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**ITEM 7 OF THE AGENDA: STATE OF INTEGRATION OF EUROPE'S FINANCIAL  
MARKETS**

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Please find enclosed the FBE comments on the reports of the banking and securities groups "State of integration of Europe's financial markets", published on September 2004.

This document is also available from the FBE homepage, by the following address:  
<http://www.fbe.be/pdf/postFSAPfinal.pdf>

At the meeting, Mr. Tanguy van de WERVE, head of the FBE Banking Supervision and Financial Markets department will report on the issue.

The relevant PowerPoint presentations will be available from the FBE MemberNet shortly after the meeting.

Enclosures: 1



Fédération Bancaire Européenne  
European Banking Federation

## **STATE OF INTEGRATION OF EUROPE'S FINANCIAL MARKETS**

**COMMENTS OF THE FBE ON THE REPORTS OF  
THE BANKING AND SECURITIES GROUPS**

SEPTEMBER 2004

## EXECUTIVE SUMMARY

- The FSAP has been a success in so far as the 2003/2005 deadlines have broadly been met.
- The extent to which the FSAP will contribute to the creation of a truly European market for financial services will mainly depend on (i) the correct and timely implementation of the FSAP measures at Member State level, (ii) convergence of national supervisory practices and (iii) proper enforcement.
- The Level 3 Committees need to develop an EU-centric view of policy and promote a culture of cooperation between their members.
- More resources need to be devoted to the services of the Commission in charge of enforcing EU legislation. Industry has to play an active role in identifying and reporting infringements.
- The FBE supports the Lamfalussy model and its extension to banking.
- While there is no need for a long list of new legislative proposals along the lines of the FSAP, many actions are yet to be taken -in different areas- in order to achieve a single European financial market.
- Carefully targeted legislation is needed in the retail banking field where removal of well-identified obstacles would help to open up national markets. The FBE considers full harmonisation of key retail banking elements, i.e. elements that are essential to foster cross-border competition, as the most effective means of creating a genuine European internal market for retail banking services, to the benefit of consumers and businesses alike. Concrete recommendations are made in this paper.
- An appropriate level of consumer protection, based on adequate information, should be promoted. At the same time, bureaucratic prescriptions should be avoided as this would be detrimental to providers and consumers alike.
- Other priorities include *inter alia* the removal of artificial obstacles to further consolidation in the European banking industry, a coherent VAT treatment of financial services, the creation of a market-driven Single Euro Payment Area spurred on by the European Payments Council, more efficient cross-border clearing and settlement processes and the implementation of the Basel Accord.
- The FBE welcomes the consolidating supervisor concept and supports the approach taken by the Commission in its proposal for a Regulatory Capital Directive.
- Policy making should be evidence-based. If there is a perceived need for action, options other than regulation should also be considered. Industry consultation must be a feature of all stages of the legislative process.
- Competition policy should be seen as central to the integration process.
- The new Commission must adopt a more collegial approach so as to ensure a better coordination between Directorate Generals.
- The creation of a European Single Market for financial services is not an end but rather a means to increasing the international competitiveness of the EU market place. Systematic assessments of the business impact of EU regulation should be undertaken.
- Given the unprecedented globalisation of financial services, there is a need for (i) a strong EU voice in the international arena and (ii) a structured dialogue with the main EU partners.

## I. COMMENTS ON THE GENERAL AMBITIONS WHICH THE EXPERT GROUPS PUT FORWARD AS A VISION FOR THE FURTHER DEVELOPMENT OF A SINGLE FINANCIAL MARKET

### BANKING REPORT

While acknowledging that the Report reflects the consensus opinion within the Banking Group, the FBE believes that the experts could have been more incisive in some of their messages. In particular, it could have been made clearer that:

- While there is no case for an FSAP II, **action is needed to open up national retail banking markets;**
- **Failure to take appropriate action would deprive the EU from reaping the benefits of retail banking integration (growth estimated at minimum 0.5%<sup>1</sup> of EU GDP p.a.) and be contrary to the Lisbon agenda;**
- As acknowledged by the FSC<sup>2</sup>, there need not be a presumption that retail markets are by nature local, fundamentally different from wholesale markets and therefore not likely to benefit from integration;
- On the demand side, consumer confidence is a pre-requisite for further cross-border retail banking integration. An appropriate level of consumer protection - based on adequate information- and FIN-NET, the out-of-court complaints network for financial services, should therefore be promoted;
- On the supply side, minimum harmonisation has resulted in divergent regulations and therefore proved to be a barrier to the provision of cross-border retail banking services. **Full harmonisation<sup>3</sup> of key retail banking elements<sup>4</sup> should be preferred. Full harmonisation should, however, not be set at too high a level, and bureaucratic prescriptions should be avoided, as this would be detrimental to providers and consumers alike and negatively impact the competitiveness of the EU as a business location.**

Like the Banking Group, the FBE believes that:

- **Competition policy should be seen as central to the integration process.** The aim should be to ensure that the broad FSAP objectives of furthering integration are not hindered by anti-competitive behaviour;
- **Better co-ordination and reinforced cooperation among supervisors is required through the Committee of European Banking Supervisors (CEBS).**

**The FBE welcomes the consolidating supervisor concept and supports the approach taken by the Commission in its proposal for a Regulatory Capital Directive.**

FBE's views on specific issues identified by the Banking Group are expressed in Chapter V.

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<sup>1</sup> F. HEINEMANN and M. JOPP, *The Benefits of a Working European Retail Market for Financial Services*, Report to European Financial Services Round Table, 2002.

<sup>2</sup> Financial Services Committee.

<sup>3</sup> To avoid misinterpretations, a definition of the full and minimum harmonisation concepts is provided in the Annex to this paper (see page 37).

<sup>4</sup> I.e. elements that are essential to foster cross-border competition.

## SECURITIES REPORT

The FBE believes that the FSAP has been a success in so far as the 2003/2005 deadlines have been broadly met. The Commission's focus on keeping the momentum going during the process and on maintaining the commitment of the Heads of State and Government and of the European Parliament to the importance of the FSAP played a key role in this respect.

**The FBE fully supports the view of the Securities Group that it is too early to say whether the FSAP has achieved its stated objectives as:**

- some key FSAP measures are yet to be adopted;
- important 'Level 2' measures are yet to be adopted;
- many measures adopted at European level still need to be transposed in Member States.

In addition, even when the full suite of legislation has been transposed into national law and the process of enforcement is under way, it will still take significant time for industry to assess to what extent the FSAP has changed working practices, opened up the securities markets across Europe and brought direct benefits to all market participants including investors.

**The FBE concurs with the Securities Group that the extent to which the FSAP will contribute to the creation of a truly European market for financial services will mainly depend on:**

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

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

With the exception of clearing & settlement and the implementation of the Commission's Action Plan for "Modernising Company Law and Enhancing Corporate Governance in the EU", the FBE sees no further areas in the securities sector that are in immediate need of regulation at EU level. **A legislative breathing space and a period of consolidation are needed.**

**A key task will be to monitor to what extent the new rules are promoting competition and innovation.** The greater the degree of regulation, the more likely it is that the competitiveness of Europe as a business location will suffer compared to other markets around the globe. It will thus be crucial in the coming years to examine whether unnecessary bureaucracy has been created and should be reversed.

FBE's views on specific issues identified by the Securities Group are expressed in Chapter V.

## II. COMMENTS ON THE EFFECTIVENESS OF THE CURRENT EU LEGISLATIVE FRAMEWORK AND ARRANGEMENTS FOR SUPERVISORY COOPERATION (“LAMFALUSSY PROCESS”)

### THE FBE FULLY SUPPORTS THE LAMFALUSSY PROCESS

**A successful Single Market will be based on effective and proportionate regulation and supervision. Meeting this objective is dependent on a viable delivery mechanism. The FBE believes that the Lamfalussy model is the right structure for the delivery of this objective.** Not only is there no other viable structure at this stage, but also the Lamfalussy model is the best and most pragmatic approach in view of the current development of the EU, political sensitivities and fragmentation of the supervisory landscape.

The FBE has been supportive of the Lamfalussy approach since its inception.

While experience of the operation of the Lamfalussy approach in the securities field has been encouraging, there is a need to (i) focus on the quality of legislation and implementing measures rather than speed and (ii) improve the transparency at all stages of the process.

It is vital for the delivery of financial stability, the protection of depositors and borrowers, and the competitive position of the European banking industry in a global market to ensure that banking regulation is focused, flexible and proportionate.

The implementation of the Regulatory Capital Directive will provide an important test of the EU’s willingness and ability to deliver this objective in practice.

The FBE fully supports the recent extension of the Lamfalussy approach to banking whilst building on developing best practice in the securities field. The democratic accountability and transparency of the process will be guaranteed by the European Parliament’s right to call back implementing measures.

