



## Newsletter - EU Financial Reforms

### February 2011

This newsletter is part of the project "[Towards a Global Finance System at the Service of Sustainable Development](#)", implemented by six European NGOs with the aim of ensuring that European economic stimulus packages do not impact negatively on development.

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### Editorial

More than two years after the financial crisis hit Europe, financial reforms are far from over at the level of the European Union. This January new EU supervisory bodies started operating. The EU took some legislative decisions last year, most which will only become operational in the member states in the coming years. For instance, the directive to regulate hedge funds will only be implemented after two years.

The year 2011 will bring decisions on important financial reforms. This newsletter covers some of the new EU rules that are already in the decision making process or in the legislative pipeline of 2011:

- Regulating derivatives trading — including food commodity derivatives — its operators and trading platforms (e.g. exchanges), over-the-counter deals and backing services;
- Deciding on a financial transaction tax or financial activities tax;
- Fundamentally reforming the system of credit rating agencies;
- Some small technical changes to collective investment instruments;
- Changing how the EU economy is being governed to maintain the Euro.

Other wide ranging reforms that are in the pipeline are the EU implementation of the so-called Basel III capital requirements, restricting tax evasion, and mechanisms to deal with financial conglomerates or banks that are failing. The final article provides some overview of the EU current financial reform agenda not covered elsewhere in the Newsletter, followed by interesting dates.

The European Commission (EC) has been posting a series of public consultations on a whole range of issues on its [website](#) over the last few months. These consultations are used in the preparation of legislative proposals by the EC on which the European Parliament (EP) and the EU Council of Finance Ministers have to co-decide. The complexity of the proposals and the short term period for response has made it difficult for civil society to give input. Some have tried, as you can read in this newsletter, but the majority of the respondents have been from the financial industry.

The EU decision-making process can be described in the way Dennis J. Snower, President of the Kiel Institute for the World Economy has stated in Davos (as quoted in The New York Times): "Many policymakers are seriously scared of making fundamental policy decisions. People in the banking industry have an interest in making the situation seem complex and difficult, even when it isn't." A Brussels based expert described the EC proposals as generally accommodating the existing business models of the European financial industry and not forcing the financial industry to adapt its business model to new regulations. The EU regulations are not based on a model in which finance is at the service of sustainable development of Europe and its citizens.

The enormous lobby of the financial industry in Brussels remains a serious problem. It has enabled the financial sector to weaken many legislative proposals and reduce them to small steps in a web of piecemeal EU laws, measures and instruments. Civil society is hardly heard in Brussels, even if the EC has been somewhat accommodating towards NGO complaints over the last year. After MEPs called for a Finance Watch by civil society last year, discussions are ongoing in Brussels for new capacity for NGO monitoring, lobbying and advocacy.

This year will need continued vigilance, action and perseverance from civil society. Opportunities and mobilisations for actions are under way, amongst others in France, who is holding the G20 and G8 presidency in 2011, and in Hungary, the current president of the EU.

This newsletter aims at being an instrument to monitor the EU's financial reform process. Given the volume and complexity of this reform, however, it is selective. A particular focus in this newsletter is given to how the EU is currently dealing with curbing financial food speculation.

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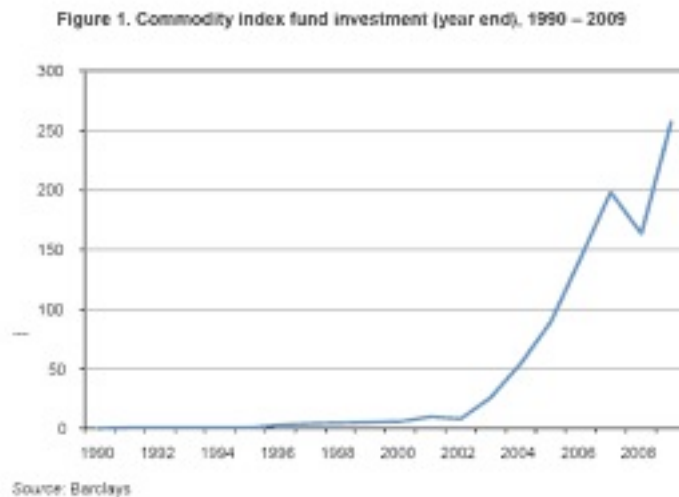
## **Food speculation on G20 and EU-agenda after new food prices rises**

With food prices on the rise again, the discussion on food speculation is back on the international agenda. The new G20-chairman Sarkozy has already called for more transparency and bringing the regulation of agricultural derivatives in line with other financial products. In 2011, the European Commission (EC) is undertaking a range of initiatives to improve the regulation, functioning and transparency of commodity markets and prevent excessive financial speculation. The European Parliament (EP) and EU Finance Ministers have to decide on the related new EU laws (see several articles in this newsletter). Regulation to curb food speculation also features prominently in NGO activities and the response of NGO's to the EC's initiatives, such as the consultation to reform the [Market in Financial Instruments Directive \(MiFID\)](#).



Early 2011, international organisations and the media reported on rising food prices in many food commodities on world markets. Politicians fear the repetition of the huge increase in the

price of food and energy resulting in some food riots, which happened in 2007 and 2008 when the IMF's food price index increased by more than 80 per cent. The consequences were most strongly felt in developing countries, especially food importing countries, where households spend 50 to 90 percent of their income on food. The level of volatility witnessed in commodity prices through 2008 was unprecedented throughout history, when high prices fell dramatically. The inflow of purely financial investors into commodities futures markets started to boom after the passage in 2000 of the U.S. Commodity Futures Modernisation Act (figure 1).



