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Editorial

by Myriam Vander Stichele

More and more money is being promised to the 'markets' in September 2012, as announced by the European Central Bank and by the revelation of a potential € 59 bn bail out for Spanish banks. But the markets – i.e. the investors, banks and speculators – have a tendency to very quickly become restless again after each promise and official statement, as recent years have shown. Since the markets are allowed to decide the interest rate of governmental bonds, this restlessness makes it more costly for countries to borrow. In order to reassure the markets that banks will not cause so much trouble again, deeper bank reforms and more overarching bank supervision at EU level are being proposed. At the same time urgent and forceful decision-making regarding current bank reforms is being delayed. In the meantime, large popular protests are taking place in various EU countries against what have so far been the results of the bank bail outs and slow financial reforms: deep budget cuts and other austerity measures, undemocratic decision-making and destructive neo-liberal policy solutions. Academics and even the IMF warn that the imposed austerity will not work in countries like Greece. The fate of the Euro, the European banks and economy, as well as democracy and welfare states in Europe are still under threat.

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Reform of the financial markets – with speculation ranging from the Euro to carbon trading – to take form through a revision of the Market in Financial Instruments Directive (MiFID) will still take several months to be finalised. This reform includes the potential limiting of food price speculation on commodity exchanges, for which civil society organisations and individual citizens have been campaigning. On 26 September 2012, the European Parliament's committee voted to not impose strong regulation by upholding some loopholes that undermine the application of mandatory position limits. More reforms that relate to commodity derivatives are being considered, for example on how commodity derivatives – or even physical commodities – can be used or traded by investment funds and banks. Therefore, strong and continuous public voices are needed to press for meaningful limitation, if not cessation, of financial speculation on food prices.

For all financial reforms at EU level, the intermediate texts during the co-decision-making by each the European Parliament and the Council of Finance Ministers in parallel, show different views and weaknesses, often introduced by the financial sector lobby. Such 'regulatory capture' is considered to be one serious cause of the financial crisis, and it continues to undermine fundamental reforms and keep these reforms away from public scrutiny. The consequences of such a decision-making process are becoming more and more visible in the economy, society and people's lives, and popular opposition is rising.

Summaries of the articles in this newsletter

The Knight in Shining Armour: The ECB as Lender of Last Resort and Centre of a Banking Union

While the Euro is still at the brink of the abyss, European governments and EU institutions increase efforts to get the situation under control. After several insufficient and inefficient reforms, the European Stability Mechanism – a kind of European IMF – is underway. The European Central Bank (ECB) has announced it will buy unlimitedly sovereign bonds that were issued by crisis states. The ECB is thus de facto taking over the role of a lender of last resort. But the effects remain uncertain. A banking union is proposed with the ECB as supra-national supervisory body of banks in the Eurozone to prevent bank failures that undermine the Euro. At the same time, new legislation on bank capital reserves, a guarantee scheme for savers' deposits and a resolution mechanism for failing banks are being discussed. The measures already face the usual barriers of vested interests of the finance industry and national interests. Although the approach might be a step in the right direction, it might turn out to be insufficient. By the end of September, Spain was already in bigger problems while protests against austerity measures increased.

For the full detailed article see below.

Bank regulation delays, bail outs, austerity and protests

The long-hailed bank reform that will focus on more capital reserves and should prevent bank bail outs, is still under discussion at EU level and might be voted on in European Parliament on 21 November 2012. There is some political goodwill for more and much deeper bank reforms as new proposals and expected proposals indicate. However, austerity measures continue after banks have been bailed out, especially in Spain and Greece where massive popular protests took place, joined by other protests in Portugal, Germany and France. More protests and critique against neo-liberal solutions and undemocratic decisions, even from academic circles, are growing.

For the full detailed article see below.

European Parliament decides to tackle commodity speculation – a little bit

The revision of the 'Markets in Financial Instruments Directive' (MiFID) has finally passed a first critical point of the EU's making process. On 26 September 2012, the responsible committee of the European Parliament (EP) voted on how to reform the supervision and the organisation of part of the European financial markets. The vote in the EP resulted among others in legal restrictions on (food) commodity price speculation on commodity exchanges and relatively strict rules on high frequency trading (HFT). However, the text still leaves loopholes that will allow commodity price speculation.

The EP is planning to hold a non-final vote in plenary on 25 October 2012 while the Council of Finance Ministers might be deciding on its position at its meeting on 13 November 2012. After these votes, a compromise text will need to be negotiated. By the end of September 2012, the Council's view on commodity position limits was not yet clear but quite some member states were in support of limits on speculators in commodity derivate markets. Both EU institutions have been put under public pressure and subjected to public campaigns to enact on strong regulation.

For the full detailed article see below.

More commodity investments in the future?

Trade in (food) commodity derivatives by speculative financial players and banks on commodity exchanges has been increasing amongst others due to the creation of all kind of (commodity) index funds. The European Commission (EC) is now consulting whether investment funds can in the future be allowed to invest in other assets, such as commodities, through a review of existing EU legislation (UCITS directives). The design and management of (commodity) indexes and their use by the funds is also being considered for new regulation by the EC. Finally, the underestimation of risks by banks who engage in trading activities on financial markets is being recognised by the international committee of major central bank governors and a first step has been undertaken for reforms.

For the full detailed article see below.

European Union revises its policy on tax evasion

The European Commission (EC) has proposed a process of changing EU policies in order to fight tax evasion. This was outlined in a discussion paper in July 2012, which was the basis for a hearing and a consultation. In their reaction to the discussion paper, several CSOs demanded the adoption of an EU definition of tax havens, country by country reporting of tax payments and more attention to the tax evasion practices of multinational corporations. At the same time, several legislative and policy proposals are on the table to change existing laws and tax dodging practices related to the problem of double non-taxation, the Common Consolidated Corporate Tax Base (CCCTB), a common system of taxation applicable to interest and royalty payments, and the Savings Tax Directive. Some changes have been hard to achieve over the past years, but current political and public discussions within the European Parliament, as well as member states such as Germany, might – in the context of budget cutting austerity – promote progress on fighting tax evasion.