### IMPROVEMENTS CAN STILL BE MADE

As argued in the FBE’s responses to the IIMG<sup>5</sup>, while the Lamfalussy process has greatly improved the pre-drafting stage of consultation, the changes introduced to a legislative proposal at the co-decision stage are still not subject to a satisfactory **degree of transparency** and evidence-based discussion. While the Parliament conducts its business in a transparent manner, the **Council still has progress to make** and could emulate improvements carried out by other institutions, e.g. the European Securities Council and certain national governments.

The legal form of implementing measures has been the focus of some debate; it has sometimes been suggested that Regulations would be speedier than Directives and should therefore be preferred. The FBE believes that **it would be wrong to give Regulations automatic preference over Directives only in an effort to speed up the legislative process**. The decision as to whether a Directive or a Regulation is the most suitable Level 2 instrument must be made on a case-by-case basis, depending on *inter alia* the nature of the implementing measure and the legal situation in the Member States.

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<sup>5</sup> Inter-Institutional Monitoring Group.

The FBE supports the observations made by the Securities Group with respect to (i) the need for Level 1 measures to consist of framework principles, (ii) the need for greater coherence between Level 1 and 2, (iii) the need to avoid too much detail at Level 1 and (iv) the need to ensure that regulation does not hamper innovation. It should be studied in this context whether **the provisions in Level 1 that enable the adoption of implementing measures** have to be used automatically. **In the FBE's view, such provisions give the Commission the option of creating detailed rules if, and only to the extent to which, there is a need to do so.** There might well be no such need. An important factor to take into account in this respect is the competitiveness of the EU as a business location compared to other markets around the globe.

The Securities Group's proposal regarding Level 3 being turned into Level 2 is ambiguous, and the FBE would caution that such a conversion should certainly not be automatic. Such a demand should only be made if there is a legal obstacle to the functioning of Level 3.

With respect to new financial products and the role of CESR<sup>6</sup> (§ 40 of the Securities Report), the FBE reiterates the point it made to CESR in the context of the public consultation on CESR's role at Level 3, that no such coordination is necessary for products and services that already enjoy an EU passport (e.g. falling under the MiFID<sup>7</sup> or the Prospectus Directive), and that it could be potentially useful only in those situations in which a pan-European product that explicitly needs permission in all EU Member States is being launched.

With respect to good consultation practices, the FBE strongly supports the IIMG's recommendation that, as a general rule, **CESR should be given 12 months for completing pieces of technical advice.** The FBE urges the Commission to explicitly endorse this principle and refrain from curtailing the period<sup>8</sup>. In addition, the possibility of introducing transitional arrangements at Level 2 should be considered so that a high quality is attained for the implementing measures and market participants have adequate time to adapt their internal organisational procedures.

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<sup>6</sup> Committee of European Securities Regulators.

<sup>7</sup> Markets in Financial Instruments Directive.

<sup>8</sup> As was done in the 2<sup>nd</sup> mandate for the MiFID technical advice (issued in June 2004 with a deadline of April 2005).

### **III. COMMENTS ON GENERAL PRINCIPLES AND METHODOLOGY FOR IDENTIFYING AND PRIORITISING FURTHER EU LEVEL LEGISLATIVE OR OTHER POLICY ACTIONS, AND IMPROVING THE EU FINANCIAL RULE-MAKING PROCESS**

The development and delivery of a Single Market for financial services is an important objective, but it is not an objective that should be pursued without regard to the balance of costs and benefits of removing barriers. **A theoretically perfect Single Market should not be pursued at all costs. Business can move elsewhere.**

For any new regulatory initiative, the Securities and Banking Reports lay out important principles for the proper regulation of financial services in the EU. Overall the FBE agrees with such principles.

**The FBE believes that any proposal for regulatory action at European level should be considered against the following tests:**

#### **Subsidiarity**

It is a key principle that legislative action should only be taken at European level if the issue cannot be resolved at Member State level or via supervisory cooperation.

#### **Evidence-based policy making**

To ensure policy is relevant, legislators should obtain evidence from relevant sources (including, *inter alia*, investors, consumers, issuers, market intermediaries, legal experts, regulators, academic experts, published information) to support decisions about:

- Whether a policy need exists, and if so, the nature thereof;
- If (and only if) a need exists, what policy approaches might be appropriate;
- Which of the possible policy approaches should be preferred.

#### **Proportionality**

Where regulation at European level is appropriate, it must be both effective and proportionate. This applies not only to Directives and Regulations, but also to implementing measures and core standards that result from supervisory cooperation.

#### **EU's competitiveness**

The definition of proportionate regulation should take account of the impact on competition both within and beyond the EU. Regulation must avoid distorting the market by, for example, favouring one type of firm over another or one type of product over another unless there is a clear reason for doing so. Unless proposed regulations and standards undergo a competitiveness test, the prospects of the EU meeting the Lisbon objective of becoming the most competitive economy in the world by 2010 will be much diminished.

#### **Proper consultation**

Proper consultation has a valuable role to play in determining whether action is necessary at European level and what form that action might take. It also provides an opportunity to test whether the approach proposed is justified by a preliminary impact assessment and whether any resulting regulations will be both effective and proportionate.

Consultation must be a feature of all stages of the process. Sufficient time should be allowed for informed input to be made by the industry and other interested parties before decisions are taken. While the **lack of sufficient time for consultation at all stages of the process** is a recurrent problem for all market participants, this problem is particularly acute for the banking industry in the new Member States. It is hoped that the overall time pressure will decrease with the conclusion of the FSAP, which was based on a very tight timetable.

If consultation is to be a valuable process for all parties, it must be 'real'. There is little benefit in undertaking consultation if decisions have effectively already been taken. In addition, consultations should be carried out in an open, transparent and systematic way. In particular, better feedback should be given on the results of consultation and especially why views have been rejected.

High consultation standards are also required from standard setters<sup>9</sup>.

### **Non-legislative approaches**

If there is a perceived need for action, options other than regulation should be considered as part of the impact assessment exercise. This includes looking at self-regulation but also at how competition policy can be used to tackle barriers to cross-border activity.

Self-regulation has the advantage of being market led and able to respond quickly to market developments. Such an approach is, however, unlikely to be effective in an area where regulation already exists at European or Member State level, unless the decision is taken that self-regulation should replace statutory regulation.

EU institutions should provide legal certainty (through the creation of a safe harbor or otherwise) as to the conditions under which self-regulation does not breach competition law.

### **Quality over speed**

Where regulation at European level is pursued, quality and hence effectiveness must not be sacrificed in order to meet politically inspired deadlines. A political commitment to the delivery of Single Market objectives is valuable, but this commitment must encompass better, more effective and proportionate regulation. Rushed legislation is unlikely to achieve this and risks falling short of the objectives set for it.

The FBE fully concurs with the Securities Group's emphasis on the transparency of the regulatory process. As mentioned above, **greater institutional transparency is required, particularly with respect to the Council.**

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<sup>9</sup> The need for high standards of consultation in the accounting field is emphasized in the [Annex](#) to this paper (see page 41).

The FBE supports the Securities Group's idea of **analysing the existing legal position in Member States at a very early stage in the legislative process**. The findings should be used as a basis for determining to what extent new regulation is necessary and what costs such regulation would incur for market participants. This practice should be adopted on a systematic basis by both the Commission and the Level 3 Committees (acting at Level 2) in their respective areas of work.

Like the Securities and Banking Groups, the FBE believes that **policy and law-making should be justified by, and built on, evidence**. This calls for preliminary impact assessments to be made. These **impact assessments should be published. It is hoped that these impact assessments will not systematically endorse the need for EU action. Otherwise, they will prove to be little more than another bureaucratic requirement**. The use of impact assessments should be preferred over that of cost benefits analysis *stricto sensu* as the costs and especially the benefits of regulatory proposals make take the form of, non-quantifiable, 'intangibles' (such as improved market integrity, transparency, consumer confidence, financial stability, etc.), a point also made by the Commission in its 10<sup>th</sup> Progress Report on the FSAP.

**The FBE encourages the Commission to make greater use of review clauses in legislation to provide triggers for evaluating the impact of legislation over time.**

**Finally the FBE welcomes the four-Presidency initiative to address the issue of better regulation** both at national and EU level and fully supports the envisaged actions to make better assessment of the potential impact on competitiveness of proposed regulation, simplify existing regulation, and look at ways for reducing the administrative burdens on business. Such actions should help release the growth potential locked up by harmful regulation. High levels of regulation and business start-up costs impact adversely on new and existing businesses and thereby on the level of competition and the rate of economic growth in Europe. Better regulation at both European and national levels will achieve desirable policy objectives at the lowest cost to business and society. The FBE hopes that this will not stay merely a declaration of intent **and calls on the said Presidencies and on the Commission to turn words into action.**

#### IV. COMMENTS ON THE NEED FOR GREATER SUPERVISORY CONVERGENCE AND BETTER ENFORCEMENT

Consistent interpretation and application of the FSAP measures and effective enforcement thereof will greatly determine whether or not a Single Market for financial services has been created in the EU. As Mrs RANDZIO-PLATH<sup>10</sup> put it **“it is essential to avoid a situation whereby there is re-nationalization by the back door from dissimilar implementation in the Member States”**.

