

# The EU Financial Services Action Plan: a guide<sup>(1)</sup>

*A Single Market in financial services has long been an EU objective. The integration of financial markets in the EU has progressed much further in wholesale than in retail financial services, with the latter still segmented largely along national lines.*

*The Financial Services Action Plan (FSAP) consists of a set of measures intended by 2005 to fill gaps and remove the remaining barriers to a Single Market in financial services across the EU as a whole.*

*This guide to the FSAP has been prepared by HM Treasury, the Financial Services Authority (FSA) and the Bank of England. The guide is intended to provide an introduction to the FSAP for the UK financial sector, corporate sector and consumer groups, where they are not yet sufficiently familiar with its potential impact, rather than for experts. The guide is being published now, because the FSAP is now in the process of being implemented.*

*The key points for the UK financial sector, corporate sector and consumer groups are as follows:*

- *The FSAP is intended to be implemented by 2005, and many measures are due to be implemented before then.*
- *The FSAP is important because EU legislation effectively determines UK law in this area.*
- *The UK financial sector, corporate sector and consumer groups will all be affected by FSAP measures, as and when they are implemented.*
- *The FSAP represents a competitive opportunity, even though some individual FSAP measures have not lived up to expectations, and barriers to a Single Market in financial services cannot all be removed by legislation.*
- *The UK authorities are keen to ensure that the UK financial sector, corporate sector and consumer groups are consulted on, and fully understand the impact of, FSAP measures.*
- *As new FSAP measures are adopted, the European Commission's priorities are gradually shifting to ensuring that legislation is implemented consistently and promptly at national level and properly enforced.*

## Introduction

This guide to the EU Financial Services Action Plan (FSAP) has been prepared by HM Treasury, the Financial Services Authority (FSA) and the Bank of England. The guide is set out in seven main sections:

- A How close are we already to a Single EU Market?
- B What is the FSAP?
- C What progress has been made in implementing the FSAP?

D How does the Lamfalussy process affect the FSAP?

E What are the implications of the FSAP for EU regulation in future?

F What key issues arising from the FSAP need to be addressed?

G How does the United Kingdom make a contribution to the FSAP?

Useful sources of further information about the FSAP are provided at the end of the guide.

(1) Based on information available at 31 July 2005.

## A How close are we already to a Single EU Market?

A Single Market in financial services has long been an objective of the European Union. In a Single Market, financial institutions authorised to provide financial services in one Member State would be able to provide the same services throughout the EU, competing on a level playing field within a consistent regulatory environment. Such a Single Market in financial services would 'act as a catalyst for economic growth across all sectors of the economy, boost productivity and provide lower cost and better quality financial products for consumers, and enterprises, in particular SMEs'.<sup>(1)</sup> A number of attempts have been made to estimate these potential benefits. (For examples, see the box opposite.)

Much has already been done to remove barriers to the integration of EU financial markets since the White Paper on the Single Market in 1985.<sup>(2)</sup> In recent years, EU financial markets—and transactions across borders within the EU—have grown in size and improved in efficiency, both because of the removal of barriers and for other reasons, such as greater competition promoted by global deregulation and the development of new technology. The launch of the euro has also acted as a catalyst for some further integration.<sup>(3)</sup>

However, the integration of financial markets in the EU has progressed much further and faster in wholesale than in retail financial services, with the latter still segmented largely on national lines. Moreover, while many barriers have been removed, those that remain appear more prominent now that 12 EU countries share a single currency.

### Wholesale financial markets

The unsecured euro money markets are fully integrated, with short-term euro interest rates being effectively identical across the euro markets, and a common money market reference yield curve, based on EONIA (overnight) and EURIBOR (beyond).<sup>(4)</sup> They are supported by two pan-European payment systems

## A Single Market in Financial Services: estimating the benefits

The Cecchini Report in 1988 put the potential increment to GDP from a fully integrated Single EU Market in financial services at 1.5%.<sup>(1)</sup> Two much more recent estimates have been published.

A report for the Commission by London Economics, in association with PricewaterhouseCoopers and Oxford Economic Forecasting, estimated the long-run increment to GDP as 1.1%, assessed in terms of a prospective reduction in the cost of capital.<sup>(2)</sup> The report estimated that some EU countries had more to gain than others, but that the benefits of financial market integration were economically significant in them all.

A report for the European Financial Services Round Table chaired by Pehr Gyllenhammar, by ZEW and IEP,<sup>(3)</sup> estimated the increment to GDP from a working European *retail* market for financial services as between 0.5% and 0.7%, depending on the country concerned, as a result of: an increase in product choice, particularly in small countries; lower prices for retail financial services; lower interest rates; and a reduction in the 'home bias' in private investors' portfolios.<sup>(4)</sup>

(1) *Cost of non-Europe in Financial Services* (1988).

(2) *Quantification of the Macro-economic Impact of Integration of EU Financial Markets* (November 2002).

(3) Zentrum für Europäische Wirtschaftsforschung and Institut für Europäische Politik.

(4) *The Benefits of a Working European Retail Market for Financial Services* (February 2002).

(TARGET and EURO1),<sup>(5)</sup> which enable euro-denominated payments to be made in real time across borders within the EU. As a result, commercial banks can effectively manage euro liquidity so as to obtain efficiency savings and cost benefits. And since the launch of the euro, dealing spreads have narrowed in the money, swap and foreign exchange markets involving the euro.

(1) Conclusion of a discussion among Economy and Finance Ministers, the ECB President and Governors of National Central Banks, at the informal ECOFIN meeting in Brussels in April 2002, on a report on *Financial Integration*, drawn up by a Working Group of the Economic and Financial Committee (EFC). The EFC consists of EU finance ministry and central bank officials, who prepare meetings of ECOFIN. The Working Group was chaired by Kees van Dijkhuizen, Treasurer General of the Netherlands Ministry of Finance.

(2) The original date for completion was 1992.

