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Editorial

This Newsletter appears once again at a time of great financial turmoil in the EU, with the whole world expressing increasing concern about the global impact, not in the least on developing countries' trade, production and jobs. The European crisis has become so complex and intractable that it resembles the Gordian knot. It is simultaneously a sovereign debt crisis, a crisis of democracy and a governance crisis, a financial and currency crisis, a banking crisis, a crisis of structural economic differences, a crisis of fiscal imbalances, and a crisis of dysfunctional and ill-regulated financial markets. Although all these dimensions are intertwined, different articles in this newsletter separately describe a number of its aspects.

The first article explains the intricacies of the Euro-crisis. The second article focuses on a major bank reform – the CRD 4/CRR – that has received little political and public attention and has been hugely watered down by the financial lobby. Discussions and proposals continue on more fundamental banking reforms but the crisis indicates that fast and far reaching decisions are needed now. The financial markets reform continues through the review the Directive on Market in Financial Instruments (MiFID). The financial lobby continues to be so influential that it is not clear if decisions will be able to be reached on limiting financial price speculation on food commodities that affect the poor in developing countries, notwithstanding demands and campaigns from civil society. A fourth article reports about the ongoing FTT process. It has become clear that an FTT is impossible to be decided on at EU-27 level. Therefore the proponents are now switching over to a 'coalition of the willing'. A final article describes how new decision-making processes on detailed technical rules by ESMA are again being seized upon as an opportunity for the financial industry to water down legislation.

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In spite of the huge crisis, decision makers and the financial industry are not able to think out of the box (i.e. out of the neo-liberal framework) to solve this deep crisis, although the growing focus on a growth strategy is opening up some windows. The voice of the many protests of citizens and workers, and alternatives that are being discussed and proposed, are still not being heard by the political decision-makers. Votes in France, Ireland, Greece, the Netherlands and other countries are fortunately still providing some democratic instruments to guide politics. Whether this will provide solutions in time is a major question: the crisis is far from over and expected to get worse. Internationally the EU will also be under pressure again to get its act together at the G-20 Summit on 18-19 June 2012 in Los Cablos (Mexico), but this international decision-making process on financial reforms is even less democratic and has even less muscle than at the EU level.

Summaries of the articles in this newsletter

Euro Crisis: Pressure in the Crater Reaches Critical Point

The EU crisis is deepening and heading towards a crossroads. The Greek elections in June 2012 might prove to be a decisive moment. The balance of power between the protagonists of strict austerity, led by Germany, and advocates of stimulation of growth, lead by the new French president, is shifting in favour of the latter. But the crisis is extremely complex and present governance structures of the EU are incapable of dealing with it adequately. The question is whether change isn't coming too late.

For the full detailed article see below.

While the bank crisis continues, banking reform remains weak and slow

After 4 years of continuous banking crises that are the heart of the Euro crisis and the governmental debt crisis, the EU institutions are in their final stages of a big bank reform called Capital Requirements Directive 4 (CRD 4). Rather than the necessary swift and far-reaching reform that should follow from the protests against the cuts in public budgets that have bailed out banks, decision making has been slowed down by different interests. The financial industry was able to weaken the draft proposals but could not oppose all new proposals to strengthen the reform. As this CRD 4 reform is still not tackling many structural and fundamental problems in the banking sector, further reform proposals are discussed and proposed at EU, US and international level.

For the full detailed article see below.

The Conservatives strike back: EU regulation against commodity speculation at risk

The European Parliament (EP) has presented its amendments to change the 'Markets in Financial Instruments Directive' (MiFID) so that food commodity derivatives trading will also be covered, amongst other changes (MiFID deals with trading of all derivatives and other financial or investment products). Given the strong diversity between the political groups, it is questionable whether the new legislation will be able to limit financial food price speculation. Some of the most contentious proposals on commodity derivatives trading range from the deletion of any trading limits to the prohibition of commodity index products. Surprisingly, EP Rapporteur Markus Ferber counters his own former draft report by weakening how limits to trading can be decided (leaving them totally up to the trading venues). The EU decision-making process will proceed, with an EP vote in the ECON Committee planned on 9-10 July, although many observers expect a delay. The Council of Finance Ministers is also working on a position which is unlikely to be finalized by end the end of the Danish presidency (end June 2012). Civil society has been active to ensure that strict regulation is included in this new EU legislation. In the meantime, some more technical details are being worked on at international level on commodity markets.

For the full detailed article see below.

The important role of ESMA in the legislative process

The European Supervisory Authorities, including the European Securities and Markets Authority (ESMA), have an important role to play in the EU legislative process, as the legislators and the European Commission will often ask them to draft the 'Level 2 implementing measures' for EU directives or regulations. This involves providing technical details on parts of the EU law that were only briefly summarised in the initial 'Level 1' legislation that passed through the European Parliament and Council of Finance Ministers. Directives or Regulations essentially only provide the basic legislative framework. When analysing its operation, ESMA appears to be susceptible to pressure from the financial services industry. An example is its Level 2 guidance on the Alternative Investment FundManagers Directive (AIFMD) and the European Market Infrastructure Regulation (EMIR). ESMA will also be called upon to draft the technical standards for the Markets in Financial Instruments Directive (MiFID) and afterwards supervise also commodities derivatives market. Given its roles, it is absolutely essential that ESMA demonstrates it willingness to stand up to vested interests. 2012.

For the full detailed article see below.

New push for FTT through François Hollande

The election on 6 May 2012 of François Hollande as the next French president is bringing new momentum to the process of achieving a Financial Transaction Tax (FTT) in Europe. The decision for the implementation of the FTT through Enhanced Cooperation is expected in the coming months, while rumours beginning May 2012 that implied Hungary would introduce an FTT have turned out to be a hoax.

For the full detailed article see below.

Euro Crisis: Pressure in the Crater Reaches Critical Point

By Peter Wahl, WEED

Photo by Martin Krolikowski

The EU continues to be unable to solve its multiple crises. The risk of a default of Greece on repayment of its debt (bonds) in the next three months, or of the country leaving the Euro has increased considerably. Hopes that the situation would calm down after the second rescues package for Greece in March 2012, combined with a non payment of part of the debt to banks (see the previous newsletter) have proved illusory. Even politically it is becoming more clear that the present type of crisis management has failed and the austerity policies are clearly demonstrating to be not only unable to lead Greece on an upward economic path but to have continuously worsened the crisis.

