Issue 9 - October 2011

This newsletter is published by SOMO and WEED. It is part of a common project on EU regulation of financial markets. Other project partners that contribute to the newsletter series are: AITEC, Glopolis, New Economics Foundation, Vedegylet.

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Editorial: The failure of financial reforms through undemocratic means

Just before the G-20 Summit on 3-4 November 2011 in Cannes, the global financial system was once again at a state of crisis. Serious and escalating problems are coming from the Eurozone and European banks that own bonds from heavily indebted European countries. While the US also is still stuck in deep economic troubles, a new balance of power within the G-20 is clearly shifting further in favour of the emerging countries. The latter might even come to the rescue of the Eurozone whose crisis is affecting emerging and other developing countries. It needs to be seen how long the general solutions being hammered out during the 25-26 October Euro summit will be able to calm the markets, given the lack of details.

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Although the Greek situation is now clearly proving that undemocratic austerity measures rather than serious debt cancellation (which is finally being decided only during the latest summit) do not work but rather stifle growth and worsen the situation, other European countries such as Italy are forced to take further far-reaching austerity measures against the will of the people. This issue of the Newsletter provides a brief overview of how the Euro crisis and bank crisis have so far been (mis)handled at European level. It also reports on one step in the right direction: an official proposal by the European Commission (EC) to impose a financial transaction tax (FTT) at EU or Eurozone level. In contrast, another new long awaited EC proposal for better control over financial markets (MiFID) fails to deal particularly with food speculation and dis-functioning of the markets as seen during the Euro crisis.

Although the Eurozone problems will be dominating the G-20 agenda, many important financial reforms have yet to be decided on, more than three years after the crisis erupted in 2008! In Cannes, the G-20 heads of state will also decide on a framework that is supposed to avoid that too-big-to-fail banks have to be bailed out by tax payers' money, while civil society is asking for splitting up banks. It is unlikely that strong measures will be taken to tackle an issue that France has been pushing on the G-20 agenda, namely food price volatility and a major underlying problem, namely food speculation in derivatives markets. Also on the G-20 agenda are deeper problems underlying the crisis, the global currency system, global economic and financial imbalances, the global inequality and global measures for growth.

The late and weak financial and Eurozone reform proposals on the EU and G-20 agenda expose how the undemocratic decision making processes and the neo-liberal measures are not able to deliver results, and that such multilateralism has reached its limits. As a result, people are suffering from unemployment and lack of public services due to official budget cuts. In developing countries, many hungry people are suffering from the food prices that are at record high level while it is unlikely that strong measures will be taken to tackle one of the underlying reasons of this price level, i.e. food speculation on financial commodity derivatives markets. In the US and the EU, people want to claim back the decision-making and push for alternative ways to approach the multi-dimensional crises. The Occupy movement is a new form of protest which gives momentum to existing protests, all indicating that popular discontent is on the rise. How long will decision-makers in the financial sector itself, the politicians and financial supervisors, continue to ignore these voices?

Summaries of the articles in this newsletter

'Orderly' default of Greece, or Chaos?

If anyone believed that the Eurozone would finally manage to gain control over the situation, recent developments prove them wrong. The Greek drama reaches a new stage since the rescue package for Greece adopted in July (see the previous Newsletter) is already overtaken by reality before it has been implemented. The report of the so called *Troïka* (surveillance committee for Greece with the IMF, the European Central Bank and the EU-Commission) has found out that Greece does not need €109 bn, as expected initially, but more than double the amount: up to at least €252 bn. The default of Greece on its bond repayments has become inevitable and the question is whether it will be an orderly process, i.e., that the consequences can be contained, or whether it will be chaotic with incalculable domino effects on Italy, Spain and other EU countries, but also on the entire world economy.

The '*French-German couple*', which is the

engine of the crisis management, is far from reaching a consensus about the instruments to master the situation. As the crisis is getting more and more expensive, the EFSF (European Financial Stability Facility) will need much more money than it currently has at its disposal. Therefore, there are considerations to increase the present amount through loans up to two trillion Euros. But such a higher amount also increases the risks. Therefore, Merkel is meeting with increasing resistance inside Germany against committing these tremendous amounts of money and has been blocking any decision in that direction.

A summit on the weekend of 22-23 October 2011 should have brought a definitive solution as a solution was promised before the next G20 summit on 3-4 November. But given the differences between Sarkozy and Merkel, a series of summit meetings had to be set up for 26-27 October. Non Eurozone countries like the UK and Poland now also want to have a say on the decision making which will make it even more complex.

The main problem, however, is the defensive approach with which governments are trying to calm the irrational markets. This strategy has failed; only disarming the markets will bring a lasting solution. We are facing a historic moment, writes Peter Wahl.