After the strong price decrease at the start of the financial crisis in Autumn 2008, food prices started rising again. Between June and September 2010, wheat prices rose by 70 per cent. Even taking the Russian crop fires into account, the world wheat harvest was still the third highest on record. In December 2010 the Food and Agriculture Organisation (FAO) reported that the FAO Food Price Index reached record levels, surpassing those of 2008. Beginning 2011, the media reported on the rising prices of many food commodities and the discussions about the role of financial, speculative and computer-based traders.

### High food prices and volatility on the G20 agenda

French president Sarkozy, who holds the chair of the G20 this year, stated in his [presentation of his priorities of the G20 agenda](#): "We want regulation of the financial commodity markets. Some of them have no basic rules against market abuse and price manipulation. (...) How can we explain that it is normal to regulate the financial market, but that we have to abstain from any rules on agricultural derivatives?"

He [singled out particular actions](#) in the field of energy and agricultural commodities:

- Confronting the negative effects of price volatility through strengthened regulation for commodity derivatives markets in common with the US, encourage sustainable investment in agriculture and introduce new financial insurance instruments.
- Reducing excessive commodity price volatility through improved transparency on the physical markets such as information about stocks and inventories, and strengthened international tools for coordinated action in time of agricultural and food crises.

However, [formally](#) and informally, the principal proposals by France for G20 in January 2011 regarding commodity derivatives regulation aimed at increasing transparency, e.g. by registering over-the-counter (OTC) derivatives (starting with wheat), by publishing information on trading and outstanding contracts ('positions') per category of actors (such as the weekly publication in the US), and by elaborating EU rules which are common with US regulations.

According to the [Heinrich Boell Stiftung \(965 KB\)](#) work on food speculation in the G20 will primarily be done by a working group led by Russia looking at reforms to the agricultural market to stabilise global food prices. Also, the working group on global governance, led by Great Britain, will re-examine a reform of international agricultural organisations.

Recently, Director-General Jacques Diouf of the UN Food and Agricultural Organisation (FAO) and the French Minister of Agriculture, Bruno Le Maire called, at a joint press conference, financial speculation on food both economically dangerous and morally unacceptable. They [called](#) for an international response at the G20 to the record food prices and volatility, which should include regulation of financial speculation on commodity markets.

The Secretary-General Supachai Panitchpakdi of the United Nations Conference on Trade and Development (UNCTAD) is among the prominent international voices who expressed "serious concerns about the way in which commodity markets have been evolving in recent years (..)" and warned of "speculative distortions" at [UNCTAD's second Global Commodities Forum](#) on 31 January 2011.

### **Discussions about food speculation in the EU**

On 2 February, the European Commission (EC) [called for broad "action"](#) on commodities and raw materials. [The proposals in the EC's communication](#) include actions to improve the regulation, functioning and transparency of financial and commodity markets. Among the key elements are improving the integrity, transparency and stability of commodity derivatives markets through a review of the directives on Market Abuse (MAD) and [Markets in Financial Instruments \(MiFID\)](#), and a [regulation of OTC derivatives](#). In addition, the EC wants research to be undertaken on the linkages between financial and physical commodities markets. NGOs claim that the time for studying is over and that action is now warranted, for instance using a precautionary approach. In response to EC consultations, NGOs such as [World Development Movement](#) support strict regulations to increase transparency and trading on commodity derivatives exchanges, and to introduce limits on how much financial actors can trade in commodity derivatives. In [a joint statement to be launched](#), more than 100 NGOs from all over the world ask policy makers to address food speculation through such strict regulations in the financial markets and banning financial speculators to buy physical food and farm land. French NGOs made [a call to civil society to mobilise](#) around the G20 and G8 events in France, among others regarding food speculation.

German Minister of Agriculture [Aigner already warned](#) against hunger riots and called for international measures against excessive volatility and speculation in commodity markets. In a [speech](#) to the World Economic Forum on 28 January 2011, also German Chancellor Merkel called to deal with volatility, speculation and lack of transparency, but also with getting 'fair' access to commodities and extractives world wide.

### **For campaign documents, statements and documents see:**

[World Development Movement's \(WDM\)](#)

[SOMO](#)

[WEED](#)

[French coalition of organisations campaigning around the G20 and G8 presidency of France](#)

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## **Complex plans about new regulations on financial (commodity derivatives) markets**

The European Commission (EC) is planning to present legislation to reform the Market in Financial Instruments Directive ([MiFID](#)) by mid May 2011. The MiFID review provides the opportunity to address the lack of regulation and transparency of financial products (e.g. [derivatives](#)), trading practices and markets (e.g. exchanges) that were at the heart of the financial crisis. In preparation of the new legislation, the EC submitted its reform proposals for consultation through its [website](#). Submissions had to be sent in by the beginning of February 2011. This MiFID consultation happens in parallel with consultations to reform the directives on [collective investment schemes \(UCITS\)](#) and packaged retail investment products (PRIIPS). These reforms complement the [legislative proposals](#) now being [discussed by the European Parliament \(EP\)](#) regarding [over-the-counter \(OTC\) derivatives markets and their instruments \(European Market Infrastructure Regulation Directive \(EMIR\), short selling and credit default swaps](#). Because the EC intends to use the review of MiFID to regulate (agricultural) [commodity](#)

[derivatives](#) trading, this article provides some more detailed explanation about this planned reform.