Outside Europe, concerns are being raised that a default of Greece could unleash a negative chain reaction on the entire world economy. At the G8 summit on 18-19 May 2012 in Camp David (US), leaders of the world's richest nations were alarmed by this scenario. Obama is afraid that the US economy will be affected by the crisis before the elections in November 2012. Central bankers and politicians in all parts of the world are becoming increasingly nervous. It becomes ever clearer that, after four years of permanent crisis, the worst is still to come and that June 2012 might be the point where the crisis takes on new dimensions.

New elections in Greece might bring a turnabout

The Greek elections on 6 May 2012 turned out to be a referendum against the austerity policies imposed by the 'Troika' of the IMF, European Commission and European Central Bank. The two leading parties of the last decades, NEA DEMOKRATIA (conservative) and PASOK (social democrat), which had executed the Troika's policies, were weakened considerably and could no longer achieve a majority to form a government. PASOK was even surpassed by SYRIZA, an alliance left of the PASOK. SYRIZA is pro European and wants Greece to stay in the Eurozone, but wants to renegotiate the conditions of the Troika's rescue package.

Because no government could be formed, new elections in Greece will be held on 17 June 2012. In an opinion poll of 20 May 2012 by the Public Issue Institute SYRIZA was at 28% (16.8% at the election results of 6 May 2012), NEA DEMOKRATIA at 24% (18.9%) and PASOK at 15% (13.2%).

If SYRIZA would lead the government there are two options:

a. The Troika agrees to moderate the conditions of the rescue package and the EU helps Greece with a growth programme, which relinquishes the one sided austerity.
b. The Troika stops all financial assistance. In that case Greece would be bankrupt in a few weeks. Because it would run out of the currency it would have to leave the Euro and have to establish a new own currency or return to the Drachma.

The second option with a Greek default would have incalculable consequences, not only for the country itself but also for the Eurozone, the EU and the world economy. It would be very expensive for the Eurozone because the guarantees from the previous rescue package amount to €160 bn. In addition the Greek Central Bank has a deficit of €100 bn with the ECB and the other national central banks of the Euro zone (TARGET II accounts). This money would be lost. Germany is not only the forerunner of the austerity ideology but also the biggest creditor. German taxpayers would have to bear 27% of the €260 bn public debt of Greece, all in all €70.2 bn. Considering this huge amount of money, Chancellor Merkel will think twice about whether she can afford this economically and politically. In addition, German and other EU private banks and enterprises would lose money and some of them would have to be rescued with additional taxpayers money. But the biggest danger would be contagion. A default of Greece could trigger a chain reaction on other crisis countries. In particular Spain is at present in such a precarious situation (see below), that a further destabilisation of the situation could push the country into the abyss.

In case that Nea Demokratika would win it might occur the same situation as in the previous elections, that no coalition is possible. But even if the conservative party could lead a government, new measures to stabilise the country would be necessary as the situation has further worsened.

Not only an economic problem

But a Greek default would not only be an economic catastrophe but also a political disaster. The image of the EU, which has already suffered considerably since the beginning of the crisis, would now be completely ruined. EU countries outside the Eurozone, which plan to join the Euro later, could lose interest. The acceptance of the EU among citizens would decline further, even in countries that were traditionally EU friendly. For instance in Germany the rate of acceptance decreased from 62% in 2005 to 41% in 2011. The Dutch government collapsed over the austerity measures, resulting in elections in September 2012. Many protests are taking place against the austerity measures and the Fiscal Pact all over the EU (see previous newsletter and see below). The whole idea of European integration would be discredited and the centrifugal tendencies in the union would become more pronounced.

If, despite all these facts, Merkel and the EU are telling the Greeks, as happened at the unofficial EU summit on 23 May, that the country has to stick to the agreements with the Troika, this must be seen as very much part of a power play. In the light of the opinion polls mentioned above, the intention of such messages is to pressurise Greek voters to bring the old and obedient parties back in government.

Merkel under pressure

Inside the EU, the hardliners of austerity are increasingly on the defensive. This is to a large extent the result of the French presidential elections. François Hollande has already indicated that he not only wants to soften the conditions for Greece, but that he also wants a paradigm shift of crisis management, away from the one sided orientation on austerity. Instead, the Fiscal Pact (see previous newsletter) should be a combined with a Growth Pact.

Although terminating the present programme of crisis management would have a positive effect, the EU will have to undergo a period of severe conflict between France and Germany before substantial change will take place that will ensure a growth strategy or pact is not just an ornament but on a par with the Fiscal Pact. The head of the Italian technocrat government, Mario Monti, is supporting the new French approach as well as the EU Commission.

Another spectacular controversy is taking place over Euro bonds, whereby bonds are not issued by national governments but issued and guaranteed by the EU countries collectively. While Hollande considers this instrument a prerequisite to solve the sovereign debt crisis, Berlin does not even want to discuss the issue. No wonder, as Germany just succeeded in placing two-year bonds worth €4.55 bn at an interest rate effectively being of 0% (zero percent). The seriousness of the conflict was underlined by Hollande when he threatened not to ratify the Fiscal Pact if Berlin would not accept the Growth Pact. At the same time, France is blocking the appointment of German finance minister Schäuble as president of the Euro-group. Hollande would accept Schäuble only if he gives up his post as finance minister. As the Paris-Berlin axis is the backbone of the Eurozone crisis management, this could result in temporary paralysis and compromises towards the smallest common denominator. The informal Euro summit on 23 May 2012 gave an idea of things to come. While Hollande was advocating Eurobonds as a first step to combat the debt crisis, Merkel excluded this instrument in the strictest terms.

On the domestic front Merkel is also coming under pressure. The result of the French elections has encouraged the German Social Democrats (SPD) and the Greens to tie their support for the Fiscal Pact to the acceptance of a Growth Programme and the Financial Transaction Tax. The Fiscal Pact needs a two third majority in the Bundestag, this is why the government needs at least the votes of the SPD and the Greens.

