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The Global Growth Agenda
MAKING THE TOUGH DECISIONS IN REFORMING GLOBAL FINANCE
G20 Agenda. Panel

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Moderator:

Adrian Wooldridge, Management Editor and Schumpeter Columnist, The Economist

Panellists:

Michael J. Andrew, Chairman, KPMG International

Madelyn Antoncic, Vice President and Treasurer, The World Bank

Michael Corbat, Chief Executive Officer, Citigroup

Chrystia Freeland, Editor, Thomson Reuters Digital

Andrey Kostin, President and Chairman of the Management Board, Member of the Supervisory Council, VTB Bank

Frederic Oudea, Chairman of the Board of Directors, Chief Executive Officer, Société Générale Group SA

Tharman Shanmugaratnam, Deputy Prime Minister and Minister for Finance, Singapore

Anton Siluanov, Minister of Finance of the Russian Federation

Ksenia Yudayeva, Head of the Expert Department of the President of the Russian Federation; Russian G20 Sherpa

A. Wooldridge:

Good afternoon. Thank you very much for turning up this afternoon. We have an extremely interesting session here on 'Making the Tough Decisions in Reforming Global Finance'. I think that after the last few years, nobody can doubt that we really do need to make some very tough decisions. Our discussion today will look at how we know what tough decisions we need to make. Do we actually know what they are, or are we still running around like headless chickens, trying to find a solution? Do we have the ability to agree on what those decisions should be? And, if we do have that ability, do we have the capacity to implement those decisions? And, most important of all, I think, do these various decisions actually fit together, or do they contradict each other? Are we trying to create a global financial system with a global set of rules, when we have different countries at very, very different stages of development?

We have a panel of people here who, I think, are quite used to making very tough decisions, and they are going to talk about this. First of all, each panellist will talk for about three minutes, giving a very brief overview about what they see as the decisions ahead and how to implement them, then we will have a discussion, which I will moderate. Then I will try to bring in the audience to ask some more questions. Today, we have a very distinguished collection, both of bankers, practitioners, and people involved in international politics: Anton Siluanov, Minister of Finance of the Russian Federation; Andrey Kostin, President of VTB Bank; Michael Corbat, chief executive officer of Citigroup; Michael Andrew, Chairman of KPMG; Frédéric Oudéa, chief executive officer of Société Générale; Ksenia Yudaeva, Russian Federation Sherpa for the Group of 20 (G20); Madelyn Antoncic, from the World Bank; Tharman Shanmugaratnam, Minister for Finance for Singapore; and Chrystia Freeland, who has literally just stepped off the plane to be here. I would ask you to talk, each in turn, for three minutes, to lay out your general perspective on what is happening in the world of global finance: the threats, the risks, the tough decisions we need to make. Then we will try to move on to a discussion session. Thank you.

A. Siluanov:

Good afternoon, esteemed colleagues.

The issue of financial regulation is one of the key topics which is discussed at G20 meetings. What I mean is that not a single meeting of the G20 ministers of finance takes place without considering financial regulation issues. The coordination of financial regulation between countries is, of course, among the priority issues for discussion. Without achieving a single platform of financial regulation and unified parameters and performance indicators to assess financial institutions, it is impossible to work effectively on that front. It is not a coincidence that the system of financial regulation was institutionalized this year and that the Financial Stability Board (FSB) achieved a certain status in order to improve and systematize financial regulation in all countries.

There are many discussions taking place about the separate regulation of the banking sector, especially if we are talking about the dominating banks in this sector, the so-called 'too big to fail' banks. What should we do with banks that hold key positions in the banking sector? What special requirements should we have for regulating these banks? How does the status of these banks affect the big picture in the banking system? Twenty-eight such lending institutions were selected and it is proposed that they should be subject to particular monitoring and supervision. Of course, we are talking about tightening the requirements for lending institutions, about implementing the Third Basel Accord (Basel III).

There are various opinions on this. Many bankers say that we should not rush to implement Basel III while the economic growth rate is decreasing. But the position of the financial authorities of the G20 countries is such that the reliability and stability of the banking system has a higher priority. We need to stick to the plans that have been established for transition to the Basel III standards. The Russian Federation clearly adheres to these plans and we are transitioning our banks to the Basel III system in line with what was agreed.

There are also many discussions about the rating agencies. It is no secret that the objectivity of rating agencies seriously impacts both the ratings and the operations

of financial companies and the real sector, as well as sovereign ratings. So the credibility of both countries and specific companies in the financial sector depends to a significant degree on how objective rating agencies are in their assessment of individual companies. The issue of the objectivity of such ratings is unavoidable. The trend here is not to create new local rating agencies, as was suggested in a number of cases, but to analyse the effectiveness of the ratings already given by the rating agencies and to analyse the justification for such ratings. This will become possible once some time passes: after the rating has been given, time has passed, and we can see how objective it was. Using these criteria, we can evaluate the rating agencies themselves. That is the direction we are going in, and this is where we see an opportunity to improve the objectivity of the agencies.