##### CONVERGENCE

While the Level 3 of the Lamfalussy approach has yet to be put to the test, the FBE is confident in the ability of the Level 3 Committees to contribute to the consistent implementation of European Directives and to the convergence of Member States' supervisory practices throughout the Community.

However, for the Single Market to become a reality, **the Level 3 Committees will need to develop an EU-centric view of policy and promote a culture of co-operation between their members** (incl. exchange of information).

**The implementation of the Regulatory Capital Directive represents a huge opportunity to improve the convergence of supervisory practices.** If an agreement can be reached between supervisors on how to apply this new, very extensive, framework, this by itself will increase convergence in a dramatic way.

The consolidating supervisor model could also provide a practical mechanism for the supervisory cooperation necessary to deliver convergence. **The development of the established role of the consolidating supervisor in the proposed Regulatory Capital Directive will make an important contribution to avoiding unnecessary duplication and costs, whilst enhancing supervisory cooperation.** The Commission's approach respects the role of national supervisory authorities whilst ensuring that a group based in the EU needs only submit an application (e.g. to adopt the Internal Ratings Based Approach for credit risk) to the consolidating supervisor. It encourages cooperation by encouraging supervisors to work in full consultation when determining applications. Importantly, the Commission's approach gives supervisors 6 months to reach an agreed view after which the consolidating supervisor can take its own view on the application. The FBE support the Commission's approach which it considers as the minimum acceptable; in other words, the FBE would oppose any attempt to water it down.

**Convergence of supervisory approaches would also be promoted by ensuring that supervisors have a common set of supervisory tools, including comparable enforcement and prosecution powers, at their disposal.**

**It would be further promoted by the introduction of a mandatory supervisory disclosure regime,** as recommended by the Banking Group. The FBE therefore welcomes the inclusion in the proposed Regulatory Capital Directive of a requirement for supervisors to disclose information to enable a meaningful comparison of approaches adopted across the EU.

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<sup>10</sup> Dr. C. RANDZIO-PLATH, *European financial integration – The perspective of the European Parliament*, European Commission Conference, Brussels, 22-23 June 04.

## ENFORCEMENT

The latest Internal Market scoreboards published by the Commission indicate a growing implementation deficit in various Member States. The newly energised approach of the Commission towards enforcement of EU measures, together with commitment from all interested parties, including the industry, will be critical to the consistent implementation of both the letter and spirit of the FSAP rules and therefore to the FSAP success.

The FBE has welcomed the **regular publication** by the Commission of FSAP Progress Reports. Such reports should continue beyond 2005 and take the form of **specific scoreboards of Member States' performance in terms of implementing and enforcing FSAP rules.**

In addition, more resources need to be devoted to the services of the Commission in charge of enforcing EU legislation.

The FBE supports the Commission's efforts to improve coordination of implementation in partnership with the Member States - *inter alia* through organizing technical meetings to discuss implementation issues and requiring the production of correlation tables by members of the ESC. Yet, the FBE would like the outcome of the aforementioned meetings to be made public<sup>11</sup>.

**The FBE is in favour of strengthening peer pressure among Member States including the wider use of quantitative targets and scoreboards.**

**The industry should be involved in reviewing and improving the implementation of EU laws and rules at all times.** In particular, the FBE suggests that the Commission solicits the views of market participants on how financial services integration is progressing before publishing its 'Spring Report' on progress towards the Lisbon Strategy.

Finally, **the FBE welcomes the recent Commission's recommendation on the transposition into national law of Directives affecting the internal market.** The FBE particularly endorses the recommendation n° 6 according to which Member States should "refrain from adding to national implementation legislation conditions or requirements that are not necessary to transpose the Directive concerned, where such conditions or requirements may hinder attainment of the objectives pursued by the Directive". It remains to be seen however whether this will have any effect given (i) the very broad (and, on occasion, possibly conflicting) objectives usually set in Directives, (ii) the absence of any reference to the said objectives in Section 3.4<sup>12</sup> of the Annex to the said Recommendation and (iii) the Member States' damaging tendency to introduce home-made conditions and requirements in the absence of a full harmonisation approach.

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<sup>11</sup> So, for example, a synthesis of the discussions (aimed at ensuring a common interpretation of the Directive in order to minimise the risk of divergent implementation at national level) of the Commission services with the Mixed Technical Group on the prudential regulation of financial conglomerates should be published on the DG Internal Market and Services website.

<sup>12</sup> Section 3.4. reads as follows: 'The addition of supplementary provisions that are not necessary to transpose a Directive is avoided. Where it happens the Ministry (...) justifies why it is considered necessary ...'.

## V. VIEWS ON ANY SPECIFIC ISSUES IDENTIFIED BY THE SECURITIES AND BANKING GROUPS AS PRIORITIES FOR FURTHER ATTENTION BY EU POLICY-MAKERS

### CLEARING AND SETTLEMENT OF SECURITIES

#### Commission's Communication

Efficient cross-border clearing and settlement processes are essential to allow market participants to operate effectively in an integrated EU financial market. The current cross-border arrangements in the EU are complex and fragmented, imposing costs, risks and inefficiencies on investors, institutions and issuers. Solutions, market-led and/or regulatory, therefore need to be found as a matter of priority.

The FBE welcomes the recent Commission's consultation on the way forward for clearing and settlement in the EU. The FBE believes that:

- The biggest gains in reducing the cost of clearing and settlement of securities will come from the removal of the tax and legal barriers identified by the Giovannini Group. This should be the focus of the Commission's efforts, in cooperation with the industry.
- The Commission is right to consider the option of introducing **a framework Directive** for clearing and settlement of securities, since such a framework **could contribute to the creation of an integrated European market which complies with the public policy objectives laid out in the second Giovannini report: cost-efficiency, fair competition and avoidance of systemic risk**. Despite these potential benefits, **however, the Commission needs to assess the net impact of the regulatory option on the market and investors**.
- There could be a benefit in a framework Directive that is focused on setting out clear framework principles for clearing and settlement of securities; introducing definitions that are consistent and coherent; establishing a risk-based functional approach to the regulation of the different actors; and establishing a clear regime of home country control. Such a Directive would clearly focus on the functions or the combination of functions which raise concerns for the stability of the system by virtue of the concentration of risks or combination of the risks they pose.
- As argued in a recent meeting of the ESC, the proposed CESR-ESCB Standards should not direct the Commission's work on a future Directive. The Commission should be ready to adopt different solutions in its own approach on the framework principles than those in the proposed Standards, and provide clear guidance for CESR to carry out a new consultation and to deviate, where necessary, from its proposed Standards when providing technical advice for any future Level 2 measure.

## CESR-ESCB Standards

The FBE has strong reservations with respect to the CESR-ESCB own-initiative work on standards in the field of securities clearing and settlement. It not only suffered from inadequate consultation but it was also carried out in the absence of an EU framework and, as such, could prejudice the envisaged future EU framework Directive. **The FBE is pleased to see that the CESR-ESCB Standards have not been adopted as originally foreseen in July, and would strongly urge the two institutions to wait for the results of the Commission's work in this area which will determine the overall regulatory framework.**

## Giovannini barriers & CESAME

The FBE regards action on clearing and settlement as a priority for the coming years. It considers that the process of dismantling barriers to cross-border clearing and settlement should continue and that markets should operate under an appropriate legal framework which will ensure that important public policy concerns, such as the safety of systems, investor protection and fair competition, are fully respected by all market players.

To help foster this process, the Commission has recently set-up a high-level Clearing and Settlement Advisory and Monitoring Expert group (CESAME), whose role is to support the integration and liberalisation project and to coordinate action in bringing down all the barriers identified in the Giovannini reports for which the private sector has sole or joint responsibility. The FBE very much welcomes the creation of this group, of which it has the privilege of being a member.

## COHERENCE OF EXISTING COMMUNITY LEGISLATION

**For European legislation to provide a coherent framework it is crucial that the rules contained in different legislation follow the same criteria and principles.** This is unfortunately not always the case. For instance, the home country principle is applied in the Directive on Electronic Commerce whereas the host country principle prevails in the Directive on Distance Marketing of Financial Services.

Likewise, the period of time in which a consumer may exercise the right of withdrawal in the proposed Consumer Credit Directive is different from that foreseen in the Distance Selling, Door-step Selling and Distance Marketing of Financial Services Directives.

**Future proposals for legislation should be focused, primarily, on the removal of such divergences in order to achieve coherence in European legislation.**

## COMPETITION POLICY

**A crucial condition for the development of pan-European market places is a well-functioning cross-border competition process.**

Competition policy should be seen as central to the integration process and **the Commission should therefore make greater use of all its competition powers to ensure that the broad FSAP objectives of furthering integration are not hindered by anti-competitive behaviour.**

## COMPETITIVENESS OF THE EU

In a globalised world, the creation of a European Single Market for financial services is not an end, but rather a means to increasing the international competitiveness of European financial markets. Achieving both a Single Market for financial services and the competitiveness of the EU vis-à-vis global markets involves a difficult balance.

