Priorities for the Completion of Europe's Financial Services Markets Integration*

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Ladies and Gentlemen,

It is a real pleasure to be speaking here today at the Belgian Financial Forum.

Indeed it is very appropriate that the subject of the address I will give today, here in Brussels, is entitled "priorities for the completion of European financial services markets integration." What better place to offer my reflections on Europe's efforts to integrate twenty five financial services markets into one single European market, than in the capital of Europe itself?

Let's now turn to the focus of today's discussion. But before I offer you my thoughts on what now needs to be done and how we can best complete the integration of Europe's Single Market, let's first very briefly consider what has helped to promote a single market in financial services. In other words, how have we arrived at the point we now find ourselves at on this path of integration in Europe?

Apart from official efforts to promote a single market in financial services, of which the Financial Services Action Plan is the most substantive, a number of factors have helped to advance integration so far. To me, those are essentially:

- the general trends towards globalization;
- technological improvements;
- the introduction of the euro;
- deregulation; and
- cross-border consolidation, although unjustified barriers to cross-border M&A exist and should be removed.

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Now, let's move on to the substance of today's conference:

Prioritisation of the issues that matter most to the integration of Europe's financial services markets is the key undertaking facing legislators over the next five years. Yet it is equally important that the industry seizes the opportunity during the current period of reflection on future priorities to shape that agenda. Likewise, consumer groups have the responsibility of ensuring that their voice is heard and that their needs are taken into account.

Prioritisation does not mean leaving no stone unturned in the financial markets and addressing every issue with a new legislative initiative. Indeed not doing something can be equally as important as doing something. Fortunately it seems that Commissioner McCreevy is well-intended in that respect and shares industry's concerns about over-regulation. But market forces, i.e. the industry, also have a role to play in order to prevent the European Commission from having to address market failures.

When I first read the recent Green Paper on Financial Services Policy for the next five years, I was by and large reassured that all sides now seem to be moving in the same direction.

I was particularly pleased to see that the European Commission's priority is to firstly complete remaining legislative measures under negotiation in the Council and European Parliament and then focus on a limited number of areas where specific issues require further attention. It does not mean however that we, at the European Banking Federation, agreed with everything stated in the Green Paper. Far from it, we do have concerns and specific requests.

While overall a dynamic consolidation phase, coupled with a very strong emphasis on implementation, convergence and enforcement, is needed in the securities field, this is less so in the field of retail banking and VAT treatment of financial services. Let me elaborate on these and some other points.

Integration of Europe's **wholesale markets** has been the main focus of the European Commission's attention to date. Putting in place relevant, proportionate and flexible legislation to facilitate the integration of Europe's securities markets has been a long and at times challenging process. It will continue to be so in the short term as the remaining parts of detailed legislation are worked out, in particular those of the Markets in Financial Instruments Directive or 'MiFID'.

While many measures have been adopted at EU level (including for instance the Market Abuse, Prospectus, Transparency and MiFID Directives), the extent to which these measures will contribute to the creation of a truly European market for financial services will mainly depend on:

- the correct and timely transposition as well as the effective and consistent implementation of the rules at domestic level;
- convergence of supervisory practices; and
- proper enforcement.

These developments will depend to a large extent on the success of the so-called Lamfalussy process and in particular on levels 3 and 4 of the process, which will be key factors for the delivery of the FSAP objectives. Ensuring the effectiveness of the Lamfalussy committee structure should therefore be one of the top priorities in the post-FSAP era.

So, apart from making Lamfalussy levels 3 & 4 work, what remains to be done in the securities/capital markets field?

With the possible exception of securities clearing and settlement, where further progress is needed (which might require some type of EU initiative subject of course to a conclusive and thorough impact assessment), and the implementation of the Commission's Action Plan for Modernising Company Law and Enhancing Corporate Governance in the EU, I see no further areas in the securities sector that are in immediate need of regulation at EU level. What is now needed is a legislative breathing space and a period of consolidation. We must let the markets take shape and perform as they now can: on an integrated basis.

