

# After the EU Financial Services Action Plan:

## UK response to the reports of the four independent expert groups

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September 2004



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# EXECUTIVE SUMMARY

In May 2004 the European Commission published reports from four independent expert groups set up to advise on the future strategy towards financial services in the EU in the form of a consultation. The UK authorities – the Treasury, FSA and Bank of England – welcome the contribution of the four expert groups, alongside other work being developed by Member States, the European Parliament and financial supervisory authorities, together with the consultative approach taken by the Commission.

Creating a Single Market in financial services is at the core of economic reform in the EU. The Financial Services Action Plan (FSAP) has been the vehicle for working towards this goal for the past five years. As the finalisation of the FSAP approaches, many barriers to cross-border integration and competition in Europe remain and global competition is intensifying. It is therefore right that there should be a debate on the future approach towards financial services in the EU.

The UK authorities published an initial contribution to this debate in May 2004, setting five priorities for the future. This paper sets out their response to the Commission's consultation, based on those five priorities. The UK authorities welcome the endorsement of their five priorities by the expert groups, in particular:

- **better implementation and enforcement of EU measures affecting the financial sector.** All the expert groups have identified this as a top priority for the EU, agreeing with the views of Member States;
- **alternatives to EU regulation.** All the expert groups recognise that EU legislation in itself cannot create the integration of markets. They identify other alternative approaches including a greater use of competition policy, better data and information sharing and developing high-level industry standards and codes of conduct;
- **better regulation.** Where EU legislation is necessary, there is strong agreement by the expert groups that it should follow the principles of better regulation – in many cases supporting the objectives of the Four Presidency Initiative established by the Governments of Ireland, the Netherlands, Luxembourg and the UK – as well as making welcome recommendations for improving consultation and improving the use of evidence and analysis. The UK authorities recommend some steps for the Commission to follow;
- **making the Lamfalussy arrangements work well.** These new regulatory arrangements are now in place to help the effective supervision of financial services across the EU. The expert groups broadly welcome these arrangements, and make some practical recommendations to make them even more effective, including enhanced levels of consultation and mechanisms to speed up the resolution of disputes; and
- **recognising the global nature of financial markets.** Several of the expert group reports draw attention to the demands of global competition and the need for any regulation to avoid damaging the competitiveness of financial centres and institutions in the EU. Building the implications for global competitiveness into regulatory impact assessments is one recommended way of achieving that, which the UK authorities fully support.



# INTRODUCTION

**1.1** In October 2003 the European Commission set up four independent expert groups to advise it on developing the EU's future approach to financial integration on:

- banking;
- securities;
- insurance and pensions; and
- asset management.

**1.2** Reports from these four expert groups<sup>1</sup> were published by the Commission in May 2004, in the form of a consultation exercise. The reports also formed the basis of a discussion at a high-level conference on 22-23 June 2004, involving industry practitioners and representatives from consumer groups.

**1.3** This paper is the response of the UK authorities – the Treasury, Financial Services Authority and Bank of England – to the consultation on the four expert group reports.

## CONTEXT – THE SINGLE MARKET IN FINANCIAL SERVICES

### Economic reform

**1.4** Developing a Single Market in financial services lies at the core of EU Member States' commitment to economic reform in Europe, designed to transform the EU into "*the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.*"<sup>2</sup> An effective, integrated financial services market would:

- reduce the cost of accessing capital and improve the allocation of capital across the EU;
- give firms increased opportunities to access markets in other Member States and to carry out business effectively on a cross-border basis; and
- give retail consumers access to a wider range of more competitively priced financial services products.

### The FSAP

**1.5** The EU Financial Services Action Plan (FSAP) has been the legislative framework for developing the Single Market in financial services. Between its endorsement by the European Council in Lisbon in March 2000 and the end of July 2004, 39 out of the 42 FSAP measures were adopted in the EU.

<sup>1</sup> *Expert Group on Banking Final Report (May 2004); Securities Expert Group Final Report (May 2004); Expert Group on Insurance and Pensions Final Report (May 2004); Asset Management Expert Group Final Report (May 2004).*

<sup>2</sup> *Presidency Conclusions, Lisbon European Council, 23-24 March 2000.*

**1.6** As the FSAP nears completion, policy makers, industry practitioners and users of financial services are discussing the extent to which the Single Market has been achieved and the next steps to financial services integration. This debate is timely as it takes place against the backdrop of:

- enlargement of the European Union from 15 to 25 Member States, expanding, in one step, the reach of the Single Market;
- a new European Parliament; and
- a new European Commission from 1 November 2004.

## THE FOUR EXPERT GROUP REPORTS

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**1.7** The four expert group reports represent an important contribution to the debate about the future direction of policy towards financial services integration in Europe. They complement the work of the European Commission itself, the European Parliament, ECOFIN, the Financial Services Committee (FSC)<sup>3</sup> and financial supervisory authorities.