All these points taken together lead to a shift in the balance of power and Germany will be obliged sooner or later to make a retreat. This will be all the more necessary as the challenges go far beyond and deeper than the Greek drama. However, the question remains whether change will be too slow and come too late.

Not only Greece

Greece is not the only and probably not even the biggest problem of the Eurozone:

- The Eurozone has entered into recession. In its recent economic outlook the OECD forecast an overall shrinking of 0.3%.
- The situation of the Spanish banking system turns out to be a ticking time bomb. According to the association of international banks (the Institute of International Finance – IIF) Spanish banks hold sluggish credits worth over €260 bn and were required to hold more capital reserves to face the bad debts. The rating agency Moody’s therefore recently downgraded 16 Spanish banks. In the final weeks of May 2012, Bankia revealed it needed € 19 bn from the government. Bankia was created after a merger of 7 troubled banks during the course of the first rescue package for Spanish banks in 2010 and had already received €4.5 bn. The case of Bankia marks also the failure of the plan to privatise the

Spanish savings banks. The OECD, and the Spanish prime minister therefore suggests to use the newly created European Stability Mechanism (ESM) to rescue the Spanish banks. By now, the ESM is only allowed to help countries. The ECB also rejected Spain's controversial plan to provide Bankia with new capital by swapping Bankia shares for governmental bonds and these bonds would then be used by Bankia as collateral to get more loans from the ECB. This plan also worried investors and interest rates for Spanish government bonds reached a new high on 28 May 2012 with 6,5%, which is close to the point that Spain would need external financial support as was the case for Greece and Ireland, a scenario which the Spanish government wants to avoid at all cost. The Spanish debt ratio to its GDP will increase considerably from 75,3% in 2011 to 90,9% in 2013. At the same time, unemployment is Spain is exploding. The OECD forecasts 25% unemployment (50% for youth below 25 years) in 2012. Spanish GDP is expected to fall by 1.5% in 2012 and 0.75% in 2013.

- The situation of Italy, the third biggest economy in the Eurozone, is characterised by structural and deeply rooted problems. The share of Italian exports on the world market has shrunk from 3.8% in 2000 to 3.1% in 2011. The export sector is concentrated on relatively traditional products such as furniture, shoes and clothes whereas the high-tech sector is weak. The household revenues in 2011 were 4% under the level of 1992. Italy will remain in recession in 2012 with a decline of -1,7% and -0,4% of its GDP in 2013 The unemployment rate is expected to go up from 8.4% in 2011 to 9.9% in 2013. The heavy public debt will continue to go up from 119,7% of GDP in 2011 to 122,1% in 2013, as well as interest rates for government bonds (from 5,4% in 2011 to 6,3% in 2013).
- Also Portugal is expected to remain in recession until 2013 while unemployment will rise to 16%.
- As for Ireland the OECD foresees a slight recovery. After the economy had shrunk by 12,1% between 2008 and 2010 there was a growth in 2011 of 0,7%. The forecast for 2012 is 0,6% growth. But the debt crisis is still not under control according to the OECD. While in 2007 the public debt was 28,7% of GDP it grew as a result of bank bail outs to 112,6% in 2011, and will further grow to 122,4% in 2013. Also the interest rates to be paid by the government when issuing long term public debt (bonds) will remain high: 7% in 2012 and 7,6% in 2013. The unemployment rate will remain over 14% until 2013.
- In Eastern Europe, Hungary has entered recession in 2012 with -1,5%. After the deep fall in 2009, when the economy shrunk by 6,7% the country is expected not to reach the level of economic growth of 2008 until 2017 – under the condition that the slow growth of 1,1%, which the OECD forecasts for 2013 remains stable. Private consumption is shrinking continuously since 2008 and is predicted to do so. Hungary is in so far a special case, as the right populist regime in Budapest is in conflict with the EU over restrictions to democracy and at the same dependent on credits from the IMF. Therefore the situation remains very fragile and could worsen rapidly.

All in all the data show, that the EU crisis has not yet reached the culmination point and that the worst should still be expected.

The complexity of the crisis is overstraining the capacities of the EU

The European crisis has become so complex that it resembles the Gordian knot. It is simultaneously a sovereign debt crisis, a financial and currency crisis, a banking crisis, a crisis of economic and fiscal imbalances, a crisis of democracy and a governance crisis, and a crisis of dysfunctional and ill-regulated financial markets. All these dimensions are intertwined with each other.

The EU governance system is in itself too complex and hence very slow, and riddled with manifold conflicts within the highly heterogeneous configuration of players within a neo-liberal constitution. As a result, the EU is structurally incapable of dealing adequately with the crisis and getting its affairs under control. In addition, countervailing forces are emerging too slowly and remain too weak. And in those cases where they have real impact, like the success of SYRIZA in Greece or the election of President Hollande, things become – at least at the beginning – more complicated and additional conflict emerges.

And alternatives from the bottom up? Popular protests and social movements are blossoming in several countries as well as deeper knowledge of the causes of the crisis . The movement of the Indignados in Spain and the Occupy movements in several countries have found quite a positive resonance in the public and in the media. From 16 to 20 May 2012, there were demonstrations in Frankfurt, one of Europe's financial centres and the domicile of the European Central Bank whose role and activities during the crisis has hardly been exposed or criticised. The city of Frankfurt had forbidden many protests and only allowed a demonstration on 19 May, which drew 25,000 people from all over Europe. However, these movements have had so far only a marginal impact on the situation. The gap between governments and the European population seems to be ever increasing.