The Market in Financial Instruments Directive ([MiFID](#)) covers those aspects of the speculative financial market aspects (the 'casino'), that are more transparent than the totally opaque but very large [OTC derivatives trading market whose regulation the EU is now deciding on \(EMIR directive\)](#). MiFID is a corner stone of regulating financial markets in the EU. MiFID covers not only financial



products such as shares and bonds, but also all kinds of derivatives, including agricultural commodity derivatives, and (complex) structured financial products. MiFID also deals with how these investment products are being traded on exchanges and platforms, and how they are being sold and marketed for instance by investment banks. After the EU agreed on MiFID in 2004 it was implemented in the member states in 2007 followed by some [technical reviews at EU level](#).

The current review of MiFID tries to deal with the following deficiencies amongst others:

- Too much risk taking by financial market products and operators, which triggered the financial crisis;
- New unregulated complex, opaque and very risky financial products and operations, some resulting from (technological) innovations (e.g. computer run automatic trading);
- Lack of common rules about MiFID implementation and lack of common supervisory practices across the 27 EU countries;
- Insufficient protection of different kind of users of those investment instruments and services;
- Lack of a uniform single EU market in these investment products and services.

The EC's public [consultation before proposing a legislative review of MiFID](#) was very complex given the many deficiencies it wants to deal with. The consultation was closed less than 2 months after it was launched, a major challenge not only for civil society but even the financial industry. The EC was consulting about its proposals how to regulate new financial market entities and trading techniques in financial products (e.g. [dark pools](#), automated trading through computers programmes) and new financial services or products to avoid disruption of the financial markets, lack of transparency and investor protection, and 'unfair' competition across the EU. The EC proposals to review MiFID included:

- Enhancing transparency of the financial markets by a better and harmonised collection of data during the different stages of trading, more reporting obligations and publication of information;
- Specific requirements related to commodity derivatives markets and operators (see next paragraph);
- Improving protection for investors using investment services or getting financial advice, by imposing more operational disciplines on service providers;
- Ensuring better information about ethical and social investments;
- Strengthening supervision: More common rules and supervisory practices across the EU and a mandate for the European Securities and Market Authority (ESMA) to resolve conflicts between national supervisors and identify risky financial products;
- Common rules in all EU countries to allow access for, and to treat financial firms and operators from outside the EU on EU markets.

### **Specific proposals on commodities**

The MiFID consultation also included specific proposals regarding operators and commodity markets – including physical trading and financial derivatives – in order to ensure that derivatives exchanges keep their original function, namely a platform for agreeing on prices ('price discovery') and signing derivatives contracts ('futures') which guarantee a given price to

producers and delivery to end-users after harvest ('hedging'). In order to fulfil that function, and because these exchanges function as benchmark for prices all over the world, exchanges and other trading platforms and markets in commodity derivatives need to provide reliable and not too volatile prices.

The commodity related proposals made by the EC in its consultation include:

- More transparency: new obligations to report per category of trader or per kind of derivative –or combined categorisation- to report on all the number of open commodity derivatives contracts, or on those financial instruments that are related or that can influence commodity prices; Reporting is being harmonised in EU; Information for the public is made available in aggregate form;
- Less exemptions from MiFID obligations for those trading in commodity derivatives because they are producers or end-users;
- More and equal powers to supervisors or regulators in all EU countries to intervene in all kinds of commodity derivatives trading e.g. restrict commodity derivative trading ('position limits') or ban products when the 'orderly functioning' of the markets is disrupted, to impose which derivatives need to be traded on regulated exchanges.

### **Different opinions**

The European Parliament (EP) had voted with a large majority on a [report regarding improving regulation of financial instruments \(200 KB\)](#) and 'dark pools' in November 2010. The EP report expressed many concerns about the risks and uselessness, as well as their lack of transparency and regulation of new trading techniques and platforms for trading in all kind of securities. MEPs requested the EC and the European supervisory bodies to do extra investigations into many of these issues. Also, the MEPs called to have Exchange Traded Funds, "exchange traded commodities" and more derivatives trade to be covered by MiFID regulation. Several MEPs felt that the EC had taken little of their concerns into consideration in the EC's consultation document and have been discussing this with the EC.

Many branch organisations of the financial industry have made submissions, aiming to restrict new regulation as much as possible. For many of them, financial markets and derivative trading is a very lucrative business compared to other services in the financial industry, which are less profitable, and [their lobby capacity is well known](#). Civil society was of the opinion that strong regulation and restrictions were needed, as explained in the next paragraph.

### **NGO concerns and activities**

Some NGOs such as [WDM](#), IATP, WEED and [SOMO](#), responded to the EC MiFID consultation. Some of the many NGO concerns, issues and criticisms of the proposals that were incorporated in the MiFID consultation include:

- There was no consideration about how many of the investments under MiFID are economically and socially useful and how many are purely speculative and socially useless; all investment instruments should be assessed for their social and environmental sustainability;
- There is enough evidence of a link between the increased financial speculation in the derivatives markets and the price increases (and increased volatility) of agricultural food commodities during the last decade.
- The EC should not further study but put stricter regulation in place of agricultural commodity derivatives markets. The EC should impose that more trade takes place on regulated trade platforms, introduce strict 'limits' on how much each category of trader can engage in speculative financial derivatives trading, and introduce better sanction mechanisms;
- Transparency and reporting to supervisors/regulators and the public needs to be hugely improved regarding all (commodity) derivatives trading: e.g. different kind of traders should be clearly identified, defined and obliged to report about each of their trading activities; reporting by traders should not be delayed for too long and should be made accessible to the public very regularly (e.g. every two weeks);

- Stronger and better resourced supervision is needed, coordinated with physical commodity market supervision and regulation, and with powers to impose bans on certain risky financial products and services;
- Opening up to financial products and trading services from third countries needs only to be done after an assessment is made of the EC's liberalisation of financial services and of trade agreements and after their negative impacts on financial regulation and stability are removed.