### **Involvement of industry and consumers**

**1.8** The UK authorities welcome all these contributions to this important debate, which they believe provide a good basis for the development of future policy towards financial services integration. They encourage the Commission to ensure the continued involvement of industry practitioners and consumer organisations in the policy debate.

### **Tax issues**

**1.9** The four expert group reports also include a number of references to tax issues. Such matters are for national governments, in keeping with the principle of subsidiarity. The Government believes that the way for Europe to meet the challenge of increasing globalisation and mobility of capital is through flexible, responsive and efficient national tax systems and by doing more to promote fair tax competition, increase transparency and tackle tax abuse and evasion.

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<sup>3</sup> Mainly comprised of senior officials from EU finance ministries.

## STRATEGIC APPROACH

**UK's five priorities** 2.1 In May 2004, the UK authorities published a strategy paper<sup>1</sup> setting out five priorities that should guide further action in developing a Single Market in financial services, reflecting the core role of financial services in economic reform.

**Box 2.1: The UK's five priorities**

The UK authorities' five priorities for further financial services integration in the EU are:

- **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;
- **alternatives to EU regulation.** In general, EU legislation should be a last resort, and alternative approaches to policy making, such as more use of EU competition policy, market-based solutions and initiatives at national level, should be considered first;
- **better regulation.** In some specific cases, market failure analysis may demonstrate that further new EU legislation in financial services could be necessary. When new EU legislation on financial services is being considered, a proper assessment of the costs and benefits should be undertaken, and financial market participants should be fully consulted;
- **making the Lamfalussy arrangements work well.** These new regulatory arrangements are now in place to supervise financial services across the EU. They have been shown to work for securities markets and are being extended to banking and insurance. They need to be further developed; and
- **recognising the global nature of financial services.** It is crucially important to remember that financial markets are global. A global perspective is needed when considering the impact of EU financial services regulation on the competitiveness of EU-based firms and financial centres. International action will sometimes be needed to tackle global issues.

**Analytical framework** 2.2 These five priorities, which the UK authorities are pleased to note have wide support across the EU, form the framework for this response to the Commission consultation on the reports of the four independent expert groups. The UK authorities will use this framework as a basis for analysing all issues, including those already under consideration or adopted, in the field of financial services in the EU.

2.3 The rest of this Chapter considers the recommendations of the four expert groups in the light of these priorities. Chapter 3 looks at two important cross-cutting issues – supervisory convergence and retail market integration – that emerged from the high-level conference held on the four reports in June 2004.

<sup>1</sup> *After the EU Financial Services Action Plan: A new strategic approach*, HM Treasury, Financial Services Authority and Bank of England, May 2004.

## PRIORITY I: BETTER IMPLEMENTATION AND ENFORCEMENT

**2.4** Many of the FSAP measures that have been adopted have still to be implemented nationally. Effective, proportionate and consistent implementation of the FSAP and other measures affecting the financial sector is key to delivering the potential benefits of economic integration from EU financial services legislation while avoiding costly burdens on business. This should take precedence over new legislative initiatives, given the resource implications for industry, Member States, supervisory authorities and the Commission. The FSAP will not meet its objectives unless sufficient resources are prioritised on achieving effective implementation.

### Agreement by expert groups

**2.5** It follows that the UK authorities strongly agree with the emphasis given by all four expert groups, as shown in the Table 2.1, on the priority that needs to be given to the effective implementation of FSAP (and related) measures, together with their subsequent enforcement.

**Table 2.1**

Expert group report	Recommendations supported by the UK
<b>Banking</b>	Implementation and enforcement: “ <i>Implementation and enforcement of existing legislation should have overall priority. Convergence of implementation measures across Member States should receive more attention before the transposition of directives. Incoherencies between existing legislative provisions should be eliminated.</i> ” (Page 22) (UK priority)
	Developing industry contacts: “ <i>The Commission is encouraged to continue its contacts with the industry and with end-users on the implementation of the FSAP.</i> ” (Page 23) (UK priority)
<b>Securities</b>	Implementation, enforcement and correcting poor legislation: “ <i>A stronger focus on implementation and enforcement of legislation, coupled with the correction of poor legislation [should be a priority].</i> ” (Page 24) (UK priority)
	Implementation in Member States: “ <i>The group considers that enforcement needs to be improved, including of basic Treaty freedoms. Good implementation in the Member States is fundamental.</i> ” (Page 3) (UK priority)
	Consultation time: “ <i>CESR should be allocated sufficient time to provide advice to the Commission on implementing measures, so that industry professionals can provide effective input through consultation.</i> ” (Page 2) (UK priority)
<b>Insurance and pensions</b>	Implementation and enforcement using Lamfalussy: “ <i>[The] focus [should be] on the convergent implementation and effective enforcement of EU legislation, strengthened by the correct application of the Lamfalussy process with due industry consultation and a new mechanism to speed up the resolution of disputes.</i> ” (Page 27) (UK priority)
	General good: “ <i>Abusive use of general good requirements should be vigorously tackled by the Commission.</i> ” (Page 19) (UK priority)
<b>Asset management</b>	Implementation: “ <i>The crucial first step towards delivering a genuine single market for asset management in Europe is the correct and even implementation of the relevant FSAP measures.</i> ” (Page 2) (UK priority)

**Agreement by Member States** 2.6 The UK authorities also note that these recommendations are entirely consistent with the work of the FSC, which in its report on financial integration<sup>2</sup> recommended that “*ensuring full implementation and enforcement of current legislation should be pursued with high priority*”. This was endorsed by the ECOFIN meeting of finance ministers in June 2004.

