CHALLENGE AREA FINANCIAL MARKET REFORM

FIVE WAYS TO REGULATION

AK WIEN

GERECHTIGKEIT MUSS SEIN

FOREWORD

Over the past decades, the world has been shaken by a number of financial crises, none of which, however, has reached the level of the crisis that took hold of the United States in 2008.

One has to keep in mind: a crisis, which was triggered by an excessively bloated financial sector, forced states to respond with stabilisation actions and bailouts worth billions, which led to a massive increase in public debt. The price of the financial crisis is to varying degrees being borne by people who did not cause the crisis – in form of rigorous austerity measures, wage cuts and a lack of investment –, whilst many in the financial markets continue to speculate.

This is hardly surprising – as taming the financial sector has made little progress since the outbreak of the crisis. The most dangerous 'fire accelerants' – such as the shadow banking system, the continued power of rating agencies, the wide range of opportunities for speculation – have not been diffused. And we are still waiting for the Financial Transaction Tax and the tax havens continue to thrive! Organised irresponsibility is alive and kicking.

From the very beginning, the Chamber of Labour has supported a comprehensive reform of the financial market – with the objective that the financial markets return to assuming a service role towards the real economy. With this brochure, we want to make an interim assessment of the most important regulatory steps and the still unsolved challenge areas.

We also hope to give an insight in the often confusing and complex dynamics of the financial markets.

President Herbert Tumpel

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INTRODUCTION

The causes of the financial crisis arose long before the property bubble in the USA burst in 2006. A relaxation of the rules in the financial sector, which had been initiated in the 1980s, only to be vehemently pursued again during the last decade, entailed a loss of transparency in respect of products and institutions, a large increase in highly complex financial instruments and an enormous acceleration and fragmentation of the market, which started to operate on various, partly intransparent trading places. This liberalisation of the financial markets and its actors culminated in the events of September 2008, which saw the collapse of Lehman Brothers.

What followed was not only the largest crisis since the end of World War II, but also the most widespread awareness that there was a problem since the regulation of the financial market had come to an end. The declaration at the end of the G-20 Summit in Washington in November 2008 said: "We commit to ensure that all financial markets, products and participants will be regulated or subject to oversight, as appropriate." The EU also set itself the ambitious goal to implement the targets of the 2009 G-20 Summit in Pittsburgh in respect of financial market regulation, capital adequacy of the banks, accounting standards and manager salaries by 2012.

This brochure will make an attempt to explain what has been achieved since these announcements were made. However, we also want to address the question: what shape must the financial sector take to make a positive contribution to the efficient functioning of the economy? Important is that more emphasis has to be placed on interests of the economy as a whole as on micro-economic issues. According to this, the financial market must again be subordinate to the real economy.

In our brochure, we have allocated the individual legislative initiatives to five "challenge areas". The first challenge area addresses the "Protection of small investors and bank customers". It deals among other with investor compensation, insurance mediation, the right to a basic bank account and secure investment products. A "solid banking system" has been required within the scope of the second challenge area. We will take a closer look to find out to which extent banks are system relevant ("too big to fail") and examine the rules on capital requirements for financial institutions (key word "Basel III"). Our focus in the third challenge area will be placed on the "stabilisation of the financial market". Here, several issues have to be addressed simultaneously, i.e. the structure of derivative markets, particularly dangerous financial products such as CDS, of the shadow banking system (including alternative investment companies), of trading places, of rating agencies and last not least of the financial market supervision. "Financial industry regulations" are at the heart of the fourth challenge. This involves the issue of responsible corporate governance and control, international accounting as well as measures against Insider dealing and market manipulation. Finally, challenge area V is a chapter concerning a measure, which contributes both to curing excessive high-frequency trading as well as to securing the states' revenue base, i.e. the implementation of a Financial Transaction Tax.

1 http://www.g20.utoronto.ca/2009/2009communique0925.html#system

CHALLENGE AREA I – PROTECTION OF SMALL INVESTORS AND BANK CUSTOMERS

Christian Prantner, Benedikta Rupprecht, Gabriele Zgubic

Introduction

The consequences of the financial crisis affect consumers in many different ways: on the one hand, they have to cope with the expensive losses of securities, which were either written off completely or suffered a long-term loss of value. Small investors do not have enough instruments at their disposal to compensate losses or to take successful legal action against their financial service provider. Apart from that, since the outbreak of the first financial crisis, Austria is also faced with big problems concerning foreign currency loans – in particular due to the revaluation of the extremely popular loan currency Swiss Franc compared to the Euro. Over many years, the "Swiss Franc loan" had been a successful financial product. This has several reasons: the high supply pressure of financial advisors and other financial intermediaries has contributed to the fact that this speculative product based on credit sold so well. As it turned out, the risks involved, in particular in respect of this product (but also of many risk-oriented investment products), had been downplayed most of the time. However, not only intermediaries, but also banks actively promoted foreign currency loans and were prepared to sell these particularly risky loan agreements to a large number of consumers. Today, people who took advantage of these foreign currency loans are faced with a variety of problems – for example, that saving products with built-in risk factor (such as unit-linked life insurances) will probably not be able to "repay" these loans. The truth is that the capital repayable on maturity of these saving products will in many cases not be sufficient to fully pay off the loan on maturity.

The crisis also resulted in a number of private loans becoming more expensive. The terms for overdrafts – very popular in Austria – were subsequently tightened: surprise credit assessments of customers, who use their overdraft facility regularly meant that they had their overdraft limit reduced. Savers too are losers. Their nest egg attracts very low interest rates, which seem to slowly approach a zero interest rate.

This chapter shall explore all those aspects of the financial market, which affect the consumers. What has been achieved since the outbreak of the crisis and where is still a need for political action?

Bank deposit guarantee schemes

Meanwhile, the European Commission has not remained idle and already addressed obvious problems of consumer protection. Quite a number of new Directives concerning the financial sector have been introduced, whereas some that were already in place, have been revised in the wake of the financial crisis. A Directive affecting all savers has been revised in respect of the **bank deposit guarantee schemes.**[2] The deposit guarantee is the legally determined guarantee of savings deposits up to a maximal amount of 100,000 Euro per bank and saver if a bank becomes insolvent. However, many savers know from experience that secure deposit guarantee schemes systems do not come free – more security costs more money – either in form of lower interest rates on their deposits or higher charges.

Important **consumer policy requirements by the Chamber of Labour** on the deposit guarantee include:

- Setting the coverage level at 100.000 Euro.
- Improved and mandatory information for savers on the deposit guarantee.
- Any promotion or advert for savings products has to include a mandatory reference to the deposit guarantee.
- The Directive should also require mandatory information in cases where an investment product (e.g. bank bond) is not covered by the deposit guarantee.
- Any ambiguities regarding the term "deposit" should be removed. A clarification in the text of the Directive on savings clubs und escrow/nominee accounts, as used in connection with buying property and their administration, would also be welcome.

The deposit guarantee amount shall apply **separately for each brand of a bank** and not only – as planned – for each bank concession. In case of bank mergers, where two banks become one, both of the merged banks will remain separate brands. Savers should not be worse off when the old bank "disappears" and becomes part of a bank, which also only belongs to one deposit guarantee scheme. It is also possible that customers open a savings account with various banking brands. In this case, the guaranteed limit of 100,000 Euro applies to both savings accounts combined.

Prospectus Directive (securities and investment prospectuses)

The financial crisis has caused thousands of small investors in Austria to lose their entire or at least large part of their savings. These losses were also made possible because investors were not – or not adequately – informed of the high-risk character of their investments, even though the legally required capital market pros-pectuses – the objective of which is to provide the investor with a detailed picture of the nature of the investment and securities issue – referred to all possible risks. The Chamber of Labour requested that the revised **Prospectus Directive**[3] would also include a condition laying down that all capital market prospectuses to be prepared by the issuer (e.g. companies, wanting to sell a bond to small investors) also had to be made available in the language of the Member State, in which an investment is publicly offered. Investor scandals in Austria (in particular in case of property securities) have shown that issue prospectuses in English are an insurmountable barrier for the understanding of small investors.

Another frequent problem is the reluctance of financial intermediaries to supply small investors with existing detailed and verified issue prospectuses or even to mention them. The Chamber of Labour therefore requests, as a priority measure, to make it mandatory for financial advisors to provide customers with a summary of a security prospectus.

2 Proposal of the EU Commission for a thorough revision of the Directive on Deposit Guarantee Schemes from 12.7.2011: http://ec.europa.eu/internal_market/bank/guarantee/index_de.htm

3 Prospectus Directive: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:327:0001:0012:DE:PDF

The most important **requirements of the Chamber of Labour** in connection with preparing prospectuses are:[4]

- Providing capital market prospectuses also in the language of the Member State
- Mandatory handing over of the summary of the capital market prospectus to investors
- Presenting the content of the prospectus summary in a modified and standardised manner
- Publication of all prospectuses on a common central website in each Member State
- More effective liability provisions

Investor compensation scheme directive

Investor compensation, which also originates from an EU Directive,[5] which is currently implemented into the Austrian Securities Supervision Act, is important for buyers of securities. However, investor compensation only applies to a small number of legally defined cases, for example, if bankruptcy proceedings have been initiated against the investment firm and if the company is no longer able to return funds or financial instruments to their investors. This means that client assets have been "lost" in particular because of embezzlement or similar misappropriation. Straight forward price losses or misleading advice of a fund manager does not warrant compensation.

The "Anlegerentschädigung von Wertpapierfirmen GmbH", in short "AeW", which acts as Liability Company based on the Securities Supervision Act (WAG), has existed in Austria since September 1999. In case of compensation and at the request of an investor, the investor compensation facility AeW, provided eligibility and the amount of the claim have been established, has to pay up to a maximum of 20,000 Euro (per investor). This investor compensation is funded by contributions of participating investment firms, but also from special contributions in case of compensation. The relevant amount has to be paid within three months. Under certain circumstances, this period may be extended for a further period of three months. This sounds good in theory; however, some investor scandals in the past have revealed the shortcomings of the current investor compensation. In Austria, thousands of investors of AMIS-Funds, who suffered losses, are still waiting for their compensation payments. It took a decision by the Supreme Court to clarify that the ca. 12,000 AMIS investors fall under the compensation duty of AeW.[6]

The EU Commission initiated a revision of the Directive,[7] as the time it takes for compensation to be paid and the financial basis of the various national investor compensation facilities have over the past years proven to be inadequate The definitive contents of the Investor Compensation Directive have not yet been finalised fest. Whilst the proposal of the Commission had still set the minimum amount of compensation at 50,000 Euro, the EU Parliament is now proposing to double the amount to 100,000 Euro (as at May 2011). The Chamber of Labour supports comprehensive Investor protection.[8]

Key demands in connection with investor compensation are:

- Compensation cases shall be processed more speedily.
- Financing of investor compensation shall be borne by market participants.
- Accompanying measures have to be put in place to prevent compensation cases in the first place.

4 More under: http://www.akeuropa.eu/_includes/mods/akeu/docs/main_report_de_104.pdf
5 Investment Compensation Scheme Directive 97/9/EC
6 The proceedings lasted about four years: Supreme Court Decision Reference no. 4 R 1/09k, August 2010
7 http://ec.europa.eu/internal_market/securities/docs/isd/dir-97-9/resume-impact-assesment_de.pdf
8 Details of the AK position on investor compensation: http://www.akeuropa.eu/de/publication-full.html?doc_id=156&vID=43

Regulation of Packaged Retail Investment Products (PRIPS-Initiative)

In 2010, the EU Commission launched the so-called PRIPS Initiative (consultation). What does the abbreviation PRIPS stand for? PRIPS are **Packaged Retail Investment Products**, i.e. "packaged" investment products, such as bonds, whose return depends on a basket of stocks. They are investment products for small investors that "depend on a different basic value". Hence, they refer above all to unit-linked life insurances and index-dependent securities. The EU Commission wants to help small investors to get a better understanding for nested investment products. It is an objective of the initiative and the consultation process[9] to provide investors with better information to enable them to compare products more effectively. Other important questions concern the scope (Which products are considered "packaged"?), the rules of good conduct for intermediaries and the pre-contractual product disclosure instrument for customers. A key issue in the planned Directive shall be the Key Investor Document (KID). A KID refers to a clear and internationally unified short summary, which shall be made available to customers prior to concluding a contract. The document already exists for investment funds.

From the point of view of investors, compact and concise written information, containing all important key points (yield, term, risk, and cost) on a few pages, is useful. However, the Chamber of Labour also takes a critical look at the PRIPS Initiative: first of all, the question has to be asked why small investors should carry out a comparison of complicated, increasingly more confusing investment products in the first place. From the point of view of a small investor one might as well ask whether packaged and per se confusing investment products are at all suited for normally risk-averse small investors. The Chamber of Labour argues for simple investment products and demands standardised product information sheets for all savings and investment products. Even simple savings products have become increasingly complicated over the past years, such as the – unfortunately not always easy to understand – interest rate adjustment clauses or cancellation terms for savings products.[10]

The key demands of the Chamber of Labour include:

- Standardised product information sheets (a type of "instruction leaflet" for financial products) shall not only be prepared for "packaged" investment products, but for each savings and investment product of the provider

- Bank and investment products should be designed in a clear, simple and comprehensible manner. One conclusion of the financial crisis identifies that small investors bought many products where not only the information in pre-contractual consultations as well as the supporting written information had been inadequate, but that product construction including their objectively existing risks were too complicated.

- Preparing pre-contractual product information sheets shall be the responsibility of the product provider. The product design as well as details of its structure lies de facto with the product issuer whilst the correct presentation of the product and handing over the product information sheets shall be laid down in the binding advisory obligations of the mediator.

Directive on insurance mediation

Some years ago, the European Union prepared a set of regulations for the various mediators of insurance contracts (e.g. brokers and agents). These provisions, which in particular include particular information, consultation and documentation duties for insurance mediators, have been outlined in the 2002 Directive on insurance mediation (2002/92).

In 2011, it was suggested to revise this Directive in order to improve consumer protection and to coordinate it with other Directives in the financial sector.

9 http://ec.europa.eu/internal_market/consultations/2010/prips_en.htm
10 Details of the AK position on PRIPS: http://www.akeuropa.eu/de/publication-full.html?doc_id=172&vID=43

In respect of insurance mediation, the Chamber of Labour considers the improvement of commission and cost transparency and an effective regulation of conflicts of interest with regard to selling insurances to be very important. What is meant by this and why are these points important? The remuneration systems applied in practice sometimes include high sales commissions for the mediator, which could have a negative effect on insurance customers. Sales and turnover targets set by the management for staff working in insurance companies and banks result in pressure to sell products, which are profitable for the company (profit margin) and sales staff (high sales commission) but which might prove costly for customers.

In practice, both large sales commissions and high sales and turnover targets have the unpleasant side effect that customers are persuaded to buy certain products, they do not want or which are completely unsuitable. These misguided sales prove to be very costly for consumers. In the short term, because monthly premiums take quite a chunk out of their income, but also in the long term, as many contracts have long maturity periods (such as life insurance contracts).

Normally, a premature cancellation of a contract entails considerable losses for insurance customers. The repurchase (i.e. the cancellation of the contract) in case of endowment life insurances – contracts where money is saved – often results in the fact that the proceeds from the cancelled contract do not even cover the amount of the premiums paid.

Therefore, the Chamber of Labour considers the customer-friendly revision of commission schemes and the effective prevention of conflicts of interest in respect of selling insurance policies as important issues.

What is a conflict of interest? For example: if an insurance product of insurance company A is remunerated with a 4% sales commission and that of insurance company B with a 5% sales commission (and if insurance company B perhaps adds a few incentives for a successful sale), the insurance advisor is faced with a potential conflict: selling life insurance A pays a lower commission, but might be more appropriate to the customer than life insurance B, which pays significantly more commission (but is probably less well oriented towards the customer's requirements).