Recent research on the competitiveness of nations (IMD World Competitiveness Yearbook 2003) has led to the conclusion that market access (openness) is one of the most important factors for improving a region's competitiveness. Open markets foster competition, thereby increasing quality and reducing prices for consumers while at the same time giving firms incentives to innovate.

Unless proposed regulations and standards undergo a competitiveness test, the prospects of the EU meeting the Lisbon objective of becoming the most competitive economy in the world by 2010 will be much diminished. As indicated earlier in this paper, **systematic assessments of the business impact of EU regulation should therefore be undertaken.**

## CONSOLIDATION OF THE BANKING INDUSTRY

The values of an open market economy and free competition are enshrined in the EU Treaty. European competition policy is built on the view that competition is good for the consumers and industry alike.

However, the full benefits of increased competition are not always achieved in practice. Increased competition in the banking sector has stimulated banks positively in a number of ways. They have increased efficiency and cut costs; adjusted business strategies, for example by developing new services and distribution channels; and consolidated through mergers and acquisitions. So far, this consolidation of activities has been seen mainly in wholesale banking services such as corporate bond and equity issuance, and mainly within national boundaries or in defined geographic regions such as in the Benelux countries and in the Nordic-Baltic area.

**The low level of cross-border consolidation partly reflects legal and regulatory differences, such as consumer, competition and debt recovery policies, which make it difficult to develop a pan-European product range.** Consolidation is also discouraged by differences in culture and in corporate governance; and, in some countries, the presence of institutions with government shareholdings or involvement.

**Looking to the future, the operation of market forces will gradually help to erode some of these barriers. But the EU and national authorities also have a role to play.** Decisions of the European Commission have in the past made the case for bank mergers in small countries less attractive (assets sell-off), on the basis of a narrow definition of "national market". This has in effect prevented banks in those countries from building a capital base large enough to compete at EU level. At **national level, the authorities may hamper consolidation through measures designed to protect their financial institutions from foreign takeovers. The enlightened application of competition rules should allow the financial services industry to consolidate in a beneficial way for both EU and domestic economies.**

## CONSUMER CONFIDENCE

While in a competitive market banks will strive to offer products that meet consumers' demands, this is not sufficient, and **explicit consumer protection rules are needed if consumer confidence is to be maintained and the cross-border delivery of financial services is ever to become commonplace.** Maintaining consumer confidence is a pre-requisite for the development of cross-border activities.

The FBE believes that European consumers have the right to expect banks and regulators to comply with the following five principles<sup>13</sup>:

- 1) The guarantee of receiving appropriate information in order to make an informed decision. Does the product meet the client's individual needs and circumstances? The quality of the information, not the quantity, is what counts.
- 2) Time for consumers to think over their purchasing decision, and a right of withdrawal in some cases.
- 3) Regulators must allow financial services providers enough flexibility in designing products. This is in effect an essential condition for innovation and meeting client needs. Naturally, this flexibility must be reconciled with balanced consumer protection of a nature to build trust.
- 4) Advisory services for clients who want them. This goes beyond information, since it aims to find the right fit between the product and the client's specific needs.
- 5) Easy and inexpensive access to mediation, in particular for cross-border transactions (FIN-NET).

While a high level of consumer protection is desirable, setting the protection standard at the highest possible level<sup>14</sup> would be damaging and counterproductive as:

- innovation would be discouraged, or even prevented, and consumer choice reduced;
- the costs to the financial industry and, ultimately, to the consumers would increase.

**In addition, a distinction should be made between the 'average consumer'** as defined by the European Court of Justice **and the most vulnerable consumers.** The latter deserve extra protection; too detailed rules should, however, be avoided as they would lead to bureaucratic procedures and unnecessary constraints that may well translate into a rise of service costs for consumers in general.

**Finally, more consumer education and awareness-measures** (incl. as regards out-of-court redress mechanisms such as FIN-NET) **are needed** in order to improve consumer confidence.

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<sup>13</sup> Like the European Financial Services Roundtable.

<sup>14</sup> i.e. taking the most restrictive provisions of each national system.

## CORPORATE GOVERNANCE

The recent scandals affecting corporate Europe have attracted negative publicity and undermined investor confidence. The implementation of the Commission's Action Plan for "Modernising Company Law and Enhancing Corporate Governance in the European Union", adjusted to take account of the lessons learned from the recent affairs, should therefore be a priority.

Effective coordination of the national responses to the accounting regulatory issues highlighted by the recent scandals is required. Many Member States are currently adopting national measures to restore confidence in their country as a financial market place. Yet, cross-border cooperation is essential if Europe is to make sustainable improvements in the accounting industry and maintain investor confidence.

**The FBE believes that there is no need for a single EU code** and that harmonisation in this field can be best achieved by establishing national codes so as to accommodate the considerable differences existing across Europe in company law regimes. Furthermore, the FBE does not see a need for adopting a specific "financial market" approach that would set banks apart from companies in the field of corporate governance and would therefore advise against it.

Any regulatory action will need to be proportionate and evidence-based.

## CREDIT RATING AGENCIES

**The FBE welcomes** the Commission's call for technical advice to CESR on possible measures concerning credit rating agencies and **the upcoming public consultation by CESR**. The FBE will participate in this consultation.

As recommended by the Commission, CESR should work in collaboration with CEBS given the importance of credit ratings in the new regulatory capital framework. Close contact with the SEC and IOSCO is also needed in view of the global context within which credit rating agencies operate and in order to ensure that any initiative taken is consistent therewith.

Credit rating agencies play a crucial role in European capital markets and, as users of their ratings, **European banks underline the need for total freedom of expression and for independence of the agencies whether from political or business influences.**

Again, any regulatory action will need to be proportionate and evidence-based.

## CREDIT REGISTRIES

The FBE broadly supports fostering competition between credit providers. Competition between credit providers could be facilitated by institutions having equal access to credit reporting data, whether it be negative, such as information on defaults, or positive data, for example in relation to exposures.

However, **excessive harmonisation of credit reporting is not a panacea and should not be proposed at this stage.** Rather, market forces should be allowed to facilitate competition between credit providers. Therefore, the FBE fully supported the more realistic and market oriented approach set out by the European Parliament in its Legislative Resolution on the Consumer Credit Directive. The Resolution abolished the Commission's provisions on establishing central national databases whilst retaining the obligation on Member States to ensure access to existing national databases, without prejudice to institutions or their Member State of incorporation.

It should be noted that some initiatives related to private sector registers are already successfully up and running without any intervention at EU or Member State level<sup>15</sup>. Moreover, the FBE notes that a number of Central Banks in Member States have already established Memoranda of Understanding for data exchange, so the purported lack of personal data for responsible consumer lending ought not to be a rising trend. At this juncture, an assessment must be made on whether the benefits of harmonising credit appraisals will outweigh the costs for market participants of increased flows of data.

Notwithstanding the above, the FBE believes that:

- it is essential that no obligation be imposed on credit providers to consult a database on positive or negative data, prior to any commitment on the part of the consumer or guarantor. If the credit provider has no reason to doubt that the customer is solvent based on the information he or she provides to it, then credit providers ought not need to refer to additional sources of data; and
- national data protection legislation should not be a barrier to the provision of cross-border financial services within the EU, under any circumstances.

#### EARLY REPAYMENT OF FIXED-INTEREST LOANS

The FBE believes that if there were to be an EU-wide general right for consumers to repay fixed-interest loans early without a justifiable reason or indemnity, then such products could not be offered in the same way they have been until now.

Nonetheless, the FBE could support a consumer's right to discharge the loan under exceptional and legitimate circumstances, for example following the sale of property. Moreover, the FBE broadly supports the wording in the existing Consumer Credit Directive which states that in the case of early repayment, *"in accordance with the rules laid down by the Member States, the consumer shall be entitled to an equitable reduction in the total cost of the credit."* Europe's banking industry supports such wording, which doesn't go as far as the proposal for a new Consumer Credit Directive, thereby respecting the principal of subsidiarity.

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<sup>15</sup> See for example, [www.accis.org](http://www.accis.org). Also, voluntary and bilateral contracts between national credit bureaus are common practice, such agreements existing between DE-IT, DE-AT, DE-NL, DE-SK, IT-NL, IT-IRL, IT-AT, IT-DK, NL-AT, NL-BE.

**If, however, more detailed regulation governing the early repayment of fixed interest loans were to be introduced, consumers' rights to early repayment should be linked with the obligation to pay an indemnity to the product provider.** This would compensate the lender for the loss and the costs to which he or she is exposed following early repayment and ensure that the lender is in the same position as he otherwise would have been had the loan been held to maturity. The indemnity claimed by the lender must be fair and in accordance with the principles of subsidiarity; the notion of fairness must be derived from the law of indemnity in force at Member State level.

