European Trade Union Confederation (ETUC)
Confédération européenne des syndicats (CES)

EXECUTIVE COMMITTEE

Brussels, 13-14 October 2010

Financial Market Reform in the EU - state of play

Annexes:

- Bank levies in the EU
- Forthcoming financial market regulation as announced by the EU Commission on 2 June 2010 (COM(2010) 301 final)

John Monks, General Secretary
Boulevard du Roi Albert II, 5 • B - 1210 Bruxelles • Tel: +32 2 224 04 11
Fax: +32 2 224 04 54 / 55 • e-mail: etuc@etuc.org • www.etuc.org

Financial Market Reform in the EU - state of play

I. Executive summary and introduction

1. Two years after the crisis culminated in the collapse of Lehman Brothers banks, it is time to take stock of the action taken by governments to reform the global financial architecture and regulate financial markets.

2. Among many policy makers and financial market experts in Europe and the US, the view is still prevailing that the financial and economic crisis has resulted from a series of unfortunate, though interrelated mishaps in allegedly efficient financial markets. To overcome the current drawbacks, it would be sufficient to merely devise a few new rules and change some existing ones and the system could get back to normal. Accordingly, those same people warn against tighter rules that allegedly hamper future growth. To date, a huge armada of financial lobbyists has managed to successfully obstruct reforms of the financial sector that would genuinely overhaul its fundamental flaws and rebalance the world of finance with the needs of sustainable growth in the real economy.

3. Other politicians, albeit in a minority position, the ETUC together with the international trade union movement, many academics and civil society organisations have taken a different view, pulling together the different strands of financial reform, striving for a new and sustainable growth model of full employment and social justice that would reassign a commensurate role for finance in society and the economy. In its resolution of October 2009, the ETUC Executive Committee called on governments and the European institutions to ensure that the national, European and global regulatory architecture provides for a banking system that delivers stable and cost-effective financing for the real economy, thereby enhancing growth, stabilising macro-economic volatility, and allocating finance to socially beneficial use.

4. The crisis for banking institutions and their managers seems to be over. The huge bail-out programmes have not given rise to any more socially responsible behaviour in the banking sector but have in fact added to moral hazard and widespread self-service mentality. Reforms undertaken so far have been shaky and hesitant, the preliminary assessment of them is mixed at best and the outlook for future progress rather bleak. Reform steps have remained incremental.

5. The leaders of the G20 have not met their own commitments formulated at their meetings in London, Washington and Pittsburgh. The outcome of the June 2010 G20 Toronto Summit revealed not only different approaches to financial reform among the G20, moreover governments have given up a uniform agenda for the regulation of global financial markets. While the US approach has focused more on the size of financial institutions relative to the economy ("too big to fail") to prevent further massive bail-outs financed by the tax payer, the Europeans have sought to raise capital requirements for banks in the framework of the Basel institutions ("Basel III", to become effective in 2019), however with lacklustre resolve. Fundamental divergences among the G20 on monetary and fiscal policy, on financial sector taxation, on minimum capital

requirements for the banking system, on derivatives and on hedge funds represent a major step backwards from their commitment in April 2009 to establish "much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards that a global financial system requires".

6. For the ETUC it is therefore even more important that European governments and institutions achieve consistently high standards of financial regulation both within the regulatory space of the European Single Market and the G20. In addition to five member states, the EU itself has a seat in the G20, and the ETUC will continue to actively take part in global trade union consultations with the G20. Tough regulations of financial institutions will make little sense when not pursued at the supranational level of the Single Market. For when one nation relaxes regulations, it sparks off a race to the bottom and harms all others by attracting foreign capital inflows, forcing the more regulated economies to loosen regulation and/or raise interest rates and lead banks to take more risk. Competition among EU Member States to attract financial investors and innovative financial products promising high rates of capital return is leading to a persistence of national caveats, thereby creating loopholes in a prospective EU regulation. The attitude of the EU Council runs counter to a truly harmonized set of core rules in the EU, mounting obstacles to creating both a single European financial market as well as a level playing field against regulatory arbitrage. When it comes to the transfer of executive power from Member States to the European level, one can observe the re-emergence of the traditional clash between a nationally oriented Council, a pro-active European Parliament and the Commission acting cautiously with regard to the Council. The ETUC strongly supports the European Parliament which is at the forefront of financial regulation in the EU, whereas the Council has sought to water down substantially the proposals that are on the table.

II. <u>The trade union agenda for financial market reform</u>

7. The ETUC Executive Committee resolution of October 2009 set out a ten point agenda for financial reform, which called for a robust regulation of financial markets and covered:

   1. Sufficient enforcement powers of supervisory authorities
   2. Regulation of hedge funds and private equity groups,
   3. Regulation of rating agencies,
   4. Abolishment of tax and regulatory havens,
   5. Taxation of financial transactions, at least at European level,
   6. Sufficient capital reserves requirements and standards,
   7. Remuneration and bonuses schemes which reflect long term and sustainable performance,
   8. Protection of working families against predatory lending and miss-selling of risky financial instruments,
   9. Encourage the diversity of the financial service sector through a functional separation of institutions and
   10. Democratisation of finance through high standards of social dialogue and the involvement of trade unions at all levels.