Social responsibility of banks: legal right to basic bank account

150,000 people in Austria live in households with no access to a basic bank account – many of them not by choice. EU-wide, 30 million people are excluded from this basic banking service. Not having access to a bank account makes it more difficult to receive a salary or other income and results in being severely disadvantaged in the labour market and difficulties in looking for a job. Today, wages paid in cash are almost unheard of. In addition, people without access to a bank account have to pay high banking charges as all bank transfer can only be carried out via payment slip or as cash payment at the bank account. These costs are far higher than those for an average bank account.

The Chamber of Labour has long been supporting a legal right to a basic bank account. The EU Commission too had been considering this issue for quite some time. However, in summer 2012 – in contrast to its original announcement – the Commission only made a recommendation to the Member States instead of adopting a binding legislative measure. This change of mind is difficult to understand as the experiences in many EU States show that the financial and thereby social exclusion of people with access to a bank account can only be ended with a genuine legal right. Even though the voluntary initiatives taken by some Austrian Banks over the past years are to be welcomed, they are not able to remove the overall problem.

From the point of view of the Chamber of Labour, access to a basic bank account should generally not be accompanied by a large number of problems; in fact all banks should be obliged to make basic bank accounts available. Speedy and unbureaucratic access to a basic bank account must be ensured. People, who have a basic account, but are unable to use it – maybe because of private insolvency or because it has been blocked – shall also have access to a basic bank account. If opening an account is rejected, effective options to settle a dispute out of court by an arbitration board shall be put in place.

Our requirements and key points of basic bank accounts include:

- The account shall be operated on credit basis
- A card for withdrawing cash should be included
- Reasonable flat rate fees may be charged
- The account must not be linked to other bank products

Key demands of the Chamber of Labour include:[11]

- The Chamber of Labour requests a mandatory product information sheet for all insurances.
- The Chamber of Labour supports the introduction of uniform information obligations for the future sale of all insurances.
- A general right to withdraw from the insurance or mediation contract (advisory contract against payment) without stating reasons shall be implemented.
- The prevention of conflicts of interest shall also be established in the insurance sector as a priority objective.
- Hence, the Chamber of Labour supports the increased use of remuneration systems that are not related to success or sales figures in both the securities and insurance sector, and thereby reduce conflicts of interest.

Interest rate restrictions

In 2010, the European Commission published a study on interest rate restrictions in credit agreements, which was based on a Europe-wide legal and economic analysis. The Chamber of Labour considers interest rate restrictions an important instrument of consumer protection and debt prevention. Apart from a traditional ban on usury, almost all EU countries have implemented restrictions on default interest, interest calculation methods and one-sided interest adjustments. However, there are big differences; some countries, for example, have fixed interest ceilings.

In 2011, the Commission asked questions on the hypotheses of the study[12] by way of consultation. The key issue for consumers was whether interest rate restrictions are generally justified. Apart from the im-portant question of responsible lending, a particular issue concerned the recognition of interest rate restrictions as a key element of protecting borrowers against over-indebtedness, which should even be extended and to prevent this defence instrument from being put into question at EU level.

Example default interest – existing restrictions are not adequate

Lenders in Austria are permitted to add a maximum of 5 % to the contractually agreed interest rate if a borrower is in default. However, this results in the fact that in addition to the added dunning and administration costs, which are to cover the damage caused to the creditor by the delay, interest rates are applied, which are far higher than the refinancing costs of the creditor, which in any case are already reflected in the contractually agreed interest rate of the basis transaction. In general, the contractually agreed interest rate already includes a risk premium. In many cases, a debtor has to expect (in this case fixed) interest rates of up to 21% as soon as repayment is due.

The consequence of this is, that even in case of small loans, a debt spiral is set into motion, which frequently affects young consumers. Due to salary attachments, many people with debt problems lose their jobs. In most cases these problems can only be solved by initiating private insolvency proceedings, which in turn presents another hurdle for accessing the labour market.

People in debt are also unable to change their provider, as due to their lack of credit worthiness, access to offers of the free market does no longer exist. Instead of being able to benefit from the advantages of the free market, they have to remain with one provider – possibly for the rest of their life. What is therefore needed, are protective measures for debt prevention implemented by civil law, in order to reduce the costs of this market failure for the society as a whole. Apart from regulating default interest, the issue is also concerned with putting a cap on compound interest as well as challenging the practice of setting off payments first against cost and interest and only then on the outstanding Capital.

11 Details zur AK-Stellungnahme: http://www.akeuropa.eu/_includes/mods/akeu/docs/main_report_de_179.pdf
12 http://ec.europa.eu/internal_market/consultations/docs/2011/interest_rate_restrictions/consultation_en.pdf

Key demands of the Chamber of Labour include:

- It should be emphasised that legal interest rate restrictions are essential and that bans on or restrictions of existing interest rate restrictions have to be firmly rejected.
- In addition, protective measures for debtors should be improved, if one considers the serious consequences, interest claims might entail in case of financial difficulties.
- The 5 % premium for default interest, which is permitted in Austria, should be reduced.[13]

Inclusion of consumer organisations and consumer protection as supervisory objective

Over the past years, the one-sided focus of the entire European financial market architecture on the market has resulted in consumer concerns not being given enough attention. The Chamber of Labour therefore demands to accelerate the institutional inclusion of consumer organisations in the legislative process and laying down consumer protection as a supervisory objective.

Consumer protection is also a responsibility of financial market supervisory authorities and as a result these should be legally required to be more active in respect of consumer protection. In order to achieve that new regulations are applied to the financial sector, it is inappropriate if planned amendments (Directives, Regulations, institutional scope and financial infrastructures) are exclusively evaluated by the financial industry, which after all is mainly interested in its own advantage. It is therefore necessary that consumer organisations and consumer-oriented committees of European institutions (EU Commission, stakeholder groups in European supervisory authorities etc.) have the necessary skills to promote these.

Conclusion

Experiences over the past years have shown that a variety of investment but also of loan products are not only complicated, but also entail significant and sometimes hidden risks (such as certificates, fund policies, index-linked life insurances, loans based on insurance policies, foreign currency loans combined with option contracts etc.). In conclusion, one can say that the complexity of the products and the increasingly aggressive advertising and marketing methods have resulted in a large number of misguided purchasing decisions. The wide range of problems from the consumer's point of view in general, and the countless investor scandals in particular demonstrate that it is necessary to regulate the "markets" by implementing targeted legal provisions.

The EU Commission has started to revise a number of existing Directives, and also proposed new initiatives to increase consumer protection – at least according to the preambles of many projects. However, the legislators in Brussels consider above all two guidelines: firstly, the consumer shall benefit from the completion of the internal market and the promotion of cross-border transport. Secondly, the consumer shall receive comprehensive information prior to concluding a contract – if this was the case consumers could make even the most complex purchasing decision. The thought that comprehensive information would be a patent remedy against dubious products and aggressive advertising methods, is out of touch with reality, as it is a proven fact that the marketing machine of the financial industry is capable of drowning out any, no matter how well intended, objective information. If providers do not change their risk-oriented product and sales culture for good, small investors will continue to suffer losses, some of which might even threaten their existence.

13 More information on the AK position: http://www.akeuropa.eu/_includes/mods/akeu/docs/main_report_de_180.pdf

CHALLENGE AREA II – A SOLID BANKING SECTOR

Why do banks have to be bailed out at any price?

Susanne Wixforth

Practically all Austrian Banks whom savers traditionally trust with their money are of systemic relevance or too big to fail. Institutions, whose failure, due to their size, the intensity of their links to other banks ("interconnectedness") and their close foreign relationships trigger significant negative knock-on effects with other credit institutions that might lead to the instability of the financial system, are defined as "systemically relevant". The larger the size of financial institutions, the greater the impact on other economic operators. This increases the probability that the state has to come to their rescue. The assumption that financial institutions that reached a certain size are too big to fail and must not be allowed to become insolvent has been confirmed by the approach of the EU Member States in the wake of the financial crisis. Famous examples for the bailout and nationalisation of financial institutions are IKB (Deutsche Industriebank), Hypo Real Estate and Commerzbank in Germany, Barclays and the Royal Bank of Scotland (overall eight banks were (partly) nationalised) in Great Britain, and Hypo Alpe Adria and Kommunalkredit in Austria. Not to forget the EU-wide bank rescue packages, which included guarantees and also direct "capital injections" in form of loans, equity capital or a combination of the two (hybrid capital), because the "market" was not prepared to make those available to financial institutions.

Due to the strong commercial relationship between financial institutions ("interconnectedness"), it has been assumed that their insolvency would be more expensive for the economy than their bailout costs combined. Therefore, large financial institutions have been classified as systemic entities, which can only be rescued by state intervention ("bailout") in order to prevent an unforeseeable domino effect including a run on the banks by savers.

Expensive bank packages

Austrian taxpayers had to pay EUR 1.4 billion for the crisis of the financial sector; globally, the costs are estimated at EUR 7.3 billion.[14] Due to attempts to tackle

14 Handelsblatt, 22.8.2009

the crisis, above all the bailout of the financial sector, combined with higher expenditure and less income because of the economic downturn, the average level of debt of the EU Member States rose from 59 % to 80 %.

Meanwhile, a number of legislative proposals have been introduced or adopted at EU level, which aim at regulating the financial markets, among other by implementing transparency rules. Does that mean that from now on EU taxpayers are immune against further rescue pack-ages? By no means!

Whilst in the US the so-called "Volcker Rule" – the ban on proprietary trading by commercial banks, i.e. they are not permitted to trade with securities and derivative financial instruments to prevent deposits by savers being put at risk through speculation losses, and the institutional separation of investment and commercial lending – has been partly implemented by the Dodd-Frank Act, the question of separating speculative and commercial transactions in the EU is only a side issue. Because we do it differently in Europe?

Looking at the financial structures reveals an interesting picture: whilst in the US, the assets held by the six largest banks constitute ca. 70 % of GDP, the three largest banks in the UK hold 333 % of GDP, banks in France and Spain ca. 290 % of GDP and in Ireland 280 % of GDP, whilst Germany as a model student comes out on top with "only" 130 % des GDP[15]. That this structure is not exactly healthy has been confirmed by the latest crisis. Ultimately, Europe has almost only systemically relevant institutions, as savings remain firmly in the grip of banks' investment transactions and speculations. A bank, getting into difficulties due to investment speculations, does not have to rely on its shareholders for help. Arguing that insolvency would put savings at risk, taxpayers will have to continue footing the bill.

Conclusion

The banking landscape in the EU Member States is characterised by a high level of market concentration; the majority of their institutions is systemically relevant – so-called SIFIs (Systemically Important Financial Institutions). Currently, a separation between commercial and investment business does not even enter the equation. Hence, it is generally approved that the status "too big to fail" encourages market participants to engage in undesirable activities, such as reducing market discipline and promoting an excessive willingness to take risks, as the prospect of a "bailout" increases the incentive to take bigger risks. SIFIs remain essentially off the hook when it comes to taking responsibility as not the shareholders but the general public compensate any losses (moral hazard). The fact that smaller corporations suffer a serious competitive disadvantage because they cannot rely on state intervention is another undesirable side effect.

This structural problem poses great risks, in particular in view of the weakened budgetary positions of the EU Member States. It will not be financially feasible to rescue the financial institutions for a second time. Many economists therefore believe that the interconnectedness between investment and loan business should be urgently capped.[16]

15 Andreas Botsch, The sustainable company (2011)
16 Also compare Gustav Horn (IMK), Handelsblatt 18.10.2011

Bank stabilisation or What on earth is Basel III?

Thomas Zotter

That banks have a special status in the economy is a known fact not only since the outbreak of the most serious financial and economic crisis since World War II. As the banking system fulfils important functions in the economic cycle, banking crises, which restrict these functions, can quickly spill over to the real economy. The most important functions include ensuring the circulation of cash and bank (cheque) money as well as enabling private persons and commercial corporations to save and take out loans, thereby fulfilling volume, maturity and risk transformation. Hence, a bank run, i.e. the large-scale withdrawal of savings triggered by panic would result in the collapse of the payment and credit system, which would mean that businesses were no longer able to finance their investments. This was one of the reasons (apart from a lack of economic intervention), why the 1930s crisis resulted in a depression.

Banks, in particular when they are very big and interconnected, are often simply too big or too interconnected to fail. The collapse of these system relevant banks can bring down the banking system and ultimately the entire economy.

In contrast to a corporation in the real economy, the banks' limited "fail ability" makes it easier for them to rely on being rescued by the taxpayer. In return, the state, which provides the rescue guarantee, has to ensure that the likelihood of a banking crash is as unlikely as possible. This is one of the key targets of a prudent banking regulation, key elements of which are capital requirement regulations to ensure solvency, and the deposit guarantee to prevent savers from panicking, which in turn helps to ensure the liquidity of the (business) banking system.

What is "Basel"?

The Basel Committee on Banking Supervision was established by a group of Central Bank Governors and has currently 27 members. Its seat is at the Bank for International Settlements in Basel (a kind of bank for the Central Banks). The objective of setting up this Committee was the harmonisation and mutual recognition of national banking regulation and supervision. The recommendations of the Basel Committee do not have legislative character, but mutual recognition only comes into effect when the states implement the recommendations. This gives these recommendations a quasi-legal character.

The First Basel Accord (1988) introduced a uniform equity capital ratio of 8 per cent for all credit institutions. Claims (assets) were furnished with risk weights (from 0 for bonds of safe countries via 50% for mortgage-backed claims up to 100% for high credit risks). In Austria, these were implemented with the 1993 Austrian Bank Act.

Soon enough, the banking sector began to lobby for a new calibration of these risk weighted assets "closer to market", and these new standard were established 2006 in the Basel II accord. These were more market-orientated and more differentiated according to risks. Overall, these standards led to a lower requirement of equity capital; the returns on equity of the bank rose considerably through higher leverages, but the equity capital was no longer adequate to withstand a more serious crisis. In addition, the market-oriented risk weights increased the fluctuations of the economy. The liquidity and solvency problems revealed in the crisis required huge and historically unique assistance of Central Banks and Governments to prevent the entire banking system from collapsing – with the known consequences for national budgets and the level of debt for public budgets.

Basel III

The crisis has shown that the equity cover of credit institutions was inadequate and that institutions were left with too little buffers. As a result banks began to shake faster than expected. In addition, institutions relied too much on the interbank money market (banks continuously lend each other money to compensate surpluses or liquidity requirements). Due to their assumption that they would be able to refinance long-term obligations at any time in the interbank market,

they took risks that were far too great. After the collapse of Lehman Brothers and the near-collapse of AIG,[17] the mutual trust of the institutions had completely disappeared and only the intervention of the Central Banks, which replaced this interbank market, was able to prevent a major breakdown of the banking system. The EU States had to provide about EUR 300 billion (about three percent of the annual economic output of the EU) in financial help.

Basel III is now making an attempt to rein in this risk to a certain degree, by (gradually) increasing the legally required ("regulator") equity capital of credit institutions in respect of quality (capital that meets the essential core capital requirements; in other word, it has to be paid in paid in full and must be able to bear losses, and it must be available for an indefinite period) and quantity by so-called conservation and cyclical buffers. On the one hand, these buffers are used to compensate for risks that are not covered by the risk weights and to smooth lending via the economy on the other. Initially, higher equity capital requirements push the return on equity down (profit in relation to equity capital), but at the same reduce borrowing costs because less interest has to be paid for a lower risk. Additional capital buffer should not only smooth the fluctuation of the lending business, but also result in a more stable return trend. This would enable banks to expect lower risk premiums on refinancing.

Apart from the requirements on capital, requirements on liquidity management shall be introduced within a transition period, in order to prevent banks from overstretching the maturity transformation, that is borrowing too much at short term from the interbank market, which can dry up very quickly. In addition it has been planned to implement a leverage ratio, which will supplement the risk weighted asset-based valuation by a simple, transparent limitation of the risk.

Directives of the European Parliament and the Council had already laid down in the past that a higher level of risk weight standards has to be applied proprietary trading (the so-called trading book in contrast to the banking book); in respect of the resecuritisation of exposures (i.e. the tradability of securitised exposures) a mandatory share of 5 % has to be retained in the balance sheet.