For the full detailed article see below.

Breakthrough for a Financial Transaction Tax in the EU: Enhanced Cooperation put on Track

There is a breakthrough in the European debate on the Financial Transaction Tax (FTT): the tax will be implemented through the special procedure or Enhanced Cooperation which is a 'coalition of the willing' of at least nine EU member states. The draft directive of the EU Commission will serve as a blueprint. In spite of the complexity of the procedure, the revenues from an FTT might start flowing in 2014. However, there is still some risk of watering down the proposal. The decision to go for Enhanced Cooperation will increase the differentiation inside the EU and is hence in line with general centrifugal tendencies in the EU.

For the full detailed article see below.

The Knight in Shining Armour: The ECB as Lender of Last Resort and Centre of a Banking Union

by Peter Wahl, WEED

Under the influence of the continuing crisis, governments in the Eurozone and the EU are beginning to understand that previous reforms of the financial system have proven to be inefficient and insufficient to really cope with the seriousness and depth of the problems. Since September 2012, some more stringent steps are being envisaged. After the final appproval to establish the *European Stability Mechanism* (ESM) – a kind of Euro version of the IMF (see previous newsletter), two other efforts testify for increasing efforts to get the Euro crisis under control:

- The announcement of Mr Draghi, the president of the European Central Bank (ECB), to buy unlimitedly governmental bonds of Euro countries at the secondary market if necessary.
- The establishment of a *Banking Union* with the ECB as central supervisor for the financial stability of banks in the Euro zone.

Breaking the rules in order to save the Euro

The ECB's announcement to unlimitedly buy governmental bonds of Euro countries in crisis is quite far reaching, even if conditions are attached. It is de facto a step towards establishing the ECB as lender of last resort in the Euro zone. The ECB is the only major central bank that is not allowed to play this role for which central banks have been invented. Formally, the practice of buying bonds at the secondary markets, i.e. bonds already issued and bought by investors/speculators who are re-selling them, is inside the rules of the ECB. In the present circumstances, it is of course an instrument to support the budgets of crisis countries: if the ECB buys the papers it increases demand, the markets lower the interest rates of the countries' bonds, countries can issue new bonds at lower interest rates which consequently helps them to refinance their budget.

However, a precondition – at least officially – for the ECB to undertake the rescue measures is that states come under the safety net of the ESM, by asking a bail-out, and its rigid austerity conditionalities. Italy refuses to do so. Also Spain, which has been particularly under pressure in September 2012, refuses the ESM conditionalities although it announced its own budget cuts and reforms on 27 September 2012. As the ECB does not disclose the details of its purchases, the bank might nevertheless buy Spanish and Italian bonds – in spite of the bank's official position.

As formally the ECB is not allowed to finance governments, Mr Draghi's announcement is somehow in a grey zone between legality and illegality. This is why the German governor in the ECB and head of the Bundesbank, Jens Weidmann, has voted against the ECB measures. But Weidmann was the only one among the ECB governors to vote against and completely isolated.

Chancellor Merkel, on the other hand, voiced immediately support for Mr Draghi. Also Jörg Asmussen, German chief economist in the ECB and former Sherpa of Merkel, was supporting the ECB measures. This surprising configuration indicates that Merkel is playing a sophisticated and tactical game. On the one hand she has to accommodate her coalition partner, the liberal party which is strongly opposed to anything that smells like financing government budgets, as well as large sectors of her own party and the majority of German opinion. On the other side she realises that the Euro is at the brink of the abyss and that the ECB is the only player who is not handicapped by the complex decision making procedures of the EU, and hence fast and flexible enough to respond with its instruments to the crisis. The manoeuvring reflects the contradictions the German position is mired in today. German elites are split with regard to the responses to the crisis, and further manoeuvring can be expected.

The ECB measures are not a real solution to the crisis. They could, however, buy time and create space for the establishment of further instruments such as the *Banking Union*, provided that speculators and markets behave as expected. It also could be possible that speculators simply use the occasion to get rid of their bonds, given the grim macro-economic perspectives of Spain and the overall Eurozone in recession. In case speculators and investors will buy new bonds issued by the debtor countries, it remains unknown what interest rates the issuing countries will have to pay as the markets decide. In that respect, the future will have to show whether the move by Mr Draghi and the ECB will work.

The Banking Union – what to expect?

There is growing consensus that the establishment of the Euro suffered from the beginning from the lack of homogeneity necessary for a common currency. Already in the 1960s, Nobel prize winner Mundell and others had established a theory of an 'Optimal Currency Area'.[1] According to this theory, a common currency requires similar reactions to external shocks, synchronicity of business cycles and common instruments for crisis management. The Eurozone did not meet any of these three requirements.

The Roadmap towards a Banking Union by the EC tries to establish at least the third element in Mundell's triangle.

The idea of a European Banking Union consists of the following elements:

- A Regulation that appoints the ECB as the common supervisory structure for the 6,000 banks in the Eurozone.
- Common rules for capital requirements and other reforms to

[1] Mundell, Robert (1961): A Theory of Optimal Currency Areas. The American Economic Review, Vol. 51, N° 4 (Sep., 1961), pp. 657-665.

implement Basel III at EU level: a new Capital Requirements Directive (CRD IV) and Capital Requirements Regulation (CRR), currently negotiated between the Council and European Parliament as explained in this Newsletter's Article.
- A Directive on deposit guarantee schemes.
- A common resolution or recovery mechanism for failing banks.

The new role of the ECB to supervise banks in the Eurozone was outlined by the European Commission (EC) in its draft Regulation presented on 12 September 2012.

According to the draft, the ECB shall have the right to authorise a bank or to withdraw the authorisation, to remove a bank's management, to require any information, to undertake on-site inspections and to impose pecuniary sanctions. Supervision will be based on the rules of CRD IV / CRR. The Commission has a very ambitious timetable and envisages July 2013 as date of implementation for systemically important banks and 1 January 2014 for all the others.

