# EUROPEAN FINANCIAL MARKET REFORM-WHAT THE NEW COMMISSIONER NEEDS TO DO

# The decision by President Elect of the European Commission, Jean Claude Juncker, to carve out financial services from DG Internal Market and establish a powerful new financial stability, financial services and capital markets portfolio in the new Commission is hugely significant and reflects the importance given to financial market reform. The decisions made by the new Commission will have important consequences for UK financial services, not just European financial markets.

Last week, MEPs in the European Parliament got the first opportunity to question Lord Hill who has been nominated as Commissioner of the new powerful brief. In an unusual move, MEPs asked him to come back for a second confirmation hearing (taking place this week).

Lord Hill’s nomination certainly raised a few cheers and a few eyebrows. City lobbyists seemed to be over the moon about it – the feeling was that the City had got its man in a very powerful, influential position. Civil society and consumer representatives raised alarm given Lord Hill’s previous connections with the finance industry.

My personal view is that we should judge Lord Hill (or anyone for that matter) by his deeds, not by his past. More important than an individual is the creation of this powerful, new financial services portfolio. Carving out financial services from DG Internal Market provides a great opportunity to focus on rebuilding and reforming a broken financial system. There are risks of course as it gives the powerful financial services lobby a single point of focus (but more on this later).

The appointment letter from President Elect Juncker to Commissioner Elect Hill was very encouraging from our perspective. It set out in no uncertain terms what the new Commissioner designate is expected to achieve in terms of making financial markets work for the real economy and consumers and will be a very powerful tool for holding the new Commission to account.

The new Commissioner in charge of this brief faces a huge challenge rebuilding financial markets and making markets work for EU citizens. Let’s remember what’s at stake here. The crisis in the financial markets rapidly turned into an economic crisis in the form of severe recessions across the European Union, which then turned into a social crisis (as society is picking up the bill for the failure of the finance industry). It has not been forgotten that the actions of the finance industry nearly wrecked the economies of Europe (some major economies still haven’t recovered) and ordinary households are paying a terrible price.

But, not only did the finance industry threaten the stability and integrity of our financial system, the finance industry failed at many of its primary economic and social functions.

We cannot allow the actions of the finance industry to threaten such economic and social destruction again and we need to make financial markets work in the interests of society, not the other way around. So what needs to be done? Three priority challenges lie ahead.

There will be new financial crises in future so we need to continue the reforms aimed at restoring and maintaining financial stability (macro prudential regulation)and making our major financial institutions more resilient to future financial crises (micro-prudential regulation).

But we also need to begin a series of major reforms on the third challenge of making markets work for society, the real economy, and financial users. What does making markets work mean? It means serious improvements in the way the finance industry performs core economic and social functions including:

* providing long term, sustainable capital and efficiently allocating resources to the real economy;
* efficient financial intermediation (transforming savings and deposits into loans);
* providing an efficient, resilient, accessible money transmission and banking system;
* efficient risk management; and
* for financial users, making sure they had access to the safe, affordable, fair products and services they need to help them save for retirement, protect against risks of losing their income and/ or health and so on.

There is much to be done – not least cutting out the huge waste in critical areas such as investment banking and asset management. There has been a huge amount of financial ‘innovation’ over the past two decades – new financial products and instruments, new technologies, new services and layers of financial intermediaries, furious competition between agents in the markets and so on.

But we have to distinguish between the illusion of innovation and competitive activity, and socially useful competition and innovation. Judged against the core economic and social functions described above, these new activities and innovations have not produced markets that work better for society. Indeed, the net effect was to introduce greater risk into the financial system, inefficient allocation of resources away from productive economic uses, while the asset management industry overall has failed to deliver decent risk adjusted returns for retirement savers – exacerbated by the extraction of value in the form of layers of fees and charges for all the various intermediaries in the market nowadays.

Remember what I said above. We have not forgotten the damage the finance industry caused to our economies. Moreover, investment bankers, analysts and fund managers are self-appointed arbiters of economic efficiency – that is, their actions, views and opinions can affect share prices and force real economy firms to cut costs and, most importantly, jobs. But the painful irony is that the finance industry is just not very efficient. In future, the well paid finance professionals must be held to account on their own terms.

So, those are the challenges ahead of the new Commissioner (whoever that turns out to be) if markets are to work for society. This needs tough policy and regulatory reforms supported by robust enforcement.

But if this is to happen, the activities of the powerful, influential and well-resourced industry lobbies must be severely curtailed. The industry spends around Euro 120million a year on lobbying – outspending civil society by a ratio of 30:1. For every meeting civil society had with policymakers, regulators and other decision makers, the industry and its lobbyists had seven[[1]](#footnote-1). The industry also dominates the important technical committees and advisory groups that influence the development of policy and regulation. The more successful the industry lobbyists are, the more damage is done to the public interest.

Moreover, effective policy and better regulation needs the engagement of civil society and consumer representatives if we want to avoid the group think that bedevilled policymaking and regulation in the run up to the financial crisis.

So, there we have it. The policies and decisions that are made by the new Commission will have far reaching consequences for EU and especially UK financial services. The stakes are high and civil society representatives will campaign as hard as possible to fight off industry lobbies so that we can produce genuine, long overdue reform of our finance industry. Interesting times ahead.

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1. http://corporateeurope.org/pressreleases/2014/09/hard-facts-europes-biggest-lobbyists-revealed-first-time [↑](#footnote-ref-1)