THE RETREAT FROM GLOBALISATION: THREATS AND OPPORTUNITIES FOR FINANCIAL MARKET INFRASTRUCTURES

As Rebecca Harding, CEO of Equant Analytics, pointed out in her opening remarks to the panel discussion she chaired at Sibos Toronto , a retreat from globalisation was an "unimaginable" concept only a few years ago. Today, it is unclear whether the gradual opening of economies since 1945 to trade in goods, capital and labour is going into reverse, or into temporary suspension under an aggressive but ultimately short-lived revival of economic nationalism. Whether the shift proves permanent or transient, the short-term implications for the regulation and movement of capital through financial market infrastructures are potentially profound.

"We are at a turning point," said Rebecca Harding, CEO of Equant Analytics to the audience at the panel discussion she chaired at Sibos Toronto. "We are at an inflection point. We have a situation where we could go right down one road - economic nationalism. We are already beginning to see some of that appearing. That is potentially extremely damaging."

However, her panellists were not convinced globalisation was in mortal danger. Paul Symons, head of government relations at Euroclear, said that globalisation might be "pretty unwell" but "rumours of the death of globalisation are greatly exaggerated." Although flows of capital across borders had shrunk in Europe and North America, they continued to climb in Asia, he said.

Globalisation is not in headlong retreat

Mark Wetjen, managing director and head of global public policy at DTCC, agreed that there was little evidence of a wholesale retreat from globalisation. "It is more of a re-consideration of the rules around international trade," he said. "I do not think there is a retreat. There is going to be a revision of the rules of the road, including for financial market infrastructures such as ourselves. It is manageable. We will be able to work through it. At DTCC we have clients in the UK, and we have clients in Europe, and post-Brexit we will still have clients in both places. We will figure out how to manage changing expectation as it relates to servicing clients in those two places."

In the United States, Wetjen found even less evidence of a diminishing commitment to globalisation. He pointed out that President Trump had appointed self-confessed internationalists to most of the policymaking and regulatory positions that supervise financial markets. In addition, a recent Department of the Treasury report reaffirmed the commitment of American regulators to participation in international regulatory initiatives, including the International Organisation of Securities Commissions (IOSCO), the Financial Stability Board (FSB) and even the Basel III capital adequacy discussions, from which the United States had previously absented itself.

Wetjen added that in August this year the Commodity Futures Trading Commission (CFTC) had licensed the first clearing house and swap execution facility (SEF) devoted entirely to crypto-currency. He described this as a "deliberate decision to demonstrate leadership in this particular space" that contrasted vividly with the attitude of regulators elsewhere to the rise of crypto-currencies. "It is another example, maybe not as obvious, of the commitment of the United States to show leadership internationally, because there is nothing more international than the crypto-currencies."

While he accepted that trade policy could be tilted in a protectionist direction, Wetjen thought it that was more likely to reflect political developments far removed from the financial markets, where the reality of policy lags far behind the rhetoric. "There is more noise than there are fundamental shifts in policy," concluded Wetjen.

Mark Austen, chief executive officer of the Asia Securities Industry and Financial Markets Association (ASIFMA), also agreed that there was little sign of economic protectionism in financial services. He thought the global policy shift in financial market policy from stability to growth, both in the United States under President Trump and in Europe in the aftermath of the successive euro crises, was unlikely to stoke protectionism. Even the allegedly more nationalist, post-Brexit United Kingdom would be focused on growth, to mitigate any structural shock from withdrawing from the European Union (EU). Nor would the British government want London to diminish as an international financial centre.

While Paul Symons thought Brexit had renewed the enthusiasm of the leaders of the EU to create a single European capital market that could compete with London, he did not think business would move from London to Frankfurt or Paris quickly. "No-one [in the EU] wants all of its capital-raising to take place outside the economic and regulatory control of a particular country [in the EU]," he said. "There is a real momentum there. But how quickly it will happen is another matter." Mark Wetjen agreed. He thought it would take "a generation" to create a single European capital market.

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Mark Austen was concerned by EU ambitions, and especially by the threat of euro clearing being repatriated from London to the eurozone. In his view, it would fragment financial market infrastructures, and potentially lead to a complex regulatory regime sub-divided between the United States, the United Kingdom and the EU.

But he remained upbeat about globalisation in general. "If you look at what is going on globally, there are actually quite a lot of positives," said Austen. He expects even an agreement between Europe and the United States on the terms of the Basel III capital regime. "It is extremely important for global financial integration," he said. "If that fragments, we have got big problems, but I am confident that will not be the case."

Chinese trade policy might be internationalism masquerading as nationalism

Asked if the "one belt and one road" initiative launched by the Chinese government marked the beginning of a more nationalist economic policy by China, Austen said little of substance had yet occurred. He added that the goal of using infrastructure to draw the markets of Asia, Eurasia, Europe and Africa into trading networks was potentially helpful to world trade, but the rhetoric had so far outrun the reality.

In principle, financial market infrastructures from developed countries could even help to fund projects under the initiative, but Mark Austen said ASIFMA members had found this hard to accomplish in practice. "The challenge we found is managing infrastructure in any emerging market," he said. "Is corruption endemic in this country? Is this a bankable project? Does this project actually make sense? Can it actually be delivered on time? Can you get the approvals?" Another problem, he added, was foreign exchange risk.