The following section sets out the current state of play of financial market reform, juxtaposing policy progress being made (if any) with our demands and priorities.

II.1. Supervision of financial markets

8. On 2 September 2010, the EU institutions achieved a compromise deal in trilogue negotiations on a new European System of Financial Supervision (ESFS) architecture, setting up a pan-European regulator composed of three new European Supervisory Authorities for micro-prudential supervision (ESAs, for Banking ([EBA], Insurance and Pensions [EIOPA], Securities and Markets [ESMA]) and a European Systemic Risk Board (ESRB) for macro-prudential supervision, which will become up and running by January 2011. The new authorities will have binding rights to intervene in the markets and act vis-a-vis national supervisors. The legislation was approved by the Council on 7 September and formally adopted by the Parliament on 22 September, and constitutes an important step forward, paving the way for a new EU financial architecture and strengthening the regulation of Europe's financial markets.

9. The ETUC was able to achieve considerable progress on strengthening the terms of the Commission's draft legislative acts and to establish a genuine European supervisory authority for banks, securities and markets as well as for insurance and occupational pensions. The joint ETUC/UNI europa network submitted proposals for amendments to the EP, all but one of which were adopted by the EP. The objective has been to open up the closed shop mentality of central bankers and the financial community and to ensure trade union representation with voting rights on the General Board of the ESRB (Article 6 of the ESRB Regulation adopted by the EP). However unfortunately, the final version of the compromise adopted in the trilogue no longer contains this provision, but confines trade union representation to the Advisory Scientific Committee (article 11a). The other three ESFS regulations would strengthen the role of trade unions in the respective Stakeholder Groups of the European authorities.

10. The legislation will ensure the new authorities will be more important than originally foreseen in the De Larosière report or by the Commission and Council. The European Parliament will be able to veto the appointment of ESA chairpersons and may request the Council to declare an emergency. A revision clause stipulates that in years time the effectiveness of the supervisory system needs to be assessed and accordingly reinforced. Among the key details of the legislation are:

- The banning of certain financial products;
- Consumer protection on financial markets;
- Binding mediation in case of conflicts between national supervisors;
- Power to directly address decisions to financial institutions and national authorities - in case of emergency, if national authorities do not act appropriately, the European Authorities are able to address binding decisions to national authorities, and if they still do not act, directly to the financial institutions concerned;
- ESA in colleges of supervisors - to ensure a coherent and consistent functioning of supervisory colleges for cross-border institutions, the EU authorities will be equal

partners in those colleges of national supervisors, breaking the dominance of national supervisors;
- Internalisation of costs - the authorities will play a key role in designing a European system of deposit guarantee schemes and banking resolution funds. This is however not a substitute for a financial transaction tax or other forms of financial sector taxation;
- Monitoring of systemic risk - the ESAs will be in charge of monitoring systemic risk and developing adequate stress testing for institutes which may pose systemic risk;
- Future transfer of tasks to the authorities - an enabling clause makes sure that ESAs can assume additional supervisory powers for derivate trading and credit rating agencies. It is now up to the Commission to provide ESMA with these in upcoming legislation, in particular with regard to derivatives and market infrastructure;
- Involvement of trade unions and the non-profit sector in advisory stakeholder groups with a provision of adequate financial compensation;
- External experts including trade unions as voting members in the ESRB - this will for the first time open up the so far closed system of the ECB

11. The agreement between Council and EP foresees that additional supervisory powers shall be conferred to for the ESAs through future legislation, including market infrastructure, such as trade depositories and central counter parties. The European Parliament hopes to strengthen the adopted regulations in the near future on matters where agreement with the Council could not be found.

II.2. Regulation of hedge funds and private equity

12. Among the measures intended to increase transparency in financial markets, only the Alternative Investment Fund Managers' Directive (AIFM) has come close to completion, regulating for the first time the highly speculative 'shadow banking' sector. The European Parliament managed to strengthen substantially the obligations for AIFM set out in the draft of the Commission based on compromises between the groups of EPP, S&D, Greens and parts of ALDE. The ETUC together with UNI europa submitted proposals for amendments to the EP, which were subsequently tabled by MEPs from the Greens and the S&D groups, a large majority of which were adopted by parliament. However, contentious issues between the EP and Council, such as the third country rule, illustrate the difficulties for some Member States to endorse the internal market principle so as to achieve a level playing field in European financial market regulation.

