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PUBLIC STATEMENT

The 18th meeting of the Market Participants Consultative Panel, jointly with CESR members

The Market Participants Consultative Panel held its 18th meeting on 11 December 2008 in Paris, jointly with CESR members.

CESR Chairman Eddy Wymeersch opened the meeting and welcomed in particular Godfried de Vidts as a new member of the Panel. In the meeting, the Panel (1) addressed various issues related to the market crisis, (2) exchanged views on the organisation, infrastructure and transparency of OTC markets and (3) discussed a future framework for EU financial supervision.

1. Update on the market crisis

General discussion

In a presentation on the general economic outlook, one member of the Panel flagged the deterioration in the market circumstances as big firms are now also impacted by the crisis. Stress for financial firms has increased, hardly any merger & acquisition activity is taking place, firms are reviewing their headcount and the investment management business experiences financial stress due to declining values of financial assets. In this context, the level of withdrawals for open-end funds is a major concern. Most important risks identified for financial firms are: internal control (including stress testing), counterparty risk, prolonged loss of confidence and low savings rates. This member applauded the consistent and proportionate approach included in the latest G-20 statement and called upon the industry to assist regulators in their efforts to restore confidence. Regulators should cooperate strongly in these times and use plain language if they aim to restore confidence. Areas to look into are, according to this member: insolvency law and a review of the impact of governing actions for supporting the financial industry, with a view to possible crowding out effects.

In a first response, the Chairman of CESR underlined the current strong cooperation among the members of CESR during this crisis and intensified cooperation with the other 3L3 committees. Referring to the call for a link between market players and regulators, one CESR member underlined global imbalances as a consequence of over-sophisticated regulation and asymmetries in information which should be addressed by additional transparency.

In response to the various governmental actions which took place so far, one member of the Panel noted the risk of a return to national protectionism. Biggest concern in his view is a spill-over effect to the market for government bonds. The creation of a common issuer for these bonds in Europe could mean a step forward in this respect. Other members of the Panel were more cautious on developments in the market, called for an intelligent approach for regulation and warned to be careful not to take wrong decisions in order to preserve the objectives of the Single Market. The Chairman of CESR summarized this part of the discussion by agreeing that restoring confidence is the top priority, but underlined the difficulty how to do this.

Short selling measures

In an observation on the short selling measures taken by regulators so far, one Panel member underlined the broad variety in scope (financial or all firms listed) and lack of common approach/definition (naked selling, without execution and as economic interest) in the various measures taken with regard to short selling. This member noted that many of the measures were taken for a period of three months and called upon regulators to review the effects on liquidity first before deciding on permanent measures. In particular, the effects of credit default swaps in combination with short selling should be reviewed. In this context, reference was made to the recent analytical paper 'The impact of short sales restrictions' sponsored by ISLA, AIMA and LIBA. Other members emphasized the benefits of short selling (e.g. better price formation, enhancing liquidity and reduction of spreads) to the market as a whole, called for in depth costs/benefits analysis of the measures (rationale, disclosure, emergence of manipulation). Members of the Panel generally agreed that in certain extreme cases, short selling measures should be accepted as temporary, regulatory responses to developments in the markets. Finally, it was noted that over time changes in regulatory responses may work de-stabilizing and the need for greater convergence was underlined. The Chairman of CESR concluded this part of the debate by stressing the need for: differentiation among cases, clarity on the rationale of the measures and the need for further convergence.

Fair value of financial instruments
In the introduction of this issue a Panel member gave an example of unexpected effects of IFRS (a big European bank expected to report a quarterly loss, was able to present a profit). A CESR member responded that CESR had agreed before that the rationale of fair value should be close to market value. The recent reclassification of IAS 39, allowing firms not to show losses, was however not opposed by CESR. This CESR member warned that introducing fast track policy changes runs the risks of making mistakes and may therefore not contribute to the objective of increasing confidence in the market. Another CESR member agreed with these views, but noted that the idea of 'fair value equal to market value' might be hard to achieve if a market is non-existent. This member voiced deep concerns about the role and initial refusal of the IASB in the process to move and to deal with the difficulties in fair value. In retrospect, also regulators might have been more alert in response to the process of externalization of risks which took place in the period of 2003/2004, according to this member. One Panel member reminded participants that in the cash repo business, transparency has not done a lot for pricing and suggested to distinguish between the purpose of holding a bond (for trading or collateral). Another MPCP member expressed concerns about the impact of the policy change of IAS 39 on the financial statements of non-financial firms. Others underlined the need to have understandable measures. One member tabled the issue whether regulators are addressing the right question as the introduction of IFRS in 2005 did not seem to have a lot of impact. This member raised doubts whether IFRS, based on economics instead of a legal basis, is a right approach. The debate on fair value was concluded by stressing: the need for regulators to follow a realistic approach, welcoming the improved openness of the IASB and the need to better manage the expectation disclosure may play in these matters.

2. Organisation, infrastructure and transparency of OTC markets

Against the background of the suggestion of the European Commission to promote a facility for central clearing of OTC derivatives (located and supervised in Europe), a member of the Panel called the idea of OTC markets as unregulated, misconceived. Many codes of conduct exist to regulate OTC practices, at this stage however the idea of an overhaul of OTC markets is accepted, but the difficulty remains how to do this. The political pressure to present immediate results is too high; robust solutions require six months to be developed, according to this member. It was also noted that not everything can be translated to central counterparty risk. Another member noted that centralization does not necessarily having an immediate impact on trading practices. Other members noted that OTC markets will remain particularly attractive for investment banks due to higher profit margins on the (tailor-made) products traded on these markets. One CESR member considered the counterparty risk as the main risk factor to deal with. Another risk may exist with regard to the underlying assets and the risk to concentrate the clearing of these products in a single or in very few places. The exchange of views was concluded with the observation that Europe – in terms of global competition – does not operate in isolation and the rumours that a growing number of products in the US might be brought into a listed environment.

3. A future framework for EU financial supervision

As an introduction to this topic the Chairman of CESR echoed the remarks made on behalf of CESR at the recent hearing of the Larosiere Group in Brussels. It was acknowledged that supervisory systems did not perform at best during the crisis, whereas most issues turned out to be of domestic nature.

Key questions to address this situation are: where to go next, how to channel information and how to equip national supervisors?
One member of the Panel made a call to pool resources for regulation/supervision and to benefit from economies of scale. Another member called for a lead-regulator, supplemented by colleges of supervisors as a future way forward. Several members noted that governments have a tendency to act locally, whereas regulators try to act and coordinate globally. One member recalled a recently published study for the creation of a European System of Financial Supervisors. The Chairman of CESR reminded all about the different supervisory models that exist within Europe and summarized the dilemma that a solution for a future framework for financial supervision in Europe may need to be found along the lines of 'central regulation and local supervision'.

4. Future meetings

The next meeting of the Panel will take place in March/April 2009 on a date to be set.