I am now moving away from securities markets and entering into the arguably less exotic, but no less dynamic, world of **payments**. I must say that we have severe concerns about the European Commission's draft proposal for a New Legal Framework for Payments in the Internal Market. In its current version, this draft proposal would prompt a considerable increase in costs for banks and for consumers. We therefore urge the European Commission to re-examine its approach to harmonising payments in Europe so as to achieve the desired goal of facilitating greater competition. The current text is a clear case where the European Commission does not meet its stated aims of only acting where European initiatives bring clear economic benefits to industry, markets and consumers.

Moving on to the provision of **retail financial services** in the EU, let me first say that I am encouraged to see that the European Commission has identified this area as one of its priorities in the years to come. The proof of the pudding is in the eating however and here again I have some concerns about the apparent desire of the European Commission to regulate the portability of bank accounts; the costs of such regulation would – in my view – outweigh the benefits by a considerable margin. The same does not hold true with respect to the online opening of bank accounts cross-border which is a field where EU-level initiatives are desirable.

As I mentioned earlier I believe that retail financial services is a policy area where well-targeted initiatives will bring benefits to the consumers, providers and the EU economy. As we all know, retail markets in the EU remain patently fragmented. The current fragmentation of the European retail banking market is not merely the result of a voluntary decision on the part of the consumers. There is ample evidence that in the field of retail banking, supply creates demand and that consumers base their purchasing decision on factors such as product availability and price. The current scarcity of supply of cross-border financial services cannot be taken to indicate an absence of consumer demand. It owes rather to the fact that foreign banks are hindered, if not prevented, from entering the market. As a consequence, consumers largely continue to be denied the chance of exploiting the full potential of the European retail banking market and its diversity of products and suppliers. We therefore strongly advocate further opening up of the still largely localised retail banking markets.

The lack of integration of retail banking markets in the EU can be explained by the existence of both natural and artificial obstacles. Natural obstacles, such as different cultures and languages, reflect Europe's diversity and richness and should not be a cause for concern. Artificial obstacles, on the other hand, may require positive action from either the European Commission or the industry.

As far as the European Commission is concerned, it should – I believe – confine itself to creating clear, harmonised and coherent framework conditions for all market participants. This can be only achieved, in my view, by harmonising at EU level the key retail banking elements, i.e. those that are essential to foster cross-border competition. Examples are the pre-contractual information and the Annual Percentage Rate of Charge. This is what we, at the FBE, call "full targeted harmonisation". I note that the other European Credit Sector Associations share that viewpoint and therefore hope that the European Commission will be sympathetic to the idea. In the absence of such harmonisation, you simply end up with a fragmented regulatory landscape and 25 different sets of consumer protection legislation. This either discourages providers to do business cross-border or makes them less competitive given the cost of adapting their IT and loan agreements to 25 different regimes, which in both cases penalizes the consumers as they

cannot benefit from the wider choice and better prices that competition brings with it.
Given the importance of consumer credit in Europe's economy, I believe that the long-awaited revised Commission's text for a Consumer Credit Directive will constitute an important test case and allow market participants to assess the Commission's commitment to creating a single market in retail banking services that will serve the interests of consumers and providers alike. This, as I said, requires the European Commission to adopt a 'full targeted harmonisation' as opposed to a 'minimum harmonisation' approach, which simply does not work in this field as experience has shown; and as opposed also to a 'full harmonisation approach' across the board (i.e. non-targeted), for which experience shows that there is no support at the level of the Council, i.e. at the level of the member States.

Of course all this should go hand in hand with an appropriate level of consumer protection. While in a competitive market banks will strive to offer products that meet consumers' demands, this is not sufficient and explicit consumer protection rules are needed if consumer confidence is to be maintained and the cross-border delivery of financial services ever to become commonplace. The difficulty then becomes to find out what this appropriate level of consumer protection should be. The European Banking Federation's stance is clear:

- An appropriate level of consumer protection, based on adequate information, should be promoted.
- At the same time, bureaucratic prescriptions should be avoided as this would be detrimental to providers and consumers alike.

As far as the often-expressed idea that the development of a '26th regime' would help creating a single market for retail financial services, I would not want to dismiss it at this early stage. Yet it should not be promoted MERELY to make up for the lack of political will to harmonise existing rules.

At the FBE, we believe that a more rigorous application of full targeted harmonisation should be pursued before the Commission starts exploring other alternatives, such as this '26th regime' concept. Nonetheless, the concept has given rise to some interest and further analysis should be undertaken.

