# Financial Services and Corporate Governance

KREAB & GAVIN ANDERSON

Financial Services and Corporate Governance

# NEWSLETTER

Brussels, April 2010

In this month's issue:

**Featured Topic**
- Reconnecting

**Issue Summaries**
- Remuneration
- Alternative Investment Fund Managers
- Supervision
- Derivatives
- Capital Requirements
- Financial Conglomerates
- Accounting
- Pensions
- Crisis Management
- Informal ECOFIN
- Insurance

**MEP Profile**

- Pervenche Berès

**The Month in Brief**
- April/May

This newsletter from Kreab Gavin Anderson Brussels provides a periodic round-up of European Union policy developments in the areas of Financial Services and Corporate Governance.

## Reconnecting

In this Annual Financial Services Conference edition of our newsletter, we look at the increasing interrelationship between financial and economic policy discussions and how effectively they are helping finance and society redefine their relationship.

Cian Rice
Partner

One of the lessons learnt from the crisis is that financial industry and society need to rethink their relationship. Trust in the system has been undermined, while the public purse is struggling to carry the costs of mistakes which are blamed on the industry. EU member states' interventions, in various forms, in the financial system, amounted to about 44% of EU GDP in mid-2009, according to calculations by the European Commission.

G20 leaders, at their November 2009 summit, called on the IMF to examine options for the financial sector to contribute "toward paying for any burdens associated with government intervention to repair the banking system." EU economic and finance ministers discussed this in Madrid on 16/17 April, without reaching a consensus on the preferred method. The European Commission plans to present ideas after the summer.

While the IMF officially presents its, heavily trailed, ideas on financial sector contribution to the April G20 Finance Ministers meeting, the debate on this issue taking place in parallel in the big G20 economies contains few clues as to whether there is a meaningful vision for the measures required for reconnection.

The many ideas are characterised by a lack of clarity on design and objective: should financial institutions' contributions help pay for past or potential future cost? Should they flow into the general government budget, to be deployed for purposes only remotely connected to the fiscal costs of the crisis, such as climate change financing or development aid? Or should they go to a special crisis prevention or resolution fund, notwithstanding the moral hazard problem? Should they incentivise reduced risk-taking or a diminution in financial transactions? Can and should they try to do it all?

Some of the basic requirements for any "Reconnection" would appear to include robust regulatory and supervisory arrangements, including clarity on cross-border arrangements; regulatory incentives for reinvigorating the credit channels; measures to prevent the buildup of systemic risk; and sustainability of public finances.

A financial sector contribution could fit into this, if properly designed. There are indications that some EU policymakers prefer a levy or fee, linked to some measure of how much an institution contributes to systemic risk.

Yet a bank levy can only contribute to the new deal between finance and society, if it provides the right behavioural incentives. This, in turn, depends on how it fits into the entire package of reforming the financial sector, including prudential and supervisory reform. It presupposes that policymakers agree on the objectives such a levy is to fulfill, and can perform the thorough impact assessment of the options required.

An ill-devised instrument, which is conceived mainly with the voter in mind, or to merely plug revenue gaps, could prove counter-productive for tax payers, the real economy as well as for industry.

None of this is simple of course and the entire regulatory policy community faces the stiff challenge of trying to steer the right course through to sustainable solutions. At the risk of sounding unconstructive, however, there is the sense at present that the foundations of the reform building are less solid than they could be. We hope the conference makes a contribution to adding some clarity and solidity.

## Financial Conglomerates

In its feedback statement in response to the consultation on the review of the Financial Conglomerates Directive (FCD), the European Commission says respondents broadly welcome the initiative and recognise four main issues: the applicability of sectoral top level provisions of the banking and insurance directives at the level of Mixed Financial Holding Companies; clarity about the inclusion of asset management companies in the scope of supplementary supervision; allowing a more risk-based identification of conglomerates, and clarity about the treatment of participations in supplementary supervision. The Commission will host a high level one-day conference on 7 June to further discuss the topic.

## Accounting

The accounting standards boards IASB and FASB have published a report on their work to improve and achieve convergence of International Financial Reporting Standards and US Generally Accepted Accounting Principles. The report notes that progress has been made on financial instruments, and most notably that the IASB in November 2009 issued new requirements for the classification and measurement of financial assets and published for public comment an exposure draft on the amortised cost measurement and impairment of financial instruments. For Fair Value Measurement, a joint public roundtable was held in conjunction with the FASB. There were also a series of workshops organized on how various types of entities would apply the proposed requirements to revenue recognition. The next progress report is due in July.