(3) HM Treasury, *The Location of Financial Activity and the Euro: EMU study* (June 2003).

(4) EONIA is the Euro OverNight Index Average. EURIBOR is the Euro Interbank Offered Rate.

(5) The Trans-European Automated Real-Time Gross Settlement Express Transfer system (TARGET) links the 15 euro-denominated RTGS systems in the EU and the ECB payment mechanism, to provide an EU-wide RTGS system. EURO1 is the Euro Banking Association's net settlement system.

In many other respects, the wholesale financial markets in euro are already closely integrated, though some barriers remain:

- *Bond trading* Government bonds are increasingly traded on a pan-European basis, supported by the emergence of electronic platforms (in particular, BrokerTec and EuroMTS), though many non-government bonds are still traded over-the-counter. Along the yield curve for government bonds by EU issuers, there are only relatively small differentials, which reflect the market's perception of differences in liquidity and credit risk.
- *Bond settlement* Most government bond transactions can be cleared through a central counterparty, and settled in Euroclear or Clearstream. Where bonds are available only in their domestic depository, differences in systems and delivery deadlines mean that they cannot be used as cross-border collateral as quickly or easily. As a result, the repo market is not yet fully integrated across borders.
- *Equity trading* Equity trading still takes place predominantly on national exchanges, partly because national listing rules for equities are complex and in some countries specifically require stocks to be traded on national exchanges. However, the role of national exchanges has been changing, through: an increase in international listing and trading; mergers and alliances between exchanges; the emergence of electronic platforms with cross-border access; and growth in remote membership.
- *Equity settlement* The costs of settling purely domestic equity transactions in Europe are competitive by international standards. But the costs of settling equity transactions across borders are typically a good deal higher, because of additional complexity, such as the need to cope with different legal and technical systems.
- *Remote access* In principle, market firms can trade remotely on trading platforms across the EU from a single location. In practice, some market firms are concerned about national rules which effectively require them to maintain local presences and use local trading or settlement systems.
- *Cross-border investment* There is some evidence of an increase in investment across borders, using pan-European rather than national benchmarks, though a 'home bias' remains.

### Retail financial services

While many wholesale financial services are provided on a pan-European basis, retail financial services in the EU are still segmented largely along national lines. The main barriers to the integration of retail financial services include the following:

- *Type of product* Some products authorised in one country (eg interest-bearing current accounts) cannot yet be provided in all the others.
- *Cost* The cost of local registration and compliance with regulatory or marketing requirements (eg in the case of mutual funds) can, on occasion, be prohibitive.
- *Tax* The local tax system may differentiate between local and foreign products (eg in the case of pension contributions across borders).
- *Preference* Cultural preferences differ across the EU. Many consumers prefer familiar domestic products, with information in their own language, and easy and direct access to the product provider. For example, the mortgage market differs significantly between the United Kingdom and the rest of the EU.
- *Delay* Authorisation of foreign products may be delayed, sometimes more or less explicitly, until local firms can compete.
- *Regulation* While most Member States have adopted a mixed approach to regulation, a broad distinction can be drawn between those which have traditionally focused on the regulation of products and those which have tended to focus on the regulation of sales/providers, though this situation is changing.
- *Redress* The arrangements enabling consumers to obtain redress across borders are still at a very early stage of development.

Reflecting the segmentation of retail financial services in the EU along national lines, there have so far been few sizeable retail bank mergers across borders. The main

examples include Fortis in 1990, Dexia in 1996, Nordea in 1998, HSBC's acquisition of CCF in 2000 and Barclays' acquisition of Banco Zaragozano in 2003.<sup>(1)</sup> Significant hurdles need to be overcome: local customers tend to identify with local banks; and differences persist in national consumer and competition laws. By contrast, there have been many more domestic retail bank mergers, where overlapping branch networks also make the scope for cost savings much greater.

## B What is the FSAP?

In June 1998, the Cardiff European Council invited the European Commission to table a framework for action to develop the Single Market in financial services. In May 1999, the Commission published a Communication containing a Financial Services Action Plan, which was endorsed by the Lisbon European Council in March 2000. The FSAP relates to a Single Market across the EU as a whole.<sup>(2)</sup> It consists of a set of measures intended by 2005 to fill gaps and remove remaining barriers so as to provide a legal and regulatory environment that supports the integration of EU financial markets.

Within the overall objective of completing the Single Market in financial services, the FSAP has the following specific objectives:<sup>(3)</sup>

- *a single wholesale market:* to enable corporate issuers to raise finance on competitive terms on an EU-wide basis; to provide investors and intermediaries with access to all markets from a single point of entry; to allow investment service providers to offer their services across borders without encountering unnecessary barriers; to establish a sound and well integrated prudential framework for investment by fund managers; and to create a climate of legal certainty so that securities trades and settlement are safe from unnecessary counterparty risk;
- *an open and secure retail market:* to give consumers the information and safeguards they need to participate in the single financial market; to remove unjustified barriers to the cross-border provision of retail financial services; to create the

legal conditions for electronic commerce on a pan-European scale; and to enable consumers to make small-value cross-border payments without excessive charges; and

- *state-of-the-art prudential rules and supervision.*

The FSAP covers a wide range of measures. Wholesale measures relate to: securities issuance and trading; securities settlement; accounts; and corporate restructuring. Retail measures relate to: insurance; savings through pension funds and mutual funds; retail payments; electronic money; and money laundering. And there are other measures relating to: financial supervision; corporate insolvency; and cross-border savings (see the box on pages 356–57).

Some FSAP measures take the form of EC Regulations, which apply directly in all Member States. Most take the form of EC Directives, which have to be transposed into the law of each Member State.<sup>(4)</sup> Of these, some replace earlier Directives (eg on investment services), which are now out of date, while others recast earlier proposals (eg on takeover bids) which failed to gain acceptance. Some measures on the FSAP list (eg on mutual funds) were already under negotiation when the FSAP was launched; others have been added to the list since it was launched.