**Practical steps** 2.7 The UK authorities value the efforts being made to work together in implementing EU financial services legislation, minimising costly unnecessary differences between Member States. Such an approach is crucial to enable businesses to operate within a Single Market, whilst avoiding unnecessarily burdensome regulation. With this shared objective in mind, the UK therefore:

- recommends that the Commission should prepare a **comprehensive work programme** for the next five years, focussed on implementation and enforcement of financial services legislation, including measurable targets, using the experience of Member States through the Financial Services Committee in preparing the draft programme. This should ensure political support through ECOFIN’s endorsement of the work programme;
- supports the introduction of national “**single contact points**” to monitor and report back to the Commission on Member States’ progress in implementing EU financial services legislation into national law. Typically, single contact points are finance ministry officials who have day-to-day responsibility for overseeing and coordinating the implementation process in their respective countries. They also provide a first point of contact between Member States and have an important role to play in helping to share best practice;
- supports the use of “**transposition working groups**” of national experts who draft national implementing legislation, which will discuss the implementation of individual directives, and facilitate discussions and information sharing both at a bilateral national level, and with CESR, CEBS and CEIOPS<sup>3</sup>;
- supports the use of **transposition tables**, aimed at demonstrating clearly the link between provisions in a directive with their corresponding provisions in national law. These tables, which, ideally, should be presented in a consistent format to aid comparison, should be accompanied with a covering letter from Member States explaining how they transposed the relevant directive into national law and highlighting any key issues that arose in the transposition process;
- believes that **peer group review** is potentially a useful way forward to help to raise standards of implementation. Such peer review should be targeted so that it is specifically aimed at problem areas; and
- supports the introduction of more effective and rapid **complaints procedures** for financial services, so that businesses and consumers are willing to report difficulties in operating in Member States. To achieve this:

<sup>2</sup> FSC Report on Financial Integration, Report of the Financial Services Committee to the Council, FSC4156/04, 17 May 2004.

<sup>3</sup> The Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS).

- the Commission should set up a better publicised and more transparent complaints mechanism for financial services and should establish deadlines by which it will respond to all complaints received;
- to the extent that complaints relating to financial services concern breaches of EU law, there should be a fast track investigation procedure carried out by the Commission, again to a set deadline; and
- where complaints relating to financial services are about inconsistent implementation by Member States, rather than a breach of EU law, the relevant Level 3 committee (CESR, CEBS or CEIOPS) should be asked to look into the issue and advise, on a timely basis, on whether agreement can be reached between the national authorities to modify their practices or arrangements. The UK authorities also support view that market participants, including consumers and end-users, should have the right to bring specific questions about practical implementation to the attention of the Level 3 committees, and notes that this is also supported by the FSC in its report<sup>2</sup>.

#### **Box 2.2: The UK's approach to implementation**

The UK continues to be a strong advocate of identifying practical steps to ensure that all Member States are well placed to meet the implementation challenge. Within the UK, the authorities:

- work closely together to ensure that implementation is handled as seamlessly as possible where more than one organisation, e.g. HM Treasury and the Financial Services Authority, has an interest;
- have put in place project management procedures to ensure that issues are handled well;
- ensure that expertise acquired during the negotiation of directives is used in their implementation; and
- will continue to develop strong links with finance ministries and supervisors in other Member States, which the UK sees as critical to ensuring effective implementation in the enlarged Single Market.

The UK's approach to implementing the FSAP was set out in detail in *The EU Financial Services Action Plan: Delivering the FSAP in the UK*<sup>4</sup>.

**FSAP review 2.8** Finally, the UK authorities support the recommendation in the Banking Expert Group Report that “*the EU institutions should conduct a full and public assessment of the impact of the FSAP within four years of its completion and publish its policy conclusions*” (Page 22).

<sup>4</sup> *EU Financial Services Action Plan: Delivering the FSAP in the UK*, HM Treasury, Financial Services Authority and Bank of England, May 2004.

## PRIORITY 2: ALTERNATIVES TO REGULATION

**2.9** Agreeing regulation, in the form of EU legislation, does not automatically lead to an efficient, integrated Single Market in financial services:

- some market differences are not susceptible to regulation;
- EU legislation can sometimes fail to be sufficiently tailored to local market needs;
- legislation can be too slow to adapt to innovation when market developments may be quicker; and
- legislation may cement national differences if insufficient time has been devoted to narrowing them down by promoting best practice.