## Pensions

The European Commission has confirmed that it will produce a Green Paper on Pension policy by the middle of 2010. The paper will assess the need to update legislation, regulation and coordination "in light of the ageing population and new challenges stemming from the crisis, to contribute to the safeguarding of European pension systems". The Green Paper is expected to investigate a wide-range of pensions-related issues, including an assessment of the need to review the IORP Directive and how to better inform investors of investment risks.

KREAB & GAVIN ANDERSON
WORLDWIDE

www.kreabgavinanderson.com

## Pervenche Berès Profile

| | |
|---|---|
| **1957:** | Born in Paris |
| **1978:** | Graduates from Paris Institute of Political Studies |
| **1981-1992:** | Adviser National Assembly |
| **1993-1995:** | Various positions in French Socialist Party |
| **1994:** | First elected MEP |
| **2004-2009:** | Chair, Economic and Monetary Affairs Committee |
| **2009:** | Chair, Employment and Social Affairs Committee |

Pervenche Berès is working against the clock drafting her interim report for the European Parliament's special committee on the financial, economic and social crisis. However, the highly experienced French Socialist MEP, who also chairs the employment and social affairs committee, is clearly relishing the challenge, as rapporteur, of distilling the huge amount of material the committee has gathered in recent months and producing clear proposals. If eventually accepted by the full parliament, this would place political pressure on the European Commission to produce legislative proposals to put these into practice.

From the outset, she argued that the committee should have a mandate that went wider than the financial crisis per se. "The reason for establishing this crisis committee was to make sure we could rebuild the puzzle in terms of where the crisis came from, the challenges ahead of us and where we should go from here," she explains.

The French MEP suggests that the simplest analysis would be to focus on the short-term and the sub-prime problems in the U.S. which had such devastating knock-on effects, particularly in Europe. But she intends to dig deeper into the causes. "The real root of the crisis for me is social inequality," she says. That inequality is related to outsourcing in emerging countries and to the distribution of added value within developed countries. The combination has led to increases in personal debt as pressure grows to maintain consumer demand.

As she draws lessons for the future, Mrs Berès, points to the development of the internal market which she considers one of the EU's most significant achievements. However, she considers it only a half way house which provides a framework for people to offer their wares, as in a market, but is not accompanied by rules, whether they be on taxation, social policy or public services. "So we don't have all the strength that we should be getting from this tremendous effort we have been doing together," she maintains.

The French MEP draws two central conclusions. The first is that the EU is at its best when concretely engaged in a strong project and has a clear idea of where it wishes to go. In the early days, this was the common agricultural policy, later the internal market and more recently the euro and enlargement. "This is the spirit we need to go back to," she says. That vision should be accompanied by agreement on the EU's role and focus on the added value it can bring by doing things better than individual member states. Here she points to the contribution it can make to major infrastructure, energy, environmental and transport projects. She also suggests it could help stimulate debate on minimum income levels in different countries or on the type of education which school and university leavers and employees most need during their working lives, although she stresses the EU should not see itself as an education provider.

The former leader of the French Socialist delegation to the parliament will look at financial markets in her report, but makes clear she has no intention of going into the detail of all the draft proposals. Instead, she points to a wider issue. "What I find missing is a forum where you can have all the proposals on the table and the capacity to negotiate between stakeholders to find out how best to rebuild the financial markets to ensure they are stable and sane. You also need to make sure they are rebuilt to fulfil the purpose you have defined and that purpose is the ability to support long-term investment," she says.

As an example, the French MEP points to the current debate on increasing the volume and quality of capital banks should hold. Opponents say it would reduce lending and place European banks at a disadvantage with their international competitors. "But if you look at the consequences of the crisis and want to avoid going back to a situation where taxpayer's money is used without any conditions to rescue banks, you have to tackle this point." While believing in the need for a strong banking sector, she also supports the introduction of a transaction tax which she places on the same level of pressing importance as Eurobonds and environmentally friendly legislation with incentives to reduce energy consumption.

While some might suggest that the G20 could provide the necessary forum she is seeking, Mrs Berès disagrees on two grounds. "We have seen what happens to G20 conclusions. It is much better than the G7 and G8, but up to now it has a low delivery capacity. Secondly, it does not raise issues at the level where we have a strong ability to act – that is the EU level."

After chairing the economic and monetary affairs committee during the last parliament, Mrs Berès is now relishing the challenge of ensuring social and employment concerns are fully integrated into the crisis committee's work. "For me, this is really added value. That is why I believe this whole topic we are discussing mu