13. On 17 May, the EP Economic and Monetary Committee (ECON) of the European Parliament adopted the Alternative Investment Fund Manager Directive (AIFM), regulating the highly speculative 'shadow banking' sector of hedge funds and private equity funds. The EP managed to strengthen substantially the obligations for AIFM set out in the draft of the Commission. It is significant that a large cross-party majority of 31:11:3 votes (31 in favour, 11 against and 3 abstentions) was reached on the basis of compromises between the groups of EPP, S&D, Greens and parts of ALDE. Since then, trilogue negotiations between the Council, the Parliament and the Commission have been ongoing, with the Council playing a particularly obstructive role. At the time of writing, it is still unclear whether EP rapporteurs and shadow rapporteurs will prevail in

the tough trilogue negotiations with the Council to achieve adoption of this important legislative act in a single reading procedure by the end of September.

14. Among the most contentious issues are the third country rule, the European passport for AIFM based within the EU and those provisions in articles 26 to 30 that are specific for private equity funds. In the version of the EP, the latter would give workers significant social rights vis-à-vis the owners/shareholders of the companies that are taken over by a fund. This was harshly criticised in a joint letter from the French MEDEF, the British CBI and the German BDI as allegedly running counter to the European system of corporate governance. The ETUC in contrast highly welcomes the EP's view as well as its decision on third countries. This addresses the 'footprint' of hedge funds not being domiciled in the EU and the problem of offshore funds being used for tax and regulatory arbitrage reasons; it has caused considerable protest from fund managers outside the EU, i.a. US funds domiciled on the Cayman Islands, and led US Secretary Treasurer Tim Geithner to attack "European protectionism". This was reflected in the G20 Summit declaration in Toronto which made reference to regulation of hedge funds in a "non-discriminatory way". For the continuing trilogue negotiations, it will be important to raise the internal market principle to achieve a level playing field in European financial market regulation. At the time of writing, the trilogue negotiations were still ongoing without any clear indication as to how and when the blockage would be eventually overcome. Opt-outs and phasing-ins are equally on option as is another postponement of the EP vote or a vote notwithstanding the trilogue.

II.3. Regulation of rating agencies

15. Conventional wisdom is that credit rating agencies (CRAs) contributed significantly to the financial crisis by underestimating the credit risk of structured credit products. CRAs issue opinions on the creditworthiness of companies, governments and sophisticated financial products. The Commission proposed new EU-wide rules in 2008 that put in place a common regulatory regime for the issuance of credit ratings. Under these rules, which will become fully applicable in December 2010, all CRAs now need to apply for registration with the European Securities and Markets Agency ESMA. The issue of conflicts of interest affecting ratings are also addressed, as CRAs cannot also offer consultancy services to the clients they are rating. However, since the euro has become the target of massive speculative attacks in spring 2010, backed up by downgrading of sovereign debt in Greece, Portugal and Spain, the ECOFIN Council, at an extraordinary meeting on 9 May, underscored the need to make rapid progress on financial market regulation and supervision, in particular with regard to the role of CRAs.

16. On 2 June 2010, a communication from the Commission proposed a revision of the 2009 CRA regulation, entrusting the future European Securities and Markets Authority ESMA with centralised European oversight and exclusive supervisory powers over CRAs that are registered in the EU. This is currently under scrutiny of the European Parliament and should provide an opportunity for the ETUC to underscore its position that the EU should set up a public and independent European non-profit organization CRA, funded by the European budget and supervised by the ESMA.

II.4. Abolishment of tax and regulatory havens

17. Almost no progress has been made to abolish harmful tax competition and to achieve more transparency in financial reporting. The cornerstones of the EU tax debate are as follows. Firstly, in the EU Lisbon Treaty, taxation has remained primarily and almost exclusively in the remit of member states. For countries belonging to the euro zone, matching monetary union with a true economic union is badly needed, yet enhanced coordination of economic policies continues to be restricted to the expenditure side of fiscal policies, excluding for the time being tax policy coordination between member states and a European system of corporate taxation. Within the current debate on European Economic Governance and EU 2020 (see agenda item 6) it is totally unacceptable that taxation should remain a matter of competition among member states whereas social and infrastructure spending is cut in a coordinated and simultaneous way. Secondly, while there should have been an opportunity to bring new member states' tax regimes more in line with the European social model, regrettably none of the rescue packages and support programmes for some of the new member states contained conditionality to substitute flat tax regimes for progressive income and corporate taxation. Thirdly, one of the main drivers for investors to put money in private equity funds has been the sophisticated tax saving model that a majority of the fund models provide. Yet this has not been subject of the debate in regulating Alternative Investment Funds. Fourthly, on corporate taxation, attempts by the Greens and the Social Democrats in the EP to establish country-by-country reporting obligations for European companies have been rejected by both the Council and the Commission. However, as part of the EU commitment for more transparency in financial markets, the EP obtained a commitment by the Commission to adopt a communication on country-by-country reporting by September 2011. Fifthly, the European institutions have not yet found sufficient answers to the liberalisation of financial markets and modern communication technologies that have made it considerably easier for individuals and corporations, including from the financial sector, to go "off-shore" to evade taxes legally due. This, combined with the lack of transparency and effective cooperation between tax administrations, has made offshore non-compliance easier. In its evaluation of the de Larosière Report, the ETUC insisted that it was clearly not sufficient for European member states and dependent jurisdictions not to appear on the OECD's black or grey lists. There are still a significant number of tax heavens and 'competitive tax regimes' within the jurisdiction of the EU, which the ETUC is firmly opposed to. Good governance in the field of taxation must be the rule.