[WDM undertook an e-action](#) providing people the means to respond to the EC's Commission's consultation on reforming MiFID, focused on avoiding excessive food speculation through the new proposed regulations on the trading of food commodity derivatives. By the consultation deadline 2,623 people sent a submission to the Commission via the EC website! The EC's email inbox mentioned it was 'full' by midnight of 2 February!

### More reading

- The EC official information about [MiFID or Directive 2004/39/EC and follow up](#)
- [Researchers – industry task force](#) and its [activities](#)

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## Regulating OTC derivatives: the European Parliament's discussions

Legislating EU rules for the large opaque derivatives that are traded 'over the counter' (OTC) and that speculate on an estimated \$ 600 or more in assets, is likely to be a difficult process. The European Parliament (EP) and the EU Ministers of Finance have to decide in the coming months on the [legislative proposal](#) for the OTC derivatives markets and their backing instruments or 'infrastructure', which was already [presented by the European Commission \(EC\) in September 2010](#). This new EU legislation is now often referred to as



the European Market Infrastructure Regulation (EMIR). Discussions at the EP in early February indicated that many changes to the draft legislation are still warranted. EMIR is part of the process to deal with excessive speculation on (agricultural) commodity markets through a complex series of new EU laws that regulate derivatives and other financial markets and instruments, as explained in this newsletter.

Discussions at the EP in early February indicated that many changes to the draft legislation are still warranted. EMIR is part of the process to deal with excessive speculation on (agricultural) commodity markets through a complex series of new EU laws that regulate derivatives and other financial markets and instruments, as explained in this newsletter.

The legislative proposal now in the decision-making process is officially called [Regulation on OTC derivatives, central counterparties and trade repositories](#). It includes regulation of market structures and instruments that make the (OTC) derivatives market function in order to prevent too high risks and financial crises. Werner Langen (EPP) at the EP is in charge of producing a report that would lead to the final EU legislation. His report was due early February but has been delayed. The European Parliament (EP) had already had taken a [resolution](#) on derivatives markets on 15 June 2010.

On 1 February 2011, the EP's Committee on Economic and Monetary Affairs (ECON) discussed with Mr Langen the EP's amendments, 125 for the moment, to the legislative proposal which are likely to be included in Mr Langen's report. The Commission is planning to remove the "OTC" reference in its proposal in order to extend it to all derivatives. Langen and other MEPs do not agree with this removal of "OTC" from the proposal. The issues that were subject of discussion and future amendments include:

- Clearing: eligibility, obligations and exemptions for clearing for particular traders and institutional investors (e.g. pension funds);
- Reporting: exempting non-financial counterparties from reporting, up to a certain threshold;
- Scope of the regulation;
- Standardisation: how much derivatives should be standardised and obliged to trade on exchanges;
- Central counterparty clearinghouses (CCPs): organisation and supervision of CCPs and admission of third country CCPs;

Finally, many MEPs in the ECON meeting uttered their concern about the issue of commodity markets and the appropriate regulation of these. They noticed the growing speculation in commodity markets and worried about possible negative impacts of this financialisation process. MEP Klute even called for a ban of any commodity speculation.

The EP Committee on Industry, Research and Energy has the right to provide an opinion to the ECON report. In a discussion on 10 February, some MEPs warned against over-regulation, which would harm end-users (e.g. food processing companies) who hedge through derivatives. Amendments to the draft opinion of this committee are due on 2 March.

The Ministers of Finance are likely to discuss the draft regulation, as presented by the EC, at their 25 February ECOFIN meeting and in meetings thereafter. The European Central Bank is also raising its voice on how the derivatives markets should be organised, given that these derivatives markets are a major cause of financial instability.

The progress of the decision making process of EMIR with documents and dates of meetings by the EP and Council can be followed at the [EP's website](#).

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## Only a few regulatory adjustments, despite over €7bn in collective investments

The European Commission (EC) is reviewing the directives regulating [collective investment schemes](#) that invest in shares and other securities on behalf of groups of individuals. The legislation under scrutiny are the Undertakings for Collective Investment in Transferable Securities ([UCITS](#)) Directives. The EC aims to enhance investors' protection via some technical improvements and to place restrictions on the pay and bonuses of managers of a [UCITS funds](#). The EC proposals were open for comments via [a website consultation](#) until the end of January 2011. A legislative review of the UCITS directives is likely to be presented by the EC in Spring 2011. So far, the EC has failed to sufficiently re-regulate the management of the € 7.7 bn assets held by European collective investment funds. The EU does not consider regulation to ensure investment strategies are conducive to long-term stability and sustainability, rather than short-term profit maximisation.



The [UCITS Directives](#) lay down common requirements for the organisation, management, free movement, liquidity and oversight of collective investment schemes. Examples of such collective investment funds or schemes are mutual funds, commodity index funds and exchange-traded funds (ETFs). However, only collective investment schemes that fulfil the requirements of the UCITS Directives can be called UCITS funds and can be offered without extra regulation across the EU. The EU directives are aimed at eliminating diverse regulations of funds across the different EU countries and at protecting individual investors e.g. through better information.

The [financial industry estimates](#) that at the end of September 2010, € 5,777 billion was invested in collective investment funds and schemes, mostly UCITS compatible, while total net

assets managed by non-UCITS compatible schemes (but regulated at national level) reached € 1,951 billion at end September 2010. In other words, the combined assets reached € 7,728 billion in the third quarter of 2010.