Beyond that, it is clear that any additional, alternative or optional regime should not lead to, or result in, straight-jacketing providers into product standardisation, as this would be detrimental to the competitive and innovative capacity of the financial services industry to meet the evolving needs of its customers.

Finally, as far as Mortgage Credit is concerned, you will have heard that the European Commission recently published a Green Paper on the subject. This is obviously an area of crucial importance for the banks, not least for those in Belgium as I am told. I would not like to prejudge the FBE opinion on this Green Paper. Indeed the consultation is still on-going and this is therefore very much work in progress. I can only invite you all to actively participate in this consultation exercise so that the European Commission gets as much informed input as possible.

Moving on, I would like to now turn to a specific priority for the industry, value added tax, or **VAT**, on financial services. This is admittedly a more technical subject but certainly no less important and it is regrettable that no mention whatsoever is made to it in the Commission's Green Paper.

In the current VAT system, most charges made to customers by banks (in particular interest) are not subject to VAT. As a result banks are only able, according to the provisions of the 6th VAT Directive, to recover a percentage of the VAT that they incur on their own overhead expenses. In this respect, banks and banking services are treated very differently from businesses such as manufacturing and retailing where VAT incurred is fully recoverable against VAT charged to customers.

The VAT system applicable to financial services is particularly harmful because normal commercial cost savings can be wiped out by additional VAT bills. Indeed each internal cost that is externalised comes back with a VAT cost of approximately 20% attached to it.

This is notably the case when Back Office activities are centralized in a centre of excellence within one company in a group. It is also the case when such activities are outsourced to independent third parties. As outsourcing can affect any part of a business, the current system prevents EU banks from rationalizing, centralizing and integrating their functions in a VAT-neutral way and hence from realizing structural costs savings. This puts EU banks at a competitive disadvantage.

The industry expects the European Commission to keep pushing for a reform of the VAT treatment of financial services despite the political difficulties. It will certainly be a hard fight to get any change if countries look no further than the immediate, direct impact on their tax revenues. However, we are concerned that no apparent recognition is given to the loss of national tax revenue as a result of driving away employment and business that is already attracted towards low cost economies outside the EU.

EU financial groups will not be able to stay competitive in a global economy if they are not given the opportunity to integrate, centralize and rationalize their functions in a VAT-neutral way in order to exploit synergies and realize costs savings. This issue should top the European Commission's priorities list.

What other priorities are there for the next five years?

I see at least two more. These are asset management and cross-border M&A.

Let me start with **asset management**. I shall be brief. The European Commission has rightly identified it as a priority. It has issued a Green Paper on the subject. Consultation is ongoing. We welcome this work stream and we are currently working on a response. I note that improvements of the current set-up should also be beneficial to overcoming the problems that an ageing European population will pose to Europe's prosperity in the future. Let me add in this regard that given that employees will increasingly have to care for much of their retirement income by themselves, I consider equipping consumers with greater knowledge and raising standards of financial literacy across the EU as a key priority, although this is more something for the Member States to take care of than for the European Commission.

Then we have **cross-border M&A**. M&A is undoubtedly an important driver of integration. In recent years, cross-border activity has grown significantly; yet we have seen a relatively low level of M&A in EU banking, notwithstanding a number of such transactions having been completed or announced in recent months.

Consolidation is not an end in itself but rather a means to achieve economies of scale and scope. These in turn will enable banks to offer their customers a wider range of services at better prices. Let's be clear: banks will not undertake the costs and risks associated with M&A, unless they see that these economic benefits, or synergies, are achievable.

Therefore unjustified barriers to cross-border transactions must be removed. A number of the existing structural obstacles to M&A that currently exist within the European banking market cannot be justified as enhancing customer value or financial stability and should be removed by policy action.

As you probably know the European Commission has consulted on that issue and is due to submit its conclusions in the coming weeks. These are expected to be discussed by the Ministers of Finance of the EU Member States on the occasion of their ECOFIN meeting of November this year.

We, at the European banking Federation, have identified a number of unjustified barriers. We have found it helpful in identifying priorities for action to distinguish between obstacles which mainly influence the feasibility of an M&A transaction, and those which mainly affect a transaction's efficiency after the M&A has taken place. Each of the barriers included in the first category may alone determine the possibility to carry out an M&A deal, whereas those in the second category influence efficiency to a greater or lesser degree in the post-consolidation phase. As the achievement of efficiencies is the driver behind M&A, the second category of obstacles may have as definite an effect as the first, preventing a project ever reaching the drawing board.