II.5. Financial transactions taxes

18. The ETUC is a founding member of the coalition "Europeans for financial reform" (EFFR) campaign, organised by the Global Progressive Forum. Membership extends now over political parties (PES, Greens), ETUC affiliates, ITUC and Global Unions and NGOs. Among the themes of the campaign, the introduction of financial transaction taxes (FTT) at global or at least European level has become the focal point of the coalition.

19. The IMF has lately become more supportive of FTT. A staff paper, "Taxing Financial Transactions: Issues and Evidence", states that securities transactions taxes (STT) existed in many countries with little evidence that they distorted markets. It argues that a small levy on transactions might help to dampen the "herding behaviour". "The fact that major financial centres such as the UK, Switzerland, Hong Kong, Singapore, and South Africa

levy forms of STTs indicates that such taxes do not automatically drive out financial activity to an unacceptable extent. (...) The impact on financial markets from a low-rate (less than 5 basis points), broad-based STT would likely be fairly modest, beyond its reduction of very short-term trading."

20. The failure of the G20 Toronto Summit to reach agreement on coordinated action to tax the financial sector globally has led governments in Europe (mainly France, Germany, Belgium, Austria) to pursue FTT at European level. On 10 March, an overwhelming majority of Members of the European Parliament in a resolution pushed the EU executive to weigh up the costs and benefits of a possible EU FTT on financial trading to compensate taxpayers for bank bailouts and plug public deficits, however parts of the Commission have continued to play an obstructive role by means of publishing working papers, such as the largely criticised "Innovative Financing" in March or the Non-paper on "Financial Sector Taxation" in preparation of the extra-ordinary meeting of ECOFIN on 7 September 2010.

21. Countering this, the ETUC has intervened several times in writing vis-à-vis the European institutions, urging them to discuss the clear benefits of FTT as a separate and equally valuable tool aside from and additional to the various proposals emerging around bank levies and resolution funds for future crisis. The ETUC has been stressing the importance of a FTT in raising the money to close deficits without damaging public expenditure cuts, while also providing the money needed to fight poverty at home and abroad and tackle climate change. Our main argument has been that workers and their families are paying a triple bill for a crisis they have no responsibility for: as job holders who are facing high and rising unemployment; as taxpayers who are facing social austerity and higher taxes for less public sector services; and as parents who are facing less quality in education, training and good quality jobs for their children. Now that the monetary tool boxes are almost empty, the ETUC believes that a FTT on all transactions can contribute to re-pay the costs of the crisis and fund other public good objectives.

22. Many ETUC affiliates are involved in national coalitions for financial transaction taxes, such as the Robin Hood Tax in the UK, Make Finance Work in France and the Netherlands, the Coalition for Decent Work in Belgium, action in the Nordic countries, the Tax against Poverty in Germany, or Zero Zero Five in Italy. The Europeans for Financial Reform are now hoping to call together pan-European organisations and national coalitions supporting financial transaction taxes, to step up the pressure for a European level initiative. In order to strengthen national campaigns supporting FTT, the ETUC has called on affiliates to intervene vis-à-vis their governments. Existing regulation on bank levies in the EU member states is listed in a table annexed to this document.

23. The European Council at its meeting on 17 June agreed that the member states should introduce systems of levies and taxes on financial institutions and asked the Council and the Commission to take work forward and to report back in October. On 7 September, an extraordinary meeting of the ECOFIN Council discussed the possible introduction in the EU of a FTT, and agreed to continue the debate at an informal meeting on 30 September - 1 October. The communiqué states that along with bank levies, FTT is "one of a number of ideas being discussed as a possible component of a new crisis management framework at EU level". On 28 September, President Barroso declared that "the Commission will present proposals for taxing financial activities" and that "the EU would continue to discuss global financial transaction tax with our international

partners". The Commission will likely publish a policy recommendation against FTT on 7 October, favouring a much softer 'Financial Activities' Tax' at the discretion of national governments of the Member States. The ETUC in cooperation with EFFR will reject any distraction from an internationally coordinated effort to introduce FTT.