As for the Russian Federation, I would like to say that we are planning a wide range of measures in the field of financial regulation. We are creating a single regulator under the Central Bank and entrusting it with significant authority under the supervision of the Government of the Russian Federation. Since financial regulation of the banking sector, the financial market, insurance companies, and pension funds is so closely linked today, the creation of such a regulator as a single entity will, we believe, improve the effectiveness of monitoring and of developing the legislative framework for regulating the operations of those involved in the financial market. In this respect, the issues of financial regulation, and standardization of financial regulation, become key, including from the point of view of investor confidence in the policy of any one country. That is why the issue has been given such attention in the Russian Federation lately. We are hoping that the improvement of financial regulation in Russia will lead to more investors becoming interested in our markets and trusting our policy. We believe that one of the key tasks in attracting investment is the fine-tuning of financial mechanisms, financial instruments, and financial regulations.

Thank you.

A. Wooldridge:

Andrey Kostin, three minutes.

A. Kostin:

Thank you very much. I will follow Mr. Siluanov's lead. He presented the government view from Group of 20 (G20), and while I am not on the opposing side, per se, but on a different side, representing the business and banking community. There is a mechanism to be developed called the Business-20 (B20). At this stage, I have the honour of chairing the so-called Finance Task Force. We are now drafting some proposals which will be in the final documents for a G20 meeting to be held here, in Saint Petersburg, in early September. Just this morning, we had very extensive discussions on priorities for the financial sector, and we approved an action plan which includes three major items. First are financial regulations. Mr. Siluanov was telling you about these. I do not think that, today, bankers are actually against the Third Basel Accord (Basel III). I think we have accepted it, probably in part, as an unavoidable evil. We understand that there is a need for improved and better regulations. However, we are telling governments, "Look, we have introduced Basel III. Let us review the situation in, say, six months' time, and see what are the consequences of the Accord." Definitely, banking will become more expensive; it will require more capital, and, as a result, that will inevitably affect banks' ability to lend money to the economy. The focus of the G20 now, as well as that of the Russian Government, is also on economic growth, as we all understand. The government expects us to lend more, cheaper money, while in parallel regulations are made more stringent. One should examine the possible room to manoeuvre in this area – although perhaps not now, but rather at a later stage. Second, is what we called financial inclusion. What we see now is that in spite of the fact that there are very soft monetary policies in European countries and the United States of America, we still have the problem of access, particularly by small- and medium-sized enterprises (SME), to financial resources. Measures taken by governments might ease access and make financial resources accessible to SMEs and to businesses. Third, we listed our recommendation for financial market infrastructure. We would

like to build infrastructure that would be more resistant to crises, particularly for emerging markets, and is more transparent. I think that is vital for the Russian Federation, for example. We are, only now, trying to create our local stock market; for example, VTB was recently the first bank to manage to list USD 3.5 billion in local shares, which was quite unique for the Russian stock market, as most of our listings had been taking place in London or in New York. The potential risk of having weak local markets, particularly in emerging markets, adds to the global risk which exists in the financial system. Thank you.

A. Wooldridge:

Michael Corbat, Chief Executive Officer of Citigroup.

M. Corbat:

Thank you very much. I appreciate the opportunity to speak with you today. A few things I would recognize: one is I think the world we are living in today remains a challenging place economically, politically, and from a regulatory perspective. We are in a world where, often, the major secular themes and trends, of globalization, for example, are at odds with the way regulatory reform is actually progressing. As a company, we are very supportive of regulatory reform. We think it is necessary to make sure that we restore credibility with our investors, with our customers and clients, with our regulators and all of our constituents. As a company, we have been very supportive, in the United States of America, of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act – which I will talk more about. We have also been very supportive of and in fact embraced the Third Basel Accord (Basel III), as we are operating our business on its model both from a capital perspective, where we have made public announcements that by year-end we should and will be operating at or above 10% against Basel III standards, as well as the liquidity coverage ratio, which we are already operating at, and in excess of. One of the things that often surprises me as I travel Europe is the degree of scepticism or doubt that is placed on the significant embodiment or movement

towards Basel III by American banks. Certainly, when you look at our perspective, we have made public announcements in terms of our embrace of Basel III, as I know the other large American financial institutions have as well. We are a company operating in over 100 countries every day. The complexity of regulation and regulatory reform is critical to what we do, and I think, as Andrey mentioned, it is critical to the business environment. We need a level playing field; we need harmonization of regulation; we need clarity of regulation. One of the big challenges, I think, that we face as an institution, but that we also face as an industry today, is that we have many regulators, many politicians – for many good reasons – pushing regulation. Often, the things that they are trying to solve are very similar, but they are taking very different approaches, and it creates conflict, not just as we go across borders, but often within a same country, which may have different regulatory branches or authorities seeking to solve problems from different perspectives. I think, as an industry, and as a global economy, we need clarity, we need finality, and we need that harmonization. We still, in many cases, have rules that are still being written; we have many rules that are yet to be finalized, and we have regulators who are not necessarily communicating as well as we would like to see them do. In this, it is challenging to be able to run a financial institution without having that clarity or finality of rules. But again, the rules, the reform are essential, and we embrace them. We look forward to continuing to work toward that clarity and finality in the rules in order to fully enact them.

A. Wooldridge:

Thank you. Michael Andrew, Chairman of KPMG International, with some words on the auditors, as well.