The normal procedure for legislative measures (ie Regulations and Directives) in the FSAP is that they are proposed by the Commission and adopted by 'co-decision', under which the Council of Ministers of the Member States<sup>(5)</sup> and the European Parliament both need to consider, amend and agree on the final content of each legislative proposal. Both Regulations and Directives have to be published in the *Official Journal*, and come into force on a specified date. Member States are given a period (usually of 18 months) to implement Directives, by transposing the provisions into their national law.

## C What progress has been made in implementing the FSAP?

Of the 42 original measures in the FSAP, 36 have now been finalised; 3 are under negotiation; and 3

(1) Fortis and Dexia involved banks in Benelux; Nordea in Scandinavia; HSBC/CCF in the United Kingdom and France; and Barclays/Banco Zaragozano in the United Kingdom and Spain. Some (eg HSBC) have retained the local brand name, while using the Group logo.

(2) Since 1 January 1994, most Single Market legislation has also applied in the rest of the European Economic Area (Norway, Iceland and Liechtenstein).

(3) European Commission, *Financial Services: Implementing the Framework for Financial Markets: Action Plan* (May 1999).

(4) The others mainly consist of Commission Communications and Recommendations.

(5) The Council decides on FSAP measures (apart from tax) by qualified majority voting.

## FSAP measures

The main FSAP and related measures can be summarised as follows:

### *Securities issuance and trading*

- The Market Abuse Directive of January 2003 harmonises rules on the prevention of insider dealing and market manipulation in both regulated and unregulated markets. It is due to be implemented by October 2004.
- The Prospectus Directive, which was adopted in July 2003, is designed to provide a 'single passport' for issuers of equity and debt securities so that, once an issue of securities meets prospectus requirements in one country, the securities can be sold across the EU. It is expected to be implemented by May 2005.
- A revision to the Investment Services Directive was proposed by the Commission in November 2002. This is due to replace the 1993 Directive, which regulates the authorisation, behaviour and conduct of business of securities firms and markets, including exchanges.
- The Transparency Directive, which was proposed by the Commission in March 2003, is set to impose an obligation on issuers to meet continuing disclosure requirements after issue.

### *Securities settlement<sup>(1)</sup>*

- The Settlement Finality Directive of May 1998, which aims to reduce systemic risk in payment and securities settlement systems, in particular the risk of the insolvency of a participant, was implemented under the FSAP by December 1999.
- The Collateral Directive of June 2002 provides greater legal certainty about the validity and enforceability of collateral backing transactions across borders. It is due to be implemented by December 2003.

### *Accounting*

- The Fair Value Accounting Directive of May 2001 brings up to date existing EU accounting Directives for companies, banks and other financial institutions, on the valuation of assets at methods other than purchase price and cost. It is due to be implemented by January 2004.

- The Regulation of July 2002 endorsing International Accounting Standards proposes that a single set of international accounting standards will apply to all listed companies across the EU for each financial year starting on or after 1 January 2005.
- The Accounting Modernisation Directive, which was adopted by the Council in May 2003, amends the Fourth and Seventh Company Directives. It is due to be implemented by January 2005.

### *Corporate restructuring<sup>(2)</sup>*

- The European Company Statute (ECS) consists of a Regulation of October 2001 enabling companies in the EU to set up under a European charter, so that they do not need to register in a number of different countries, together with a Directive on employee involvement. The Regulation will have effect from, and the Directive is due to be implemented by, October 2004.
- The Takeover Bids Directive, which was proposed by the Commission in October 2002 in place of an earlier Directive on which agreement was not reached, proposes a minimum framework for the national approval of takeovers, including applicable law, protection of shareholders and disclosure.
- New Commission proposals for 10th and 14th Company Law Directives are expected in early 2004.

### *Insurance*

- The Directive of November 2000 amending the Insurance Directives and the Investment Services Directive permits information exchange with third countries. It had to be implemented by November 2002.
- Two Directives of March 2002 update solvency standards for life and non-life insurers, and a scheme is being considered for the protection of policy holders. The two Directives are due to be implemented by September 2003.<sup>(3)</sup>
- The Insurance Mediation Directive of December 2002 introduces an EU framework for the

(1) The Commission is also proposing to adopt a Communication this autumn on improving the efficiency of clearing and settlement of cross-border securities transactions, though this is not part of the original FSAP.

(2) The Commission also proposed in May 2003 an Action Plan on *Modernising Company Law and Enhancing Corporate Governance* in the EU, based on the recommendations in the Winter Report on corporate governance, and priorities for improving statutory audit. However, this is not part of the FSAP.

(3) The Commission is also hoping to present a Framework Directive, Insurance Solvency II, by early 2005, and is working on Insurance Guarantee Schemes.

authorisation, capitalisation and regulation of intermediaries and brokers who sell insurance products. It is due to be implemented by January 2005.

- A Commission proposal is also expected around the end of 2003 to harmonise the framework for reinsurance supervision in the EU.

#### *Long-term savings*

- Two UCITS Directives of January 2002 amend earlier (1985) Directives by liberalising the types of asset in which UCITS (ie mutual funds) can invest, and regulating management companies and the production of simplified prospectuses. They are due to be implemented by February 2004.
- The Distance Marketing Directive of September 2002 governs conditions on the sale of retail financial services products, if they are not sold face-to-face. It is due to be implemented by October 2004.
- The Pension Funds Directive of May 2003 regulates the operation of employment-related pension schemes across borders in the EU. This is based on mutual recognition of home state regulation, and establishes a 'prudent person' approach in Community law, so that a prudent investment policy can be followed for scheme members in each Member State. It is due to be implemented by August 2005.

#### *Retail payments*

- The Commission is also expecting to publish a Communication on the EU Legal Framework for Payments in the Internal Market, which aims to rationalise existing EU legislation on retail payments, and propose legislation around the end of 2003.