In order to give the impression of democratic accountability, the ECB will have to answer questions before the European Parliament and report regularly. However, the leadership of the new institution will be appointed by the Council.

At first glance the project looks very reasonable. But looking into the details of the proposals and the circumstances, it is doubtful whether they will be really able to get the crisis under control.

First of all there was the Basel III accord, which from the beginning was considered insufficient. Both the Swiss and the UK government want higher capital requirements for instance (see a previous newsletter).

Then there is the problem of the linkage of the new institution under the roof of the ECB to the already existing European Banking Authority (EBA), which was established in 2011. Although EBA conducted two stress tests, the institution did not see the problems of *Bankia* and other Spanish Banks nor did they realise the LIBOR scandal, in which almost all big European banks were involved. Therefore, in its roadmap the Commission recognises: "Supervisory failings have, since the onset of the banking crisis, significantly eroded confidence in the EU banking sector and contributed to an aggravation of tensions in euro area sovereign debt markets." (draft Regulation on ECB, p.2). While the EBA may be weaker, it is the relevant institution for the EU-27. And while the new supervisory structure by the ECB is stronger, it only applies to the Euro-zone. Hence, the fragmentation of the EU will be deepened.

There is, furthermore, the issue of internal conflicts of interests: the function of supervision that is based on existing regulations, would require a completely different type of activity inside the ECB. What happens, for instance, if the ECB in its capacity as supervisor would have to close a bank which is indebted towards the ECB, which then would have to incur losses? The draft speaks of a strict separation between the two different departments, but why then not create an independent new institution from the beginning?

And of course, like in all European projects there is the tension between the national and the supranational level. In order to obtain political acceptance, the draft foresees a strong role for the existing national supervisory bodies. And in fact, as it is impossible to supervise 6,000 banks with one single institution, the new body will largely depend on national state administrations and thus lose a great deal of efficiency. Supervision of bank subsidiaries and branches in non-European countries will remain dependent on (weak) cooperation between supervisors.

A common deposit guarantee scheme ?
A revised Directive on Deposit Guarantee Schemes to be applied by each member state, presented by the EC in July 2010, still needs to be decided upon by the European Parliament and the Council of

Finance Ministers. A Directive on bank resolution and recovery was announced by the Commission on 6 June 2012 and the EC plans to propose a single (common) resolution scheme for failing banks within the banking union. In a *Roadmap towards a Banking Union* the Commission mentions how all the different proposals are being coordinated and form a comprehensive reform.

A common deposit guarantee scheme is still too political senstive and the national interests will even be stronger, as this concerns money and its distribution. There is not only the case of Saving Banks and others, who are not taking part in big speculation and therefore do not want to give guarantees to speculative business models of investment banks, but also the Finnish government who does not want to give guarantees for Greek banks and the German government who does not want to stand behind Italian banks, and so on. But a common supervision, the deposit guarantee scheme and the resolution mechanism are like a tripod. If one leg is missing, the whole thing will fall down.

Winning or failing ?
To conclude: although the basic approach towards an optimal currency area is a step in the right direction, expectations should not be too high. It will take considerable time to reach an agreement, if any, and there will be watering down through vested interests of the finance industry's lobby as well as national interests. Not to speak of the deeper roots of the crisis, such as the trade and current account imbalances inside the Eurozone and the unequal distribution which fuels financialisation, speculation and lack of reform of the financial markets, and hence instability. There is the risk that the ECB may share the fate of the knight in shining armour in Wagner's opera Lohengrin, who in the end fails tragically in his mission as a savior.

Bank regulation delays, bail outs, austerity and protests

By Myriam Vander Stichele, SOMO

Since The EU has still not made a final decision about the major bank reform that requires banks to be more robust to absorb losses and avoid bail outs in times of crisis, by having more liquid and longer-term financial buffers as well as better supervision. After the Council of Ministers and European Parliament (EP) each decided on their proposals in May 2012 of what is to become the Capital Requirements Directive IV (CRD 4) and Capital Requirements Regulation (CRR) (see Newsletter No 12), discussions on a compromise text are taking place behind closed doors in the 'trilogue'. Differences have been about flexibility for regulation and supervision by member states or European institutions, governance & remuneration at banks, crisis management and sanctions. Compromise texts are planned to be reached in the coming weeks (since the G-20 requires implementation from 2013 onwards) and a decisive vote at the plenary of the EP is provisionally scheduled for 21 November 2012. For more detailed info and the exact voting date, click here or here.

The continuing bank crises and scandals, the manipulation of basic interest rate the 'Libor' for example, provide the political will to go further than the small steps taken up till now. More bank reforms are on the agenda or in the pipeline (see the article "The Knight in Shining Armour" in this Newsletter and Newsletter No 12). The dependence of European Banks on shadow banking through 'money market mutual funds' based in the US has also become an issue of discussion (see article by Aldo Caliari) . A proposal for more structural changes is expected from the High-level Expert Group on Reforming the Structure of the EU Banking Sector (called the Liikanen Group) on 2 October 2012. See the full report here.

The financially costly consequences of risky behaviour of banks, and the lack of bank reforms and downsizing of speculative financial markets, are still very visible. Indeed, huge budget cuts and other austerity measures as a result of bank bail outs paid by tax payers' money, are causing more and more economic recession, social hardships and more troubled banks. In an attempt to stop this vicious circle (see Newsletter no 13), Spain and Europe formally agreed on 20 July 2012 that up to €100bn would be available if needed to recapitalise Spanish banks, first by the European Financial Stability Facility (EFSF), and, from October 2012 onwards, the new European Stability Mechanism (ESM). On 28 September 2012, stress tests of Spanish banks revealed that € 59 bn, or almost 6% of Spain's GDP, would be needed for different (regional) Spanish banks in times of severe crisis. The Spanish economy is already shrinking and has a high unemployment rate of 25%. In addition, the Spanish government has announced an austerity package on 27 September 2012 to cut its budget by € 40bn the next year, while implementing structural economic and labour reforms (through 43 new laws) and tax increases. The Spanish government followed EC recommendations in an attempt to avoid being subject to formal external stringent conditionality, as was the case of Greece, in case Spain should have to be bailed out by the Troika, i.e. the IMF and EU funds (EFSF and ESM – see also the related article in this Newsletter "The Knight in Shining Armour"). The new Greek government has been trying to find a compromise to cut more than €11 bn by the beginning of October 2012 since that is a condition to receive the next € 31 bn instalment of its international loans. Given the enormous social and economic down-turn in Greece, the Greek government and even the IMF and France are informally suggesting that Greece should be given more time to fulfil its stringent conditions and stimulate its economy.

