European
Banking
Federation

Report on Integration of European Financial Services Markets

Brussels, December 2007

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Foreword

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Established in 1960, the European Banking Federation (EBF) is the voice of the European Banking Sector which represents an estimated 5% of GDP of EU-27 and 1.5% of jobs. It plays an important role as an interlocutor for the EU institutions by representing the interests of over 5,000 banks in Europe, large and small, through its members, the national banking associations of the EU Member States, and Iceland, Norway, Switzerland and Liechtenstein. Together, its Members account for over 2.3 million employees and total assets of more than €30,000 billion.

In no area is the EBF's role more central than in the dynamic process of integrating financial markets in Europe. **A long-standing supporter of the gradual and pragmatic creation of a single financial services market in the EU, it works, in close cooperation with its membership and the European institutions, towards enabling banks to operate across Europe with the same ease as within their home country.** In pursuit of this objective, the EBF will seek to ensure that new regulatory actions comply with the better regulation principle, that existing laws facilitating the single financial market are implemented fully and consistently by the Member States, and that further financial integration is promoted by appropriate and sensitive rule-making and, most of all, through the efforts of the markets themselves.

This report on the Integration of European Financial Services Markets offers our recommendations on an efficient framework for the European banking sector's activities over the coming years, so that our members can play the fullest possible role in developing the economic potential of the European Union.

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Executive Summary

Executive Summary

The concept of economic integration – and financial market integration in particular – has with good reason been at the core of EU policy-making in recent decades. Integration is one of the main strategies for promoting economic and social development in the EU. Impressive progress has been made so far. Much success has already been achieved. A single financial area has been gradually moulded, beginning slowly with the early steps taken in the 1960s to abolish restrictions on the freedom of establishment and freedom to provide services, through the 1980s and 1990s which saw the Single European Act and the creation of Economic and Monetary Union. With the launch of the Financial Services Action Plan (FSAP) in 1999, a new, more dynamic phase of Community action began, since followed by the White Paper on Financial Services Policy 2005-2010 published two years ago.

A single market for wholesale financial services is close to reality, but it is widely recognised that the integration of important parts of the financial market, in particular retail finance is not yet complete. Furthermore, a number of factors are holding back further financial market integration. These shortcomings in the process towards further integration are having an impact not only on the sector's development but also on economic growth and consumers' welfare in the European Union.

Without a healthy, efficient and competitive banking sector the EU economy cannot thrive. Apart from its direct contribution to the economy, the banking sector facilitates economic activity by providing for the most efficient allocation of capital around the economy; and supplying financial liquidity and instruments to control and spread risk. Greater efficiency in this sector, when induced by integration of financial markets, has a multiplier effect. From the production side, it lowers operating costs for other parts of the economy, acting as a catalyst for economy-wide gains in growth and productivity. From the consumers' side, it improves the price, quality and variety of financial services available. The more flexible, competitive market place should allow each client, whether based in a city or a village community, entrepreneur or farmer, to benefit from a similarly broad range of appropriate and attractive services.

Integration is a driver for efficiency. Apart from its contribution to the economy as a whole, the banking industry has an autonomous and specific interest in the process towards further financial market integration. As profit-oriented organisations, for European banks, further integration should equate to further efficiency gains in a bank's value chain, which encompasses the production and support phase or "*back office*", and the phase of distribution to customers. In the production and support phase, the potential benefits of further integration lie broadly in achieving the lowest cost of producing a given output (economic efficiency) and in reaping economies of scale and scope associated with size. In the distribution phase, economies of scale (and scope) are

achieved because banks can supply a wide range of products to the same customer using the same technology and distribution channels.

Integration is a driver for competition. The integrated single market in financial services can be achieved through a number of business models, corporate structures or legal forms. A pluralistic banking market structure is an asset of the European financial market insofar as it offers business and consumers the possibility to opt for their preferred banking services provider. However, the respect for the diversity of banking services providers is subordinate to the need to ensure fair competition between different market participants along the principle of "*same business, same risks, same rules*". The result of competitive forces in a perfectly competitive environment, where each market participant is subject to pressure exerted by others - and therefore, it is not shielded from competition - will push firms to strive for economic efficiency.

Further integration is also a response to increased global competition. There is a clear need to promote the competitiveness of the EU financial services industry on the global scale. European banks operate in a truly global business environment, which requires that global competitive considerations become bigger drivers of integration policy. New EU regulation must always be framed with an eye to maintaining the international competitiveness of European banks. This external dimension of financial integration calls, paradoxically, for an internal precondition: the EU must ensure the regulatory framework is applied and enforced consistently EU-wide. Only if the quality of regulation and supervision can be guaranteed for all market segments and across the entire EU will the EU be able to put the advantages of EU financial market integration to work at a global level.

Further integration is urgently needed to give the banking system the means to deal with the challenges of the global business environment, including crises of confidence in the financial system. The increasing interconnectedness and sophistication of financial markets has transformed bank-customer relationships and created new challenges for risk assessment and prudential control. The current unsettled conditions on financial markets, triggered by the crisis in sub-prime mortgages in the US, have brought into relief the complexity of financial policy-making and the importance of maintaining investor confidence in the efficiency and safety of financial systems.

The report offers concrete proposals on some of the main challenges on the path to achieving integration. We identify eight priorities for action on the part of policy-makers and the financial services industry in their joint efforts to release the potential of the single market. The following "*Key Challenges*" are identified.

1. The removal of barriers to cross-border banking consolidation

Banking consolidation is one of the main avenues for banks seeking to improve their efficiency; update their technology and management skills, and improve their customer services. Consolidation encourages competition, which in itself tends to expand customer choice and value. Greater freedom for banks to operate around the entire EU will help to promote a vibrant financial sector, well able to compete on global markets.

So far, cross-border consolidation has been seen mainly in wholesale banking services and in defined geographic regions. The relatively low level of cross-border consolidation as compared to other business sectors still reflects remaining artificial and unjustified restrictions that are inhibiting normal economic and market processes.

Among the highest priorities for action are fiscal obstacles. The current rules for the taxation of investment income are a source of a range of potentially significant difficulties for cross-border operations: cumbersome procedures, which are not only costly but hinder the functioning of capital markets; fiscal discrimination against foreign products or services, which may make it difficult for cross-border groups to achieve synergies; withholding tax on interest in a business to business environment; and the taxation of dividends, which may significantly reduce the net return of individual EU investors in a cross-border operation.

Much work is also required to address obstacles arising from corporate taxation, in particular: the corporate tax cost applied to transfer pricing issues, which allows Member States to decide arbitrarily how much of the profit margin realised within a group is to be made subject to taxation within a given country; the lack of a common system of loss compensation across the EU, which leads to discrimination against cross-border operations; and the risk of double taxation in cross-border restructuring, resulting from differences in national regimes within the EU.

From a prudential perspective, the EBF stresses the need to overcome the legal shortcomings derived from national discretions contained in the CRD and diverging CRD implementations.

On the legal front, it is essential to achieve a targeted full harmonisation of civil-law rules to protect retail banking customers as this would facilitate banks' screening of national legal frameworks to identify areas where economies of scale or fixed-costs savings could be achieved. With regard to Company Law, the EU Regulation on the Societas Europea should be amended in regard to employee participation.

2. Advancing towards an integrated EU retail banking market

Integration in retail financial markets is limited and uneven, due partly to natural barriers such as differences in language and mentality, but also because of legislative differences among the EU Member States, in particular in the area of consumer protection. Fragmentation adds considerably to the cost of penetrating new markets by non-local institutions, and locally distributing financial products manufactured elsewhere. This has led to a loss of cost-efficiency for society as a whole.

Targeted full harmonisation[1] is the most effective means of creating a genuine European internal market for retail banking services. By this we mean the full harmonisation of key provisions which would foster cross-border competition and facilitate further integration. For the more residual/peripheral provisions and for provisions beyond the scope a Directive, the EBF recommends the use of mutual recognition as a tool to facilitate application by Member States of harmonised EU provisions while procuring progressive convergence.

Market-driven solutions should be preferred whenever possible. Nonetheless, the authorities will need to introduce or reassess regulation in certain areas, such as the legal framework for consumer credit.

In developing future European policy in the field of consumer protection, we urge the authorities to base themselves on actual as opposed to perceived needs of consumers and be grounded on appropriate principles-based legislation. The objective should be to reconcile the demand and supply sides and at the same time build consumer confidence. Policy should respect the principle of proportionality and be based on the assumption of an informed, reasonable consumer who takes his/her buying decisions confidently, while also bearing the financial consequences of his/her actions. In preparing the ground for consumer decisions, quality and not quantity of information, should be the objective. Standardisation of products should be avoided, so that banks can continue to cater to customers' individual needs and so as not to hamper product innovation and competition, but standardisation of some products' aspects, *e.g.* in the use of information sheets, is useful. Customised advice can be provided on request but without obligation, and a simple customer complaints system is desirable.

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[1] The term **Targeted Full Harmonisation** is a recognised concept already broadly used by the EBF and other important stakeholders such as the European Commission. It implies full harmonisation of key issues that are essential to foster cross-border competition. The notion of "targeted maximum harmonisation" in the sense that there is no discretion for the adoption by Member States of stricter rules that those which are covered by the specific pre-determined harmonised issues (and not in the meaning of an harmonisation at the highest standard) is also sometimes used for the same purpose.

3. Achieving a level playing field among different market participants

The EBF embraces the notion of free competition in the financial marketplace and as such does not aim to question the diversity of business models nor the specificities of different forms of organisation or incorporation open to different market players but it is imperative that there is the same level playing field for all kinds of institutions and that there is no distortion of competition.

With regard to other credit institutions, we recommend a closer examination of a number of issues, including: the lack of contestability of ownership, the existence of state support or guarantees to certain institutions on the basis of their law of incorporation, function or affiliation; the articulations in some Member States' laws and regulations on certain territorial limitations and name protection, which unduly complicate cross-border or cross-sectoral consolidation; and the possibility for a Member State to avail of consolidated rules for a particular banking group without fulfilling strict consolidation requirements.

With regard to non-bank market participants, the EBF considers that the current multiplicity of regulatory frameworks for payment service providers, in terms of competent national authorities, processes and instruments is an obstacle towards ensuring that all participants in the payment services chain are treated equally with regard to the risks they undertake.

4. Making consolidated prudential supervision work

Prudential supervision is at the forefront of policy discussions in the EU, all the more so following the recent market turbulence. The contagious effect of the difficulties in the US sub-prime lending market has demonstrated the importance of an EU-wide supervisory structure which can accurately assess and protect against risk, and respond appropriately in times of crisis.

In the drive for efficiency, financial institutions are more and more organised along European and/or worldwide business lines and functions. Supervisory structures and regulation, by contrast, still remain to a large extent segmented and are mainly nationally oriented. The lag in designing an adapted supervisory structure to accommodate the needs and concerns of an integrated banking industry is a matter of considerable concern.

Two developments have signalled an encouraging change of trend towards more consolidated supervisory decision-making mechanisms at group level: the adoption of the Lamfalussy process, which has brought about cooperation among the Member States' supervisory/regulatory authorities in the financial sector; and Article 129 of the CRD which has recognised the need to address the emergence of increasingly cross-border banking

activity by attributing to the home supervisor the responsibility for the evaluation of internal risk measurement systems of such banking groups with foreign subsidiaries.

Policy-makers' attention must now be focussed on two issues: (i) to what extent is consolidated supervision working, and (ii) whether the time is right for further evolution of the supervisory architecture in the European space, and what that further evolution could or should look like.

In our view, the model of consolidated supervision has not yet become a full reality at EU level because EU authorities have not reached a common understanding of how the concept of consolidated supervision could be made to work in practice. For that reason we believe that first, all EU authorities together with market participants should concentrate on pragmatic solutions. A case in point is action to overcome the legal shortcomings arising from the national discretions contained in the CRD and diverging CRD implementation. There are also a number of issues to be addressed regarding the practical implementation of the concept of the consolidating supervisor, in particular the trust-building capacity of national supervisors, the enforceability of the consolidating supervisor's decisions, and the concrete way in which delegation of supervisory tasks and responsibilities would be organised within the college of supervisors, having in mind accountability mechanisms and divergences of national supervisors' powers.

Then, there should be a debate and cost-benefit evaluation of possible deeper and longer-term structural changes to the supervisory framework. A future EU supervisory framework should embrace the key aspects of financial supervision and financial system stability. This will require it to cover Solvency II, deposit guarantee schemes, crisis management and the role of the ECB.

The EBF is preparing a special report dedicated to the examination of a selected number of potential models for the framework of prudential supervision. The report is expected to be released in spring 2008.

5. Implementing SEPA successfully

The Single Euro Payments Area (SEPA) is a highly significant step towards integration, helping the euro area draw full benefit from the single currency, and one which has been achieved by means of self-regulation and by the creation of an EU legal framework.

The arrival of SEPA will allow customers to make non-cash euro payments to any beneficiary located anywhere in the euro area using a single bank account and a single set of payment instruments. It is therefore introducing

changes necessary for the move towards a more integrated payments market. This will imply economic benefits after the period of investment and implementation, mostly for businesses and consumers. SEPA would be impossible without technological innovation, and its continuous advancement will help to automate most payments in the future and allow them to be treated electronically.

However, SEPA also poses challenges, and the European banking industry, which is responsible for restructuring the payment systems of the euro area, will have to successfully face these. In the first place, SEPA offers institutions the possibility to offer customers additional services. These business opportunities will come, nonetheless, at a considerable cost in the short term. Secondly, the success of the process requires the involvement and support of various stakeholders – in particular, on the part of public administrations in some Member States - whose interest will have to be aligned. Lastly, for SEPA to be successful, an effective level of harmonisation of the implementation of legal provisions in force in SEPA-countries is needed.

The EBF will carry on working to ensure that the financial industry is able to deliver the new SEPA instruments efficiently and on time.

6. Reforming the VAT treatment of financial services

The current VAT system, as it impacts financial services, is a major obstacle to financial integration.

1. It is not neutral. This restricts financial institutions' right to recover the VAT they have incurred on their own expenses. The lack of neutrality frustrates the efforts of financial institutions to implement business models where key support functions are standardized and centralised in centres of excellence.

2. The legislation is out of date. It has not been adapted to the massive developments in the financial services industry that have taken place over the last 30 years. This results in an unacceptable level of legal uncertainty, particularly in wholesale banking which is already truly international.

3. It creates an uneven playing field between traditional payment products and similar non-regulated products such as mobile-phone cards, as charges for payments made by banks are exempt from VAT and subject to a high level of regulation. Exemption of the charges for payments made by banks means that banks are unable to recover VAT on their costs.

4. There is uncertain and inconsistent application of a non-supply rule at the EU level enshrined in the VAT Directive. This rule provides that Member States may consider that no taxable supply takes place in the

event of a transfer of a totality of assets or part thereof, *i.e.* the transfer of a going concern. It is of critical importance for financial institutions, most of which have no or only a limited right to recover input VAT.

The EBF calls for a reform of the VAT treatment of financial services based on a modernisation of the language of the 6th VAT Directive; new provisions to enable related entities to perform intra-group transactions without levying VAT; and the introduction of an option to charge VAT on financial services.

7. Handling IFRS adequately

The EU decision to require all EU listed companies to report according to International Financial Reporting Standards (IFRS) from 2005 was a key milestone on the way to an integrated European (and global) financial market. The adoption of IFRS ensures transparency and comparability of company accounts.

Further steps are necessary if closer financial integration is to be achieved, both in terms of the scope of companies allowed to use the standards, and as far as the adoption of IFRS is concerned. It is also crucial that financial statements reflect the substance of the presented transactions and economic reality; and, in particular, that the specificities of European banks are recognised by the IASB and duly taken into consideration when adopting standards.

The EBF recommends that all EU members allow non-listed companies within group structures to use IFRS for the preparation of their statutory accounts. Furthermore, we call for IFRS to be of high quality and to reflect business models: in particular we are willing to see the "carve-out" used in Europe regarding interest margin hedge removed under certain conditions, and are working on solutions to improve hedge accounting rules. We recommend the European Commission and the Parliament to take steps to ensure that the endorsement process and adoption of IFRS is carried out swiftly and efficiently.

It is of crucial importance for the functioning of capital markets that investors can have confidence in the quality of the IFRS financial statements. This is important, in particular, in light of the IASB's envisaged initiative to measure all financial instruments at fair value. We will strongly argue against full fair value of financial instruments, as such a model overstates the extent to which instruments are held for trading or managed on a fair value basis within the business, and the extent to which deep and liquid markets exist. Recent financial events add weight to this recommendation.

On a more general note, we recommend the European Commission and the Parliament to ensure that the European influence in the international standard setting process at the level of the Board is strengthened.

8. Intensifying international cooperation

There is a clear link between the level of integration of the EU financial sector and the international competitiveness of the banking industry, as a deeper and wider marketplace offers banks the chance to attain the economic benefits enjoyed by competitors operating in a more integrated economic environment. EU cooperation with third countries both bilateral and at multilateral level, is crucial. Pressing issues for international cooperation are, among others:

- The reduction of barriers to the provision of banking and financial services on a global scale.
- The guarantee of a level playing field between financial institutions in different countries.
- Addressing the weaknesses of the international financial system.
- Meeting the challenges brought about by the globalisation of financial markets, for example, fast technological evolution, the emergence of new, dynamic capital markets (in particular China and India), the new approaches to financial services (*e.g.* Islamic finance) and the rising importance of private capital markets.