The FBE believes that harmonisation of standards should only be considered where there would be a distinct boon to integration within the single market. Specifically:

- **there should not be any harmonisation of early redemption fees.** Early repayment is a product option for which a price must be paid. It follows that harmonising early redemption fees amounts to price fixing; and
- **legally enforceable caps on early redemption fees should be removed where they still exist under national law.**

#### HARMONISATION (DEGREE AND EXTENT OF)

**The minimum/full harmonisation debate did not receive sufficient prominence in the Banking Report.**

Citizens will gain confidence in Europe as customers if they are offered better and more competitive services and products by a number of providers. The key challenge is therefore to enable consumers to enjoy appreciable performance and price advantages in the Single Market through a greater product variety. To this end, simple consumer protection rules are needed that will facilitate cross-border supply of financial services. **Today different specific rules are applied in Member States for the design and marketing of almost identical products. This diversity of consumer protection rules makes cross-border transactions impossible without costly modifications. As a result, no European financial company sells the same retail financial products in a cross-border way in all EU countries. The practical consequence is to restrict competition, consumer choice and innovation.** If the range of products were extended through innovations, without the limitations imposed by different national regulations, European consumers would find among the offers of a greater number of financial services providers, the products that meet their exact needs.

Contrary to the principle of full harmonisation, the principle of minimum harmonisation allows Member States to introduce, or maintain, more stringent requirements by means of their national legislation<sup>16</sup>.

**Minimum harmonisation forces financial services providers to comply with different sets of rules and is a major obstacle to further integration of the European retail banking markets.**

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<sup>16</sup> To avoid misinterpretations, a more detailed definition of the full and minimum harmonisation concepts is provided in the Annex to this paper (see page 37).

**The FBE considers full harmonisation of key retail banking elements, i.e. elements that are essential to foster cross-border competition, as the most effective means of creating a genuine European internal market for retail banking services, to the benefit of consumers and businesses alike.** Concrete examples of such elements are provided further below (under 'Retail banking').

Subject to adequate harmonisation, country of origin rules based on the principle of mutual recognition can play a role for remaining issues and on a case-by-case basis. The Commission should however make sure that "general good" provisions are not being used to protect vested national interests.

As already mentioned in this paper (see 'Consumer confidence' above), **while a high level of consumer protection is needed, full harmonisation should not be set at the highest possible level as this would in the long run be detrimental to providers and consumers alike.**

**This issue of minimum/full harmonisation is not merely an academic one.** It has substantial practical consequences. Avoiding entering the debate by simply saying that it should be analysed on a case-by-case basis is not acceptable. **An informed debate is needed as a matter of priority. The FBE calls for a much better coordination between, *inter alia*, DG Internal Market and Services and DG Health and Consumers' Protection in this area.**

#### MONITORING AND MEASURES OF INTEGRATION

**Close monitoring of the effectiveness of the FSAP measures over time is required.**

**Not all aspects of the FSAP measures adopted to date are fully aligned with their objectives. It will therefore be important to identify the gaps and deficiencies in any of the legislation that was part of the FSAP.**

The review mechanisms that are foreseen in some of the FSAP Directives will be an important tool in fine tuning the legislation once problems of content start to emerge on the basis of experience with implementation.

The Commission has developed, and continues to refine, a comprehensive set of indicators to assess the extent of integration of Europe's financial markets. Many of these indicators may be used in a time series to indicate trends in integration. It will be important to interpret the data resulting from the indicators with caution. The utility of any single indicator may vary over time, depending on economic conditions and developments in the policy debate. Due note should be taken of the prevailing circumstances and the likelihood of change in the future. It will also be important to have a clear understanding of what integration means for a market, taking a view on the significance of a particular outcome -e.g. uniformity of prices and diversity of providers- for a given market.

With that in mind, the FBE welcomes the recent publication of the first annual Financial Integration Monitor report and considers it a valuable contribution to the analysis of the changes in the level of cross-border integration in key financial segments over the last couple of years.

## NEED FOR A STRONG EU VOICE IN THE INTERNATIONAL ARENA

The development of technology has led to an unprecedented globalisation of financial services. While there are obvious economic advantages to this, there is also an increase in global systemic risk. A common approach must therefore be achieved in areas such as corporate governance, capital adequacy, money laundering, fight against terrorism financing, data protection and accounting standards.

While there are international bodies that provide guidance on a number of these issues (Basel Committee for Banking Supervision, IOSCO, FATF, IASB, etc.), **the EU does not sufficiently speak with one voice** in some of these fora. In certain cases, this may affect the ability of the EU to influence the content of these standards and therefore be contrary to European interests.

Given the different nature and role of these fora, *ad hoc* solutions should be preferred over a one-size-fits-all approach. Possible solutions may include *inter alia* a strengthening of the role of the Commission, and, in the accounting field, of EFRAG<sup>17</sup>. Once they are firmly established and have developed an EU-centric view of policy, the Level 3 Committees (CESR, CEBS and CEIOPS) might also play a role in some of these bodies (e.g. CESR in IOSCO).

The importance of the transatlantic relationship for both the EU and the US cannot be underestimated. **The FBE therefore welcomes the role played by the Commission in the EU-US financial markets regulatory dialogue.** In addition, it recommends the sharing of agendas at an early stage to avoid regulatory problems and to discuss rule-making in order to facilitate regulatory convergence.

The concept of regulatory equivalence is at the core of this dialogue and requires extensive EU-US cooperation and convergence on common principles. “Equivalent” should not mean identical, however, as what matters primarily is that a high level of investor/consumer protection is achieved on both sides of the Atlantic irrespective of the methods used to achieve it.

**Similar structured dialogues should be established with the other main EU partners, including *inter alia* Switzerland, Japan and China.**

## NEW LEGAL FRAMEWORK FOR PAYMENTS

As a measure of enhanced integration of the Single Market, the European Commission focuses on the area of payments, where it is required to transpose FATF Special Recommendation n° VI in order to capture all payment actors via legislation.

Following the December 2003 Commission’s Communication on *A new legal framework for payments in the Internal Market*, the Commission has begun drafting a proposal for a Directive. Based on the latest available draft of the said proposal, it appears that:

- The Commission does not want to legislate at the level of individual payment instruments and thinks that its proposal creates an overall framework that will stand the test of being applied to each instrument (Push versus Pull, Credit Transfer, Direct Debit, Card, etc). From drafts seen to date, the FBE believes that this objective has largely been achieved and the risk of intrusion into individual payment instruments thus avoided. This aspect needs further testing however.

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<sup>17</sup> The need for a strong EU voice in the accounting field is emphasized in the Annex to this paper (see page 40).

- The Directive will only regulate the relationship between payment service users and their providers, not between payment service providers (e.g. bank to bank) – it being assumed that this area can be fully self-regulated.
- The Commission is now including payment services involving a payment in which one leg (payee or payer) is outside the EU but limiting the obligations of payment service providers, especially in relation to execution times. This requires careful consideration.
- Although the position of non-bank providers of payment services (payment institutions) has been clarified, the draft proposal includes a provision by which the registration of a payment institution can be waived by Member States. Under this condition the Commission's ultimate aim of capturing those non-bank providers under the Directive cannot be achieved. These issues will be subject to in-depth scrutiny by the FBE and market participants during September 2004.

In any event, the FBE will continue to reaffirm the position of the banking industry which is to:

- avoid disruption of efficient domestic infrastructures;
- ensure a level playing field, striking a balance between open access and prudential oversight / risk management;
- concentrate on legislation which creates transparency and legal certainty for consumers, but avoid defining technical standards; and
- promote self-regulation wherever possible.

Finally, the FBE hereby reiterates its firm commitment to the creation of a market-driven Single Euro Payment Area spurred on by the European Payments Council.

#### OMBUDSMAN

While fully agreeing with the principle of avoiding costly and lengthy procedures and especially supporting the idea of involving the market in a direct way, the FBE does not see a market need for the ombudsman system referred to in the Securities Report. As implementation of the FSAP is in its infancy, there will continue to lack, for the immediate term, the data for several factors that would be relevant to the decision as to whether or not to set up such a system. Such factors include *inter alia* the number of cases, level of problems with implementation and any gaps in the effectiveness of the existing mechanisms (in particular the Commission as a first recourse). Also there is a need to know the level of political support for such a proposal.

Besides, the FBE fears that such a mechanism would create an unnecessary layer of additional bureaucracy. Indeed, the Commission's renewed commitment to enforcement under Level 4 of the Lamfalussy process would seem to meet the need that an ombudsman is aimed at. In addition, the FBE fails to see how an ombudsman could be useful given that its decisions cannot be binding under the different national legal systems.