The EC's [proposals to review of the UCITS Directives](#) aim at:

- Enhancing investors' protection via firmer rules on [depositories](#): One problem with the existing UCITS Directives is that different EU countries have different interpretations of the "safekeeping" duties of the depository supervising the invested assets (e.g. the shares of a company the fund invests in). The latter point has received a lot of attention in the aftermath of the fraud by Madoff, who did not invest in what he said he did invest in and instead siphoned off billions for himself, which went undiscovered for years. There is a lack of clarity on the due diligence process a depository must go through when selecting and monitoring sub-custodians. Currently depositories and [sub-custodians](#) are not legally required to be externally audited on a regular basis to ensure assets really are where they are claimed to be. Member states also do not currently agree on the degree of legal liability depositories may be subjected to in the event that a [sub-custodian](#) loses a fund's assets.
- Restrict pay and bonuses of [UCITS funds](#)' managers: The EC is considering changing regulations on supervisors' and fund managers' salaries and bonuses of [UCITS funds](#), investment funds that have been established in accordance with the [UCITS Directives](#). This would include a legal obligation to delay the payment of a given percentage of every bonus to allow for a decent period of time, in which the success of an investment strategy can be analysed.

The EC consultation indicates that the EC has so far been more interested in making [UCITS funds](#) tradable all over the EU – increasing competition and restricting national regulation, while allowing short-term profits – rather than promoting financial stability through investments that serve the real long term needs of the economy and sustainability. Figures in Eurosif's European Socially Responsible Investment (SRI) Study for 2008 show that socially responsible investments only represent 3.4% of the European asset management industry. (Eurosif, European SRI Study 2008, p. 10.) SOMO [research](#) has found that banks offering investment products (e.g. mutual investment funds) assume that the clients make the ethical considerations in which fund to invest. Banks do not include ethical considerations in the investment funds they offer to clients except if the funds are ethical or sustainability/green funds. The impact on developing countries from investments in these countries' bonds and company shares are also not discussed.

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## **Economic governance reforms and why the EU 'Pact for Competitiveness' does not tackle the basic problems of the Euro-zone**

The Keynesian rescue packages and stimulus programs to save the financial sector have stabilized the financial crisis for the moment. However, they have transformed the financial crisis into a crisis of public finance and a crisis of the Euro due to pressure from the financial markets. This resulted in a crisis of governance of the EU. Difficult discussions have been taking place at EU level about enlarging a fund that provides loans to countries in need of cheap finance, like Greece and Ireland. Germany, with the



support of France, has stepped up the discussions about conditions to harmonize financial and economic governance, to avoid Germany becoming the financial rescuer who pays for the rest of 'uncompetitive' Europe. The new proposals on economic governance will be discussed at a

special summit of Euro-countries on 11 March 2011. The harsh conditions on social systems that are being proposed would plainly lead to socializing of the losses of the financial crisis. However, what is not part of the reform discussions are the German trade surplus, the diverse and unequal circumstances in countries with one currency, and full restriction of financial market speculation (see other articles in this newsletter). The themes of currencies and economic governance are also subject to discussions at G20 under the presidency of France.

*"Financial markets with their merciless realism have cleared away un sentimentally within few weeks the illusions and half-truths, the unrealistic autism and the continuous self-deception of the EU-Europeans, of their heads of state and government, their media and their political public." Joschka Fischer, former German foreign minister*

The financial crisis has revealed a basic fault in the construction of the Euro system: In the long run a common currency is not possible without common financial and economic governance that avoids too divergent economies. The present German government had until recently refused to develop a common financial and economic policy, in order to avoid that Germans would have to pay with 'their hard work' for the rest of Europe who is 'less disciplined'. In the meantime, politicians in Berlin have understood that the Euro-zone might collapse if there is no closer cooperation. The coalition partners in the German government have gradually come to a consensus that the existing European fund to rescue Euro-countries in budgetary and financial difficulty, was needed to be enlarged up to € 725 bn. To get Germany's support, the government in Berlin wants a qualitative leap in political coordination of economic, financial, budgetary and social policies. The general approach is now: if a deeper integration cannot be avoided, it should at least happen under German leadership and at the terms of German economic policy, which is neo-liberal and neo-mercantilistic. As Chancellor Merkel puts in her speech at the World Economic Forum (in Davos) in January 2011: "The criterion for Europe must be the global competitiveness. A stronger political coordination in future has to be orientated towards this."

There is not yet an official proposal of the German government, but these issues of economic governance and a 'Pact for Competitiveness' will be discussed among Euro-zone countries at a special summit on 11 March 2011. However, some informal proposals have been voiced at the European summit early February 2011, including through an unprecedented German-French press conference and power display of Chancellor Merkel. Some cornerstones of the German proposals of EU integration which have surfaced are:

- A budget control mechanism with sanctions would make it impossible for any government to pass a certain limit of public debt; this would entail that countries and parliaments would have to adopt strict austerity policies and loose the sovereignty over their budget if they don't follow the rule;
- 'Harmonization' of social systems such as a common retirement age, adjusted towards the upper limits (Germany and the Netherlands have recently set the limit at 67 years) or according to Merkel, tied to life expectancy;
- 'Harmonisation' of labor laws which would include 'social reforms' that deregulate social systems such as abolishing the automatic adjustment of salaries to the inflation rate, and 'harmonisation' of salaries in the public service;
- Common taxation policies.

These ideas have caused quite some upheaval in other, often smaller, European countries who feel that Germany, and France, are imposing these ideas on the other countries. This 'Pact for Competitiveness' aims at securing confidence from the financial markets and putting governments 'ahead of the markets. However, it would give member states a major influence on crucial economic issues. This caused protest from the European parliament (EP) and fears that EP and the European Commission would be marginalized.