#### *Electronic money*

- The E-Money Directive of September 2000 defines electronic money and governs the capital and authorisation requirements for a new category of electronic money institution. It had to be implemented by April 2002.
- The Electronic Commerce Directive of June 2000 aims to create a legal framework for the free movement across the EU of electronic commerce, including financial services. It had to be implemented by January 2002.

#### *Money laundering*

- The Second Money Laundering Directive of December 2001 extends the scope of predicate offences for which reporting of suspicious activity is mandatory, and broadens the regulated sector to include new professions, such as solicitors and accountants, and activities, such as casinos. The regulations in the United Kingdom are expected to be laid down in September 2003.
- A proposal from the Commission for a Third Money Laundering Directive is expected by the end of 2004.

#### *Financial supervision*

- The Financial Conglomerates Directive of December 2002 determines how the lead supervisor of a financial conglomerate should be decided and ensures that gaps in supervisory arrangements are filled. It is due to be implemented by August 2004.
- A proposal from the Commission for a Risk-based Capital Directive is expected in 2004 to implement in the EU the capital framework for banks and investment firms planned in the revised Basel Capital Accord. While the Basel Capital Accord will apply only to internationally active banks, the Risk-based Capital Directive is expected to apply to all banks and investment firms.

#### *Corporate insolvency*

- The Insurance Winding-up Directive of March 2001 ensures that the principle of mutual recognition is applied to the winding-up and reorganisation of insurance undertakings in the EU. It had to be implemented by April 2003.
- The Bank Winding-up Directive of April 2001 ensures that banks can be wound up and reorganised in the EU as a single entity. It is due to be implemented by May 2004.

#### *Taxation of savings income*

- The Taxation of Savings Income Directive, adopted in June 2003, is designed to prevent cross-border tax evasion by individuals within the EU. It provides for Member States to exchange information on interest income paid to non-residents, or (in Austria, Belgium and Luxembourg) to tax that income at source, with equivalent treatment in Switzerland and the dependent territories. It is due to be implemented by January 2004, with the provisions applying from January 2005.

proposals have still to be made.<sup>(1)</sup> The final date for adoption at EU level is mid-2004, allowing 18 months for transposition by the deadline of the end of 2005 (see the box on pages 356–57).

An expected timeline for key FSAP Directives outstanding is shown in Chart 1. They are divided into three categories: measures which have not yet been proposed; measures which have been proposed but not yet adopted; and measures which have been adopted but not yet implemented.

## D How does the Lamfalussy process affect the FSAP?

Given the scale<sup>(2)</sup> of the task involved in adopting and implementing such a large programme of FSAP Regulations and Directives, ECOFIN decided in

July 2000, as its top priority, to complete a single EU capital market by 2003. A Committee of Wise Men chaired by Baron Alexandre Lamfalussy was appointed. The Lamfalussy Committee recommended a new decision-making procedure for the adoption of EU legislation affecting the securities markets, which was endorsed by the Stockholm European Council in March 2001.<sup>(3)</sup>

The Lamfalussy process is designed to improve the quality and effectiveness of EU financial services legislation by: differentiating between framework legislation (at Level 1) and technical implementing measures subject to 'comitology' (at Level 2), so that changes in technology and market practice can readily be accommodated; consulting market participants more fully as it is drawn up; and creating an EU network of national regulatory authorities to ensure consistent and

**Chart 1**  
Expected timeline for key FSAP measures outstanding

	2003		2004				2005			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Measures not yet proposed</b>										
Legal Framework for Payments		■								
Reinsurance Supervision Directive		■								
10th and 14th Company Law Directives			■							
Risk-based Capital Directive				■						
Third Money Laundering Directive						■				
<b>Measures proposed but not yet adopted</b>										
Takeover Bids Directive				●						
Investment Services Directive				●						
Transparency Directive				●						
<b>Measures adopted but not yet implemented</b>										
Life and Non-Life Insurance Directives	◆									
Second Money Laundering Directive	◆									
Collateral Directive		◆								
UCITS Directives (amendments)			◆							
Fair Value Accounting Directive			◆							
Taxation of Savings Income Directive			◆							
Bank Winding-Up Directive				◆						
Financial Conglomerates Directive					◆					
Distance Marketing Directive						◆				
ECS Regulation and Employee Directive						◆				
Market Abuse Directive						◆				
International Accounting Standards Regulation							◆			
Accounting Modernisation Directive							◆			
Insurance Mediation Directive							◆			
Prospectus Directive								◆		
Pension Funds Directive									◆	

■ Plan for proposal ● Plan for adoption ◆ Deadline for implementation

Source: Based on information available at 31 July 2003.

(1) The Commission's *Eighth Report* on the FSAP (3 June 2003), updated. Legislative proposals on the original FSAP list under negotiation: Takeovers; Transparency; Investment Services. Legislative proposals on the original FSAP list still to be made: 10th and 14th Company Law; Risk-based Capital.

(2) The Initial Report of the Committee of Wise Men on *The Regulation of European Securities Markets* (November 2000) says: 'it takes three years on average to agree a Regulation or a Directive.'

(3) The priorities recommended in the Final Report of the Committee are: 'a single prospectus for issuers, with a mandatory shelf registration system; modernisation of admission to listing requirements and introduction of a clear distinction between admission to listing and trading; generalisation of the home country principle (ie mutual recognition) for wholesale markets, including a clear definition of the professional investor; modernisation and expansion of investment rules for investment funds and pension funds; adoption of International Accounting Standards; and a single passport for recognised stock markets (on the basis of the home country control principle).' (February 2001).

