

"Europe and the City: What will the euro crisis mean for the UK's financial services industry?"

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"In shadowy silent distance grew the iceberg too" ²

What will the euro crisis mean for the UK's financial services industry? Of course it is dangerous to draw premature conclusions on the impact of an ongoing crisis on an industry undergoing its own related crisis in an unstable environment. Nevertheless, that is the question I have been asked to consider. I welcome the opportunity to do so and hope to bring some light to the debate.

So my first answer is simply that it is too early to tell and that we would do well to react sceptically those who offer simple answers.

My second answer is based on the view that all those concerned with the financial services "industry", including prudent policy-makers, should be thinking hard about all the ramifications of the crisis. The euro crisis and the measures taken to deal with it are

¹ Director General, Internal Market and Services, European Commission. The author expresses his personal views in this paper, which is a more elaborate version of remarks made at a conference organised by Open Europe in London on 2 March 2012.

² Thomas Hardy, Convergence of the Twain.

having and will continue to have a major impact on British, European and global politics, which in turn form the environment in which the British financial services industry (hereinafter, with apologies for the Londoncentric shortcut, the City) operates.

The new Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) concluded by 25 EU Member States³ has already given rise to considerable controversy. Its impact on relations between the UK and the rest of the EU and the borderline between fiscal policies governed by the new treaty and single market issues dealt with by the EU treaties are matters of great importance. When one adds that the UK is already in a legal dispute⁴ with the European Central Bank over its location policies, requiring that central counterparties processing euro-denominated transactions be present inside the eurozone⁵, one can see the risk of icebergs ahead of us.

³ Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), signed in Brussels on 2 March 2012. See <http://european-council.europa.eu/eurozone-governance/treaty-on-stability>

⁴ Cases T-496/11 and T-45/12 before the General Court of the European Court of Justice. See OJ C 340/29, 19.11.2011.

⁵ "The absolute and relative size of an offshore CCP's euro-denominated business provides a useful proxy for the potential implications of this CCP for the euro area. The Eurosystem applies thresholds for application of the location policy to CCPs similar to those for payment systems. However, taking into account the specific nature of the CCP business, the threshold of €5 billion applies to offshore CCPs that on average have a daily net credit exposure of more than €5 billion in one of the main euro denominated product categories. The location policy is applied to all CCPs that hold on average more than 5% of the aggregated daily net credit exposure of all CCPs for one of the main euro-denominated product categories. This means that CCPs that exceed these thresholds should be legally incorporated in the euro area with full managerial and operational control and responsibility over all core functions exercised from within the euro area."

European Central Bank, Eurosystem Oversight Policy Framework, July 2011, <http://www.ecb.int/pub/pdf/other/eurosystemoversightpolicyframework2011en.pdf?737e79a9304c3b8285cc3e7a1761067b>

However, enforcement of Treaty rules by the European Commission and Court of Justice, together with political statesmanship and prudence, are capable of steering relations between London and the rest of Europe in a constructive direction, one in which the City will be able to prosper in a stable single market setting. The European Commission will continue to apply the EU treaties to all Member States and companies on an equal footing. The single market must not be undermined.

The UK has a strong interest in resolution of the eurozone's problems. It has a surplus in financial services with all of its leading trading partners. In 2010, the City's surplus with the rest of the EU was £13.3bn, 38% of the total, compared to £7.9bn with the USA⁶. The eurozone is the City's hinterland and its home market. Meanwhile, the weaknesses of the eurozone economies are not very different from many of those found in Britain. Europe has problems and Europe is solving them.

We are living through two related financial crises in Europe. The first, starting in 2007, had its roots in poor management, inadequate regulation and lax supervision. It is usually associated with the US subprime mortgage market and the associated spread

⁶ See TheCityUK, UK Trade in Financial and Professional Services, Economic Trends series, December 2011, p. 4: "The geographical breakdown for UK trade in financial services shows that the UK recorded a significant surplus with the EU, the US and Japan in 2010. The US is by far the most important single country destination, with the UK recording a net surplus of £7.9bn in 2010, down from £9.4bn in the previous year. The aggregate trade surplus with EU Member States totalled £13.3bn in 2010, equivalent to 38% of the trade surplus in UK financial services. The EU balance included surpluses of more than £2bn with each of the Netherlands, Germany and France and over £1bn with Luxembourg and Ireland. Outside the EU and the US the largest surpluses were recorded with Switzerland £1.4bn, Japan £1.1bn, Australia £859m and Canada £846m."

of toxicity through an unprepared financial world. The second crisis is home-made and brings together another toxic mix: weak eurozone governance, uncontrolled debt and deficit levels in some countries and lack of competitiveness in others. The first gave rise to the G20-driven agenda now being implemented around the world. The second has led to national retrenchment measures and, in the eurozone, to EU/IMF recovery programmes in several countries and a massive political effort to create a binding set of fiscal rules by international treaty.

Both of these crises and measures taken to resolve them affect the City.

