Financial Crisis Do We Need More Regulation

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Thank you for inviting me here today. You have asked me to talk to you about the outlook for regulation in the mid and post-crisis environment.

But before I turn to that subject let me say that I believe there has been far too much emphasis on new regulation. And too little on the other - and in my view potentially far more effective - tools needed to underpin a safer financial system.

Over the past ten years the EU and its Member States have introduced and transposed thousands of pages of new regulations, and directives in financial services. Individual Member State supervisors, together with the EU Committees of Supervisors of the insurance, banking and securities industries have been intimately involved in their transposition and implementation. But despite the unprecedented level of work and extent of regulation, our financial system has ended up at the edge of an abyss - with taxpayers picking up the bill for failure. Against this background it is incumbent upon us to ask ourselves whether the calls for even more regulation should be so intense - and whether there might be reasons - other than too little regulation - for the widespread financial failure we have seen.

To me the answer is clear: It was not too little regulation that caused the problems. And it is not lots more regulation that will solve them. The main failure of the past decade was the failure not of regulation itself but of the supervisory resources used to oversee enforcement of that regulation. Failure of the education system, which rarely encompasses sufficient emphasis on the life skills needed to understand, manage and mitigate personal financial risk has been another factor.

The absence of a supervisory framework for the supervision of cross-border banking groups is of course an obvious gap in the regulatory and supervisory armoury - a gap that we are now seeking to fill. But the supervisory resources of individual Member State supervisors were clearly wholly inadequate too. Unless more attention is paid to this issue, we will find another crisis hitting us in a decade or two's time. In fact I suspect that the challenge of having supervisory resources that are up to the task becomes greatest just at the time in the cycle when the risks of the absence of those resources are greatest too: That is, when the market is at its hottest, and prepared to pay mega-bucks for the hottest and most innovative financial engineers it can find - and with whom regulators struggle to keep up.

It is always difficult for the public sector to match the remuneration packages of the best in the financial services industry. But every Member State must reflect on the cost to its taxpayers of having supervisory resources that might be several paces behind the curve in terms of overseeing the risks building up in the system as a result of ever-ending and complex financial innovation. That cost is tiny relative to the cost of supervisory failure. The lesson is clear: Member States will have to invest substantially more in both the quantity and quality of their supervisory resources - and find ways to overcome the straitjacket of pay parities and relativities that dominate public service remuneration scales.

Equipping citizens with the life skills necessary in respect of borrowing, saving and investing - equipping them with the ability to understand financial risks and how and why they can and should be mitigated - is another part of the jigsaw. I have sought to step up the focus of the EU on this issue over the past few years but it is primarily a Member State competence and responsibility - and going forward I hope and expect it will be taken more seriously in each Member State of the Union.

The third failure relates to what I call the creation of the leaky holes in regulation: In some ways these are the product of our complex, three-legged decision making processes in Europe and the power of the lobbyists who act mainly for the sell-side of the industry: I will give just one example- Earlier this year I brought forward proposals to tighten up the regulation of the securitization market- what was then a highly controversial but modest proposal requiring mortgage originators to retain 5 per cent of the exposure to what they securitize across the various tranches of the securitization. I was told at the time that there was no support for this and that Europe would be put at a disadvantage because there was no way other jurisdictions would follow suit. On the latter point my critics were proved wrong- as indicated by the support now emerging in the US congress, the G20, and even within IOSCO for a similar proposal. However, on the support within Europe for the measure, my critics were proved right to some extent - in terms of the unanimous and perhaps understandable opposition on the part of "sell" side of the market. Their lobbying resources are massive. But the "buy" side of the market - who I know largely supported my proposal -went virtually unheard, because they are largely unorganised for the lobbying task. The consequence was that although the proposal was not defeated, it was so comprehensively amended in terms of exceptions and alternatives - and by unanimous agreement in the Council - that the proposal cannot in my view achieve its original purpose - namely to align the interests of the originator and investor in securitization structures. It is this, what you might call, "leaky hose" phenomenon in regulation - brought about by injudicious amendments, which is one of the curses of our regulatory process: Financial regulation, to be effective, must sometimes be watertight. But by the time the compromises are negotiated it rarely is. I do not have an immediate solution to this but I do strongly believe that much more engagement of -and by- the buy-side of the market will be imperative in the period that lies ahead- in order to ensure that investor interests - as opposed to just distributor and trader interests - are properly taken account of.