For the full detailed article see below.

photo above by FracturedPixel

Breakthrough for Financial Transaction Tax (FTT): European Commission presents draft directive

The European Commission (EC) has presented a draft directive for the implementation of a Financial Transaction Tax (FTT) on 28 September 2011. After years of pressure from civil society – and in the recent period also from the French and German government – this is a breakthrough for the FTT. The final version of the EC proposed directive is better than its first proposals explained in the July 2011 Newsletter. All in all the EC's draft directive has taken quite a lot of elements on board, which had been advocated by the proponents of the tax, such as the inclusion of taxation of over-the-counter (OTC) derivatives, the residence principle to prevent tax avoidance and above all the intention to not only generate revenues but to have a regulatory impact on speculation, in particular on high frequency trade. Nevertheless, the proposal also contains some weaknesses. In particular, it does not mention development and environment as areas for which the revenues should be used, while civil society wants at least a share of the tax income to be spent in those areas. With regard to the tax base, the Commission wants to exclude currency trade.

The reluctance of the UK, Sweden and the Netherlands to introduce the FTT might be a problem. Therefore, in spite of the very positive step forward, pressure from below will be still necessary, writes Peter Wahl.

For the full detailed article see below.

The G20 and EC do not speak out against food speculation

The G20 finance ministers met on 14-15 October 2011 in Paris and discussed, amongst others, how to address commodity market reforms. In their Communiqué, the Finance Ministers made no reform commitments beyond more transparency and general support for a new IOSCO report that, indeed, does contain some useful considerations. In the meanwhile, EU reforms of financial and more specifically financial commodity markets proceed at a slow pace. While the new regulation on OTC derivatives (EMIR), on which this Newsletter reported in previous issues, is still being negotiated by the Parliament and the Council, the long expected and often postponed proposal for a revision of the Markets in Financial Instruments Directive (MiFID) has been released. It improves

supervision of the commodity derivatives markets but falls short of comprehensively regulating these markets.

Read the article: The G20 does not speak out against food speculation

Read the article: Food and commodity speculation: looming EU reforms

Small steps to control giant SIFIs which affect the global economic system

After long and secret talks and lobbying, proposals are finally on the table at international level to avoid that too-big-to-fail banks and financial conglomerates can again require tax payers' money to avoid disruptive bankruptcies. The different proposals are limited to restricting the risks of systemically important financial institutions (SIFI's). The proposed reforms fail to shrink or split these global financial giants. In November 2011, the weak proposals will be incorporated in a draft EU legislative proposal, which should fully open the debate for more radical solutions even if, or better just because, the European banking sector is currently seen as undercapitalised.

Read the full article

Articles

'Orderly' default of Greece, or Chaos?

By Peter Wahl, WEED

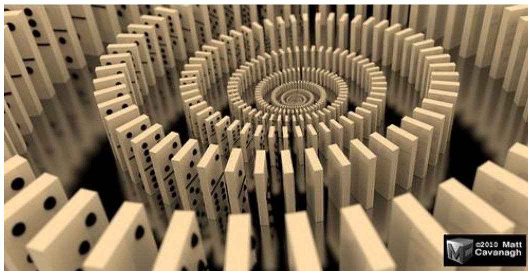

photo by FracturedPixel

There was a sigh of big relief all over Europe when on 13 October the Slovak parliament finally adopted the rescue package for Greece agreed in July 2011 (see the previous Newsletter). The price to pay was the fall of the government in Bratislava, because the neoliberal party SAS, which is part of the government coalition, refused to vote for the package and the decision could be taken only thanks to the social democratic party in the opposition. The sacrifice was in vain, however. In the meantime, the rescue package for Greece had been overtaken by reality. The *Troïka* (the surveillance committee for Greece with the IMF, the European Central Bank and the EU-Commission) had to admit what the critics of the crisis management had been saying from the beginning: the plan to pull Greece out of the crisis through a brutal austerity programme was entirely unrealistic. Greece, like many other countries in the past, proved unable to fulfil the radical requirements of IMF, ECB and EU Commission – backed by member states from Northern Europe like Germany, France,

the Netherlands, and Finland. Thus, the Eurozone was in full crisis again although the *Troïka* had stuck to its own rules, which would have forced them to refuse the release of the next instalment of €8 bn from the 2010 rescue package because Athens could not comply with many of the conditionalities that had been imposed on the country. Only due to a political decision is Greece receiving the new instalment. The decision is meant to buy time to prepare for an orderly default.

The new momentum in the crisis, which resulted in a series of new Euro summits on 22-23 and 25-26 October, came after the assessment report of the *Troïka* made it clear that Greece needed at least €252 bn until 2020 in order to reach 'debt sustainability' (ability to pay for its own debts). The July 2011 package was assuming that the country would only need €109 bn.