If the proposals would have to lead to a change in the Lisbon Treaty, Germany is willing to support such a change. However, it would be a major problem for the UK government, whose Conservative coalition partner promised a referendum in the case of changes in the EU treaty, and whose Liberal coalition partner is pro-European.

### **Basic problems ignored**

The above proposals do not tackle a major problem of the Euro-zone: The German trade surplus, which is still a taboo for Chancellor Merkel. Under the cover of the common currency, competition between the EU economies was stimulated and the competitiveness of the German economy increased vis-à-vis other EU countries (except Austria, Belgium and the Netherlands) - mainly as a result of neo-liberal social reforms (the so called Agenda 2010), i.e. at the expense of wages, social welfare and domestic demand. For instance the German unit labor costs increased by 6 percent since 2000, whereas in the other countries of the Euro-zone they increased by 30 percent at the average. The German economy built up an accumulated trade surplus since 2000 of € 1,4 trillion while, the Mediterranean member states of the Euro zone (incl. France) accumulated a current account deficit of € 1,4 trillion. Consequently, these economies and public budgets incurred huge debts. When it became obvious that Greece, Portugal and Spain were at the brink of insolvency, a hectic crisis management started at EU level. However, the current solutions of the 'European Financial Stability Facility', which guarantees up to € 725 bn for rescue packages, and the exceptional measures of the European Central Bank (ECB), such as buying bonds of the countries in financial difficulty, would not work in the long run if the trade imbalance are not solved.

Another problem is that speculation (e.g. against Euro-zone country bonds and the Euro) by the financial markets is still not, or hardly, being regulated or restricted given the slow and weak EU reforms of the hedge funds, derivatives markets, investment instruments, etc. as explained in this newsletter. The whole crisis management was and still is defensive. It provides protective shields to accommodate and 'calm the markets' which results in European governments being dominated by the financial markets while under democratic conditions governments have to be masters of the markets.

### **G20 deals with similar problems**

The G20 has also been facing monetary problems due to the 'currency wars' as a result of some emerging market countries (e.g. Brazil, South Korea) suffering from overvalued currencies because of hot money inflows. President Sarkozy of France, who has taken over the presidency of the G20 and G8 since November 2010, has put the reform of the international monetary system, the reform of global governance - i.e. dealing with budget, currency and trade imbalances such as between China and the US - and regulating financial markets as key items on the G20 agenda. This will be discussed at the meetings of the G20 Ministers of Finance in Paris on 18-19 February 2011, the G20 Finance Ministers in Washington DC on 14-15 April 2011, the G20 Heads of State summit on 3-4 November 2011 in Cannes as well as in G20 working groups. Germany's Chancellor Merkel has supported this G20 agenda. In her view, the currency system should mainly reflect economic fundamentals, and global imbalances and destabilizing capital movements should be tackled.

For more information about the G20 see the [website of the French presidency](#)

[Photo above by aranjuez1404](#)

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## **Financial Transaction Tax – 2011 a decisive year**

Recently, the debate on the Financial Transaction Tax (FTT) has considerably intensified at EU level. Germany is seriously considering to introduce a financial transaction tax with the support of the financial industry. At the European Parliament (EP) there is support for a global FTT but so far not enough support for a European FTT. An important EP vote will take place in March 2011. France, as president of the G20 and of its summit in November 2011, has announced to put the FTT on the G20 agenda even though it was rejected last year. FTT campaigners are active on many of these policy fields. All this is likely to put pressure on the European Commissioner responsible for taxation, who is opposing a FTT but is in favour of a financial activities tax (taxing salaries).

Germany remains serious on introducing a financial transaction tax. The government has already started talks at working level with the financial industry. Revenues of two billion Euro have been planned for the 2012 budget. The German government is focusing on a tax at European level. It wants to tax all financial assets – shares, bonds, derivatives and currencies – in order to avoid the weaknesses of the failed Swedish FTT experiment. The rate is set at 0,01 percent. Officially Germany does not want the FTT to have a regulatory effect. But, even if the 0,01 percent is lower than civil society proponents of the FTT and academia hope for, speculation would be affected to a certain extent, at least speculation via high frequency trade. As for the use of the revenues from the tax, they should – for German legal reasons – go into the general budget. But informally some agreement might be possible to use a certain amount for development and environment as the French propose (see next paragraph). Also, the German government is clearly against a Financial Activities Tax (FAT), as suggested by the IMF. The difference between a FAT and FTT is that a FAT taxes the salaries of the management and the employees working in the financial industry, while the FTT is taxing financial transactions.



German policy makers believe, that in the light of the heavy economic problems in the UK, the British could still agree on the FTT. However, the UK government has argued that the EU should not implement a FTT unilaterally because transactions can easily be moved overseas. The UK would rather implement an FAT (taxing bonuses and profits) in cooperation with other countries at international level. In the mean time, the government has formally ruled out imposing a bonus tax but has agreed on 8th February to increase the levy on banks to £2.5bn in 2011 - raising an extra £800m compared to 2010.

President Sarkozy has announced at several occasions, that France will put the issue of the FTT on the Agenda of the G20 which [France is chairing](#) until the G20 summit on 3-4 November 2011. In order to get acceptance by the G20 (the Toronto summit could not agree on the FTT), Sarkozy proposes that the revenues of such a tax should be earmarked for development and environment. Details of the French position with regards to tax base and tax rate remain unclear so far (end of January 2011). Sarkozy favours an international FTT which he claims to be "useful for dissuading speculation and effective for finding new resources for development of poor countries". However, he has also been talking about "the best formula" agreed by a worldwide consensus, which could result in a shift to any other 'innovative financing for development' such as taxing container ships or taxing internet connections.