II.6. Sufficient capital reserve requirements and standards

24. European legislation on capital requirements has continued as work in progress. Rules on capital standards and the possible utilisation of capital are listed in the Capital Requirement Directive (CRD) of 2006, which transposes the Basel II framework accord on credit institutions' capital adequacy into EU law and which is subject to revision in two new Directives (CRD III and IV). In parallel, the Basel Committee on Banking Supervision (BCBS) has worked on changes to international capital and liquidity requirements ("Basel III accord"), in preparation of which the EU has not played a leading, but a wait and see role. In contrast to this, the ETUC put forward that the EU should not wait for an agreement on international guidelines to be reached before moving on its own legislative process.

25. The BCBS and the Financial Stability Board have concluded in a joint study published in mid-August that economic growth is not very sensitive to tighter capital standards. Yet the banking sector, in particular the Institute of International Finance, is fiercely opposed to any more capital tightening, putting the argument forward that this would risk stifle the recovery. The Basel III rules would stymie the banks' ability to function and curtail lending. Banking associations but also industry federations such as the MEDEF or BDI are doing their utmost to fend off any potential profit cuts for the banking sector.

26. It is therefore worrying that the Basel institutions already watered down significantly their reform proposals between December 2009 and July 2010, lowering liquidity rules and allowing higher leverage. According to the Basel agreement of 12 September, the minimum tier one capital ratio is likely to be raised from currently 4 per cent to 8,5 per cent. The core tier one ratio, which is defined as the highest quality capital, is set to rise from 2 per cent to 4,5 per cent starting in 2013.. Until 2019, banks will also have to build-up so-called additional buffers of 2,5 percentage points of tier-one capital, with a further 2,5 percentage points required of those deemed systemically important by national regulators at their discretion. From 2017 onwards, the leverage ratio will likely be set at 3 per cent, meaning that the balance sheet total is restricted to 33 times the amount of tier one capital. A formal endorsement of the proposals including a timetable for the phasing-in periods of the different measures is on the agenda of the next G20 Summit meeting in Korea (11-12 november 2010).

27. The week following the announcement of the details of a Basel III accord, the price of bank shares soared in the majority of EU Member States. Expressing their discontent with the compromise found in the Basel Committee, national regulators such as the FSA in the UK and FINMA in Switzerland have announced their intention to further tighten capital requirement rules at national level (10% core capital for Swiss banks), a move that subsequently was fiercely opposed by the president of the Institute of International Finance and CEO of Deutsche Bank, Josef Ackermann, The ETUC welcomes tighter capital requirements and calls on the EU institutions to shorten the phasing-in period in implementing the Basel III accord in the European Union.

28. On 7 July, the European Parliament adopted the CRD III Directive "Capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies". This part of the CRD revision process constitutes a positive step in the right direction. It has led to agreement on: -an increase (near doubling) of the amount of capital held against the trading book; -higher capital (almost trebling) to be held against re-securitizations; -a more rigorous capital adequacy regime for off balance sheet exposures; - the establishment of supervisors' colleges for the 40 largest cross border institutions operating in the EU, albeit their limited margins for manoeuvre.

29. However in addition to strengthened capital adequacy requirements for trading, securitisation and structured products, further revisions of the CRD are required. After a public consultation procedure in the spring of this year, the Commission decided to put the announced CRD IV revision on hold until the Basel institutions will reach an agreement on a Basel III accord, which in turn would come into effect in 2018 the earliest. This is a serious sign of weakness, for it buys precious time for the banks and will allow financial institutions to continue to pile up leverage and credit risk and to rely on public support at the expense of all.

30. The ETUC has criticised that instead of going ahead, the Commission regards an agreement in the framework of the Basel institutions as a prerequisite for strengthening capital requirements for banks combined with a reversal of pro-cyclical accounting in banking. Yet changes in the IFRS and US GAP standards, which promote pro-cyclical mark-to-market accounting, and a convergence of the two systems of accounting, currently seem as unlikely as before the crisis.

31. Stress tests are normal measures that banks undertake to weigh their risk exposure and define future lending policy. In its October 2009 Executive Committee resolution, the ETUC put forward the demand for an EU wide stress test of banks through a generalised and non-discriminatory insight in the books of banks, insurances and other financial institutions. This would pursue the objective to restructure the financial sector so as to put it back on a healthy basis. Because of the huge uncertainties resulting from the crisis, the ETUC demand was harshly resisted by the big private banks in question, until the ECB conducted the stress test for 91 major banks in Europe during the spring of 2010. The results sparked scepticism for only few banks failed the stress test. In addition, it turned out that the highest exposure to risk for banks, i.e. sovereign debt of Southern Europe and Ireland, was not properly taken account of. Stress tests must in the future be conducted on a regular basis by the European System of Financial Supervision, forcing banks to raise their tier one capital ratios if needed. Only then confidence can be restored.

II.7. Remuneration and bonuses

32. Banks' executive pay and remuneration policies have been based on perverse incentives geared to short-term success at the expense of long-term profitability and, in some cases rewarded outright failure. This has fostered a culture of excessive risk-taking by financial institutions, from banks to hedge funds, and brought the world economy to the brink of collapse. Banks paid bonuses on the basis of expected profits from the deals that traders were making, the bigger the risk, the bigger the potential profit and the bigger the

bonus. While governments have pumped billions of taxpayers' money into failing banks, their high-earning bosses have stayed out of the public view.