Pressure in the EU and on the EU is increasing. An explosive eruption becomes ever more likely, and prospects for getting the lava under control and channelling it become more and more difficult to realise

While the bank crisis continues, banking reform remains weak and slow

By Myriam Vander Stichele, SOMO, with contributions from Aldo Calieri (CoC), Markus Henn (WEED), Gildas Jossec (AITEC), Lydia Prieg (NEF) and Rens van Tilburg (SOMO)

Photo by Cesar Pics

It has become more and more clear that the Euro crisis and the sovereign debt crisis and the heavy strain from the markets, which has brought Spain and its banks in severe crisis (see article about Eurocrisis), are caused by serious continuous bank crises. Banks had taken too many risks, after which the crisis in 2008 erupted. Now it is clear that banks – including those from Germany and other countries – lent too easily and with sloppy risk management to governments and business or real estate in Spain, Greece, Ireland, etc. Nevertheless, bank reforms at the EU level have been moving only slowly and in watered down form, without much public debate, even though there is much public anger about the bank bail outs, bonuses of bank bosses and the austerity measures after cuts in public money that was used to save the banks.

As explained in previous Newsletters, the internationally agreed Basel III standards are now being integrated at the EU level as a directive and a regulation (CRD 4 / CRR) on capital requirements, availability of cash (liquidity ratio), borrowing levels (leverage ratio), risk management requirements for banks and investment firms (for more explanation see also Finance Watch, 'Basel 3 in 5 questions': keys to understand Basel 3, May 2012). The European Commission (EC) had already published its text to apply Basel III in the EU on 20 July 2011. A major issue of contention that delayed decisions at the European Parliament (EP) and the Council of Finance Ministers was whether countries with banks that have balance sheets that are 3 to 5 times larger than the annual GDP of a country (UK, Sweden, Netherlands) would be able to set higher capital requirements. While Basel III agreements were about 'minimum requirements' for capital reserves, the EC had turned them into a fixed percentage which was more or less the maximum, so as to avoid too much lack of 'harmonisation' between different countries in the 'Single European Market'.

On 14 May 2012, the Economic and Monetary Committee (ECON) of the European Parliament (EP) voted on 2,195 amendments to the draft EP report that amends the EC text. Apart from voting for the proposed capital requirements, the MEPS voted amongst others for:

- sufficient flexibility for countries with very large banks to set higher capital requirements; to protect themselves against harmful bank collapses;
- better treatment of how banks can finance exports and other trade;
- basic aspects of resolving a bank crisis;
- reporting on lending of securities;
- variable remuneration awarded to bankers not to exceed their fixed pay (which is considered controversial and not in the EC text); and
- benchmarking banking models in order to get a better understanding of how bank models compare.

On 15 May 2012, the Finance Ministers (ECOFIN) of all the EU countries agreed on the compromise proposals by the Danish Presidency for CRD 4/CRR after an extraordinary Council meeting on 2-3 May 2012. These very lengthy Council texts on CRD4 and CRR were published a week later.

Important compromises reached by the Ministers were:

- In addition to Basel III requirements on capital reserves and buffers (for more details see explanations by the Council) each member state would be allowed to impose an additional 'systemic risk buffer', with only prior Commission authorisation needed if set at high levels (at more than 3% or more of each banks' global assets, adjusted for risk);
- the EC has the possibility to impose for one year stricter prudential requirements on all member states;
- the opportunity for member states to impose, for up to two years (extendable), stricter prudential requirements for domestically authorized financial institutions;
- liquidity reserve requirements (liquidity ration) to be introduced at national level from 2013, and at EU level from 2015 onwards;
- requirements for guaranteeing longer term funding and for a limit to borrowing (leverage ratio) would be introduced only after agreements reached in respectively 2016 and 2018.

For more details, see amongst others the Council's press release and its annexes.

The Council's proposals are considered by some member states to be weaker than Basel III since they address 'certain European specificities' based on the fact that CRD 4/CRR would be applied to all of the EU's approx. 8,300 banks. The EC argued these specificities did not go against the Basel regime overall. For instance the possibility for banks to include holdings in insurance companies (in the same financial conglomerate) as own funds is seen as watering down the capital reserve requirements. The UK lambasted the compromise text as not as tough as Basel III, and that this was happening specifically to assist struggling German and French banks. However, the introduction of a 'systemic risk buffer' was a response to its demands for higher capital requirements.

The fact that no fixed liquidity ratio and limit to borrowing (leverage ratio) has been introduced, has been the consequence of heavy lobbying by the banking industry, as analysed by Corporate Europe Observatory in its May 2012 publication 'Addicted to risk'. The European banking lobby with strong influence of Deutsche Bank was already successful in avoiding strict banking reforms when Basel III was being decided (e.g.

banks can continue to rely on, and manipulate, their own risk management models) and when the EC made its CRD 4/CRR text (e.g. the EC proposal to have the same level of maximum capital requirements rather than minimum requirements, an issue of major contention that delayed the decision making). After the Council's decision, the European bank lobby already wrote a letter to the Council of Ministers on 23 May 2012 to ask the Council to adopt the more lenient rules for financing trade as agreed by the ECON committee of the EP (see above).

After the ECON and the ECOFIN had agreed on their own texts, the EP and the Council have started behind-close-doors discussions to come to a common text, if possible by June 2012. The new compromise text could then be voted on in EP plenary on in July or September 2012 (for an update on the vote date, see here.

MORE STRUCTURAL BANK REFORMS DISCUSSED BUT NOT YET DECIDED

The CRD 4/CRR does not solve many fundamental and structural problems, such as moral hazard and too big to fail banks, as many critics have pointed out (see for instance a new publication by Finance Watch). Given the continuous dire state of the European banking system, some more banking reforms are being discussed and are expected to be proposed, amongst others the EU bank deposit guarantee system that would avoid that national governments have to guarantee deposits at banks headquartered in their country but operating in other EU countries.