These recommendations by the Basel Committee shall be implemented in two parts in the EU by the so-called CRD IV Directive (Capital Requirement Directive) and the CRR (Capital Requirement Regulation)[18]: the directive is to be implemented by the national states, which is mainly directed towards national supervisory authorities and which should ensure more unified rules and proceedings, and the regulation, which addresses the banks directly. In doing so, the Commission wants to achieve far-reaching harmonisation, in order to prevent institutions from relocating to a country, which applies the lowest regulation standards ("regulatory arbitrage"). The Commission presented the legislative proposal in July 2011. The negotiations between European Parliament, European Council and European Commission will begin early 2012. The gradual implementation shall begin in 2013.

Demands by the Chamber of Labour:

- It must be the objective to replace the core function of the financial sectors in the economic cycle at the centre of considerations and regulating measures, namely the funding of long-term investments by non-financial corporations, private households and the public sector. Risks, which financial markets – due to their complexity, trading volume and lack of transparency – transfer to the economy as a whole, have to be analysed and controlled

- The significance of external ratings for regulatory capital has to be drastically reduced; ratings should not be automatically changed (see chapter "Ratings in crisis").

- Bank liquidation: we need a mechanism, which saves banking functions without the need to rescue shareholders, management and bond creditors as well. They must be the first ones to bear the risk and not the taxpayers. The proprietary rights of taxpayers have to take priority over the proprietary rights of shareholders.

17 The American International Group, Inc. (AIG), a major globally operating insurance group based in New York, had to be rescued by the government during the course of the financial crisis.

18 AK Position on Directive: http://akeuropa.eu/de/publication-full.html?doc_id=206&vID=43

- Restricting proprietary trading and separating the risks between investment banking and commercial banking activities: the risk weights in the trading book should be higher and the equity capital for investment banking should be separated from the equity capital of business banking, in order to avoid the risk of contagion, and to be able to deal with both sectors separately if needed (e.g. liquidation of the investment bank with continued operation of the business bank.)

- Remuneration systems must provide sustainable incentives. Taking into consideration performance over a longer period, or non-transferable occupational pension schemes as well as sustainable criteria of performance measurement have to replace short-term, risk-prone incentives.

- Transactions with tax havens and offshore centres: transactions via and in tax havens and offshore centres lead to regulatory standards being undermined. The Chamber of Labour demands a strong stance towards offshore centres and tax havens and a restriction of transactions on these venues.

- Pushing back "off-balance sheet activities" and the shadow banking system: credit institutions increasingly remove risky investments from their balance sheets to bypass capital requirement regulations. This issue has to be addressed on two levels: funding of such instruments and financing vehicles via banks must be restricted (indirect regulation), and corporations that assume banking functions, have to be regulated – in accordance with their functions – in the same way as banks in the respective activities (direct approach, see chapter "Alternative Investments or "vulture funds" – the new plague from biblical times?").

- Admission of financial products: financial products should meet certain minimum standards and be subject to risk assessments. Proof of the compliance to certain minimum security standards would mean better information for the Supervision, which in turn would be able to better assess systemic risks of individual products and innovations as well as the benefit of products. Setting minimum standards does not mean being hostile towards innovation. Here, particular focus has to be put on over-the-counter

transactions (OTC). In order to be able to install minimum standards in the first place, it has to be clear which products are to which extent "on the market". All transactions should have to be processed on stock exchanges or a central counterparty. Faults and distortions in this sector may not only affect both business partners, but if they exceed a certain volume and depending on the interconnectedness of the financial system, entire economies and countries, as has been demonstrated by the financial crisis.

- Financial market supervision in Austria:

  – Trust in the financial system is an essential requirement for it to work. Hence, the target must be the continuous and sustainable strengthening of the Financial Market and Banking Supervision. Competencies, such as the authority's investigatory authority and entitlement to make information public should be extended in the interest of improved investor protection and increased transparency.

  – One lesson learned from the financial crisis is that supervisory authorities and regulators should have adequate resources and ought to make sure that their staff have sufficient know how and are continuously trained to enable them to keep up with the development in the financial markets. In order to avoid excessive fluctuation, appropriate incentives – such as adequate remuneration – are required.

  – Institutionalised dialogue in the FMA: experience over the past years has clearly shown how important the dialogue and the flow of information are between all participants. Exchanging information with the Financial Market Authority could be significantly improved if an advisory board would engage in an institutionalised dialogue between representatives of industry, workforce, consumers and the scientific community.

Conclusion

Basel III and the implementation at European level capture some weaknesses in the banking regulation; they go in the right direction but are hesitant in parts and sometimes do not go far enough. Improving quality bank equity capital is to be welcomed, as is the implementation of conservation and cyclical capital buffers, as they contribute to banks becoming more crisis-resistant and make their conduct less dependent on and driven by the business cycle. It is also to be welcomed that the over-reliance on external ratings for legally required equity capital shall be reduced. Any exemption clauses in the legislative proposal shall be deleted; risk assessment is an essential responsibility of credit institutions. However, there is still a long way to go in respect of removing some of the incentives which led to the crisis: the bailout of the banks confirmed to shareholders and managers that they will be rescued if a crisis occurs, hence there is a risk of moral hazard. Holding equity separately for investment banking and commercial banking (deposit and lending business) under company law and the introduction of a Bank Resolution Act, the risk of contagion should be limited, and the rescue of functions of a credit institution, which are important for the economy – without having to bail out the entire Institution – would be made easier.

CHALLENGE AREA III – STABILISING THE FINANCIAL MARKET

The new fire station is called European System of Financial Supervision

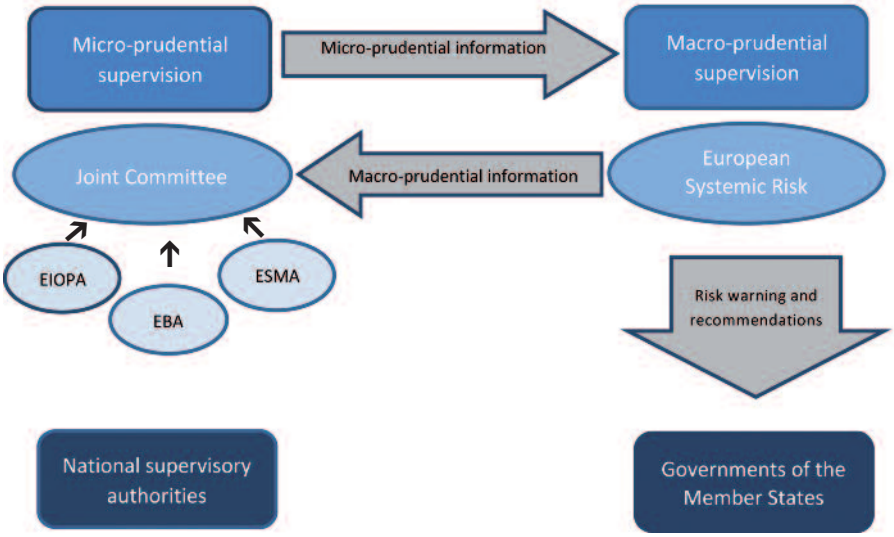
Susanne Wixforth, Sepp Zuckerstätter

After a considerable amount of taxpayers money had been invested to prevent a collapse of systemically relevant European financial institutions, everybody agreed that such a 'surprise' should never happen again. The proposal by the European Commission for a new macro and micro-prudential supervisory structure was rushed through on 16.12.2010.

Now, hope rests on this new supervisory structure that Europe will never again be caught unaware by untoward developments, which eventually led to the Lehman collapse in 2008 and subsequently to a prolonged financial and economic crisis. Europe's citizens shall be better protected and confidence in the financial system shall be restored. The focus at European level shall not only be put on supervising individual institutions, but in particular on the stability of the financial system as a whole.

How is the new supervision organised?

The European System of Financial Supervision is made up of a macro-prudential and a micro-prudential supervisory area. The most important new EU authorities in the Micro-prudential area are EIOPA (European Insurance and Occupational Pensions Authority), EBA (European Banking Authority) and ESMA (European Securities and Markets Authority). In future, the European Systemic Risk Board (ESRB) will be responsible for the macro-prudential[19] supervision. As a result, the picture of the future European System of Financial Supervision (ESFS) will have the following layout:



19 Macro-prudential supervision: its focus is in particular placed on the stability of (national or global) financial systems as a whole. In contrast, the term "micro-prudential" refers to the supervision of individual institutions.

The responsibilities, which have been assigned to the still young micro-prudential EU supervisory authorities, represent a big challenge. Only in exceptional cases, it has been provided with rapid intervention powers, – for example, suspending the trade with securities, which appear to be systemically risky. Essentially, the responsibility remains with the national authorities; the task of EU authorities is to harmonise and stabilise the supervision of financial institutions by commenting on concerns and issues. As they are not permitted to examine financial products in advance or to ban their sales, European and national supervisory authorities will basically continue to chase market trends in an attempt to regulate them. The same applies to investment strategies, even if they are highly risky, as described among other in the chapter on hedge funds. However, it appears to be even more difficult to meet the expectations put on the European Systemic Risk Board (ESRB). An "early warning" can trigger a dangerous downward spiral and make things worse. Apart from that, many governments (among them Germany and France) consider macro-prudential recommendations an intrusion in the economic and fiscal competences of the Member States.

Officially, the ESRB is not authorised to prescribe binding measures to Member States or national authorities. Instead it is expected that its reputation and its high ranking composition will ensure that political decision-makers and supervisory authorities will bow to its moral authority. Hence, its tasks include to evaluate and comment on the macro-prudential situation, taking the level of interconnectedness and mutual dependence of companies within the financial system into account, to give risk warnings and recommendations and to point out potential imbalances in the financial system, which increase the systemic risk as well as to suggest appropriate remedies. In order to raise the political acceptance of this system, which essentially works outside any democratic control and responsibility, accountability and reporting duties towards the European Parliament have been stipulated. However, the European Parliament has not been given an active role; it can only ask the ESRB to examine specific issues or to take part in hearing before Parliamentary committees.

Institutionally, the ESRB is practically an extended Council of the European Central Bank. However, in the meantime, the development in Europe has overtaken the macro-prudential supervision, as both the requirements within the scope of the EU rescue packages as well as the comprehensive requirements of EBA for banks as central participants in the financial sector enable far more serious interventions into macro control, than those which had been granted to the ESRB. Unfortunately, this does neither change anything in respect of the lack of democratic legitimation of European macro policy or macro-prudential supervision nor with regard to its basically misguided baseline, which is still based on the belief in the self-regulating power of the market.

Conclusion

The new supervisory authorities are in their constitutional phase. They were established as at 1.1.2011. Essentially, they assume the role of harmonising subsequent regulator at micro-prudential level (insurance, banking and securities supervision). However, there will still be no prior vetting of harmful investment methods, such as using high levels of leverage, a lack of security, the sales of structured, complex financial products to small investors, at EU level. Whether the "moral power of persuasion" of the European System of Financial Supervision will be adequate for a sector that excels by making little effort to act morally and by collective irresponsibility is more than questionable. The lack of democratic legitimacy of the system appears to be an additional factor, which put success into question. It would have at least been desirable to grant the European Parliament more information rights.

Derivatives

Judith Vorbach, Susanne Wixforth

Forwards, futures, options and swaps are confusing terms, which can be explained as speculating on a certain Market development. The word 'derivative' originates from the Latin "derivare" (to derive). This hits the nail on the head as the value of a derivative derives from another value: e.g. from the exchange rate, from interest rates, from the price of wheat, from the oil price or from the value of a share. The enormous rise in the volume of derivatives, which the American investor Warren Buffett in 2003 already criticised as "financial weapons of mass destruction", meant that the speculative aspect saw a huge increase in the financial markets. The useful function of derivatives for the real economy, for example when exporters hedge against the risk of exchange rate fluctuations, is losing increasingly in importance.

According to estimates, 80-90% of derivative trading is taking place outside of regulated stock exchanges – i.e. "over the counter". The default risk, i.e. the risk that the counterparty is unable to meet its payment obligations at the due date, is difficult to predict. Apart from that, there are no collateralization provisions, which often results in trading without a hedge.

The over the counter derivatives market is characterised by

- an extremely high market volume:[20] more than 10 times the amount of global GDP, i.e. ca. 700 trillion USD (June 2011),
- a high proportion of non-standardised, but customized contracts,
- use of very high leverage,[21]
- lack of transparency,
- high market concentration and strong mutual interdependence of major market participants
- and above all a lack of regulation and market organisation.

Current EU activities

Apart from OECD, IMF and many others, the EU Commission too has recognised that the uncontrolled trade with derivatives has been one of the major causes for the outbreak of the financial crisis.

As a result it presented a draft proposal on OTC derivatives, central counterparty and trade repositories.[22]

This draft proposal is an attempt to get over the counter derivatives, i.e. trading outside stock exchanges, back under control. This is to be achieved by two essential measures: on the one hand by reporting requirements to get an overview of the market trading volume, and on by setting up central counterparty to process "eligible" (standardised) derivative transactions the other. The advantage of trading via a central counterparty lies in the collateral provisions. If a contracting party is unable to provide securities, it will be excluded from trading. In doing so, one hopes to limit the counterparty risk resp. to keep it under control.

Following tough negotiations, EU Parliament and Council finally agreed on the draft bill in February 2012 so that the new regulation will probably come into force in 2013.

20 Based on the amount of outstanding nominal values

21 Leverage effect means that only a fraction of the invested capital is needed to move significantly higher nominal values e.g. of shares. This enables a disproportional participation in changes in underlying asset prices. Therefore, leveraged products carry a higher risk that might result in a loss which exceeds the invested capital.

22 COM(2010) 484 final, vom 15.9.2010

Content of the Regulation

The assessment of the Langen Report[23] and the Proposal by the EU Commission show: ex post control is still a major part of the considerations, as is improved transparency. However, no attempt has been made to influence how products are designed, i.e. in particular to rate financial products, whose risk cannot be assessed, as not tradable.

The situation is further aggravated by the fact that the clearing obligation by central counterparties continues to be limited to trading with standardised products. This provides an incentive for market participants to increasingly switch to unregulated OTC trading, which might also increase systemic risks (complicated customized products, too few or no collateralization, high leverage).

Also missing are provisions against market concentration resp. the systemic risk coming from trading partners: the EU Commission did not insist on position limits resp. the volume of derivative contracts held by members of central counterparties, or on the lever used. There are also no minimum requirements for collateralization.

Finally, the EU Commission fails to address the problem that central counterparties create a new systemic risk, which has to be subject to particular democratic control. It leaves their organisation to civil law and the commercial ideas of their founders, as it is the case within the scope of the MiFID.[24] As a result, the central counterparties will compete with each other, mainly based on the fees charged and the liquidity offered, but also and in particular on the costs of the required collateralization and the safety precautions overall.

Demands by the Chamber of Labour

Due to the fact that the instability of European and global financial markets entails serious effects for European

employees and taxpayers – according to estimates of the OECD, the crisis so far has cost industrial countries about 13 million jobs and youth unemployment in Europe has reached an embarrassing level (headed by Greece and Spain at almost 50 %)[25] – establishing new financial market regulations, is a key demand of the Chamber of Labour. The most urgent task is to implement measures that reduce the immense volume of the OTC derivative sector and couple it to conditions in the real economy again. Its growth is damaging and not comprehensible in macroeconomic terms. Based on the high level of intransparency in this market, it is no longer possible to assess potential dangers such as excessive prices, bypassing regulations, supervision and taxation as well as the formation of financial market bubbles in respect macroeconomic stability and their effect on the real economy.

23 Werner Langen, Berichterstatter des Wirtschaftsausschusses im Europäischen Parlament
24 Market of Financial Instruments Directive (RI 2004/39 EG)
25 Eurostat, Pressemitteilung, 1.3.2012

This policy must be based on three pillars:

- Product control

  Derivatives, which are not traded on regulated trading venues, have to be subject to an approval procedure. Financial products, whose risk cannot be assessed, where no macroeconomic benefit can be proven resp. which might even cause damage, may not be approved. Products, which are traded on public trading venues and cleared by a central counterparty, have to meet the following minimum standards: no structured product,[26] solid initial security and the lever applied may be maximum 1:5.