The European Economists for an Alternative Economic Policy in Europe, called the EuroMemo Group, met at the end of September 2012 in Poznan and declared their solidarity against EU policies of austerity and neo-liberalism through undemocratic processes that lead to a social and economic downward spiral. Their critique was also voiced in their EuroMerandum 2012 declaration issued in December 2011 in many languages, titled European integration at the crossroads: Democratic deepening for stability, solidarity and social justice.

People's protests in Europe have become louder against the austerity measures that are based on undemocratic decision-making and neo-liberal responses to bank misconduct. On 25-26 September 2012, large protest in Madrid of around 100,000 people, who responded to an appeal from the Indignados, was violently repressed and protests as well as violent repression continued through the following weekend. In Greece a huge general strike took place on 26 September against the growing poverty and new austerity measures that the government is discussing to fulfil conditionality by the lenders (see above). Protests also took place on Saturday 29 September in Portugal and in 40 cities across Germany, and in Paris on 30 September.

From all over Europe, over 150 members of movements, trade unions, networks and campaigns are involved in the preparation of 'Firenze 10+10', a massive civil society meeting which will take place in Florence (Italy) from 8 to 11 November 2012. Florence is symbolic as the place where the first European Social Forum took place ten years ago, which started better interconnectivity among social movements and their analyses and activities. The event in Florence wants to bring together resistance, alternatives and the bottom-up building of democracy. The activities will be focused on 5 areas (or 'pillars'):

1. Democracy in Europe
2. Finance/debt/austerity
3. Labour and other social rights
4. Natural and social common goods + public services
5. Europe in the Mediterranean and the world

The gender dimension is transversal to all the pillars and a sixth pillar, a transversal group, will propose short and long term strategies.

For more information click here.

European Parliament decides to tackle commodity speculation – a little bit

By Markus Henn, WEED

As reported in Newsletter No 12, the European Parliament (EP) and the EU Council of Ministers of Finance (ECOFIN) are currently each in the process of co-decision on the review of the 'Markets in Financial Instruments Directive' (MiFID). Over the summer months, many drafts and compromise papers were circulated and amended by informal working groups preparing the vote in parallel, both for the Parliament's responsible committee for economic and monetary affairs (ECON), and for the ECOFIN.

After the vote in July 2012 was postponed, the EP's ECON committee came to a common position in its vote on 26 September 2012. The EP's Rapporteur, MEP Markus Ferber (EPP group, Germany), was keen to have a broad majority vote as there obviously was no clear majority of his party together with the other conservative group (ECR) and the liberal group (ALDE). Indeed, a broad majority vote provides the EP Rapporteur with a strong mandate and position when negotiating a compromise text with ECOFIN. An EP plenary non-final vote on MiFID II / MiFIR has been planned for 25 October 2012 (for an update of the exact voting date, consult the EP website). Such a vote should provide the EP with an even stronger position when negotiating a compromise with the Council during the so-called 'trilogue' process.

Civil society has targeted the MiFID process in various ways. For instance, before the ECON vote, website campaigns called on citizens to sign on to letters to the European Parliamentarians. At a public action that took place on the morning of the ECON vote on 26 September, almost 100,000 signatures were handed over to those responsible in the different political groups, including Rapporteur Ferber. All actions called for meaningful measures (position limits) to restrict speculative trading in food commodity derivatives.

Limited regulation of food speculation on commodity exchanges

Before the 2012 summer break, EP Rapporteur Ferber had apparently given up some strong amendments to limit commodity price speculation as explained in Newsletter No 12. Particularly, he seemed to have changed his opinion that position limits should be obligatory and set by law. He was publicly criticised for this change by several NGO petitions in June and July 2012. In direct exchange with NGOs, Mr Ferber stated never having abandoned his initial strong proposals to limit commodity derivatives trading by speculators, even though internal documents supported the NGO accusations.

The final ECON vote decided that position limits should be obligatory on all commodity derivatives exchanges, or other trading venues, for financial traders while others who are hedging the risks of their physical commodity trade receive exemptions. Other measures to control trade in commodity derivatives can be taken in addition, according to the ECON decision. Traders that are hedging a risk related to their physical commodity business, will be subject to particular position control measures. The ECON voted text now includes important details proposed by NGOs and other political groups such as setting the limits to prevent "market distorting positions" and covering cash and delivery settled contracts. A worse outcome luckily has been prevented at the last minute. Before the vote, the draft text would only have allowed to limit trading "towards the end of a contract's expiry", a proposal made by the UK MEP Kay Swinburne (ECR), a former investment banker. This would have undermined the effective prevention of financial speculation that (also) takes place in the months before the expiry month. However, the Social Democrats (S&D group) tabled a last minute amendment to take this wording out and replace it with "over a certain period of time". Another last minute change now demands to discriminate towards classes of traders rather than setting position limits only per single trader.

Notwithstanding the obligation to have position limits, the ECON text still implies loopholes and dangers during the design of the implementation detailed regulations. For example, the position limits do not clearly cover all trading months which would be necessary to address the trading techniques of financial speculators. Civil society organisations criticised the ECON vote for allowing different loopholes, including that position limits would only apply on net positions rather than on the amount of contracts or the open interest.