Therefore, in the absence of a well-evidenced market need for such a mechanism and in view of the existing uncertainties regarding its operation, funding and interaction with other mechanisms of legal remedy and dispute resolution, as well as the potential for creating an unnecessary administrative burden, **the FBE sees no rationale for the creation of an ombudsman mechanism at this point.**

## PLURALISTIC BANKING MARKET

While the FBE agrees with the Banking Group that a pluralistic banking market allows the consumers to choose from a large variety of providers, it calls on the Commission to establish and maintain a level playing field between the various providers of financial services.

## REGULATORY CAPITAL

The implementation of the new Basel Accord in the EU is an issue of considerable importance for the European banking industry.

The move to a qualitative risk-based system for the determination and application of capital requirements for credit institutions and investment firms in the EU will lead to better targeting of capital and has the potential to deliver wider economic benefits.

**Overall the FBE is pleased with the Regulatory Capital Directive recently proposed by the Commission and calls for a rapid agreement of the new framework, which must be consistent with the Basel framework, able to keep pace with developments in industry practice, markets and supervisory needs and result in consistent application and supervisory convergence.**

## RETAIL BANKING

### There should be no prejudice against integrated EU retail banking market

The FBE perceives and regrets the existence, in the Banking Report, of a *leitmotiv* in favour of local banks having a wide network of branches<sup>18</sup>. Indeed, stating that “obstacles to cross-border banking activities and market entry remain (...) [in] retail banking (...) due to the inclination of consumers to turn to their local and more familiar institutions” does not render service to the completion of the Single Market. Natural inclinations are undoubtedly important, but they themselves are inclined to change over time<sup>19</sup>.

Similarly, underlining the need for “direct physical contact” and “bricks-and-mortar establishments” puts too much emphasis on the historical importance of the bank branch. Modern retail banking no longer exclusively relies on an extensive branch network to reach as many customers as possible. Standard banking services are increasingly being dealt with online or at self-service terminals, not in branches. This should be the starting point for further measures.

Customers today expect banking services, especially routine ones, to be permanently available. They want to be able to carry out transactions smoothly and swiftly at their own convenience, i.e. even outside conventional business hours.

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<sup>18</sup> Such a biased view can also be found from time to time in the Economic and Monetary Affairs Committee of the European Parliament, usually from (a limited number) of MEPs representing one or two specific countries.

<sup>19</sup> According to a recent opinion poll conducted by KPMG, 60% of the consumers interviewed would like to buy products from a foreign bank and as many as 68% felt restricted in their choice and called for further efforts to facilitate cross-border access to banking products in the EU.

**Consumers should ultimately be able, for instance, to physically shop around in their local branch, ask for more information through the Internet, conclude the deal by phone banking, receive updates and re-finance through the Internet.**

The Internet may presently not have the widest possible acceptance as a distribution channel, but it is in any event a rising trend, complementary to the already solid bricks-and-mortar infrastructure that European banks have developed.

**While full capacity to distribute exclusively through the Internet is not an end in itself, the challenge for the banking industry is to provide high-quality service through a combination of customer-friendly delivery channels** ('multi-channel delivery').

European commercial banks, through direct banking, specialized subsidiaries or intermediaries, have already managed to sell banking products in countries other than those in which they are established, using the same electronic platform for all transactions, thereby reducing transactional costs. The cross-border introduction of new, innovative, foreign products enhances competition with local banks and ultimately benefits local consumers.

There is ample evidence that, in the field of retail banking, supply creates demand and that consumers base their purchasing decision on factors such as product availability and price<sup>20</sup>.

**It should also be noted that the image of banking as a lifetime relationship based on loyalty is changing.** This is not to say that banks will not -as dictated by the law of the market- always seek to develop and maintain a loyal client base; in the same way that clients will, through information, transparency and facilitated movement from one bank to another, become more demanding and thus less inclined to commit themselves to a single bank.

**The FBE fully agrees with the FSC that “there need not be a presumption that retail markets are by nature local, fundamentally different from wholesale markets and therefore not likely to benefit from integration”.**

#### Need to open up national retail banking markets

The current, undisputed, fragmentation of the European retail banking market is not merely the result of a voluntary decision on the part of consumers, nor can **the scarcity of supply of cross-border financial services** be taken to indicate an absence of consumer demand. It is owing rather to the fact that **foreign banks are hindered, or even prevented, from entering the market**<sup>21</sup>. As a consequence, consumers largely continue to be denied the chance of exploiting the full potential of the European retail banking market and its diversity of products and suppliers.

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<sup>20</sup> According to the opinion poll conducted by KMPG, the three most important factors when choosing a bank are (i) low charges and fees, (ii) good Internet banking and (iii) competitive rates of interest.

<sup>21</sup> In addition, one should not lose sight of the fact that the main reasons why consumers are not spending is stagnant disposable income and uncertainty about their future pension entitlements. Domestic and cross-border demand would be boosted if governments were successful in reforming economies and generating economic growth.

**While, overall, a consolidation phase -coupled with a strong emphasis on implementation, convergence and enforcement- is needed in the securities field<sup>22</sup>, this is not so in the retail banking area where further action is needed to open up the still largely localised retail banking markets and allow consumers to reap the benefits of cross-border competition.**

#### Artificial barriers must be removed

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

- (i) the interdiction in some Member States of concluding consumer loan contracts over the Internet;
- (ii) the lack of harmonisation for on-line identification and authentication;
- (iii) the lack of harmonised pre-contractual information;
- (iv) the lack of harmonised method of calculating the Annual Percentage Rate of Charge;
- (v) the lack of harmonised right of withdrawal for all consumer contracts; and
- (vi) the impossibility for consumers from certain Member States to open a cross-border on-line account over the Internet.

#### Status quo is no viable alternative – actions are needed

As already mentioned in this paper, the cost of non-integration has been estimated at minimum 0.5% of EU GDP *p.a.*

As indicated by Mr PADOA-SCHIOPPA<sup>23</sup>, "greater financial integration would enable the EU corporate and household sectors to benefit from access to comparatively cheaper and higher quality financial services".

Promoting new entrants into markets across the Union will increase consumer choice, widen the product range and through increased competition, reduce fees and charges.

**Actions are therefore needed.** The *status quo* is no viable alternative. **Concrete recommendations as to how to remove the above-listed artificial barriers are provided in the Annex to this paper (see page 32). The FBE urges the EU institutions to adopt these recommendations as a matter of priority.**

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<sup>22</sup> In the securities field, legislative measures aimed at integrating the retail segment have already been taken. This is the result of an effort ongoing since 2002, when the retail and wholesale conduct of business rules were adopted, and has continued with all other legislation adopted in this area, which have always included the principle that the impact of any regulatory action may be different between retail and wholesale markets and that regulation should be proportionate to the needs of each segment (see, in particular, the Prospectus and Market in Financial Instruments Directives).

<sup>23</sup> Mr T. PADOA-SCHIOPPA, *Challenges of financial integration in the post-FSAP period*, European Commission Conference, Brussels, 22-23 June 04.

Going forward, the FBE intends to continue playing a proactive role in identifying artificial obstacles to the creation of an efficient European retail banking market and suggesting ways to eliminate them in order to allow the “European banking customer” easier access to retail banking products and obtain world class products and value for money.

#### STANDARDISATION OF PRODUCTS

##### **The FBE does not favour regulatory standardisation of products.**

Banks may at their own initiative standardise products to achieve cost benefits for consumers' sake, but should ultimately be free to create and maintain a wide number of different products.

##### **EU institutions should avoid creating product standards that slow the markets' innovation potential, in particular with regard to retail banking services.**

If market integration is aiming at deregulation, markets must have the possibility to react to the changing needs of their customers with appropriate products. Product innovation -a result of testing, updating, improving and creating variations of existing products- benefits the consumers; regulatory standardisation of products does not.

The creation of a 26<sup>th</sup> regime, i.e. standard products with a EU legal framework co-existing alongside 'national products', might be, in certain cases, an option worth exploring further, in consultation with the industry and the consumer associations.

#### TAX ISSUES

In recent years, the range of financial services available to businesses and consumers has vastly expanded. Financial markets have become much more competitive. In order to stay competitive and to be able to cope with the burden and cost of rapidly changing information technology and increased shareholder pressure for financial performance, financial groups have been obliged to seek structural cost savings and exploit synergies by integrating, centralizing and rationalizing their functions internally and by outsourcing to third parties (e.g. cross-selling of financial products and centralized production of IT and other support services). As a result of this integration and centralization of functions and as a result of the obligation to comply with transfer pricing regulations, the amount of intra-group cross-border supplies and cost allocations has increased dramatically in the financial services industry.

##### Company taxation

The FBE encourages in principle any initiative that would remove the tax obstacles to cross-border activities, provided that such initiative would not introduce any double taxation of profits or any discrimination between taxpayers and that it would not jeopardize the principle of equal treatment. However the FBE would oppose the application of the most severe tax regimes currently applied across the EU and the introduction of uniform tax rates across the EU.