- **Dealing with banks in crisis**: A legislative initiative at the EU level on a framework on how banks should recover or be dissolved during a bank crisis ('bank recovery and resolution framework' as explained in Newsletter nr. 6) is expected before mid June 2012.
- **Dealing with banks that are too big to fail**: In France, it remains to be seen how the new president will follow up his promises during his electoral campaign to separate the activities of banks that are useful for investment and employment, from their speculative activities. Francois Hollande wanted to forbid French banks to engage in tax havens, and to end toxic financial products that enrich speculators and threaten the economy. He also wanted to increase tax on bank profits by 15%. In the UK, the Vickers Commission had proposed in 2011 bank reforms to avoid that too big to fail banks would need to be rescued by tax payers' money, including by ringfencing retail banking away from investment banking. The proposals have continued to stir up debate in the UK and the banks are maintaining pressure on the government to relax the proposed ringfence. Greater technical detail about the reforms is due to be released by the government in June 2012, followed by draft legislation in the autumn. At international level, the G-20 follows the work by the Financial Stability Board to extend their new additional requirements for banks that can wreck the financial system (SIFIs) to domestic systemically important banks (D-SIBs) by November 2012.
- **Reducing the risks of banks that are trading securities**: The Basel Committee of Banking Supervision published a consultation on 3 May 2012 to review the risk models of banks who trade in securities: they could so be required to hold more and better capital reserves. The proposals, that would complement Basel III and other post-crisis reforms, would make it harder for banks to switch capital between their balance sheets and trading books, would restrict trading and reduce profitability.
- **Volcker rule discussed in the US and EU**: The US Dodd-Frank Act contained the so-called 'Volcker rule' that prohibits banks that receive public guarantees from trading at their own account ('proprietary trading') and either financing or owning hedge funds or private equity funds. But many exceptions were allowed to the rule due to financial industry lobbying as Aldo Calieri explains in his article. After JP Morgan lost $2 bn or more in May 2012, some politicians and the US Administration started showing a

stronger resolve for enforcement. But enforcement of the Volcker rule would most likely not have prevented JP Morgan's behaviour. Nevertheless, the Volcker rule and the prohibition of propriety trading at EU level was being discussed at a public hearing at the European Parliament on 25 May 2012.

- **Better supervision and regulation of shadow banking**: At the request of the G-20, the Financial Stability Board's report points out how to monitor and address risks posed by the shadow banking system. The FSB is working on two main initiatives: First, an annual global data to monitor shadow banking activity. Second, there will be regulatory recommendations on how to mitigate spill-over effects between regular and shadow banking system and other types of related risks. The FSB plans to issue the full set of recommendations by end-2012.

The Conservatives strike back: EU regulation against commodity speculation at risk

By Markus Henn, WEED

Difficult decision making process at EU level

As reported in the previous newsletter, the European Parliament (EP) Rapporteur, MEP Markus Ferber (EPP group, Germany), released in March 2012 his proposals for EP amendments to the review of the Markets in Financial Instruments Directive (MiFID). This review was drafted by the European Commission (EC) in October 2011 and is referred to as MiFID II / MiFIR. Ferber's so-called draft report included stronger position limits for commodity derivative trading and stronger restrictions for high frequency trading than those proposed by the EC. By 10 May 2012, MEPs had to submit amendments to Ferber's draft report. By mid-May, it was revealed that about 2,000 amendments were finally submitted, some of them calling for dramatic changes.

Parallel to the above mentioned discussions by the MEPs in the ECON (Economic and Monetary Affairs Committee), the working group of the Council of Finance Ministers (ECOFIN) is working out a text that should result in a compromise of the different positions of the EU country governments. A draft compromise text was ready on 9 May but it is clear that the ECOFIN will not be able to finalise its position at the end of June 2012 when the Danish presidency will be replaced by the Cypriot presidency. Once the Council position has been agreed, the EP and Council will try to arrive at a compromise of their positions.

On paper, the Parliament and the Council are supposed to finish their work before the 2012 summer break, with the EP discussion on amendments in the ECON meeting of 18-19 June 2012 and the ECON vote on 9-10 July 2012. An EP plenary vote, in theory based on a compromise between the EP and the Council, is being planned for October 2012. However, it seems unlikely to most observers that this timeline will be kept. It is even possible that the EP and Council cannot reach a compromise ('second reading').

ISDA (International Swap and Derivatives Association), is one of the financial industry lobby organisations closely following the decision making process, and heavily lobbying among others by regularly producing papers about their positions and commenting on draft texts by the Council, for instance on the draft compromise text of 9 May 2012 which is not widely available to the public.

Many issues related to derivatives are contentious

- The strongest proposal to amend the EC review of MiFID as regards the market structure seems to be the rejection of the so called **'organized trading facility' (OTF)** by the social democratic group (S&P) and some single MEPs. The creation of this new trading facility was intended by the Commission to bring more of the opaque over-the-counter (OTC) derivatives' trading on organised and regulated trading places, with the most important feature being that the OTF can execute orders in a discriminatory way (as opposed to other regulated markets that have to be non-discretionary). However, the OTF issue raised many debates and there are fears – with good reason – that the OTF would only lead to a more fragmented and complex derivatives' market, threatening the stability of the financial markets. Rapporteur Ferber had only suggested limiting the OTF to non-equities (i.e. not for trading of shares and bonds). It remains to be seen for whose amendments the ECON members will vote.

- **Regulating high frequency trading (HFT)**, as expected, caused a heavy debate amongst MEPs. All agree that a distinction between computerized trading based on algorithms and HFT is necessary, the latter being the real problem due to its extreme speed. However, literally every political group suggests different characteristics to define HFT and propose different restrictions for this type of high-speed trading. Most political groups only want to discriminate against HFT to diminish it. The GUE is the only left political group that wants to prohibit HFT completely. The Greens suggest limiting it to 20% of a trading venue's trading book. The other groups just want to prohibit certain forms of – 'sponsored', 'unfiltered', 'naked' – access to the market places. All parties suggest different resting times to slow down trading. This regulation of HFT can also affect European commodity markets since HFT definitely has begun to infiltrate European commodity markets. Although information is scarce, at least one HFT fund – H.F. Cyril by John Locke Investments – is active in soy and corn at European exchanges.
- There is little agreement amongst MEPs about regulating the **commodity derivatives markets**. The only common denominator of the amendments to the Ferber draft report seems to be that all groups stress the difference between hedging related to price risks from physical commercial commodity activities and financial commodity speculation, and want to discriminate against the latter.
    - The application of position limits that restrict how many contracts a commodity derivative trader can enter into or hold, turns out to be a very controversial one. In his draft report, the EP Rapporteur Ferber had tabled some of his most restrictive proposals to amend the EC's text on regulating financial commodity markets, amongst others proposing to not allow 'alternative arrangements with equivalent effect' to position limits, a substitute for strict and hard limits which the Commission included in its text. But – as a big surprise - Werner Langen who is part of the German conservatives from the EPP group, the political party of Rapporteur Ferber, now suggests deleting the entire article on position limits. This is obviously the result of lobbying by the Associations of the German Industry, the German Treasurers and the German Stock Corporations who proposed exactly the same in a joint lobby paper. But the bigger surprise comes from Ferber himself. In contrast to his own draft report, he now wants to change from 'position limits' to 'position control', which means the exchanges or other trading venues 'can' use either position

