The 12th Annual European Financial Services Conference
Financial Markets and the Growth Agenda
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Executive Summary

Stefano Micossi, Director General of Assonime, introduced the conference, saying that financial tensions have eased and economic growth is increasing globally. While growth is lower in the euro zone, there is still more cause for optimism than for a number of years. In addition, much had been achieved in financial regulation, and the Transatlantic Trade and Investment Partnership (TTIP) was raising hopes of improved regulatory cooperation between Europe and the United States.

The keynote addresses and first session would look at new banking models and stability, and the important questions to consider were: Is Europe now safe from potential financial crises, now that the Single Supervisory Mechanism (SSM) is in place and the single resolution mechanism (SRM) is being hammered out? Could there be more initiatives, such as measures to separate commercial and retail banking? And what would be the impact of these changes on business models and the financial services industry in general?

The second session would look at the relationship between financial services and growth, particularly after the large drop in investment rates and the associated likely drop in potential growth. Was the bank-centred financial system adequate to support the needed rebound in investment? Or would new initiatives be required in order to encourage nonbank financing of infrastructure and of high-risk, high-growth industries?

Finally, the lunchtime session would look at transatlantic relations and the failure of Congress so far to grant the President fast track authority to negotiate the TTIP. It would also discuss the U.S. decision unilaterally to impose separate capital and liquidity requirements on large European banking institutions operating in the U.S.

In the first keynote address, Barclays Bank CEO **Antony Jenkins** suggested three areas that the financial services industry should look at: completing regulatory reform and cultural reform within the industry – both of which he said were being carried out; and helping to foster sustainable growth – which he said he was less optimistic about.

Recent financial reforms mean that banks are much more resilient than before, he said, with radically improved standards of capital, and liquidity and leverage. Banks are also making plans to become resolvable, which would mean they could fail

without systemic contagion or recourse to the taxpayer.

He reminded the audience of the importance of cultural reform in banking. Before the crisis, banks became too focussed on the short term, too self-serving and too aggressive. They also paid too little attention to the broader social context. To remedy all this, Barclays is changing the way it does business and interacts with society, he said. This would lead it to focus on the long term and its responsibilities to society. Barclays is aiming to lead the industry's reform efforts. It is not a quick fix, however. The financial industry built up a way of working over the course of almost 30 years and it is therefore realistic to believe it will take 5-10 years to completely reform.

New ways to finance growth businesses are needed, as much of the world has relied too much on excessive leverage, he said – whether in the housing market or as the mechanism for funding businesses. This created a short-term illusion of prosperity, but is unsustainable as a growth model. However, while banks and policymakers have focused on small and medium enterprises (SMEs), there has in recent years been comparatively little change in either the number of businesses or in their size. He called for a change of focus towards growth businesses.

For an investor, growth potential very often means risk, Mr. Jenkins pointed out, meaning that bank lending is an imperfect mechanism. Banks lend their depositors' savings, and could not use them to take major equity-like risks.

But about 80 percent of business finance in the United States currently comes from non-bank sources, compared to 20 percent in Europe. He said it was essential to address the growth finance gap, as well as making sure traditional lending remains strong.

Michel Barnier, EU Commissioner for Internal Market and Services, called in the second keynote address for further regulatory measures for the financial sector and to improve public finances.

Reforms taken so far appear to be effective, he said. Markets are now calmer; Ireland and Spain are recovering impressively; and Italy has started to grow again after two years of recession. However, EU growth continues to be slowed by unemployment – which afflicts nearly 11 percent of Europeans – and the difficulty of financing SMEs. In particular, it is necessary to complete two big tasks from the past four years: stabilising the European financial system and consolidating the euro zone. A third big task is to take ambitious measures to boost growth and competitiveness on the basis of the stability created by these first two efforts.

Under the first task of stabilising the financial system, regulations proposed over the past four years are coming into force little by little and will help put finance back at the service of the real economy, Mr. Barnier said – but there are three outstanding issues which need to be tackled in order to restore growth in Europe.

The first condition is that the legislation, which has been adopted, needs to apply to all actors, irrespective of their size. For example, rules on supervision, capital, and resolution would help prevent another financial crisis, but they might prove inadequate for the biggest banks – those that are “too big to fail”. That's why he has proposed structural reforms to the 30 biggest banks in Europe, banning them from the most risky speculation, and letting the supervisor demand the creation of subsidiaries for activities in risky markets.