The European Parliament (EP) plans to vote on 7 March 2011 in plenary on [the so-called Podimata Report on 'innovative finance'](#) which includes a FTT. Although there is a consensus for a global FTT, such a tax at European level, if a global FTT should fail, is still highly controversial. The outcome of the final EP vote is unclear after it was only by one vote that the EP's Committee on Economic and Monetary Affairs (ECON) [rejected](#) an amendment that stated that, if a global FTT fails, a European FTT should be introduced.

Although the EP is not a full fledged parliament that can decide on tax matters, it has some possibilities to block the European Commission (EC). In so far, the decision at the EP will also influence the EC. The EC is expected to release an official report on the FTT and the FAT this summer. Although the responsible [Commissioner, Algirdas Semeta \(Lithuania\)](#) is a hard headed neo-liberal, it will be difficult for him and the Commission to bluntly speak out against the FTT while France, Germany and several other countries like Austria, Belgium and Finland are in favour.

European civil society is having a dynamic campaign for the FTT. A plan of action was adopted at a strategy meeting in January 2011, which was well attended by NGOs – in particular those working in development, health and environment –as well as trade unions and movements.

The activities, that are being planned so far, include a global day of action on 17 February just one day before the G20 Finance Ministers meet in Paris (18-19 February), a day of action in June/July, a global e-signature campaign and other activities at grassroots level targeting the EU and the G20 Summit (3-4 November), as well as lobby initiatives at several levels. French civil society organisations announced a full year of [mobilisation](#) and a People's summit at the beginning of November near Cannes.

**The main NGO websites for information and position papers are:**

- <http://www.makefinancework.org/?lang=de>
- <http://robinhoodtax.org/>
- <http://europeansforfinancialreform.org/en/news/support-podimata-report>
- <http://europeansforfinancialreform.org/en/news/euro-mps-fight-eu-financial-transaction-tax>
- <http://europeansforfinancialreform.org/en/events/launch-effr-campaign-regulate-global-finance-now-austria>
- <http://www.steuer-gegen-armut.org/>
- <http://www.altermob.org/?lang=en>

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## **European Commission consults on some more fundamental regulation of Credit Rating Agencies**

[Credit Rating Agencies](#) (CRAs) play a crucial role in modern finance by assessing the risk of defaulting on loans provided by banks to companies, countries, etc. or defaulting on other debt products traded in the financial markets. CRAs have been strongly criticised for their role in creating the financial crisis and more recently for their role in the Euro-crisis by not foreseeing many risks associated with the financial products and countries they were rating. Following earlier weak proposals, the European Commission (EC) has just ended its website [consultation](#) on proposals for further CRA reforms. The New Economic Foundation (NEF) and SOMO welcomed the more fundamental changes proposed by the EC but pointed to the omission of incorporating environmental and social risk assessments in the proposals as well as the effect of CRAs on developing countries. The EC intends to present new legislation on CRAs in spring 2011.



Because CRAs play a crucial role in modern finance, the EC has acknowledged that CRA reforms by the EU have so far been [insufficient](#). CRAs have been strongly criticised for their role in creating the 2007-2008 financial crisis by inflating ratings and underestimating risks of complex financial products. Some problems became again clear in 2010 when CRAs escalated the Euro-crisis, after they suddenly downgraded Euro-countries only when financial problems were visible for all, and when these country's bonds were under attack of speculators. By assessing the default risk of loans and all kinds of financial products traded in the financial markets, CRAs strongly determine the interest rates governments and companies have to pay to service their debt. CRA ratings also feature heavily in the legal framework. For example, institutional investors, such as pension funds, are only permitted to invest in securities rated above a given level.

The [EC consultation](#) on further CRA reform proposals ended beginning January 2011 and precedes new legislative proposals by the EC expected in spring 2011. The EC proposals in the EC consultation follow further discussions of the role of CRAs by the Euro countries, the International Monetary Fund (IMF) and the Financial Stability Board (FSB). The Euro countries now want a governmental CRA. The IMF has published their recommendations in her recent [global financial stability report](#). The FSB endorsed [principles to reduce on financial institutions' reliance on CRA ratings in October 2010](#). It wants to, wherever possible, remove references to CRA ratings from laws and regulations or replace them by suitable alternative standards of creditworthiness.

The EC consultation paper discussed some structural problems such as the inherent conflict of interest due to the fact that the issuer of debt or a financial product pays for the rating ('issuer-pays' model), the risk of overreliance on credit ratings by financial market participants (instead of making own risk assessments), the lack of number of CRAs resulting in a high degree of concentration in the credit rating sector which can result in abusive fees due to lack of competition, and the lack of civil liability when CRAs get it wrong and cause much damage.

Both the [NEF](#) and [SOMO](#) have made [submissions to the Commission](#), supporting stronger regulation and in particular alternatives for the current issuer-pays model such as a publicly financed independent CRA and having an independent agency, that decides which CRA should be used by the issuer of a financial product that is to be rated (as provided for in the Dodd-Frank Act in the USA).

However, three important issues were identified as missing from the consultation document:

- The need to incorporate environmental, social and governance issues in the risk assessment made by CRAs and other financial institutions and regulators: By not looking at these factors, important risks are left out of sight.
- The effect of CRAs on developing countries: [A 2007 report from the World Bank \(372 KB\)](#) noted that nearly 70 developing countries have never been rated, even though they would be eligible for a B-rating or higher. This strongly hampers their access to finance on global financial markets and makes loans more expensive. Furthermore, [research suggests](#) that CRAs often devote less staff and resources to rating developing countries' debt. This might lead to lower ratings than warranted as it is found that firms in developing countries that receive more attention tend to end up with higher ratings than poor countries that receive minimal attention. By making CRA ratings more robust but at the same time more expensive, CRA ratings of developing countries and their firms might become less accessible.
- Lastly, also the remuneration models used by credit rating agencies are not discussed by the EC even though this is one of the issues that, according to the existing CRA Regulation, the Commission is required to monitor and assess by end of 2012 (Article 39 (1) of the CRA Regulation).