In addition to fresh money for Greece, a substantial reduction ('haircut') of the repayment of the Greek bonds to banks would be necessary. The *Troïka* understood that the 'voluntary' haircut of 21% as agreed last July, was insufficient. New proposals were being discussed to a cut of 50% to 60%, which comes nearer to the present market value of Greek bonds. A cut of 50% would reduce the Greek debt burden from 160% of GDP to 120%. A cut of 60% would be a reduction to 110% of Greek GDP. It was understood that such a haircut would create a very dangerous situation for banks in Italy, Spain and other EU countries, as they are holding high numbers of Greek bonds. A spill-over of the crisis would be inevitable if there would not be additional measures to strengthen the resilience of European banks. After some assessment, the bank supervisors proposed that the capital reserves of banks needed to increase by estimated €108 bn.

As Greek banks hold most Greek government bonds and would be hardest hit from a haircut of 50- 60%, an amount of €10 to 30 bn has been earmarked to support the Greek banking sector.

French-German conflicts over strategy

The European Financial Stability Facility (EFSF) in its present shape disposes of a 'fire power' of €440 bn. This would be enough to rescue Greece, but not enough in case Spain and/or Italy come under pressure. A simple capital increase is very costly and would again require the agreement of parliaments in several countries of the Eurozone. Therefore, the idea was born to 'leverage' the €440 bn up to €1 trillion through loans. However, bilaterally there was no consensus for a long time between France and Germany on how to leverage, as there are different possibilities.

France had suggested giving a banking license to the EFSF. This would allow the EFSF to sell bonds to the European Central Band (ECB) and to generate cash flows ('liquidity'). As a matter of fact it would be a hidden method to finance public expenditure through the central bank. Unfortunately, the ECB is the only central bank in the world which is not allowed to finance governments and thus to play the classic role of *lender of last resort*. The ECB mandate is confined to the task of preventing consumer price inflation. Critics have always pointed at this rule and characterised it as an extreme expression of neo-liberal ideology that restricts any intervention in the markets. The French proposal would have resulted in transforming the ECB into a normal central bank.

This is why the Germans were strictly opposes to the French idea. They are afraid that the ECB would definitively lose its strict character as keeper of the holy philosophy of the Bundesbank. However, changing the functioning of the ECB would result in a paradigmatic change that could open the way to a meaningful reform of the entire architecture of the Euro. Because, in other words, the ECB could then do what the central banks of the US, Japan or the UK already do: print money to combat the crisis. The reality, of course, is that under the pressure of the crisis, the ECB has already broken its own rules and purchased bonds of distressed countries on the secondary market, from the private sector. And the ECB still continues to play this role. This

helped for instance to stabilise the difference between the buying and selling price (spreads) of Italian and Spanish bonds.

The German government has been in favour of an insurance like model as leverage of the EFSF. In this scheme, the EFSF would guarantee the repayment of a certain percentage of a bond, for instance 20%. This would decrease the risk of the papers losing all value and might attract investors. In case of default on guaranteed bonds, the EFSF would absorb the first twenty percent of the losses. Still, at the Euro Summit of 23 October 2011, the German government got the upper hand in the controversy and dictated again its concept to the rest of Europe (see also previous newsletter. Another opportunity has been missed to initiate a substantial change instead of muddling through.

In the meantime, other non-Eurozone members of the EU wanted to have more say in the messy decision-making process on the Euro, which also affects their countries. The UK and Poland insisted that all 27 EU countries would be able to participate in the decision making to resolve the Euro crisis. The failure of the crisis management and the dramatic turn of the situation make political leaders visibly nervous. The British Prime Minister, Cameron, has called for a 'Bazooka' to find a definite solution to the crisis. The UK, which is not member of the Eurozone, is already in deep trouble with high debt, poor growth and increasing inflation. Rating agency *Moody's* has threatened that France might lose its triple A rating – which would definitively be the death knell for all rescue plans.

Solution without detail
After lengthy behind the door discussions among the Euro and other member states, the ad hoc Euro summit of 25-26 October came with some overall solutions, but was blamed for the lack of detail. First, the value of the Greek bonds held by banks would be cut by 50%. This was a general deal with the banking sector, negotiated through a representative of their big lobby organization, the Institute of International Finance (IIF). Secondly, the EFSF would have an enhanced financial potential up to €1 trillion, and perhaps up to €1.25 trillion including a potential contribution from China. Thirdly, more economic and fiscal coordination among the Euro member states was agreed but little publicized.