We need to learn from what happened and make sure it does not happen again.

Given that financial regulation will remain one of the pillars of a sound financial market, we must ask what purpose it should serve?: First and foremost , it should serve to prevent the failure of individual financial institutions where such failure would result in contagion, threaten the financial system as a whole, and possibly require support from the taxpayer. But we also need to ask ourselves whether we can live with "too big to fail" and "too complex to fail" institutions? And continued implicit guarantees from the taxpayer to the financial sector?

Regulation should serve to protect depositors and investors from unfair practices such as mis-selling by means of robust but proportionate conduct of business rules- However in this area, financial education in my view is the much better tool. And finally, in everything we do, we must ensure that we avoid stifling business and innovation - It is a difficult balancing act.

Businesses must be facilitated to take risk and regulation must facilitate risk taking. If we do not have a culture that supports entrepreneurship, then we will not be able to create the growth and jobs necessary to move forward on a sustainable basis.

While small depositors should have their savings protected, the same should not apply to those whose business model is to take risks to a greater or lesser extent.

They should be incentivized to continue taking risks but without putting the entire system at risk.

Balanced consultation means not just welcoming views from all interest stakeholders, but actively seeking them, especially from the buy side of the industry.

One of the outcomes of this financial crisis is the realisation of how inextricably linked national economies are - both within Europe and globally. The best regulation and supervision in the world will be of no use to Europe if the rest of the world is not appropriately regulated. So global cooperation is key.

Many elements high up on the EU's agenda were reflected in the last G20 summit conclusions and most of the measures which we have or will shortly bring forward respond to commitments made at the level of the G20 with our main international partners. Very often in the past 18 months we have taken the lead - and others have followed. I am glad I resisted some of the pressures to slouch in the back of the bus, waiting to see what others do first, but instead set the example, and others are now following on.

With regards to regulation, our programme aims to fill gaps where European or national regulation is insufficient or incomplete, based on a 'safety first' approach.

We published during the summer a consultation on the safety of derivatives markets and a proposal for a Directive on Alternative Investment Fund Managers. The latter has the objective of creating an effective regulatory and supervisory framework for Alternative Investment Funds at the European level. I hope that this latter proposal is reasonably proportionate. It takes into account the ongoing work at the global level to tackle the issue of offshore centres, whilst avoiding closing the door to funds and service providers located outside the EU. Finally, the proposal opens new internal market opportunities for industry through the new passport, whilst ensuring that investors are properly protected. However, I am not pretending that the proposal is perfect, and I look forward to working with the Parliament and Council to facilitate improvements in the period ahead.

In the banking sector, we have further work to do, and I am especially keen to make the current framework less pro-cyclical with the introduction of more dynamic provisioning to enable banks to set aside bigger bad debt provisions in the good times as a buffer for recessionary periods. And within the coming weeks, I will be bringing forward our comprehensive proposals for pan-European supervision.

Ladies and Gentlemen, the challenges facing regulators and industry are clear. We need to rebuild confidence. We need to convince stakeholders that the financial markets can and do make a positive contribution to the European economy. And we need to strike the right balance between promoting future stability and avoiding excessive regulatory burdens. We are committed to working with all concerned to build a stronger, more reliable financial system for the future.

So, I hope that I have given you a sense of what is being done and some of what still needs to be done. I hope I have made it abundantly clear too that I see regulation as but one pillar in the task of developing a more robust and more responsible financial sector that stands on its own two feet and ceases to be a call on taxpayer resources. To those of you who will be affected by our legislative proposals I would encourage you to ensure that your voice is heard because it is only by working together with industry and consumers that we can ensure that we have financial services regulation that is fit for purpose in the years that lie ahead.