- Control of trading partners

  All trading partners, financial and non-financial (i.e. corporations of the real economy) have to be subject to the new clearing obligation (processing via central counterparties). Position limits for the members of the central counterparty and their clients must also be included.

- Control of institutions

  Due to the fact that the creation of central counterparties brings with it new systemic risks, the Chamber of Labour rejects a free right to alter legal relationships based on the principles of civil law. In future, central counterparties shall be assigned an important role to achieve systemic safety of the financial market. Hence, they must essentially act in the public interest. Therefore, a requirement has to be a legal form based on public laws (corporation, institution), as well as strong democratic control (right to be heard of the Parliament in respect of members of the board). The supervisory authority must be represented in a suitable organ and also be involved in the appointment of organs. Any influence by financially strong members of a central counterparty on its organs must be excluded.

Conclusion

Based on the present draft bills of the EU, it cannot be expected that anything will change in respect of the instability of the European and global financial system. No precautions have been made against the trade with complex, structured financial products and the unhealthy volume of OTC trading will hardly be reduced. On the contrary, incentives have been created, which will make market participants increasingly switch to the OTC market to avoid higher costs (in form of securities and fees for central counterparties).

The systemic risk, which has been created by the central counterparties, has been left to the safety precautions of private founders, whereas national supervisory authorities have to act as fire fighters in case of a blaze. Only a few provisions are in place enabling prior control. For example, there are no participation rights concerning the appointment of organ members, their hearing as well as their admission to the board of directors.

Finally no attempt has been made to use the database created by the central counterparties and trade repositories as a basis for collecting the planned European Financial Transaction Tax.

26 Structured products are combinations of a classic investment such as a share or obligation with one or more derivatives. These elements are combined to one parcel, which results in a separate investment product. The repayment of this investment product is derived from the development of one or several base values. Due to its complicated construction and the lack of transparency, structured products are very complex and assessing their risk is difficult. The development of structured capital products is also referred to as financial engineering.

Short selling of securities – a risky commercial practice

Judith Vorbach, Susanne Wixforth

Stock exchange jargon speaks elegantly of short selling to describe a transaction where the seller sells a product (i.e. securities) that is not in his possession. The reason behind this procedure is speculation: he hopes to buy the securities cheaper at some time in the future. Hence, he speculates that the price of these securities will fall in the meantime – i.e. during the period between concluding the transaction and acquiring the securities. The difference between sales and purchase price is his profit – or loss.

The problem arising from this is quickly explained: whilst the profit of the short seller is limited to the lowest price of the security, a loss can almost take unlimited proportions, as the short seller has to obtain securities, which are not in his possession at the time of the delivery date, whatever the price. Because of this uncertainty in respect of making either a profit or loss, the short sale is also compared to a bet. The short seller makes a profit if he succeeds in buying securities in the market, which he had previously sold (short) at a high price. There are two variants: the less speculative is the covered short sale, where the seller can use the securities upon concluding the contract, even if they are not in his possession, for example in form of a securities lending. And the highly speculative naked short sale: the seller is not in possession of the securities when he concludes the contract. He has to acquire the owed securities before the agreed deadline.

Covered and naked short sales – a danger?

Naked short sales are problematic for two reasons: on the one hand because it is possible to sell more financial instruments than overall exist resp. are available on the market. Most naked short sales are carried out when – mostly due to bottlenecks – it is difficult to cover them by securities lending. This increases the risk that the contract cannot be fulfilled or only at high cost. On the other hand, (covered and naked) short sales are normally used to speculate on falling prices. This can trigger a downward spiral, which puts the stability of the entire financial system at risk.

The scale of the financial crisis suggests that companies had systematically carried out short sales without actual sales intention in order to negatively influence their price. Flooding the market with securities resulted apparently in the insolvency of companies. However, during daily business it is difficult to distinguish between so-called "abusive naked short selling" and "serious" short selling, which fails because of the inability to fulfil the contract (because no securities are available). Both cases only distinguish themselves by the subjective characteristic of a lack of will to perform, which in practice can only be concluded from the behaviour of the market participant.

Special case Credit Default Swaps (CDS)

CDS are derivatives, which can be compared to an insurance against the default risk of bonds, which are issued by corporations or governments. The buyer of a CDS pays an annual premium to hedge against the insolvency of the corporation or the state.

If an investor buys a CDS without owning a corporation or government bond, i.e. without being exposed to a default risk, one speaks of "naked CDS" (naked Credit Fault Swap), a credit insurance without a need for insurance. Why does the investor nevertheless buy a CDS? Because he expects resp. speculates that the risk will occur. In contrast to a credit insurance, the insured receives the compensatory payment even if he does not carry a risk. According to this, the seller "bets" on the default of the corporation or the state as he obtains the amount insured when the credit event (insolvency) occurs. CDS in their present form were "invented" by JPMorgan Chase & Co in 1997 with the aim to transfer the credit default to a third party, thereby reducing the risk requirement. However, CDS are also used to trade credit risk.

The total amount, which is paid annually for insuring against these risks, is referred to as "CDS spread" (risk premium). The higher the probability that the reference debtor will default, the higher the CDS spread. "CDS spreads" are used as reference for assessing the creditworthiness of debtors. Corporations, for example, are directly affected by the level of these spreads when the interest on credit lines is based on these spreads; the same applies to states whose bond interest is influenced by them. The market value of those CDS increases, whose spread was set at a lower level in the past than it should have been according to the current (less positive) assessment.

The financial crisis has also shown that the economic sense of CDS has been reduced to removing risks from the bank books in order to release as much capital as possible for further transactions resp. to bloat the volume more and more. This was added by the fact that there was no longer any proximity to the underlying transaction, and thereby an actual assessment of default risks had been replaced by the calculation of probabilities.

Many dangers – where does trading take place?

Even the European Commission, which since the 90ies, undeterred and in spite of negative signs to the contrary, preached the reliability of the free play of the market forces, had to admit during the course of the 2008 financial crisis that the invisible hand of the market, despite the serious distortions that the liberal system entailed, had remained invisible. And continued be so: because the speculative trade with naked CDS is getting more and more EU Member States into difficulties. Due to the outlined pricing based on the calculation of probabilities, it becomes increasingly less clear to which extent the ratings of Greece, Spain, Portugal, Italy, Ireland and France are based on fundamental data or on the calculation of probabilities and gossip, which triggers a herd instinct, manifesting itself in the majority of investors buying or selling at the same time. The United Nations Conference on Trade and Development (UNCTAD) is currently denying the financial market the capability to set correct prices for securities in the broadest sense, which are justified by fundamental data.[27]

In autumn 2010, the European Commission presented a draft proposal,[28] whose analysis admitted that short sales and naked CDS pose a problem for the stability

27 UNCTAD Study, June 2011: http://wien.arbeiterkammer.at/online/spekulation-verteuert-rohstoffe-61725.html?REFP=1159
28 COM(2010)482, Proposal for a Regulation on Short Selling and certain aspects of Credit Default Swaps

of the financial market. Nevertheless, it continued to reiterate their importance for the liquidity of financial markets, which takes priority over all other socio-political objectives.

After long negotiations on the draft proposal between European Council and European Parliament, agreement was reached in autumn 2011. The trade with naked CDS has been banned. A victory of reason over the invisible hand? By no means! Because: the ban can be lifted – after examination by the European Security and Markets Authority (ESMA) - at the request of an affected Member State – if the liquidity of its financial market is at risk.

In terms of naked short sales: they will be more transparent in future as reporting and information duties – however, only from certain threshold values – will be introduced. The "locate rule" shall prevent more securities being sold than are actually available on the market; i.e. the short seller must prove that his expectation to carry out the settlement is plausible – leaving plenty of room for interpretation.

An attempt is also being made to reduce the risk associated with naked short sales by setting a time limit, i.e. the positions have to be backed with appropriate securities by the end of the respective trading day. Otherwise the short seller might be faced with a penalty at a level, which prevents him from making a profit. This shall enable supervisory authorities to intervene faster and to recognise systemic risks earlier if they suspect market abuse and aggressive short sales strategies.

Unfortunately, politics abstained from the establishment of market regulation, for example by introducing an "uptick rule" ("circuit breaker rule"). By this provision, short sales of securities, whose price has fallen more than 10 % below the official closing price of the previous day, will be automatically restricted. Instead, the legislator is hoping for the alertness of supervisory authorities to recognise systemic risks and then prevent them by a ban on short sales. However, this requires a speedy recovery of the market as the measures have to be limited to 3 months.

Conclusion

One can recognise a revision of the current European strategy, which relied on the total deregulation of the financial markets. Whether the cautious approach with a view to the rapid product and sales innovations on the financial market since the first financial crisis in 2008 is enough remains to be seen. Nevertheless: one courageous step has been taken – the naked credit default swaps have been banned.

If only exemptions would not exist, which create fragmented submarkets and thereby once again open up a variety of bypassing opportunities. One can only hope that transparency in respect of covered and naked short sales is enough to recognise their possible destabilising effect in time. After all, the new intervention powers of ESMA might at last result in a harmonised approach against systemically relevant risks for all securities apart from bonds and CDS. In case of cross-border effects, ESMA is able to prescribe measures itself.

The Regulation was adopted by the European Parliament in November 2011. It will come into force on 1.11.2012.

Alternative Investments or "vulture funds" – the new plague from biblical times?

Susanne Wixforth, Sepp Zuckerstätter

Hedge funds and private equity corporations are alternative investment companies. Together with other financing vehicles they belong to the so-called "shadow banking system". They provide financing, which is not subject to banking regulations. According to the EU Commission, the volume of global shadow banking systems is estimated at EUR 46 billion; this is equivalent to about a quarter of the entire financial sectors.[29]

Hedge funds and private equity corporations are similar insofar that both frequently use loans to implement their investment strategies; that means they increase their investment volume by borrowing. This also distinguishes them from "traditional" funds, which normally only invest the capital provided by their customers. Apart from that, there is a huge variety of business models among so-called hedge funds. Starting from private equity corporations, which are often responsible for destroying target corporations by borrowing capital to purchase them and then transferring the loan to the acquired company, up to "classic" hedge funds, which use leverage to bet on the rising or falling value of securities, derivatives or indices and often have an exacerbating effect on a crisis.

The classic "vulture funds" were private equity corporations, which bought companies using a small amount of equity capital; they subsequently burdened the acquired companies with repaying loan and lending rates (leveraged buyout), thereby putting them under financial pressure.

Whilst the activities of private equity corporations have a detrimental effect on individual companies, hedge funds, which primarily rely on the speculation with derivative financial instruments, have a systemic effect on the stability of the financial market. They act like "fire accelerants" in a crisis.

It has been suspected that they share the responsibility for the collapse of Lehman Brothers in 2008 and for the Euro crisis. Hedge funds have nothing to do with the original meaning of the word "hedging". The method of "hedging" was originally developed to hedge futures. These are transactions whose settlement date lies in the future. The classic example is the farmer who sells his summer harvest to the miller in spring to secure a certain price and the sale of his harvest. The miller in turn secures sufficient quantities of the raw material at a previously fixed price.

However, this has little or nothing to do with a hedge fund. Typical for this type of fund is the massive use of derivatives, i.e. financial instruments, whose value depends on the price of other securities, currencies or raw materials. The price of these derivatives – depending on the structure of the product – can rise or fall with the price of the underlying value. As these financial instruments, apart from speculation, can also be used for hedging, the financial institutions trading them are referred to as hedge funds.

The great danger for the financial sector, originating from hedge funds lies in their high implicit or explicit leverage. This means they aim to achieve a higher return on equity based on borrowing (leverage effect). The borrowing can amount up to the level of 100 %; hence, the losses in case of insolvency are not incurred by the hedge funds but by the lending banks. As hedge funds were not subject to any investment or regulatory provisions, they practically enjoyed unlimited "creative" freedom. The investment strategies applied by fund managers are based on a variety of actuarial resp. econometric models. As many assumptions of these models are far from economic fundamentals, the approach of fund managers is often compared to bets. Bets are placed on or against currencies, corporations or entire states. In this context, they are accused of pushing up crisis management costs to the detriment to the economy as a whole.

29 On March 19, the Commission presented a Green Paper on Shadow Banking for public consultation: http://ec.europa.eu/internal_market/bank/shadow_banking/index_de.htm

A market out of control – what has been done so far?

In the wake of the Madoff scandal, but in particular after the economic and financial crisis, which followed the collapse of Lehman Brothers in 2008, hedge funds were rated as a systemic risk for financial markets. A declaration was made at the G-20 Summit in November 2008, according to which hedge funds had to become subject to regulation.

This put the EU Commission, which until then had relied on the self-regulating powers of the free market economy, in a tight spot. In spring 2009, it presented a draft Directive aiming at the regulation of alternative investment fund managers (AIFM Directive). The title alone makes one prick up one's ears: the target of the Regulation was no longer to be the funds and the method applied – i.e. using borrowed capital to bet on rising or falling prices – but their managers. This made it clear from the outset that the EU Commission stuck to its political principle: no interference in type and scope of transactions or business methods, but essential only a registration and licensing procedure for fund managers.

This principle reveals the following weaknesses:

- For example, threshold values have been set for the registration – starting from EUR 100 million Assets under Management (AuM) for fund managers of hedge funds, and from EUR 500 million Assets under Management (AuM) for private equity fund managers. This opens up the possibility to bypass these obligations by respective corporate structures.

- The licensing of fund managers also includes exemption clauses, which are typical for the financial market: at first glance, the introduction of an EU passport appears to be a big step towards transparency and harmonisation of the licensing requirements. From 2013, there will be an intra-EU passport for EU fund managers, from 2015 an EU passport for fund managers from third countries. However, this EU passport will not be issued by an EU authority in accordance with uniform requirements, but by the relevant authority of the Member State, in which the third country fund manager wants to become active. This license will then be valid for all other Member States. The tendency to engage in forum shopping, i.e. selecting the authority with the least requirements, is obvious. Once the first shock of the economic crisis dies down it is clear that some Member States will be tempted to attract such financial institutions through lax regulation. It has only been planned for 2019 to integrate this national licensing procedure into an EU licensing procedure. However, in the end, such a passport appears to be little more than an entrance ticket required for a casino: especially as no restriction on the leverage used has been planned.

- The choice whether to ban the possibility of participation in such funds for small investors remains at the discretion of the individual Member States.

However, the second form of alternative investment, the so-called “asset stripping” by private equity corporations has only been regulated to a certain degree. A new and positive point in this regulation is that employees – up to a certain level – have to be informed about ownership and corporate strategies but not much more. The idea behind it is to prevent the management from “doing something” with the investment funds behind the back of its workforce. It is to be welcomed that the practice to buy corporations with borrowed capital and to transfer the debt to the corporation, which was taken over, will be inadmissible within two years after the takeover of the target corporation. However: takeovers of small and medium-sized enterprises[30] are exempt from the scope of the AIFM Directive in any case – hence the new safeguards do not apply to the majority of for example Austrian companies.

30 In accordance with the EU SME definition, a medium-sized enterprise is defined as an enterprise which employs fewer than 250 persons and whose annual turnover does not exceed EUR 50 million or whose annual balance-sheet total does not exceed EUR 43 million. A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million.

The Directive was adopted on 11 November 2010, following tough negotiations between the European Council (where the Member States are represented) and the European Parliament. In spite of a Conservative majority and massive lobbying by sections of the financial industry, the European Parliament had demanded a slightly stricter regulation than the Council. The Directive came into force in September 2011. Now, the Member States have two years to implement it into national law.

The current regulation is a first small step towards a stability-oriented financial regulation. It remains to be seen whether further steps will follow before the next possible financial crisis. In any case, here the often vilified European Parliament has shown that it was better tuned to the needs of the European population than national governments, which are still attached to country-based competitive thinking at the expense of the European citizens.