Thus far I have spoken about which areas should be the priorities to integrate Europe's financial services market. At this stage I would like to reflect on how we can best integrate Europe's financial services markets. In other words, after the "What's", let's reflect on the "How's".
A successful Single Market will be based on effective and proportionate regulation and supervision; this requires a viable delivery mechanism. The FBE believes that the Lamfalussy process – with its 4 levels and its various Committees – is the right delivery mechanism.

The FBE fully supports the Lamfalussy process. Yet, while experience of the operation of the Lamfalussy approach in the securities field has been encouraging, there remains a need to:

- focus on the quality of legislation and implementing measures rather than speed; and
- improve the transparency at all stages of the process.

The FBE further supports the extension of the Lamfalussy approach to banking. It is vital for the delivery of financial stability, for the protection of depositors and borrowers, and for the competitive position of the European banking industry in a global market, to ensure that regulation is focused, flexible and proportionate. This holds especially true for the new capital adequacy framework. The European banking industry has repeatedly stressed the importance of flexibility in the new Capital Requirements Directive. Such flexibility is necessary to ensure that the new framework is able to keep pace with developments in industry practices, markets and supervisory needs. As it currently stands, the risk is real that the proposed Directive will eventually not provide the necessary flexibility, due mainly to interinstitutional tensions.

I have emphasized earlier in my speech the importance of ensuring the proper functioning of the Levels 3 & 4 of the Lamfalussy process in the securities field. I shall now turn my attention to the banking field and in particular banking supervision.

The banking industry feels that effective and efficient banking supervision must be able to cope with not only the needs of smaller players more reliant on a local client base, but also with the demands of large and complex financial groups doing business cross-border.

Today's banking regulation was originally designed to protect the soundness and stability of the national banking system and sometimes even to politically control it. Thus, supervisors as well as central banks have national mandates and responsibilities vis-à-vis their politicians and citizens. This fragmented system of supervision is now in conflict with the ultimate goal of creating a single market in financial services. More importantly, it no longer reflects business reality and the way cross-border banks are managed.

As integration moves forward, there is an increasing need for rebalancing the distribution of competences between national cooperating supervisors.

The industry is therefore on a journey with legislators to arrive at a structure that is both appropriate and proportionate for all sizes of bank, large and small, and can at the same time ensure financial stability and afford a suitable degree of protection for consumers, whichever jurisdiction the bank operates in.

This, as I am sure you are acutely aware, is no easy task since many elements of the puzzle must be slotted into place before we achieve truly effective and efficient supervision.

Looking at the proposals set out in the European Commission's recent Green Paper on Financial Services Policy, whilst I recognize the need for an evolutionary approach, with Lamfalussy as the point of departure, I feel strongly that an opportunity has been missed to set out clear and ambitious policy objectives in banking supervision.

I consider that a critical path is needed to demonstrate how the many separate but inter-related issues will be dealt with in the coming years. In this context, I look forward to seeing more concrete proposals set out in the European Commission's White Paper due to be published in November this year.

The issues that need to be addressed in the White Paper are varied but are ultimately inter-related. They include:

- the elimination of duplicative supervision;
- the elimination of inconsistencies between Directives and obsolete exceptions to the home country principle;
- the review of the banking safety nets;
- supervisory convergence;
- co-operation between the Level 3 committees; and
- co-operation between all stakeholders.

The said issues are essentially political. They are about how to share the risks and costs of financial integration. As long as these issues are left unaddressed, they constitute political barriers to integration.

Many European banks have set consolidated banking supervision as their ultimate objective in this area, which the Commission acknowledges is now a legitimate demand.

However, I feel that there is a lack of clarity from the European Commission on whether supervisory convergence is needed before consolidated supervision can be delivered. In my view, until the European Commission identifies consolidated supervision as the objective in the EU, the Committee of European Banking Supervisors, or CEBS, will continue to lack a clear goal in its work. The objective and eventual implementation of consolidated supervision should act as a catalyst for supervisory convergence in a limited timeframe.