**2.10** Where significant cross-border barriers remain to be removed, a full range of alternatives to EU legislation should first be considered, including:

- competition policy;
- market initiatives;
- measures to improve consumer confidence;
- co-operation between financial supervisors; and
- national initiatives.

### Agreement by Member States

**2.11** The UK authorities, like the FSC, welcome the fact that the Commission has pursued important non-regulatory initiatives, which among others include tackling illegal state aid and enforcing competition policy in the financial sector where there have been significant damage to markets. As a result, the UK authorities strongly endorse the call by the ECOFIN Council for non-legislative action to be taken “*where possible and appropriate*”<sup>5</sup>.

### Competition policy

**2.12** The UK authorities believe that the role of competition policy is extremely important in creating a competitive, integrated Single Market in financial services in the EU. There are two key aspects to this role:

- **investigations into firms and groups of firms.** The UK authorities urge the Commission to make greater use of its competition powers to tackle barriers to competition created by the anti-competitive behaviour of other businesses. In the UK, the competition authorities have followed a similar approach investigating the supply of banking services to small firms; and
- **investigations into regulatory arrangements and their impact on competition** to make sure that regulation is encouraging rather than preventing competition in national markets. In the UK, the Office of Fair Trading (OFT) is conducting a thorough review of the impact of the Financial Services and Markets Act on competition in financial services markets.

<sup>5</sup> ECOFIN conclusions, June 2004.

**2.13** Consequently, the UK authorities would urge the Commission to make greater use of all its competition powers to tackle barriers to competition, such as considering taking forward investigations into credit cards, credit bureaux and market infrastructure – all areas where businesses appear to encounter difficulties in entering national markets in some Member States.

**2.14** The UK supports the following recommendations from the four expert groups for alternatives to EU regulation.

**Table 2.2**

<b>Expert group report</b>	<b>Recommendations supported by the UK</b>
<b>Banking</b>	Personal data: <i>“Together with the industry the Commission should examine the possibilities [to] improve the availability of personal data for responsible consumer lending, consistent with the Data Protection Directive.”</i> (Page 22) (UK priority)
<b>Securities</b>	<p>Non-legislative solutions: <i>“should be considered ahead of regulation. Competition policy also has a role in tackling remaining barriers.”</i> (Page 2)</p> <p>Examples of non-legislative solutions: <i>“the development of a pan-European approach to information dissemination, standard documentation and the development of unique security identifiers.”</i> (Page 12)</p> <p>Disclosure of information: <i>“The dissemination of disclosable corporate information needs to be fast and simultaneous throughout the EU.”</i> (Page 3) (UK priority)</p> <p>Corporate governance: <i>“There is no need for a single EU code, but common guidelines should be adopted at EU level, taking into account different methods and organisational models.”</i> (Page 3)</p>
<b>Insurance and pensions</b>	<p>Non-legislative measures: <i>“Adopt a flexible and targeted approach to EU initiatives and legislation: use non-legislative measures where possible (e.g. self-regulation, codes of conduct, ombudsmen, etc); [and] resort to legislation only where necessary.”</i> (Page 28)</p> <p>Organic development: <i>“Foster the organic development of a single market by: ... encouraging business to develop pan-European products.”</i> (Page 27)</p>
<b>Asset management</b>	<p>Operational procedures: <i>“The industry should take the lead ... to achieve further pan-European standardisation of operational protocols. In particular further work should be undertaken on the development of pan-European standards for cross border fund processing.”</i> (Page 20) (UK priority)</p> <p>Statistics: <i>“The industry should agree suitable and relevant indicators for progress towards a Single Market and [a] mechanism for monitoring competition.”</i> (Page 22)</p> <p>Governance: <i>“The industry should take the lead in the further development of convergent high-level principles on governance and on the prevention of conflicts of interest in close cooperation with the European Commission and CESR.”</i> (Page 24)</p>

**Retail Markets 2.15** Integration of retail financial services is considered in more detail in Chapter 3.

## PRIORITY 3: BETTER REGULATION

### Evidence-based policy making

**2.16** As noted above, new EU legislation on financial services should only be considered when a thorough consideration of the alternatives to legislation has been exhausted; and only when it can be demonstrated that the legislation in question will produce a clear net proportional benefit. The essential requirement is that decisions must be based on analysis and evidence and be taken transparently in consultation with business and consumer representatives. It is recommended that the following steps are followed:

- the Commission should undertake an objective EU-wide analysis of whether a **market failure** exists on a significant scale;
- if it does, the Commission should undertake a **cost-benefit analysis** of the options for addressing it. The options considered should include that of doing nothing and non-legislative options as well as legislative ones;
- if the Commission believes that there is no alternative to a legislative response, it should deliver on its commitment to provide a detailed **regulatory impact assessment**, in standard form, for the Council and European Parliament. This should be developed in parallel with the legislative proposal and should be amended where significant changes to the proposal are made. In addition, it should include competitiveness testing and an assessment of administrative burdens;
- at each stage, **consultation** of financial market participants and representatives of the users of financial services is vital. The Commission should ensure that sufficient time is allowed for consultation when a call for advice is given; and
- for major issues, a **Green Paper** (discussion paper) should be produced, setting out a range of non-legislative as well as legislative approaches.