The second condition, Mr. Barnier said, is that the EU needs to be aware of new risks that have not yet been dealt with in the regulatory measures – such as manipulation of indexes. That was the reason for the European Parliament’s market abuse directive, which specified penal sanctions for index manipulation.

As a third condition, the EU needs to make sure that its economic partners have adopted laws with equivalent effects that can function alongside EU regulations. If U.S. rules are applied to transactions already covered by EU rules, the result could be judicial insecurity, higher costs and an incitement to seek out less regulated jurisdictions.

The second big task of the past four years is to consolidate the euro zone. Measures to achieve this include the European Semester to coordinate economic policy and improve public finances, as well as the European Central Bank’s (ECB) direct supervision of 130 banks from November, which should better protect taxpayers and citizens from risks taken by banks.

However, he said that stabilisation measures by themselves will not be sufficient to bring back growth in Europe – the third big task. One move to promote growth was the 2011 Single Market Act, which included the creation of a single European patent, the simplification of public markets and a digital single market.

To start the panel discussion, **Jeremy Anderson**, Chairman of Global Financial Services at KPMG, asked for comments on the new regulations being introduced. He hoped that the SRM would represent a big step forward, but pointed out there were always fears of the unintended consequences of reform. He also asked panellists to give their views on the current state of cross-border resolution and the extent to which funds and capital could move seamlessly across borders.

Elisa Ferreira, a Member of the European Parliament and its Committee on Economic and Monetary Affairs, described the complicated negotiations over the proposed SRM for ailing banks. Banking union is important after the crisis and there's a need to prevent fragmentation of financial conditions in the euro zone, she said. The Parliament needs to finish work on the measures by April or May, before the European Parliament elections, as it is not clear whether the next Parliament will have the same momentum as the current one. In addition, the SSM will be operational in November, and it will need an SRM in order to function properly.

She mentioned several conditions that the Parliament regarded as non-negotiable. The resolution procedure must be efficient, credible and predictable, and it needs to be applicable over a weekend in a crisis situation – so it should not be complicated or lengthy. It also needs a fund financed by industry from the very beginning. Taxpayers should be protected. The link between sovereigns and banks should be broken. Finally, banks should be treated equally in a resolution procedure, whatever their member state of origin.

Edouard Fernandez-Bollo, Secretary General, French Autorité de contrôle prudentiel et de resolution, Banque de France, emphasised the role of supervisory bodies in the current, crucial phase of European financial regulation. He said that the SSM is a very strong tool against fragmentation, but that the devil was in the application as well as the details. While new prudential rules constitute a very strong tool against fragmentation, this is not enough, he said.

Koos Timmermans, Vice-Chair of ING Bank, pointed out that new technology is changing retail banking and the way customers think about their needs. Following the shift to Internet banking in the past decade or so, consumers are using their mobile phones to access services. "The concept of liquidity was traditionally seen as a pile of cash", he said. "This is changing due to increased technology, which is becoming more important in customer loyalty. Nowadays a key consideration is: does my bank have the right app? So this also influences the concept of liquidity".

He said the ongoing change in banking culture should allow a bigger role for external awareness of how banks operate. In addition, it is important for cultural change to go beyond the board room, so ING is rolling out programmes to transmit the message to the bank's tens of thousands of employees. He also pointed to the difficulty banks have in matching excess savings in some countries with excess assets in others.

He added that it remains to be seen whether the banking union will effectively lift the barriers banks face in their cross-border activities. For example, ING has an excess of savings in some countries and an excess of assets in others, but it is not

possible to match these. Moreover, people tend to compare the size of a bank such as ING with the economic strength of the taxpayers in its home country – in its case, the Netherlands. So a major challenge for the banking union will be to demonstrate to smaller countries such as the Netherlands that "too big to fail" is no longer an issue, because problems are addressed in the context of the euro zone rather than of individual states. That requires a strong role for the SSM and that regulators and national governments resist the temptation to impose more stringent national rules. If this does not happen, the SSM will not be strong and divergence in Europe could increase, Mr. Timmermans said.

Cyrus Ardalan, Vice Chairman and Head of Government Relations and Public Policy at Barclays, emphasised the importance of economic growth for financial stability. While greater stability is now in sight, markets remain fragile and the environment is challenging, he said. Because it is difficult to imagine maintaining stability without growth, regulators should incorporate growth considerations into their thinking. Prioritisation of reform is crucial and a focus on a few select reforms can disproportionately contribute to increased financial stability, allowing policy makers to also devote time to look at growth enhancing measures. Internal EU coherence of recently enacted rules is also very important and the European Parliament has done some valuable initial thinking on this topic. Finally, international consistency is crucial and it's essential to continue to work on improving mechanisms for ensuring internationally aligned outcomes.

