Workshop V

"Levelling the Regulatory Maze"
Workshop on European Financial Institutions in Asia

The recent global economic turmoil has European regulators debating how to rein in financial institutions. Europe's watchdog agencies are preparing a regulatory response to the financial crisis that could come close on the heels of new rules in the United States, where the size and activities of banks are expected to be restricted.

Europe's reflections about the future were on the table at an Asian Financial Forum (AFF) workshop on 21 January entitled European Financial Institutions in Asia – Levelling the Regulatory Maze. The main speaker was Emil Paulis, Director of Financial Services Policy and Financial Markets for the European Commission (EC).

Mr Paulis said the EC was urging more member states not only to adopt the common Euro currency but also to accept stricter supervision of financial institutions. He said oversight needed to be on a European rather than a national level.

"With one approach or one voice, Europe will have the equivalent to the SEC [the Securities and Exchange Commission in the US], and Europe's will be – and I'm sorry to say so if Americans are in this room – better than the US," said Mr Paulis.

"We will have truly European bodies not only for banking, not only for insurance, but also for securities," added Mr Paulis, describing proposals he said would be in place by the start of 2011.

Mr Paulis said regulators were committed to creating a "level playing field" and to becoming "serious" about sanctions in the future. "It is unbelievable, it's laughable, how ridiculous the fines and sanctions are in the financial services sector," he said.

Ghosts of the Recent Past

Other workshop speakers pointed out a need to find ways to ease the pain of high-profile failures of institutions such as Lehman Brothers. Rory Gallaher, co-head of the Regulatory Committee of the Alternative Investment Management Association in Hong Kong, said

regulators must pay more attention to the recovery of fund assets in the event of a company going insolvent.

“There is an enormous amount of detail to be dealt with by way of subsidiary legislation. It’s inevitable that after periods of crisis there will be heightened regulations,” said Mr Gallaher. But he admitted that solutions would be difficult to find. “Hopefully we’re heading for a reasonable compromise. That’s one where nobody is satisfied.”

Mr Paulis said Europe wanted to find a new approach that was not solely focused on regulation and supervision but also pushed financial institutions to work out their own tools to resolve a crisis.

“Firms should have the mechanism at their disposal to help themselves and they should be the first line of defence. In principle, they should bear all consequences. They should prepare for consequences, and the taxpayer should not have to pay for it,” said Mr Paulis.

Hedge Trimming

The EC official said hedge funds were in for much closer scrutiny under new European regulations, even though many financial experts have said the funds were not directly responsible for the global turmoil.

Mr Paulis said the changes are part of European efforts to “go further” than simply repairing problems with the regulatory framework.

“We want to create a more integrated market for hedge funds and private equity as well. Our concept and our approach is not just crisis driven. Let’s be very frank: hedge funds can of course – through certain leveraging and through the cumulative effect that we have seen in the crisis – add to the negative spiral. They can contribute to the crisis.

“That does not mean that they are responsible for the crisis, but they can be a factor of instability at a certain point in time, and we do think that should be taken care of now. We should not wait until we have a real problem.”

Burden of Proof

Speakers at the workshop also debated proposals to change regulations that would impact liability when investments go bad. Mr Paulis pointed out that during the fallout from the Lehman Brothers failure, the burden of proof was on the investors to prove that the company did anything wrong.

“This cannot be right. If I entrust an asset to you, why on earth should I have the burden of proof? You should have the burden of proof that you did everything to avoid the loss of my assets,” said Mr Paulis.

“We therefore propose that the burden of prove should be inverted. Then we can talk about what should be the standard of proof,” he said, adding that the “standard of proof has to be adjusted to the type of duties of the depository.”

“I believe that we can’t have just one simple rule of standard of proof for all of these functions. We have to be more granular and we have to specify what are then the exact obligations of the standard of proof to apply to this.”

Balancing Act

Mr Gallaher said European financial institutions, including those based in Asia, were well aware that more regulation loomed and were ready to provide more information despite additional administrative burdens.

But Mr Gallaher voiced caution about proposals to “reverse” the burden of proof, saying it was a controversial approach that would dramatically increase the risk for depositories.

“That will have an impact obviously on the terms on which they will do business. It may reduce competition because many depositories will simply say they don’t want to do that kind of work anymore because the margin isn’t sufficient to justify the risk. I think it does have its dangers as an approach.”