management or position limits, as they wish. This proposal is even weaker than the Commission's initial one where the exchanges or other trading venues at least 'shall' have in place one measure. Even the liberal group (ALDE) does not show such a strong resistance to position limits as Ferber and Langen do, even though they want 'clear thresholds' shall be specified from which trading volumes onwards position limits shall apply. On the other hand, the green, social democratic and left groups have tabled amendments to strengthen the position limits in commodity derivatives trading. The Left proposes to limit the market share of positions that are not hedging physical commodity activities to 20%. All three want to delete the 'alternative arrangements' and introduce limits for classes of traders. All suggest to refine the justification for setting the limits, with the Greens and the Left to 'prevent excessive speculation', each proposing different definitions of 'excessive speculation'. This terminology stems from the US law, and is the basis for the current US implementation of legally binding ex ante position limits. The fact that the US financial industry has filed the first ever law suit against the interpretation and measures by the US regulator, the CFTC, to prevent excessive speculation, demonstrates the high importance of this amendment. Similar to this idea, the Social Democrats want to 'prevent market distortion'. Finally, important details are being tabled by some parties, such as the coverage by the legislation of (relevant) OTC commodity derivatives trading by the Greens, the Left and one liberal MEP.

    - Two political EP groups go beyond position limits and call for a prohibition of certain commodity products such as index funds, namely: "the marketing, distribution and sale of all financial instruments offering commodity index replications" (the Social Democrats) and "financial products and funds that are related to commodity price development and products including such elements (the Left).
    - In addition, the choice of how and when to report to the public and to the trading venues, on a weekly or daily or real time basis, is subject to very divergent amendments. For instance, the EPP MEP Langen, as proposed in the mentioned lobby paper by the German industry, wants to prevent real-time reporting by the traders to the trading venues.

- All groups are supportive to strengthen the role of ESMA (see the article on "The important role of ESMA in the legislative process") in drafting the technical standards for MiFID II/MiFIR implementation (after which they still would need to be approved by the Commission). However, the Greens are the only party to call for a specialised commodity unit within ESMA.

It is not clear yet what the **Council of Finance Ministers**' position on commodity derivatives will be. It is not expected to be finalised until mid-June 2012. On other issues such as the OTFs, transparency, scope and HFT, the Council do not seem to have such strong amendments as the MEPs but rather follows the Commission's proposal.

Civil society has in April 2012 issued a joint appeal for strict EU regulations that must curb food speculation. NGOs have monitored with concern the Conservatives' and lobbyists' attempts to water down new EU legislation to regulate commodity markets and diminish food price speculation, knowing that the political groups of EPP and ALDE have a blocking majority. Since position limits are an important tool to stop (excessive) speculation and prohibitions of commodity derivatives' investment products tabled by the Left and the Social Democrats can help resolve volatility and the disfunctioning of the price discovery function of commodity derivatives exchanges. NGOs have also called to strengthen the commodity derivative markets supervision by ESMA and the special unit at ESMA proposed by the Greens would be a very important step. Finally, given mounting evidence that HFT can have very detrimental effects on markets while not serving a useful economic purpose, a strong approach is justified not in the least for commodity markets. Civil society plans further activities to highlight this political debate and raise its concerns. They have already raised debates at banks and financial conglomerates speculating on food prices, such as Oxfam Germany with the following publication: *Mit Essen spielt man nicht. Die deutsche Finanzbranche und das Geschäft mit dem Hunger* (the English summary can be found here) and WDM in the UK: a shame award for Barclays bank and a protest at Barclays' annual shareholder meeting.

Furhter work on commodity market reforms at international level

The G-20 Ministers of Finance who met on 19-20 April 2012 declared that they were expecting the IOSCO progress report how to implement its principles for regulating and supervising the Commodities Derivatives Markets at their next meeting on 4-5 November 2012 (Mexico). IOSCO is expected to present at the G-20 Summit in Los Cabos (Mexico, 18-19 June) recommendations on the functioning and oversight of price reporting agencies. The EU position on the G-20 summit refers to G20 Action Plan on Food Price Volatility and Agriculture agreed in 2011 and the further steps taken on increasing sustainable agriculture productivity and investment, but not to regulating financial food price speculation.

In follow up of G-20 decisions on regulating OTC derivatives markets, the FSB coordinates work to provide a global framework for safeguards for central counterparties (CCPs). This should support G-20 countries to implement their commitment – as is included in the EU legislative proposals on MiFID II / MiFIR - that all standardized OTC derivatives be centrally cleared in CCPs with the appropriate safeguards.

The important role of ESMA in the legislative process

By Lydia Prieg, New Economics Foundation

The European Securities and Markets Authority (ESMA) was established in January 2011 as part of the new European Supervisory Authorities (ESAs) introduced to replace the EU Committees of Supervisors (see Newsletter nr. 3), which were deemed to be inadequate. Specifically, ESMA replaced the now obsolete Committee of European Securities Regulators (CESR), and its primary purpose is thus to ensure the orderly running of the European capital markets and the protection of investors. However, ESMA also often has an important role to play in the EU legislative process, which is often not visible to the public but which is subject to intense lobbying from the financial industry.