Conclusion

It has been demonstrated that hedge funds can put entire economies under pressure. It will need more than the registration of their managers and the disclosure of business models to reduce this risk. The much heralded fireworks concerning the regulation of alternative investment funds turned into a squib. A compromise, which did not address the actual problem, i.e. the reduction of speculation risks, from the outset. The new legislation is limited to purely organisational requirements, and does not provide for any general restrictions with regard to eligible investment instruments and investment techniques for alternative investment funds. Hence, hedge funds still pose systemic risks, as they are able to create new financial products which they can sell to anyone. Even the protection of small investors remains at the discretion of the Member States.

The Chamber of Labour therefore demands

- that not only the managers, but the funds themselves must be subject to regulation;
- a ban on trade of financial products, which have not been admitted by the supervisory authority;
- that the use of leverage must be tightly restricted;
- an EU-wide ban on selling structured products, i.e. products, whose risk is difficult to assess, or not at all in some cases, to small investors;
- all threshold values must be cancelled, all hedge funds and private equity transactions will be subject to regulation.

Trading financial products – but how?

Judith Vorbach, Susanne Wixforth

With the "old" Markets in Financial Instruments Directive – coming into force 2007 – a framework had been provided for the European securities market. Already now this is undergoing a revision process. In view of the fragmentation of the market into a complex structure of trading venues, lack of transparency, a vast number of obscure financial products, excessive speculation with food and raw materials and the strong increase of algorithmic trading, it does not come a minute to soon. Unfortunately, far too little emphasis has been placed on the question, how the securities market can be structured to support a positive development of the real economy as best as possible.

The Directive

The Markets in Financial Instruments Directive, MiFID, was regarded by the EU Commission as a "core pillar in EU financial market integration" And rightly so, as it covers a broad spectrum of the financial sector. It determines the framework for securities trading and financial services in the European Union, and creates new provisions for trading venues.

The predominant purpose of the MiFID 2007 was to increase competitiveness and efficiency of the EU financial markets. And indeed, since 2007 competition increased, the spectrum of providers and instruments broadened and the costs of financial transactions were reduced. However, the flipside of the coin of these alleged achievements include bloated und fragmented markets, a diversion of the trade away from comprehensively regulated stock exchanges, intransparency and dubious products.

Hence, the revision of the relatively young MiFID became part of the efforts to reform the financial markets, which was initiated in the wake of the financial crisis. A proposal for a new Regulation was presented in November 2011. The aim is to alleviate the problems associated with the "old" MiFID and to stay abreast of the latest financial markets developments. For example, the "old" MiFID mainly regulates trading in stocks (as well as money market instruments and futures contracts), whilst a number of new financial instruments has been "invented" since 2007. These shall now be covered by the new Regulation. This leads to a very complex Regulation, which is divided into two legislative proposals: the revised Directive itself (MiFID new) and the Regulation on markets in financial instruments (MiFIR). The comprehensive and nested legislative proposal covers several central aspects of EU financial markets:

The meeting points of financial products: trading venues

The Revision determines that the entire organised trade has to take place on regulated trading venues. These shall be divided into three types: "traditional" stock exchanges (i.e. "regulated markets), Multilateral Trading Facilities (MTF) and Organised Trading Facilities (OTF). These platforms shall (to a large extend) be subject to identical requirements on transparency, reporting, organisation and market supervision.

"Traditional" stock exchanges, where shares or derivatives are traded in accordance with strict guidelines, have been around for centuries. Globally important stock exchanges are in New York, London, Frankfurt, Tokyo or Chicago. According to the MiFID 2007, apart from "traditional" stock exchanges, MTFs too are recognised as regulated trading venues. Hence, a part of previously off-exchange trading was now diverted to the new category of regulated trading venues. As on "traditional" stock exchanges, MTFs too combine supply and demand in accordance with previously determined

rules. MTFs can also be operated by an investment firm (for example a bank). Compared to "regulated markets", the demands of MTFs on issuers and traded financial instruments are lower. Nevertheless, they are competing with "traditional" stock exchanges. Examples for MTFs are Turquoise in London (founded by nine major banks), Tradegate in Berlin and Chi-X in London. However, there are also some smaller and specialised MTFs. Currently, a total of 139 MTFs are licensed in Europe. Based on the new MiFID, it is intended to create another sub-category of MTF, i.e. the so-called "SME growth markets".[31]

Apart from that, the revised MiFID shall also integrate OTF into the legal framework. So far, the increased number of such trading platforms is not subject to any regulation. Hence (as is the case regarding the construction of MTF) at least a part of the trade taking place there, shall be transferred to regulated trading places in order to bring more transparency to the non-public financial trade. This affects for example those (currently) overt-the-counter (OTC) derivatives, which in future shall be subject to a trading obligation (compare the following section). However, this will (from the point of view of the EU Commission) only apply to those derivatives, which are "eligible" for public trading (i.e. sufficiently standardised and liquid). "Dark Pools", where buyer and seller remain unanimous, and Broker Crossing Networks, where investment firms combine customer orders, shall also be covered.

In contrast to "regulated markets" and MTF, operators of OTF enjoy a margin of discretion and do not have to meet previously laid down rules. As a result they can perform services to clients, which are (according to the definition of the MiFID new) "qualitatively if not functionally" different from services provided by regulated markets and MTFs. Hence, that seems to leave the door wide open for further fragmentation and bloating of the market. The fact, that OTC trading is by no means prohibited, must also not be ignored.

Whilst OTF are not permitted to invest their own capital, "systematic internalisers" (SI) are free to do so. These are investment firms that – in an organised and systematic manner – frequently trade on their own account, by carrying out resp. combining customer orders off trading places just described. In this case, less strict transparency requirements apply and the various market participants can be treated differently. The new version of the Regulation intends to at least raise the standard of regulation for SI. Only twelve, in general very large investment firms, consider themselves SI and are registered accordingly.

The consequence of this very laborious differentiation of trading venues resp. "quasi" trading venues is a very complex market. It has to be feared that due to competition, the clear rules of "traditional" stock exchanges will be increasingly watered down. After all, constant attempts are being made, to adapt trading places to market developments, which results in a continuous effort of the Regulation to keep up with market trends.

Adapting the Regulation to market trends: (commodity) derivatives and "trading machines"

A good example for positive approaches by the new regulation and its softening through exemptions, vague information and time delays can be found with regard to the trading obligation for derivatives on OTF described above: initially, the European Securities and Markets Authority (ESMA) shall prepare drafts of technical regulation standards, in which it suggests certain derivative categories for the trading obligation. It will present these to the EU Commission; however, not without having carried out a prior public hearing with the stakeholders (consumer protection organisations, trade unions, representatives of the financial industry etc.). The EU Commission is then able to publish an invitation to present proposals for trading with these derivatives. With regard to the question when ESMA is supposed to present such recommendations to the EU Commission, the MiFID so far only provides preliminary stubs instead of a date.

Commodity derivatives refer to food products and raw materials and are regulated separately in the "new" MiFID. Rightly so, as trading and speculating with them

31 In order to enable SMEs to access financing more easily, softer regulations concerning transparency, organisation and security shall apply to this type of trading platform.

have hugely increased since the 2008 financial market crisis. A connection with soaring food and oil prices is rather obvious. Now it shall be possible to also lay down position limits. That means that operators of such trading venues have to impose caps on the number of contracts an individual actor can enter into in a certain period. However, quite sobering is the wording that "alternative regulations that have an equivalent effect" may be possible, which in turn leaves room for interpretation. To enable the speedy and effective reduction of trading with commodity derivatives, these position limits would have to be laid down in advance, and certain market participants (such as index funds) would have to be banned from trading with commodity derivatives. This is the aim of the US Commodity Futures Trading Commission, which is working on a unified regulation for the entire US. However, in Europe, the ESMA shall only monitor whether the position limits set for the various trading places are implemented "consequently and fairly".[32] This is added by the fact that due to a lack of European control, the position limits may be undermined at any time by actors, which transfer their activities to another trading venue. One must also bear in mind that a considerable proportion of the trade with commodity derivatives is OTC.

In order to do justice to electronic trading, one would like to implement stricter organisational requirements at least for regulated markets. It is estimated that about half of the stock exchange trade is now taking place via computers, whereby decisions to buy are partly independently carried out by machines, based on algorithms. Particularly controversial is the so-called high-frequency trading. Based on trading impulses in microseconds, minimum price differences of the same securities on different trading places are used to achieve the highest possible profit. This is not only beneficial to traders, but also to trading places, where turnover and profits increase with the number of transactions.[33] Automatic trading can trigger an abrupt slump in prices without the existence of comprehensible reasons in the real economy. Now trading shall be automatically halted when sudden price fluctuations occur. However, the circumstances, under which such a mechanism will be set into motion, will be left to the operators of the various trading platforms. Participants shall also be obliged to submit their trading data to the supervisory authorities, including the algorithms used. These approaches are to be welcomed. However, the fact that "trading machines" significantly influence important economic data and increase trends remains unchanged.

Transparency and reporting requirements

Transparency requirements are being improved to tackle the problem of a complex market with many different trading venues. The quality of all market data shall be improved and collected in one place. For example, post trade data (see below) shall be available free of charge within 15 minutes. A wider range of financial instruments shall become subject to more comprehensive transparency obligations, i.e. share certificates, funds traded on stock exchanges, certificates and similar financial instruments issued by corporations, but also bonds, structured financial products and derivatives. Investment firms will be obliged to at least disclose transactions that take place off trading places, via approved publication systems.

It will be differentiated between pre-trade transparency and post-trade transparency. Pre-trade transparency concerns the continuous publication of current bid and asked of financial instruments (until now particular in respect of shares) and the market dept,[34] i. e. data, which is important for participants to be able take the best possible buying and selling decisions. Post-trade transparency obliges regulated trading venues and systematic internalisers (SI) to publish – if possible in real time – the scope, the price and the time – of trans-

32 Compare Financial Times Germany, Brussels raps speculators and financial advisors on the knuckles, 20.10. 2011

33 Compare Die Zeit, Fliegenflügelschnell, 29.10.2010

34 Market depth refers in particular to price continuity. The assumption is that high market depth would stabilise prices as a sales or purchase would cause less price fluctuation. Less volatile process give investors more security when making their investment and can also lead to more transactions, which in turn increase market depth.

actions carried out with certain financial instruments (until now predominantly shares).[35] However, certain financial instruments are still exempt from these requirements. SI, for example, are not obliged to publish binding quotes for transactions (pre-trade transparency), which exceed the "standard" market size, i.e. very high-volume transactions.

The implementation of stricter reporting requirements for transactions to the authorities has to be welcomed without reservation. The enhanced quality of notifications shall help to improve the implementation of new regulations. Investment firms are obliged to keep records and the authority shall have unlimited access to all records. However, there are also exemptions, for example for certain OTC financial instruments.

More powers for authorities – rights of intervention in market and positions

The new rules shall give more powers to ESMA and the competent national supervisory authorities. As a result, the latter, in agreement with ESMA, can suspend or ban individual products, services and practices, thereby intervening in the market if investor protection, financial stability or the proper functioning of the market is at risk. Unfortunately, certain conditions are attached to these rights of intervention, which might result in a delay and leave room for interpretation.

Authorities shall also be granted greater powers in respect of derivatives. A reporting requirement concerning the positions held shall help to gain an overview to which extend certain groups of market participants are involved in trading in commodity derivatives. It shall also be possible to ask individual participants to provide information on positions. The hope is that this will help to improve assessing the role speculation plays on these markets. The authority shall also have the power to prescribe position limits if the stability of the financial market is at risk.

Other important issues

Consumer issues were already an important part in the "old" MiFID; that is why it often was only dealt with under this aspect. The "new" MiFID also addresses important consumer issues, in particular in respect of rules on commissions and disclosure requirements and brings at least here some improvements. However, these are not at all adequate as the opportunity to sell highly complex financial products with difficult to assess risks to small investors still exists.

Another issue is the access of trading venues to central counterparties (CCP) where trade is carried out and vice versa. The intention of the EU Commission is to ensure more competition among clearing houses. Unfortunately, concerning this sector, which is essential for the stability of the financial market, one relies once again on the market forces. This gives cause for concern as the CCPs might base their competitive ambitions on reduced security standards. Hence, competition among trading venues creates incentives to that effect that trading places give preference to those CCPs that provide the "most favourable clearing" in form of less strict collateralization requirements.

Common regulations for the access of third country firms shall be created to tackle the "fragmentation into different national third country regimes" within the European Union. However, it has to be ensured that this does not undermine the European Regulation.

The Member States shall meet minimum requirements in respect of sanctions for violations against the provisions of MiFID or MiFIR. These will reach from public notification to fines that are high enough to cancel out the expected profit.

Both legislative proposals are currently negotiated in the European Parliament and in the Council. They will come into force in 2013 at the earliest.

35 Compare Gabler's economic lexicon

Conclusion

Unfortunately, the recommendations of the EU Commission only represent a compromise of the smallest common denominator. They always follow the orientation on the "market". This trust is incomprehensible in view of the obvious shortcomings in the financial sector; after all, the almost unchallenged market freedom of financial markets was a major contributor to the worsening of the financial crisis in the European Union. At the same time, national supervisory authorities were restrained through national borders, which made cross-border prosecution and control impossible.

Apart from that, the EU Commission is still trying to catch up with market trends instead of implementing a clear framework through market organisation. Hence, the complexity of the markets is reflected in the scope and the complexity of the proposed Regulation, which in addition (Directive and Regulation combined) proposes ca. fifty delegated acts[36] to ESMA resp. the Commission, and this in case of important issues. This certainly does not meet the demand for a simple and clear Regulation in form of a democratisation of the financial sector. The stability of the financial market has to be at the heart of the new Regulation: how should financial markets be regulated to ensure that they contribute as best as possible to the functioning of the economy as a whole?

To control the trade on regulated markets with unified quality and security requirements, requires the cancellation of a wide range of exemptions (in particular for OTC derivatives and systematic internalisers) as well as of the proposals on the introduction of new trading places (OTF, SME markets). Speedy rights of intervention have to be available to supervisory authorities. EU regulation must not be softened through special rules for third country firms. Practices, which have severe negative effects on the real economy, for example in form of excessive food prices, or are associated with a serious risk for the market and which clearly lead to results which are far away from the fundamentals, have to be prohibited. These include, for example, the speculation with food products and high-frequency trading. The trading and clearing obligation for derivatives must also be implemented speedily and should be far more comprehensive. Finally stricter sanctions must be provided for breaching the rules.

36 Based on the category of legal acts, which was newly created by the Treaty of Lisbon, the legislator authorizes the Commission to adopt legal acts for amending certain and non-essential provisions of a legislative act.

Ratings in crisis

Michael Heiling, Thomas Zotter

How do ratings work?

Rating agencies are private companies that assess (rate) the creditworthiness of a debtor resp. the profitability of an investment. The security of the investment, which is expressed by the rating, is subsequently reflected in the interest or risk premium. In practice, the ratings of the creditworthiness are depicted in certain categories.[37] The rating agencies are financed by corporations that issue bonds. This system, which was established in the 1970s, is called issuer-pays system.

Between 130 and 150 rating agencies exist worldwide. However, the "big three" (Moody's Investor Service, Standard & Poor's (S&P) and Fitch Rating Operations) have a joint market dominance of almost 95 %. In the US, almost all bonds are rated by S&P and Moody's; globally, Fitch rates two thirds of all bonds. Hence, there is a considerable market concentration. Apart from that, the rating agencies belong to companies that themselves issue securities, which have to be rated.

The agencies emphasise that their private services – producing ratings – are only "opinions". However, based on different regulations, these non-binding "opinions" often have very binding and far-reaching effects. The level of capital requirement regulations requested by the Basel Committee, for example, depends directly on ratings (these regulations are known as Basel II/III resp. as CRD Directive[38] in the European Union). Basel II stipulates that the minimum equity capital that banks are required to hold has to correspond to the actual risk. This is where rating agencies enter the picture: credit ratings co-determine the minimum equity capital for banks. The higher a credit has been rated the lower the level of equity capital required. This led to the banks being underfunded, as these ratings were too high during the boom before the crisis.