In its 23 October 2001 Communication, the Commission envisaged a two-track strategy comprising (a) a large debate on comprehensive measures providing companies with a consolidated corporate tax base for their EU-wide activities and (b) an immediate action on targeted measures.

(a) The Commission concluded that in the longer term Member States should agree to allow EU companies to use a single consolidated base for computing tax on their EU-wide profits. It considered four schemes for consolidating the tax base for groups of companies with operations in more than one Member State. The possibility of introducing pilot schemes to test the application of some form of EU-wide consolidated tax base on SME's and on the European Company was envisaged. The Commission also decided to explore International Accounting Standards (IAS) as a way to assist the definition of the tax base.

On 7 July 2004, the Commission issued two non-papers ahead of the informal ECOFIN Council meeting of 10/11 September 2004. These documents are respectively entitled:

- "A common consolidated EU corporate tax base"; and
- "Home State Taxation for Small and Medium-Sized Enterprises".

The FBE does not consider as a priority the introduction of a common consolidated tax base. If some harmonisation is to be adopted, this should be a step-by-step process, starting with the definition of common principles for the taxation of individual companies. Even if a common consolidated tax base is to be adopted, a 'speeded up' convergence through the premature introduction of IAS into the computation of the tax base is likely to give rise to practical difficulties, as there are wide divergences between Member States as regards the interaction between financial accounting profits and taxable profits.

(b) Among the targeted measures being considered by the Commission, the FBE welcomes in particular those aiming at the elimination of problems related to cross-border losses and transfer pricing. The lack of ability to set off tax losses in one Member State against taxable profits in another Member State results in excessive tax costs. In the worst case the tax exceeds overall profit. **There is an urgent need for legislative changes to allow losses of companies to be set off against taxable profits of related companies resident elsewhere in the EU.** Therefore the FBE looks forward to seeing the innovative solution which the Commission announced it would propose.

Double taxation arises where one country makes an adjustment to taxable profits on intra-group transactions and the second country fails to make a corresponding adjustment. The FBE believes that **there is a need for an EU-wide accepted form of documentation regarding intra-group transactions and transfer pricing adjustments.** In addition, all tax treaties should be updated to OECD standards. Above all, **financial institutions need binding arbitration procedures to avoid double taxation.** The issue of capital allocation to branches has not been specifically addressed by the Commission but is of primary concern to the FBE. Unless there is a common EU-wide interpretation of deemed branch capital, double taxation is likely to occur. **Capital attributions to branches should be consistent** and there should be binding arbitration to ensure that any tax adjustment is matched by an equivalent reciprocal adjustment in profits at Head Office level.

The FBE is further concerned that tax discrimination still arises when a Member State gives more favourable tax depreciation for assets leased locally compared with assets leased to customers in another Member State. **There is a need for an equal relief for capital equipment leased cross-border and capital equipment leased domestically.**

### Withholding tax on interest payments made between companies

Withholding tax on interest payments between companies results in a lack of competition. When a withholding tax is imposed, resident EU banks are put at a disadvantage compared with local banks within a country. **There should be no withholding tax on intra-EU cross-border interest payments between companies.**

### VAT treatment of financial services

**The current VAT treatment of financial services causes major problems for the European financial industry.**

VAT on intra-group cross-border transactions, and in some cases within one country, prevent the efficient organisation of business. Due to their reduced right to deduct input VAT, financial institutions incur multiple VAT taxation on intra-group allocations of external costs. Centralized internal costs (payroll costs, self-developed software, Head Office costs) that are allocated to other group entities result in substantial additional costs where there are no VAT grouping provisions. European financial groups would only be able to maintain a competitive position in global financial markets if they are given the opportunity to cooperate, integrate and centralize their functions in a VAT neutral way in order to achieve synergies and structural cost savings.

In addition, the European financial sector has to cope with legal uncertainty about the VAT treatment of financial services and with inconsistent application of VAT across the EU.

The FBE was pleased to learn that the Commission was currently conducting an investigation into the problems raised by the existing VAT treatment of financial services and was drafting a list of possible solutions. **The FBE particularly welcomed the opportunity it was given to assist the Commission in this exercise and to make detailed representations on the VAT treatment of financial services, a summary of which is provided in the Annex to this paper (see page 35).**

### TIMELY TRANSPOSITION, IMPLEMENTATION AND ENFORCEMENT OF FSAP MEASURES

**The FBE fully concurs with both the Securities and Banking Groups that timely transposition, implementation and enforcement of FSAP measures should be given priority attention.**

Indeed, consistent interpretation and application of the FSAP measures and effective enforcement thereof will greatly determine whether or not a Single Market for financial services has been created in the EU.

Hence, and as already indicated in this paper, more resources need to be allocated to those services of the Commission that are in charge of monitoring implementation and enforcing FSAP measures.

In a non-Lamfalussy context, the Savings Tax Directive offers a good example of the importance of consistent interpretation and implementation of Community legislation, as further elaborated in the Annex to this paper (see page 39).

## VI. OTHER ISSUES THAT SHOULD BE GIVEN PRIORITY CONSIDERATION

### ALTERNATIVE DISPUTE RESOLUTION (ADR)

The European Commission has stressed on many occasions that improved consumer confidence in non-costly, simple and effective alternatives to legal action is crucial to the creation of an integrated internal market in financial services. The FBE shares this point of view and supports in particular FIN-NET, the network designed to facilitate the out-of-court resolution of consumer disputes when the service provider is established in an EU Member State other than that where the consumer lives. The existence and use of ADR systems should, however, not deprive consumers of their ultimate right to appeal to the courts.

Unfortunately it seems that the existence of FIN-NET so far is not common knowledge. **The FBE therefore calls on the Commission, the consumers groups and the financial industry to make FIN-NET more widely known and better understood.** Turning words into action the FBE has recently invited its member associations to make a clear reference to the FIN-NET website on their homepage.

**Besides, the FBE urges:**

- **the new Member States to create Ombudsman schemes where these do not yet exist;**
- **the Commission to invite the Ombudsman schemes from the new Member States to adhere to FIN-NET as a matter of priority;**
- **the Ombudsman schemes from the new Member States to adhere to FIN-NET;**
- **the stakeholders in the relevant new Member States to press for such creation and/or adherence.**

### BETTER COORDINATION BETWEEN DGs

Like Mrs RANDZIO-PLATH<sup>24</sup>, the FBE believes that **“consistency within the Commission is (...) [to] be ensured (...) [to] avoid situations whereby different parts of the Commission are bringing forward initiatives which are taking as their basis differing principles and objectives.** The responsible Commissioners must co-ordinate their work rather than set to work on individual and separate issues”.

**For instance, while the objective of providing a high level of protection to consumers is a perfectly legitimate one -and one that is fully supported by the FBE- this objective cannot be taken in isolation and must be compatible with other - equally important- objectives such as the Single Market and the Lisbon agenda.**

Adopting too patronizing an attitude towards consumers by harmonizing consumer protection laws at the *highest* possible level is unreasonable in the ever-more-global world we live in. This would inevitably lead to less choice, less competition, higher prices and a less competitive EU in the global market place. While this is a lose-lose situation, this is more so for the consumers. Indeed if business (and investment) can easily move elsewhere, the same cannot necessarily be said of the (EU) workforces. As Mr. McCreevy put it<sup>25</sup>, “excessively restrictive regulation could stifle the innovation that is so essential in the financial services sector, undermine its competitiveness in the wide international arena or even drive the market into more accommodating jurisdictions”.

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<sup>24</sup> Dr. C. RANDZIO-PLATH, *European financial integration – The perspective of the European Parliament*, European Commission Conference, Brussels, 22-23 June 04.

<sup>25</sup> Mr C. MCCREEVY, Conference on European Financial Integration, Brussels, 22-23 June 04.

As indicated above, in the retail banking field, the FBE favours the full harmonisation of the elements that are essential to foster cross-border competition. Such an approach is the only one able to reconcile the Lisbon objective with that of a high level of consumer protection. **The FBE urges the new Commission to adopt a more collegial approach so as to ensure a better coordination between Directorate Generals. So, for example, much better coordination is required between DG Internal Market & Services and DG Health & Consumers' Protection. Also the goals of competition policy and financial markets policy should be linked.** The creation of task forces to address problems covering a number of policy areas should be considered.

Much is made of the 'Lisbon process', which should help the EU become a competitive, technology-driven economy, but little has happened on the ground. While the Prodi Commission presided over the largest ever enlargement of the Union, **the Barroso Commission will be judged on the success or failure of the Lisbon agenda.** In this regard, the FBE welcomes the early indications that the Barroso Commission will take an ambitious stance on implementing the legislation adopted under the Lisbon agenda. In particular the FBE is encouraged by the President-elect's intention to set up a group of Commissioners with specific responsibility for coordination of the Commission's policy, and to appoint a Vice-President to represent a coherent Commission position in the Competitiveness Council.