M. Andrew:

Yes, that is one of the three issues I would like to raise with you. There is a lot done about capital allocation and risk-weighting, but I think that one of the things that has not been thought through in the entire reform process is the role of intermediaries,

whether it be rating agencies, financial supervisors, or auditors. I would argue that auditors had a very good global financial crisis, and seemed to find the issues early on. The question is that since the global financial crisis still happened, could you have actually done something far more differently? And we have certainly had some very constructive discussions with the Financial Stability Board, which I might expand upon later. The second issue that worries me is – this picks up a little bit on what Michael has said – we must decide whether we want to be global regulators or local regulators, or at least get the balance right. Too many times, today, I go to countries and see the regulators actually requiring banks or financial institutions to subsidize, or bring their capital back into the local environment. This, of course, then leads to a significant contraction of liquidity, a concentration of risk, and does not actually leverage global balance sheets. I also see a series of domestic rules, which have extraterritorial impact, which actually distorts the market in many jurisdictions in which those companies operate overseas, and, I think, therefore restricts lending and finance availability, particularly for small and medium enterprises. The final question I would raise is the whole issue of the shadow banking system. Being based in Hong Kong, and spending a lot of time in China, there is one risk in the world that worries me at the moment, and that is the shadow banking system in China. It is effectively forcing people into that system because of the regulatory environment, and the lack of available capital and resources there at the moment. It is one thing to lay a regulation over the formal banking system, but there must also be an element of ensuring that we supervise what goes on in the informal sector as well.

A. Wooldridge:

Excellent. Thank you. Next, we have Frédéric Oudéa, Chairman of the Board of Directors and chief executive office of the Société Générale Group.

F. Oudéa:

Good afternoon. As the third representative from the banking sector, I would in large echo what my colleagues, Michael Andrew, Andrey Kostin, and Michael Corbat have said. I would like to highlight three top items in my agenda, when I think about our strategy going forward as a large, international banking group based in Europe. One is an opportunity, and two are worries. Firstly, the opportunity, in the form of the European Banking Union. It is a major transformation set to take place in the coming 12 months, with, as you might know, the change of regulator for large banks like Société Générale. We will have a regulator working at the European level, and is close to the Central Bank. It is, again, a model that I think works. It is similar to what we have in France, which I feel is a good model. Secondly, of course, we have a transition phase that we must manage with an assessment of the balance sheet, then a stress test, and so on, to ensure that problems have been dealt with. And then, of course, beyond the regulator, are issues related to its structural function, resolution mechanisms, and the possible cooperative management or solidarity between the Deposit Guarantee Scheme and the banking union. You can see it is a big change for the banking system. But for me it is an opportunity because it is the necessary step, on one hand, of course, to further build confidence, but on the other, to ensure that we can reverse any trend towards fragmentation in the euro zone, and to ensure that large banks, such as Société Générale, can take advantage of developing capital markets, and much more fluid capital markets, for example, in the euro zone. That is the opportunity. My colleagues have already touched on the two worries. First is the fragmentation which is taking place. To a certain extent, when you think about potential standards, I have my doubts that it could be that easy to implement the same standards everywhere, like the accounting industry. If you remember, with regard to accounting, there was this grand idea to have one standard everywhere. This has largely been put on the back burner. Nevertheless, this fragmentation is a bit worrying, in particular, in a world where you want to have growth. Here in the Russian Federation, for example, in the infrastructure sector, we need funding. If you think about that, it is good to be able to tap into international markets. It will be very complicated, in my view, to have

fragmentation between the different regions of the world, and different rules regarding these global financing needs. The Third Basel Accord (Basel III) is a good thing from that perspective; we want, of course, to have our monetization. Let me also say that in France, banks, including Société Générale, will be and are in line with Basel III. It is a given to a certain extent, and it will be good in terms of creating a level playing field. The second worry is really the balance between regulation and capacity at the end of the day to move forward and finance the economy as a bank. Let me just say here that I am still a bit worried; again, Basel III is in itself a big change. For Société Générale, which did not change, fundamentally, in terms of size or business model, we reduced our balance sheet, but instead of adding EUR 25 billion, we now have to remunerate EUR 50 billion. We had to double the capital with less activity. It is a big structural change, and if you add too much additional regulation on top of that, it makes our life very difficult, and makes banking activities very difficult to develop, and hence, perhaps, creates a threat to our capacity to finance the economy. So balance is also important.

A. Wooldridge:

Thank you very much. Everyone is keeping to their time fantastically well. Now, Madelyn Antoncic, Vice President and Treasurer of the World Bank.

M. Antoncic:

I am very grateful to be here to share my views, as well. Clearly, in the aftermath of the 2008 banking crisis, I do not think that anyone would disagree that there was need for some change in regulation. Certainly, we needed to strengthen oversight in certain areas and in certain corners of markets. It is very positive to find transparency, to find increases in disclosure, to get a safer and sounder banking system. There are a few things in particular that I am very happy to see with regard to the regulation that is on the horizon, certainly with respect to some regulatory schemes, and that is a development going toward a functional approach to regulation, as opposed to an institutional approach. In my mind, probably one of the