While position limits are an important tool, important other proposals to ensure that commodity derivatives markets are not flooded with investors' money were not voted on. For instance the ECON decision did not adopt a proposal by the Social Democrats and the Left (GUE) to prohibit certain financial products related to commodity prices, such as commodity index funds. The ECON compromise text only stipulates that "Particular attention shall be given to financial instruments offering commodity index replications."

Organized Trading Facility (OTF)

The introduction of a so-called 'organized trading facility' (OTF) remained controversial in the EP. The Social Democratic shadow Rapporteur, Robert Goebbels from Luxemburg, tried very hard to prevent these new trading venues that would be less transparent and regulated than exchanges but more so than current private trading platforms. While his position might be driven by lobby interests of the exchanges ('regulated markets') and banks (who now provide non-regulated trading platforms), it also seems to be favourable for the public as it prevents further market fragmentation and deregulation. However, in the end, a compromise solution by Rapporteur Ferber was voted on, which only excludes equities from being traded on OTFs. Also, OTFs shall only have discretion (i.e. a free decision) over "how a transaction is to be executed and how clients interact". Nonetheless, this compromise solution would mean that commodity derivatives could be traded at these new kind of trading venues that will only be lightly regulated compared to regulated markets. This might undermine effective control and prevent more over-the-counter (OTC) derivatives to be traded on exchanges. Even though, for example, position limits shall apply to OTFs too, it will be more difficult for authorities to have oversight if different forms of trading places are active in a particular market.

Regulating the speed of high frequency trading (HFT)

HFT was a very strongly debated issue in the EP. Finally the ECON vote pushed for a pretty ambitious set of measures, here are a few of them:

1. A minimum holding period in a trading venue's system of 500 milliseconds. This should ensure that the markets do not further speed up whereby the trader with the fastest computer and software formulas to offer and cancel trades, makes the most profit.
2. Higher fees for cancelled positions: large parts of offers for trading are not executed but cancelled. This is extensively used by high frequency traders and massively drives up the volume of the trading while making

interested parties unsecure of how they can trade without manipulation.

While these and other additional measures are promising limitations on HFT, it is not clear if they could really change the so-called “arms race” that high frequency traders are involved in or stop the increasing number of financial parties (on the stock exchange, HFT constitutes around 60% of trading in the US and around 40% in the EU) making profits from speculative HFT transactions that are far remote from economic considerations.

What will the Council of Finance Ministers do?
As of 1 July 2012, the EU presidency shifted from the Denmark to Cyprus who is supported by other member states to compensate for its lack of human resources to conduct the MiFID negotiations. The Finance Ministers are planning to vote on the ECOFIN position on MiFID II and MiFIR at their meeting of 13 November 2012. Under the Cypriot presidency, new text proposals and new compromises for the many working group sessions have been made to prepare the vote on the MiFID review by the Ministers of Finance. By mid September 2012, the EU member states had been asked to provide comments on new additional criteria that would need to be taken into account when setting the mandatory position limits on commodity derivatives trading.

The draft Council texts suggest a very broad and thus worrisome loophole, namely the exclusion from the full scope of the Directive of “market makers in relation to commodity derivatives, emission allowances, or derivatives thereof” which goes back to the interest (and lobbying) of the energy sector.

Regarding HFT, the Council so far did not propose measures comparable to the ones voted on by the EP’s ECON Committee. The only sign of possible action by a national government on this issue is a national draft law by Germany, which included at least some measures going into the direction of the EP.

The debate about the review of MiFID will continue until the whole co-decision process has been finalised. For instance, Finance Watch will hold a conference on 10 October 2012 on MiFID in Brussels. The question is whether the EU decision-making will be influenced by the District Court of the District of Columbia which ruled on 28 September 2012 in favor of the International Swaps and Derivatives Association, a forceful financial lobby, against the CFTC’s new rule to limit speculative OTC commodity derivatives (swaps). The new CFTC rule was to have gone into effect on 12 October 2012.

More commodity investments in the future?

By Myriam Vander Stichele, SOMO

To be or not to be: more commodity (derivatives) investments by funds?
A major EU legislation that regulates investment funds is the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) (see issue 5 of this newsletter). Examples of such collective investment funds or schemes, in which individuals or institutional investors invest their money in, are mutual funds, commodity index funds, as well as exchange-traded commodity funds (ETFs) whose shares can be bought on the stock exchange. However, only collective investment schemes that fulfill the requirements of the UCITS Directives can be called UCITS funds and can be offered without extra regulation across the EU.

The European Commission (EC) announced that it intends to reform the UCITS Directive for the fifth time after step-by-step reforms. It has issued a public consultation through a technical questionnaire which is difficult to digest for individual investors and is, again, targeting responses from the financial industry. Responses are due by 18 October 2012. The consultation covers among others:

- How to manage the assets of the funds in a less risky way (they are often being lent to third parties!) and less becoming engaged in shadow banking;
- Ensure enough liquidity (cash) at the funds in case many investors withdraw their money at once;
- Whether to promote long-term investments and what measures are needed to do so.

An important question asked by the EC is whether the funds can base their investment strategies and assets on other asset classes than those currently allowed ('eligible'). Under current legislation, UCITS funds cannot invest in physical commodities or real estate, and are restricted, for instance, to equities, bonds and bank deposits. Derivatives can be used to a certain degree to allow tracking an index which is for instance based on prices of commodities which themselves are ineligible under UCITS. Commodity ETFs that track the value of commodity indexes have been growing recently. 'Synthetic' commodity ETFs do not (directly) invest in commodity derivatives.

A questionnaire by KPMG revealed that the financial industry is keen to be able to invest in commodity derivatives in the future.

If the EU will agree that UCITS compatible investment funds can invest more in commodity derivatives , this could result in more speculative financial counterparties buying and selling on the commodity exchanges, as well as more use of cleared OTC commodity derivatives – the use of which is also an issue in the EC consultation.

