



Developments in EU financial services legislation and associated initiatives

Speaker: Dr David Doyle, EU Policy Advisor on financial markets

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Overview

David began by commenting on the general situation which he described as an interesting time, with some positive elements, some challenging elements and some elements still to be defined. The EU Financial Services action plan first began in 1999 and was pushed through in great haste and with, at times, fragmented consultation with the industry. As at late 2007 most legislation is now in place, some still needs defining and some is still to be put in place during the rest of this year and 2008.

Developments in the McCreevy era

The most significant factor of the McCreevy era as commissioner was the determination to undertake a massive review of the plan. What emerged in 2005 was the EU strategy paper which tried to envisage what things would look like by 2010. There was also a determination to apply the concept of “dynamic consolidation” to existing legislation, with quick fix solutions for inadequate or incomplete elements. Some countries were very late in transposing some legislation so that there was not a level playing field. There was also the recognition that some directives were susceptible to misinterpretation; there was also a problem with gold plating. There was a conclusion that there was a need for improved quality of legislation. There needed to be ways of reducing the burden of legislation and also asking whether it was actually necessary. For example, following an economic impact assessment conducted by the EC, it was recently been decided not to take forward a draft “one share one vote” directive.

There needs to be enhanced supervisory convergence. If you have a weak structure across Europe you are bound to have problems. Many European states have inadequate resources and thus there has been an emphasis on enhancing the cross-border supervision regime. For example, common enforcement processes, exchanging information and having standard investigative procedures.

Competition in Financial Services

McCreevy put a lot of emphasis on encouraging competition and ensuring a level playing field. Up to two years ago the DG for competition focussed on areas like telecoms not Financial Services. This has been very successful in telecoms with a series of reduced charges to the benefit of the consumer. The DG then started to focus on FS and found many examples of uncompetitive behaviour in cross-border banking M&A activities. . This focus has been welcomed by the City. The view is that investigation of anti-competitive practices is better than taking the legislative route. It is preferable to get the market to put forward their own views on how to resolve issues rather than force legislation through without consultation. Finally there was the recognition that Europe does not live in a vacuum. There is the US with massively well-established and liquid capital markets which Europe needs to respond on the basis of a potential and symmetrical mutual recognition approach rather than seek complete harmonisation.

McCreevy said early on that we need to cut back on the amount of legislation, but it has been necessary to introduce in some cases e.g SEPA where by 2010 we will be able to use of electronic cross-border payments at a fraction of today's costs and on the same day. There is still a great gap between typical European charges and US charges for essentially the same function. This pricing/cost pressure should lead to more outsourcing of this essentially commodity type business. Banks are looking at how to automate this end to end but are meeting market resistance from small businesses who do not have much cross border transactions. Their fear is they will get increased costs if they only have a few cross-border payments to make.

Investing across European borders is currently a nightmare as is payments as any one owning a house in France or Spain and trying to make a payment would know.

The Banking Directive

The Banking Directive amendment will curb the power of central banks to affect or delay the outcome of M&A activities. This is likely to lead to more banking consolidation across Europe especially with those countries having many smallish banks. With respect to asset management, the UCITS Directive is moving towards the removal of obstacles to selling cross-border funds offerings in Europe. There was a definition of eligible funds, which still does not include hedge funds, but was expanded beyond purely bonds. Another piece of improvement was clarifying who does what in regard to approval of funds, ie, home and host country regulatory roles, but we still have to consider the outcome of a review of cross border communications. We need straightforward and more prompt notification procedures for regulators. For example what should go into the marketing and sales literature, who should regulate it and at what point in time? The danger is that it is left too late.

Solvency II

Solvency II deals with insurance, with risk management and disclosure. There will be a common method for valuating risk. Regulations will be put in place and processes for controlling risk. Solvency II is clearly a recast directive. However many believe this alone will not compensate for poorly managed insurers. There is a view that we will need to strengthen the supervisory activities. Some insurers will no doubt reach the view that some categories of insurance will not be worth offering. For example in France many insurers will not insure multi-owned properties. The result should also be less cross subsidisation by insurance companies across their lines of business.

Clearing and Settlement

With regard to Clearing and Settlement there is a recognition that across borders it is very expensive in the EU, some seven to ten more expensive in cases than corresponding transaction in the USA. The voluntary Code of Conduct has three pillars: price transparency, access rights and interoperability and account segregation and unbundling. There is a voluntary code of conduct not a directive.

Retail FS

There is a green paper on retail FS. This has been the Cinderella area of EU action and policy development on FS in general, with only 1% of EU citizens invest across borders. However this is becoming critically important in retirement planning and the offerings of pension funds.

MiFID

MiFID is coming into operation on 1st November this year. We need to agree on record requirements that the market players must retain. We also need to resolve the issue of market data consolidation. CESAR has taken up the issue of inducements – begging the question as to who has what responsibility in the chain.

EU_US Economic relations

With regard to the EU_US financial services regulatory co-operation, more EU legislation is being influenced by the US. The issues are focused presently on

- re-insurance,
- de-registration
- corporate governance
- IFRS/USGAAP convergence
- Hedge funds
- Sovereign wealth investments
- Investment rules.

David concluding by giving us a list of what's coming next for consideration and what requires continuing vigilance.

Whats coming?

- Rating agencies and valuing new forms of alternative investments and forms of securities
- Private equity financing and hedge funds
- Financial Meltdown and contingency plans
- Credit mortgage crisis: Basel II
- Corporate governance - a review eg on NEDS, directors pay etc
- Portuguese Presidency priorities which includes having to deal with 2nd draft of EU constitution

Points requiring continuing vigilance.

Prompt and timely consultation

Consistent interpretation and even implementation of existing legislation

Targeted amendment of existing legislation

Adequate resources for enforcement

The distinction between professional, wholesale and retail activities

Q&A session

Some interesting questions and observations arose from the floor

Is there the risk of regulatory arbitrage, of shopping around for the most benign regulator?
CESAR needs to accelerate the extent of co-operation and information exchange

Is the need for an overall or lead regulator?

There is some talk of a lead to regulator to oversee - this might be the most experienced one. The risk is that the EU approach might not convince the Americans who might in turn enter bilateral arrangements with individual member states thus undermining the EU harmonisation approach

Does the EU measure and monitor the effects of its legislation and directives?

The EU has been responding to pressures to clarify and makes changes in the interests of improving the quality of the processes and thereby achieving the objectives.

How good and independent are the regulators?

In some countries the regulators are not independent or skilled enough- they are political appointees.

Could regulation be outsourced.?

Although theoretically possible, politically it's very unlikely in the near term

Conclusion

This was a fine, lucid exposition of EU policy and thinking on various issues in relation to Financial Services