Among our policy recommendations, we ask the European Commission to: concentrate on the successful completion of the Doha Round of trade liberalisation, so as to attain an appropriate result in the services package commensurate to the importance of financial services for the European economy; to conclude meaningful Free Trade Agreements (FTAs) with selected jurisdictions to achieve the elimination of national legislation and standards regarded as discriminatory against EU banks; and to deepen existing financial regulatory dialogues. With particular reference to the EU-US dialogue, we believe that the recently agreed Framework for Advancing Transatlantic Economic Integration will provide a valuable forum where solutions to transatlantic regulatory issues can be sought, in particular applying the principle of mutual recognition.

We stress that the time has come for the EU to have a unified voice in the international arena. The speed of globalisation is accelerating while the importance of global standard setters (*e.g.* Basel Committee on Banking Supervision, IOSCO, Financial Action Task Force, IASB…) increases. The lack of sufficient European influence in these bodies could be already prejudicing the interests of European banks.

In conclusion, the EBF reasserts its staunch support for financial integration in Europe. Its guiding principles reflect this commitment. In particular, it plans to work towards the removal of barriers to the conduct of banking business in the EU single market; lobby at EU and international level in support of the free market and to ensure that European banks face a level playing field on EU and global markets; and support the banking industry's efforts to increase efficiency and improve customer service, so that consumers can have access to

competitively-priced banking services and European companies can compete as effectively as possible on world markets.

Motivated by this philosophy, the EBF calls on all relevant stakeholders to redouble their efforts to achieve the objectives of the Lisbon Agenda on time.

Guidance for readers

Guidance
for readers

Guidance for readers

The core of the report starts with an Introduction which explains what financial integration is and why it is important for the economy as a whole and to the banking industry in particular. Part 2 outlines eight Key Challenges still lying on the way to a closer integration of financial services and formulates the EBF position on each of them. The Key Challenges are:

i. Removing barriers to cross-border banking consolidation.
ii. Advancing towards an integrated retail banking market.
iii. Achieving a level playing field among different market participants.
iv. Making EU consolidated prudential supervision work.
v. Implementing SEPA successfully.
vi. Reforming the VAT treatment of financial services.
vii. Handling IFRS adequately.
viii. Intensifying international cooperation.

A summary table of our main recommendations for each Key Challenge is presented in the Annex.

Part 3.1, Policy and Regulatory Environment, lays out the problematic issues of the EU regulatory nature and puts forward recommendations on how to overcome them, as well as discusses the crucial aspects of transposition of EU policies at the national level. Part 3.2 reviews the Issue-Specific Measures at the EU level as of today. In particular, it focuses on problems arising from ongoing EU regulatory initiatives and deals with the inefficiencies that need to be tackled. Part 4 consists of a brief Conclusion to the report.

Part 1

Part 1 : Introduction

1. Introduction

Financial market integration: a deeply rooted idea with good reason

When retracing the economic history of the European Union it becomes clear that **the concept of economic integration – and financial markets integration in particular – is a beneficial process deeply rooted in all important political acts**. This concept emerges from the Treaty of Rome, is central in the Single European Act, and is one of foundations of the Lisbon Strategy, approved by the EU Council in March 2000 with the aim of making Europe "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".

Financial services are seen as fundamental to achieving the Lisbon goals:

> "*Only through an integrated and efficient European capital market will consumers and businesses alike reap the full benefits of the euro. Competitive financial markets will lead to increased choice and lower prices for consumers and investors, with appropriate levels of protection.*" (Barcelona Council, March 2002).

BOX 1: Milestones in the process of financial market integration:

1957	Treaty of Rome
1986	Single European Act
1988	Council Directive on the Liberalisation of Capital Movements
1989	Second Banking Directive: single passport for banks
1999	Monetary Union and start of the Financial Services Action Plan (FSAP)
2005	Completion of the FSAP
→ 2010	White Paper-Financial Services Policy 2005-2010

The creation of the single currency and the policy choices over the past five years (*e.g.* Prospectus Directive, MiFID, CRD) have accelerated the achievement of an integrated European capital market. A single market for wholesale financial services (*e.g.* interbank lending, government and corporate bonds, investment banking…) is close to reality, as some benefits from this process seem to confirm: lower funding cost for issuers, increased product range for investors, declining fees in the provision of investment banking services…

However, as a recent report published by the IMF[2] manifests, the integration of important parts of the financial market (*e.g.* clearing and settlement systems, securitisation and asset management and, specially, retail finance)

[2] See chapter 1 of "Integrating Europe's financial markets" by Jörg Decressin, Hamid Faruqee, and Wim Fonteyne. IMF (September 2007)

is not yet complete. The factors that hold back further financial market integration will be analysed in more detail in the "*Key Challenges*" part of the report.

The shortcomings in the process towards further integration have an impact on economic growth as some studies have signalled. For example, the aforementioned IMF report suggests[3] that underachievement by financial services accounted for half the gap in productivity growth between the euro area and the US between 1996 and 2003. A recent EC[4] report indicates that greater financial market integration would produce GDP and employment level increases of 1.1% and 0.5% respectively in the long run and a sustained increase in value-added growth in manufacturing by 0.8%-0.9% per year. The positive effects of financial integration are however not limited to economic gains. Another EC report has recently noted that the effects of financial integration via imposing discipline on macroeconomic policies and exposing domestic firms to competition of foreign entrants result in better government and corporate governance.

As evidence seems to demonstrate, integration of financial services is unquestionably welfare-enhancing at the macroeconomic level. As the ECB[5] has recently put it:

> "... *a well developed financial system enhances productivity by accelerating the speed of capital reallocation in the process of 'creative destruction'. The idea is that financial markets help to channel resources (mainly capital) from declining industries to firms, entrepreneurs and sectors with good growth prospects. So, financially well developed economies converge faster to the efficient production frontier and experience higher overall productivity growth, since capital is allocated to the sectors that earn higher returns*".

That helps explain why financial integration has progressively become one of the main political objectives at the top of the European Commission agenda and also why European banks are developing growth strategies to yield benefits at the micro level from fully integrated European financial markets.

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[3] Chapter 2, box 2.1 (see note 2)

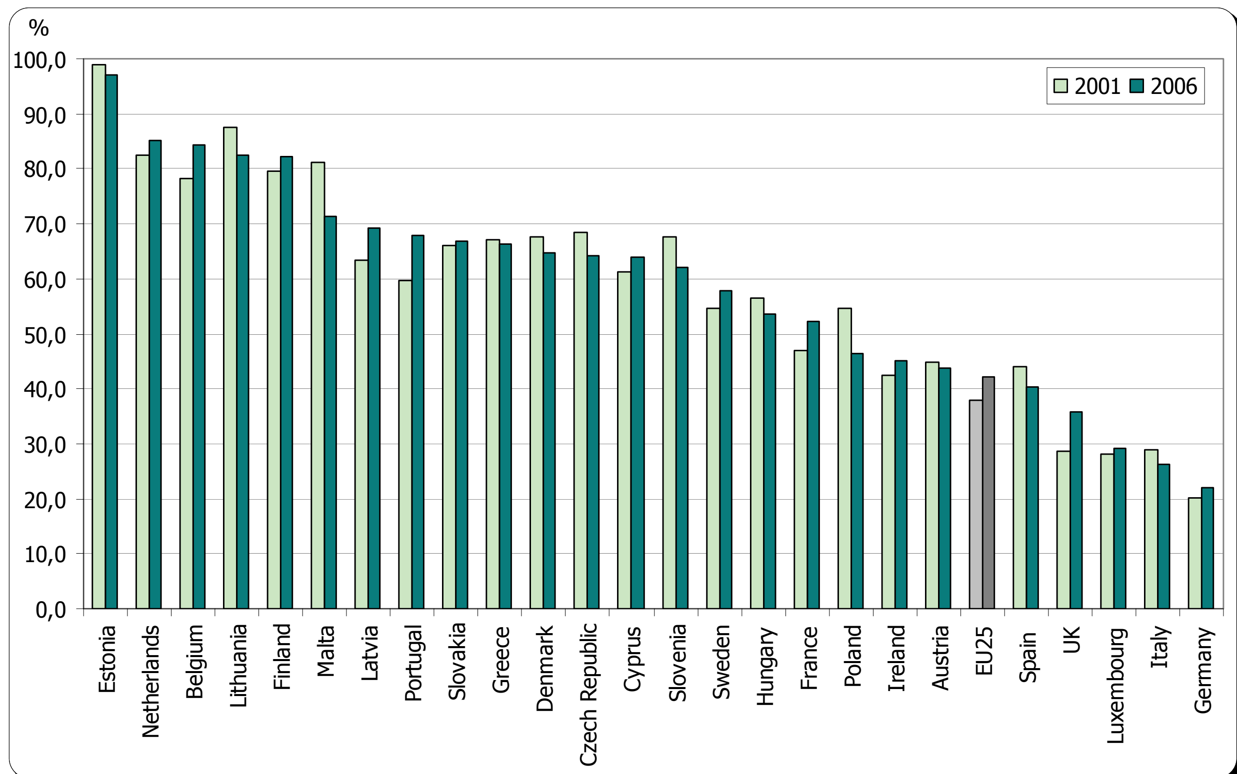
[4] EC Staff Working Document Accompanying document to the Communication from the EC "Raising productivity growth: key messages from the European Competitiveness Report 2007"

[5] ECB "The role of Financial Markets and Innovation in Productivity and Growth in Europe", Occasional Paper Series No 72, September 2007

Some figures: EU bank structure

The structure of the EU banking sector has changed rapidly in recent years. Consolidation at the national level has resulted in the number of banks in EU-25 falling by some 13% between 2001 and 2006. The concentration of assets among the main five banks has risen from 37.8% to 42.1% in the EU-25 over the same period[6] (see by-country breakdown in Figure 1)[7].

Figure 1: Market share of the 5 largest Credit Institutions (% of total assets)



In a parallel process, cross-border banking integration has quickly accelerated over the 10 past years. According to recent research[8], the volume of assets that banks hold in European countries other than that of their headquarters has nearly doubled over the mentioned period, from 13% to 24% (see Table 1).

[6] ECB "EU banking structures", October 2006 and 2007

[7] These figures experience a substantial increase in some European counties (*e.g.* Italy) when banking groups are considered.

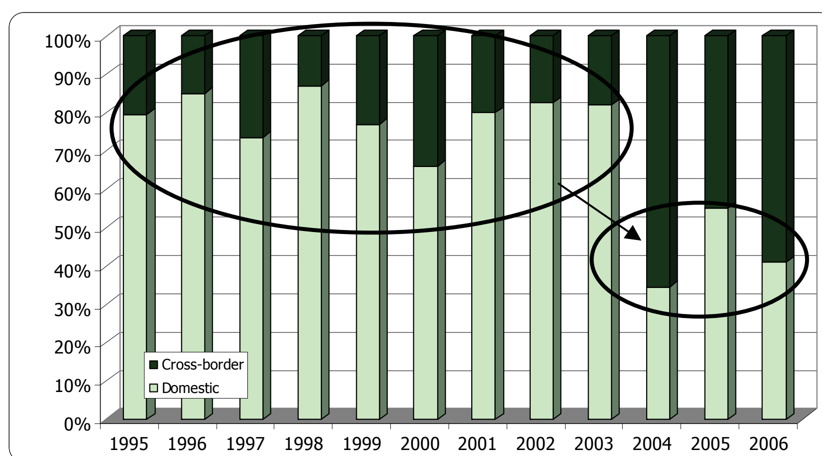
[8] "Is Europe ready for a major banking crisis?" by Nicolas Véron, Bruegel (August, 2007)

Table 1: The 15 Largest EU Banks' Assets Holdings

EU's 15 Largest listed banks (by decreasing order of market value)	Home Country	Assets in home country (1997)	Assets in the rest of Europe (1997)	Assets in home country (2006)	Assets in the rest of Europe (2006)
HSBC	UK	35%	4%	27%	12%
RBS	UK	81%	1%	68%	7%
Santander	ES	55%	8%	26%	58%
BNP Paribas	FR	53%	19%	58%	20%
ING	NL	55%	11%	23%	16%
UniCredit	IT	77%	17%	26%	70%
Barclays	UK	71%	8%	41%	20%
ABN Amro	NL	38%	15%	29%	43%
Intesa Sanpaolo	IT	70%	15%	84%	8%
BBVA	ES	85%	3%	61%	9%
Société Générale	FR	80%	7%	54%	27%
Deutsche Bank	DE	32%	35%	18%	47%
HBOS	UK	83%	8%	85%	9%
Crédit Agricole	FR	88%	3%	77%	13%
Lloyds TSB	UK	86%	5%	95%	2%
Average (unweighted)		66%	11%	51%	24%
Average (asset-weighted)		60%	13%	48%	24%

These data are corroborated by a recent analysis[9] that points out that from 2004 until 2006[10] a phase of intense cross-border consolidation vis-à-vis national concentration has been taking place.

Figure 2: M&A in European Financial Sector: Domestic vs. Cross-border



[9] "De financiële wereld in woelig water?", KBC Bank, October 2007

[10] The figure is deemed to rise also in 2007 owing to the ABN Amro operation

Despite this strong internationalization trend, the European banking industry is relatively domestic if compared to other industries. European banks are more concentrated on their "*home*" market than any other industry save telecoms and media. Only 27% of the European sales of the 22 largest banks in Europe take place outside their headquarters zone[11] (Table 2).

Table 2: Internationalisation and Europeanisation of industries' assets

Sectoral breakdown of Europe's top 100 listed companies	Average Europeanisation rate
Life sciences	84%
Consumer products & services	74%
Manufacturing and business services	66%
Oil, gas and mining	57%
Insurance	53%
Energy and water utilities	31%
Banking	27%
Telecoms and media	24%
Average *all* sectors	49%

Therefore, if the example of other major industries is to be followed, further cross-border consolidation and integration appears very likely. By underpinning this trend with sensible policies, and with the help of external developments (*i.e.* technological innovation), further cross-border banking consolidation will bring additional important economic benefits. As the Bruegel study points out:

> "*Pan-European banks provide a link between national financial systems and the highly efficient wholesale capital markets of London and smaller European hubs, as well as global capital markets. This has the potential to bring more dynamic financial development and a quicker spread of financial innovation, facilitate access to credit for consumers and entrepreneurial firms, and ultimately improve the ability of Europe's financial system to foster growth*"[12].

[11] Headquarters zone is identified with national borders but in some cases: UK & Ireland, Iberia, Benelux and the Nordic region

[12] "Is Europe ready for a major banking crisis?" page 4

The logic of further financial integration for the banking industry

a) Integration as a driver for efficiency: a value chain approach

Apart from aforementioned welfare-enhancing considerations for the economy as a whole, the banking industry has an autonomous and specific interest in the process towards further financial market integration. As profit-oriented organisations, European banks see financial market integration as an opportunity to realise efficiency gains in their value chain:

A banks' value chain encompasses:

- The production and support phase or "*back office*". This typically includes risk management, structural organization, payments, clearing and settlement and general prudential supervision. This stage of the value chain will generate and support trading and sales.

- The distribution phase. Trades and sales are made available to customers. Delivery and distribution are made possible through the freedom of establishment (*i.e.* branches and subsidiaries) and the freedom to provide services.

In the production and support phase, the potential benefits of further integration lie broadly in achieving the lowest cost of producing a given output (*i.e.* economic efficiency) and in reaping economies of scale and scope associated with size. The lowest cost of production is linked to the idea of "*centres of excellence*", where horizontal services (fixed cost) are provided to the different entities of the banking group[13]. Economies of scale take place if average production costs of a bank product declines as output of that product rises. At the same time, economies of scope exist when the cost of one bank producing several products (*i.e.* mortgages, insurance, securities trading…) is less than the costs of several specialised firms (*i.e.* mortgage lender, insurer, securities broker) producing the same bundle of products[14].

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[13] In a joint study, Morgan Stanley and Mercer Oliver Wyman "European Banking Consolidation" (February 2005) estimate that in banking, the share of fixed costs in the total costs rose from 10-15% in the early 1990s to around 25-30% today. More generally, cross-border groups tend to centrally manage decisions that invest the different elements of the value chain, such as risk, liquidity and asset-liability management, therefore avoiding costly duplication and achieving economies of scale at the organisational configuration level.

[14] Potential economies of scope arise whenever a significant fixed cost (information acquisition, staff, reputation…) can be shared across products and services.

In the distribution phase, economies of scale (and scope) are achieved because banks can supply a wide range of products to the same customer using the same technology and distribution channels.

The EU strategy for further financial integration will, therefore, be positive if:

- It removes the obstacles that limit a bank's ability to arrange the production of its services from an organisational point of view (negative integration).

- It creates the conditions for banks to generate economies of scale and scope by favouring the expansion of the products offered and the types of customers served (positive integration).

In other words, **further market integration should also be considered in the light of its impact on the value chain of banks**. Taking into account that each line of bank activity responds to a different value dynamic, financial integration needs to proceed on a pragmatic case-by-case approach, considering the particular obstacles and conditions associated to the production and supply of each specific product and the required tailored solutions.