biggest causes of the financial crisis that we saw in 2008 was actually not a lack of regulation, but inconsistent regulation, and inconsistent enforcement. You would find banks, investment banks, insurance companies, hedge funds, all doing similar or even the same activities, but being regulated based on how they were incorporated, and how they were chartered. Therefore, that really created this big arbitrage, which really led to a lot of the destruction that we saw. I think that it is a very good, positive outcome that there are regulators looking to undertake a functional approach to regulation. However, I have a couple of concerns as well. I would like to make two points. The first was touched upon a little bit, and that is that there is still an enormous amount of uncertainty in the world about what the regulation will be. Keep in mind that regulation is just one thing at the very beginning of the timeline of things we have to implement. There is regulation, there is then writing the rules, there is implementing the rules, and then there is the monitoring. Basel just came out with a study a month or so ago which showed that of the 27 countries that are members of the Basel Committee on Banking Supervision, only 14 have really written all of the regulations. Of those, only 11 have written the rules, and of course, many have still not implemented them. I think that there is still a long way to go, and I think the issue here is, of course, the lack of certainty with respect to what exactly is required, or will be required in the future, and what is then going to be the model of banking. And, of course, I think this has a negative impact on the real economy, to the extent that banks are uncertain, and they are not sure how much capital they will require, or of the rules, I should say. Therefore, I think it really constrains lending, which has negative impact on the real economy. The other issue that concerns me, and concerns the World Bank, is the unintended consequences, in particular on emerging markets and on developing economies, and here there are two sides of that. Firstly, from the capital requirement perspective, we have already seen deleveraging, certainly in Eastern Europe, and I think the important point is that, not only for emerging and developing economies but also for small- and medium-sized enterprises (SME), even for developed economies, certainly in Europe, for example, where they do not really have access to capital markets. In the

United States of America, corporations mostly get capital, probably 70–80%, through capital markets. On the other hand, in Europe and in emerging markets, it is probably flipped, maybe 20% from capital markets and the rest from banks. Now, when banks are uncertain about the rules, they then pull back in terms of making loans, and, in particular, when capital charges become rather onerous, and some of the rules become onerous, then, of course, certainly risk weighting assets. They really will discriminate against SMEs, and against emerging and developing economies. That is one concern. My main concern is about the leverage ratios, whether it is the leverage coverage ratio or the net stable funding ratio. On the leverage coverage ratio, we did see some progress, with the Group of 20 (G20) being able to be vocal and suggesting that there are issues with respect to emerging economies. As a result those issues have been resolved. But there are still issues, one of which is the requirement for high-quality, liquid assets. Many emerging markets and developing economies do not have large amounts of high-quality assets to have on their balance sheets, to satisfy this liquidity requirement. One reason, of course, I just mentioned: they do not have deep capital markets. Part of the problem then becomes having to have more sovereign debt, which of course creates concentration. One of the concerns, certainly even in Europe, is that banks have too large a proportion of sovereign debt on their balance sheets, while the Third Basel Accord (Basel III) is actually making that an outcome. I think that there is an unintended consequence that must be looked at. On the net stable funding ratio, developing economies and emerging markets have heavy loan-to-deposit ratios. Again, that is penalized with the Basel III rules, and I think therefore, that penalizes developing economies, and that has to be considered. These are the direct impacts of the unintended consequences. There is also an indirect impact with respect, again, to liquidity ratios, for banks and developed economies. The requirement for the net funding ratio to be shorter-term will really encourage banks and developed economies to make shorter-term loans, and so that hurts developing economies in terms of infrastructure loans, because infrastructure loans will obviously hurt the requirement of the net stable funding ratio. I think that these

unintended consequences really have to be taken into account when we look at all of the rules, especially if you think about the Basel Committee, which is coming up with the rules. The Committee is made of 27 countries, and most of these, obviously, are the major developed markets like the United States of America and Europe.

A. Wooldridge:

Ksenia Yudaeva, Head of the Experts' Directorate of the Presidential Administration of the Russian Federation, for the G20 Sherpa.

K. Yudaeva:

Thank you. While the Ministers are speaking on behalf of the G20, and businesspeople are speaking on behalf of the B20, I am speaking on my own behalf, and giving my view as an expert on the current situation. I think, while we are almost five years on from the crisis, from the time that we first started to implement regulatory reforms, it is probably the time to make some initial assessments, and to see what was done, what the results have been, and what the unintended consequences have been, what was achieved and what was not achieved. If you look at the regulations that we introduced, they were inspired by the situation in developed countries, certainly the United States of America, and maybe in Europe. The focus of many of these regulations involved situations that are not strongly present in the Russian Federation, or not present at all. The focus of the reform, at the beginning, was largely on the American and the European situations, with only partial implemented in other regions. What are the results thus far? We see that securitization has gone down. We see much less or even no subprime anymore, but we still have bubbles and our financial markets are still very unstable. From this perspective, the goal has not been reached. Financial markets have not become considerably more stable because of regulations. Perhaps it has nothing to do with the change in requirements; it is just that we need some time to live through the consequences of the crisis. We must, however, still understand that these

reforms have not brought us a more stable financial sector. There is still volatility and, now, new unintended consequences. With regard to circumstances such as the fragmentation of the economy, we clearly see that we have this in the Russian Federation. Foreign banks are not increasing their activity to the extent that they used to before, and, whether good or bad, the feeling before the crisis was that foreign investments brought new technologies and improved access to financial services. This is not happening to the same extent anymore. Let us say at least that it is unclear whether this is positive or negative. As I said, we still have some bubbles; we still have a lack of legislation, and still a lack of desire, I think, on the part of regulators in different countries, to really cooperate, particularly on the regulation of some multinational banks, as well as to provide financial protection in sometimes hidden ways. Finally, one thing that has been happening lately is financial rebalancing. Certain economies believe in that this crisis is the result of a global savings glut, a result of developing countries beginning to generate a lot of savings, but financial systems not providing them with enough devices to digest all of those savings. We have a significant transitional force, and we need some significant financial rebalancing in order to have a more stable financial system. This has not yet happened to the necessary extent, as far as I understand. We need to understand that strengthening financial regulation is probably not enough to fully stabilize the financial system. We also need some financial development in order to make it more stable, particularly in underdeveloped regions. Thank you.