Marcin Kawiński, a Member of the Financial Services User Group, said that banking services have to some extent become a semi-public good, because it is difficult nowadays to live without them. That means that the market cannot be supervised as it was in the past. Major changes in supervision are required, and it is important to check the quality of the supervisory authorities. Additional institutions – ranging from media to watchdogs – also have a role to play in monitoring the behaviour of financial institutions, he said.

Vítor Constâncio, Vice-President of the ECB, kicked off the session on the relationship between financial services and growth with a speech in which he put Europe's problem of low growth in perspective. He said there is a simplified narrative that the culprit of weak growth is the behaviour of credit and the banks, which lack capital and need to repair their balance sheets. According to the ECB's analysis, which is backed up by surveys of banks, the problem is predominantly lack of demand for credit rather than supply restrictions.

Low projections for potential economic growth– around 1.25 percent or 1.5 percent – can partly be explained by demographic change. Because the working population is either flat or decreasing in many parts of the euro zone, any growth potential will

have to come from increases in the productivity of labour.

These problems cannot be solved just by the banking sector, and it would be wrong to expect that everything would change for the better after October with the ECB's Comprehensive Assessment. More non-bank financing could boost growth, Mr. Constâncio said. European finance currently depends mostly on the banks, with balance sheets representing 270 percent of GDP, compared to 70 percent for the U.S. So capital markets should be opened more to provide long-term financing for SMEs and infrastructure projects. Banks were responsible for 90 percent of infrastructure projects in the past, but they are now shying away from such long-term projects, he said. Other possible solutions include the project bonds that the European Commission and the EIB have been developing.

Panel discussion moderator **Wolf Klinz**, a Member of the European Parliament, said that there are still differences in the percentages of people that get credit and those that don't in different countries. He invited the panel to talk about whether enough had been done to create new sources of finance outside the banking system.

Gerassimos Thomas, Director Finance in the European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN), said that new financial regulations and the creation of the Banking Union have the clear benefit of restoring financial stability. But regulators also need post financial crisis to look at the potential unintended impact of the cumulative regulation on the cost of capital for banks and other financial institutions.

There is a risk that while the banking system is more stable, banks might not manage to provide all the financing that the economy needs, in particular the long-term lending they did in the past. That could lead to a problem financing European infrastructure and innovative, high-growth companies. He agreed with Vítor Constâncio that at the moment there is a problem of low demand and thin pipeline particularly in the area of infrastructure. This has to be tackled rapidly post crisis if Europe has a chance to achieve its Europe 2020 investment targets.

Making European infrastructure attractive to the rest of the world would help attract bank and capital market financing from non-European sources, he said. Part of the solution could be to emphasise the new types of investment now needed, such as intelligent transport systems instead of just roads.

Francesco Papadia, Chairman of the Board of Prime Collateralised Securities and former Director General for Market Operations at the ECB, said that thinking is shifting. Instead of saving the euro, the current task is becoming that of generating growth. He said that the bank dominance of the financial system in Europe is a

problem and that asset backed securities (ABSs) are one way to expand financing opportunities.

However, it is important to be able to say clearly what kind of ABSs are good, he said, and the crisis has revealed some of the characteristics that make some types of securitisation prone to problems. He suggested that ABSs should "maintain skin in the game" rather than buying and then immediately selling an asset, and that there should be no re-securitisation, no embedded security transformation and no opacity. The resulting high quality securitisation could significantly contribute to the funding of a more vibrant European economy.

He pointed out that a number of European countries have negative total factor productivity; added to its demographic problems this requires fighting the "hysteria over immigration" if one is serious about growth in Europe. In addition, immigrants are young, risk tolerant and more willing than others to move to find a job, he said.

Dr Lutz-Christian Funke, Senior Vice-President for Managing Affairs and Communication at KfW Bankengruppe, said people often ask how to create demand. The answer is having something different – having viable, innovative companies with sound business plans.

Behind banks' alleged reluctance to provide loans is their lack of liquidity and their high awareness of risk. This makes it hard for them to invest in projects such as offshore wind farms, which take a long time to produce a return on investment. High quality ABS could play a role in mitigating this problem, but policy makers still have to find a proper policy response.