33. By adopting the CRD III Directive on 7 July, the European Parliament proposed new rules for bonuses and remuneration that would be the strictest in the world. If EU governments agree to the proposals, from January 2011 bankers will be able to take only 30% of the total bonus in cash. For particularly large bonuses the upfront cash limit is set at 20%. Between 40% and 60% of any bonus must be deferred for at least three years and can be recovered if investments do not perform as expected. Moreover at least 50% of the total bonus will be paid as "contingent capital", funds which would serve first in case of bank difficulties, and shares. With the proposal, supervisory authorities are enabled to impose capital 'sanctions' on financial institutions.

34. The ETUC has welcomed these measures as steps in the right direction. However, as financial markets have recovered and showing pre-crisis turn-over rates, we warn against a new round of record bonus levels for top managers of financial institutions at the end of this year. Massive bonuses for the few and massive austerity measures for the many would provoke a massive backlash in our democratic societies. Financial institutions including their managers' remuneration must contribute to pay for the crisis.

II.8. Derivatives and OTC trading

35. The Greek crisis has highlighted once more the destabilizing power of derivatives, in particular, credit default swaps (CDS) and those traded over-the-counter (OTC). These customized contracts in which two parties place bets on the movement of prices for other assets, in this case Greek sovereign bonds, brought Greece onto the brink of insolvency, by forcing the government to raise fresh money at prohibitive interest rates. The joint EU/IMF rescue plan for Greece, amounting to €135bn, has also served as a wake-up call to the European institutions to announce a regulation of OTC derivatives. A communication from the Commission, requiring derivatives to be traded through central clearing houses, is still awaited for 15 September.

36. In preparation of this, the Commission launched two public consultations on derivative markets and short-selling during the spring of 2010. The ETUC, together with UNI Europa Finance, took part in this in writing. The main questions from the Commission were ranging over mandatory and centralised clearing, the clearing obligation for non-financial counterparties (e.g. industrial companies, airlines), and organisational requirements for centralised counter-parties (CCP). The ETUC's view was that the clearing obligation should apply to all derivatives. Non-financial (corporate) counterparties may have legitimate interest in building hedging positions which shield them from market volatility and high fluctuation in prices. However it has become practice in many non-financial corporations, in particular their finance departments, to behave like financial institutions and engage in derivative trading at volumes largely exceeding their productive needs.

37. On 15 September, the Commission adopted proposals for regulations on OTC derivatives, central counterparties and trade repositories and on Short Selling and Credit Default Swaps. Intensive lobbying has again yielded fruit for vested interests, as European companies have managed to persuade the Commission not to force them to use clearing

houses for over-the-counter derivatives trades. According to the Commission proposal they be given exemptions. The European Association of Corporate Treasurers (EACT), composed of large industrial companies like Siemens, Eon, Lufthansa and Rolls-Royce, has been at the forefront of lobbying. The Commission draft now proposes thresholds that will determine whether non-financial users of OTC derivatives need to use clearing. The ETUC together with UNI Europa Finance will follow the legislation process closely and work with the European Parliament to close these in-built loopholes of the regulations.

II.9. "Too big to fail" and functional separation of institutions

38. While most measures so far have put the emphasis on preventive measures, too little not enough has been done that would clear up the mess when financial institutions run into trouble. Commission proposals adopted in May 2010 to let each Member State define its own conditions for setting up national bank resolution funds to prevent future crises show fundamental flaws in cross-border management. They also do not satisfactorily answer the question of who should pay for the enormous damage that this very banking sector has inflicted on public finances, employment and the European economy as a whole. To get to the root of the problem, crisis prevention policies must restore the fundamental role of the financial system of intermediation, allocation and transfer of capital to productive and social use and roll back the transfer of credit risk to society at large. Such a new financial landscape would bear the following five attributes, all starting with the letter S: smaller in size, slower in speed, simpler in structure, separated functionally, less short-term oriented, and, resulting from this, more stable.

39. For the ETUC, a forced reduction in the size, complexity and functionality of systemically important financial institutions, e.g. through variable taxation rates or capital requirements, would be equally important steps to stabilize the financial sector. Re-establishing a functional separation should lead to a more diverse banking landscape and smaller institutions that are closer to their clients. These would offset some of the huge employment losses in the banking sector and at the same time better respond to investment financing needs of the real economy than big conglomerates that easily become "too big to fail" (TBTF).

