

THE FINANCIAL SERVICES ACTION PLAN: THE OUTLOOK AFTER BARCELONA

Summary: The objectives of the Financial Services Action Plan are clear: deep, liquid European Capital Markets; and removal of barriers to cross border retail financial services with a high level of consumer protection. Since its inception, the Lisbon Agenda has set an overarching aim of creating the most innovative, dynamic, knowledge-based economy in the world. Financial services provision will underpin this. There is talk of a new reality following from the events of 11th September, Enron and AIB. The temptation to ‘do something’ needs to be set against the longer term and over-riding objectives of the FSAP and Lisbon. The mid-term review highlighted the need for swift progress and picked out a number of specific initiatives to be implemented this year. These and others were also identified at the Barcelona Council meeting which followed. There are a number of themes which should influence developments going forward, beyond specific legislative initiatives already in train. For example: the need to make the Lamfalussy process work in terms of the level and quality of consultation, the danger of over regulation and the need for flexibility; the desirability of keeping the Lisbon and FSAP objectives in mind when considering regulatory and legislative initiatives; the differences which exist between wholesale and retail markets; how supervisory co-operation (an issue specifically identified in the FSAP) can be developed; externally generated regulatory initiatives (Basel) and the way these should be implemented in the EU.

THE FINANCIAL SERVICES ACTION PLAN

Background

The Commission produced its Financial Services Action Plan (FSAP) Communication on 11th May 1999 [Com(1999)232]¹. This encompassed a mixture of proposed new legislation, amending legislation, Commission Communications and Recommendations all within an ‘Optimal Timeframe’ for completion by 2005 – later amended to 2003 for wholesale capital market integration.

In terms of objectives, three main and one subsidiary areas were identified. Wholesale markets where the prize is cheaper, more flexible financing arrangements for corporates and where the ‘present mass of barriers needs to be stripped away’. Retail markets ‘rather than attempting harmonisation of products, mutual recognition ... should be pursued’ with ‘progressive harmonisation of marketing and information rules’. Supervisory structures ‘market integration has pushed the issue of reinforced EU collaboration to the forefront’ and the highest standards of prudential regulation need to be maintained. General conditions for an efficient EU financial market such as Corporate Governance and Taxation.

For the Action Plan to deliver on its promise it will be essential not only to have legislation in place but for that legislation to further the aim of market integration by eliminating existing impediments rather than the legitimisation of existing impediments or creation of new ones. In other words, the goal is good legislation, not just any legislation.

The Commission’s Fifth Progress Report on the Action Plan, 30th November 2001 [COM(2001)712 final] highlighted the need for “a broad and critical mid-term review ... of what has been accomplished, what benefits of integration there are and what still needs to be done. Political action must follow.”

¹ http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm

A mid-term review with the financial industry took place on 22nd February 2002. It

- welcomed progress already made;
- stressed the need for further rapid progress if the plan is to be completed by 2005;
- called for renewed efforts over pensions, prospectuses, financial conglomerates and take-overs;
- hailed agreement on the Lamfalussy process as a springboard for further progress;
- stressed the need for clear information to consumers on the benefits of long term financial integration;
- identified the need to monitor implementation of existing and future legislation to ensure it delivers its objectives;
- noted that new realities existed post 11th September: Enron, AIB
- welcomed the successful introduction of euro notes and coins.

Barcelona

The rhetorical context for the Barcelona Council meeting is the aspirations articulated at Lisbon in 2000. The promotion of prosperity through increased levels of productivity and employment, “to make Europe the most innovative dynamic knowledge based economy in the world by 2010.”

Financial Services are seen as underpinning this whole effort, not least through the provision of competitively priced capital to the enterprises which would create employment and prosperity.

Politicians inflated expectations describing the meeting as ‘make or break’ whereas some commentators regarded the process as already broken because of the lack of tangible progress.

In the event financial markets merited one paragraph (No.35) in the Presidency Conclusion. The Council

- welcomed the agreement on Lamfalussy and urged implementation;
- reaffirmed commitment to the 2003 and 2005 deadlines;
- singled out six Directives and one regulation for adoption in 2002²

In addition, in the context of entrepreneurship and competitiveness (paragraph 15) comment was passed on the possible adverse effects on SMEs of the Basel proposals. The Commission was requested to produce a report on the general economic consequences of the Basel proposals with particular attention to SMEs.

Whilst Council Members have portrayed the outcome of Barcelona as a success, responses at large have been more muted.

² Collateral, Market Abuse, Insurance Intermediaries, Distance Marketing of Financial Services, Financial Conglomerates, Prospectuses and Occupational Pension Fund Directives; and the International Accounting Standards Regulation.