In addition to CRD and Basel II/III, Central Banks, institutional investors, financial investors and funds, such as large pension funds, also follow the ratings of the agencies. For example, ratings by the European Central Bank (ECB) are used to assess securities, which the ECB applies to provide liquidity for the banks. It is not uncommon that loan agreements include clauses to the effect that in case of a subsequent change of ratings, securities and/or interest rates have to be adjusted automatically. Therefore, changes of "non-binding opinions" have a stronger effect – even on investment decisions in the private sector. Prior to the crisis for example, investors felt – because of negligent ratings – even more moved to invest in so-called "mortgage-backed securities", which let the bubble grow. However, ratings often have a direct and binding effect on decisions by governments and Central Banks – even though ratings are often not comprehensible and transparent.

37 Standard & Poor's and Fitch for example apply the category AAA to a prime rating (with a default risk of near zero) and the rating category D resp. DDD to junk status (equivalent to default). Moody's Systematisation is slightly different; here AAA represents the best and C the worst rating.

38 Capital Requirements Directive; implemented by Directives 2006/48/EC and 2006/49/EC; a Proposal by the Commission on amending the Directive on implementing a Regulation has been submitted to the EU legislator.

EU activities

Prior to 2009, the term “regulation of rating agencies” in Europe[39] was almost unheard of. What was available was the code of conduct for rating agencies by the International Organization of Securities Commissions (IOSCO), which the agencies were to comply with on a voluntary basis. The European Parliament already urged the Commission in 2004 to consider a Regulation; however, this was rejected by the Commission with reference to the self-regulating forces of the industry and the voluntary code of conduct.[40]

It was not until 2008, that the Commission initiated two consultations on rating agencies, which resulted in a legislative proposal. The key elements of the proposal included the mandatory registration of rating agencies, rules of conduct, which were mainly based on the IOSCO Code as well as a new supervisory structure. The Regulation,[41] which also included the publication of key rating assumptions, models and methodologies of ratings, was adopted by Council and European Parliament in September 2009. The previously rather complex supervisory structure in the Regulation was amended in 2010. Since then, a central supervisory authority, the European Security and Markets Authority (ESMA) has been in place whilst previously national and European authorities shared the supervision.

The European Parliament[42] urged the Commission in June 2011 to present stricter rules for rating agencies. The European Parliament requested the creation of an independent European rating agency (European Credit Rating Foundation), the reduction of conflicts of interest due to the issuer-pays system, as well as the review of a possible civil liability of credit rating agencies.

The European Commission presented a new draft in November 2011, which recognised the previous shortcomings and above all provided for new regulation,

liability and publication obligations for rating agencies. Initially, the most central aspect was also regulated. The idea is that institutional investors may no longer exclusively or automatically refer to the assessments of the agencies; in addition, European supervisory authorities may no longer refer to rating agencies in their guidelines. According to the wishes of the Commission, in future, methods and pricing strategies of rating

39 A regulated registrations and approval procedure for rating agencies existed in the US already in the 70s.

40 The respected Communication of the Commission on rating agencies (2006/59/02) states: “The Commission is confident that these Directives – when combined with self regulation by the credit rating agencies themselves on the basis of the newly adopted IOSCO Code will provide an answer to all the major issues of concern raised by the European Parliament.”

41 Regulation 1060/2009 of the European Parliaments and the Council of 16 September 2009 on rating agencies.

42 Resolution of the European Parliament No. 2010/2302 of 8 June 2011 on future perspectives of rating agencies.

agencies must also be disclosed; country ratings must be accompanied by a comprehensive and clear research report, and a rotation mechanism shall be established for rating agencies. In respect of liability it has been clearly regulated that rating agencies in case of gross professional misconduct and a lack of due diligence towards investors are liable to pay compensation if these have relied on their rating. Some of these issues are very welcome; others are lacking the final push.

However, there is no sign of the European rating agency demanded by the European Parliament in the Proposal of the Commission; some regulations put up for debate by Commissioner Michel Barnier, were also not addressed, for example the temporary ban on country ratings or a ban on large rating agencies, to acquire an interest in smaller competitors. However, it has to be noted that the call for a European rating agency would not be able to revoke the recourse of the legislator and the private institutions on the rating agencies.

Demands by the Chamber of Labour

- No blind trust in ratings by professional investors

  The blind trust on external ratings was one of the main causes of the current crisis. No bank, no financial institution, no insurance company, no investment funds and no pension fund, and above all the ECB and Central Banks may base their investment decisions on external ratings alone. Ratings may continue to flow into these decisions, but only as one of many criteria. Risk assessment is an essential task of the credit and investment sector and may not be left completely to others. Transactions, whose risk cannot be assessed by professional investors themselves, should be out of bounds.

- Reducing the importance of ratings in legal and contractual bases

  Basel II transferred quasi-sovereign tasks to rating agencies because the legislator – and subsequently many investment provisions – elevated their risk assessment to benchmark status. Apart from democratic concerns, in particular potential conflicts of interest and above all experience speak against such a quasi-sovereign function of rating agencies. Therefore, external ratings should be removed from normative bases both at European and national level.

- Making rating agencies liable

  The current draft of the Commission provides for the creation of civil liability and the reversal of the burden of proof in case of disputes, the rating agencies have to proof that their actions were not wilful or grossly negligent. This is to be welcomed as it is almost impossible for third parties to furnish proof. However, the reversal of the burden of proof should also apply to issuers – i.e. to countries/corporations, whose rating provided by agencies was verifiably too poor and who incurred costs because of this. Apart from that it is important to link the court of jurisdiction to the seat of the investor.

- No automatic interest clause in case of subsequent changes of ratings

  All contractual clauses should be legally banned, which include automatic consequences (e.g. higher interest rates for borrowers, additional securities, due dates) as a result of changes to ratings. Reviewing the creditworthiness is an essential responsibility of credit institutions. Such clauses increase the tendency to rely on external ratings. If – correctly – the original review of the creditworthiness may not exclusively rely on external ratings, automatic clauses in respect of subsequent changes shall also be banned, as these clauses might trigger a downward spiral.

- Combating market concentration

  In view of the high market concentration, the Chamber of Labour demands to ban rating agencies, which occupy more than 20 percent of the market from acquiring other rating agencies.

- Review of alternative payment models

  Another problem of the current systems lies in the fact that it is too expensive for investors – those who are actually interested in the information – to pay for a rating, which must also be made available to others. It is therefore common place that issuers order the rating, which, however, can lead to serious conflicts of interest. Therefore, alternative payment models should be reviewed and evaluated. For example, payments (normally a fraction of the volume in question) could be made via an agency, which either instructs a rating agency in accordance with the review of the quality of the rating in the past, or which distributes the rating fee among those agencies that provide ratings – with a share in results to be paid later, depending on the quality of the rating.

Conclusion

Due to the too relaxed handling of their certifications, rating agencies have contributed to the financial crisis and subsequently – by intransparent ratings – aggravated the national debt crisis. Not having had a Regulation in Europe by the end of the last decade, initial steps within the EU have been made since 2009 towards a Regulation as well as a more in-depth debate. A key point of this debate appears to be to clarify that rating agencies are private companies providing a service. It is therefore essential to remove all collective liabilities from these services, i.e. to ensure that laws and other regulations (Investment Directives, etc.) do not automatically rely on decisions by rating agencies. In addition, it must become clearer what kind of information ratings can actually provide and how limited their meaningfulness is. The liability of rating agencies for their “opinions” must be clearly regulated, and a review of alternative payment models is also necessary to avoid conflicts of interest. The current proposals of the European Commission have addressed a large part of these issues; however, further steps have to follow in and after the legislative process.

Bank levy in Austria

Thomas Zotter

As a reaction to the burden on the public budget in the wake of the financial and economic crisis and the additional burden as a consequence of the comprehensive "bank rescue package" within the scope of the Interbank Market Support Act (IBSG) (guarantees to retain liquidity) and the Financial Market Stability Act (FinStaG) (recapitalisation measures) and to satisfy the systemic risks of banks, Austria introduced the so-called stability levy, aka "bank levy" based on the Stability Contributions Act (StabAbgG) on 1.1.2011

At the beginning of February 2012, the Constitutional Court rejected a complaint by a bank against this stability levy and declared it constitutional both based on good ground an in accordance with the basis of assessment.

The unconsolidated balance sheet total minus guaranteed deposits plus the volume of speculative derivative transactions in the trading book of the banks formed the basis to calculate the tax base. Institutions with a balance sheet total below EUR 1 billion are not taxed. The levy for a total between EUR 1 billion and 20 billion is 0.055 %, above EUR 20 billion 0.085 %. Speculative derivatives are taxed independently of the balance sheet total at 0.013 %.

EUR 500 million had been estimated for 2011; the stability level generated EUR 509.9 million, which meant it was very close to the estimated amount.

The bank levy was increased by 25 % in the course of and due to the bailout and partial nationalisation of Österreichische Volksbanks-AG (ÖVAG). However, this increase, which is to fund the resources the government was already forced to spend on the ÖVAG, will come to an end in 2017.

Demand of the Chamber of Labour fulfilled!

This action fulfilled an demand of the Chamber of Labour for a causer-based contribution to tackle the crisis. It should be considered whether the limit of the balance sheet total of 1 EUR billion is justified. This limit is relati-vely arbitrary and benefits above all institutions in the multi-level sector, such as Raiffeisen or Volksbanken (which have a central institution at their helm), which indirectly also benefitted from the bailout of the top institutions.

Conclusion

The bank levy shall cover a part of the risk that credit institutions pose for taxpayers. It should therefore be regarded as a supplement to a Financial Transaction Tax, which on the one hand alleviates the risks coming from the markets (steering effect) and partly cover these on the other (fiscal effect). The stability levy seems more than justified due to the low level of corporation tax generated by credit institutions, even in good and exceptionally good years, due to the implicit public guarantee for banks in distress, and the liability of the state associated with it (see chapter banking regulation), due to the massive rescue package, which put an enormous burden on public budgets, both directly and indirectly, and in view of the systemic risk posed by the financial sector, at the centre of which are the banks. In this case, the political decision-makers have found the right answers.

CHALLENGE AREA IV – FINANCIAL INDUSTRY REGULATION

Corporate governance and remuneration policy in financial institutions

Helmut Gahleitner, Christina Wieser

What is "Corporate Governance"?

Corporate governance is the umbrella term for the entire management and control system of a corporation: at its centre is the question as to how responsible and transparent corporate governance and corporation control can be guaranteed. To achieve this, transparency and appropriate control mechanisms are necessary requirements, in particular with regard to the early identification of untoward developments.

"Good governance" is particularly important in financial institutions: apart from a sustainable supply of the real economy with loans, the main aspect is to ensure a stable financial market. However, the latest financial crisis has identified serious shortcomings and demonstrated the urgent need for action and reform. European policy is more in demand than ever.

EU level: Green paper on "Corporate Governance in Financial Institutions and Remuneration Policy"

By recently making a critical analysis on the causes of the financial crisis in the Green Paper on "Corporate Governance in Financial Institutions and Remuneration Policy' (COM(2010)284/3, the EU Commission put the issue back into the spotlight. At the centre of the discussion paper are in particular three problem fields:

- inadequate supervision of executive boards and control of Managing directors
- insufficient risk management and
- inappropriate remuneration policy with risk enhancing Incentive systems

Apart from the already mentioned deficiencies, the role of shareholder has been referred to in this context for the first time. The growing number of shareholders, who resell their shares after a short period (three to six months), is becoming a rising problem. This group is only interested in short-term gains and takes increasingly greater risks. In connection with the shareholder value approach,[43] which has been promoted for years – including by the Commission – the ground was prepared for increasingly more risky business models.

The Commission has recognised that the one-sided orientation of corporate governance towards the interests of shareholders is in contrast to comprehensive corporate governance, which lays down and pursues sustainable and long-term goals. The fact that the interests of further stakeholder groups (employees, investors, etc.) have to be included in corporate decisions, is mentioned for the first time in the Green Paper. The opinion of the Commission that recommendations without a binding duty of compliance (e.g. voluntary corporate governance codes) cannot develop any practical effect because control and necessary sanctions are missing, must also be emphasised.

43 Shareholder value means that corporation policy predominantly concentrates on the needs of shareholders. In contrast, a stakeholder-oriented corporation policy also includes employees, customers and other social groups.

Demands by the Chamber of Labour

Strengthening the board of directors

Several measures have to be implemented to achieve an overall strengthening of the control and steering committee of the board of directors; these include:

- Limiting the number of board mandates per person: in view of the growing complexity of supervisory and control responsibilities, board activities require increasingly more time and care. It is therefore necessary to reduce the number of board mandates, which a person can hold simultaneously.

- Strengthening the diversity within the board of directors: corporations shall no longer be allowed to ignore the different points of view, skills and problem solution competencies, which are associated with internationality, gender and age. In this context, the Chamber of Labour demands a mandatory gender quota of 40 % and strongly emphasises the necessity to fill managerial positions with women.

- Self-evaluation of the board of directors: it is definitely necessary for the board to be self-evaluated on a regular basis with the assistance of an external moderator (every one to two years). The efficiency audit and the critical reflection shall improve the achievement of objectives and the effectiveness of the activities of the board of directors.

Improving risk management, strengthening the independence of the auditor

We welcome the direct reporting obligation of the risk manager[44] to the board of directors. Need for action exists in particular with improving the communication between executive board and board of directors: detailed and written information on the risk management has to be provided within the scope of the quarterly reporting obligations. Apart from that, it is necessary to clearly separate risk management from "risk-related" organisational units. This calls for a clear legal requirement. The proposal in the Green Paper to set up a risk committee within the board of directors also appears to be very sensible.

In order to strengthen the independence of external auditors, it is necessary to introduce a mandatory rotation (e.g. every three to five years). This would also encourage competition within the highly concentrated auditor market.

Strengthening der Supervisory authorities

Strengthening the supervisory authorities is of particular importance: on the one hand, this means more control rights for supervisory authorities within the scope of the internal corporate governance of financial institutions, and effective sanctions at the disposal of supervisory authorities on the other. Only when additional control rights are accompanied by clear and transparent sanctions, we have reached a step towards more quality concerning corporate governance of financial institutions. One could for example consider an annual evaluation of the administrative board resp. executive board and the board of directors in respect of the organisation and efficiency of risk management with the involvement of external auditors.

From the point of view of the Chamber of Labour, it has to be ensured at this point already that board members available for selection at the general meeting have the necessary professional qualifications.

Departure from the shareholder value approach and the voluntary principle

Against the background of the financial crisis it has become apparent that a growing number of shareholders favour increasingly shorter investment horizons and are only interested in short-term yield maximisation. These investors regard a corporation as a "commodity", which is bought or sold; they are not interested in controlling the compliance of sustainable corporate rules. The question therefore arises whether and to which extent these shareholders resp. groups of shareholders should be granted sovereign rights. In addition, it should be considered to grant long-term investing shareholders stronger voting rights (e.g. double or triple voting rights).

44 Risk manager: Board member responsible for the implementation and execution of risk management.

From our point of view, it is urgently required to depart from the shareholder value approach. Corporate decisions may no longer be exclusively oriented towards shareholder interests. The bodies (administrative board resp. executive board and the board of directors) have to be obliged to consider the interests of stakeholders (employees, creditors, suppliers and the public sector) when corporate decisions are being made.

Only legally binding rules create more transparency and bring the desired success. Practice has shown that no progress is made with codes based on voluntary agreements. From the point of view of the Chamber of Labour, the voluntary principle has to be abandoned: management bodies urgently need clear and binding standards as well as effective sanctions if standards are not complied with.

Transparent and appropriate manager salaries

Binding regulations are needed as soon as possible to improve and develop corporate governance in particular in respect of manager remuneration. Voluntary recommendations are not adequate to guarantee important developments. This has once again been demonstrated by the corporate governance practice in Austria: as studies of the Vienna Chamber of Labour show, salaries in Austrian Top-Management over the past decade have reached exorbitant levels, having increased from being the equivalent of 20 times the salary of an average employee to 48 times that amount in 2011.