Having regard to the previous considerations, European banks are making a series of policy recommendations for the further integration of financial markets looking at the value chain of their business. The table below provides selected examples of how those recommendations, included in the "*Key Challenges*" section, relate to the value chain:

Table 3: Selected examples of bank's business chain value extraction

Key Challenge[15]	Production phase	Distribution phase
Removing barriers to cross-border banking consolidation	The lack of a common system of loss compensation across the EU discriminates in favour of national-only activities and against cross-border operations, thus preventing efficiency gains.	
Advancing towards an integrated EU retail banking market	The targeted full harmonisation of the legal framework in the area of consumer protection would allow banks to reach out to more	To the extent that risks attached to alternative products or services are not perfectly correlated, economies of scope in risk management can be

[15] For the remaining two key challenges (*i.e.* on level playing field and international cooperation), we do not see efficiency gains as the primary driver for integration, despite the fact that these also come into the picture. For example, although international cooperation may give rise to market opportunities that eventually will generate economies of scale and scope, we think that international cooperation is primarily a key challenge because it will help put the advantages of an integrated EU market to work at the global level.

	customers, thus reaping economies of scale.	secured by banks that build up a diversified portfolio of services, products and countries.
Making consolidated prudential supervision work	Promoting banking supervision convergence would help avoid duplicated reporting requirements and high compliance cost.	
Implementing SEPA successfully	SEPA will promote the achievement of efficiency gains and cost savings through the use of one processing pipeline for standardised mass euro payments.	SEPA will offer banks the possibility to offer customers additional services (*e.g.* back office, processing, notifications and booking information, additional functionalities for specific products…) thus allowing entities to reap economies of scope.
Reforming the VAT treatment of financial services	The elimination of VAT on intra-group transactions would facilitate the creation of "centres of excellence", thus generating efficiency gains	Simple and transparent tax systems across borders will raise the number of potential customers and, therefore contribute to economies of scale.
Handling IFRS adequately	The application of a single set of globally accepted standards would eliminate the need for reconciliation, and consequently, reduce cost.	IFRS adoption will allow companies to reach out to a wider pool of investors (who are customers of financial information) and, consequently, reduce their funding cost.

b) Integration as a driver for competition: a level playing field

BOX 2: Synopsis of the ECB analysis of integration in the EU[16]

From the economic perspective, according to the ECB, there are three aspects that need to be kept in mind when assessing the expectations related to integration among different areas:

- Firstly, integration is independent of the financial structures within regions. Financial structures respond to the interaction of financial intermediaries channelling funds to and from households, governments and corporations. Integration is possible despite lack of convergence of financial structures.
- Secondly, frictions in the process of financial intermediation can persist after financial integration is completed. Several areas can be financially integrated as long as frictions affect these areas symmetrically.
- Thirdly, from the point of view of the demand and supply, full integration requires the same access to banks or trading, clearing and settlement platforms across the entire integrated area to all market participants. When a structure systematically discriminates against foreign investment opportunities due to *e.g.* national legal restrictions, then the area is not financially integrated.

In addition, the ECB study shows that the degree of integration varies greatly depending on the market segment and is correlated with the degree of integration of the underlying infrastructure. This analysis leads to the conclusion that **integration does not mean 'unification'**, but the harmonisation of certain aspects of financial intermediation.

Financial integration is the process of moving towards a single financial market. Players in the international debate, even market participants with close similarities, often have in mind different concepts to define financial integration. In this respect, we fully share the view recently expressed by the ECB on financial integration:

> "(…) *a market for a given set of financial instruments and/or services is integrated if all potential market participants with the same relevant characteristics: face a single set of rules when they decide to trade in those instruments and/or services, have*

equal access to the set of instruments and/or services, and are treated equally when they are active in the market"[16].

The ECB recognises that the integrated single market in financial services can be achieved through a number of business models, corporate structures or legal forms. The EBF is supportive of that view. For example, commercial banks can indeed pursue a multinational approach (*i.e.* with presence in different Member States, using whatever form: subsidiary, branch, joint venture…) or a true cross-border model (*i.e.* provision of services via internet). These channels should co-exist with domestic-only providers of financial services (*i.e.* small and local banks) and with other credit organisations (savings banks, cooperative banks) and even non-bank providers of banking services (*i.e.* money transfer operators) that do not necessarily follow the commercial bank business model. A pluralistic banking market structure is, therefore, an asset of the European financial market insofar as it offers business and consumers the possibility to opt for their preferred banking services provider.

In this respect, it is worth recalling that financial integration can also be advantageous for small banks and local banks, allowing them to strengthen a customer base already attracted to their individual business profiles and skills in areas such as innovation. A recent study[17] suggests that "*local financial development still matters*" and "*domestic financial institutions are likely to remain important in a financially integrated Europe and, more broadly, in a financially integrated world for the time to come*". This suggests that as the integration of financial markets increases, small-sized banks will have better opportunities – due to soft information - to finance firms not financed by large and international banks and, perhaps more importantly, will have new opportunities in terms of distribution of banking products of large banks. Furthermore, some important factors which have arisen in the last two decades – *i.e.* information and telecommunication technology, globalisation and outsourcing – help small and local banks to benefit from economies of scale and/or scope.

The respect for the diversity of banking services providers is, however, subordinate to the need to ensure fair competition between different market participants. Following the ECB definition, an integrated financial market only exists if "*market participants with the same relevant characteristics -therefore, not identical-* (…) *are treated equally*". Consequently, a fair level playing field according to the principle "same business, same risk, same rules" must be ensured.

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[16] Measuring Financial Integration in the Euro Area, ECB Occasional Paper Series N 14, (April 2004)

[17] L. Guiso, P. Sapienza and L. Zingales, "Does local financial development matter?" *The Quarterly Journal of Economics*, 2004

The result of competitive forces in a perfectly competitive environment, where each market participant is subject to pressure exerted by others - and therefore, it is not shielded from competition - will push firms to strive for economic efficiency. Following the rationale from the previous section, where the link between market integration and efficiency was spelled out, it is clear that ensuring a level playing field between different market participants helps the cause of financial market integration. European banks describe the items associated with this argument in the corresponding Key Challenge ("*Achieving a level playing field among different market participants*").

c) Further integration as a response to increased global competition

On top of the efficiency and level playing field dimensions, the European banking industry realises the need to promote the competitiveness of the EU financial services industry on the global scale. European banks operate in a truly global business environment. Global competitive considerations need to become bigger drivers of integration policy. New EU regulation must always be framed with an eye to maintaining the international competitiveness of European banks. In the face of continuing competitive challenges from the US and the emerging economies, it remains key that the EU:

- Adopts a regulatory framework that does not, in any way, disadvantage European banks in the international context;
- Helps remove barriers to open and competitive financial services worldwide;
- Cooperates effectively in the establishment of commonly agreed standards, based on evidence, designed to achieve results and set according to best practice;
- Ensures that European banks are not subject to the extraterritorial effects of other nation's financial rulemaking;
- Promotes similar approaches to financial regulation which, ultimately, allow for a mutual recognition of rules.

The external dimension of financial integration calls, paradoxically, for an internal precondition: the EU must ensure the regulatory framework is applied and enforced consistently EU-wide. Only if the quality of regulation and supervision can be guaranteed for all market segments and across the entire EU will the EU be able to put the advantages of EU financial market integration to work at a global level.

The Integration Report offers detailed policy recommendations for this item under the corresponding Key Challenge ("*Intensifying international cooperation*").

What do we need, in a nutshell, to go forward

The European banking industry has a vision for the integration of European financial markets. Policy in this area should aim to achieving the following results:

1. The production of financial services should be allowed in any country to allow a bank freedom to benefit from efficiency gains. Distribution should be allowed in any other country through all the possible channels (direct over the counter, through a financial intermediary, e-banking and other distribution systems) without hindrance or additional costs. Financial integration must make economic sense from the value chain perspective.

2. The prudential framework should be rationalised and the cost that it imposes on the financial system alleviated. In the light of the present challenges to financial stability, the re-examination of supervisory tools is not only economically rational but politically necessary.

3. The level playing field among different financial services providers has to be preserved as a guarantee for competition in the financial marketplace and increased efficiency gains.

4. The global competitiveness of European entities has to be maintained and that calls, closing the circle, for a quantitative and qualitative strengthening of the integration process.

BOX 3: Choice of policy tool

From a regulatory point of view, we are also concerned about the **policy tools** that need to be employed to realise our vision. In Part 3.1 of the report "Policy and regulatory environment", we consider the full range of policy instruments available (*i.e.* binding and non-binding decisions, "soft law" and even the decision not to act) and for each Key Challenge we have tried to set out our preferred kind of adopting instrument (if any) to better implement the suggested recommendations. Specific regulatory options will depend on the choice of authority or system that will be charged with the management of any given policy (*i.e.* the question of competence) and on the regulatory catalogue available to that authority (*i.e.* the question of applicable law).

In terms of legislation, we believe that better regulation is of key importance. Policies must be based on solid economic evidence and be subject to thorough impact assessments characterised by better methodological soundness, increased transparency, more cost-effectiveness and greater external oversight.

Part 2

Part 2 : Key Challenges

(i) Removing barriers to cross-border banking consolidation

Introduction

Banking consolidation is not a goal in itself: it is a means to promote banking efficiency; introduce new technology and management skills; and improve the price, quality and variety of products for the bank customer. Consolidation should encourage competition in banking services, which should further expand customer choice and value. Greater freedom for banks to respond to business opportunities across borders will help to make a reality of the single market and strengthen EU banks' ability to meet global competition.

The EBF believes that the fiscal aspects and obstacles impacting the efficient operation of cross-border entities need to be tackled as a matter of urgency.

So far, cross-border consolidation has been seen mainly in wholesale banking services and in defined geographic regions such as in the Benelux countries and in the Nordic-Baltic area. Despite some important transactions in the past few years, the relatively low level of cross-border consolidation as compared to other business sectors still reflects remaining artificial and unjustified restrictions that are inhibiting banks from achieving efficiency gains. We consider these restrictions to be either of direct nature *i.e.* they mainly influence the feasibility of an M&A transaction; or indirect, *i.e.* they mainly affect a transaction's efficiency after the M&A operation. Among the former, the particular restrictions on the legal ownership of some credit institutions in some EU members receive more attention under Key Challenge on "*Achieving a level playing field among different market participants*".

Called for by the EBF, the recent amendment of Article 19 of the CRD has been welcomed as a positive step towards removing the obstacles to the feasibility of cross-border M&A. It provides for clear criteria against which supervisors are to assess proposed cross-border M&A transactions within clear assessment timeframes with precise deadlines. National political interference and protectionist behaviour in M&A assessments should no longer be possible. In that respect, the EBF also welcomes that a review of the amending Directive's application has been provided in Article 5 (2007/44/EC) to evaluate whether its primary objectives have indeed been fulfilled.

With the exception of the legal ownership issue, the remaining challenge for national and European regulators in the short to medium term now lies in the removal of the obstacles that make cross-border mergers and acquisitions unprofitable. These obstacles are principally of a fiscal, prudential and legal nature.

Our position

The EBF believes that the fiscal aspects and obstacles impacting the efficient operation of cross-border entities need to be tackled as a matter of urgency. Remarks are made elsewhere in this report regarding the problem of the lack of VAT neutrality (see Key Challenge on "Reforming the VAT treatment of financial services"), which hinders attempts to achieve cost savings from consolidation.

The current rules for the taxation of investment income are a source of various difficulties for cross-border operations:

1. Domestic withholding of tax and transactions tax procedures. Cumbersome procedures hinder the functioning of capital markets and involve high compliance costs. The EBF welcomes existing debates *i.e.* Fiscal Compliance Expert Group (FISCO) on how these obstacles to "post trading" can be remedied.

2. Fiscal discrimination against foreign products or services. The EBF criticises the absence of any harmonisation of domestic rules, which leads to situations where it may be more difficult for a cross-border group to sell products or services in a Member State in which a discriminatory tax treatment is applied for foreign products or services. As a consequence, synergies will be more efficient for a domestic group than for a cross-border-group.

3. Withholding tax on interest in a business to business environment. The EBF recommends complete abolition of such taxes for intra EU lending.

4. Taxation on dividends. The EBF notes that economically justified cross-border operations may find resistance from individual shareholders located in Member States whose tax system may not absorb the foreign withholding tax on dividends or when the Member States apply a limited credit method, thus significantly reducing the net return of their EU investment.

Corporate taxation is another fiscal area where the current state of integration is not satisfactory and major improvements would be welcome, in particular, as regards:

1. The corporate tax cost pertaining to transfer pricing issues. Acceptance of arms-length transfer pricing is a critical factor when charges are made between different parts of a group, whether it be between companies within a group or between branches (usually referred to as "permanent establishments" in tax terminology) and head office. In the view of the EBF, it is critical that there should be a common approach to both interpreting the arms-length transfer pricing principle and a

measure of allocating taxable profits within and outside the EU. Cross border expansion of EU companies is hindered, if tax administrations of Member States may arbitrarily decide how much of the profit margin realised within a group is to be made subject to taxation within a given country.

2. Loss compensation. The lack of a common system of loss compensation across the EU (*e.g.* headquarters cannot reduce their taxable profits by settling losses incurred in subsidiaries and/or permanent establishments) discriminates in favour of national-only activities and against cross-border operations.

3. Double taxation. The EBF highlights the fact that the risk of double taxation in cross-border restructuring exists as an EU member may under certain circumstances impose an exit tax on the deferred tax on the (unrealised) capital gains on assets transferred, and also on the assets of a permanent establishment, which is located in another state. If the permanent establishment is located in the EU, a fictitious tax credit should be granted. However, the methods for crediting the foreign tax are quite restrictive in some EU members. Thus, unrealised capital gains are taxed in a number of cases.

From a prudential perspective, we stress the need to overcome the legal shortcomings derived from national discretions contained in the CRD and diverging CRD implementations.

EBF welcomes the Commission's communications of December 2006[18] to address the losses and exit tax issues.

The Commission is working on the development of a Common Consolidated Corporate Tax Base (CCCTB) with a view to enabling companies to follow the same rules for calculating the tax base for all their EU-wide activities. The business environment in general would only accept the introduction of such regime if it would be optional for the tax payer.

As regards financial services specifically, a lot of work still remains to be done if a workable regime is to be achieved. Consequently, it is probable that the Commission would look at the financial services sector separately. EBF is committed to working very closely with the Commission to ensure that European banks perspective with all its specificities is appropriately covered and that the European finance industry's interests are well represented and addressed in the final report.

[18] COM(2006) 825 on Exit taxation and the need for co-ordination of Member States' tax policies and COM(2006) 824 on Tax Treatment of Losses in Cross-Border Situations

From a prudential perspective, we stress the need to **overcome the legal shortcomings derived from national discretions contained in the CRD and diverging CRD implementations** (see Key Challenge on "*Making consolidated prudential supervision work*"). An inadequate harmonisation of banking supervisory rules across the EU means that entities planning a cross-border operation will face wide-ranging and costly adaptation of business processes pertaining to the part of the business not located in the home jurisdiction, which would give rise to onerous reporting requirements and costly IT adaptations.

On the legal front, it is essential to achieve a targeted **full harmonisation of civil-law rules to protect retail banking customers** at the right level between appropriate customer protection standards and legal standards built on customer responsibility and contractual freedom existing elsewhere (see Key Challenge on "*Advancing towards an integrated retail banking market*"). Full harmonisation of key elements would facilitate banks' screening of national legal frameworks to identify areas where economies of scale or fixed-cost savings could be achieved. We also recommend a broader alignment of civil law and contract law in the European space which would permit banks operating across borders to standardise business processes and to enforce claims arising from cross-border contracts more cheaply.

With regard to **company law**, progress has been made with the cross-border mergers directive (10th Company Directive) and the European Company (Societas Europea – SE) regulation and related directive, but it is insufficient. The "employee participation compromise" found for the SE in particular cannot serve as a model, as it failed to achieve the aim of a level playing field (for example, German companies, due to their "*equal representation*" model, are unlikely to be welcome as partners in a SE). We recommend this unsatisfactory state of affairs should be rectified by an appropriate **amendment of the EU Regulation on the SE**, and the directive supplementing it, in regard to employee participation or, alternatively, by adapting national laws and provisions that leave without effect "*true cross-border mergers*" as envisaged by the SE regulation. As the 10th Company Directive is based on the negotiating model of the SE Directive, and therefore, does not resolve the issue of co-determination – in particular when more than one third of employees previously enjoyed the right of representation at board level, the EBF encourages Member States to adapt their own provisions to raise this threshold and also to remove unnecessary barriers to cross-border mergers.

(ii) Advancing towards an integrated EU retail banking market

Introduction

According to the European Commission[19], retail banking accounts for more than half of all banking in the EU, generating 2% of European gross domestic product. The integration of retail financial services does not seem to have reached its full potential yet. Various indicators provide this evidence:

- Still wide price differences in retail banking products, despite signs of convergence in mortgage loans.
- Fragmented market structure, with only few foreign banks having already achieved pan-European consolidation operations and/or penetration of national markets.
- Low level of cross-border transactions. For instance, while 26% of consumers currently buy financial services in their home countries over the phone or internet, only 1% of EU consumers do so cross-border.

Apart from natural barriers such as differences in language and mentality, European retail banking markets are fragmented due to legislative differences among the EU Member States, in particular in the area of consumer protection. Fragmentation has made both market penetration by non-local financial services institutions and local distribution of financial products manufactured elsewhere, very costly. This has led to a loss of cost-efficiency for society as a whole.

The EBF recommends targeted full harmonisation as the most effective means of creating a genuine European internal market for retail banking services.