ESMA exercises its legislative role as follows. Once a legislative proposal (a new Directive or a Regulation, or a revision of an existing one) by the European Commission (EC) has been adopted jointly by the European Parliament (EP) and the European

Council (ECOFIN), the so-called 'Level 1' text is ready. This essentially means that the new EU law sets out the basic framework of the legislation, and stipulates areas and rules where further technical details will need to be fleshed out at a later date. Often the new law indicates where draft technical proposals are to be written by a particular ESA, for example, ESMA. If not, the EC will ask one of the ESAs to help with the technical process of drafting so-called 'Level 2 implementing measures', which provide this extra level of detail. Work on this will typically start after the Level 1 text has been agreed by the EP and Council; however, with some directives, a very tight schedule has meant that ESMA has had to start work on Level 2 before Level 1 has been fully finalised.

ESMA's role and the influence of the financial industry

ESMA has already provided Level 2 advice for the Alternative Investment Fund Managers Directive (AIFMD: see Newsletter nr. 2), and the new EU legislation regulating credit rating agencies (CRAs) and short selling. Drafting these implementing measures has frequently proved to be yet another opportunity for the financial services industry to lobby for the weakening of proposed legislation.

For example, ESMA, the finance industry and the EC are currently engaged in a disagreement about Level 2 measures on the AIFMD, which will introduce legislation to regulate the managers of alternative investment funds (AIFs) such as hedge funds, private equity funds, venture capital funds, and the like.

In November 2011, ESMA published its Level 2 advice on the AIFMD. ESMAs proposals, substantially weakened the likely impact of the new legislation which rose fierce debates. For example, a key point of contention is the 'third country issue', i.e. how to regulate the AIFs based outside the EU that market themselves to EU investors. ESMA's advice opened up a loophole on this issue, by removing the mandate that the "equivalence" of a third country's regulatory regime with that of the EU must be proved before a fund can market itself across the EU. The industry was generally extremely pleased with ESMA's work. For example, the Alternative Investment Management Association described the process as 'exemplary', and stated that it provided every opportunity for stakeholders to be heard. A private equity company also praised ESMA for not "saddling the economy with red tape", and BlackRock, a large investment manager, described ESMA's advice as a "significant improvement" on what was implied by the Level 1 text.

However, the European Commission (EC), which is the final decision-maker on level-2 texts and has the right to reject ESMA's advice, appears, to a certain degree, to have exercised its powers of rejection. In March 2012, the EC released its 'supplementing rules', which prompted an angry response from AIFs. For example, the industry argues that rules around banks that hold assets for AIFs ('custodians'), leverage limits, and third country fund managers have changed significantly from ESMAs proposals. In short, the industry is arguing that the 'compromise' reached between the EU and the finance industry in the Level 1 text, which ESMA adhered to (or, as many NGOs would argue, ESMA watered-down even further), is now being dismantled by the EC's Level 2 text. The Commission maintains that it has just provided further clarification on issues that had remained uncertain, but the industry is pushing for a revision to the language used in the ESMA text. For example, banks that act as custodians, such as HSBC and Deutsche Bank, are arguing that the Commission's proposals are not compatible with collateral management practices and derivatives clearing.

In April 2012, a member of the EP publically complained about the level of hedge fund lobbying around the directive, and reminded the industry that ultimately the Commission writes the complementary legislation; ESMA merely provides advice. Earlier that month, Michel Barnier, the Internal Market and Services Commissioner responsible for the financial services sector regulation, also complained about excessive lobbying.

ESMA's heavy workload on level-2 legislative details

The financial services industry is also hard at work with regards to the European Market Infrastructure Regulation's (EMIR) implementing measures, which ESMA is currently in the process of drafting. EMIR seeks to regulate the over-the-counter (OTC) derivatives market; for example, by mandating that 'standardised' derivatives are 'cleared', i.e. collateral is posted, via so-called central counterparties (CCPs) that will sit in the middle of every eligible trade. EMIR also mandates that OTC derivatives trades are recorded in trade repositories, to increase the transparency in these markets for regulators, for example, to help the latter identify systemic risks.

ESMA has a key role with this directive, because it is responsible for defining which derivatives are sufficiently ‘standardised’ and thus should be cleared. CCPs must be able to assess risks and value financial products to know how much collateral to demand from the counterparties to the derivative. If a CCP gets this assessment wrong, and one of the counterparties in a trade defaults, then the clearing house has to pay and may find itself on the line for any missing value on that trade. Thus, on one hand, ESMA must be careful not to force clearing houses to deal with highly complicated products that they do not fully understand. However, on the other hand, if too few products are cleared, then the legislation will have very little impact on reducing risk in the OTC markets.

Clearing houses have been lobbying for the clearing rules suggested in ESMA’s consultation paper to be watered down so that clearing is a less costly process. In short, they argue that ESMA will make European clearing houses look unattractive in comparison to those based elsewhere. They maintain that the measures indicated in ESMA’s discussion paper go far beyond what was implied in the Level 1 text; thus implying that ESMA had overstepped its mandate. The European Association of CCP Clearing Houses (EACH) criticised ESMA’s expected proposals for being “too prescriptive”, stated that they “will not adequately cater for the diversity in CCP models and cleared products”, and asserted that it would prefer a “criteria-based approach”.

ESMA is expected to release its formal advice in June 2012, and any rules must ultimately be implemented by the end of the year 2021, if the EU is to comply with the G20’s pledge on OTC derivative clearing and reporting. By 2014, ESMA will also be expected to formulate rules around the ‘interoperability’ between clearing houses, i.e. the extent to which, and method by which, trades cleared through different CCPs can be netted against each other.

ESMA is also currently working on the Level 2 implementing measures for the amended UCITS directive, which regulates EU investment funds, including some exchange-traded funds (ETFs). Finally, ESMA will be expected to draft the Level 2 texts for the Markets in Financial Instruments Directive (MiFID) and the Market Abuse Directive (MAD), once their Level 1 counterparts have been agreed by the Council and the Parliament.

New push for FTT through François Hollande

By Peter Wahl, WEED

The election of François Hollande as the next French president brings new momentum to the process of achieving a Financial Transaction Tax (FTT) in Europe. During his electoral campaign Hollande expressed his strong support for stricter regulation of financial markets in general and for the introduction of an FTT in particular on several occasions. He already raised the issue at the G8 summit in Camp David (18-19 May 2012).