For more information see [here](#).

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## 2011 – A full programme of financial reforms in the EU

### Priorities of the Hungarian presidency

The Hungarian presidency has outlined the following priorities for the Council of Finance Ministers to deal with during the first 6 months of 2011 regarding the financial sector:



- Significant steps to reach agreement on the [proposed regulation on short selling and credit default swaps](#);
- Significant steps to reach agreement on the [proposed regulation on OTC markets and its infrastructure](#);
- Reaching agreement with the European Parliament on regulating and supervising [Financial conglomerates](#);
- Reaching political agreement on tax evasion (the savings tax directive);
- Discussing the EC proposals on [MiFID](#) reforms, [a mechanism to resolve bank crises](#), and a new capital requirements directive to implement Basel III;
- Discussing financial sector taxation;
- Discussing [reforms of deposit guarantee schemes](#), and [investor compensation schemes](#);
- Agreeing on the insurance sector (Solvency II) reform;
- Agreeing on supervisory arrangements for the prospectus directives.

### Consultations by the European Commission (EC)

Apart from this long list of topics that policy makers need to deal with, the EC is already consulting on new proposals or technical aspects of regulation, which will be dealt with later in

2011.

The full list of outstanding consultations can be found [here](#) and is constantly updated.

Important consultations include:

- [Strengthening bank capital requirements for counterparty credit risk](#): the consultation is closing on 9 March 2011;
- [Details of a European framework to manage bank crises](#): the consultation is closing on 3 March 2011.

### **Liberalisation of financial services in trade agreements contrast with EU reforms**

In the mean time, financial services continue to be liberalised through the free trade agreements (FTAs) the EU is agreeing upon, such as the FTA with South Korea. Financial services liberalisation is also included in the current attempts to finalise negotiations at the WTO. However, the way in which financial services are liberalised in the GATS contrasts with many of the current financial reform proposals. [Research by SOMO](#) points out how the GATS and FTAs rules restrict regulation and can be incompatible with current and future EU financial reforms.

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## **Calendar of official events**

For 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](#)

### **February**

- **14, Strasbourg (ECON)**: meeting
- **15, Brussels (ECOFIN)**: Minister of Finance meeting a.o. on [OTC/EMIR directive](#)
- **16-18, Paris (G20)**: Institute of International Finance (bank lobby) scheduled to meet G20 Finance Ministers
- **17, Paris (NGO)**: Day of action on FTT
- **18-19, Paris (G20)**: Finance Minister and Central Bankers meet on how to measure global imbalances
- **28, Brussels (ECON)**: meeting, scheduled to adopt [report on short selling & CDS regulation](#)
- **28, Brussels (ECON)**: presentation English draft [report on OTC/EMIR directive](#)

### **March**

- **3, Brussels (EC)**: deadline to respond to [consultation on bank crisis management](#)
- **3, Brussels (EC)**: planned launch of consultation about review Capital Requirements Directive (CRD 4)
- **7, Strasbourg (EP)**: plenary, scheduled adoption of [report on innovative finance/FTT](#)
- **9, Brussels (EC)**: deadline to respond to [consultation on strengthening bank capital requirements for counterparty credit risk](#)
- **11, Brussels (European Council)**: extraordinary meeting of heads of state of Euro-zone countries
- **15, Brussels (ECOFIN)**: discussion planned on [short selling & CDS regulation](#)
- **15, Brussels (ECON)**: scheduled deadline for amendments on draft [report on EMIR/OTC regulation](#)
- **15-16, Brussels (ECON)**: meeting scheduled to adopt [CRA report](#)
- **21-22, Brussels (ECON)**: meeting
- **24-25, Brussels (European Council)**: heads of state meet on economic governance

## April

- **4, (ECON):** discussing amendments to [report on OTC/EMIR directive](#)
- **5, Strasbourg (EP):** plenary, scheduled to adopt [short selling & CDS regulation](#)
- **7, Budapest (ECOFIN):** informal meeting of Finance Ministers
- **7, Budapest (NGOs):** alternative ECOFIN meeting planned
- **13-14, Brussels (ECON):** meeting
- **14-15, Washington DC (G20):** meeting of Finance Minister and Central Bankers
- **19-20, Brussels (ECON):** meeting and scheduled adoption of [report on EMIR/OTC regulation](#)

## May

- **2, Brussels (ECON):** meeting
- **Mid May, Brussels (EC):** presentation legal review proposals of MiFID
- **17, Brussels (ECOFIN):** scheduled political agreement by Finance Ministers on [OTC / EMIR regulation](#) and [short selling & CDS regulation](#)
- **26-27, Deauville, France (G8):** summit meeting

## June

- **?, France (G20):** postponed meeting of G20 Ministers of agriculture
- **6, Strasbourg (EP):** plenary vote scheduled on [OTC/EMIR regulation](#)
- **15, Luxembourg (ECOFIN):** Finance ministers meet probably on financial sector taxation
- **24, Brussels (European Council):** Heads of state meets.

## November

- **1-3, Cannes (NGOs):** scheduled alternative people's summit
- **2-4, Cannes (G20):** heads of state summit