## The Lamfalussy process

The Lamfalussy process for securities markets involves four levels:

- **Level 1** Community legislation, in the form of Directives or Regulations proposed by the Commission, following consultation with all the interested parties, is adopted under the 'co-decision' procedure by the Council and the European Parliament. Legislation should be based on framework principles, and define implementing powers for the Commission.
- **Level 2** Community legislation is adopted by the Commission to lay down the technical details for the framework principles agreed at Level 1 under the 'comitology' procedure:
  - Technical advice is prepared by the Committee of European Securities Regulators (CESR), following a mandate from the Commission and based on consultation with market users.
  - A vote is taken by qualified majority of the Member States represented in the European Securities Committee (ESC).
  - Resolutions are made by the European Parliament: within three months, on the draft implementing measure; and within one month after the vote by the ESC if Level 2 measures go beyond implementing powers.
- **Level 3** CESR, which is a committee of national securities regulators, facilitates consistent day-to-day implementation of Community legislation. CESR may issue guidelines and common, but non-binding, standards. It also

compares and reviews national regulatory practices.

- **Level 4** The Commission, which is responsible for enforcing Community legislation, checks compliance of Member State laws with Community legislation. If necessary, the Commission takes legal action against Member States before the Court of Justice.

Chart 2 shows the new committee structure for financial sector rule-making when all the committees at Levels 2 and 3 have been set up.

- At both Levels 2 and 3, there are to be three separate sectoral committees, for: banking; insurance, including pensions; and securities, including UCITS (ie mutual funds). In addition, a fourth committee at Level 2 will deal with certain specific rules on financial conglomerates, which have operations across different sectors.
- The Level 2 committees may sometimes meet in joint session; and the Level 3 committee chairs and secretariats are also expected to coordinate their activities. The committees can exchange confidential information between them.
- National banking supervisory authorities and non-supervisory central banks are both eligible to attend the Level 3 banking committee. Only supervisory authorities can vote.
- Since 16 April 2003, the acceding countries have had 'active observer status' on all committees, and will in due course have an important role to play and significant voting weight in the Council.

equivalent transposition of legislation at Levels 1 and 2 (see the box above).<sup>(1)</sup>

Following a joint initiative by the Chancellor of the Exchequer and the German Minister of Finance in

May 2002,<sup>(2)</sup> ECOFIN decided in December 2002 to extend the Lamfalussy process from legislation on securities to legislation on banking, insurance and financial conglomerates as well.<sup>(3)</sup> The first four Directives operating under the new process, at least in

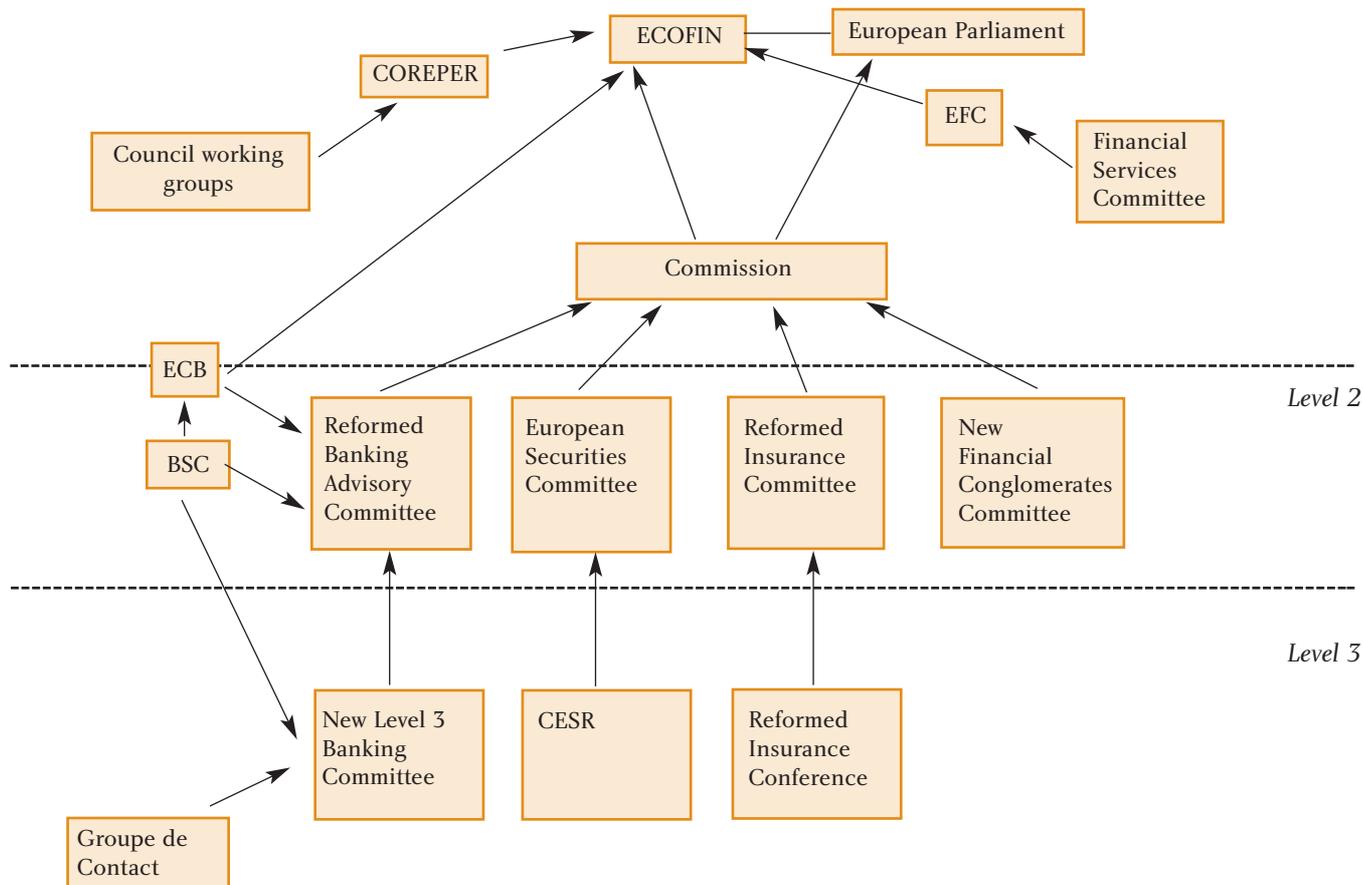
(1) Final Report of the Committee of Wise Men on *The Regulation of European Securities Markets* (February 2001).