Further integration in retail banking services would promote competition and enable the industry to achieve efficiency gains, triggering cost reductions that would be passed onto the consumer. By increasing the number of providers in each Member State, choice would rise, costs would fall and citizens would feel the benefit of a single European market. Integration of retail banking markets would therefore deliver economic and social benefits in line with the Lisbon strategy and would also increase the international competitiveness of EU markets.

[19] Green Paper on Retail Financial Services, EC, 2007

Our position

First, the EBF considers that it is time to make progress in the integration of retail banking, to the benefit of consumers and businesses alike. The removal of various legal and regulatory obstacles to the provision of cross-border retail banking services, in particular the inadequate harmonisation of consumer protection laws, will facilitate such integration.

The EBF recommends targeted full harmonisation as the most effective means of creating a genuine European internal market for retail banking services. By this we mean the full harmonisation of key provisions which would foster cross-border competition and facilitate further integration. For the more residual/peripheral provisions and for provisions beyond the scope of a Directive, the EBF recommends the use of mutual recognition as a tool to facilitate application by Member States of harmonised EU provisions while procuring progressive convergence.

Secondly, we think that priority should be given as much as possible to market driven solutions, recognising the merits of self–regulation. Further legislation will not as such bring about more cross-border integration. Moreover, the European banks are already actively and heavily involved in structural reforms of the banking environment.

Thirdly, we believe that, in addition to addressing the problem of inadequate harmonisation of consumer protection laws (see next paragraph), the priorities for action should be the achievement of:

- a well-balanced legal framework for consumer credit;
- non-discriminatory access to credit data registers;
- easier cross-border opening of bank accounts by removing unnecessary barriers related to AML rules and improving information to consumers about AML requirements;
- a review of the Directive on the distance marketing of financial services;
- an evaluation and possible review of the Directives on e-commerce and e-signatures; and
- withdrawal of the proposed Article 5 of the Rome I proposal for a regulation. (For further information, please go to section 3.2.5 on “Retail markets”.)

Fourthly, we recommend that any future European policy in the field of consumer protection be based on actual as opposed to perceived needs of consumers and be grounded on appropriate principles-based legislation. The EBF therefore encourages the EU legislator to focus on conducting empirical research into consumers’ genuine needs and building on this to identify which measures are appropriate. The objective should be to reconcile the demand and supply sides and at the same time build consumer confidence.

European policy on consumer protection should be based on uniform guiding principles including the following:

1. Proportionality and the better regulation approach. Voluntary and market-oriented measures (self-regulation, which may operate at either national level or EU level) may be preferable to legal provisions when possible. Measures should only be pursued where there is evidence of clear and concrete benefits for citizens and industry as well as a strong economic rationale.

2. Reasonable consumers. EU measures should be based on the assumption of an informed, reasonable consumer who takes his/her buying decisions confidently, while also bearing the financial consequences of his/her actions.

3. Quality and not quantity of information. Consumers' decisions should be based on meaningful, not over-abundant information. The EBF therefore supports a thorough review of information requirements.

4. Avoid standardisation of products. European banks do not support product uniformity as this would make it impossible to continue to cater to customers' individual needs and would surely hamper product innovation and competition at large. We favour, however, standardisation of some products' aspects. For instance, as regards information provision, the use of standardised sheets, such as the ESIS sheet for mortgage credit, has great potential for improving consumers' understanding and the comparability of products and services.

5. Customised advice on request but without obligation. Banks cannot be obliged to provide advice. Consumers should receive advice tailored to their personal needs only upon request. Unlike mere product information, advice is a banking service on its own, which banks should be able to offer at a price, according to their business concept.

Any future European policy in the field of consumer protection should be based on actual as opposed to perceived needs of consumers and be grounded on appropriate principles-based legislation.

6. Simple customer complaints system. Both financial services institutions and customers would benefit from a simple and efficient system of settling disputes between them. When looking at this issue, we recommend that the Commission takes into account existing redress mechanisms in Member States, including those at sectoral levels.

Lastly, we want to emphasise that targeted full harmonisation will not provide by itself the level of confidence that European consumers need to make the right choices. Further efforts are required to ensure that consumers are confident and enjoy the

same rights, regardless of the location of the financial institution and of the selling mode chosen. We call on the public authorities, in cooperation with financial institutions, to develop initiatives to improve the financial education of the public.

(iii) Achieving a level playing field among different market participants

Introduction

a) With regard to other credit institutions

Considering the historic roots of banking institutions in Europe (private commercial banks, banking cooperatives and public sector credit institutions), the original banking harmonisation directives deliberately chose for a wide scope to the definition of a bank to simplify the European financial institutions' landscape and to create the same competitive conditions for all. In that respect, European legislation aimed at creating equivalent conditions irrespective of institutions' legal forms for the exercise of banking activities in Europe, thus putting into practice what the European Central Bank (ECB) has come to define as one of the indicators for a fully integrated market *i.e.* that all potential markets participants are "treated equally when they operate in the market" (see "*Introduction*", page 20).

The EBF believes that the principle "same business, same risks, same rules" must be applied among all market participants.

b) With regard to non-bank market participants

On a different but similar line of concern, as regards the maintenance of the level playing field among different market participants, we notice the incorporation to the payments business of institutions that do not hold a banking license. This is not in itself a matter of concern, as they are rightfully exploiting a market opportunity granted by the recent approval of the Payment Services Directive (PSD). The EBF welcomes competition. However, the EBF acknowledges that diversified players in the payments business pose new risks, such as operational risk, security threats, fraud, and possible legal risk from merchant disputes. Also new intermediation channels and new system interdependencies should be accounted for from a systemic risk perspective.

Our position

The EBF embraces the notion of free **competition** in the financial marketplace and as such does not aim to question the diversity of business models nor the specificities of different forms of organisation or incorporation open to different market players. But it is imperative that there is the **same level playing field** for all kinds of institutions and that there is no distortion of competition.

The EBF underlines that the conditions under which different market players are in **competition** with each other in a variety of fields must ensure a level playing field in the European banking landscape, irrespective of their legal nature. The EBF believes that the principle "*same business, same risks, same rules*" must be applied among all

market participants. To this end the EBF highlights the following issues:

a) With regard to other credit institutions

1. **Institution's legal form / Public (*i.e.* state) ownership.** In competition terms this issue relates to the contestability of ownership. In some countries public banks cannot be acquired by an interested buyer and this isolates them from the pressure of a competitive market mechanism. In Germany this protection has been enshrined in the Federal banking legislation whereby the savings banks' independent local institutions and/or their central organisations are excluded from the outset from (unfettered) mergers with or acquisitions by other banks - be they of domestic or European origin. This should include the difficulty, if not outright ban, on selling off entities from within the publicly owned credit organisations (This remark is to be seen in conjunction with our comments under Key Challenge on "*Removing barriers to cross-border banking consolidation*").

   In other countries, the ownership of quotas of certain kinds of cooperative banks is subject to a number of limitations, thus escaping from competition mechanisms. In Italy, mergers of small cooperative banks resulting in a bank of a different legal form can be authorized but only on limited grounds.

2. **State support or guarantees**. In some countries certain banking institutions benefit from State support or guarantees on the basis of their law of incorporation, function (*i.e.* social or societal) or affiliation to particular deposit guarantee schemes.

3. **Territorial limitations and name protection.** In some countries restrictions on the use of a specific denomination are in force. In Germany, Section 40 of the Banking Act stipulates that only public-sector banks can use name "*Sparkasse*". The agreement reached between the European Commission and the regional government for Berlin, whereby any potential acquirer of the troubled Berliner Sparkasse may freely use the name "*Sparkasse*" in the future should not be unduly restricted and allowed to cover all future privatisations of savings banks; this unduly complicates cross-border or cross-sectoral consolidation (through mergers and acquisitions[20]).

4. **Prudential regulation.** In some Member States (*e.g.* in the case of Austria for savings banks) **decentralised banking groups are allowed to avail themselves of consolidated rules without fulfilling strict consolidation requirements** by leaving it to the respective competent authority to determine that certain

[20] See also EBF's Survey on Obstacles to Cross-border Mergers and Acquisitions in the Financial Sector, June 2005.

contractual relations over a mutual support mechanism ("*Haftungsverbund*") can constitute the necessary "*capital ties*" under the CRD. Therefore decentralised groups can dispense with the acquisition costs of consolidation that vertical groups must absorb.

In the context of the Capital Requirements Directive (CRD) banking groups that do not fulfil requirements of Article 3 and thus do not constitute a parent/subsidiary relationship, in other words a decentralised group, were granted the same rights in respect of the weighting of intra-group exposures as a vertical concern (within the same Member State). The fulfilment of the necessary requirements, *i.e.* the joint and several liability within the group including the strength of the membership of their sector's institutional protection scheme, the monitoring of collective solvency and liquidity and the capacity for central management to issue instructions should be ensured in order to be seen as a single unit for prudential purposes. The 0% risk weight results in the decentralised groups concerned no longer having to set aside capital against inter-bank transactions with other institutions in their sector.

b) With regard to non-bank market participants

The EBF thinks that the current multiplicity of regulatory frameworks for payment service providers, in terms of competent national authorities, processes and instruments is an obstacle towards ensuring that all participants in the payment services chain are treated equally with regard to the risks they undertake.

The EBF believes that in the process of developing adequate risk mitigation standards, credit institutions have, therefore, a legitimate expectation that new market entrants will be subject to a similar or equal regulatory environment for payment functions. We note that a lighter regulatory regime for new entrants vis-à-vis credit institutions can pose threats in creating divergence in compliance with anti-money laundering rules and anti terrorist rules.

In particular, we urge central banks and regulators to rigorously monitor that the entry of new competitors in the payments business occurs under conditions that do not compromise the data protection, governance, safety and public confidence that are traditionally associated with the banking industry.

(iv) Making consolidated prudential supervision work

Introduction

Prudential supervision is at the forefront of policy discussions in the EU, all the more so following the recent market turbulence. While there is currently no clear political consensus as to what and how to change within the existing institutional set-up, EU institutions agree on the urgency of achieving an appropriate regime for prudential supervision.

We believe that, in order to achieve day-to-day progress in convergence of supervisory practices, we should concentrate on pragmatic solutions.

Financial institutions are, for the sake of efficiency, more and more organised along European and/or worldwide business lines and functions, thus crossing the jurisdictional boundaries of a group's individual operating vehicles. Today, 16 European banking groups hold 38% of their assets outside their home countries.[21] Supervisory structures and regulation, by contrast, still remain to a large extent segmented and are mainly nationally oriented. As a result, the desired harmonised framework is at best an illusion, due to the plethora of national options and interpretations left to Member States, or in the worst case, amounts to little more than an alignment with the strictest requirements. The lag in designing an adapted supervisory structure to accommodate the needs and concerns of an integrated banking industry is a matter of considerable concern. In particular, the contagious effect of the difficulties in the US subprime lending market has demonstrated the importance of EU-wide supervisory structures which can accurately assess and protect against risk, and respond appropriately in times of crisis.

Two developments have signalled an encouraging change of trend.

In the first place, the adoption of the Lamfalussy process, which has brought about an institutionalised cooperation among the Member States' supervisory/regulatory authorities in the financial sector (*i.e.* CEBS, CESR and CEIOPS) with a view to fostering supervisory convergence.

Secondly, Article 129 of the Capital Requirements Directive (CRD) has recognised the need to address the emergence of increasingly cross-border banking activity by attributing to the home supervisor the responsibility for the evaluation of internal risk measurement systems of such banking groups with foreign subsidiaries *i.e.* consolidated supervision.

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[21] ECB (2007), J.C. Trichet keynote speech at the first CEBS conference in London, 9 May 2007

This departure from the principle of single entity supervision towards more consolidated supervisory decision-making mechanisms at group level – both at the European and national levels – poses two main questions which should be further discussed at EU level: (i) to what extent is consolidated supervision working; and (ii) whether the time is right for further evolution of the supervisory architecture in the European space and what that further evolution could or should look like.

A future EU supervisory framework should cover key aspects of financial supervision and financial system stability such as Solvency II, deposit guarantee schemes, crisis management and the role of the ECB.

A supervisory system which cannot keep pace with market developments at the very least results in higher cost in terms of work duplication and co-ordination of compliance and reporting duties with all the different competent authorities involved. Making consolidated supervision work is therefore a crucial first step towards bringing supervisory convergence to fruition and thus to securing the benefits of deeper financial integration, particularly in the case of institutions with cross-border ambitions, as well as to ensuring security and stability in financial markets. The EBF acknowledges that deeper financial integration must be combined with improving the arrangements that underpin financial stability.

Our position

Although important steps have been taken to enable greater integration with the adoption of the CRD and the Lamfalussy process providing an important platform for implementation convergence at CEBS, the supervisory framework remains fragmented.

The aim should be to arrive at a supervisory framework that would permit banks in Europe - be they small, mid-sized or large, cross-border or domestic in scope - to be supervised in a consistent and coherent manner irrespective of the organisation of the European supervisory framework. The prime objective of supervisory convergence work should be to remove undue differences in regulatory practices which hinder the implementation of consistent regulatory approaches across Europe resulting in very heavy administrative burdens for institutions.

The EBF regrets that, practically speaking, the model of consolidated supervision *i.e.* a consolidating supervisor[22] coordinating and validating the work of, and advised by, a college of supervisors[23] has not yet become a full reality at EU

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[22] Usually the home supervisor of the parent company

[23] Colleges would be composed of host supervisors and be the forum where host supervisors' interests and responsibilities could be duly taken into account through cooperation and exchange of views by the

level (some colleges are already in place and others are being set up among the EU). We believe that all EU authorities should reach a common understanding of how the concept of consolidated supervision could be made to work in practice.

Secondly, although any amendment to achieve greater convergence could create additional cost and restructuring burdens for the industry, we believe that, in order to achieve day-to-day progress in convergence of supervisory practices, we should concentrate on pragmatic solutions. The following suggestions could go some way to improve the (sub-optimal) functioning of the current supervisory arrangements.

- We support the thorough assessment of the CRD's implementation being conducted in the near future in order to propose innovative steps to overcome the legal shortcomings arising from the national discretions contained in the CRD and diverging CRD implementation. With more political impetus, this may lead to improvements to CEBS' functioning and decision-making processes that could in turn stimulate greater supervisory convergence. Additionally, the proposals made by CEBS' operational networking platform could promote convergence as they contain a number of fields in which workable solutions can and should be achieved in the short term.

- We support the action of CEBS and the European Commission to put pressure on countries that have so far not yet thoroughly fulfilled their legal disclosure responsibilities as required by CEBS' disclosure framework.

- We support the mediation mechanism for CEBS (and CEIOPS) to be put in place by January 2008, as advocated by the FSC and implemented by CEBS[24]. We expect that the mere existence of the process will act as an incentive for supervisors to cooperate and strive for convergence. Used as a last resort, it will facilitate dialogue amongst supervisors and reduce the scope for regulatory arbitrage.

- We recommend the establishment of truly common formats for reporting requirements to overcome the discrepancies noted in the present CoRep and the increase of data sharing among supervisors. Meanwhile, extending the role of the consolidating supervisor in Article 129(2) of the CRD to cover reporting requirements would reduce inefficiencies and additional costs related to multiple reporting standards with which cross-border banking groups are faced.

- We recommend that European cooperation and convergence be explicitly defined as a

consolidating/home supervisor in its coordination and validation work.

[24] CEBS' mediation mechanism entered into force on 25th September 2007

major requirement in the national supervisory authorities' legal mission statement. The lack of visibility of the European dimension of national supervisors' work appears indeed as one of the reasons for CEBS' members' insufficient commitment to apply standards and guidelines developed by CEBS to achieve more convergence of supervisory practices.

- We recommend that, pursuant to Article 131 of the CRD, supervisors sign a Memorandum of Understanding, whereby they commit to comply with decisions made at the CEBS level and, if not, duly explain and justify why they did not. This should also apply to the outcomes of the CEBS mediation procedures. Coupled with detailed disclosure, peer pressure would most probably create a positive incentive for supervisors not to implement diverging local rules.

Thirdly, there are a number of outstanding questions which need to be addressed regarding the practical implementation of the concept of the consolidating supervisor, in particular:

- The trust-building capacity of national supervisors. Strong commitments from supervisors to comply with cooperation and decision-making procedures is central to permitting trust to emerge and grow within the supervisory community, which could subsequently facilitate the consistent application of colleges' decisions in all the Member States concerned as well as the organization of the delegation of supervisory tasks mentioned earlier.

- The enforceability of the consolidating supervisor's decisions. This concept involves an element of surrender of sovereignty given that an administrative act issued by the consolidating supervisor would apply across borders. Time would need to demonstrate whether the cumulative association of written arrangements, peer pressure, unequivocal reference to the EU dimension of supervisors' tasks and the elimination of burdensome regulatory practices can remedy the lack of legal obligations behind written arrangements.

- The concrete way in which delegation of supervisory tasks and responsibilities would be organised within the college of supervisors. The FSC recommendation to CEBS to explore whether guidelines could be drafted to help develop arrangements for delegation of tasks is encouraging but it may not be sufficient to allow for a true delegation framework. This is due to (i) the non-binding nature of such guidelines, (ii) the low level of trust amongst the supervisory community, (iii) the unresolved debate on the legal basis of consolidated supervision decisions at national level, and (iv) the lack of assurance that supervisory decisions made by the college would be consistently applied in the respective jurisdictions of the college's members.