A. Wooldridge:

And now, Tharman Shanmugaratnam, Minister for Finance for Singapore.

T. Shanmugaratnam:

Thank you. Let me make three broad points. First, I think the great complexity of the situation we face has been reflected in many of the comments that we have just heard. We are trying to prevent the next crisis at a time when we have not yet exited the current crisis. We are trying to insure ourselves against the next crisis when we

are still far away from normal growth in advanced economies, and far away from a reasonable level of health in our banking systems. We are quite far from normality coming out of the last crisis, but we know that we also have to start preparing and strengthening the system in order to avert the next crisis. I think that requires a lot of clarity, because of the complexity of facing two challenges at the same time. It requires a lot of clarity around priorities, instruments, and sequencing or timing. We all, in my opinion, are in danger of focusing too much on preventing the next crisis by imposing layers of regulation, principally capital charges and liquidity requirements, which make a lot of sense when you look at them in their own right when you try to think about how we can prevent the next crisis. But these efforts are suboptimal given the situation we currently face. Now what are the alternatives? I think the main alternative, which requires a lot more attention, is to emphasize supervision more than regulation. Clearly, banks need more capital, and banks in Europe are still significantly undercapitalized. Clearly, there was a need for better liquidity buffers. However, we need a lot more emphasis on supervision: ongoing, intrusive supervision with greater supervision for the systemically important institutions, because it is a lot more growth-friendly. Banks do not need to pay as high an insurance premium through supervision compared to regulation. That is my first point. My second point is that I think we are focusing a bit too much on the structure of banks. Whether it is the Vickers Report in the United Kingdom, the Volcker Report in the United States of America, or the Liikanen Report in Europe, we are focusing too much on structure, and we are taking too much of a national perspective as we design these new structural proposals. First, we have a problem, because we are not going to be able to get harmonization between these different structural proposals; the same global institutions are going to be subjected to at least three different structural proposals. For instance, a British bank will be subjected to the Vickers and Liikanen Reports, plus more, if they are operating in the United States of America. It greatly complicates supervision, quite apart from imposing regulatory costs and uncertainties. Second, to take Madelyn's point, bear in mind that a large part of the world has systems which are still very dependent on

banks, and which need to develop capital markets. Certainly this is the case in Asia, and in emerging markets generally. The real priority is to develop capital markets, and frankly, large, globally diversified institutions – what we call global cities – are critical players in making markets in emerging market countries. They are critical players in providing liquidity, taking the other side of the bet, and being able to allow for hedging markets to develop. A large part of the world, and particularly a part of the world that is going to provide future growth, is going to require large, globally diversified institutions. I think that international perspective is extremely important when we think through structural proposals. Furthermore, to take another point that was made, briefly, if you think shadow banking is going to be a little messy, and something that we are going to have difficulty getting our hands around in a national system, just think about what shadow banking will be like internationally. If we overdo our structural proposals, slicing retail banking away from market businesses, we are going to accentuate the problem of shadow banking globally, and it is going to be extremely hard to regulate, let alone supervise. My final point is to think on the longer-term challenges facing finance, the mega-shifts. We do not yet have the institutions and the instruments that will cater well to the large pool of aging savers in advanced or mature nations. Savers are getting older. They need yield for their retirement savings, but they cannot take too much risk, and they need some liquidity. With regard to newer economies, there is tremendous demand for long-term investments, there is tremendous demand for infrastructure finance, but it is longer-term, and it is higher risk. We now have a mismatch, globally, as well as in national and regional financial systems between the needs of the largest pool of savers in the world, who are still in mature economies, who increasingly, want some decent yield, but without too much risk and illiquidity. A mismatch between that and the needs of the underlying, real economies that are going to generate the bulk of global growth, which is the need for long-term finance, which means new instruments, new intermediaries, and much stronger capital markets. Thank you.

A. Wooldridge:

Chrystia Freeland, from Reuters.

C. Freeland:

Well, I am a journalist, not a finance minister or the chief executive office of a bank, so I will just...

A. Wooldridge:

Perfect qualification.