WHAT REMAINS TO BE DONE

Keep the key objectives in mind.

It is worth reiterating what the objectives at stake are:

- deep liquid European capital markets;
- removal of barriers to cross border retail financial services with a high level of consumer protection.

As underscored in all Council statements since Lisbon, these are not merely desirable ends in their own right, but the key foundations to building a prosperous Europe with a thriving economy which will benefit and be supported by all its citizens.

Make Lamfalussy Work

Agreement between the three institutions was a necessary but not sufficient step. There are three key issues still to be addressed:

1. Consultation – an essential element of the Lamfalussy proposals is the requirement that interested parties be fully consulted. To date CESR has put in place arrangements designed to secure this. It remains to be seen how these are actually put into practice. For consultation to be genuine, conclusions which are controversial need to be thoroughly explained and should be measured against the over-riding objectives.
2. Danger of over regulation – heavy-handed regulation runs the risk of stifling enterprise, innovation and the development of skills and knowledge – all essential elements of the Lisbon Agenda. Within the framework legislation envisaged by the Lamfalussy proposals there is the real possibility that the weight of ‘secondary’ legislation designed and proposed by regulators becomes disproportionate.
3. The need for flexibility – if markets are to remain innovative and dynamic then the Lamfalussy process must also be used in an innovative and dynamic way. Regulators are now required to conform to a new, more forward-looking paradigm that promotes efficient markets.

Basel

The Basel Committee’s review of international capital adequacy standards is proving to be more drawn out than anticipated and a conclusion is not yet assured. What is certain is that, at least in the wholesale markets, which are global in nature, a delay in implementing Basel in the EU by way of a new Capital Adequacy Directive, or a Directive which is significantly different to the Basel Accord, may well prejudice the European financial services industry vis-à-vis their US and other third-country competitors. If it is significantly disadvantaged then the ability of the EU's financial services industry to provide capital to industry to deliver on the Lisbon agenda will be impaired.

Wholesale – Retail dichotomy

In many respects the wholesale market is already a global one. Uniform market practices and corporates' ability to choose applicable law and jurisdiction with relative ease cut across national and regional boundaries, although legal and regulatory barriers in the Member States significantly add to the cost and risk of doing cross-border business even at this end of the market. In this context the challenge for the EU is to remove remaining barriers and to preserve the right environment within the EU to allow the market to flourish here. Damage to the stature of particular financial centres in the EU such as London, Paris, Frankfurt or elsewhere should not occasion Schadenfreude in any quarter. On the contrary, it should be a cause of deep concern for us all.

The retail market is different. As the EFSRT (European Financial Services Roundtable) sponsored report highlighted, besides the legislative and regulatory barriers which can and should be addressed, there will remain others which are cultural which may well take beyond 2005 to meld into a single market.

Accounting

Comparable and reliable financial information is fundamental for cross-border investment. In the interest of common accounting standards in Europe, the proposed directive is to be welcomed. But the problems for those European companies that apply US-GAAP will be solved only if until 2005/2007 an understanding with the US authorities on truly global standards can be reached.

Supervision

A final piece of the jigsaw is the thorny question of the nature of supervision. A number of alternatives to the Lamfalussy approach, if it should prove inadequate, have been suggested:

- A euro SEC – to cover securities markets and exchanges on an EU wide basis.
- A euro FSA – to cover all financial services activities on an EU wide basis.
- An optional euro FSA – to cover only those institutions which operate across borders in a meaningful way across Europe.
- An integrated framework of Regulators – perhaps institutionalised along the lines of the European System of Central Banks.

Serious questions which have been raised about these proposals include:

- Would a pan-European supervisor have adequate resources and expertise to oversee the markets effectively?
- Would such an entity be too remote from the markets?
- Could such an entity be created without greater convergence of regulatory rules and practices and enforcement methods across Member States?

Discussion of these institutional issues is likely to continue up to the IGC in 2004, when a review of the Lamfalussy procedures will be undertaken. The important point to bear in mind is that any institutional arrangement for supervision should meet the dual tests of ensuring market

stability and investment protection on the one hand, and promoting efficient, competitive markets on the other.

Conclusions

There has been progress on the FSAP and there remains strong but sometimes rhetorical support. In the coming months and years the underlying objectives need to be kept firmly in mind:

- Deep, liquid European Capital Markets.
- Removal of barriers to cross border retail financial services with a high level of consumer protection.
- The facilitation of an innovative, dynamic economy.

Regulation and alternative arrangements supported by market forces needs to promote these objectives and do so in a proportionate, flexible and consultative fashion. All three EU institutions have an important role to play in ensuring that this happens.

Briefing notes are prepared by the Industry Advisory Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Advisory Committee.

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