Lastly, we feel that once sufficient experience on how the current framework meets the requirements is available, a debate and cost-benefit assessment on the deeper and longer-term structural changes to the supervisory framework should be launched. A future EU supervisory framework should cover key aspects of financial supervision and financial system stability such as Solvency II, deposit guarantee schemes, crisis management and the role of the ECB. We also feel that the EU institutions should give priority to clarifying the legal framework within which national authorities can coordinate and act with a European "*reflex*" on matters ranging from exchange of information through to crisis management.

The EBF is preparing a special report dedicated to the examination of a selected number of potential models for the framework of prudential supervision. The report is expected to be released in spring 2008.

The EBF is preparing a special report dedicated to the examination of a selected number of potential models for the framework of prudential supervision. This examination aims at providing precise definitions of the concepts under scrutiny, at assessing their implications for the banking system and at indicating their legal and political impact. The report is expected to be released in spring 2008.

(v) Implementing SEPA successfully

Introduction

The Single Euro Payments Area (SEPA) is a great step on the road to integration, helping the euro area draw full benefit from the single currency. It also represents a self-regulatory initiative supported by the creation of an EU legal framework.

Before SEPA, retail payments were processed differently throughout the euro area in terms of payment instruments, standards and processing infrastructures. In such an environment, companies with a substantial number of cross-border payments had to maintain bank accounts in many of the countries in which they did business, in order to allow them to manage their payments. This fragmented market led to low service levels, inefficient products and a lack of cheap alternatives for making payments.

Nevertheless, more and more innovative payment instruments that are being introduced use new information and telecommunication technologies that were previously not available for payment purposes. E-banking is part of this development, and when it becomes more common, banks will also provide other banking services payments through the Web. In the future, consumers and companies will deal with the majority of their transactions with banks and authorities electronically, independently of both the medium and the time. With Europe's ageing population, and consequent reduction of the labour force, it is important for the banking sector to automate payments procedures, hence achieving considerable savings in administration and raising competitiveness.

The EBF will carry on working to ensure that the financial industry is able to deliver the new SEPA instruments efficiently and on time.

In this regard, the arrival of SEPA is very helpful because it allows customers to make non-cash euro payments to any beneficiary located anywhere in the euro area using a single bank account and a single set of payment instruments. SEPA is therefore introducing changes necessary for the move towards a more integrated payments market. This will imply economic benefits after the period of investment and implementation, mostly for businesses and consumers.

However, SEPA also poses challenges, and the European banking industry, which is responsible for restructuring the payment systems of the euro area, will have to successfully face these. In the first place, SEPA offers institutions the possibility to offer customers additional services. These business opportunities will come,

nonetheless, at a considerable cost in the short term. Secondly, the success of the process requires the involvement and support of various stakeholders whose interest will have to be aligned. Lastly, for SEPA to be successful, an effective level of harmonisation of the implementation of legal provisions in force in SEPA-countries is needed, as well as solid ground regarding the relevant provisions of the law applicable to contractual relations with consumers (Article 5, Rome I).

Some remarks pertaining to the entrance of non-bank entities in the payments business are made under the Key Challenge on "*Achieving a level playing field among different market participants*".

Our position

The EBF will carry on working to ensure that the financial industry is able to deliver the new SEPA instruments efficiently and on time.

Once the new SEPA instruments become available, in order to ensure their wide adoption **we recommend that the current lack of commitment and support from public administrations to SEPA be reversed**. As of today, around 50% of euro area GDP is channelled through the public sector. We will therefore maintain our dialogue and communication with government departments. Public endorsement of the new framework is also vital if possible initial resistance to the changeover to SEPA from retail customers (*i.e.* replacement of bank account identifiers, changes to the layout of forms…) is to be overcome.

The EBF also recommends that for the successful roll-out of products and services by banks based on the SEPA Direct Debit Schemes, **SEPA countries implement a common legal framework for payments** and, in particular, ensure a consistent interpretation and transposition into national law of the Payments Service Directive.

On a separate thread, we are concerned by the recent positions expressed by the European Commission seemingly putting into question **the principle of interchange fees which underlie the business model** on which most cards transactions in Europe are based. In this respect, we recommend prudence as we see no apparent merit in reforming a system that has made card payments an alternative to cash which is considered to be more costly for all stakeholders (card holders, merchants and banks).

(vi) Reforming the VAT treatment of financial services

Introduction

The current VAT system, as it impacts financial services, is considered today a major obstacle to financial integration for a number of reasons:

1. It is not neutral. This restricts financial institutions' right to recover the VAT they have incurred on their own expenses. The lack of neutrality frustrates the efforts of financial institutions to implement business models where key support functions are standardized and centralised in centres of excellence.

2. VAT legislation, which includes definitions of financial services, is outdated. Although the 6th VAT Directive (1977) was recast in 2006 (2006/112/ECI), it was not adapted to the massive developments in the financial services industry that have taken place over the last 30 years. This results in an unacceptable level of legal uncertainty, particularly in wholesale banking which is already truly international.

3. It creates an uneven playing field between traditional payment products and similar non-regulated products such as mobile-phone cards. Charges for payments made by banks are exempt from VAT and subject to a high level of regulation. Payments made by mobile telephone are taxable and often subject to no regulation. Taxation of charges for payment services allows the providers to recover the VAT on their costs, notably technology costs. In contrast, exemption of the charges for payments made by banks means that banks are unable to recover VAT on their costs.

Reform of the VAT treatment of financial services will help to reduce uncertainty regarding VAT treatment of transactions, reduced locked-in VAT and eliminate deterrents to mergers.

4. There is uncertain and inconsistent application of a non-supply rule at the EU level enshrined in the VAT Directive. This rule provides that Member States may consider that no taxable supply takes place in the event of a transfer of a totality of assets or part thereof, *i.e.* the transfer of a going concern. It is of critical importance for financial institutions, most of which have no or only a limited right to recover input VAT. For these institutions, any business case involving acquisition of a financial business will become negative, hence resulting in a major obstacle to cross-border establishment, if the cost of the acquisition would have to be increased by an amount of non-recoverable VAT ranging from 15% to 25%.

Reform of the VAT treatment of financial services should not only tackle the legal and competitive aspects of the problem, but also dissolve European governments' exaggerated concerns about the potential budgetary implications of reform. This will help to reduce uncertainty regarding VAT treatment of transactions, reduce locked-in VAT and eliminate deterrents to mergers by institutions that need to consolidate their activities to survive in a highly competitive international market place.

Our position

The EBF calls for a reform of the VAT treatment of financial services based on three pillars:

First, the language of the 6th VAT Directive should be modernised, so that the definitions of financial exemptions are updated and cover new financial instruments as well as back-office services supplied by specialist third parties under certain conditions. A Regulation providing descriptions and definitions of the main categories of financial services, based on their economic nature, should be adopted. All these suggestions are intended to give legal certainty, simplification and consistent treatment.

Second, the appropriate solutions should enable related entities (*i.e.* entities which, though legally independent, are closely bound by financial, economic and organizational links) to perform intra-group transactions without levying VAT. A number of Member States have implemented 'VAT Grouping' legislation, according to which eligible entities are treated as a single taxable person, meaning that transactions between such entities remain outside the scope of VAT. The EBF has advocated that VAT grouping be made available in all Member States on an optional basis and be extended to cross-border situations. We have argued that a light approach to VAT grouping may alternatively take the shape of an exempt sharing of joint costs between related entities. According to this so-called '*non-supply view*', an intra-group transaction would simply be considered for VAT purposes as a settlement of accounts. Another option may finally consist of the consistent application of the VAT-exemption for cost sharing entities that is already available in the current VAT legislation, but which is currently applied inconsistently around the EU. Under this scheme, services performed for their members by such entities are exempt provided that the aim is the sharing of joint costs.

Third, financial institutions should be given the option to charge VAT on financial services. Such an option is already available in some EU Member States. Wider adoption of this option would, in a business-to-business environment, allow financial institutions to supply services in perfect VAT-neutrality. Indeed, business customers would be able to recover the VAT incurred on the cost of incoming financial services and would no longer have costs inflated by hidden VAT. So as to ensure that perfect neutrality is actually achieved, such an

option to tax should be combined with appropriate provisions regarding the allocation of input tax to ensure full recovery of VAT on costs made to provide VAT-able output.

(vii) Handling IFRS adequately

Introduction

The EU decision to require all EU listed companies to report according to International Financial Reporting Standards (IFRS) from 2005 was a key milestone on the way to an integrated European (and global) financial market. The adoption of IFRS ensures transparency and comparability of company accounts, which allows more investors to make better investment choices.

Looking to the future, further steps are necessary if closer financial integration is to be achieved, both in terms of the scope of companies allowed to use the standards, and as far as the adoption of IFRS is concerned. The announcement by the SEC last July to allow non-US companies to use IFRS and to authorise US companies to choose between IFRS and US GAAP demonstrates the increasing importance of IFRS. The application of a single set of globally accepted standards would enhance the desired comparability of financial statements.

It is crucial that financial statements reflect the substance of the presented transactions and economic reality; and, in particular, that the specificities of European banks are recognised by the IASB and duly taken into consideration when adopting standards.

Our position

Firstly, we recommend all EU Member States to allow non-listed companies within group structures to use IFRS for the preparation of their statutory accounts.

Secondly, we call for IFRS to be of high quality and to reflect business models. In this respect:

1. We are willing to see the "*carve-out*" used in Europe regarding interest margin hedge removed but only if the IASB Board clarifies IAS 39 either by issuing appropriate guidance or by amending the standard in a way that recognises the specificities of European banks and their business reality. We are working on solutions to improve hedge accounting rules and we have detected a willingness in the IASB Board to reach a compromise.

2. We recommend the European Commission and the Parliament to take steps to ensure that the endorsement process and adoption of IFRS is carried out swiftly and efficiently.

   As an example we would like to point to the postponement of the adoption of IFRS 8 "*Segment Reporting*". This draft standard was given broad support by market practitioners during the IASB's consultation phase and both the European Financial Reporting Advisory

Group (EFRAG) and the Accounting Regulatory Committee recommended that the standard should be adopted. As a consequence, we would regret the European Parliament's involvement in the revision of any IFRS if it resulted in European companies being put at a competitive disadvantage by the fact that the EU is not able to adopt standards that command broad support within a reasonable timeframe. A means should be found to distinguish between standards on which EFRAG and the Standards Advice Review Group have declared themselves content and standards which merit further consideration.

3. While we support the EC Round Table on consistent application of principles-based IFRS, we underline that only IFRIC - the IASB's interpretations committee - can provide definitive interpretations of IFRS.

It is crucial that the specificities of European banks are recognised by the IASB and duly taken into consideration when adopting standards.

Thirdly, it is of crucial importance for the functioning of capital markets that investors can have confidence in the quality of the IFRS financial statements. This is important, in particular, in light of the IASB's envisaged initiative to measure all financial instruments at fair value. Though recognising that fair value measurement provides an appropriate accounting base for financial instruments held for trading purposes or otherwise managed on a fair value basis, we will strongly argue against full fair value of financial instruments, as such a model overstates the extent to which instruments are held for trading or managed on a fair value basis within the business, and the extent to which deep and liquid markets exist. It is for this reason that the EBF in its response to the Discussion Paper on Fair Value Measurements explained that while there were circumstances in which market exit price provides an appropriate measurement base, in other instances valuations are being sought for accounting purposes only and are not supported by business use or significant trading. We consider the debate on fair value measurement as a major issue for the EBF in the coming years. The same applies to the joint IASB/FASB projects on an improved Conceptual Framework, on Convergence and on Financial Statement Presentation.

Lastly, we recommend the European Commission and the Parliament to ensure that the European influence in the international standard setting process at the level of the Board is strengthened. The EFRAG has a key role to play in this respect. While the business community and national standard setters support their work, we recommend that EFRAG's funding arrangements be placed on a firmer footing. (This recommendation must be seen in conjunction with other remarks made under the Key Challenge on "*Intensifying International Cooperation*").

(viii) Intensifying international cooperation

Introduction

There is a clear link between the level of integration of the EU financial sector and the international competitiveness of the banking industry, as a deeper and wider marketplace offers banks the chance to attain the economic benefits enjoyed by competitors operating in a more integrated economic environment. If the EU successfully establishes itself as a solid base from which European players may operate on the international stage, it will be able to promote further growth in employment and prosperity in Europe (*e.g.* by creating centres of excellence for the management of worldwide business functions).

In a world characterized by the absence of truly international decision-making bodies, in order to put the advantages of an EU integrated market to work at the global level, EU cooperation with third countries both at bilateral and at multilateral level, is crucial. Pressing issues for international cooperation are, among others, the following:

The time has come for the EU to have a unified voice in the international arena.

- The reduction of barriers to the provision of banking and financial services on a global scale.
- The guarantee of a level playing field between financial institutions in different countries.
- Addressing the weaknesses of the international financial system.
- Meeting the challenges brought about by the globalisation of financial markets, for example, fast technological evolution, the emergence of new, dynamic capital markets (in particular China and India), the new approaches to financial services (*e.g.* Islamic finance) and the rising importance of private capital markets.

Our position

Firstly, we recommend the European Commission to concentrate its efforts on the successful completion of the Doha Round of trade liberalisation. This means attaining an appropriate result in the services package commensurate to the importance of services, especially financial services, for the European economy. We find it paradoxical that agriculture - contributing 3% to the EU's GDP - can hold to ransom the services sectors of Europe that contribute 60-70% to EU GDP.

Secondly, and as a necessary complement to multilateral talks, we recommend the European Commission to conclude meaningful Free Trade Agreements (FTAs) with selected jurisdictions. Currently, negotiations are taking place, among other countries, with South Korea, ASEAN and India. We urge that, in the course of these

negotiations, the EC achieves the elimination of national legislation and standards regarded as discriminatory against EU banks. We will continue to supply feedback to the EC's negotiating teams on barriers to market access and operational obstacles in the aforementioned countries.

Thirdly, we urge the European Commission (DG MARKT, in coordination with other DGs) to deepen existing financial regulatory dialogues (*i.e.* with the US, Switzerland, Japan, India, Russia and China) insofar they are a useful tool to enhance market opening, eliminate regulatory burdens for European banks acting in those markets, promote regulatory recognition and address the possible extraterritorial impact of third country measures. As these dialogues mature and parties build common trust, we recommend that, while maintaining their informal settings, they become more transparent and open to interested stakeholders.

The EBF urges the European Commission and CESR to genuinely explore the feasibility of a practical application of the concept of mutual recognition in the EU-US dialogue.

With particular reference to the EU-US dialogue, we believe that the recently agreed Framework for Advancing Transatlantic Economic Integration will provide a valuable forum where solutions to transatlantic regulatory issues can be sought. We welcome the introduction of the so-called "lighthouse projects" in the area of financial services – currently the mutual recognition of the accounting standards IFRS and US GAAP – where progress will be assessed regularly. The agreement also opens the door to the practical application of the concept of mutual recognition[25]. In this respect, the EBF will actively participate in the development of a recent SEC proposal whereby foreign exchanges/brokers serving US investors could be exempted from US registration requirements on the basis of these actors being comprehensively regulated and supervised in their home jurisdictions. The EBF urges the European Commission and CESR to genuinely explore the feasibility of this initiative. European banks would, however, oppose a unilateral adaptation of the EU regulatory system (*e.g.* MiFID) solely to satisfy the SEC's comparability assessment. The best course of action would be to achieve a system of bilateral EU-US mutual recognition, thus avoiding the risk of the US entering into selective bilateral agreements with EU member jurisdictions with systems more similar to its own.

Lastly, we stress that the time has come for the EU to have a unified voice in the international arena. The speed of globalisation is accelerating while the importance of global standard setters (*e.g.* BCBS, IOSCO, FATF, IASB…)

[25] Throughout the report, **the concept of mutual recognition** is used in an ad-intra context (*i.e.* within the EU) and applies to residual and peripheral provisions that have not been fully harmonised. However, in the international context, *i.e.* ad-extra, the applicability of this concept is associated with the establishment of a framework on the basis of high-level shared principles between comparable regulatory regimes.

increases. The lack of sufficient European influence in these bodies could be already prejudicing the interests of European banks. This is particularly regrettable at a time when these bodies are becoming more transparent by consulting on their priorities for standard setting and new exploratory work (*e.g.* IOSCO). In the field of accounting, we recommend a strengthening of the role of EFRAG (see also Key Challenge on "*Handling IFRS adequately*") and the exploration of ways to ensure the participation, at least as observers or affiliates, of the Lamfalussy Level 3 Committees in some of these bodies (*e.g.* CESR in IOSCO, CEBS in the Basel Committee).

Part 3

Part 3 : Technical & Policy Background

3.1. Policy and regulatory environment

Clearly one of the major challenges facing the EU institutions, Member States and supervisory authorities in building a European internal financial market concerns the regulatory environment. Two main elements have to be considered: the way in which EU legislation is decided; and the way it is implemented and enforced at Member State level.

3.1.1 EU context: principles for regulatory action

Further integration of financial services is an important objective, but not one that should be pursued without regard to the balance of costs and benefits of achieving the so-called "*positive integration*" policy measures. A theoretically perfect Single Market should not be pursued at all costs. Business can move elsewhere.

The EBF believes therefore that any proposal for regulatory action at EU level should follow some basic principles and be considered against the following tests.

(i) Consider the full range of policy tools – including non-legislative approaches

Choosing the appropriate policy instruments is essential. Both binding and non-binding instruments are possible, as are considered decisions not to act. All policy initiatives suggested must be based on the necessary evidence. If there is a perceived need for action, options other than regulation should be considered.