### Better Regulation initiatives

**2.17** Such an approach to EU legislation on financial services would be consistent with the disciplines and principles set out in the Commission's Better Regulation Action Plan, and the joint initiative of the Irish, Dutch, Luxembourg and UK Presidencies (see Box 2.3). It is also consistent with the approach recommended by the FSC<sup>2</sup>.

**Box 2.3: Better Regulation initiatives**

In 2002, the Commission adopted a Better Regulation Action Plan, which introduces: a system of impact assessments, with extended assessments for all significant proposals; a programme of simplification and modernisation of existing legislation with the objective of removing unused or outdated legislation as well as unnecessary complexity; and an eight-week consultation period for legislative change.

To build on the momentum of the 2002 initiative, the Finance Ministers of Ireland, the Netherlands, Luxembourg and UK – the then current and three succeeding EU Presidencies – published in January 2004 a Joint Initiative on Regulatory Reform<sup>6</sup>, which aims to:

- enhance the quality of impact assessments by continuing efforts to develop capacity to produce and evaluate these assessments;
- use impact assessments to “competitiveness-proof” all proposals;
- ensure that the analysis provided by impact assessments actually influences the decision-making process;
- encourage the Council, Commission and the European Parliament to make greater use of imaginative, outcome-based approaches to legislation: for example, mutual recognition can, in many areas, allow for greater progress in delivering shared objectives; and
- encourage the Commission to make greater use of review clauses in legislation (to provide triggers for evaluating the impact of legislation over time), extending them to a significant proportion of all new EU legislation.

**Agreement by Member States**

**2.18** Such steps also provide a practical step-by-step approach to implementing the recommendation of the FSC that “*where an analysis based on a non-exhaustive list of analytical factors suggested in the report and the indicators of financial integration ... show that integration could deliver real benefits, the FSC recommends an approach based on a thorough examination of the precise nature of the barriers to integration, a comprehensive impact analysis of the possible approaches to tackling those barriers, including cost-effectiveness analysis, and a decision on whether to pursue further integration and the manner in which to do so.*”<sup>2</sup>

**Other contributions**

**2.19** The UK authorities also welcome two recent contributions to the debate on better regulation:

- a paper<sup>7</sup> published by the **Corporation of London**, which discusses how to construct meaningful and robust regulatory impact assessments; and
- work done by the **Dutch Finance Ministry** and submitted to the informal ECOFIN meeting of finance ministers in the Hague on 10-11 September 2004, which discusses how to promote economic growth by reducing administrative burdens, linked to the Joint Initiative on Regulatory Reform, something which the UK authorities support. Accordingly the UK authorities believe further steps should be undertaken to reduce administrative burdens resulting from regulatory and supervisory costs.

<sup>6</sup> Joint Initiative on Regulatory Reform. An initiative by the Irish, Dutch, Luxembourg and UK Presidencies of the EU, January 2004.

<sup>7</sup> Reducing the regulatory burden: the arrival of meaningful regulatory impact analysis, Corporation of London, July 2004.

**2.20** The UK supports the following recommendations from the four expert groups for better regulation.

**Table 2.3**

Expert group report	Recommendations supported by the UK
<b>Banking</b>	Regulatory impact analysis: <i>“Further integration efforts should be subject to ex-ante analysis as to the costs and benefits of intervention ... Removing obstacles should be pursued if the benefits are higher than the costs of implementation for both banks and if integration delivers net benefits to the end customer.”</i> (Page 22)
<b>Securities</b>	Evidence based policy-making: <i>“Implementing information-gathering procedures prior to future policy-making and adopting an evidence-based approach to legislation, embedding regulatory impact analysis fully within the process.”</i> (Page 23) (UK priority)
	Evidence-based policy making: <i>“where new rules are introduced, the underlying policymaking must be evidence-based; they must bring benefit and not simply increase costs; they should not conflict with other rules; and they should be repealed when no longer relevant, with consideration given to use of ‘sunset clauses’.”</i> (Page 10)
	Evidence-based policy making: <i>“Before legislative proposals are made at Level 1 or 2, more work needs to be undertaken by policymakers to identify the existing content of laws and rules in the Member States and the underlying position within the financial markets in the Member States. This would allow for clearer objectives to be set for proposed legislation and for flexibility in implementation to be decided as a matter of policy at Level 1.”</i> (Page 10)
	Innovation: <i>“is essential for a vibrant financial market. Care must be taken so that the regulatory process does not inhibit innovation and its quick dissemination...”</i> (Page 2)
<b>Insurance and pensions</b>	Regulatory impact analysis: <i>“Prioritise any EU policy initiative by rigorous evidence-based justification and quantitative cost-benefit analysis, where feasible.”</i> (Page 28) (UK priority)
	Competitiveness testing: <i>“Test the impact of any proposed measure on wider business competitiveness for both proprietary companies and mutuals.”</i> (Page 28)
	Simplification: <i>“Make existing FSAP and other EU-insurance related legislation more coherent, and simple where possible.”</i> (Page 27)
	Consultation: It is important to <i>“consult widely and in a timely fashion with industry and other stakeholders.”</i> (Page 28)