Dissatisfaction with muddling through
An increasing dissatisfaction with the risky muddling through and ever-more-austerity strategy can be found in parliaments, in the media and among the people. And, last but not least, street protests of the Occupy Movement have now reached Europe and are receiving positive media resonance. More and more civil society groups are becoming publicly and politically organised against the austerity measures.

Indeed, the European crisis management that has been failing so far, displays the following pattern:

- There has been all the time an underestimation of the depth and scope of the crisis.
- There was an ideologically biased approach to favour austerity as the one and only solution.
- The crisis management based on such a one-sided austerity strategy turned out to deepen the crisis.
- There never was a proactive strategy. The basic feature of the crisis management was always defensive whereby politicians' actions were driven by reacting to the unregulated and uncontrolled financial markets and their irrational behaviour. The moves of the markets have always been accepted as an inalterable parameter rather than politicians trying to control, attack and disarm the financial markets.
- Adjustments of the strategy were late and were driven by the emergence of new problems and dramatic movements on financial markets.

Since the official strategy has been to react to, and calm, the financial markets, and this so far has been done in vain, more and more people are asking for an offensive

approach, taking back democratic control over the markets and totally disarming them. The introduction of a financial transaction tax (see [other article in this newsletter 'Breakthrough for the FTT']) could be one element in such a new strategy. Also the proposal by EC Commissioner Barnier to ban ratings of countries under pressure is a step into the right direction. All this would not be enough, but the latest proposals indicate that some members of the political and economic establishment are beginning to understand what is at stake.

These are extraordinary times. Financial markets have radically worsened the economic, social and political conditions of hundreds of millions of people. It is time to react on an appropriate level.

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Breakthrough for Financial Transaction Tax (FTT): European Commission presents draft directive

By Peter Wahl, WEED

The official proposal by the European Commission (EC) in September has been the result of a very long process during which most politicians and officials refused to take the FTT serious. It all started in 1996, when the UNDP was digging out a proposal which Keynes had already made in the thirties of the past century and which had been taken up by Nobel price winner James Tobin in 1972: a tax on transactions of financial assets in order to contain speculation. The so-called *Tobin Tax* became an important issue on the agenda of civil society, not only as an instrument for financial regulation but also as an innovative source of financing for development and environment. The 'altermondialist' organisation ATTAC that was created during the Asian financial crisis (1997) even has *Tobin Tax* as part of its name.

The progress towards the implementation has been very slow. There was some some progress, for instance, when a law was introduced in Belgium by which the FTT would enter into force if other European countries would follow. The financial crash of 2008 and the recent crisis of public finance served as a catalyst to make the FTT one of the EU's top proposals as part of the financial reforms. All of the highly indebted European member state countries badly need huge amount of money. Some members of the political establishment are also beginning to understand that speculation has to be contained and that the FTT is an appropriate instrument for that purpose.

All in all the EC's proposed directive is surprisingly positive and has taken quite some elements from civil society and heterodox economists on board. There was a broad and open consultation process via internet before the writing of the draft, in which quite a lot of NGOs participated.

Positive elements in the EC's proposal
The EC wants to tax the trade of shares and bonds with a rate of 0.1% and the trade of all derivatives with a rate of 0.01%. The most important positive elements in the proposal are the following:

a. The residence principle which can reduce tax avoidance. This means that every transaction by a bank that is legally registered in the EU has to pay the tax. This also includes deals with parties outside the EU. The trade can easily be identified through the electronic platforms for trade (see point d.).
b. The tax base includes derivatives and complex so-called structured

financial products (e.g. credit default swaps (CDS), etc.). The Commission explicitly includes the OTC derivatives, i.e., derivatives, which are traded bilaterally without going through any third party exchange, trading platform or clearing. OTC derivatives make up more than 90% of the trade in derivatives.

c. For derivatives, the **notional value of the underlying assets** is used as tax base and not the fee of the derivative. This means for instance, that if somebody buys for a fee a future that has crude oil as the underlying asset and that is valued at one million Euros notional amount outstanding, the one million serves as tax base and not the fee for the future which might be only something like 3% of the one million Euros.
d. **Levying at gross real time**. As the financial industry works with electronic platforms for the exchange of information (SWIFT) and for settlement of the payment of transactions (for instance TARGET or Continuous Link Settlement Bank), these platforms can be used to levy the tax. This system is as simple as collecting the fee from everybody's bank account. It makes tax avoidance not completely impossible but more difficult than for many other taxes. Normal payments, loans and transactions of the central banks are not taxed.
e. The EU wants the directive to be **implemented by 2014**.