Self-regulation has to be taken into consideration because it has the advantage of being market-led and able to respond quickly to market developments. Specific measures are already being developed which stem from the banking sector's own initiatives.

The establishment of an optional Pan-European Regulatory Regime (at present a **28th or 31st regime** if one includes the EEA) for specific financial products could be envisaged on a case by case basis for specific products featured in such a way that might allow them to be distributed and used in all Member States. It remains unclear to what extent negotiating an optional regime will be easier than harmonising national legislations, especially as the relationship of such a regime with existing domestic regimes remains particularly problematic. Furthermore another problematic issue will be to work on a civil law harmonisation without achieving a general harmonisation of contract law. Due to these reasons it is not clear yet whether there is a business case or not.

However, in principle, the industry is in favour of any means through which it can expand its business so it would be useful to encourage the Commission to work with us to determine whether there is a business case or not, perhaps by establishing a specific group of experts.

(ii) Maintain international competitiveness as a benchmark

The creation of a European Single Market for financial services should be a means to increase the international competitiveness of the EU market place, in line with the overall priorities set by the Lisbon Agenda, which aims at making the EU the most competitive market in the world. A judgment must be made of the consequences for the competitiveness of the industry and the economy before reaching a decision on each and every European initiative affecting financial services markets. This assessment should include analysis of the approach to the relevant issue taken outside the EU, and particularly among the EU's main competitors on international markets.

(iii) Reduce regulatory density, avoid overregulation

The price to pay for financial integration should not be the resurgence of burdensome regulatory practices or the overregulation of the financial sector. The flood of regulations is judged by many players to be excessive and this trend is probably not sustainable, especially for small companies or small countries.

Overregulation is a threat from two perspectives:

- Beyond a certain threshold, the marginal impact of regulation becomes negative and creates a vicious circle whereby the industry has to bear the direct costs (to finance the inflation of regulatory resources) as well as the indirect costs (regulation becomes inefficient and counterproductive). A growing share of the financial business is then swallowed up by the need to respect reporting, audit and compliance requirements.

- Overregulation harms the level playing field insofar as overregulated entities suffer from a competitive disadvantage compared to less regulated players, for which risk is addressed through indirect supervision (*i.e.* that of their regulated counterparties).

Rules that are no longer needed or do not deliver the results intended should be withdrawn.

(iv) Focus on better regulation

In terms of legislation, we believe that better regulation is of key importance, and we welcome the support being given to this principle by EU policy-makers. Policy and law-making should be based strictly on the principle of subsidiarity, *i.e.* be justified by, and built on necessity and proportionality. In concrete terms this means that a maximum of voluntary and market oriented measures are preferable to legal provisions. In line with the better regulation principles, regulations should only be pursued where there is evidence of clear and concrete benefits for citizens and industry alike and a strong economic rationale. Policies must be based on solid economic evidence and be subject to thorough impact assessments and enacted only if cross-border activity can be improved. The assessment of appropriate solutions must be made on a case-by-case basis, depending on the specifics of the market and problems identified.

Proper consultations have to be organised at all stages of the process. Taking into account the still increasing number of consultations, the lack of sufficient time continues to be an important concern for market participants. Sufficient time should be allowed to all stakeholders to provide relevant answers, in particular, during holiday periods.

As far as impact assessments are concerned, available evidence reveals that the way in which they have been conducted at EU level has not always delivered the ideal result. In fact, impact studies undertaken in the field of financial services have sometimes appeared weak or at least been disputed (*e.g.* Mortgage credit by London Economics and the PSD by the Commission). In the future, it will be important to strive to ensure that such consultation exercises and impact assessments are characterised by better methodological soundness, increased transparency, more cost-effectiveness and greater external oversight. The scope of the requirement for impact assessments should also be extended, to apply to all important pending legislation. This important discipline was not applied in the case of proposals such as the Rome I Regulation and the modified proposal for a Consumer Credit Directive. The EBF remains convinced, nevertheless, that the Commission is committed to the better regulation process and takes impact assessments seriously. The establishment of an Impact Assessment Board (IAB) is in this respect a commendable step forward, even if experience with this new body is too limited to draw any firm conclusions. The EBF would welcome the same commitment to better regulation to be evident in equal measure across the other EU institutions, including the European Central Bank.

The Commission should also develop its expertise to conduct not only ex-ante but also ex-post impact assessments to ensure that the quality of regulation remains in line with the constant evolution of the market.

To facilitate this, ex-post impact assessment criteria against which the performance is measured should be provided from the outset *i.e.* in the legal instrument.

(v) In retail services, seek targeted full harmonisation coupled with mutual recognition

A certain range of legislative policy measures should however be considered when necessary, especially in retail banking.

The traditional method of harmonising or converging national rules by means of Directives with the minimum harmonisation approach has proven to be problematic because Member States can go beyond those rules, by so-called "*gold-plating*". The result is that instead of having converging or harmonised rules, large differences emerge in transposition and interpretation between Member States, which almost make it necessary to adopt a new directive. These differences prevent European providers from fully benefiting from an integrated European financial services market.

An all-embracing harmonisation (all areas of civil, commercial and procedural law) appears attractive but would be very difficult to achieve politically. Moreover it could arguably be questioned whether such difficult and time-consuming complete harmonisation is desirable or even necessary.

Instead of following the minimum or maximum approach the EBF favours the idea of full harmonisation of key elements of individual retail services across the EU, the so-called targeted full harmonisation concept. This means the harmonisation of elements that are essential to foster cross-border competition, and only those.

We believe that this approach is the most effective means of creating a genuine European internal market for retail banking services. However, it should not automatically mean setting standards at the highest possible level, or adding new requirements at the national level. This would be counterproductive since a balance must be struck between how rigidly a consumer is protected and how much that protection costs. Additional cost to the industry is reflected in the prices offered to consumers and/or the range of products and services, so ultimately at least part of the cost of consumer protection is borne by the consumer. Ideally, consumer protection rules should facilitate the sale throughout Europe of products developed in one domestic market without the need for substantial modification, rather than hinder it.

In order to avoid that the non-key elements of a proposed EU Directive (*i.e.* those that are not subjected to full harmonisation) become an obstacle to the cross-border provision of services or products, the EBF proposes that Member States accept the use of mutual recognition for these more residual/peripheral provisions. Provisions

beyond the scope of a Directive would obviously remain within the remit of Member States, but here too the application of mutual recognition must be used as a tool to facilitate application by Member States of harmonised EU provisions while securing progressive convergence.

(vi) Support the Lamfalussy process, a means to deliver supervisory convergence

The Lamfalussy process has proved to be a valuable approach to enhance the flexibility and pace of the legislative process and as well as a useful mechanism to foster supervisory convergence across the EU.

Level 1 of the process can be considered a success, overall. The objective of setting the principles of an overall framework for a piece of legislation is sound. We have witnessed increasing adherence to the spirit of the process by legislators as confidence based on experience of the process has developed. We expect this confidence in the process to be further evident in the future.

Experience of Level 2 has been largely positive, although the question of how far technical implementing measures are "*political*" is moot. A practical distinction between high level principles and technical implementing measures can be drawn at an early stage and with greater discipline by legislators and stakeholders alike so as to not re-open in Level 2 debates that were closed in Level 1.

At the time we commended the European Commission for coming to a practical resolution on the choice of legislative instruments to deliver Level 2 of MiFID. In our view they had found the right balance between practical and legal considerations in delivering on the objectives of Directive. The EBF also praised the European Parliament following its adoption of the MiFID Level 2 implementing measures for not seeking to re-open debates that were already closed out at Level 1. Both of these experiences were encouraging.

With regard to Level 3, we think that the Committees have made valuable contributions to the convergence of supervision. Nevertheless, challenges and some problems, particularly on the prudential side, have arisen for market participants in practice and therefore more and faster progress is needed to meet the needs and expectations of the industry. A step forward towards reinforcing the power of the Level 3 Committees, and in particular CEBS and CEIOPS would be to enable them to issue legally-binding guidelines. However, in light of the current European legal framework and high political sensitivity surrounding it, such a step would seem too ambitious.

It remains an important objective for Level 3 to promote more supervisory convergence, but we lack a robust European definition of the Level 3 concept.

Promotion of supervisory convergence would also be helped by coming to a clear understanding and definition of "*supervisory convergence*". For the EBF, supervisory convergence should be a principle-based, proportionate, outcome focused approach to reaching consistent regulatory solutions and removing undue differences in regulatory practice that is ultimately based on best supervisory practices.[26] Four basic objectives should inform further work on supervisory convergence:

1. Protection of the interests of depositors/investors/insurance policy holders, as well as protection of systemic stability – this should be the overarching objective;
2. Promotion of financial integration;
3. Compliance with the better regulation principles; and
4. Reduction of the administrative burden which institutions have to cope with.

Furthermore, to achieve supervisory convergence it is essential to identify the factors which inhibit the fulfilment of the above-mentioned objectives. Such factors should be assessed and disclosed in an open and transparent way.

The process of supervisory convergence can be accelerated by all supervisory authorities seeking to implement the practical recommendations of the "2nd Thierry Francq Report" of April 2006. Following from the conclusions of that Report, we recommend the Level 3 Committees to focus on improving the knowledge and regulatory approaches of national regulators *e.g.* peer review, allocation of dedicated staff, training programmes and staff exchanges and audits of national practices and differences. In parallel, there is a need to identify a common understanding of how to assess progress. Two elements are important: identifying meaningful (non-simplistic) criteria and agreeing sufficient time for complex projects to develop.

Related to the "*Francq recommendations*" and in addition to existing mechanisms to mediate between different regulators' interpretations and applications of legislation, there is also a need for an informal, non-confrontational process for firms and regulators to identify issues and concerns. This would allow for these concerns to be resolved, as well as for overall consistency of approach to be maintained, without having to resort to more formal procedures for enforcement, complaint or redress. We note that such fora[27] are already in

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[26] At the same time, given the essence of conduct of business supervision, it should be recognised that securities supervisors are nationally accountable and have local knowledge, that markets have national characteristics and that regulatory diversity can facilitate competition and innovation.

[27] Such as CEBS Consultative Panel and the Operational Networking Platform.

place with banking supervisors. This clearly needs to be encouraged in order to make progress on converging supervisory practices.

Level 4 is largely untested but remains very necessary to ensure that the process functions as it was intended. It is in the vital interest of the financial industry that Level 4 becomes fully operative. We will carefully monitor how the Commission approaches Level 4 to ensure greater consistency of implementation of Lamfalussy legislation. The EBF does not shy away from its responsibility to inform the Commission of instances where it feels that Member States have not been faithful to the letter or spirit of the legislation in question.

3.1.2 National context: suggestions for effective transposition

(i) Consistent implementation

Effective competition and integration can only be achieved if EU rules are implemented, applied and enforced consistently in all Member States.

The EBF considers therefore that a consistent implementation of measures across Europe is a crucial element in creating a Single Market for financial services and therefore Member States should abstain from 'gold plating' when transposing measures domestically.

The introduction of an "*anti-gold plating*" article into Level 2 of MiFID (Article 4) was an attempt to limit the scope of divergence from the European text at national level. The Article in question limits the room for Member States to apply additional requirements in certain areas covered by MiFID. It sets out the conditions for creating or retaining such national requirements that go beyond MiFID and requires that these be notified and justified to the European Commission. In the summer of 2007 notifications continued to be made to the European Commission by Member States. The effect of this Article will only be assessed once the MiFID regime has been fully implemented and experience has been gained.

Besides our endorsement of steps to avoid gold-plating, the EBF encourages and supports the European Commission's efforts to accompany the implementation process at Member State level. Concrete actions have therefore to be taken to ensure that rules are implemented properly and on schedule, such as:

- Making more use of workshops for Member States to ensure common understanding of directives and the way they have to be transposed
- Scrutinising draft legislation from Member States before it is enacted with a view to highlighting possible mis-transposition

- Publication of table and charts on transposition to encourage peer pressure. This should also be complemented by more qualitative information on transposition.

It is also important to examine afterwards the extent to which EU rules have been complied with. The EBF will support the efforts of the European Commission to monitor the transposition of EU rules as set out in Commission's Recommendation of 12 July 2004 on the transposition into national law of Directives affecting the internal market [2005/309/EC].

(ii) Realistic transposition deadlines

Timing remains an overarching concern.

Taking the example of MiFID once more, today legislators and stakeholders are attempting to resolve some of the thorniest public policy questions that were not resolved in the Level 1 negotiations and which were subsequently submitted to a future review; the possible extension of MiFID pre- and post-trade transparency requirements is a case in point. The practical reality for the industry subject to Lamfalussy legislation is that the procedure of resolving the most contentious areas of legislation after implementation causes a good deal of instability (and all that it practically implies) in the markets.

Timetables for advice on national implementation are set by the Commission before the finalisation of Level 2 and can compress Level 3 Committees' ability to produce guidelines that can usefully influence national implementation. This has certainly been the experience with MiFID where pan-European guidance on MiFID was only finalised five months before the Directive is due to be implemented. While it is important to create incentives for progress and momentum for convergence at Level 3, and to agree benchmarks to assess progress, deadlines for implementation should be kept under review during the implementation phase. This we feel would have alleviated the severe time squeeze firms are facing today in respect of being MiFID compliant by 1 November 2007.

The fact that only three out of 30 of the EEA Member States transposed MiFID on time is well documented. The practical result is that there is a good deal of stress on the industry to deliver MiFID by 1 November 2007, and in a number of Member States, without the benefit of having sight of the national legislation. We therefore call on legislators to, in the future, set practical and flexible deadlines and take the time necessary to conclude negotiations in their fullest possible form. The quality and completeness of the legislation and its thorough implementation must take precedence over the speed of its delivery. In the context of Lamfalussy texts, the EU Commission could organise transpositions roundtables with members states once a level is passed, this would

concretely avoid the situation encountered in MiFID where more than 2 years after the level 1 text has been agreed at EU level no members states had been able to provide the industry with a draft version of the national text. These transposition roundtables would increase speed during the transposition phase as well as harmonisation of the texts.

3.2. Review of issue-specific measures

3.2.1 Prudential aspects

The EBF welcomes the Capital Requirements Directive (CRD). The CRD has been designed to allow for the delivering of a coherent more risk-sensitive, supervisory framework. A well-managed and well-capitalised banking system will deliver greater stability in the banking sector, providing a sound platform for businesses to expand and innovate. Thus, notwithstanding EU banks' significant expenditure on improvement of risk management systems to comply with the Directive's requirements, the EBF's expectations remain high as regards what the new framework can achieve in the interests of both Europe's consumers and its industry at large.

Note: For further information on this Section, and in particular on current supervisory arrangements, please refer to EBF's Key Challenge on "Making consolidated prudential supervision work".

(i) Capital Requirements Directive: elimination of national discretions

The objective of the CRD, which transposes the Basel II rules into European legislation, is to have in place a comprehensive and risk-sensitive framework and to foster enhanced risk management amongst financial institutions. A crucial aspect of the new framework is its flexibility which allows institutions to adopt the approaches most appropriate to their situation and to the sophistication of their risk management. The CRD, by encouraging enhanced risk management, aims at ensuring a level playing field across EU Member States and different financial institutions. However, to our disappointment we observe a significant **fragmentation in the interpretation and practical application of the rules**. This is not only a result of the high number of national discretions included in the Directive, which pose a serious threat for a level playing field in the financial market, but also, and arguably more importantly, of different supervisory philosophies. The EBF therefore supports all initiatives which can reduce these national discretions. An example is CoRep, the Common Reporting framework (see below).

The EBF appreciates the Commission's efforts to improve the situation, including the coordination mechanism of the CRD Transposition Group and the renewed call for advice on national discretions to CEBS. However,

whilst we are hopeful that the work on national discretions will lead to tangible results, we wish to point to the supervisory structures as one of the main difficulties in achieving a satisfactory degree of convergence.

(ii) COREP

A particularly burdensome area regarding the CRD is that of reporting. Our initial disappointment about CEBS' Common Reporting framework (CoRep) is currently being confirmed by the renewed negotiations that have started within CEBS. Within the vast amount of information requirements included in CEBS' framework, every supervisor chooses in practice a different set of data requirements, meaning that cross-border active institutions will be required to report almost the entire framework. In addition, we note that even the common definitions for each item do not prove sufficient to ensure a common understanding of these items.

We therefore continue to believe that CoRep will have to be transformed into a truly European framework, focusing on those information items that all supervisors estimate essential for their scrutiny and assessment process and ensuring that cross-border firms be able to rely on a single template, applicable to all their EU subsidiaries.

(iii) Large Exposures regime (LE)

The reconsideration of the large exposures regime represents a good opportunity to adopt a more principles-based-approach in prudential rulemaking, whilst maintaining a clear distinction between LE limits on the one hand and overall concentration risk under Pillar 2 on the other hand.

To this end, if supervisors and regulators esteem that the Basel II rules for concentration risk do not yet take sufficient account of single-name concentration risk, the LE rules should be designed as a light-touch regime that merely introduces a regulatory backstop, within which institutions retain much freedom in the design of their internal systems. An important objective of the review is in this case to remove unnecessary frictions between the regulatory framework and institutions' own practices, and especially to align exposure calculation and risk mitigation techniques with the CRD.

