and seek a conclusion within the life of the present Presidency. With good will on all sides, we can do this. On the management company passport, I believe there are difficult issues to resolve. CESR is prepared to give us further advice by the end of October. We should wait for its conclusions before hammering out the legislative details.

EU-US regulatory dialogue

Let me finally say a few words on EU-US relations. The financial turmoil has clearly underscored the importance of good cooperation with the US. A weakening of the global economy, the financial turmoil, and high commodity prices present a dangerous cocktail. Even more so in the pre-electoral period in the US.

At a global level, the EU and the US converge on the international policy response to the financial turmoil, especially within the Financial Stability Forum and the G7.

Of course this does not mean that we should always opt for the same solutions to achieve our shared objectives. We need to address these issues in the way we consider necessary to protect the interests of our investors and enhance the stability of our financial institutions. On the other hand, we will always look to minimize divergences and spill-over effects in global markets.

We are working hard with the US on mutual recognition in the field of securities as well. The SEC has proposed to relax its access requirements for EU foreign broker dealers to the US market. This is good news for our firms. The main remaining hurdle is to agree on a method to assess equivalence of our frameworks. We have moved forward – and I hope to make an announcement soon.

On accounting, SEC Chairman Cox has unveiled a roadmap where US companies would switch from US GAAP to IFRS by 2014. Unthinkable only two years ago! A dramatic signal indeed. Following the EU's lead, the US is indicating it also wants to choose global standards. One set, in sight, at last. And of course we need to strengthen the governance of the IASB. That is why we are working hard with some of our major counterparts to install new, strengthened oversight mechanisms.

Madame la Présidente, Honourable Members,

The turbulence in our economies and financial markets is going to with us for some time. No doubt we will be feeling its effects well into 2009.

The measures the Commission has and will be bringing forward will, when adopted, help strengthen our financial institutions and markets. I believe that by working constructively together on these proposals, we can provide a concrete response that will help reassure people in these uncertain times.

I look forward to a busy and fruitful work schedule in the coming months.