Problematic elements in the EC's proposal

The EC wants to exempt transactions in currencies from the tax. This would mean that a considerable potential of revenues and the chance to have a regulatory impact on currency trade is to be left out. The official argument is that taxation of currency trade would be detrimental to the free flow of capital as anchored in the EU treaties. However, this interpretation is not considered correct. The FTT is not detrimental to the free flow of capital, but makes it only more expensive. Being detrimental and more expensive, however, is not the same. If this were so, the market itself would be detrimental to the free flow of capital if exchange rates go up as a result of increasing demand. Additionally, legal studies of the issue suggest that taxing currency transactions is fully compatible with European law.

As for the use of the money, the EC proposal is completely silent. The Commission wants the revenues to be allocated to European institutions, thus creating an independent income source for the EU. This is a very delicate issue, as it would shift the balance of power towards the supra-national at the cost of the national level. Several governments, including Germany, have already indicated that they would not accept such a change. The Commission knows this, and it seems therefore that this part of the proposal is very much intended as a bargaining chip in the upcoming negotiations on the new EU budget.

Also, some sectors in civil society are against allocation of money to the EU for more basic reasons. They say that as long as the EU does not change its neoliberal policies and rules in favour of a more social and democratic Europe, no new resources should be given to the supra-national level.

Political resistance

The initiative of the Commission has not been welcomed by all countries. The UK has publicly rejected the tax. As the City of London is a Mecca for speculators, strong pressure is of course being exerted from the financial industry against the FTT. Sweden, Poland and the Czech Republic have also expressed their opposition, whereas the Netherlands has recently changed its opinion and dropped its rejection of the FTT.

In this light, the implementation of the FTT in the Eurozone only might be a fall back position. German Finance Minister, Schäuble, has already considered this option. Another option could be the use of the concept of *Enhanced Cooperation*, in case there would be no agreement in the Eurozone. This procedure requires the

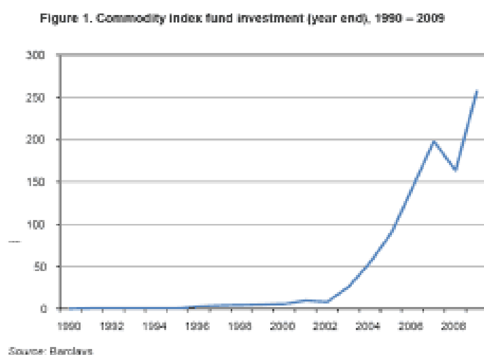
participation of at last nine countries, irrespective of the group they are belonging to. The *Schengen Agreement* on immigration for instance is a prominent example of *Enhanced Cooperation*.

The European Council of Heads of State have stated on 23 October regarding their position at the G20 that "the introduction of a global financial transaction tax should be explored and developed further". French president Sarkozy will push the issue at the upcoming G20 summit in Cannes. He had asked Bill Gates to prepare a study on 'innovative finance' for development. As Gates has said to be in favour of the FTT, this might give further dynamic to the debate, although there is little chance that the G20 will adopt the FTT. Apart from the US, Canada and Australia, some emerging countries, such as India, are also against.

This means that further pressure from below will be necessary to secure the definitive implementation of the FTT.

The G20 does not speak out against food speculation

by Markus Henn



The G20 discussion on commodity price volatility and commodity market reforms is reaching its final stage ahead of summit on 3-4 November 2011 in Cannes. French president Sarkozy had started the G20 discussion against food speculation and the G20 asked the International Organization of Securities Commissions (IOSCO) to come up with a report. In June 2011, the Ministers of Agriculture deferred regulation of food commodity derivatives markets to their financial colleagues.

In September 2011, IOSCO released a report on 'Principles for the Regulation and Supervision of Commodity Derivatives Markets'. The report lists general principles for commodity derivatives markets such as:

- Accountability of the market authority, including having a clear framework for supervising the markets;
- Economic usefulness ('utility') for the users needing the commodity exchanges to hedge risks from physical commodities;
- Responsiveness for potential users, which means having reasonable price signals;
- A close link ('correlation') between the derivatives and the physical commodity markets, also with corresponding prices in both of them ('convergence');
- Transparency of market and contract conditions, like prices and else.

Importantly, the IOSCO report recommends interventions in the market with effective intervention powers by the authorities. This "should necessarily include position management powers that […] authorize a Market Authority to place ex-ante restrictions on the size of a position a market participant can take in a commodity derivatives contract" (i.e., position limits). In other words, supervisors should set a limit on how many derivatives contracts a participant can hold. Market authorities should also have the powers to, amongst others:

- set limits on price movements
- call for additional margin (i.e., a collateral payment)
- order the liquidation or transfer of open positions

- suspend or curtail trading on the market (e.g., trading halts and 'circuit breakers')
- cancel trades

Regarding supervision, the report says that authorities should monitor and analyse the markets both on-exchange and off-exchange. Therefore, they should be able to collect data with sufficient access to information, and to require special reporting for large positions. The report finally stresses the importance of intervention against different forms of market abuse such as causing or attempting to cause artificial pricing in the market, creating or attempting to manipulate the market (e.g. create a 'corner' or 'squeeze' which means that one trader takes control of a large share of the market and thus blackmails the other traders). Another form of market abuse that needs watching is the violation of existing position limits, especially through multi-market abusive trading. Authorities should also have sufficient disciplinary sanctions against market members at their disposal, which should include trading prohibitions and suspension or expulsion from membership of an exchange, or even a criminal referral to the courts.