C. Freeland:

Yes, exactly. I will just comment very briefly on what seemed to me to be the key themes that have been raised. Firstly, it seems to me that the dominant issue we have all been talking about is the mismatch between a world in which capital and business is global, but political authorities are national. That is why, I think, the point made about this danger of fragmentation is absolutely correct. But that is why it is going to be an exceedingly difficult problem. There is not going to be an easy solution to it, and I think that we are just at the beginning of incredible tensions being felt on precisely that fault line. The hope that we heard about Europe coming together on banking: it is not an accident that that is happening in Europe, because Europe, with tremendous pain, is starting also to consolidate its political authority, and that is why it is able to consolidate its financial regulation. I do not think that it is because regulators are stupid, or bankers are pig-headed, that you are unable to make these two things match up. There is just a fundamental mismatch happening in the global political economy there. One level of that, which was also reflected in our conversation, is the mismatch between how the economy works in developed economies and in emerging markets. When you put those things together – capital being global and government being national, and national governments and economies operating in very different spaces – you can understand why this is terrifyingly complicated. The second big issue that I think Mr. Shanmugaratnam, especially, touched on, and probably the bankers were too polite to touch on, is that

all of this is insanely complicated, and we, as a world, are expecting the work to be done by government regulators, at a time when national budgets are under tremendous pressure, and the ability to pay those regulators is not that great. You are asking people to take on this tremendously difficult, complicated, often politically unrewarding task at a time when budgets to support those institutions are probably shrinking, and, by the way, the entities that you are regulating are pretty rich by comparison. I think that is another really big fault line that has been alluded to, a little bit, in our conversation, and is another reason why this is a fiendishly complicated problem. Just to add a third point. A lot of us have been talking about how this set of issues, financial regulation reform in finance, is backward-looking. It is about responding to 2008, and people have reflected on the fact that actually, in some ways in 2013, the more urgent problem is growth. I think that is absolutely right. I would just point to what looks to me, from the perspective of a journalist, to be a new set of thorny problems that are going to be thrown up: difficult, political problems that are already being coming to light in the financial sector. That is the whole issue of global taxation, particularly including the issue of tax havens. I think that is the latest place where we are becoming more aware that this mismatch between global capital and national governments is really starting to get a lot of citizens angry, and is starting, frankly, to strain the budgets of a lot of national economies. So I predict – and some of the SPIEF organizers are here – that in 2014, there will be a panel focusing specifically thereon, which you should all participate in.

A. Wooldridge:

Well, I wanted to pick up on Chrystia's point about tax havens and global taxation in general, and ask Minister Siluanov a question. The Group of Eight (G8) has just concluded with some very vigorous talk about clamping down on offshore financial centres. Is this something that is going to be carried forward in the next few months, or was it just populism, and just for show? Are tax havens the next big item on the agenda, Minister?

A. Siluanov:

Undoubtedly, the issue of transparency, the issue of openness from the point of view of the ultimate beneficiaries of the company, is one of the key issues related to market transparency, since it is one faced by Russia and the rest of the world. We have discussed this at the G20 as well, by the way. Today we are following the path of concluding bilateral agreements between the United States and a number of other countries. Russia is also involved in preparing such an agreement. We will finalize it by the end of the year.

However, we should probably be talking about a universal agreement (maybe under the aegis of the Organization for Economic Cooperation and Development – the OECD) to disclose the ultimate beneficiaries of the company, so that company operations become clear and transparent. This, by the way, is not just about taxes and tax evasion, but also about clear capital structure and company stability. If we know who the ultimate beneficiary of the company is, if we know about its relations with interested parties, that is – interested party transactions; this has an impact on company stability.

This issue will be considered more and more in discussions at the international level. That is why the Russian Federation has prepared a number of legislative initiatives to improve company transparency, especially for companies that operate in non-transparent jurisdictions. A number of measures have been proposed to prevent tax evasion by such companies and, consequently, to improve their stability. I think this work will come into effect and should be coordinated at the international level over the coming years.

A. Wooldridge:

Mr. Kostin has also asked to speak on that. I would like him to speak, but I would also like to ask him a subsidiary question. He talked about the disconnect between the banking sector on the one hand and the real economy on the other, and how small and medium-sized businesses are finding it very hard to get money, even

though there is so much money sloshing around. And I would like him to address that question as well, but first some words on the tax havens.

A. Kostin:

On tax havens: I think that within the next couple of years, they will be closer to extinct than thriving. I think that rules coming from the United States of America, from Germany, and even from the Russian Federation, now mean that tax havens will soon cease to exist, at least as a haven for taxes from a legislative point of view, as was recently discussed by the Russian Government. There is some more advanced corporate legislation in Cyprus, for example, than in the Russian Federation. But otherwise, I am afraid, or I would like to say, that they will probably be useless. I strongly recommend that those present in the audience move their money away, to Saint Petersburg, to a VTB branch, or a Citigroup branch, or a Société Générale branch, as they are all present here. It is safe here in the Russian Federation, and nice from a tax point of view.

On the second issue, I think that, of course, first of all, we have to say that in order to borrow money, SMEs should have business opportunities. A very pressing issue for the Russian Federation, for example, and maybe for other countries as well is how to actually develop greater SME involvement in worthwhile sectors of the economy. In the Russian Federation, SMEs still play a very limited role outside the service sector. I agree that they are the first to suffer when something happens in the global economy, and one of the reasons for this is the lack of funding. But I am afraid that in this regard, there is no alternative other than to provide some kind of support to banks for the risk they take on through some kind of governmental support, either from local governments or from government institutions which do exist in many countries. Secondly, perhaps SMEs should have easy access to refinancing through a bank mechanism, but that is definitely a risky area for all banks, riskier than lending money to large corporations in many cases, although not always. This risk should be reduced if we want to provide an adequate level of lending to SMEs, and at a reasonable price. I truly believe there is no other way to

provide some kind of government guarantee to enlarge this mechanism. In the Russian Federation, for example, that mainly lies with the local government and the national development bank. In other countries, such as, for example, France, there are other organizations. I know that we have even discussed the idea of Central Banks providing a special refinancing facility. However, we know that the Russian Central Bank, for example, is completely against this separation of liquidity depending on purpose. They provide liquidity for the banking sector only, and without regard to SMEs or large enterprises or financial market operations. Thank you.