**Asset management** Principles-based approach: “The group considered that a flexible, principle-based approach offers the best prospects for an appropriate EU-level framework for alternative investment vehicles ...” (Page 3)

Further regulation: “In any case, any further regulation in this field, which should be carefully calibrated and not over-prescriptive should be based on the Lamfalussy approach ...” (Page 3)

Respecting market differences: “There was broad agreement that any further legislation should not merely focus on product harmonisation, but also even more importantly take into account the way that markets actually function and operate.” (Page 28) (UK priority)

Investment fund simplification: “The registration of UCITS should be simplified. As a first step, CESR, in cooperation with the Commission should develop consistent standards for the registration requirements foreseen by the existing UCITS directive. National authorities should commit themselves to streamline the registration process. As a second step the UCITS-directive should be amended to replace the current registration requirements with a simple notification process.” (Page 16) (UK priority)

## PRIORITY 4: MAKING THE LAMFALUSSY ARRANGEMENTS WORK WELL

**2.21** New regulatory structures, set up under the Lamfalussy framework designed to make the legislative process more effective, are now in place. Although relatively recent in formation, they appear to have worked well so far.

### Agreement by Member States

**2.22** The UK authorities endorse the view of the FSC in its recent report<sup>2</sup> that the three Lamfalussy Committees offer “a realistic, practical and cost efficient way to achieve greater convergence of supervision between Member States, while maintaining the competencies of the existing national supervisors ...[and] that the flexibility offered by the Lamfalussy approach should be exploited optimally in order to achieve an appropriate degree of convergence of supervisory practices and to develop an appropriate response to the different problems faced by supervisors”<sup>2</sup>.

### Developing Lamfalussy

**2.23** In line with the views of the FSC, the UK authorities believe that the Lamfalussy framework would benefit from being developed further, to ensure that the legislation it introduces is as targeted as possible. This suggests that, going forward, the Lamfalussy arrangements need to encompass:

- enhanced **consultation** with business;
- greater **transparency**; and
- **better regulation principles**.

### Accountability

**2.24** The accountability of the Lamfalussy arrangements remains important. The UK authorities welcome the recent agreement that the chairs of CESR, CEBS and CEIOPS should report annually to the FSC and is supportive of ways to improve their transparency for market participants and with regard to the European Parliament.

**2.25** The UK authorities support the following recommendations in the four expert group reports for making the Lamfalussy arrangements work better.

Table 2.4

Expert group report	Recommendations supported by the UK
<b>Banking</b>	<p>Consultation: “<i>Formal consultation mechanisms with industry should be established.</i>” (Page 23) (UK priority)</p> <p>Supervisory convergence: “<i>The Commission and CEBS must work systematically to converge practices.</i>” (Page 23)</p>
<b>Securities</b>	<p>Strengthening Lamfalussy: “<i>The emphasis should now switch from speed to improving the quality of the output by improving the process. However, fast-track solutions will also be essential to remedy or repeal bad legislation.</i>” (Page 2)</p> <p>Innovation: “<i>is essential for a vibrant financial market. Care must be taken so that the regulatory process does not inhibit innovation and its quick dissemination ... It is essential Level 1 texts should be drafted as framework legislation that can accommodate innovation through timely adaptation at Level 2.</i>” (Page 2)</p>
<b>Insurance and pensions</b>	<p>Strengthening Lamfalussy: “<i>[The] focus [should be] on the convergent implementation and effective enforcement of EU legislation, strengthened by the correct application of the Lamfalussy process with due industry consultation and a new mechanism to speed up the resolution of disputes.</i>” (Page 27) (UK priority)</p> <p>Supervisory coordination: “<i>Better coordination between supervisors is a prerequisite to better individual, group and financial conglomerate supervision.</i>” (Page 13)</p>
<b>Asset management</b>	<p>Supervisory convergence and cooperation: “<i>should deliver consistent enforcement and the legal certainty needed to support effective market access.</i>” (Page 2) (UK priority)</p>

**2.26** Supervisory convergence is considered in more detail in Chapter 3.

## PRIORITY 5: RECOGNISING THE GLOBAL NATURE OF FINANCIAL SERVICES

**Global markets** 2.27 A global perspective is often needed when considering the impact of EU financial services regulation because:

- the **global nature of some financial problems**, such as financial crime, requires policy makers in the EU to work with others elsewhere to ensure that solving a problem in one country, or even across the EU, does not lead to its emergence elsewhere;
- global policies towards financial services need to help promote greater **openness and integration**, so as to contribute globally to reducing the costs of capital, improving the efficiency of allocating capital and risk, and improving choice and competition on a global basis, whilst recognising the need for proportionate protection of financial market users; and
- EU-based financial institutions and EU financial centres are **competing internationally in a global economy**, and can move their activities or location rapidly in response to unfavourable regulatory developments.

