

MARKET INTEGRATION AND THE RETAIL CONSUMER

Introduction

In June 1998, the European Council in Cardiff invited the European Commission to prepare a framework for action to develop the Single Market in financial services. In May 1999, the Commission published a Communication containing the Financial Services Action Plan, which was endorsed by the Lisbon European Council in March 2000. More recently, the Kok report¹ commissioned by the European Council published in November 2004, called for the EU to ‘Unleash the dynamism of Financial Markets’. What can Europe’s retail financial services consumers expect?

Retail ambitions of the Financial Services Action Plan

The retail aims of the FSAP were to create an open and secure retail financial services market which would give retail customers the information and safeguards they need to participate in the single financial market by removing unjustified barriers to providing cross-border retail financial services; by creating the legal conditions for electronic commerce on an EU scale; and by enabling consumers to make small value cross-border payments without excessive charges.

Benefits of integration for consumers, industry and Europe

An effective, integrated financial services market would deliver benefits for consumers, in the form of greater choice of products and lower prices. Cross-border competition between financial services providers would reduce some of the observed product gaps and put downward pressure on prices.

Several attempts have been made to quantify these benefits. For the mortgage industry, a study made by Mercer Oliver Wyman² concludes that improvements in efficiency such as reductions in servicing, distribution, origination, and funding costs could deliver substantial benefits for consumers and lenders alike. In addition, greater product availability via the closure of observed product gaps could result in a market expansion of up to 10% expanding access to housing finance for many and thereby increasing homeownership.

On the banking industry side, benefits would accrue through greater diversification and increased efficiency driven by convergence of infrastructures, economies of scale and competition. Banking best practice would spread across Europe, the pace of innovation would accelerate with new products being introduced to many markets. An important benefit for many institutions will also be access to larger markets, as many national markets are now ‘mature’ with little scope for further growth.

For the European Union, a report for the Commission by London Economics,³ estimated the long-run increment of having a single financial market as a 1.1% growth of EU GDP. Financial market integration was found to be economically significant in all countries. The European Financial Services Round Table (EFR) regrouping Chairmen or CEOs of 20 leading EU banks and insurance companies issued two reports on the benefits of fully integrated retail financial markets.⁴

¹ “Facing the Challenges – The Lisbon Strategy for growth and employment”, Report from the High Level Group chaired by Wim Kok, November 2004

² “Financial Integration of European Mortgage Markets”, Mercer Oliver Wyman, commissioned by the European Mortgage Federation, www.emf.org, October 2003

³ “Quantification of the Macro-Economic Impact of Integration of EU Financial Markets”, London Economics in association with PricewaterhouseCoopers and Oxford Economic Forecasting, November 2002

⁴ *The Benefits of a Working European Retail Market*, F. Heinemann (ZEW) and M. Jopp (IEP), sponsored by EFR, January 2002; *Consumer Protection and Consumer Choice, Consumer protection and the Single Market - A fresh approach to breaking the deadlock*, EFR, March 2004

How far is there to go?

Assessment of FSAP Progress

The Final Report by the Expert Group on Banking of May 2004⁵ concludes that there is no pan European retail market yet. It underlines that in spite of the existence of an EU passport, banks have shown a preference to develop their cross-border activities via subsidiaries rather than branches and that direct, 'physical' contact remains the predominant means of delivery. It notes that whilst internet banking is on the rise it is not yet a significant factor in cross-border service provision. This may explain that internet banking has not yet been able to establish total consumer confidence and therefore has not yet materialised the hopes of greater cross-border competition.

On the other hand, the Report notes that many of the larger financial groups maintain a presence in other countries using both branches and subsidiaries and that even if the number of cross-border mergers and acquisitions has been limited, in some cases they have led to the emergence of regional banking groups, such as in the Benelux and Nordic countries.

Retail Financial Services are not just confined to those offered by banks. Retail financial securities firms offer services ranging from internet based execution only sites to advice based portfolio management. The FSAP brings changes which are likely to reduce cross border barriers. However, the assessment for these and other retail securities firms and services cannot yet be made

What is the evidence on integration so far?

In the case of retail financial services, prices (e.g. for consumer credit) and products (e.g. for long-term savings) vary substantially between different countries and sometimes also between different regions. There has been little cross-border retail or small business banking; a small amount of cross-border retail non-life insurance business; some cross-border selling of mutual funds; but very little cross-border life insurance or pensions business.

Although cross-border activity in the mortgage market is currently limited to niche markets such as holiday homes, there is some evidence that mortgage rates have converged partly as a result of the Euro and also thanks to more integrated capital markets. This is supported by the Mercer Oliver Wyman study. Furthermore, the Commission's Financial Integration Monitor 2004⁶ sees some convergence of unsecured lending rates.

How can financial institutions create a single retail market?