A. Wooldridge:

It is also a huge subject, I should say, in the United Kingdom. I am now going to ask Madelyn to talk just briefly, and then I am going to move on to a different subject.

M. Antoncic:

Thank you. I just wanted to comment about the SME issue. I think that here we have another example of an unintended consequence, and with respect to securitization. If I heard correctly, you commented that securitization was down, and that this is a good thing. It is not so clear to me that that is necessarily a good thing. Securitization has been around, at least in the United States of America, since the early 1980s, essentially 30 years. It has been an effective way of getting money to companies and to others who might need the access to credit and would otherwise not be able to get that credit. At the end of the day, I think the problem was that it had always been a means to an end, and then, with all of the regulatory arbitrators I spoke of previously, it really ended up becoming an end in and of itself. I think that we really need to be careful, with regulation, not to throw out the baby with the bathwater. SMEs, clearly, could benefit if regulators would relax a little bit on the whole issue with respect to securitization. If a bank is not going to be able to get its loan assets off the balance sheet, particularly if they are longer-term loans – because you have two issues: the capital and risk weighing charges, because, of

course, SMEs are going to have higher risk weighing charges, and also the net stable funding ratio – there is a disincentive in both cases. So allowing them to securitize, to get them off the balance sheet, would be more productive in terms of economic growth.

A. Wooldridge:

This is a question for Michael Andrew first, and then for anybody else who wants to answer it. With regard to the Chinese shadow banking sector, how big of a problem is it? How big of problem is it for the world economy outside China? What can be done about it?

M. Andrew:

I think that it is a very significant problem. I think that there is a real bubble there, where SMEs in China have not been able to access the full banking system, and, as a result, there are a lot of loans which are simply outside prudential supervision, and have been done on very speculative assets. I think that at some stage, there will be a day of reckoning...

A. Wooldridge:

Do you think it is a bubble that might burst?

M. Andrew:

I think if there are any bubbles around the world at the moment, this is the one that troubles me the most. It may well burst. Now, do I think that is going to implode the Chinese banking system? Absolutely not. I think that the major formal banking systems are well regarded, well capitalized, and they will cope, but I think that there has got to be a situation where, as part of the economic reform package that is announced in October this year, the Chinese Government really does tackle this huge sector of the economy which is, to me, completely contradictory to what we would call normal commercial banking practice.

A. Wooldridge:

Do you see any signs they might be willing to tackle it?

M. Andrew:

I think they need to tackle it, and I think they know they need to tackle it. I think now that you have some very experienced bankers in the finance stream and the prudential supervision stream, you are going to see some action there.

A. Wooldridge:

Okay.

M. Antoncic:

Could I just make a comment on that?

A. Wooldridge:

Yes, please.

M. Antoncic:

Clearly, it is an issue, and the International Monetary Fund (IMF) just came out with a study in April showing that of the USD 2.4 trillion of new debt in the Chinese market in 2012, 40% came from shadow banking. But again, clearly, the regulators now see the problem, and in fact, just this week I believe they announced that asset managers – for example, trusts, which are where a lot of this money is coming from – are going to be limited to capping the loans that they all lend to 30% of their assets. They recognize that it is an issue, and I think that they are trying to do something about it. I think, on Mr. Shanmugaratnam's point about fighting the last war and not looking forward, this really strikes me as a little bit unusual. I believe there is an issue with shadow banking, but again, throwing out the baby with the bathwater is not prudent. If you think back, at least in the United States of America –

and maybe some people in the audience may not be familiar, but I recall, very vividly, when I was an economist at the United States Federal Reserve – where the big concern, back in the mid-1980s, was the money market and mutual funds, and they were considered a shadow bank. The big concern was that they really were hurting the monetary transition mechanism, and because the Federal Reserve was not really able to control money supply anymore, because how did you define money when you had all of these money market accounts and mutual funds? I feel that no one can really imagine a current landscape without money market and mutual funds and other kinds of savings accounts that can be used as cash. I think that just saying, “No shadow banking”, and putting a bad connotation on it is really not the most prudent way forward. I think we need to figure out how to deal with it, how to regulate it, and how to be prudent about it, but not just to totally think about shutting it down, because at the end of the day, again, access to capital is what is important. Developed capital markets develop an alternative that is economically efficient and beneficial, and I think you will see an equilibration.

A. Wooldridge:

This is a question for Frédéric Oudéa. I feel as though, as a patriotic Englishman, I would not be doing my duty if I did not ask you this. Is there not a danger that, in trying to combat the fragmentation of the financial system in, for example, Europe, you will actually do more to promote fragmentation? That trying to impose a one-size-fits-all policy will actually encourage some people to exit the system and make it more difficult to sustain?