**Agreement by Member States** 2.28 In its report on financial integration<sup>2</sup> the FSC noted that the globalisation of financial markets is a reality and concluded that it was “*essential for the global characteristics of financial markets to be fully taken into account when further developing and implementing an EU strategy for financial services*”. Among other things, the FSC’s report stressed:

- the need to ensure that EU regulatory regimes take account of their impact on the **competitiveness of financial institutions** located in the EU and of the EU as a location for financial activity;
- the **importance of considering global solutions to global problems**, such as financial stability, and that simply displacing activities outside the EU and into other jurisdictions will not remove the threats to either EU or global markets; and
- the need to remember that **EU regulatory actions have effects in other jurisdictions**, and vice versa.

2.29 Taking account of the four expert group reports, the UK supports the following recommendations relating to global competitiveness.

Table 2.5

Expert group report	Recommendations supported by the UK.
<b>Banking</b>	Regulatory dialogue: <i>“The Commission should continue and deepen its regulatory dialogue with major trading partners to identify problems upstream, seek early solutions and converge policy views. There should be appropriate mechanisms to involve industry and provide feedback.”</i> (Page 23) (UK priority)
<b>Securities</b>	International competitiveness: <i>“Regulation must also take account of its impact on Europe’s international competitiveness, both by ensuring that European firms can access international financial markets in an environment that represents a level playing field, as well as recognising the needs of non-EU market participants carrying out business in Europe. The aim should be that Europe is the securities market of choice for issuers and investors worldwide.”</i> (Page 2) (UK priority)
	Regulatory equivalence: <i>“The Group recognises the value of close international cooperation to achieve regulatory equivalence.”</i> (Page 2)
	International Accounting Standards (IAS): <i>“The principle of agreeing and using a set of universal accounting standards would greatly assist in making company accounts more reliable, transparent and comparable. It is important that the IASB takes into account the needs of all users of accounts and that the IASB consults effectively and assesses the economic impact of IAS standards.”</i> (Page 3)
	Credit rating agencies: <i>“It [the group] considers that credit rating agencies must be looked at in a global context ...”</i> (Page 3)
	Regulatory impact analysis: <i>“[The expert group] considers that any impact analysis of regulatory changes must include an evidence-based assessment of the contribution of new legislation to the global competitiveness of the EU, and that international competitiveness must be one of the main guiding principles of European financial services legislation.”</i> (Page 14) (UK priority)
<b>Insurance and pensions</b>	The global dimension: <i>“The European financial services market, while still relatively independent, remains strongly linked with the world, and particularly the US economy. Due to regulatory proliferation, there are increasing supervisory overlaps with direct impact on EU companies. More effort has to be made to co-ordinate legislative initiatives with the US regulators on a proactive basis.”</i> (Page 16)
<b>Asset management</b>	International standards: <i>“National authorities should be open to accept international standards for operational issues...”</i> (Page 20)

## Recent global developments

**EU-US dialogue 2.30** A constructive EU-US Summit was held in June 2004, where economic cooperation was an important part of the agenda. The parties were able to point to the Financial Markets Regulatory Dialogue as an area where good progress has been made, and cooperation is strong. The Summit released a joint report which stated that “*the US and the EU will intensify their cooperation through the Dialogue*” and that both sides will encourage work to (amongst others) “*maintain the highest standards of investor protection; ... strengthen corporate governance on each side of the Atlantic; and lower transaction costs of cross-border business*”.

**2.31** The UK authorities welcome this statement, and support moves to intensify the Dialogue and cooperation. In particular, the UK believes that there are a number of steps that can be taken in the short and medium term towards this goal:

- **widening the Dialogue** to include relevant and timely input from other key stakeholders such as the FSC, CESR, CEBS and CEIOPS and the financial sector and its users; and
- creating a **more forward-looking** agenda by consulting earlier on proposed changes to regulation, and considering longer term strategies towards convergence to improve market efficiency.

**2.32** A more forward-looking agenda could be advanced by considering a broader range of topics that, while not yet critical, might raise issues for the future, such as:

- opportunities for integrating capital markets;
- future approaches to the supervision of clearing and settlement;
- potential convergence of listing and delisting rules;
- development of common approaches to recognizing mutual funds; and
- opportunities for forging an international supervisory regime for reinsurance.

**Conglomerates Directive 2.33** The UK authorities also welcome the progress made on the Conglomerates Directive, in particular the guidance issued in July that the US and Swiss systems of consolidated supervision are broadly equivalent to those in the EU. This will benefit further close cooperation between the EU and supervisors in the future.