Hollande is also proposing a European Growth Pact in addition to the austerity measures which had been adopted in the Fiscal Pact in March 2012 (see previous newsletter). Germany will have to compromise on this and accept some stimulus measures (see the article about the Euro crisis in this newsletter). Therefore, fresh money has to be found and the FTT is the first option for providing it.

The FTT is also a project upon which France and Germany have consensus. Against the background of their divergences on several other issues, both governments will be interested to bring the common interests to the fore.

The domestic balance of power in Germany is also shifting in favour of the FTT. As Merkel needs a two-third majority in the parliament for the adoption of the Fiscal Pact, the German opposition parties, SPD (Social Democrats) and the Greens, have declared that they would link their support for the European Fiscal Pact to the adoption of a Growth Pact á la Hollande and the FTT.

In May 2012 the European Parliament (EP) adopted a report in support of the European Commission's draft directive on the FTT, with a broad majority. Although this is not binding it has a political impact, in particular as it demands the implementation of the FTT in the framework of Enhanced Cooperation in case there is no unanimity at the level of the EU 27. This means that a minimum of nine member countries have to support the initiative ('coalition of the willing'). It could then be implemented in the framework of EU legislation in these countries. Of course, the big economies next to France and Germany, i.e. Italy and Spain, would have to be part of the Enhanced Cooperation.

Tactical manoeuvres of the German Finance Ministry

This general trend dispels the recent fears of civil society as well as the contrasting hopes of the financial sector (who has been lobbying fiercely against it – as described by Corporate Europe Observatory), that the whole project would be watered down extensively, or even rejected as a whole. These hopes and fears were nourished by a German room paper, presented at an informal meeting of finance ministers in Copenhagen and in a working group meeting of the European Council, in which Berlin presented a 'two step approach'. In a first step, a tax similar to the British Stamp Duty would be introduced and in a second one it would be extended to the proposal of the EU Commission from September 2011 (see this pdf). But the UK did not give up its hardliner opposition and the attempt to still reach a compromise with London has definitively failed. Against the background of the UK resistance, the German push was more of a tactical manoeuvre to isolate London than a real move to give up the substance of the FTT.

Next steps

As the FTT in the EU-27 is impossible as a result of the British veto, the only way forward is Enhanced Cooperation. Before this option can be decided on, the failure of the Commission's EU-27 directive has to be declared officially. It is expected that this will be done in the coming months, perhaps already before 2012 summer break.

Once the decision is taken, it will, however, still last one to two years until the project enters into force, because the decision at the EU level still has to be translated into national legislation, a time consuming procedure. Nevertheless, a happy end seems to be in sight for the FTT in Europe.

No Hungarian FTT

During the first weeks of May 2012, rumours surfaced hinting that Hungary would introduce an FTT. Hungary is deeply in crisis and desperately looking for new sources of revenue, while the IMF and the EU have threatened to stop financial support.

Given the extremely nationalist and right-wing populist regime in Budapest it would have been quite difficult for civil society, who are in favour of an FTT, to have this government as an ally. Budapest is indeed introducing a new tax. Although it is called Financial Transaction Duty, it has nothing to do with the FTT. According to the Ministry of National Economy, the duty will be levied at a rate of 0.1% on certain non-cash payments, such as postal cash or bank transactions of private and corporate customers, bank transfers, direct debit mandate payments and bank card purchases. This tax has no intention of regulation of financial markets but simply aims to cash in from ordinary people as well as from corporations.

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

June

- **1, Brussels (High-level Expert Group on Reforming the Structure of the EU Banking Sector):** deadline for submissions to the consultation
- **6, Brussels (EC):** proposal on bank crisis management (planned)
- **7, Brussels (ECON):** planned vote on re-regulating credit rating agencies
- **12, Brussels (EC):** deadline for EC consultation on bank accounts
- **15, Brussels (EC):** new deadline for EC consultation on shadow banking
- **18-19, Los Cabos (Mexico) (G20):** heads of state summit
- **18-19, Brussels (ECON):** 2nd discussion on amendments to MiFID II draft report
- **20-22, Rio de Janeiro (Brazil):** Rio +20 conference
- **22, Brussels (ECOFIN):** meeting, earliest agreement on CRD IV
- **25, Brussels (ECON):** meeting
- **27, Madrid, (IOSCO):** deadline consultation on regulating ETFs
- **28, Brussels (EC):** conference on financial conglomerates
- **28, Brussels (EC):** informal consultation about future trading book capital requirements
- **28-29, Brussels (European Council):** heads of EU states meeting
- **30, Brussels:** Danish presidency ends

July

- **1, Brussels (EU):** Cyprus presidency starts
- **3, Brussels (EP):** tentative date vote on re-regulating CRAs
- **9, Brussels (ECON):** tentative date for vote on MiFID II and MAD II
- **10, Brussels (ECOFIN):** meeting

September

- **3, Brussels (ECON):** meeting
- **13-14, Mexico (G20):** deputy Finance Ministers & Central Bank Governors‘ Meeting
- **19-20, Brussels (ECON):** meeting
- **26, Brussels (ECON):** meeting

October

- ?, Brussels : the High-level Expert Group on Reforming the Structure of the EU Banking Sector presents its final report to the EC
- **8-9, Brussels (ECOFN):** meeting
- **9, Brussels (ECOFN):** meeting
- **12-14, Washington (IMF / World Bank):** autumn meeting
- **15, Brussels (ECON):** meeting
- **22, Strasbourg:** tentative date for plenary vote on MiFID II and MAD II/ MAR

November

- **4-5, Mexico (G20):** Finance Ministers & Central Bank Governors‘ Meeting
- **5-6, Brussels (ECON):** meeting
- **13, Brussels (ECOFIN):** meeting
- **28-29, Brussels (ECON):** meeting

December

- **3, Brussels (ECON):** meeting
- **6, Brussels (ECON):** meeting
- **14, Brussels (ECOFIN):** meeting
- **17-18, Brussels (ECON):** meeting

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This newsletter is produced by SOMO and WEED and is intended for wide circulation to interested parties. We appreciate receiving feedback as well as announcements of research reports, campaign actions, and meetings, which can be sent to m.vander.stichele@somo.nl.