Commodity and other indexes under scrutiny

There are numerous index tracking funds (e.g. commodity index funds, funds tracking company shares, etc.) whose return to investors is based on the index. An increasing number of new indexes are being created. Some funds adapt the indexes to markets circumstances on a daily basis, the risks of which are not always revealed to the investor. For instance, 'synthetic' commodity index funds that are UCITS compatible use an index as a benchmark for the value of the fund. However, these funds can engage in a derivative that is a 'total return swap' issued by an offshore hedge fund that does trade in commodities (that the UCITS fund is not allowed to invest in).

Recently attempts are being made to better regulate the calculation methodology of indexes as well as the use of these indexes by investment funds.

The EC has launched a public consultation (deadline 15 November 2012) on indexes amongst others about their use by funds as price benchmark, their creation and governance. New guidelines by the European Securities and Markets Authority (ESMA) on the use of indexes by UCITS funds will have to be implemented by February 2013.

Less risky trading in derivatives and other financial markets by banks?

The Basel Committee on Banking Supervision (BCBS), composed of Central Bank governors of major countries, has recognized that banks have been miscalculating the risks of their trading activities on the financial markets, including (commodity) derivatives markets. The Committee declared that bank reforms that were so far proposed and untaken have been insufficient. In a consultation paper, the Committee proposed measures to avoid that banks:

- Wrongly earmark particular financial products as a category of products that can be traded (trading book) and therefore need less capital reserves;

- Do not foresee the risk of a full financial crisis that can lead to total loss of financial market products or inability to trade on the financial markets;
- Do not consider that risk mitigating strategies for trading on the financial markets (e.g. hedging) can be invalid in times of severe crisis.

Because banks have been underestimating the risks of trading on financial markets, they set aside insufficient financial reserves. Indeed, the BCBS allowed banks, through the Basel II and Basel III accords, to use their own 'internal model' to assess risks and capital requirements (which the banks of course used to their advantage). In its consultation paper, the BCBS proposes to :

- Reduce the use of the 'internal model';
- Improve the risk assessments methods of the 'internal model';
- To oblige to use the risk assessment model agreed upon by the BCBS (the "standardised model") as a benchmark and floor for calculating trading risks;
- To improve the standardised model.

By 7 September 2012, the consultation by the BCBS was closed and it will take some time before a formal proposal for a new bank reform (to be called 'Basel IV'?) will be decided on. So far, only financial risks of bank trading on financial markets are being considered in the reforms, not the social or economic impact nor the uselessness of many trades on financial markets has been taken into account.

European Union revises its policy on tax evasion

By Markus Henn, WEED

There are some recent developments in the battle against tax evasion at the European level. The European Commission (EC) staged a public hearing in July 2012, at which the EC's general approach towards tax evasion was discussed. The discussion was based on a "Discussion paper on possible future measures against non-cooperative jurisdictions and aggressive tax planning and a possible strategy at EU level". It is hard to draw any conclusion from the paper about the Commission's current position. However, it includes a few elements that are crucial in the fight against tax evasion as explained below.

Contrary to the former dominant focus by countries on avoiding double taxation, the EC now attempts to address the reverse problem: that a company profits from double non-taxation so that it has to pay no taxes. An earlier public consultation in May 2012 suggested various tax evasion models for comments and several civil society organisations such as WEED (see submission) took part with a submission. While some tax evasion models, for example via a Dutch subsidiary, could be highlighted, there is still a vast uncertainty about the role and effects of double non-taxation.

Another core element of the EC policy is the ongoing debate about a Common Consolidated Corporate Tax Base (CCCTB).

Such a CCCTB can be a means to tackle corporate tax evasion and secure a minimum corporate taxation throughout Europe. However, the EC proposes that companies can choose to apply the rule, which would mean huge potential for increased tax dodging. At the hearing in July 2012, business representatives therefore were pretty open to a CCCTB but criticised the Commission for looking at double non-taxation. Civil society organisations urged the Commission to continue with the double non-taxation work and to tackle tax evasion effectively, including a compulsory CCCTB. This compulsory approach had already been called for by the European Parliament earlier in 2012.

In addition, after the July 2012 hearing, a group of ten organisations raised the following core demands in a written response to the EC's draft discussion paper on possible future measures against non-cooperative jurisdictions and aggressive tax planning and a possible strategy at EU level:

1. Adopt an **EU definition of tax havens**. Such a definition should build on the agreement reached by the European Parliament and the Council in the framework of the Alternative Investment Fund Managers Directive (AIFMD). But to be complete, it should also include other criteria like preferential treatment to non-residents and secrecy regulations; both essential features of non-cooperative jurisdictions or tax havens. Such a definition should also be applied to EU jurisdictions.
2. The toolbox should be complemented with other incentive and offensive measures, including a **'full' country by country reporting** requirement at EU level; **automatic cross-border exchange of tax information**; and **alternative options for the taxation of multinational enterprises** (e.g. unitary taxation and thin capitalisation).
3. Pay greater attention to the role of multinational corporations, major players and users of non-cooperative jurisdictions, and the impact of non-cooperative jurisdictions on **developing countries**, most of which lack the resources to effectively fight against tax evasion and aggressive tax planning. The Commission should explore ways to strengthen tax administrations in developing countries and to ensure the implementation of the principle of Policy Coherence for Development.

Besides the EC's draft discussion paper, other law making processes are in progress. Regarding corporate taxation, on 11 September 2012, the EP adopted a resolution on the Commission's draft review of the Directive for a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. In the resolution, the EP takes a stronger position against tax evasion and tax dodging than the Commission and introduces various good amendments. Amongst others, the EP voted for an effective minimum EU tax rate on interest and royalties income, measures against abusive deductibility of interest, prevention of derivatives abuse for tax planning and mitigation of double non-taxation.

Another enduring discussion that has been going on for several years, is the revision of the EU Savings Tax Directive. However, the attempts to extend this directive are currently countered by various bilateral tax agreements, amongst others the ones between Switzerland and Germany. However, in Germany huge criticism by opposition parties and civil society led to a heated public debate, and currently it seems that the agreement might finally fail in the states' (Länder) parliament (Bundesrat).

