

SWISS DERIVATIVES *Review*

32nd Bürgenstock Meeting - Wednesday, September 7, 2011

The opening session of the 32nd SFOA Bürgenstock Meeting took place today at the Grand Hotel Victoria Jungfrau in Interlaken, where the meeting seems to have found its new home. There is nothing constant in this world but change, and so too with SFOA, from which Chairman **Paul Meier** announced his resignation after 10 years of loyal service in his opening speech. Paul Meier has personally witnessed the birth and growth of the derivatives industry, from its humble open cry days in New York, through the rough and tumble years of crisis, to become a complex and robust essential component of financial markets today. His parting message to the industry came as a warning to the exchanges to not to lose sight of the primary function of markets and to be careful to serve the needs of all stakeholders, not merely the shareholders.

Paul Meier is being succeeded as SFOA Chairman by **Otto Naegeli**, who brings a steady hand to steer the organization through today's challenging waters.

The year that has passed since the last Bürgenstock Meeting can best be described as turbulent. From the Arab Spring, to Japan's tsunami and nuclear disaster, to the euro crisis and downgrading of the US credit rating, we live, as the Chinese say, in interesting times. The paradigm is shifting and the cards are being reshuffled. Each region, country, industry and company is being challenged to adapt to conditions and structures that are passing away while seeking to profit from those arising, or at least to not be flattened by them.

The Bürgenstock meeting's host country, Switzerland, has always steered its own, often defiantly, independent course. **Michel Y. Derobert**, Secretary General, Swiss Private Bankers Association, took on this topic in his keynote speech entitled, "The Swiss financial center, which way ahead?"

While Switzerland has adroitly managed to ride out the crisis of 2008 relatively unscathed, success apparently also has its price. With the Western economy in crisis, from the US to Europe, the Swiss franc has become a safe haven, skyrocketing in value over the dollar and euro, threatening the competitiveness of Swiss exports, the tourism industry and ultimately its economy. With yesterday's decision by the Swiss National Bank to set the minimum exchange rate at CHF 1.20 per

euro, the Swiss are taking a bold stand to defend their currency while also sending the markets a message. In reaction to the credit crisis and the resulting bailout of its largest bank, UBS, Switzerland is taking drastic measures to deal with its 'too big to fail' banks, which go far beyond Basel III in an unprecedented regulatory response to today's equally unprecedented financial crisis.

Western governments handled the 2008 crisis by bailing out the private sector. Now, many of them are financially on the ropes themselves, particularly in the euro zone. They need to boost revenue and one route some have taken is to put the squeeze on traditional small financial havens such as Switzerland, even as they tend to turn a blind eye to their own fiscal inequities.

The Swiss have had to scramble hard to maintain their constitutionally ensconced banking secrecy while avoiding sanctions and worse from their global partners. In uniquely engineered deals as finely crafted as one of its vaunted watches, Switzerland has signed bilateral agreements with nearly all its major trading partners to settle most outstanding issues by guaranteeing taxation of the bank holdings of foreign nationals while retaining their anonymity and assuring them legal protection, and at the same time ensuring strict future compliance with foreign tax rules, while in turn receiving improved market access for Switzerland. The bilateral agreements provide enhanced legal certainty for banks and clients alike, restoring confidence in the Swiss financial center.

The bold steps being taken by Switzerland and its institutions provided an inspiring start to the conference, showing how this small, but valiant country is efficiently and concertedly adapting to an economic world in flux.

Mr. Derobert also joined the conference's first panel discussion, which so neatly dovetailed with his keynote speech and was provocatively entitled, "Quo vadis Europe?" It was ably moderated by **Mark Dittli**, Deputy Editor of the Swiss business magazine, *Finanz und Wirtschaft*. He outlined the ongoing euro crisis. What began with a seeming fleabite in Greece 20 months ago has now spread into a contagion of loss of confidence, first in

Portugal and Ireland, and now Spain and Italy, reaching closer to the heart of Europe. Lacking a fully centralized approach, the European solutions taken thus far amount to kicking the can further down the road, usually doing too little, too late.

Ketan Patel, CEO, Greater Pacific Capital Ltd in London named the elephant in the room by questioning whether Europe truly is a vital entity. In clear need of major recapitalization, Europe is going to have to turn to the existing deep sovereign capital pools. He suggested that such investors do not perceive a single European entity, but three Europes consisting of first those economically sound nations, followed by others that are under-capitalized and then a third group of countries that more resemble developing nations. There is no single Europe in the current environment, at least not in economic terms.

Alexis Lautenberg, Senior Policy Advisor, Stephoe & Johnson LLP, and former Swiss Ambassador to the UK, wondered how the Europeans have managed to drop the ball. The markets have recognized deep, fundamental flaws, which the unwieldy EU governing structures have handled ineptly and too slowly. This combination of flaws and doubts in the ability of European institutions has led to a crisis of confidence.

Vincent Derudder, Chairman, FECIF, Brussels pointed out that markets react like people do. If there is no captain in the cockpit, the passengers get nervous. He sees no captain in Europe's cockpit nor even a consensus on who that captain should be. Mr. Derudder feels that a complicated reorganization of the political structure is needed both for Europe and the Western world as a whole. Mr. Lautenberg agreed with the relationship between personalities and institutions. The post-World War II structures imposed by the victors of that struggle have become dysfunctional in today's world. Changing them will not be easy.

Mr. Patel stated that Europe needs to buy itself some time to make the necessary changes. No one is interested in seeing Europe fail. Yet, the nations with capital, such as China, are in a prime position to negotiate favorable deals in the upcoming European fire sale. They will surely demand their pound of flesh. Mr. Lautenberg pointed out a supply country such as China depends on intact markets and surely has a vested interest in keeping Europe afloat. However, Chinese capital has its price in terms of political power and this will force a re-examination of the rules of conduct forged after World War II.

This is a strategically important political question. Mr. Patel warned that we should not forget why the European Union was created in the first place. He wondered if a monetary union and fiscal union, such as the American system, might not be intrinsically linked.

Mr. Derudder does not see a European fiscal union coming into being; there are simply too many vested interests.

While politicians such as Germany's Wolfgang Scheuble are calling for a harsh dose of austerity in Europe's economic laggards, as the unrest in Greece and Spain has shown, such austerity comes with a price. Managing a tightening of the belt without throttling economic growth requires agility that Europe's bloated institutional structures are finding hard to handle.

Mr. Patel went as far as to wonder aloud whether the Arab Spring will be followed by a European Winter, ushering in populist movements that could potentially lead to disintegration of Europe itself and the end of the European experiment.

Mr. Dittli backed away from the edge by suggesting that there is a room for a golden middle. Mr. Lautenberg added that different recipes and trade-offs will be needed in different countries.

Mr. Derobert echoed the general panel opinion that more European debt restructuring is inevitable, perhaps in multiple waves.

Mr. Derudder stuck to his view that the problem is fundamentally a political one with democratic systems in which politicians base decisions from a short-term, election cycle driven perspective, leaving European governments unable and unwilling to make the difficult changes needed. Europe is suffering a leadership crisis.

In response to Mr. Dittli's final panel question regarding where the panel members see the EU monetary union in five years time, there was a resounding lack of confidence in the euro expressed among them. Views ranged from total disappearance of the currency to a core euro zone with soft boundaries and some members on sabbatical.

The essential question seemed to be how much Europe and its population is willing to suffer to keep the European experiment moving forward. It is a defining moment in history, a sure sign that we are indeed living in interesting times.

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