**Trade negotiations 2.34** Whilst realising that supervisory issues are not trade issues, and should not be brought into trade negotiations, there are several areas of the global financial services marketplace that could be enhanced by the multilateral trade round. The UK authorities are a strong supporter of, and committed to, the World Trade Organisation (WTO) and the Doha Development round of negotiations. They welcome and strongly support the recent developments in Geneva, and envisage a positive round of negotiations. The users of financial services globally stand to benefit as liberalisation is secured for all WTO members – enabling developing countries to benefit from the financial expertise in developed countries and encouraging increased global stability.

**3.1** Two particular cross-cutting issues were discussed at the Brussels conference on the four expert group reports, on 22-23 June 2004:

- **supervisory convergence**; and
- integration of **retail financial markets**.

**3.2** In this section, the initial views of the UK authorities are set out on each.

### **SUPERVISORY CONVERGENCE**

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**3.3** As Europe's financial markets become more integrated, the question about how best to supervise them becomes more complex. Financial integration increases the ability and ease by which firms can operate cross-border and consumers can purchase products in countries and jurisdictions other than their own. As a result:

- firms doing increased cross-border business need to deal with **several national supervisors**, each acting independently, and with their own rules and practices;
- supervisors will be mindful that, as firms engage in more cross-border business, so the potential for spillover effects resulting from a **financial crisis** increases; and
- consumers will need the **confidence** to consider purchasing financial products from cross-border firms.

**Objectives 3.4** In terms of designing the most appropriate framework for supervising these cross-border business activities, firms, supervisors and consumers typically have the following objectives:

- firms will want to maximise efficiency and reduce their costs by having simpler arrangements for supervising cross-border business;
- supervisors will want to ensure that there are adequate arrangements across borders in place to prevent a financial crisis or deal with it, should one occur; and
- consumers will need the reassurance about supervision and that they have recourse to the necessary redress mechanisms if, and when, they need them.

**Five challenges** 3.5 Many of these issues are complex and there is no single best solution to the supervisory issues that arise. Rather, appropriate solutions will be multiple and multi-faceted. The UK authorities will continue to assess the issues, in order to contribute to the debate in autumn 2004. However, there appear to be five challenges in developing an enhanced level of supervisory convergence in the EU, many of which reinforce the priorities identified in Chapter 2:

- to ensure the effective, consistent, proportionate **implementation and enforcement** of EU legislation on financial services;
- to improve **cooperation** between financial supervisory authorities;
- to ensure the supply and sharing of **data** to, and between financial supervisory authorities, is efficient and effective;
- to ensure that financial supervisory authorities are able to appropriately manage **financial crises** that emerge; and
- to continue to develop **trust** between market participants and supervisors and between supervisors themselves.

## INTEGRATION IN RETAIL FINANCIAL MARKETS

**Different barriers** 3.6 The enhanced integration of the European wholesale financial services market has not been matched by a parallel integration of retail markets. This is despite studies<sup>1</sup> showing small but significant benefits to customers and overall EU growth from further integration in retail markets. Not only would an opening up of retail markets lower costs through greater economies of scale, but it would give consumers, especially in smaller or less developed markets, access to a greater range of products, better tailored to their individual circumstances.

3.7 In seeking greater integration, the better regulation principles already outlined need to be followed. Moreover, it needs to be emphasised that many of the barriers that obstruct the single market are not regulatory, for example:

- **language barriers**, which may prevent purchasers of financial products from either understanding the products available, or purchasing them;
- **cultural practices**, which may result in consumers preferring, for example, to use domestic financial services providers as opposed to unknown “foreign” brands, for example; and
- **patterns of spending, saving, borrowing and investing**, which differ between Member States.

<sup>1</sup> *Financial Integration of European Mortgage Markets*, Mercer, Oliver Wyman (published by the European Mortgage Federation), October 2003, estimated a net gain to the EU economy of €6-12 billion if a fully integrated EU mortgage market was in place. Study by Instituto Valenciano de Investigaciones Economicas, 2002, (and cited by the European Commission in its seventh FSAP progress report) estimated that interest rate savings in integrated retail markets could amount increase EU GDP by 0.7% in the long run.

**3.8** Even where barriers exist which legislation can remove, legislation may not be the most efficient method of removing them. Retail consumers lack the same sort of professional resources and information on foreign legal systems that companies take for granted. Research conducted by the UK financial sector in 2003 found evidence of a large number of practical barriers for business in developing retail services in other Member States. Those that have been identified include:

- obstacles such as: different consumer protection requirements; difficulties for consumers in moving from one financial services provider to another; fragmentation of retail payment systems; restrictions on provision of electronic financial services across borders; and national credit card restrictions;
- restrictions on products (e.g. rules on product specifications), or delays in authorising them, which pose particular difficulties for new entrants to national markets; and
- costs of registering and complying with regulatory or marketing requirements.

**Research and evidence** **3.9** The EU's future strategy towards retail financial services should, at least in part, be based on clearly identifying and tackling specific barriers such as these, in a focussed manner, and should follow the five priorities discussed in Chapter 2. Moreover, the Commission should examine Member States' retail markets in depth as an essential pre-requisite to any further initiatives in the retail area.

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