Daniel Godfrey, Chief Executive of the Investment Management Association, highlighted the role that investment managers could have in filling Europe's financing gap. Their job is to turn savings into capital for companies that need it, and they are normally focussed on the long term. Moreover, investment managers do not invest proprietary money and they don't usually leverage investments, meaning their activities did not carry a high risk of destabilising the financial system.

John Houston, Senior Partner at Kreab Gavin Anderson, introduced the lunchtime session on International Financial Markets and the Transatlantic Opportunity by saying that transatlantic financial reform has been largely harmonious. But he remarked on a comment in a recent Atlantic Council report that it is not unusual for divergences to appear in the process of national implementation.

Prof Chris Brummer of Georgetown University is the author of the Atlantic Council report, "The Danger of Divergence: Transatlantic Financial Reform & the G20

Agenda". Reflecting on the responses to the report, which was co-sponsored by Thomson Reuters and TheCityUK, Professor Brummer summarized his latest conversations on the divergence of regulatory practices in Europe and the U.S. with three basic observations.

First, international economic diplomacy is different from diplomacy in trade, and notions like "commitments" and international "obligations" are different. Most basically, the pledges made by G20 countries are not made via binding legal commitments or formal treaties. Instead, they are expressed through "soft law" instruments. But the pledges are nonetheless serious, and there is an expectation among countries that commit to regulatory reforms and approaches that their reforms will be implemented.

In the end, this makes financial diplomacy an extremely complicated process with regards to the legislative, administrative and diplomatic processes at play. So it doesn't take much to get divergent outcomes. In the implementation of Basel III, for example, both the EU and the U.S. appear ready to undertake largely consistent reforms. But there are differences in the U.S. and European approaches to banking structure and resolution and to the handling of foreign banks. Sometimes these differences are only at the margins. But even technical questions can have important implications: If, for example, you don't have the same accounting rules, it's hard to understand the degree to which a bank is leveraged.

Second, Prof Brummer said the process of resolving transatlantic differences can be "ugly". Compared to the U.S., the EU legislative process is often more prescriptive. The trialogue process plays a bigger role than in the United States where big decisions are often delegated to regulatory authorities. Plus tackling problems involves jumping through different hoops since dealing with sovereign countries in the EU is a fundamentally different kind of exercise than that practiced in the United States. Collectively, this generates very different rulemaking timetables and cycles. And when jurisdictions don't move in concert, they are increasingly inclined to call one another "weak."

Third, despite these difficulties, there is some "low hanging fruit" in international regulation. Since 2008, regulatory leaders have all been trying to upgrade their domestic financial systems at the same time. That presents an opportunity for coordination, especially in new areas where no jurisdiction already has a long-standing regulatory model. As a result, he said, upgrading the financial markets regulatory dialogue and rethinking the formal and informal tools of regulatory coordination, from substituted compliance to TTIP, presents a number of interesting opportunities.

Verena Ross, Executive Director of the European Securities and Markets Authority (ESMA), said it is an advantage that regulation in different jurisdictions is being carried out against the background of commitments that were subscribed to at the G20. That means there is political commitment. However there also needs to be early engagement before legislative provisions are finalised. She emphasised that, in addition to rule making, cooperation on day-to-day supervision is important and can build trust and a common culture between supervisors.

Roger Hollingsworth, Executive Vice President and Managing Director for Global Government Affairs at the Managed Funds Association, said that the TTIP is, in his personal view, an extremely worthwhile endeavour, as it would give the U.S. closer bonds with the EU. He said that a lot of the hard work needed can be done, and that it was helpful to allow regulators who trust each other to talk together in a room.

However, U.S. politics would make TTIP very challenging, as the President does not have the same power as a European head of government. In particular, he said, TTIP would not be possible without giving the President fast track authority to negotiate it.

Because of the current uncertainty over fast track, regulators should focus not only on TTIP but also continue to pursue agreements through existing channels, and through harmonisation and convergence. He called for more focus on goals and less on the means towards those goals; and for less reliance on politicians, especially those in the U.S. He said that Europeans have a government model at the moment that is in fact more efficient and more rational than that of the United States.

Wolf Klinz said he is an optimist by nature – but not as much as Mr. Brummer and Ms. Ross when it comes to the regulatory agenda. He said it will take another crisis before people get serious and try to find a global answer to a global problem.

Americans are more pragmatic than Europeans about locating a problem and fixing it, he said. In Europe, citizens still believe that the financial sector consists of greedy crooks, and hedge funds are still stigmatised, he said. He warned that the National Security Agency (NSA) surveillance revelations are a setback for the TTIP, and negotiations could take longer than first hoped.