(2) The Chancellor of the Exchequer and the German Finance Minister circulated a letter about regulation in the EU, before the informal meeting of ECOFIN in Oviedo in May 2002. The letter stressed the primacy of finance ministries in providing democratic accountability and control of any public funds used in rescuing financial institutions.

(3) The European Parliament has agreed, though it is seeking powers to call back secondary legislation. This would require an amendment to the Treaty.

**Chart 2**  
Possible new committee architecture for financial sector rule-making

Level 1



part, are the Market Abuse Directive, the Prospectus Directive, the proposed revision to the Investment Services Directive and the proposed Transparency Directive.

ECOFIN has also set up an EU Financial Services Committee (FSC), which has replaced the Financial Services Policy Group (FSPG). The FSC is chaired by a Member State representative<sup>(1)</sup> (whereas the FSPG was chaired by the Commission), with a secretariat provided by the Council, and consists of senior finance ministry officials. Its mandate is to provide advice for ECOFIN and the Commission on the oversight of:

- financial integration (ie monitoring progress in implementing the FSAP);
- clearing and settlement;
- corporate governance, in so far as this relates to financial markets; and

- implementation of the recommendations of the Brouwer reports, which involve coordination of, and cooperation among, national regulators on financial stability and crisis management.

Following the Brouwer Reports, a Memorandum of Understanding (MOU) was agreed between all banking supervisors and central banks in the EU to help ensure financial stability. This came into effect from March 2003. The main elements of the MOU are that:

- it consists of a set of principles and procedures for cross-border cooperation between banking supervisors and central banks in the event of a financial crisis with systemic implications affecting more than one Member State;
- these principles and procedures deal specifically with the identification of the authorities responsible for crisis management and the

(1) Dr Kees van Dijkhuizen, Treasurer General of the Netherlands Ministry of Finance.

exchange of information across borders between them; and

- the MOU also provides for the setting up of a logistical infrastructure to support enhanced cross-border cooperation between the authorities.

## E What are the implications of the FSAP for EU regulation in future?

The Lamfalussy Committee considered how the Single Market in financial services should be regulated. It proposed that cooperation between national regulators should be strengthened by creating a network of securities regulators through CESR (see the earlier box on the Lamfalussy process on page 359). However, the debate about how the Single Market in financial services should be regulated in future is not yet over. There are differing views:

- The Lamfalussy Committee recommended (in February 2001) that its proposed regulatory structure should be reviewed in 2004, or earlier if sufficient progress was not being made; but that, only if its approach 'did not have any prospect of success', might it be appropriate to consider a Treaty change, including 'the creation of a single EU regulatory authority for financial services generally in the Community'.<sup>(1)</sup> As the Lamfalussy Committee recommended, the EU institutions have set up an Inter-Institutional Monitoring Group, consisting of representatives of the Council, Commission and the European Parliament, to monitor how the Lamfalussy process is working. The Group's interim report, on the operation of the Lamfalussy process for EU securities legislation, was published in May 2003.<sup>(2)</sup> Its conclusions on the effectiveness of the process to date were largely positive.
- Consistent with the Lamfalussy process, the Wicks Report, published in November 2002 by the Corporation of London,<sup>(3)</sup> recommended a

market-oriented, risk-based approach to regulation, together with better implementation and enforcement of existing EU legislation, transparent consultation, and less use of new legislation in future. It proposed that 'a group of representative market participants' should provide, for the European Council each spring, 'independent, regular reports of progress towards the creation of a fully functioning Single Market'.

- Eurofi 2000 (an association of officials and market participants based in Paris) published a preliminary report in November 2002<sup>(4)</sup> arguing that, to build on the Lamfalussy process, 'a European Regulatory and Supervisory System could be established'. This might be based on the model of the European System of Central Banks, and 'would have to be run by a common decision-making process', while the application and enforcement of the resulting rules would be implemented at national level.<sup>(5)</sup>

## F What key issues arising from the FSAP need to be addressed?

A Single Market in financial services has been a long-standing Community objective. Substantial progress has been made towards achieving this, particularly in wholesale financial markets, which are closely integrated already. The achievement of a Single Market in retail financial services is further away. The FSAP is a welcome initiative to close the remaining gap. But it is important that EU regulation addresses the views of market experts (see the box on page 362); that it works with the grain of the market, so as not to stifle financial innovation and risk-taking; and that it creates a level playing field so as to enhance competition among providers of financial services across the EU.

Against this background, what do the UK authorities consider to be the key issues arising from the FSAP that need to be addressed, and where is there common ground on how to address them?

(1) Final Report of the Committee of Wise Men on *The Regulation of European Securities Markets*: Brussels (February 2001).

(2) Inter-Institutional Monitoring Group: *First Interim Report Monitoring the New Process for Regulating Securities Markets in Europe* (The Lamfalussy Process) (May 2003).

(3) *Creating a Single European Market for Financial Services: a Discussion Paper* produced by a working group in the City of London, chaired by Sir Nigel Wicks ('the Wicks Report'), November 2002.

(4) *The European Integrated Financial Market*: Paris (November 2002).

(5) In a paper on *Four Predictions about the Future of EU Securities Regulation* (January 2003), Gerard Hertig and Ruben Lee argued that the Lamfalussy process 'will not work, because of its failure to address two fundamental issues: national protectionism and bureaucratic inertia. The resulting failure will make increased harmonisation and some centralisation of supervision inevitable. Notwithstanding current opposition to the establishment of a pan-European securities regulator, there will be a European Securities and Exchange Commission (ESEC). The ESEC will focus initially on corporate disclosure issues, [and] obtain 'soft' enforcement powers.' However, see also a response, *The Unpredictable Future of European Securities Regulation* (April 2003), by Michael McKee, Executive Director, British Bankers' Association.