40. In contrast to the US, where the proposed Volcker rules and the enacted Dodd-Frank financial reform bill (Kanjorski amendment) gives federal regulators the power and the responsibility to limit the activities or even break up big banks if they pose a "grave risk" to the financial system, European policy has remained largely silent about TBTF. The frequently used argument has been that European banks were not as big as those in the US, hence posing less danger for systemic stability. Looking at the size of banks as measured by their total assets relative to GDP, this view is at best naïve and misses reality. In the US, the six biggest banks' balance sheets (Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo) amounted to almost 70% GDP at the end of 2009. In the UK, the three biggest banks' (RBS, HSBC and Barclays) total assets were at 333% GDP; in France, BNP Paribas, Crédit Agricole and SocGen together amounted to 290% GDP; and in Germany, Deutsche, Commerzbank and HRE weighed 133% GDP in 2009. The most striking case in the EU is Ireland, where the three main banks, Allied Irish, Bank of Ireland and Anglo Irish, totalled more than 280% GDP in assets in 2008. After having received 14 billion Euros in state aid, the fully

nationalised Anglo Irish Bank in August 2010 received a further 10 billion rescue package. Allied Irish required further 3 billion in September, raising state ownership to almost 90 per cent. With bail-out cost totalling nearly 50 billion, the deficit in the Irish state budget will likely attain the vertiginous rate of 32% GDP in 2010. In Switzerland, the combined liabilities of UBS and Crédit Suisse exceed more than four times Swiss annual GDP. The Swiss authorities have announced to shorten the phasing-in of the Basel III implementation and to introduce caps on leverage already in 2013.

41. Caps on the size of banks relative to GDP, combined with a functional separation between investment banking branches and commercial and retail banking seems therefore vital and no deposit-taking bank should be allowed to engage in proprietary trading. This would counter moral hazard of banks to being almost certainly bailed-out for their sheer size, and prevent the financial system to take the whole of society as hostage.

II.10. Democratisation of finance and involvement of trade unions

42. Throughout the crisis, policy has disproportionately benefited banks and corporations while it has largely failed to help households directly and has instead relied on hopes of trickle-down effects from the bail-out of banks. It is therefore essential to end the closed shop and self-service mentality of financial institutions and to open up the self-referential financial and banking advisory groups that the Commission and national governments have surrounded themselves with. It is significant in this context to ensure that trade unions, consumers and other civil society organisations become part of those advisory groups and have their say in the future European System of Financial Supervision (see II.1. above).

43. On 20 May 2010, the Commission has appointed members of a Group of Experts in Banking Issues (GEBI) with the aim to “facilitate direct communication between the banking industry, consumers and the European Commission, Internal Market Directorate General”. The group’s role is to advise the Commission on policies and possible legislative proposals concerning banking regulation, and to provide information, forecasts and analysis concerning the possible impact of banking policies and possible legislative proposals on various stakeholders. The ETUC protested against the original composition of that group, among the members of which, only one should represent the trade unions in the banking sector. The Commission would be ill advised to follow the failed concept of self-regulation, letting the closed shop mentality of the financial community prevail.

44. The non transparent selection process for the GEBI was subsequently re-opened and a second trade unionist nominated, next to two from consumers’ organisations and a large majority from the banks themselves. In this context, Commissioner Barnier also announced to reconsider the composition of all financial advisory groups to the Single Market DG for a better balance.

45. On 27 September, members of the European Parliament from the Greens, the PES, the European Popular Party and the Liberals invited the ETUC, UNI Europa Finance, national trade union centres and civil society organisations to reflect upon the launch of a Finance Watch organisation, with the objective to organize counter-lobbying and

pooling counter-expertise to the banking lobby. Background of this has been the experience with the legislative process on financial regulation so far. MEPs , in particular rapporteurs and shadow rapporteurs, have repeatedly been swamped by thousands of amendments to their reports, most of which drafted by 'experts' from financial institutions and other vested interests. The ETUC has welcomed this cross-party initiative and declared our support to MEPs in building democratic public pressure for true financial reform.

III. Further steps

46. Until recently the Commission, in particular former Commissioner McCreevy, was acting slowly and remained reluctant to implement the de Larosière's recommendations fully into legislative proposals. In some cases, e.g. the regulation of hedge funds and private equity funds, it stayed behind them in both scope and content. Since Michel Barnier took over the Internal Market portfolio in February 2010, the Commission seems more resolved to complete the agenda agreed at the level of the G20.

47. On 10 June, the Commission adopted a communication entitled "Regulating financial services for sustainable growth". This lists four adopted measures on financial market regulation since 2009, four that are currently under negotiation and 26 forthcoming proposals, which the Commission is confident to conclude to the stage of legislation by the end of 2011. A full list can be found in annex II to this document. The ETUC will continue to follow closely the legislative work ahead, and work together with UNI Europa Finance and affiliates to shape financial regulation in the interest of workers and their families in Europe.

