

Financial Services Priorities 2005-2010

Summary: There is broad agreement on some of the priorities for action in the field of financial services regulation: an initial emphasis on enforcement and implementation of FSAP measures; anchoring future regulation on cost-benefit analysis; streamlining and reduction of existing rules. Beyond the aforementioned issues, there is comparatively less agreement on the need and desirability of further legislative action. There are, in fact, a number of important and complex issues on the table already – most importantly: the transposition of Basel II into EU law; clearing and settlement; the Consumer Credit Directive; the New Legal Framework and payment services in general, and the Company Law Action Plan. In addition to these, no time should be lost thinking about some complex areas: integration of retail markets, structure of financial supervision, consolidation of rules, and co-ordination with foreign regulators.

It is widely agreed that an initial emphasis must be placed on the implementation and enforcement of the legislative measures of the FSAP. This is a demanding task for both supervisors and for the financial industry, which will absorb substantial personnel and financial resources. It is also agreed that future legislative and regulatory action should be based on a more comprehensive cost-benefit analysis, which will require a more rigorous approach than is currently adopted. Moreover, there is agreement that the FSAP produced some over-regulation and inconsistencies (e.g. between the Distance Marketing Directive and the E-Commerce Directive). Therefore, emphasis must now be placed on the streamlining and consolidation of regulation. Financial services regulation must also be co-ordinated with related work, especially in the field of accounting, in order to avoid divergent rules.

Beyond that, there are differences regarding the preferred course of action: some call for a "regulatory pause", a complete standstill in EU financial market legislation, in order to give all parties time for digestion. Others argue that the EU cannot afford such a "pause" given the number of serious obstacles to a truly integrated market, the removal of which will take some time in any case. A delay in tackling these would therefore be undesirable and set back further the realisation of the substantial welfare gains, offered by financial market integration. In any case, it should be clear that overcoming the remaining obstacles does not always require legislative action. Often, stricter enforcement of existing rules, application of competition policy and the basic principle of free capital movement, closer alignment of regulatory and supervisory practices, and elimination of duplicative or unnecessary rules will be more appropriate and lead to faster results. Effective review procedures will help in identifying and rectifying any flaws in existing legislation that act as a brake on market integration. The idea of creating an ombudsman system to provide a more flexible and discreet method of dealing with complaints than infringement procedures, is still the subject of divergent views.

There are a number of measures already on the table which need to be considered. These include:

- *Capital Requirement Directive:* The transposition of Basel II into EU law, and subsequently national law, is probably the single most important item of the 2005-2010 legislative agenda. There are a number of acute challenges. (1) immense time-pressure: Basel II must be transposed early enough to guarantee sufficient lead time and legal certainty for financial institutions and to avoid competitive disadvantages for EU institutions; at the same time the legislative process must remain flexible enough to incorporate last-minute changes including those expected to arise from ongoing Basel work; (2) competitive neutrality within the EU must be guaranteed; hence, the number of national discretions should be kept to the absolute minimum, and banking supervisors must align Pillar 2 practices; (3) banking supervisors will have to sort out the so-called home-host issue, i.e. avoid inconsistent or duplicative demands to internationally active institutions.
- *Clearing and Settlement (C&S):* Notwithstanding the importance of an efficient C&S structure – currently lacking for cross-border trading – for an integrated EU capital market, the arrangements, the technical harmonisation, and the consolidation of systems should evolve in a market-driven process. Measures to support effective competition between providers may be required, but must be based on proper cost-benefit analysis. The Giovannini reports set out the path, and their

implementation will be monitored by “CESAME”, the Commission’s new advisory group of C&S experts.

- *Consumer Credit Directive*: Following a first reading by Parliament, which included a number of Compromise Amendments, the publication of the Commission’s response is imminent. The original Commission text had raised serious concerns about provisions potentially detrimental both to consumers and financial services providers. The termination of entire product lines and the de facto exclusion of whole customer segments, however well-meant the original text, would be contrary to consumers’ interests, reducing the choice available to them, and hindering competition. Moreover, any increase in ‘risk aversion’ on the part of providers could lead to some withdrawals of credit facilities, which would disproportionately affect more marginal risks.
- *New Legal Framework (NLF) for Payments and payment systems in general*: Financial market integration is concomitant with a single payment area. This should primarily be a market-driven process, which is in fact already taking place within the institutional framework of the *Single European Payments Area (SEPA)* initiative. While the latest *NLF* draft directive is a considerable improvement from previous versions, some issues remain critical. The impact of the Payments Regulation on prices should be seen as a reminder that well-intentioned regulation can have unintended negative consequences for customers.
- *Corporate Governance and Company Law Action Plan*: The Action Plan’s implementation is high on the EU’s agenda for the coming years but is complicated by the great divergences in existing practices across the EU. Regulatory action should be proportionate, evidence-based, and concentrate on principles of general application.

Further issues which will require the attention of legislators and regulators include:

- *Retail markets*: The Commission’s work on financial market integration indicators clearly shows that retail markets are the least integrated market segment. In principle, there is no reason to assume that consumers and suppliers of retail markets would benefit less from market opening than actors in wholesale markets. Barriers to retail market integration are higher though, as differences in contract law, consumer protection, data protection and taxation play a greater role. Ultimately, these will have to be tackled head-on. So, an intermediate step to set integration in motion could be an intelligent case-by-case mixture of (i) full harmonisation, (ii) minimum harmonisation and mutual recognition, and (iii) optional use of a “26th law”.
- *Structure of financial supervision*: As markets evolve there is a need for supervisory approaches to evolve too. Debate on this has already begun but there are as yet a number of divergent views. Certain legislative acts have already promoted the idea of a lead supervisor (Financial Conglomerates and Capital Requirements Directives). There are those who favour a less formal collegiate approach and others who believe a European system of supervision is the best way forward. However the debate evolves, it is essential that all stakeholders are involved and that proposals are subject to cost benefit analyses.
- *Consolidation and streamlining of financial market regulation*: It would contribute to the consistency and clarity of financial regulation if the various measures in the respective fields of regulation, especially those in the field of securities markets, were brought together in one codification.
- *Intensification of regulatory dialogue with the US*: The global competitiveness of EU financial services providers and financial markets must become one of the yardsticks for future regulatory activity in this field. EU financial market integration and regulation must not be at the expense of external competitiveness. At the same time, EU institutions should help to ensure that EU financial institutions are not put at a disadvantage or burdened by other countries’ rule-making. Wherever sensible and appropriate, co-ordinated global rule-making should be aimed for, reflecting the global nature of many financial markets. Consequently, EU institutions and authorities should intensify the dialogue, on both political and working levels, with foreign countries, particularly with the US, Japan and China.

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.

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