## Market experts' views about the FSAP

Financial market experts are widely in favour of completing the Single Market in financial services. But market experts have views about the way in which the FSAP can best be used to help achieve this, and they are particularly aware of problems in retail rather than wholesale financial services.<sup>(1)</sup>

### Market consultation

Market experts consider that they need to be properly consulted: first, to help indicate where legislation is necessary, and where alternatives which do not involve legislation, such as encouraging best market practice, may be at least as effective; and second, where legislation is necessary, to improve it. However, proper market consultation (eg by CESR) requires a genuine dialogue, which takes time, and should not be rushed. And when consultation takes place, the Commission and other authorities need to take full account of the message they receive from the market, while market participants need to respect the consultation process by accepting the majority view. If this is done, new measures will be more robust: that should be more efficient from the market's point of view and save legislative time in the longer run. Consultation of consumer groups (eg through the FSA in the United Kingdom) also helps to improve new legislative measures.

### Negotiation of new measures

Many market experts consider that, while a great deal of progress has been made in designing and implementing new measures under the FSAP, the negotiation of new FSAP measures does not always meet the objectives originally set, for a number of reasons:

- *Approach to financial integration* Member States have advocated different approaches to achieving financial integration in the EU. Some Member States have focused on harmonising a minimum set of core principles, and ensuring market access through mutual recognition, so that a market firm authorised to provide services in its 'home' country has a 'passport' to provide them in all other EU countries. But other Member States regard harmonisation of core principles as insufficient, and advocate uniform standards, under which consistent and detailed rules would apply throughout the EU.
- *Restrictions on competition* In the negotiation of new Directives, the Commission sometimes

faces resistance to the removal of barriers by Member States concerned to maintain existing restrictive practices. For example, clauses in Directives concerning the 'general good' and consumer protection have been used by Member States to retain national rules which create barriers to foreign competition, whether through a local branch or cross-border.<sup>(2)</sup>

- *Retail financial services* More progress has so far been made in integrating wholesale financial markets across the EU than retail markets. It is not clear that regulatory harmonisation alone will be sufficient to complete the Single Market in retail financial services, as tax, legal and cultural barriers remain.<sup>(3)</sup>

### Implementation and enforcement

There appears to be a growing consensus among market experts that, once the original FSAP measures have been adopted, the Commission and regulators (eg in CESR) should focus to a greater extent on the timely and accurate implementation and enforcement of existing legislation rather than on the introduction of more new legislation.

### Flexibility and speed of adaptation

Many market experts consider that the regulation of professional investors in wholesale financial markets needs more flexibility than the regulation required for retail markets. This is difficult to achieve in some Member States, as national legislation is too detailed to allow the degree of discretion that is common in, for example, the UK regulatory system (eg in distinguishing between professional and retail investors, or allowing 'prudent man' discretion in pension fund asset allocation). There is also a risk that, if EU legislation relating to retail markets is not well drafted, it will have adverse consequences for the operation of wholesale financial markets.

### Costs and benefits for market participants

Many market experts consider that the Commission should analyse in more detail the cost-effectiveness of proposed new FSAP measures, and the interaction between them. Their impact needs to be considered, not just on market behaviour and the efficiency of financial markets within the EU, but also on the EU's global competitiveness, and in particular in relation to the United States.

(1) See, for example, the Wicks Report (November 2002).

(2) See also: Friedrich Heinemann (ZEW)/Investment Management Association, *Towards a Single European Market in Asset Management* (April 2003).

(3) See also: Association of British Insurers, *Retail Financial Markets in the EU: a Critical Survey* (February 2003).

- First, proper market consultation remains important: to help indicate where legislation is necessary, and where alternatives which do not involve legislation, such as encouraging best market practice, may be at least as effective; and, where legislation is necessary, to improve it. However, market consultation requires a genuine dialogue, which takes time, and should not be rushed. It is more important that proposals should be well designed than that they should be quickly adopted, even if this means that the target date of the end of 2005 for the completion of FSAP measures is not achieved in every case.
- Second, new FSAP measures should be based on mutual recognition, with common core standards, especially in wholesale markets. There is room for debate about the degree of 'singleness' required to complete the Single Market in financial services, but no clear or simple answer.<sup>(1)</sup> New EU legislation may not be the best way of removing barriers that are peculiar to one Member State and are not common across the EU as a whole.
- Third, more emphasis should be given to ensuring that FSAP measures are implemented consistently and promptly at national level and properly enforced. This is the responsibility of the Commission, the Lamfalussy committees and Member States themselves. But market participants, trade associations and consumer groups also have a role to play in bringing complaints to the attention of the relevant authorities.
- Fourth, the Commission needs to attempt an objective analysis of the cost-effectiveness of FSAP measures, the interaction between them and their impact on market behaviour. The Commission's proposals for indicators of efficiency and integration may help to achieve this.
- Fifth, greater recognition is needed that financial markets today are global. The consequences of EU action on the competitive position of EU-based firms and markets need to be considered. Equally, greater efforts are required to seek solutions to regulatory issues at a global level through, for example, mutual recognition agreements, strengthened dialogue and information exchange.
- Sixth, the EU and national competition authorities have a vital role in investigating barriers to competition in financial services across the EU, and instituting remedial action. Besides competition internally across the Single Market, competition is also important externally (eg *vis-à-vis* the United States).
- Seventh, national regulators need to be able to use their discretion in adapting quickly and flexibly to market developments. This is especially the case in wholesale markets.
- Finally, the priority should be to make the Lamfalussy process work well by reinforcing the cooperation that already exists between the network of national regulators, rather than to create a central system of European regulation—for which the specification remains in any case very unclear and which would require a change in the Treaty. The EU network of national securities markets regulators (CESR)—and the equivalent Level 3 banking and insurance committees—have a major task ahead, and need the resources to match.