A last tax issue relates to the revision of the Accounting Directive, which is an opportunity to implement so-called country-by-country reporting for companies on certain accounting information, an important measure against tax evasion and corruption. The EC published its draft revision law already in November 2011 (for more details see these official FAQ and this Eurodad comment. The proposal is now being discussed by the EP and the Council. The EP voted on its opinion in the Legal Affairs Committee (JURI) on 18 September 2012. The result was welcomed by Oxfam and Eurodad as a step in the right direction, obliging oil, gas, mining firms and the logging industry to report what they pay to governments in countries in which they work. Now it will be crucial to influence the national governments in order to achieve an acceptable result in the Council too.

Taken all together, the EU seems to be improving its tax policy towards more tax justice. However, it is unclear to what extent the promising approaches will lead to another policy.

Breakthrough for a Financial Transaction Tax in the EU: Enhanced Cooperation put on Track

By Peter Wahl, WEED

In the May issue of this newsletter we wrote: ‘A happy end for the FTT in Europe is in sight.’ In fact, before the summer break, there was a green light to start the procedure of Enhanced Cooperation, as the EU Council officially declared that the attempt for a Financial Transaction Tax (FTT) in the EU-27 had failed due to the strong opposition of the UK in particular.

Enhanced Cooperation means, that a ‘coalition of the willing’ – at least nine countries – can implement a common project in the framework of the EU rules, even if the others do not participate.

During the summer the German finance ministry took the lead to start the procedure, which is quite complicated, because even if not all member states participate, a qualified majority in the European Council is necessary to trigger the procedure. Qualified majority means that:

- a majority of 255 votes out of 345 (= 73.9%) is necessary. As a reminder: the big countries (UK, Germany, France, Italy) have 29 votes each, Spain and Poland 27, Belgium 12, and so on down to the smallest which is Malta with 3 votes; and
- 62% of the population has to be represented.

If these criteria are not met, the proposal fails.

It seems that the initiative was able to gather even slightly more than the required quorum, among them the four biggest economies of the Eurozone. Besides Germany, France, Italy and Spain, also Austria, Belgium, Greece and Portugal came on board, as well as some smaller countries.

As the European Commission (EC) is also open towards the FTT project, the perspectives for the project are still quite positive. The details for a FTT will be close to the draft for a directive on a common system of financial transaction tax that had been presented by the EC in September 2011. This means a broad tax base including derivatives, taxation of the face value of derivatives and efforts to make avoidance of the tax as difficult as possible.

The first step of the current procedure is to get the potential participating countries to write a letter to the Commission. Then, the

European Parliament has to agree – which will probably be no problem, as it has already spoken out several times in favour of the FTT (see Newsletter nr. 12). After this, the vote in the Council with qualified majority as described above has to take place. The EC then will table a proposal. That proposal will be negotiated among the participating countries.

In the past, two other projects implemented through Enhanced Cooperation took a very long time. A family law was negotiated for five years before it was implemented. Negotiations even lasted ten years for the other project one on patent rights (!). Nevertheless, the German government is optimistic that there will be an outcome in the next six months. In the budget for 2013, an amount is already earmarked for the personnel who will have to manage the tax, and in the draft for 2014 revenues of € 2 bn are foreseen.

The revenues may probably be even higher. A recent study of the leading German Economic institute DIW calculated that a well-made tax through Enhanced Cooperation could raise € 37.44 bn, of which € 11.15 bn would fall to Germany, € 10.79 bn to France, € 5.32 bn to Italy and € 4.94 bn to Spain (an English summary of the study is available here). It is obvious that in the context of the euro crisis such amounts are not a *quantité négligeable*. Furthermore, the EU also expects a considerable regulatory effect from the FTT on High Frequency Trade.

The formal decision to go for Enhanced Cooperation is a breakthrough, although there remain still risks that the proposal will be watered down during the complex procedure. But once the procedure has been triggered, it would be difficult to step back at a later stage. On 28 September 2012, France and Germany were the first to send their letter requesting the opening of the procedure for *Enhanced Cooperation* to the Commission.

Many NGOs have strongly supported the FTT, some of them being primarily interested in the revenues of the tax, which they feel should be used to finance development and environment. But both the budget rules of the EU and of many countries, which prohibit earmarking of tax revenues, as well as the needs of the European countries to open up new sources of funding to cover the costs of the crisis, mean strong pressure will be required for at least a share of the revenues to be used for environment and development.

One interesting side effect of the developments with regard to the FTT is a further fragmentation of EU politics. Enhanced Cooperation in itself is on the one hand a tool to overcome blockades inside the EU 27. On the other hand the structural differences between the countries outside and those inside the Enhanced Cooperation are deepened through the procedure. This seems to reflect a general trend. The European Stability Mechanism (ESM) is even going further, as it is a multilateral agreement completely outside the EU legislation (see the article "A knight in shining armour"). The crisis is a catalyst of centrifugal tendencies in the EU-27.

Overview of EU financial reforms not covered in this newsletter

Review of the Market Abuse Directive (MAD II) and a new Market Abuse Regulation (MAR): review of the directive on market abuse and criminal sanctions for insider dealing. After the EC published its proposals on 20 October 2011, a draft report by the ECON committee of the EP was published on 20 March 2012. Amendments have been proposed in May and the committee is scheduled to vote on 8 October. The draft report will probably be submitted to an EP plenary sitting in January 2013.

Key information documents (KID) for packaged retail investment products (PRIPS): the EC proposed a regulation on key information documents for investment products. Its goal is to improve transparency in the investment market for retail investors. EP Rapporteur Pervenche Berès (S&D)

plans to table her draft report in October 2012.

Insurance (Solvency II Directive / Omnibus II): different legislative and technical processes to reduce the riskiness of the insurance sector and improve supervision, and reduce abuse in selling insurance products (Insurance Mediation Directive). Solvency II is completed and awaiting publication in the Official Journal. The date of the obligation on Member States to transpose the Solvency Directive is postponed (till 31 June 2013), because the OMNIBUS II proposal will not be in force on time. Otherwise, this would have created a legal vacuum and serious financial problems for investors. To further protect consumers, the EC published its proposal on an Insurance Mediation Directive in July 2012.