(iv) Definition of own funds

Any dilution of principles of the own fund rules (no double gearing, eligible Tier I capital must be immediately available at any time) and any national discretions in this respect must be avoided.

a) Eligibility of Hybrid Instruments

With the development of international markets for capital instruments, a variety of hybrid instruments (*i.e.* a mix of debt and equity features) have been considered to be eligible to be included in regulatory original own funds, on a case by case basis. As the CRD has not been updated to specify a common treatment of these instruments, the European Commission intends to examine how the Basel Committee's 1998 "*Sydney Agreement*" on hybrid instruments has been implemented in the EU Member States. The EBF welcomes this initiative insofar as a common treatment of hybrid instruments can help bring about a level playing field among financial institutions while ensuring that the quality of original own funds is maintained.

The EBF agrees that principles enunciated in the Sydney Agreement are sound and appropriate as a starting point. Adopting a principles-based approach, the EU should primarily focus on formulating the characteristics of these principles with a view to clarifying and, possibly, updating them even though that may imply that banks need to accept that they would have to make additional disclosures under Pillar III on the characteristics of the components of their capital base. In this respect:

- The three basic eligibility criteria on which the Sydney Agreement was based – *i.e.* permanence, loss absorption and flexibility of payments – may need to be reviewed as they are closely inter-related and are probably even overlapping to a large extent.

- It should in any event be noted that Basel II has been changing the way in which banks are managing their capital. As a result, their capital base will need to become more flexible to adapt to the new environment. Therefore, there may be a need to give less weight to the permanence criterion.

- It is essential, moreover, that the eligibility of capital instruments would increasingly be based primarily on economic substance rather than legal form in the future.

b) Alignment across sectors

The question arises whether the different nature of the business in which banks and insurance companies are involved might justify a need to differentiate capital requirements across both sectors. For the sake of level playing field considerations and also to facilitate the management of financial conglomerates, the EBF believes that such differences should not have any impact on the definition of capital and, therefore, on the eligibility of capital instruments.

It would in particular be essential for the following main differences between the insurance and banking sector to be addressed:

- The eligibility of hybrid instruments in both sectors needs to be aligned because of obvious level playing field considerations (see above).

- The disparity in the treatment of deductions needs to be remedied. The deduction issue is of a major significance as it could result in regulatory arbitrage.

- As prudential filters are currently being applied differently in both sectors, more consistency is needed in this area as well by means of a principles-based approach.

- Finally, the most striking difference between the insurance and banking sector, *i.e.* that insurance companies are currently not being supervised on a consolidated basis should be examined closely. The calculation of capital in both sectors should be applied on a consolidated basis. It can be recalled in this context that Solvency II accepts that it is indeed ultimately up to the group supervisor – in cooperation with other regulators - to set the Solvency Capital Requirement (SCR) for the group and its subsidiaries whenever risks are managed at a group level.

(v) Liquidity management

The lack of adequate supervision of banks' liquidity risk management prevents the EU from reaping the efficiencies of a more integrated financial market and increases systemic liquidity risk. For this reason, it is essential that authorities adopt a concerted approach to achieve consistency across, and avoidance of conflict between, different supervisory regimes, not just on a pan-European level but across all material jurisdictions globally. It is to be hoped that recent months' liquidity difficulties will encourage the authorities to treat this as a priority.

In the view of the EBF, substantial progress in this area can be made only if EU Member States are prepared to recognise that host countries' authorities should refrain from supervising liquidity in an isolated way and be prepared, instead, to work together with the authorities of the home country of the parent bank. Any progress made by the EU may, moreover, serve as a precedent and an example to the international banking community.

The prudential supervisory framework to contain liquidity risk should build on the range of practices which banks have developed in this regard and, more particularly, address the following basic foundations:

1. Best Practices. The banking community has developed a set of best practices in the area of liquidity management over time. Regulators should encourage the banking community to continue improving and refining those practices, and continue their dialogue with banks on further developments in this area.

2. Internal Quantitative Framework. The common supervisory framework needs to ensure that banks have set up an adequate internal quantitative framework to measure liquidity risk per currency on a going-concern basis, which fully captures the liquidity risk to which they are exposed. Such internal frameworks should measure liquidity risk on a group-wide basis and be validated by the consolidating supervisor on the basis of transparent validation criteria. The right application and understanding of the model by the subsidiaries of the group needs to be examined and host supervisors should be involved in this process. As each bank will define its internal framework on the basis of (i) its specific business model, (ii) its risk appetite, (iii) local regulatory requirements as well as (iv) its capacity to generate liquidity, supervisors need to accept that quantitative frameworks used by banks will differ and, therefore refrain from imposing a single framework and permit flexibility and a range of advanced approaches.

3. Stress Testing. The regulatory framework should make sure that banks or banking groups have developed some form of stress testing which demonstrates that they are able to cope with crisis situations if they arrive, and define the main principles and parameters of how such testing needs to be performed.

4. Contingency Funding. Finally, the regulatory framework should require banks or banking groups to put in place contingency funding plans, without becoming overly prescriptive in this regard.

At the same time, regulators should re-consider those prudential supervisory rules which currently prevent an optimal flow of liquidity within a group in an unduly way. This implies, amongst others, taking another look at Large Exposure requirements. Many host supervisors expect the parent company to be the last resort within a group in case of a crisis. However, often the home supervisor has put restrictions on cross-border credit limits, which prevent the parent company from bailing out a subsidiary in a crisis. Such rules and practices need to be reviewed.

It is also essential that monetary authorities be involved as well in the process for their role as lenders of last resort. This implies taking a view which is broader than merely preserving micro-economic stability.

Their main focus should be on improving the means which banks and other financial institutions have at their disposal to avoid liquidity crisis situations.

3.2.2 Markets in Financial Instruments Directive (MiFID): EU members adhering to a "copy out approach"?

Whilst retaining the principle of the EU "*passport*" – a novelty of the Investment Services Directive (ISD) – MiFID has also introduced the concept of 'maximum harmonisation' which places more emphasis on home state supervision. This is a departure from prior EU financial service legislation which featured a "minimum harmonisation and mutual recognition" concept. Maximum harmonisation does not permit EU Member States to be "*super equivalent*" or to "*gold-plate*" EU requirements detrimental to a "*level playing field*". During the implementation phase of MiFID, most EU Member States have gone on record to state that they will not deviate to any significant extent from the European text in the national implementation and a host of Member States have adopted a "copy out approach" meaning that the EU text will effectively be transposed without modification into national legislation. The transposition of MiFID was, nonetheless, completed late in the vast majority of cases. It is **too early to state definitively if most Member States will indeed adhere to a "*copy out approach*"** or if in transposing MiFID it is deemed necessary to flex or add further requirements. In a second stage of analysis the practical effects of any divergence of implementation will have to be considered. What is clear however is that the cumulative effect of any significant divergence across the 30 EEA Member States who are obliged to transpose MiFID could be quite pronounced and would only serve to undermine the creation of a single pan-European capital market.

EBF remains vigilant and has high expectations of the directive's in-built anti-gold plating deterrent whereby Member States will have to comply or explain why divergent approaches are considered justified.

3.2.3 Payment Services Directive: avoiding too divergent national interpretations

Note: For more concrete information on SEPA, please refer to EBF's Key Challenge on "Implementing SEPA successfully".

The PSD was voted in the European Parliament in April 2007 and has been forwarded to the Council for final adoption. The text of the Directive is expected to be translated by October 2007 and must be transposed into national legislation at the latest by November 2009.

The PSD is a very complex piece of legislation and allows flexibility for the Member States in (too) many articles, generating the risk of inconsistent interpretation and transposition into national law. The EBF will play its role in facilitating the implementation and promoting as consistent an application as possible in order to ensure that a truly common legal framework for payments within the EU materialises and to avoid complications arising in the future as a result of too divergent transposition. It is indeed the responsibility of the national banking associations to cooperate with national authorities in the transposition/ adoption of the PSD at the local level. Moreover it is crucial to avoid too divergent national interpretations and a high level of consistency is desirable. The EBF has decided to create an implementation forum to facilitate national implementation.

3.2.4. Wholesale markets

(i) Prospectus

The EBF regrets that the core idea embedded in the Prospectus Directive - the passport - is not fully realised, insofar as, in many cases, host authorities impose additional requirements on issuers instead of communicating their concerns to the competent authority of the home Member State. For example, often host Member States' objections are made on the basis of language or translation concerns, thereby disrespecting the principle that the competent authorities of the host Member State shall not undertake any approval or administrative procedures relating to prospectuses.

EBF notes that in addition to the work at Level 3 of the Lamfalussy process, there are also some single market obstacles that can only be resolved through legislative measures, especially regarding the language regime and requirements that go beyond the scope of the Directive. We believe that **it would be too early to review the Prospectus Directive at this stage**, but call on the European Commission to remain vigilant and monitor continuously its functioning.

(ii) Investment funds

a) Management company passport

As the Commission is aware, the passport for fund management companies is not working in practice owing to ambiguities in the text of the Directive and concerns relating to splitting supervisory responsibilities between authorities. In its exposure drafts for amendments to the UCITS Directive, the Commission has suggested that in deciding whether all supervisory functions could be exercised by the home authority of the management company, or whether part of them would have to be undertaken by the authority where the fund is located, the latter, *i.e.* a "*partial passport*" could be a pragmatic solution. The EBF believes that in terms of a single market, the full passport would be the most logical and desirable solution, and that supervisory cooperation should be developed with this objective in mind. However, from a pragmatic point of view we recognise that a coherent and swiftly implemented partial passport would be preferable to a lengthy discussion of the full passport, which could potentially drag on for years.

In this case, to ensure that the partial passport really limits the responsibilities of the host supervisor to some well-defined key functions and thereby achieves the desired efficiency effects it will be crucial to establish a clear division of responsibilities among supervisors.

b) Simplified prospectus

Regarding the UCITS simplified prospectus, the EBF regrets that, as it currently stands, there is such a divergence in the scope and granularity of the information required. As a result, issues in countries with more onerous requirements are put at a disadvantage, and cross-border marketing is made more difficult in view of the far-reaching adaptation requirements. As a consequence, the reform of the simplified prospectus is a key element in the view of the EBF. The Commission's current proposal of replacing the current extensive format with a limited number of key investor information items seems suitable to alleviate these difficulties. The aim must be a short, fully harmonised document that does not leave any scope for gold plating and focuses at the same time truly on the needs of retail investors.

c) Notification

The notification requirements in the UCITS Directive are onerous and have in addition often been abused by Member States to effectively protect their national markets. There are frequently additional checks and information requirements by the host authority, and the deadlines of the Directive are often exceeded. The streamlining of the notification procedure finds therefore universal support. We expect that the Commission's current considerations with regard to ex-post checks would be appropriate to solve the main shortcomings. In

order to limit the legal risk implied by this procedure, we would suggest that each supervisor be required to publish on their website an exhaustive list of all country-specific additional requirements that issues from other Member States have to fulfil.

(iii) Clearing & Settlement: ensuring co-regulation delivers expected results

In the post trading space a combination of co-regulation and self regulation has been employed to tackle the removal of the so called "*Giovannini barriers*" to an open and competitive post trading environment. The 2001 Giovannini Report identified 15 barriers which it divided into three categories:

- National differences in technical requirements and market practice;
- Differences in tax procedures; and
- Legal certainty

Progress has been encouraging with respect to the ironing out of the national differences in technical requirements where work has been led by cross-sectoral working parties from the industry (*e.g.* the Common Communication Protocol for EU Clearing & Settlement, Harmonisation of Corporate Actions Processing), including the EBF. However, progress has been less impressive with respect to tackling differences in tax procedure and legal certainty, for which the European Commission is coordinating action by the Member States (*e.g.* Legal Certainty Group).

The removal of the Giovannini barriers is complemented by market infrastructures voluntarily signing up to the self regulatory Code of Conduct for pan-European clearing and settlement. The signatories to the Code are market infrastructures operating in Europe, securities exchanges, clearing houses (CCPs) and central securities depositories (CSDs). It is the common objective of the Code's signatories to establish a strong European capital market and to allow investors the choice to trade any European security - whether it is a domestic or a foreign security - within a consistent, coherent and efficient European framework. These aims are strongly supported by the community of users (banks) of market infrastructures.

The Code sets bold objectives for an industry that is only now beginning to move into a competitive environment. The enforcement of the Code will be all important and therefore the role of the Monitoring Group in which the EBF sits is critical. An important balance must be struck between keeping the pressure on market infrastructures to implement and adhere to the Code, while at the same time ensuring that users maintain a dialogue with infrastructures so as to facilitate feedback and recommend improvements. The EBF will follow the implementation of the Code in order to assess its practical results.

Also, the project of the European System of Central Banks (ESCB) to integrate settlement on a single platform, an initiative known as TARGET2-Securities, is aimed to address a number of obstacles to pan-European settlement. Countries (coinciding with currency areas) originally developed their own 'domestic' infrastructure for securities trading, clearing and settlement and this situation continues today despite the introduction of the euro in 1999. As long as settlement remains fragmented, transfers between separate systems – operating under different legal and regulatory regimes – will remain more complex and, therefore, more expensive than domestic transfers.

The ECB has stated that integration of the infrastructure means access for all users to the same services on the same conditions – regardless of the location of the user or provider. CSDs will be invited to settle on the TARGET2-Securities platform in the first quarter of 2008 after the user requirements for the project have been carefully considered. Assuming the ECB Governors deem the Project still to be viable after the development of the user requirements (Q1 2008), the single platform is due to be designed, built and implemented by 2013.

3.2.5 Retail markets

Note: For more information on this Section, please refer to EBF's Key Challenge on "Advancing towards an integrated retail banking market".

(i) Law applicable to contractual obligations with consumers: Rome I Convention

The EU Commission, in its Proposal for a Regulation incorporating the Rome I Convention on the law applicable to contractual obligations, chooses to modify the regime created by the Convention for contracts concluded with consumers. It provides that, under certain conditions, the law applicable to those contracts has to be the law of the consumer's country of residence (Article 5). This will have, in our view, the consequence of greatly discouraging financial providers from crossing borders to reach potential clients in other Member States. The immediate consequence of this will be to deprive consumers of the benefit of a wider range of offers and greater product variety.

The Commission has, in our view, chosen an approach which endangers the exercise of one of the main rights established by the EC Treaty, namely the free provision of services. This is, in our view, in full contradiction with the intention expressed by the EU institutions to favour integration in this sector, without privileging any specific model of business to the detriment of others. Furthermore, imposing the consumer's country law as the only one applicable to consumer contracts without any possibility for the parties to derogate to such a provision

appears quite evidently disproportionate in light of the ECJ's case-law[28]. This has clarified the limits for Member States to invoke consumer protection as a matter of general interest justifying barriers to the Internal Market in non-harmonised areas.

The EBF stresses the need to create an environment which facilitates the cross-border provision of services, and urges the EU legislator to ensure as a priority the full harmonisation of key elements of consumer protection as soon as possible in combination with mutual recognition of the non-key elements. In the meantime, the Convention's wording on this point should be maintained. As an alternative, EU institutions could consider full exclusion of all financial services from the scope of application of the proposed Article 5.

(ii) Consumer credit

The EBF is generally supportive of the adoption of a Directive on Consumer Credit, as an important step forward in the direction of further integration of the retail financial services' market. However, after having secured the survival of the proposed directive at Council level, the EBF still considers the directive unsatisfactory, in particular since it might raise costs too much without really increasing in a first step the integration of the market. Further improvements are therefore now sought at EP level.

In particular the following main concerns should be addressed:

- Key elements should be fully harmonised without leaving any national discretions to Member States. Mutual recognition should apply only to non-key elements.
- Scope: threshold (minimum ceiling too low and maximum ceiling too high) and exclusion of overdrafts.
- The duty to inform should not be complemented by a systematic duty to assist. The assessment of creditworthiness should remain under prudential rules.
- The period for the right of withdrawal should be reduced to 7 days with a waiver.
- Fair and objective compensation rule in case of early repayment.

[28] See, among others, ECJ C-442/02, Caixa Bank France, 5 October 2004, Rec. I-8961.

(iii) Mortgage credit

After the publication in November 2005 of a Green Paper and the consultation of two stakeholders' groups during 2006, the Commission is preparing a White Paper due to present the policy guidelines for the integration of the home loan sector in the EU.

The EBF is favourable in principle to further integration of the home loan market insofar as the areas where there is room for such integration are clearly identified, the means chosen to achieve this integration are adequate and proportionate, and such action would bring direct benefits for consumers as well as the industry. Actually the national home loan markets in the European Member States are already highly competitive, efficient and well-functioning. As recently showed by a study[29] commissioned by the European Mortgage Federation (EMF), there is a continued increase in the level of integration in Europe. The study showed also that between 2003 and 2006 adjusted prices of home loans have fallen in all markets for which data was previously reported and the range of products available has significantly broadened. This is partly linked to the increase in competition due to new entrants into national markets. Home loans markets are already well functioning and more integration would not be achieved by more stringent consumer protection rules.

Against this background caution should be exercised when assessing the remaining margin for further integration and the potential effects of any external measures on an already efficiently operating market. EBF is in favour of maintaining the self-regulatory Code of Conduct on Home loans in place in its current form to cover the pre-contractual information, although there might be a few items of its content that could be reviewed to improve it.

It is clear however that there are some benefits to be derived from further integration in some areas, such as funding. Evidence tends to show indeed that, for the time being, cross-border activity in this sector relies on lenders – not consumers – going abroad. In this respect the following obstacles should be addressed first:

- A legal framework for efficient portfolio trading that would allow the development of a liquid secondary mortgage market.
- Easier transfer of real-estate security interest.