The reality of today's single market and the rules governing it means that a lot of the new wave of regulation in response to the financial crisis comes in the form of EU law. The G20 and the Financial Stability Board have agreed a wide set of commitments on such issues as bank capital, liquidity and leverage ratios, a resolution framework for banks in difficulty, credit rating agencies and derivatives trading. These commitments are now being implemented in law. In the EU, because it is a single market and there is an undisputed consensus among its leaders that it needs a "single rule book", that means a mixture of European regulations which are directly enforceable in each Member State and directives which need to be legislated into each country's national law. As a result, it is increasingly EU law originating in global commitments which sets the rules by which the City operates. That should not be surprising when one recalls that the crisis was and remains international. Rules enacted nationally by

each country are likely to be ineffective and to invite regulatory arbitrage. Need I add that the record of the recent past shows this abundantly? There is no World Finance Organisation with law-making powers above States. We are fortunate here in Europe to have a regional organisation like the EU to reach decisions and make binding rules. So one thing the crisis has already meant for the City is that it is more subject to European law than it was before. This is not something to worry about; it's a reality to work with. The single rule book is not a uniform straitjacket and must contain the flexibility needs to allow agile national authorities to react to local circumstances without undermining the fundamental integrity of the single market.

Is the single market working in financial services? Yes, but not well enough, and the sooner we can get back to our core business of improving its performance instead of coping with the crisis and its aftermath the better. According to the Financial Times⁷, "the assets of cross border funds rose 182% in real terms between December 2001 and December 2011, to €2.25 trillion, doubling their market share to 43%...the trend has been driven by regulations enabling houses to create funds in one country and passport them into others". In another recent article⁸, the FT reported research demonstrating that "trends in European fund platforms show there has been progress towards a single market".

⁷ FTfm, 27 February 2012

⁸ FTfm, 4 March 2012.

That is the single market at work, with smart European regulation opening it up to cross-border business.

The City plays a very active part in the consultation processes which go into making EU law and policy. The British Government is of course a key participant in those processes and in the legislative work of the Council. British MEPs are prominent participants in the work of the other "co-legislator", the European Parliament.

How influential is the British view? I make the assumption, largely substantiated in my experience, there is enough consensus in Westminster, Whitehall and the City to engender a common position on most European financial regulation issues most of the time. This is not very different from the situation in other Member States with important industries. Thus, for example, one would expect Germany to be very active in framing EU policies affecting cars and chemicals. One can multiply examples across Member States. So yes, the UK has considerable experience in the development of European financial sector policies. It has a major national interest in their success and a great deal of experience, mostly good, some painful, to bring to the table.

The EU's implementation of the G20 agenda will give the City high quality regulation and a stable level playing field in its home market, from which base it can carry on shining in worldwide competition. European supervisory authorities now coordinate the work of national supervisors, ensuring that uncoordinated reactions to cross-border issues are a thing of the past. The UK

will add national regulation where appropriate and essential supervision of the City will remain in the hands of British authorities. There is a consensus that there must be no return to the uncoordinated, light touch failures of the pre-crisis years.

What do adversaries of the EU fear? Apparently that the City will be suffocated by excessive regulation designed by and for policy and law makers who do not have its best interests at heart. The more conspiracy theory-minded, who seem to thrive in the British debate on Europe, will speculate about dark French threats to move City business and jobs to a new greater Paris, spreading from the sinister-sounding La Défense all the way up to the shores of the English Channel. This is to ignore the reality of EU law and how it is made. In the preparatory phase in the Commission and then in the legislative process in the European Parliament and the Council of Ministers, the arguments are all about the lessons to be learned from the crises, the international context, the particular concerns of Member States, the protection of consumers and investors, the importance of the "industry" and its structure and place in the national, European and global environments. Of course the City is a much larger financial centre than any other in Europe. This is duly reflected in EU outcomes. Not once has the UK been outvoted on a financial services proposal since Michel Barnier was appointed Commissioner.

The system is working well and producing results. This is not recognised as much as it should be. Recently when, after months of debate and effort, the European Parliament and the Council of Ministers reached agreement on a hugely important and complex

regulation on derivatives⁹, how was this achievement presented in some British media? As a triumph for patient, determined diplomacy, collective European endeavour and the EU's institutional framework? As the fulfilment of a major G20 commitment ahead of many of our international partners? As a welcome demonstration that the EU is capable of reaching consensus on major regulatory reform in the financial sector? Or as a victory for doughty Britain against wicked foreigners? No marks for guessing.

Britain is not alone in claiming domestic credit for European success and blaming national failures on Brussels. 'Twas always thus. But we must be careful not to undermine the credibility of the EU system.

So let's concentrate on facts and ignore xenophobic conspiracies. They may sell newspapers and fill blogs, but they do not help anyone understand important and complex realities.

Will the fiscal compact treaty lead the 17 eurozone countries, accompanied by nearly all other EU countries, down a path of economic integration towards a protectionist single market of their own, leaving the UK outside? If lots of mistakes are made, something like that could happen. But not necessarily. The European Commission and Court of Justice, not always the most appreciated of institutions in Britain, are resolute guardians of the EU, its law and its single market. 40 years of British membership of the EU have created lasting habits of cooperation. The

⁹ <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/91>

eurozone and its treaty partners include many close friends of Britain, bound to it by historical ties and sharing similar economic and international outlooks. They do not want Britain left outside. Britain, from all I see and read, does not seek isolation either.

So my answer to the question is that the resolution of the euro crisis will bring stability and opportunities to the UK's financial services industry.

12 March 2012