So far, the already existing corporate governance rules in respect of the orientation of managers towards sustainable and long-term business goals have not led to any changes in the remuneration structure. The most frequent criteria for success are still EBIT (earnings before interest and taxes, annual surplus und ROCE (Return on Capital Employed). The transparency rules - such as the publication of individual board salaries - are also mainly ignored.

The Chamber of Labour demands a binding directive, which regulates the minimum standards concerning the level and composition of remuneration components. Share options for board members and other executives should be banned in general. The incentive mechanism, which accompanies share options, was after all one of the causes of the recent financial crisis. Apart from that, share options also invite the misuse of insider information.

A key issue is the clear regulation of redundancy payments. These are generally paid when limited manager agreements are terminated prematurely. Apart from the already existing grounds for dismissal, future agreements should include additional statutory reasons for terminating (e.g. deterioration of the economic situation, the board acting in breach of its duty), which result in no or reduced redundancy payments. In case a management agreement is terminated prematurely, the redundancy payment may not exceed an annual salary.

Variable remuneration components shall also include non-financial criteria: instead of coupling business goals to share prices, they should be linked to social and employment-relevant criteria as well as ecological guidelines. In addition, variable salary components should be capped in relation to the salary and only paid once the respective goals have been achieved.

The overall level of board salaries must be in proportion to the performance of the board, to the situation and development of the corporation as well as to the general remuneration, whereby the level and the development of wages and salaries within the corporation must also be taken into account.

Conclusion and outlook:

The points of criticism voiced in the Green Paper on the predominant corporate governance in financial institutions represent a first important analytical step, which must now be followed by speedy implementation. The voluntary principle has failed; genuine "good governance" requires clear standards and sanctions. It is not enough to criticise the shareholder-value concept. In respect of corporate governance and corporate control, administrative board resp. executive board and the board of directors must also be obliged to bear in mind the interests of all stakeholders.

It has yet to be seen which measures and conclusions the Commission will draw from the Green Paper. Meanwhile, the Commission has published another Green Paper "The EU corporate governance framework" (Com(2011) 0164 final). It is expected that, based on these two Green Papers, the Commission will publish proposals on improving corporate governance mid-2012.

Caution required in the field of business valuation!

Alice Niklas

Since 2005, consolidated financial statements of capital market-oriented corporations have to be prepared in accordance with International Financial Reporting Standards (IFRS). The impact of the financial and economic crisis was aggravated by these standards, which are generally based on the shareholder-value principle. The fair-value principle, i.e. evaluation at current market value, which is embedded in the IFRS, also gains increasingly in significance in respect of national financial reporting regulations – such as the Austrian Commercial Code (UGB). As a result, the previous creditor protection principle and thereby "cautious" balancing (for example by limiting valuation values to the level of historical costs) are increasingly pushed into the background.

Problems of fair value assessment

The application of international accounting has significantly contributed to the aggravation of the financial market crisis. In case of rising prices, valuations at fair value present high accounting profits, which, however, have not yet been realised. This form of profit recognition is primarily aimed at investors, who are interested in high yields and want to know how the market value of a corporation develops. This increases short-term management decisions, which will quickly lead to success – such as reorganisations, acquisitions,[45] and downsizing programmes.

Prices fell considerably during the 2008/2009 economic crisis and, due to the fair value assessment, corporations were faced with high losses in value, in particular in respect of financial investments such as securities and participations. Some securities were no longer tradable (illiquid) and had to be completely written off. Hence, real economy losses were increased by book losses, and the crisis became more serious as a result. The reduction of equity capital associated with this put the existence of corporations at risk. Hence, international accounting standards have a procyclical effect (accelerate the downturn).

Subsequently, the scope for borrowing became smaller and triggered a downward spiral. Many markets in the financial sector broke down and banks were confronted with high depreciation losses.

Assessments at fair value result in high fluctuations of business results and share prices and destabilises the long-term development of a company.

45 Company takeovers

Due to the current national debt crisis, which was primarily triggered by the financial market crisis and the continuing strong fluctuations on the markets associated with it, there are already signs that the procyclical effect on the balance sheets of the coming years will be repeated. Many corporations – in particular banks and insurance companies – will again have to show high investment losses, as already happened in case of Erste Bank and Unicredit.

International Accounting Standard Board (IASB) – a private standard setter

Another criticism of the International Accounting Standards lies in the fact that these standards have not been set and developed by democratically legitimised institutions, but by the International Accounting Standard Board (IASB). The IASB is a private orgafinancial statements), and representatives from research and teaching, dealing with accounting.

The standards will be implemented into EU law within the scope of the EU endorsement process and subsequently transformed to national law.

The Chamber of Labour generally rejects this influential role of the civil law organisation in developing accounting standards. The influence of the IASB should be returned to a consulting and supporting role. The political will must come from competent democratic bodies, and not the other way round from a private institution. All relevant stakeholders have to be integrated in the consultation process.

Apart from that, since the reorganisation in 2001, international trade unions are no longer involved in IASB Committees. As a result, employee interests are no longer represented.

Global Convergence of accounting

The call for globally unified accounting rules became louder in the wake of the financial crisis. Die consolidation of US-American and European Accounting systems was decided for the first time in 2002 between FASB[46] (Financial Accounting Standards Board) and IASB. The demand to accelerate standardisation was again voiced at the 2011 G-20 Summit in Cannes.[47]

Both boards are jointly working on unifying standards. At the centre is the “Memory of Understanding“ (MoU), in which the projects are enshrined. The four current “long-term” projects include (financial instruments, turnover realisation, insurance contracts and leasing).

Over the years, the IASB has developed into a globally recognised standard setter. IFRS is currently used in 130 states. Important economic nations such as India and Japan will decide on the introduction of IFRS in the near future. The U.S. Securities and Exchange Commission (SEC) will make the final decision by the end of 2011, whether IFRS will be adopted for American Corporations and replace US GAAP. This would complete the international enforcement of IFRS.

Setting up an enforcement authority

Based on the 2004 Transparency Directive, the Member States were asked to set up an enforcement authority ("balance sheet police") to audit national annual financial statements prepared in accordance with IFRS. It is the responsibility of this authority to check whether the annual financial statements prepared by capital market-oriented corporations comply with national laws and international accounting standards. If this is not the case, relevant measures have to be taken. Hence, significant measures can be put in place to prevent resp. detect incorrect accounting at an early stage and to strengthen confidence in the capital markets.

Meanwhile, Austria is the only EU country, which still has not set up this authority; hence, she has so far failed to implement the Directive even though its establishment is enshrined in the current manifesto.

A relevant draft bill on the establishment of an enforcement authority was presented for consultation in 2006. So far, however, it has not been implemented.

The Chamber of Labour therefore demands the speedy implementation of a one-step procedure. All audit and administrative competencies shall be transferred to a

46 FASB prepare the US GAAP (United States Generally Accepted Accounting Principles), which apply in the US.
47 http://www.ifrs.org/NR/rdonlyres/FAFA7E92-E34B-481E-AF3B-AD576380E371/0/ResponsetoG20conclusionsOCT2011.pdf

central enforcement authority, where the independence of the authority has to be insured. It is important, in particular during the economic crisis, to set a positive signal to strengthen the Austrian financial market.

The role of auditors

During the financial crisis, auditors too did not escape criticism. They had audited balance sheets positively, even though risk positions had not been devalued or made transparent. The value of audits with regard to the financial soundness of corporations was thrown into doubt. A proposal of the European Commission is expected for the end of 2012, which above all will deal with strengthening the independence of auditors.

EU activities

Due to the economic crisis and the strong pressure of the EU, the IASB in October 2008, within only a few days, developed a proposal, which enables banks in future to transfer certain securities under exceptional circumstances from the category held-for-trading resp. available-for sale at the latest fair market value (i.e. a market price, which was paid for the securities or which is based on an internal assessment of the banks) to the category held-to-maturity. The financial market crisis was considered an exceptional circumstance and justified its application by corporations. The EU subsequently transformed this proposal into EU law.[48]

As a further consequence of the crisis, the IASB is currently working on a new standard for financial instruments (IFRS 9), which is divided into three project phases. Phase 1 (Classification and Measurement of Financial Instruments) was completed at the end of 2010. Phase 2 (Impairment) is currently in the process of being developed and shall be completed in 2012. Phase 3 deals with Hedge Accounting and shall also be adopted in 2012.

In view of the initial mandatory application of IFRS 9, the IASB published a draft in August 2011, proposing a postponement from 2013 to 2015. The IASB justified its decision by explaining that corporations shall have the option of implementing all three phases of the IFRS 9 revision together and with plenty of time to prepare. The complex matter caused repeated delays in the project schedule. However, it is also possible to apply IFRS 9 earlier. The endorsement process of IFRS 9 within the EU has not yet started. The EU rejects a successive introduction of parts, which have already been adopted by the IASB. Hence, the new regulations will only be implemented into EU law once the complete IFRS 9 Standard has been adopted. As a result, corporations in the EU can only implement these regulations after the endorsement process.

To help corporations to save administration costs, the Commission plans to modernise and simplify accounting in the course of the EU's Better Regulation Strategy. The Commission has therefore prepared a proposal for a new Directive, which will combine the current Accounts and Consolidated Accounts Directive. At the centre is the reduction of reporting duties for businesses, in particular for small and medium-sized enterprises (SME). Increased threshold values will reduce reporting duties. SMEs shall be exempt from the audit of annual accounts.

In this connection, the Chamber of Labour considers it important that the quality of accounting and the relevant publication for the benefit of stakeholders will not deteriorate. This applies to all corporations. Transparency plays an important role, in particular during financial crises.

The Directive proposal is currently dealt with by Council Working Groups.

Demands by the Chamber of Labour

The fair value assessment is based on the current market value, which is created on liquid markets by participants that are independent on each other. Only then it is possible to determine the market value objectively. If this is no longer the case and if the value is determined by intransparent methods, the corporation is able to influence its annual result deliberately; hence, the accounting reliability is no longer guaranteed.

48 http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1513&format=HTML&aged=0&language=DE&guiLanguage=de

- The Chamber of Labour demands to make profit recognition at fair-value more transparent. Reconciliations shall show not "realised" profits. Voting rights (e.g. different valuation approaches) are to be reduced.

- Valuation standards applied to fair-value assessments have to be questioned. Both market value standards and valuations based on the capitalised earnings method, pose the risk that excessive non-realised profits are used. Non-realised profits must be subject to strict bans on dividends. The integration and representation of off-balance transactions must be reinforced.

- The Chamber of Labour considers the development of accounting standards by private standard setters problematic. From our point of view, it is essential to involve European resp. international labour representatives and other relevant stakeholder groups in the legal development process. The democratic legitimisation process is to be strengthened; the influence of private IASB should be returned to a consulting and supporting role.

- IFRS has many voting rights; only rudimentary classification systems exist, resulting in comparability and transparency problems in respect of annual financial statements of corporations. Hence, a simplification of evaluations stands resp. voting rights would be welcome.

- The Chamber of Labour supports the establishment of an independent accounting authority for Austria. It is particular in times of economic crises important to set a positive signal to strengthen the Austrian financial market.

- To help corporations to save administration costs, the Commission plans to modernise and simplify accounting in the course of the EU's Better Regulation Strategy. In this connection, the Chamber of Labour considers it important that the quality of accounting and the relevant publication for the benefit of stakeholders will not deteriorate.

- The Chamber of Labour rejects the application of international accounting standards to small and medium-sized enterprises. These corporations have to focus primarily on creditor protection.

- The role of auditors has to be scrutinised. The objective of reform must be to strengthen independence. The quality of audits must ensure the balance sheet addresses are in able to recognise the financial soundness of audited corporations.

Conclusion

The procyclical impact of International Financial Reporting Standards (IFRS) represents a key point of criticism. The restrictions of the evaluation at current market prices have to be shown resp. the underlying fair value assessment has to be questioned. The discussion on the further development of accounting rules should take place on the basis of fundamental principles – as enshrined in Austrian law.

This would require that the IASB gives more prominence to the considerations of regulatory and supervisory authorities and all relevant stakeholders. Democratic bodies should be given more influence in developing standards. Transparency and comparability of annual financial statements of all corporations are key elements within the scope of the further development of international accounting. This particularly is important in difficult economic times to strengthen resp. rebuild trust in the financial markets.

The role of auditors must also be reconsidered. Audit quality must be ensured.

"MAD" – the new framework for financial markets

Susanne Wixforth

Insider dealing and market manipulation take away the last bit of trust in the already battered financial markets, if they are not seriously tackled. According to the EU Commission, 13 Member States do not have any or any appropriate sanctions in place with regard to insider dealing. A similar picture emerges with regard to market manipulation, which is not sanctioned in four Member States. A frightening picture the EU Commission wants to improve with stricter legislative initiatives: the Directive on criminal sanctions for insider dealing and market manipulation and the Regulation on insider dealing and market manipulation (previously the so-called "MAD" – market abuse directive).

Apart from the inadequate and non-harmonised implementation of "MAD", the prohibitory provisions did not include new trading places such as multilateral trading facilities, open trading facilities and other unregulated trading venues. However, during the financial crisis it clearly emerged that an increasing part of the trade with financial instruments took place outside regulated markets resp. stock exchanges, among other on these platforms or completely outside trading places resp. bilateral. Hence, the previous Directive became to a large extent toothless. On the contrary, it even increased the incentive to withdraw trading from regulated stock exchanges.

It is also the objective of the new legislative proposal to cover all traded financial instruments by abuse standards: i.e. financial, derivative and spot markets as well as OTC (over the counter) trading, as the correlation between spot and derivative market on the respective other market may result in price manipulations by market abuse. And, the European Commission also addresses the potential abuse by using new methods: high-frequency trading and problematic strategies, such as "quote stuffing" (pretence order),[49] "layering" (concealing cash flows)[50] and "spoofing" (concealing the identity)[51] associated with it, may present market abuse and will be threatened with sanctions.

What is prohibited?

Market manipulation resp. abuse and insider dealing – at first glance, everybody seems to know what is covered by these terms. At second glance, however, things are no longer that straightforward. Investors generally base their decisions on information they believe gives them an advantage. However, by using large sums of capital resp. large levers or certain practices, such as naked short sales, investment decisions may influence both market development and prices. How then can investments and criminal actions be separated?

The European Commission uses the umbrella term market abuse to combine all improper actions on financial markets under one heading: insider transactions, the abuse of insider information and market manipulation. However, even the definition of insider information proves to be difficult: the European Commission choses the approach that covers only information of a "precise nature", which might significantly influence the price of financial instruments, the commodity spot contracts associated with or auction objects based on issue certificates – leaving plenty of scope for interpretation.

Legal consequences only apply to precise information, which has a significant potential to influence: for example information on the status of contract negotiations, preliminarily agreed provisions in contract negotiations, the option of placing financial instruments etc. What does an investor have to do in order not to be sanctioned? He must immediately disclose this information to the supervisory authority. In doing so, his knowledge is made available to the public who will then be able to

49 A trader places many orders at a stock exchange only to cancel them again instantly. Only the trader knows that these pretence orders (short stuffing) are cancelled again. The cancellation takes place within seconds and significantly influences the price - the trader benefits from this information advantage.

50 The term is used in respect of money laundering: assets are constantly moved by a vast number of transactions, making it difficult to trace their origin.

51 The term derives from the IT sector; it refers to attempts to deceive in computer networks to disguise one's own identity.

make investment decisions based on the same information – at least in theory. This obligation is in addition to the duty to prepare insider lists, which record persons, who, at issuer level based on an employment contract or similar, have access to insider information. Persons working for an issuer in a leading position are subject to special disclosure requirements: information on own-account deals have to be published within two days.

Hence, abuse of insider information can only take place before it is disclosed by an issuer. Sanctions are applied to insider transactions, i.e. transactions based on unpublished insider knowledge – purchase or sale of financial instruments based on this information, cancellation or amendment of a contract the information refers to. Attempting insider transactions is also prohibited, as is the recommendation or instigation to engage in them.