[29] Mercer Oliver Wyman (MOW) study on mortgage market integration (2007)

- Legal and infrastructural issues which deter lenders from going cross-border, such as transparency and speed of enforcement procedures on collateral and cross-border non-discriminatory access to land and credit registers, and
- Divergences in property valuation principles.

(iv) Non-discriminatory access to credit registers

The EBF supports non-discriminatory access to positive and/or negative public/private credit registers. It would be important to create terms for access to obtain credit history, but also to ensure (reciprocal) contributions to same registers.

The European institutions should promote the collation of information on existing databases in all Member States and the development of a "*Memorandum of Understanding*" between the owners/controllers of such registers. With the precondition of harmonisation of credit databases, we deem it appropriate that such a memorandum of understanding promotes the non-discriminatory access to data of different registers to foreign financial providers based on a reciprocal mechanism across the countries, to guarantee a level playing field between national and foreign lenders and foster cross-border business. In this respect we welcome the approach adopted by the Council in its common position on the proposed directive on credit to consumers where now each Member State has to ensure access to credit databases on its territory in case of cross-border provision of credit on a non-discriminatory basis.

There should be no obligation to establish new databases.

The issue of cross-border transferability of consumer credit data, *e.g.* if the consumer moves to another country, is a very complex issue related to fundamental data protection considerations and has also strong competition aspects between financial institutions. Any initiative in this area should therefore in our view be submitted to an in-depth cost/benefit analysis.

It is also worth noting that existing national data protection legislations do not allow credit providers to fight efficiently against fraud (in particular identity theft). The set-up of a fraudster database should in our view be allowed.

(v) Use of credit intermediaries

The use of credit intermediaries is crucial to banks and financial intermediaries, in particular to those lacking their own network of branches. Regulation of these subjects is therefore a matter which must be handled very

carefully in order to provide clients with all the necessary transparency and to avoid an excessive cost burden on the customer.

It is therefore necessary to define specific rules for credit intermediaries which, among other things, identify:

- Terms and conditions for their business activity with respect to both lenders and borrowers, also through specific self-regulation initiatives.
- More stringent requirements for the enrolment in a specific Register, based on a training course with mandatory final examination.
- A code of conduct and a series of sanctions (up to the cancellation from the Register) for those credit intermediaries who do not behave properly with respect to customers.

A distinction should exist between banks, intermediaries and agents, where agents never conclude contracts and operate on behalf of a principal and should therefore be subject to a less stringent liability regime. In Italy, there are regulations for parties who fall in the broader genus of credit brokerage (ex. the legislation on financial agents and on credit mediators). It is therefore necessary to keep in mind the regulations implemented in single Member States, in order to ensure that credit brokerage activities are carried out under predetermined standards. In case that brokerage activities should be opened to other categories, without prejudice to the above-mentioned criteria, we believe that the "*same business, same risks, same rules*" criterion should be applied, thus ensuring a level playing field among players.

As regards the possible content of any future EU policy on credit intermediaries, we recommend the Commission to first launch a study as referred to in the White Paper on financial services Policy (2005 – 2010). In particular, we invite the Commission to consider self-regulation (code of conducts).

(vi) Customer mobility in relation to bank accounts

The EBF has vigorously contested the assumptions made in the Sector Inquiry report that insufficient customer mobility indicates a lack of competition. Accordingly, industry experts who participated in the Bank Account Expert Group (BAEG) established by DG MARKT have supported the view that further evidence should be provided on the alleged lack of customer mobility, as recent surveys have demonstrated the contrary: seven out of ten EU citizens believe they can easily change banks and only 35% of citizens find it expensive to have a bank account (Eurobarometer survey on Public opinion in Europe on Financial Services 2005).

Moreover as many domestic markets have already adopted facilities to improve customer mobility (from national switching codes to mobility guides, partnerships with authorities on consumer literacy in this specific area…), initiatives in this field should be left to those Member States where the problem seems to be more felt by consumers or where no facility has been created so far.

The implementation of SEPA will also have a great influence on the actual demand for customer mobility. Indeed, SEPA will decrease the reasons for customers to have to change accounts when moving abroad (profession, studies, retirement, holidays, etc). No specific action at EU level should therefore be undertaken before SEPA has been implemented.

It follows that the EBF also strongly opposes the adoption of account number portability. Such a measure would be inappropriate and would impose an unacceptable burden on both banks and customers. It would require the complete conversion of customer databases at banks, other commercial undertakings and public administrations; replacement of all payment cards; and alteration of customer letterheads containing account numbers, among other adaptations.

The EBF believes that to improve mobility the Commission should primarily rely on market-driven and voluntary initiatives at local levels.

In addition, legislation implementing Anti-Money Laundering rules applicable to client identification may represent restrictions to cross-border mobility and consumer choice. Consumers often experience difficulty in opening a bank account owing to the identification and verification requirements that all banks must follow to fulfil their money laundering obligations. The EBF would therefore welcome the recommendation made by the BAEG that the Commission should further analyse the impact of anti-money laundering rules on customer mobility and the impact of divergent legal and regulatory requirements for the opening of bank accounts in the EU.

Allowing for cross-border bank accounts to be opened over the Internet without cumbersome need to furnish proof of identity by non-electronic means would for instance make life considerably easier for both consumers and banks. This would require a legal basis permitting bank accounts to be opened throughout the EU with an advanced electronic signature. The evaluation and possible review of the e-commerce Directive and the e-signature Directive should therefore also be considered.

(vii) European Contract Law – The Common Frame of Reference Initiative

The EBF sees the Commission's Action Plan to create a more coherent European contract law as a major step towards improving the civil-law framework for cross-border transactions in the internal market, particularly in retail banking. The barriers to doing business across borders in the European internal market make it necessary to harmonise the relevant rules and regulations at European and national level. The main objective of the Common Frame of Reference (CFR) – to create a "toolbox" to assist the Commission and EU legislators in improving existing and future EU legislation related to civil law – is very welcome. But what is still needed is an open discussion of the central issues with the involvement of all parties, including academics, which have been responsible for national contract law regimes up to now.

(viii) The review of the Consumer *Acquis*

The Commission's objective of revising the consumer *acquis* with a view to creating a true internal market is to be warmly welcomed. In a European market which is becoming increasingly integrated with more and more cross-border banking and financial services, it is essential in the interests of consumers and banks to eliminate existing obstacles to cross-border business and establish pan-European solutions. There can be no scope for national interpretation. This should be achieved by means of successive full harmonisation of those aspects of law that have a particular bearing on doing business across borders – the concept of targeted full harmonisation.

Particularly in the field of pre-contractual information duties there is even a need to reduce the catalogue of obligations, which are far too extensive and not suited to the requirements of the consumer. Only specific explanation to the consumer of the circumstances relative to him places him in a position to make his own decisions. A surfeit of information regularly leads to the contents no longer being grasped. For this reason future regulating measures in this field should concentrate on the quality of information and not the quantity. Furthermore, it is particularly in this area that the Commission should take into account more than hitherto the generally recognised concept in the community legal structure of the "*responsible consumer*", who is considered to be "*averagely informed*" as well as "*aware and rational*" and is capable of playing his role as an "*active fellow-citizen*" responsibly and reasonably from a business aspect.

(ix) The review of the Distance Marketing of Financial Services Directive

Consumers' cross-border access to providers and products at a distance is still difficult today, in particular due to natural obstacles such as differences in language but also because the current legal framework, in particular the Directive on Distance Marketing of Financial Services, has not significantly promoted the cross-border sale of financial services.

Instead, the Directive makes distance selling even more complicated to the detriment of the bank and the consumer, because of minimum harmonisation clauses and excessive information requirements.

The financial services industry aspires to seize commercial opportunities in the development of a true cross-border market. Actually, contracts concluded under distance marketing laws are becoming more and more common in our era of e-commerce. Consequently, we believe that there is a potential for growth if the current problems raised by the application so far of the Distance Marketing of Financial Services Directive are solved in a constructive manner.

3.2.6 Reporting aspects: FINREP

Reporting requires substantial costs and efforts. Reporting requirements are, therefore, an important integration barrier as they may prevent (or reduce the incentives for) a financial institution to provide services across Member States' borders. For major groups, reporting might not be the main element of the consideration when cross-border business decisions are taken. However, it is a relevant indirect integration barrier as well as a competitive barrier.

The EBF would favour transforming FINREP into a true common reporting process at all levels. The emphasis on the development of common reporting in those areas where entities are required to report to the host country should be the relationship between efficiency and cost. To ensure that a common reporting framework is cost efficient and becomes a driver of supervisory convergence, supervisors are encouraged to develop what would be best practice in Europe rather than a format which would be an aggregate of all reporting practices.

Part 4

Part 4 : Conclusion

4. Conclusion

The integration of financial markets is key to consolidating and strengthening the banking sector and therefore to furthering EU economic development and prosperity.

With this in mind, the report has depicted the most urgent priorities on the agendas of the banks and the EU policy makers. These priorities evolve around creating an internal market for retail customers, optimising European supervisory structures, eliminating prudential, legal and fiscal obstacles to mergers and acquisitions in the financial sector and achieving a true level playing field among financial institutions. Attaining these significant milestones will help European banks become stronger, more flexible and adaptable to the challenges of the unfolding global environment of today.

An active promoter and facilitator of the EU's vision of an integrated financial market, the EBF - in conjunction with its member associations – will continue playing its role on accomplishing financial integration in Europe according to its guiding principles:

- Work towards the removal of barriers to the conduct of banking business in the EU single market, so that the banking industry is better able to support its customers and contribute to prosperity and employment.

- Lobby at EU and international level in support of the free market and to ensure that European banks face a level playing field on EU and global markets, operating free of unfair distortions of competition.

- Support the banking industry's efforts to increase efficiency and improve customer service, *e.g.* through infrastructural improvements, thus enabling consumers to avail themselves of competitively-priced banking services and helping European companies to compete as effectively as possible on world markets.

Motivated by this philosophy, the EBF calls on all relevant stakeholders to redouble their efforts to achieve the objectives of the Lisbon Agenda on time.

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Abbreviations

Abbreviations

Abbreviations used in the text

AML –	Anti-Money Laundering
BAEG -	Bank Account Expert Group
BCBS –	Basel Committee on Banking Supervision
CCCTB –	Common Consolidated Corporate Tax Base
CCP -	Central Counterparty Clearing
CESR –	Committee of European Securities Regulators
CEBS –	Committee of European Banking Supervisors
CEIOPS –	Committee of European Insurance and Occupational Pensions Supervisors
CFR -	Common Frame of Reference
COREP -	Common reporting (framework)
CRD –	Capital Requirements Directive
CSD -	Central Securities Depositories
DG -	Directorate General
EC -	European Commission
ECB -	European Central Bank
ECJ -	European Court of Justice
EBF –	European Banking Federation
EFRAG –	European Financial Reporting Advisory Group
EFR –	European Financial Services Round Table
EP -	European Parliament
EU -	European Union
ESIS -	European Standardised Information Sheet
FATF –	Financial Action Task Force
FISCO –	Fiscal Compliance Expert Group
FSAP –	Financial Services Action Plan
FSC –	Financial Services Committee
GAAP –	Generally Accepted Accounting Principles
GDP –	Gross Domestic Product
IASB –	International Accounting Standards Board
IFRS –	International Financial Reporting Standards
IOSCO –	International Organization of Securities Commissions
ISD –	Investment Services Directive
M&A –	Merger and Acquisition
MoU -	Memorandum of Understanding
MiFID –	Markets in Financial Instruments Directive
MS -	Member States
PSD –	Payment Services Directive
SE -	Societas Europea
SEC –	Securities and Exchange Commission
SEPA –	Single Euro Payments Area
VAT –	Value-Added Tax

Annex

Annex

ANNEX: Summary Table of the Key Challenges

Issue	Action proposed	Objective	Executor
(i) Key Challenge: Removing barriers to cross-border banking consolidation			
Taxation of investment income	Remedying obstacles to "post-trading"	To move towards VAT neutrality	EC
	Harmonising domestic rules as regards the provision of goods and services by domestic and cross-border groups	To eliminate fiscal discrimination against foreign products or services	EC, MS
	Completely abolishing interest taxes for intra-EU lending	To stimulate the business-to-business environment	
	Reforming taxation on dividends in cross-border transactions	To allow economically justified cross-border operations	
Corporate taxation	Finding a common approach to interpret the arms-length transfer pricing principle and a common measure of allocating taxable profits	To enhance fiscal integration in the EU	EC
	Working out a common system of loss compensation		
	Eliminating the risk of double taxation in cross-border restructuring		
Civil-law rules for protection of retail banking customers	Fully harmonising the key elements	To achieve economies of scale & cost-saving and to standardise business processes	EC
	Allowing a broader alignment of civil law and contract law		
EU Regulation on the Societas Europea	Amending EU provisions on the SE in regard to employee participation	To achieve level playing field in cross-border mergers	EC

Issue	Action proposed	Objective	Executor
10th Company directive on cross-border mergers	Raising the threshold of co-determination (*i.e.* employees' role in the management of a company)		MS
(ii) Key Challenge: Advancing towards an integrated retail banking market			
Retail banking legislation	Targeting full harmonisation of key provisions, in particular consumer protection laws	To foster cross-border competition and facilitate further integration	EC
	Enforcing mutual recognition as regards residual (*i.e.* non-key) provisions		MS
	Refraining from a wave of new legislation	To give a chance to market-driven solutions	EC
Consumer protection	Conducting empirical research into consumers' genuine needs	To build consumer confidence	EC
	Creating uniform guiding principles		EC
(iii) Key Challenge: Achieving a level playing field among different market participants			
Competitive conditions	With regard to other credit institutions: highlighting a number of issues: institutions' legal form/public ownership; state support or guarantees, territorial limitations and name-protection and prudential regulation	To ensure a level playing field between different types of market participants	EC, MS
	With regard to non-bank market participants: monitoring the entry of new competitors in the payments business		Central Banks, Regulators
(iv) Key Challenge: Making EU consolidated supervision work			
Model of consolidated supervision	Reaching a common understanding on its practical implementation	To bring consolidated supervision model to reality	EU authorities

Issue	Action proposed	Objective	Executor
CRD	Conducting an assessment of CRD implementation	To overcome legal shortcomings arising from national discretions and diverging CRD implementation	CEBS
CEBS working arrangements	Further developing its functioning and decision-making processes	To improve the current (mal-)functioning of the consolidated supervision model	EC, MS
	Completing its disclosure network		National supervisors
	Putting in place a mediation mechanism		CEBS / National supervisors
	Ensuring the enforceability of its decisions and the outcome of its mediation procedures (MoU)		
Framework for supervisors' cooperation	Enhancing trust-building capacity	To enhance national supervisor's cooperation and convergence	National supervisors
	Changing their legal mission statement		
	Organising the delegation of supervisory tasks & responsibilities within the college of supervisors		CEBS / National supervisors
	Establishing truly common formats for reporting requirements & data sharing		
	Ensuring enforceability of the consolidating supervisor's decisions (MoU, peer pressure…)		EC, MS, National supervisors
(v) Key Challenge: Implementing SEPA successfully			
SEPA instruments	Dialoguing with public administrations	To ensure the wide adoption of SEPA instruments	EBF, National Banking Associations
Payment Services Directive	Ensuring consistent implementation and transposition into national law	To ensure the successful roll-out of SEPA products and services	MS
Payment Cards	Preserving the principle of interchange fees	To avoid damaging Europe's card payments business model	EC

Issue	Action proposed	Objective	Executor
(vi) Key Challenge: Reforming the VAT treatment of financial services			
Recast 6th VAT Directive (2006/112/EC)	Adopting a Regulation to update the definitions and scope of VAT financial exemptions	To increase legal certainty and to simplify and ensure consistent VAT treatment	EC
	Granting an EU-wide option to charge VAT on financial services	To allow financial institutions to supply services in VAT neutrality	EC, MS
VAT Grouping legislation	Granting an EU-wide option to treat eligible related entities as a single taxable person	To allow that intra-group transactions can be performed without levying VAT	EC, MS
(vii) Key Challenge: Handling IFRS adequately			
IFRS handling	Endorsing and adopting IFRS swiftly and effectively at the EU level	To ensure the desired transparency and comparability of financial statements EU-wide	EC, MS
	Allowing non-listed companies within group structures to use them		MS
	Issuing guidance (or amending) hedge accounting rules (IAS 39)	To accommodate the specificities of European banks and their business realities	IASB Board
	Discouraging adoption of a full fair value model for financial instruments	To maintain investors' confidence in the quality and reliability of IFRS financial statements	IASB Board
IFRS setting framework	Strengthening European influence at IASB Board level and placing EFRAG's funding arrangements on a firmer footing	To ensure that the specificities of European banks are recognized and duly taken into consideration by the IASB	EC, EP
(viii) Key Challenge: Intensifying international cooperation			
Doha Round	Concentrating the negotiating effort	To attain an appropriate result in the services package	EC
FTAs	Concluding FTAs agreements with selected jurisdictions	To eliminate local legislation (*i.e.* market access barriers) and standards discriminatory to European banks	EC

Issue	Action proposed	Objective	Executor
Regulatory dialogues	Deepening existing financial regulatory dialogues with key jurisdiction (US, Japan, China, India…)	To enhance market opening and eliminate regulatory burdens for European banks	EC
	Exploring the practical implementation of regulatory mutual recognition with the US	To facilitate the business operations of European banks in the US (*e.g.* securities trading)	EC, CESR
Global standard setters	Unifying the EU voice in the international arena	To better promote the interest of European banks	EC, MS