While obviously being a compromise document, the report still contains some long-awaited clear wording on the necessity of strong regulation of financial commodity markets, including imposing position limits.

Parallel to the IOSCO report, another report on financial investments in commodity markets was publicised by the Institute for International Finance (IIF). The IIF is the big banks' very influential global lobby group that was also requested by the G20 to make a report. The report seriously downplays the harmful effects of financial investments in commodity markets on commodity price volatility. This was denounced by 14 civil society organisations in an open letter.

The G20 finance ministers and central bank governors who met in Paris on 14-15 October to prepare for the G20 head of states' summit in Cannes did not make any explicit decisions on price volatility and commodity derivative markets. In their Communiqué, they stressed that "proper functioning of commodity markets is key for sustained global economic growth". However, they only endorsed the above mentioned IOSCO report and its "first recommendations" on market integrity. One small concrete measure was the support for a joint oil data initiative (JODI) that would make the oil commodity market more transparent. The G20 Finance Ministers also endorsed a report by the Financial Stability Board (FSB) on the implementation of over-the-counter (OTC) derivatives reforms in general. They agreed with the FSB that it was important to work towards setting standards for collateral ('margins') that OTC derivatives need to apply when they are not centrally cleared. The FSB issued a warning to the G20 that the G20 countries were behind the promised timing for regulating OTC derivatives.

The G20 Finance Ministers generally seem to be disconcertingly weak on the important issue of excessive commodity speculation. Obviously, some G20 governments are impeding strong decisions by the G20 as a whole on commodity markets. Therefore, in Germany, for example, Oxfam, Attac and WEED ran a photo stunt with the slogan 'Don't gamble with food'. They criticised German Finance Minister Schäuble for his weak and probably even obstructive position in this regard.

The G20 Paris meeting did not take any measures regarding the instability risks that Exchange Traded Funds (ETFs) pose both to the financial markets and to the economy and society as a whole. The opacity of these funds and possible conflicts of interest have recently come under scrutiny by the financial press (e.g., here, here and here) following the trading debacle of an UBS trader with a stunning loss of more than $2 bn. This is even the more surprising as the Financial Stability Board had already released a critical note on 'Potential financial stability issues arising from recent trends in Exchange-Traded Funds' in April 2011.

Political processes to reform commodity derivatives markets are looming too at G20 member states' level. In the US, a fierce debate about the implementation of the

Dodd-Frank Act took place before the Commodity Futures Trade Commission decided on (weak) position limits. The EU is still struggling to come to a final agreement on its very first law regulating (commodity) derivatives markets (EMIR: see next article).

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Food and commodity speculation: looming EU reforms

by Markus Henn

Final but non-transparent negotiations to finalise EMIR

The political debate and decision making process on the new European Market Infrastructure Regulation (EMIR) on over-the-counter (OTC) derivatives, clearing by central counterparties (CCP) and trade repositories (for details see the July 2011 issue of this newsletter) continues. One year has passed since the proposal was released by the European Commission (EC) in September 2010. Negotiations between the Council of Ministers of Finance, the European Union, the European Parliament and the EC in the framework of the so-called trilogue are taking place behind closed doors. On 4 October 2011, the Council of Ministers agreed on its proposal (see press release) to come to a compromise with the Parliament's position. The Council proposes that:

- The European Securities and Markets Authority (ESMA) is responsible for the identification of OTC derivative contracts that will need compulsory clearing through CCPs.
- National competent authorities, in coordination with a college of supervisors, are responsible for authorising and supervising CCPs, except for third country CCPs.
- Venues of execution of derivatives trade have access to any CCP to clear OTC derivatives transactions.
- CCPs have access to the trade flows from trading venues.
- A CCP is required to have a mutualised default fund.
- Pension schemes are exempt from the clearing obligation for a period of three years, which can be extended by another two years through a review clause.

It remains to be seen if this compromise will be accepted by the European Parliament.