Working to achieve more efficient and more effective supervisory arrangements in Europe is but one very important task ahead of us. It is in effect one of three elements I would consider to be vital to the success of HOW best we can tackle the priorities we have identified.

The second element, my second 'how', is the global dimension.

As Chairman of a large internationally active bank, I cannot overstate the importance for the EU's financial sector to be competitive in global markets. With that in mind, I welcome the European Commission's initiatives to deepen the EU-US financial markets dialogue, to strengthen financial relations with Japan, China and India and to widen the agendas of those dialogues. It is of vital importance however that the industry be allowed to input into the agenda for these dialogues in order to give a sense of priorities from the perspective of European banks.

The globalization of capital markets and financial services, and the absence of truly international decision-making bodies, have resulted in global standard setters (such as for example the Basel Committee on Banking Supervision, the Financial Action Task Force on money laundering, the International Accounting Standards Board and the International Organisation of Securities Commissions) playing a very important role in policy making. The EU does not sufficiently speak with one voice in some of these fora. In certain cases, this may affect the ability of the EU to influence the content of the standards and therefore be contrary to European interests.

Given the different nature and role of these fora, ad hoc solutions should be preferred over a one-size-fits-all approach. Possible solutions could include, inter alia, a strengthening of the role of the Commission, and, in the accounting field, of the role of EFRAG, the European Financial Reporting Advisory Group. Once they are firmly established and have developed an

EU-centric view of policy, the Level 3 Lamfalussy Committees (CESR, CEBS and CEIOPS) could also play a role in some of these bodies (e.g. CESR in IOSCO).

I should emphasize however that issues as diverse as the membership, accountability, governance, financing and 'better regulation' practices of some of these bodies require further analysis as in some cases the situation is unclear, if not unsatisfactory.

The third and final element is to focus on better regulation.

The European Commission seems determined to follow a 'better regulation' approach. We welcome it and hope that all Directorate Generals will follow it. I shall not be elaborate on what 'better regulation' should encompass. Time is flying. Let me much just say that any proposal for regulatory action at European level should, in my view, be considered against the following tests:

- Subsidiarity
- Evidence-based policy making
- Proportionality
- EU's competitiveness
- Proper consultation
- Self-regulation (depending on the issues: for example payments)
- Quality over speed.

As we move into a post-FSAP environment, it is right that we take stock of what has been achieved and what our future priorities should be to complete the integration of European financial services into a Single Market. Legislators, consumers and industry are all responsible for ensuring that the priorities are the right ones and are handled in the most effective way.

We now have that opportunity to contribute towards making substantial progress in invigorating Europe's economy, reducing red tape, creating jobs and boosting, not just prosperity, but also confidence in the financial system for all Europeans. In other words, it is an opportunity to make real progress towards meeting the objectives the EU set itself when it established the Lisbon Agenda.

In financial services, the EU can make significant steps towards meeting the Lisbon goals by addressing a number of priorities either through targeted action or by letting the pan-European markets evolve on their own.

To recap, what needs to be done?

- Firstly, complete remaining FSAP measures and combine the best efforts of all the stakeholders to integrate the retail financial markets by proposing a fully harmonised consumer protection framework that provides customers with a high level of protection and relieves providers of excessive red tape.
- Secondly, address barriers to integration in the field of cross-border M&A and in VAT on financial services.
- Thirdly, allow for a regulatory pause in wholesale markets – with the possible exception of clearing and settlement.

How can we successfully achieve our goals? There are in my opinion three crucial elements which we all must work towards in the future:

- The overriding priority has to be to lay the foundations for the most efficient and effective supervisory arrangements for all European banks, both large and small. Without this our efforts to become the most dynamic and competitive financial sector in the world will be in vain.
- Secondly, we must never loose sight of the global dimension. It has never been as important to meaningfully engage with our global competitors and ensure that the EU speaks with a strong voice in international fora.
- Then we also must ensure that better regulation principles are followed.

These priorities are underpinned by the aim of encouraging depth, liquidity and dynamism in financial markets so as to enable capital and financial services to be channelled efficiently to all parts of the economy.

I believe that if we focus on the priorities I have suggested today, we pave the way for a stable, integrated and competitive financial sector thrive in Europe.

This is an opportunity too important to miss.