Financial market integration in the EU can take a number of forms, such as:

- **Cross-border sales** : where a firm in Member State A may sell its products or services directly to users in Member State B;
- **Networks of branches or subsidiaries** : where a firm in Member State A may distribute its products or services using its own network in Member State B (gained through merger or acquisition or developed from scratch);
- **Local distribution networks** : where products such as investment funds are produced and managed in Member State A by one institution, and sold in Member State B through the sales network of another institution; and
- **Asset transactions** : where a deeper more liquid market for assets such as credit card receivables or mortgage debt could lead to banks or other financial institutions acquiring European exposures without the expense of developing multi-country distribution networks.

What is holding us back?

The barriers to the integration of retail financial services are numerous and can be summarised as:

- Some types of product cannot be provided in different Member States;
- Authorisation of foreign product may be delayed;

⁵ Final Report, Expert Group on Banking, FSAP : Progress and Prospects, May 2004

⁶ Financial Integration Report 2004, Commission Staff Working Document, DG MARKT

- Regulations differ, for example on consumer protection;
- The cost of local registration can be high;
- The local tax system may differentiate between local and foreign products;
- The arrangements enabling consumers to obtain redress across borders are still at an early stage of development.
- Cultural preferences differ across the EU and many consumers may prefer well-known local providers;
- Markets closed to competition.

What actions should be taken?

- **Building Consumer Confidence** - Cross-border ombudsman schemes, such as FIN-NET, can sometimes provide dispute resolution procedures without the need for legislation, though they need to be developed further. They also have a major role to play in helping to facilitate a Single Market by giving consumers confidence to buy products on a cross-border basis. However, financial ombudsmen differ widely in their responsibilities and their remits. Firstly, a financial ombudsman would need to be established in each country with universal coverage. Secondly, ombudsman networks would need to be strengthened and consumers made more aware of them, in order for them to be truly effective.
- **Case by case approach** – A pragmatic case-by-case approach is needed, considering particular obstacles relating to the cross-border supply of each specific product and the required and tailored solutions. In that regard, the principle of a lead supervisor would be helpful in order to avoid too much national discretion that will hinder a level playing field in the EU.
- **Adequate harmonisation of national consumer protection rules** – Some degree of harmonisation of national consumer protection rules should be achieved to allow a level playing field and a common level of protection for consumers. Providers complying with the set of harmonised, well-balanced rules should not be subject to additional requirements when they provide services in another Member State. Legislators need to consider the mutual recognition principle that eventually could apply to those parts of a product not covered by harmonisation. This would allow overcoming major barriers to cross-border selling of retail financial services and ensuring product diversity within the EU.
- **Better implementation and enforcement** of EU measures affecting the financial sector. A significant number of the FSAP measures that have been adopted have still to be implemented nationally. That should be a top priority, together with their subsequent enforcement. This should extend to the greater and more proactive use of competition powers by the Commission to open markets to new entrants.
- **Market based solutions** – Represent a cost-effective alternative to legislation and can help build a level playing field across Member States. This can include Voluntary Codes of Conduct extending to shared consumer protection standards, common and comparable documentation or data sharing schemes.

Conclusions

It is unlikely that there will be a big rise in cross-border banking, credit activity or the provision of other retail financial services in the next few years in view of the scale of barriers to integration. However over the longer term, the benefits which could accrue to consumers, the industry and Europe more widely are clear. In that light targeted initiatives should be designed to promote consumer choice and competition between providers. It is therefore vital that initiatives such as, the Financial Services Action Plan or the Forum Group on Mortgage Credit are as successful at the retail level as the FSAP has been in recent years at the wholesale level.

However, the lessons of the FSAP need to be learned and legislation be brought forward in future only when cross-border activities cannot be fostered by other means. Also, any legislation needs to be well targeted and subject to good prior impact analysis.

Briefing notes are prepared by the Financial Industry 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 Financial Industry Committee.

Steering Committee

Pervenche Beres, MEP
Robert Goebbels, MEP
Chris Huhne, MEP
Piia-Noora Kauppi, MEP
Alexander Radwan, MEP
Peter Skinner, MEP
Theresa Villiers, MEP

Chairman Financial Industry Members

Rainer W. Boden
Deutsche Bank, EU-Representation
17, Avenue Marnix
B – 1000 Brussels
Tel: 0032 2 551 60 06
Fax: 0032 2 551 61 08
E-mail: rainer-w.boden@db.com

Secretary

John Houston
EPFSF Secretariat
Av. de la Joyeuse Entrée, 1-5
B – 1040 Brussels
Tel: 0032 2 504 80 40
Fax: 0032 2 504 80 50
E-mail: secretariat@epfsf.org

Founding Members (2000)

Richard Balfe MEP
C.A. Gasoliba I Bohm MEP
Robert Goebbels MEP
Chris Huhne MEP
Othmar Karas MEP
Giorgos Katiforis MEP
Piia-Noora Kauppi MEP
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