New legislative proposals for commodity trading: MiFID and MiFIR

The review of an important EU law for (commodity) derivatives markets is lagging even farther behind the decision-making process for EMIR. Indeed, the revision of the Markets in Financial Instruments Directive (MiFID) has just begun. On 20 October 2011, the EC released its proposals not only to review the existing Directive on Markets in Financial Instruments Directive (MiFID) but also to have a new Markets in Financial Instruments Regulation (MiFIR).

Both proposals aim at regulating investment firms and trading venues for financial and derivative markets. They cover so-called regulated markets (e.g. commodity exchanges), multilateral trading facilities (MTFs) and a new type of organized trading facilities (OFT) that were introduced to better regulate the opaque and often even dark over-the-counter derivatives markets. The EC proposals include special requirements for financial markets in commodities and CO2 emission allowances (carbon trading):

- Real-time reporting by traders to trading venues
- A weekly public trade data report, classifying traders according to their main business

- Position limits which limit the amount of contracts a market member or participant can hold in a certain period of time
- In order to prevent large quick price swings, the EC proposes:
- Price limits and 'circuit breakers' that halt trading if too erratic, though only for regulated markets;
- Stronger requirements for risk and trading controls when engaging in algorithmic and high-frequency trading;
- Strict transparency requirements for ETFs and certain complex or opaque investment products (e.g., certificates)

ESMA and the EC will have a strong role in developing technical standards and prescribing position limits. However, national competent authorities would also still play an important role in supervising the market, for example regarding possible trading prohibitions and restrictions.

In a joint press release, a group of civil society organisations made a critical analysis of the proposals. The proposals are seen as a first step in the right direction to improve transparency that "will shed light on financial traders' bets on food commodities". However, as the release goes on, "when it comes to preventing speculation from fuelling high and volatile food prices, the EC proposal will not do the job" and does not prevent excessive speculation that distorts food prices and increases hunger and poverty worldwide.

A major loophole is that position limits on commodity markets might be replaced by 'alternative arrangements with equivalent effect'. Position limits, as the press release rightly points out, are essential to tackling excessive speculation.

In addition, the proposed rules on algorithmic and especially on high-frequency trading are dangerously weak. Apart from a little more risk control, not much is done against this often highly speculative and destabilising trading which exploits smallest price differences with micro-second speed. Banning it, as recommended amongst others by former wheat trader and FAO advisor Ann Berg, obviously is not the intention.

A serious shortcoming is that the massive speculation by pension funds and big institutional investors that use commodity futures to 'diversify their portfolio' is not banned from commodity markets even though authorities are provided with the ability to do so.

Review of market abuse rules

On 20 October 2011 too, the EC released a proposal to revise the Market Abuse Directive (MAD). This proposal will be analysed in the upcoming issue of this Newsletter.

From now onwards, the MiFID, MiFIR and MAD proposals will be negotiated within both the European Parliament and the Council of Ministers, and between those two institutions. Given the experiences with other legislation, this process will not be completed before Autumn 2012. This slow progress in regulating derivatives markets allows for ongoing reckless commodity speculation by the financial sector, neglecting the interests by societies in the EU and developing countries to sustainable commodity markets.

Publications and actions on food speculation

Email action calling on head of Deutsche Bank Josef Ackermann to pull out of food derivatives markets and support regulation.

D. Frenk, W. C. Turbeville: Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, Better Markets, Washington DC, October 2011.

M. Lagi, Y. Bar-Yam, K. Bertrand, Y. Bar-Yam: The Food Crises: quantitative model of food prices including speculators and ethanol conversion, New England Complex Systems Institute, Cambridge MA, September 2011.

In German: H. Schumann: 'The Hunger Makers', Foodwatch, Berlin, October 2011. English summary.

Small steps to control giant SIFIs which affect the global economic system

by Myriam Vander Stichele

Banks and financial conglomerates that can undermine the financial and economic system, and thus societies, when they fail, are called Systemically Important Financial Institutions (SIFIs). When they can pose a threat to the global system they are called G-SIFIs. SIFIs are at the centre of the political and public debate on how to deal with too big to fail banks and financial conglomerates (who also operate insurance and other financial activities), and to find ways to avoid that tax payers' money is needed ('moral hazard') to escape a breakdown of the financial system when these SIFIs fail. The very recent case of Dexia, whereby the Belgian and French tax payers' money was used to avoid bankruptcy indicates how little has been put into place so far to solve the problem.

For a long time, extensive behind-the-door discussions and lobbying have been held, as well as open consultation procedures, to come up with proposals to reduce the threats from SIFIs. These discussions have especially been held by the Financial Stability Board (FSB), the Basel Committee on Banking Supervision, and the G20 is approving their proposals.

A lot of time has been invested in identifying who the global and national SIFIs are and for what reasons (size, threat to instability, interconnectedness, substitutability, complexity, etc.). The FSB has prepared a secret list with banks that are SIFIs that are globally important. Already in August 2011, Moody's estimated that 28 banks would be on the list.