F. Oudéa:

At a European level, I do not think so. What is happening today is a premonition, if you wish. This fragmentation of a single-currency market, where euro in one country do not easily finance credit in an another, where you have, as you know, a problem regarding SME financing in Spain and Italy in particular because of the cost of credit and difficulty of its access. I think it is very difficult to imagine that it makes sense, or

that it would be efficient to carry on in this manner. At a euro zone level, where we share the same currency and where the idea was to have an efficient single market, with savings being able to – again, in an optimal way – finance the economy, this is absolutely needed. Furthermore, there are two strategic objectives with regard to Europe and its efforts to effectively draw a line under the crisis. The first is building a strong European banking system which will be able to compete internationally and, of course, play its role in financing emerging markets and economies, providing funds either for balance sheets or with a capital market structure with savings in Europe, while trying to deal with the mismatch that Mr. Shanmugaratnam mentioned. The second is building capital markets, because in Europe we have a very difficult transition to manage, which is, as was also said, to move from a system where banks were financing the economy to a much more balanced system with more capital markets, a more British or American approach. You cannot do that by the end of a quarter. You have to move progressively because investors have to be comfortable with these categories of assets. There is a transition phase, and it is a complex one, and we need, of course, a strong capital market structure to ensure that we also have the infrastructure to navigate this transition. Consequently, it is absolutely necessary to take a European view, or at least a euro zone view, rather than having each country try to deal with these topics on its own. That, for me, is a given.

A. Wooldridge:

I would now like to bring the audience in. Is there anyone out there wanting to ask a question? I am afraid we have only five minutes left. We are very pressed for time. No one? Then I am going to ask Mr. Shanmugaratnam about his emphasis on supervision rather than regulation. What exactly does that mean, and is it just a bit woolly? Is it a cop-out?

T. Shanmugaratnam:

First, regulation comprises capital charges; it comprises requirements for liquidity; it comprises some concentration limits that regulators place on banks, especially. Supervision is ongoing. It is where there is a constant presence of a supervisor, sometimes, within large institutions. It is constant interaction between different levels of management, including the board, all the way down, and it is constant reporting, particularly of the information that supervisors require for stress tests. There is a whole set of instruments at play here, but it is continuous. It does not pretend to be perfect, but it is not very costly. One of the reasons why I think that we have not placed enough emphasis on supervision post-crisis is that there has been a little too much of a desire to make it seem as if the sole problem was that banks were undercapitalized, or that banks made mistakes. Actually, everyone made a mistake. Supervisors were caught blind on many issues. I think that it just requires a lot of humility on everyone's part, bank boards and management, supervisors, credit rating agencies and the markets themselves. Everyone was blind to certain risks and the buildup of concentration risks. Everyone was blind to what was going on in the shadow banking system, but these are not problems that are impossible to tackle with some degree of assurance. It is not going to be perfect. The search for perfection, in capital rules and the restructuring of banking by taking retail out from market businesses and so on, is, I fear, going to be the enemy of the good. Supervision does not pretend to be perfect. It is a constant exchange, and the supervision that I was tutored in when I was a bank regulator, about 15 years ago, was actually old-style United States Federal Reserve supervision and that of New York state banking supervisors who simply went into banks regularly, pawed through their books, and engaged in conversations with every level of management. It was intrusive, but it was the way in which we ensured information was passing between all sides, all the time. I think we lost sight of the importance of regular supervision, and regular exchange between supervisors and banks.

A. Wooldridge:

We have a couple of minutes left. I just wanted to ask Michael Corbat a question. There seems to be general consensus that we need deeper, better, richer capital markets in Europe, the United Kingdom, and the Russian Federation, and that the American model is admirable in that sense. What can we do? How can we learn from you with regard to capital markets?

M. Corbat:

I will not be presumptive; I do believe that there is a lot of learning to do, but I think that you can look at a couple of statistics, and a couple of things that have happened. First, there has to be recognition in the financial space today that the costs of funds are, in fact, higher for many banks than those of its customers' access to capital markets. Why does it then make sense for bank balance sheets to be saddled with loans to clients, when that very client has access to capital markets at a cheaper level? There is this crowding out that occurs. If you look at some statistics or some numbers in the United States of America today, there is approximately somewhere around USD 8 trillion of corporate borrowing, and roughly 20% of that borrowing sits on bank balance sheets. If I compare that against Europe today, on a pan-regional basis, there is roughly the same amount of borrowing in the corporate space, but 70% of that sits on bank balance sheets, and potentially crowds out access by certain segments of either the individual or the corporate population to those balance sheets. I think that the good news is, today, that financial borrowing, as banks have deleveraged, has come way down. I think as you look at the search for yield, and the search for assets, that has allowed capital markets to expand, and you saw, just in the first half of this year, probably largely rate- and liquidity-driven, but as robust of a calendar as we have ever seen. I think that we need to continue to push forward and to push the edges, and I concur that we do need a healthy, functioning securitization market, whether that is in the United States of America or in Europe. We have got to get that and give people access to those monies. We need to continue to push the boundaries. We need to encourage our SMEs to get ratings, because without them they are disadvantaged

under Basel III. I think that they will see a warm and healthy welcome from capital markets as they try and do that.

A. Wooldridge:

I think we have heard this afternoon from a very distinguished and also a diverse panel. Thank you.