## G How does the United Kingdom make a contribution to the FSAP?

HM Treasury, the FSA and the Bank play key roles in identifying, influencing, promoting and overseeing the United Kingdom's interests in financial services in the EU.

- HM Treasury is responsible for the United Kingdom's strategy towards financial services legislation in the EU. The Chancellor represents the United Kingdom at ECOFIN, and Treasury Ministers are directly accountable to Parliament. HM Treasury is responsible for UK policy at Level 1 and Level 2 of the Lamfalussy process.
- The FSA has responsibility in the United Kingdom for the authorisation and supervision of financial services institutions and markets and, within the agreed legislative framework, for regulatory policy. The FSA contributes at Level 2 of the Lamfalussy process through the provision of technical advice on implementing measures, and is responsible in the

(1) See, for example, David Green, Head of International Policy, FSA: 'We are convinced that mutual recognition based on harmonised core standards is the best way to go. The trick, of course, is to identify just which standards need to be harmonised, and which can be left to local discretion without damaging the integrity of a single financial market.'; *Philosophical debate or practical wisdom? Competing visions of the EU's financial services sector*: FAZ Conference (March 2003).

United Kingdom at Level 3 through the Regulators' Committees.

- The Bank is responsible for the overall stability of the UK financial system and has a role in promoting the effectiveness of UK financial services. It will contribute to the Lamfalussy process, and provides a window on the ECB's impact on the functioning of the EU financial sector, especially in the operational payments and settlement areas.

HM Treasury and the FSA, with support from the Bank, consult market participants on FSAP measures. Market associations also play a key role in ensuring that market participants' views are fully represented at EU level in Brussels. The UK consultation process includes:

- regular Ministerial breakfasts for chief executives and financial leaders to raise awareness of EU financial services issues at a high level;
- high-level public-private sector discussions, jointly chaired by HM Treasury and the FSA, to consider EU financial services strategy;
- regular EU stocktake meetings at HM Treasury for trade associations, organised markets and consumer groups, to provide information and obtain feedback;
- quarterly international roundtables at the FSA with HM Treasury, trade associations, consumer groups and other relevant bodies, to provide information and discuss EU and global financial services issues;
- roundtables, and small drafting groups, at HM Treasury on specific Directives, so as to consult the market on the Government's negotiating stance in Brussels; and
- consultation documents on implementing FSAP measures by HM Treasury or the FSA, as appropriate.

The FSA also has two statutory objectives relating to consumers, under the Financial Services and Markets Act 2000. The first is to promote public understanding of the financial system. The second is to ensure an appropriate degree of protection for consumers. These objectives inform the FSA's approach to financial services issues in the EU as well as domestically.

## Further information

A common theme running through this paper is the importance of consulting market participants on the FSAP. Consulting the market is particularly important in the United Kingdom, because of the City of London's role as an international financial centre, and the contribution it already makes to the Single Market in financial services. However, for consultation to be effective, market participants need to be aware of new initiatives under the FSAP, and ready and able to respond in a considered and timely way. Useful sources of further information about the FSAP are included below:

- The European Commission publishes six monthly reports on *Progress on the Financial Services Action Plan*, which are available, along with a wide range of other material about the FSAP, at [http://europa.eu.int/comm/internal\\_market/en/finances/actionplan/index.htm](http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm)
- A full list of FSAP measures, including the state of play on those not yet completed, is provided at [http://europa.eu.int/comm/internal\\_market/en/finances/actionplan/annex.pdf](http://europa.eu.int/comm/internal_market/en/finances/actionplan/annex.pdf)
- Details of individual directives by subject (eg banks, insurance, securities etc) are provided at [http://europa.eu.int/comm/internal\\_market/en/finances](http://europa.eu.int/comm/internal_market/en/finances)
- The Inter-Institutional Monitoring Group for securities markets has a website at [http://europa.eu.int/comm/internal\\_market/en/finances/mobil/lamfalussy-comments\\_en.htm](http://europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm)
- The Economic and Monetary Affairs Committee of the European Parliament carries relevant material on its website at [http://www.europarl.eu.int/committees/econ\\_home.htm](http://www.europarl.eu.int/committees/econ_home.htm)
- HM Treasury publishes summaries of the key issues on individual FSAP measures, and links to texts. Its website is at <http://www.hm-treasury.gov.uk/>
- The Financial Services Authority (FSA) publishes consultation papers on FSAP measures and discussion papers on other relevant EU issues on its website at <http://www.fsa.gov.uk/pubs/index-type.html>

- The Committee of European Securities Regulators (CESR) publishes mandates from the Commission, and other material on securities markets directives under the Lamfalussy process, on its website at [www.europefesco.org](http://www.europefesco.org)
- The Federation of European Securities Exchanges (FESE) website contains position papers and submissions in response to consultations on FSAP directives at [www.fese.be/initiatives/european\\_representation/index.htm](http://www.fese.be/initiatives/european_representation/index.htm)
- The British Bankers' Association (BBA) produces a regular EU newsletter for members. Its website includes BBA and European Banking Federation (EBF) submissions in response to consultations on directives at [www.bba.org.uk/public/corporate/#35473](http://www.bba.org.uk/public/corporate/#35473) The EBF website is at <http://www.fbe.be/>
- The Association of British Insurers (ABI) website includes a short section on EU regulation under 'current issues/Europe', with contact details at the ABI, at [www.abi.org.uk](http://www.abi.org.uk)
- The London Investment Banking Association (LIBA) website provides, for members, a market commentary on some EU directives, and includes a section on 'EU issues (also see electronic commerce, accounting and taxation)', at [www.liba.org.uk](http://www.liba.org.uk)
- The Investment Management Association (IMA) website includes a section on 'publications/responses to consultations', including a European section at <http://www.investmentfunds.org.uk/Publications/default.htm>