Globalisation is suffering reverses at the micro-level

Alan Marquard, chief corporate strategy and development officer at CLS, was more cautious about the outlook for free trade around the world, but even he thought globalisation was more likely to slow down than halt altogether. "Globalisation at some level will continue," he said. "I do not think the world will turn its back on inter-connectedness completely."

His concern was that the process of opening markets and aligning regulations would decelerate for a number of years before regaining momentum. "The drivers of globalisation, on the long view, will mean that infrastructures will function again, and that there will be global levels of co-operation at some time in the future," said Marquard. "But I think it is going to take a while, and I think that we are going to miss opportunities to address risk and efficiency in the market in the next few years."

Damage would occur at the micro-level, thought Marquard. For example, repatriating euro clearing from London to the eurozone would undermine liquidity and inadvertently damage the mutual recognition of clearing houses between Europe and the United States.

There was an additional post-Brexit risk that European participants in CLS would lose various forms of protection they currently enjoy under English law. While the problem can be solved easily by amendments to European directives, Marquard was not confident they can be made in the current environment. He thought similar considerations would undermine CLS plans to build a cross-border payment utility.

Marquard also foresaw the co-operation between the 22 central banks that supervise CLS becoming strained, because one central bank was challenging the dominance of the Federal Reserve as the lead central bank.

"Most infrastructures are about systemic risk, and that is by definition about connection, and the way that you solve problems of connection are through co-operation," said Marquard. "It is almost self-defining."

As he pointed out, CLS is a typical example. It was invented by a group of regulators to eliminate Herstatt risk from the settlement of high value cross-currency payments, and does so in 18 separate currencies through a banking operation in New York that is

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The retreat from globalisation: threats and opportunities for financial market infrastructures took place on Thursday 20 October 2017

View the entire panel discussion **here**

Moderator

Dr. Rebecca Harding, CEO, Equant Analytics

Panellists

Mark Wetjen
Managing director, head of global public policy, DTCC

Alan Marquard
Chief Corporate Strategy & Development Officer, CLS

Paul Symons
Head of Government Relations, Euroclear

Mark Austen
Chief Executive Officer, ASIFMA

governed from London by English law, while being overseen by a club of 22 central banks.

"It is a really fuzzy, cosy story of how to get on and solve a problem," he said. "So when you start talking about regulators not getting on and driving national agendas, that goes right to the heart of the ability of a financial market infrastructure to function cross-border. In 2017, I feel that playing out. On the ground, at least for us, globalisation is already showing cracks. Even among regulators, clear linear thinking is being substituted by position-taking."

Economic nationalism reflects not hostility to globalisation but concern for its casualties

Mark Austen countered that national interests were always pursued, even in the most co-operative and multi-lateral of negotiations, so position-taking by regulators was nothing new. What had changed, he thought, was the wider political environment. Negotiators could no longer take it for granted that globalisation was in the national interest.

"A lot of people in the western, developed democracies feel that they are under threat," he said. "They feel they have been squeezed by globalisation. If you look at the figures, it is clear that in most developed countries the middle class has shrunk, and the rich are getting richer. So you have got this backlash against globalisation."

Paul Symons attributed at least part of the backlash to discontent with the role of powerful corporations, which are seen to exert enormous economic power, not to pay their fair share of taxes, to over-pay their senior executives, and not to treat their employees with sufficient respect.

"The balance of power has shifted considerably over the last ten years, and we need to address that," said Symons. "How we re-engage is difficult because the electorate who voted for [Brexit] clearly felt that they could not be worse off than they are today. It was worth a punt. Things might improve. The irony of this is that, if globalisation does retreat a bit, the people who will be hurt the most will be the people who voted for it. It is a really difficult social question to address, and politicians have an exceptional challenge to deliver that."

The benefits of globalisation need to be sold

Mark Wetjen thought there was a practical answer to the question. "Someone has to take it on," he said. "Someone who has benefited very much from globalisation, whether it be an individual or a corporation, has to fund an organisation that takes on, as its mission, educating the populace about the benefits [of globalisation]. It is very simple. That is what needs to happen but, if you look around the world, no one is doing it." In his view, electorates do not understand the issues well enough to vote for what is in their own economic interest.

Mark Austen agreed. "We need to show humility," he said. "We may all be globalists, but at the end of the day there are other views, and they are as valid as ours. We really need to sell globalisation. Rather than just taking it for granted, and ridiculing anybody that does not agree, actually say why it is a benefit."

Alan Marquard endorsed this view too, citing Brexit as an instance in which voters did not have enough information to make a sensible decision. But he warned the financial services industry against continuing to pool their agreement that the Brexit vote was foolish. "The very arrogance that walked everybody into this situation has actually continued post the event," he warned. "People are just clubbing together, feeling very joined-up about thinking it is crazy."

Editor
Dominic Hobson
dominichobson@dominichobson.com

Head of Market Infrastructures, SWIFT
Carlo Palmers
Carlo.Palmers@swift.com

Design
Bim Hjortronsteen
bimhjortronsteen@gmail.com

Publisher
SWIFT
Avenue Adèle 1
B-1310 La Hulpe
Tel: +32 2 655 31 11
Fax: +32 2 655 32 26
SWIFT BIC: SWHQ BE BB
http://www.swift.com/