European Trade Union Confederation (ETUC)
Confédération européenne des syndicats (CES)

Annex I –bank levies in the EU

	EU level	Germany	France	Hungary	Sweden	UK
Objectives	Agreement has been reached by the European Council on 17th June that bank levies should be "part of a credible resolution framework".	Bank resolution fund (in addition to the existing re-insurance fund of corporate commercial banks)	General budget Further details in 2011 budget (September 2010)	General budget	Stability Fund (finance measures to counteract risk of serious disturbance to SE financial system)	General budget
Levy Basis	Common basis for levies should be the credit institution's liabilities less guaranteed deposits and bank capital	Bank's business volume, size, degree of integration in financial markets. Liabilities to other financial institutions will be considered. A twofold base: ○ balance sheet total minus liable capital and liabilities to customers ○ value of derivatives held off balance sheet.	"targeted on most risky business of banks"	On the basis of 0.5 percent of banks' assets over HUF 50 billion (app. EUR 180 m) at the end of 2009	The fee, which amounts to 0.036 % per annum, is levied on the institution's liabilities (excluding equity capital and some junior debt securities) according to an approved balance sheet. Only 50% of the fee will be charged in 2009 and 2010. New proposals planned for 2011 on the possible	Total liabilities (i.e. both short and long term liabilities) excluding: • Tier 1 capital; • insured retail deposits; • repos secured on sovereign debt; and • policyholder liabilities of retail insurance businesses within banking groups.

		Capped at 15% of credit institutions' annual profits			design of a risk-differentiated fee in a combined system with the deposit guarantee scheme	
Scope	Differences in the scope of national levies can result in credit institutions active in two or more Member States having to pay levies in more than one jurisdiction. Contributions should therefore only be levied by governments whose national authorities are responsible for supervision and crisis management of the institution. Levy would be imposed by each home Member State on institutions they supervise as well as their branches operating in other	Credit institutions (i.e. carrying out regulated banking activities such as deposit taking, lending, principal broking services, safe custody business). Collected on a single entity, not group basis.	Prefer a broad scope	Banks, insurers, brokers, and other financial service providers	Banks and other credit institutions incorporated in Sweden. The levy applies to the branches of banks operating outside Sweden, and to foreign subsidiaries established in Sweden.	Banks with aggregate liabilities of £20 bln or more • Global consolidated balance sheet of UK banking groups and building societies • the balance sheets of UK banks in non-banking groups; and • the aggregated subsidiary and branch balance sheets of foreign banks and banking groups

	Member States.					operating in the UK.
Amount of tax collection	Figures not available. Commission cautions Member States about levy "set so high that it damages prospects for economic growth".	€1.0 bln annually (estimate)	? €300m - €1bln (estimate)	€700m in 2010 – 0.7% GDP	Target to reach 2.5% GDP in 15years	£2½ bln annually

European Trade Union Confederation (ETUC)
Confédération européenne des syndicats (CES)

Annex II – Forthcoming financial market regulation as announced by the EU Commission on 2 June 2010 (COM(2010) 301 final)

Forthcoming proposals:		
UCITS – implementing measures	June 2010	June 2010
Revision of Credit Rating Agencies Regulation (EU-level supervision of CRAs)	June 2010	By end 2011
Green Paper on Corporate Governance in Financial Institutions	June 2010	By end 2011
Creation of a Financial Services Users Group	Summer 2010	n/a
Revision of the Deposit Guarantee Schemes Directive	July 2010	By end 2011
White Paper on Insurance Guarantee Schemes	July 2010	n/a
Revision of the Investor Compensation Schemes Directive	July 2010	By end 2011
Derivatives – legislation on market infrastructure	Summer 2010	By end 2011
Revision of the Financial Conglomerate Directive	Summer 2010	By end 2011
Second "Omnibus" Directive of changes to sectoral legislation to align it with the proposals on supervision	Summer 2010	By end 2010
Directive on legal certainty of securities holding & transactions	September 2010	By end 2011
Regulation on SEPA (Single European Payments Area), setting a deadline for transition to SEPA	September 2010	By end 2011
Communication on a framework for crisis management	October 2010	n/a
Measures on short selling/credit default swaps	October 2010	By end 2011
Initiative on access to minimum basic banking services	October/November 2010	By end 2011
Communication on sanctions in the financial services sector	December 2010	n/a
Revision of the Capital Requirements Directive (CRD4)	December 2010	By end 2011
Revision of the Market Abuse Directive (securities)	December 2010	By end 2011
Review of the Markets in Financial Instruments Directive	Spring 2011	By end 2011
UCITS – depositories function	Spring 2011	By end 2011
Implementing measures for Solvency II Directive on capital requirements for insurance undertakings	Spring 2011	By end 2011
Packaged Retail Investment Products legislative proposals	Spring 2011	By end 2011
Crisis management legislative proposal (including bank resolution funds)	Spring 2011	By end 2011
Insurance mediation Directive revision	Spring 2011	By end 2011
Further amendments to the Credit Rating Agencies Regulation	Spring 2011	By end 2011
Legislation on corporate governance	Spring 2011	By end 2011