Directive on Credit Agreements Relating to Residential Property (mortgage credit): The process of co-decision started after the EC made a legislative proposal on 31 March 2011 to protect consumers against abusive selling of mortgages. A draft report by the EP committee (ECON) has been tabled for plenary in December 2012. The EP is also separately working on an integrated European market for card, internet and mobile payments.

Recommendation on Universal Access to Basic Banking Services: The EP adopted a resolution on access to basic banking services on 4 July 2012. This is a non-legislative resolution which calls upon the Commission to draft a proposal for a directive that should allow every EU citizen to open a bank account. The EC published a Commission staff working document on 22 August 2012.

Review of the Credit Rating Agencies Regulation: The co-decision legislative process started after the EC made its proposals in November 2011 for reforming the credit rating agencies business (as explained in a previous newsletter). A report, drafted by the ECON committee, is tabled for an EP plenary and will probably be voted on in December 2012.

Shadow Banking: A draft report by the EP, published in August 2012, calls for the monitoring and tackling of the systemic risks of shadow banking. It asks the EC to come up with a legislative proposal at the beginning of 2013.

Improvement of the safety of investment products:

- Proposal to amend the directive on central securities depositories (CSDs): It will introduce common standards for securities settlement in order to reduce settlement failures and costs. The proposal is awaiting EP's first reading in plenary, which is scheduled for March 2013.
- EC legislative proposal for a Securities Law Directive (SLD) is expected to create an EU legal framework for safe holding and disposition of securities, the exercise of investor's rights and the creation of a supervisory regime to control any activity of safekeeping and administration of securities.
- Review of the Directive on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market: First reading in EP plenary scheduled for January 2013.
- European Venture Capital Funds legislation: The EC published a proposal at the end of 2011. The EP adopted amendments to the proposal on 13 September 2012. Voting has been postponed to a subsequent EP plenary.
- Common Provisions on European Funds and Repealing Regulation.
- Review of the Anti-Money Laundering Directive: The EC aims to release a draft directive in January 2013.

Taxation (see also the article on tax evasion in this newsletter):

- Taxation of energy products and electricity: restructuring the

Community framework: Awaiting final decision. Most-debated issues are the introduction of CO_2 based taxation and the principle of parallelism.

- European system of national and regional accounts in the European Union: A report, drafted by the ECON committee, is tabled for an EP plenary in November 2012.
- Action programme for taxation, FISCALIS 2014-2020: The Commission proposal of a successor programme of the Fiscalis 2013 programme, which ends on 31 December 2013, is awaiting first reading by ECON committee (scheduled in November 2012).
- The EC (DG TAXUD) will release a Communication on strengthening good governance in the tax area ('tax havens, uncooperative jurisdictions and aggressive tax planning'), due to be released in the 4th Quarter of 2012.

Calendar of official events

For more background to the official agenda of European institutions, see the following websites:

The European Commission (EC)

The Economic and Financial Affairs Council (ECOFIN)

The Economics and Monetary Affairs Committee (ECON) of the European Parliament

October

- **5, Paris (ESMA):** Consultation closes on Exemptions under Regulation (EU) 236/2012 on short selling and certain aspects of Credit Default Swaps
- **8, Luxembourg (Eurogroup):** Meeting
- **9, Luxembourg (ECOFIN):** Meeting, including discussion on MiFID II
- **8-9, Brussels (ECON):** Meeting
- **9-14, Tokyo (Worldbank and IMF):** Annual meetings
- **10, Brussels (Finance Watch):** Conference on MiFID II - Financial Markets: Serving the Real Economy and Society?
- **15, Brussels (ECON):** Meeting
- **18, Brusssels (EC):** Consultation closes on another review of UCITS (see article in this Newsletter More commodity investments in the future?)
- **18 – 19, Brussels (European Council):** Summit meeting of heads of state
- **22-26, Strasbourg (EP plenary):** Plenary (non final) vote on MiFID II and MiFIR

November

- **3-4, Mexico City (G20):** Deputies of Finance Ministers and Central Bank Governors meet
- **4-5, Mexico (G20):** Finance Ministers & Central Bank Governors' Meeting
- **5, Brussels (EC):** Consultation closes on Problems that arise in the direct tax field regarding cross-border venture capital
- **5-6, Brussels (ECON):** Meeting
- **8-11, Firenze (Civil society):** European meeting '10+10" to strategize on European crises
- **9, Brussels (ECOFIN):** Meeting on budget
- **12, Brussels (Eurogroup):** meeting
- **12-13, Brussels (ECON):** extraordinary meeting
- **13, Brussels (ECOFIN):** Meeting and potential decision on MiFID review
- **13, Brussels (EC):** Consultation closes on reforming the structure of the banking structure (Liikanen report)
- **14, Brussels (EESC):** European Economic and Social Committee meeting
- **15, Brussels (ECON):** Meeting
- **22-23, Brussels (European Council):** Summit meeting of heads of state28-29, Brussels (ECON): Meeting
- **29, Brussels (EC):** Public consultation closes on the Regulation of Indices

December

- **3, Luxembourg (Eurogroup):** Meeting
- **3, Brussels (ECON):** Meeting
- **4, Brussels (ECOFIN):** Meeting
- **6, Brussels (ECON):** Meeting
- **7, Paris (ESMA):** Consultation closes on Guidelines on remuneration policies and practices (MiFID)
- **11-12, Moscow (G8 and G20):** CSO/NGO strategy meeting
- **13-14, Brussels (European Council):** Summit meeting of heads of state
- **17-18, Brussels (ECON):** Meeting
- **20, Frankfurt (ECB):** Governing Council and General Council meeting

January

- **1, Brussels (EU):** Irish presidency starts
- **30-2 (Feb), Davos (Switzerland):** World Economic Forum Annual Meeting

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