Due to the fact that no market regulations, i.e. no product licence resp. control and only a few restrictions concerning trading practice and places exist in the financial market, the term market manipulation has to be defined as broadly as possible to cover all future technological developments. A big challenge for the legislator. The European Commission makes an attempt by listing certain strategies of algorithmic trading, in particular high-frequency trading. Manipulation has to be understood in the widest sense, referring to all actions which aim at achieving a certain impact on the price of a financial instrument. This also includes placing orders that are not carried out, spreading incorrect or misleading information by inventing obviously wrong facts, deliberately withholding essential information as well as knowingly stating incorrect facts. Hence, all actions, which send wrong or misleading signals in respect of supply, demand or price of a financial instruments or which aim at achieving an abnormal or artificial price level of one or more financial instruments. These include commodity spot contracts, which are linked to financial instruments. Also covered is the spreading of information via media including the internet if the informer ought to have known that the information was wrong or misleading. This is also an important issue for rating agencies, whose hold over the markets has taken on such dimensions that unintentionally or mistakenly sent information can cause serious financial turbulences. Here too, one is left with a sour taste, in so far that the penalty has been increased and the threshold for the offence has been lowered; that, however, the real problem has not been tackled at the root. The future will show whether attempts to prove gross negligence will succeed. Considering the great public interest in the integrity of the financial market, applying liability even in cases of slight negligence would be a minimum requirement to make prosecution easier. Nota bene, as one has to expect a higher standard of due diligence in particular of professional financial actors.

The attempt of manipulation, i.e. undertaking typically manipulative actions, is also a criminal offence, even if they do not have the desired effect on the price of a financial instrument.

Finally, as a side issue so to speak, it should be noted that - as it is meanwhile common practice for legislative acts in the financial market sector – a large number of delegated legal acts have been provided for the benefit of the European Commission. This means that major legislative acts are not adopted by the European Parliament. An increasing problem for democratic policy, in particular where the legal framework is only very cursory, but the discretion of implementation broad.

What next?

Both legislative proposals (the Directive on criminal sanctions for insider dealing and market manipulation and the Regulation on insider dealing and market manipulation) were presented to the European Parliament and the European Council in October 2011. The first reading has been scheduled for July 2012, the plenary vote for September 2012, which means that the Directive cannot come into force before 2013. Two years have been allocated for implementing the penal sanctions and individual provisions of the Directive. Therefore realistically, a comprehensive application of the facts of abuse is not to be expected until early 2015. This is added by the fact that Great Britain and Ireland might opt out of the system to combat abuse – they will probably request many concessions – and that Denmark will definitely not participate. Taking into account the fact mentioned initially that the current Market Abuse Directive is either not applied at all or very differently within the EU, these circumstances are anything but good news.

Conclusion

Bans are only effective and act as a deterrent if violating them is dealt with and if sanctions are imposed speedily. Due to the complexity of the sites of crime to be supervised, their interaction and the difficulty to provide evidence – did the case concern precise information or just "basic" information, did the agency send out wrong signals by mistake, or did it know or ought to have known that it was doing so – the hopes of the European Commission are probably aimed too high with regard to rebuilding the integrity of the financial market.

"The spirits that I summoned up I now can't rid myself" comes to mind when one contemplates the creativity of the financial markets since the promotion of trade outside regulated stock exchanges: OTF, MTF, systemic internalisers, structured products, derivatives, which, detached from the underlying product, have assumed a life of their own. It is to be feared that the strict bans and sanctions will not make an impact. The preventive effect will have no bearing on financial market actors as, because of the complicated control system, it is unclear, who is covered and what has been banned. Furthermore, the controlling effect is bound to fail because of the uncontrolled creativity in launching more and more products and trading places: there seems to be no escaping from the fact that supervisory authorities have to continue being satisfied with assuming the role of the hare in the hare and hedgehog game.

Only a pre-authorisation of products as well as their regular monitoring, the restriction of trade to stock exchanges, which are publicly owned and the ban of dubious trading practices or the introduction of minimum retention periods for financial instruments – which would mean that many questionable technical innovations (such as high-frequency trading) would automatically lose their area of application – in short the creation of financial industry regulations will make it possible to restrict if not eliminate market abuse.

CHALLENGE AREA V – IN FAVOUR OF A FINANCIAL TRANSACTION TAX

Valentin Wedl

The financial sector really knew how to take advantage of the financial market euphoria and managed to a large extend to rid itself of taxes. Large chunks of its profitable business were transferred to tax havens, customers were let into the secret of tax avoidance schemes, corporation tax was minimised by creative accounting and stock exchange turnover taxes were frequently removed as were property taxes. This detaxation has contributed to a huge increase of risky financial transactions.

Meanwhile, a large part of such financial transactions is exclusively carried out with the scope of the so-called (computer-controlled) high-frequency trading. Here, securities are bought and sold again within a short time to benefit from the tiniest profit margin. Apart from the fact that it guarantees traders enormous (monopoly) rates, high-frequency trading also has a destabilising effect. It increases trend and herd behaviour as well as the fluctuation of securities prices and results in prices on financial markets differing significantly from their fundamental values (based on supply and demand).

The introduction of a Financial Transaction Tax is necessary for the following reasons:

- Consequential costs (bank bailouts, lost taxes, higher unemployment,…), triggered by the financial and economic crisis, which are reflected in an acute rise in the budget deficits of the EU States, have to be funded in a **causer-related** manner.
- Similar **to all sales** of commodities and services, which are subject to turnover tax, financial products must also be taxed.
- If introduced EU-wide, a Financial Transaction Tax based on a tax rate of up to 1 promille could generate **up to EUR 250 billion p.a.** This income could be used to fund the EU agenda, the consequential costs of the crisis and important future investments.
- A taxation of financial transactions would be an effective instrument **to counteract the untoward developments of high-frequency trading** by increasing transaction costs.

Europe-wide campaign of the Chamber of Labour and the Austrian Trade Union Federation

Together with over 20 partners from trade unions, political parties and NGO s, the Chamber of Labour and the Austrian Trade Union Federation have set up the Europe-wide alliance **Europeans For Financial Reform.**[52] The campaign, as a flagship of the alliance, under the aegis of the Chamber of Labour, has been able to establish itself as an ardent supporter of the Europe-wide introduction of a Financial Transaction Tax.

The campaign sees itself as the voice of EU **citizens** vis-à-vis decision-making persons and bodies of the EU. Its strategy is based on combining professional expertise with tailor-made political communication. Depending on the current status of the dossier, the respective important decision-makers within the bodies were addressed in several phases. This gave individual supporters of the campaign the opportunity to direct political, but also technical com munications at the people concerned.

52 http://europeansforfinancialreform.org

Stage 1: European Parliament

In March 2011, about half a million email petitions were collected, which helped to support the EP in in its vote for the introduction of the EU FTT. Following the initial opposite positioning, the EU FTT was finally welcomed with an overwhelming majority of 529 to 127 votes.

Stage 2: European Commission

Hence the ball was in the corner of the European Commission: it alone is responsible for presenting a legislative proposal – which it initially brusquely rejected. Algirdas Šemeta, EU Commissioner for Taxation openly called the vote of the European Parliament "irresponsible" and "immature".

By sending further email petitions to individual Commissioners and submitting large numbers of specialist articles, the campaign made a major contribution to overcome initial resistance in April 2011. Commission President Barroso was able to announce a proposal even prior to the European Council in June 2011, which we also campaigned for (Stage 3).

On 28 September 2011, just about six months after we had started our campaign, things got finally off the ground: Commission President Barroso gave a passionate speech, which would have made a trade union leader proud, to accompany the legislative proposal of the Commission.

Strong pressure makes it possible: Commission proposes Directive

The Directive Proposal presents a U-turn of the previous Commission policy. Whilst in previous studies, the Financial Transaction Tax – from the point of view of the efficiency market hypothesis – attracted exclusively negative comments, this opinion has now radically changed. The experiences with the national debt crisis at the latest probably raised awareness that financial markets tend to engage in speculative exaggerations, short-sightedness and self-fulfilling prophecies. The Commission explicitly points out that a Financial Transaction Tax does not only have a fiscal aim (more budgetary income), but that it also refers to a positive guiding role by sensibly supplementing regulatory initiatives. Another reason given for the usefulness of tax is the opinion that the financial sector was by no means adequately taxed. In contrast to previous statements, the positive distribution effects of a Financial Transaction Tax are now being recognised.

Key points of the proposal:[53]

- **Time frame:** the proposal names January 1, 2014 as the date when the tax shall be implemented.
- The **tax rate** is 1 promille on common transactions and 0.1 promille for derivatives based on the notional value. These values are minimum tax rates, which can be raised individually by the Member States.
- **Tax basis:** a comprehensive approach was chosen to prevent tax evasion and substitution by other financial instruments. Stock exchange traded and off-market transactions, structured products (e.g. trading with securitised loans) as well as trading with (alternative) fund units will be taxed. However, there are also exemptions for currency and raw material transactions.
- **Principle of domicile:** a transaction will be taxed as soon as one of the counterparties has its seat, its permanent address or a branch in an EU country.

An example: if a transaction is carried out between a branch of an US-American and a branch of a French bank, and if both branches are located in Switzerland, both branches have to pay tax to the French tax authority.

53 http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/com(2011)594_de.pdf

The next steps

The ball is now in the corner of the EU Council where all Member States are represented. The rule is simple: a proposal concerning tax issues must be accepted by all. If only one country vetoes the proposal, it has failed at EU level. In this case, one could only resort to poorer alternative solutions (e.g. the FTT will only be implemented by a group of Member States). No doubt, the coming months will be filled with feverish negotiations at Council level.

Keeping the pressure up

We shall do our bit.

From the point of view of the Chamber of Labour, two issues are at stake:

1. Demanding **content-related improvements,** in particular:

- **Closing the tax gap:** transactions of private persons and corporations that are not financial institutions must also be included. Otherwise an essential part of transactions will be exempt.

- **Adapting tax rate for derivatives:** there is no reason why derivatives should only be taxed at a tenth of conventional transactions (at a tax rate of 0.1 promille). The derivatives trade is vastly greater than the share trade and is – in case derivatives are not used as securities – highly speculative. Taxing derivatives not at least at the same level as shares, would defeat the purpose of the tax, i.e. to kerb speculative transactions.

- **Including currency transactions:** The exemption of currency transactions is explained by the free movement of capital within the EU. In any case, it is economically questionable. Back in 2010 already, the daily traded volume of currency transactions amounted to about a third of the entire daily currency trading volume of USD 4 billion. This is a particular popular playground for high-frequency trading.

- **Including commodity trading:** another exemption applies to commodity trading. However, derivatives are taxed. One might argue that these transactions are motivated by the real economy and taxing them is not justified. Again, the problem might be all sorts of bypassing activities. Apart from that, the tax rate is so low that taxation would hardly make an impact.

Conclusion: we fight on!

Together with the Austrian Trade Union Federation and the other partners of our Europa-wide alliance we will continue to put pressure on the decision-makers of the EU, including representatives of the "renegade" Member States.

In a first debate among the Member States (ECOFIN Council) it was in particular the United Kingdom who clearly rejected the proposal of the Commission (supported by smaller countries such as Sweden or Czechian Republic with similar leanings). George Osborne, the British Chancellor called the idea of a EU-wide Financial Transaction Tax "fanciful".

Haven't we heard this before?

Within the scope of our campaign for a Financial Transaction Tax, we will continue to give Europeans the opportunity to make their voice heard:
www.financialtransactiontax.eu

FINAL CHAPTER: WHAT HAS TO BE DONE

A lot is happening with regard to the regulation of the financial markets; so far, however, many reforms have only been partly implemented. Many important issues, which were already quite timid, have now been weakened even further under pressure of the financial lobby.

To provide a better overview, we have listed below a summary of the most important demands of the Chamber of Labour, which still apply.

Protection of small investors

- Investors must be better informed about the deposit guarantee. The coverage level shall be set at EUR 100,000 Euro.
- Information on securities ("prospectus") has to be made available in the respective national language and must be easy to understand.
- Investor compensation has to be processed more rapidly and must be borne by the market participants.
- Investment products shall be clear, simple and easy to understand.
- The transparency concerning commissions and costs of insurance mediation has to be improved. Conflicts of interest have to be avoided.
- The protection of debtors must be increased, among other by limiting interest rates.
- Each person must have the right to a basic bank account.

Solid banking sector

- The problem of banks which are too big to fail must be solved. Otherwise we might be faced with further expensive stabilisation measures of the financial sector at the expense of the taxpayer.
- Banks must again focus on their core function, i.e. to enable investments by the real economy, by households and by the public sector. Savings must be released from the firm grip of the banks.
- Prohibiting off-balance sheet activities (funding of the shadow banking systems).
- Supervisory authorities must be equipped with adequate competencies and resources.

Stable financial markets

- All regulating measures shall have one objective, i.e. to bring about a reduction of the worryingly high trading volume on the financial markets. In June 2011, the volume of OTC derivatives was more than ten times higher as the global GDP (USD 700 billion).

- Financial products have to be licensed for trading and have to meet certain minimum standards.

- Regulation of the shadow banking system: anybody assuming banking functions shall be regulated like a bank (alternative investment funds such as hedge funds and private equity funds and other financing vehicles).

- The trade with financial products may not take place/be processed outside regulated exchanges and/or clearing houses.

- Clearing houses must be structured under public law and democratically controlled.

- Practices, which have a negative impact on the real economy and society as whole or whose risks are too high, must be banned. This includes the speculation with raw materials or with the creditworthiness of countries or high-frequency trading.

- The power of rating agencies must be reduced. Laws are no longer to refer to ratings and contracts may not include clauses where a change in ratings automatically entails consequences (e.g. interest rates in loan agreements). Apart from that it is necessary to tackle the market concentration in this area.

Financial industry regulations

- The power of the board of directors in financial institutions must be strengthened. This includes a restriction of the board mandates per person to ensure more due diligence, strengthening the diversity of the board of directors (internationality, gender, age) and a regular self-assessment of the board of directors

- Risk management must be improved.

- The shareholder value and the voluntary principle must be abandoned. Only legally binding rules bring the desired success.

- Manager salaries must be transparent and proportionate in relation to the development of the corporation and the usual remuneration (within the corporation and the industry).

- Accounting rules must be transparent and subject to the principle of caution.

One of the most important challenge areas is the introduction of a Europe-wide tax on financial transactions. It would generate urgently needed money for the public households and at least partly compensate the costs that the crisis has caused. Apart from that, the Financial Transaction Tax would be an effective instrument to limit the speed of trading and to slightly rein in the bloated financial market.

LIST OF AUTHORS:

Helmut Gahleitner
AK Wien, Abt Wirtschaftspolitik
helmut.gahleitner@akwien.at

Michael Heiling
AK Wien, Abt Betriebswirtschaft
michael.heiling@akwien.at

Alice Niklas
AK Wien, Abt Betriebswirtschaft
alice.niklas@akwien.at

Christian Prantner
AK Wien, Abt Konsumentenschutz
christian.prantner@akwien.at

Benedikta Rupprecht
AK Wien, Abt Konsumentenschutz
benedikta.rupprecht@akwien.at

Judith Vorbach
AK OÖ, Abt Wirtschafts-, Sozial- und Gesellschaftspolitik
vorbach.J@akooe.at

Valentin Wedl
AK Wien, Abt EU und Internationales
valentin.wedl@akwien.at

Christina Wieser
AK Wien, Abt Betriebswirtschaft
christina.wieser@akwien.at

Susanne Wixforth
AK Wien, Abt Wirtschaftspolitik
susanne.wixforth@akwien.at

Gabriele Zgubic
AK Wien, Abt Konsumentenschutz
gabriele.zgubic@akwien.at

Thomas Zotter
AK Wien, Abt Wirtschaftswissenschaft
thomas.zotter@akwien.at

Sepp Zuckerstätter
AK Wien, Abt Wirtschaftswissenschaft
sepp.zuckerstaetter@akwien.at

www.arbeiterkammer.at

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