These SIFIs should implement additional capital requirements and other regulations on top of the new reforms for banks ('Basel III') and financial companies. Since these extra measures would constitute additional costs to SIFIs, concerns of SIFIs and authorities regarding loss of competitiveness have made political progress on this issue very slow. In response, the Bank of International Settlements (BIS), the central bank of central bankers, released an "Assessment of the macroeconomic impact of higher loss absorbency for global systemically important banks" which came to the clear conclusion that imposing higher capital requirements would be much less costly than not doing so. The BIS has been entering the debate and is pushing to get SIFI reforms through. In his speech on 19 October 2011, the BIS chief economist Stephen Cecchetti said he remained "somewhat surprised to hear the occasional voices which claim that the too-big-to-fail problem is overstated".

Here are some extra measures and tools for SIFIs to prevent SIFIs from failing, and introduce a regime that should allow SIFIs to go bankrupt without risk to their key payment and deposit functions, and without loss of tax payers' money:

- Banks and conglomerates with banking services, which are systemically important, will need to hold more capital reserves than other banks. The Basel Committee on Banking Supervision proposed that additional capital requirements should range from 1% to 2.5% formed by banks best quality capital ('common equity tier 1'). In addition, measures to discourage banks from becoming even more important were included. This was agreed by the G20 Ministers of Finance on 14-15 October 2011.
- Better supervision has to start with improved collection of data for supervisors to dispose of. The

Financial Stability Board launched a public consultation about this data collection.

- Better cooperation to supervise SIFIs among the Basel Committee on Banking Supervision (linked to its Basel III framework), International Association of Insurance Supervisors (IAIS) and International Organization of Securities Commissions (IOSCO), and stricter assessment by the IMF and World Bank.
- SIFIs need to have plans, tools and regimes in case they fail and go bankrupt, to wind up and be 'resolved' without harming the economy, basic financial services and tax payers. Proposals include having in place a 'living will' that plans how to close down a SIFI that goes bankrupt.

The different measures for dealing with SIFIs will be submitted for approval by the G20 Summit on 3-4 November 2011 in Cannes. The European Commission plans to issue proposals on how to deal with crises at banks that are (almost) failing on 15 November 2011.

The New Economics Foundation publications show how too-big-to-fail banks have been receiving a lot of advantages and indirect subsidies just by being so large. Many civil society calls have been made to split or separate too big to fail banks but the official agenda's and financial reforms have so far failed to take powerful steps to that extent. With governmental budgets at their limits, more radical solutions are needed to avoid a disorderly failure of a big financial conglomerate, which would affect many people world wide.

Calendar of official events

For more background to the official agenda of European institutions, see the following websites:

The European Commission (EC)

The Economic and Financial Affairs Council (ECOFIN)

The Economics and Monetary Affairs Committee (ECON) of the European Parliament

2011

October

- **21, Paris (G20):** conference on development
- **25-27, Brussels:** Summits and high level meetings on Euro crisis

November

- **?, Brussels (EC):** publication of an impact assessment on potential new financial sector taxes
- **1-4, Cannes, France (NGOs):** scheduled alternative People's Forum with NGO activities
- **2, Nice, France (G20):** social G20 conference
- **3-4, Cannes, France (G20):** G20 heads of state summit
- **5 (G20):** Mexico takes over G20 presidency
- **7, Brussels (ECON)**: meeting
- **8, Brussels (ECOFN):** meeting
- **14?, Brussels (EC):** publication on proposal to reform credit rating agencies
- **18, Brussels (ECOFIN):** meeting
- **29, Brussels (ECON):** meeting
- **30, Brussels (ECOFIN):** meeting
- **30, Brussels (European Commission):** release of Central Securities Depositories (CSD) proposal

December

- **5, Brussels (ECON):** hearing about MiFID
- **7, Brussels (European Commission):** release of Social investment funds
- **9, Brussels (European Council):** meeting

2012

January

- Danish Presidency starts six-month Council Presidency
- **22 and 24, Brussels (ECON):** planned discussion on draft CRD IV report

February

- **27, Brussels (ECON):** planned deadline for amendments on CRD IV report

March

- **20-21 and 26-27, Brussels (ECON):** planned discussion about CRD IV report amendments

April

- **21-26, Doha (Quatar):** UNCTAD XIII
- **24-25, Brussels (ECON):** planned vote on CRD IV

June

- **4-6, Rio (UN):** Rio +20 conference
- **10-11, Mexico (G20):** G20 heads of state summit
- **?, Strasbourg or Brussels (EP)**: planned plenary vote on CRD IV

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