#### EUROPEAN COMPANY (*SOCIETAS EUROPAEA*)

On 8 October 2001 the European Company Statute was adopted by the EU's Council of Ministers (Council Regulation (EC) No 2157/2001). For companies active across the Internal Market, the European Company offers the prospect of reduced administrative costs and a legal structure suited to the Internal Market as a whole.

As mentioned in the recital of the said Regulation "The completion of the internal market and the improvement it brings about in the economic and social situation throughout the Community mean not only that barriers to trade must be removed, but also that the structures of production must be adapted to the Community dimension. For that purpose it is essential that companies the business of which is not limited to purely local needs should be able to plan and carry out the reorganisation of their business on a Community scale".

**However, when initiating a process of change aimed at establishing a one-bank European Company structure with one legal entity conducting business in all local markets by means of branches, Directive 94/19/EC on deposit guarantee schemes and its differing implementations in the EEA States give rise to certain negative effects, which constitutes an obstacle to the adoption by banks of the European Company status and therefore to the creation of a truly single market.**

Changing the legal structure of a group with separate national banking entities into a one-bank structure with branches, will shift the deposit guarantee cover for all the group's deposits to the deposit guarantee system of the legal domicile of the bank, although the operations of the group in the other countries concerned will otherwise be materially unchanged. The shift of responsibility can lead to different serious problems, depending on how the deposit guarantee schemes are financed in the countries involved.

- Banks and other credit institutions remaining in the former "home" countries can gain a competitive advantage, since the need for contributions to that country's guarantee fund can be reduced or eliminated, without any of their respective deposits being decreased.

- Banks and other credit institutions in the new "home" country can face a competitive disadvantage, since the need for contributions to that country's guarantee fund can be increased, without any of their respective deposits being increased.
- In order to be able to provide the same consumer protection conditions as its local competitors, the transformed bank may have to contribute to the systems where the branches operate (depending on the level of coverage) to top-up the deposit guarantee for its customers. However, it may be unable to use its former contributions to the guarantee funds concerned for this purpose.

**The FBE urges the Commission to consider this issue as a matter of priority, in consultation with the banking industry and EFDI, the European Forum of Deposit Insurers.**

#### FINANCIAL REPORTING

Reporting requirements for statistical and regulatory purposes should be as uniform as possible and the relevant formats standardized and leanly structured.

For the financial industry in particular, the level of red tape is threatening to get out of hand owing to manifold reporting and information requirements. Success on the market is considerably hampered by an obligation to meet highly complex, bureaucratic regulatory requirements. **To the extent that there is a shift from quantitative to qualitative supervision, new additional tasks should not be introduced without critically questioning existing regulatory requirements. Regulatory tools and reporting requirements that have become obsolete should be abolished without replacement.**

**XBRL (eXtensible Business Reporting Language<sup>26</sup>) provides organisations with a way to prepare, publish in a variety of formats, reliably extract, and automatically exchange a wide variety of business reporting information – financial and otherwise.**

Financial services organisations that operate across country borders generally need to provide regulatory data in every country in which they are licensed. Similar but slightly different reporting obligations create re-work and substantial effort, not just for accounting, capital management and risk management specialists but also in terms of IT capital spent.

Therefore, the time is ripe for regulators to (i) examine, together with the banking industry if -and to what extent- they wish to promote the use of XBRL to cooperate across borders and (ii) take advantage of such an opportunity to re-asses not just the broad principles associated with regulation but also the specific definitions of regulatory reporting concepts. The FBE is open to this type of cooperation and intends to send the CEBS and the Commission a more detailed submission in this respect by the end of 2004.

#### INTER-INSTITUTIONAL MONITORING GROUP

The FBE has supported the efforts of the EU institutions to evaluate the implementation of the Lamfalussy process *via* the Inter-Institutional Monitoring Group with the objective of bringing about improvements. **As the current mandate of the IIMG is coming to an end in 2004, the FBE calls on the EU institutions to prolong the term of the IIMG's**

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<sup>26</sup> [www.xbrl.org](http://www.xbrl.org)

**mandate** so that the IIMG has the opportunity of evaluating the continuing regulatory reform as it enters the stages of Level 3 and Level 4.

In addition, and following the extension of the Lamfalussy process to banking, the FBE considers that the implementation of the process in this area should also be monitored by an IIMG and it suggests that some (but not necessarily all) of its members be drawn from the existing IIMG so as to ensure a transfer of experience and knowledge in procedural aspects.

#### REINVIGORATING THE INTEGRATION PROCESS

**Achieving a high level of competitiveness in the EU through the creation of a Single Market involves political will and the vision to see Europe as a global competitor. Without these little can be achieved.**

**Member States and the European Parliament must be conscious of the costs associated with national discretions, optionality** (the most meaningful provisions of the Takeover Directive have been made optional), **vague compromises and excessive transitional periods.** The Lamfalussy process must not become the means to allow political disagreements to be postponed to Levels 2 and 3; on the contrary, it should be recognised as a tool to achieve the best and most flexible solutions.

In some cases the political will to achieve a Single Market will involve Member States making sacrifices and accepting a standard across Europe which may not be as stringent as their own. **In addition, deals or horse-trading between Member States to neutralize the impact of reforms should be avoided as they render all efforts useless. This is a self-defeating strategy that may serve some short-term political interests, but only at the expense of the longer-term objectives.** On the other hand, it is difficult for Member States to find good compromises around the table in Council if market participants are not prepared to do the same. Industry in each Member State must set aside its national interests and consider the long-term advantages of the competitiveness of the European market place as a whole. In too many cases necessary steps to make Europe more competitive failed owing to the protection of vested national interests.

**The FBE commends the Commission for the vigorous way in which it expressed its disappointment with the text of the Takeover Directive that was eventually adopted by the Council and the Parliament.** The Commission, as defender and promoter of the EU good, should not hesitate to take similar stances in the future if so required. Besides, the Commission should avoid including in its original proposals political compromises merely with a view to speeding up the co-decision process and gaining the Member States' approval at first reading.

Political will must also extend to implementation of legislation where many Member States have a poor track record. Industry should take an active role in identifying infringements so that implementation and enforcement can gain momentum.

## ANNEX

### OPENING UP OF NATIONAL RETAIL BANKING MARKETS: CONCRETE RECOMMENDATIONS

#### *# 1: Provision of a model contract*

Requirements by some Member States' supervisory authorities (e.g. Belgium, Italy) that credit institutions provide consumers with a model contract before starting negotiations for on-line and off-line lending transactions create distortions of competition, not only between banks that are subject to such requirements and those that are not but also between on-line and off-line lending transactions. The FBE therefore calls for the abolition of such model contracts.

#### *# 2: Harmonised pre-contractual information and Annual Percentage Rate of Charge*

Pre-contractual information is crucial in order for consumers to be well oriented for the product or service offered and to decide whether they are interested in proceeding with a contract. The elements that are necessary for making informed decisions include information on the identity of the supplier, the main attributes of the product or service on offer, the costs which the consumer will have to pay to the supplier in conformity with the terms of the proposed contract if the latter is fully complied with, the duration of the commitment, the right of withdrawal and the methods of payment. Requiring suppliers to provide additional pre-contractual information is usually unnecessary. Far from protecting consumers, information overkill confuses the addressee and results in higher costs.

The FBE strongly believes that pre-contractual information should focus only on the above-mentioned elements and be harmonised at EU level.

The role of the Annual Percentage Rate of Charge (APRC) is to allow comparisons to be made between products offered on the market. For such comparisons to be meaningful however, the definition of the APRC must be harmonised. That means that costs included in the APRC should only be product-related costs, all other costs (incl. voluntary insurance premiums and costs alien to the creditor) being excluded.

Harmonisation of the APRC should not introduce the notion of usury at EU level. Usury legislation or maximum rate provisions existing in some Member States amounts to price regulation, an obstacle to the free provision of financial services, and should therefore be abolished.

#### *# 3: Recognizing equivalence of 'KYC' standards*

The second Money Laundering Directive's 'Know Your Customer' (KYC) rules are sometimes interpreted very restrictively by competent authorities in Member States. For example, in Germany compliance with national (i.e. German) KYC standards is required for cross-border direct banking, making it impossible for consumers from certain Member States to open an account. In addition, in some Member States banks cannot insist on the production of a passport or an identity document as holding of these documents is not mandatory. Requirements such as these set by the supervisory authorities constitute an obstacle to cross-border business relations. This situation could be remedied by an adequate EU harmonisation of the main KYC standards. On the basis of this adequate harmonisation, a clause providing for recognition of the equivalence of national KYC standards in the EU could be incorporated into the upcoming third Money Laundering Directive.

#### *# 4: Right of withdrawal*

The period of time in which a consumer may exercise its right of withdrawal differs from one Directive to another. Such divergences are not justified and create unnecessary confusion for the consumers and costs for the suppliers. The FBE therefore calls for the establishment of a single right of withdrawal for all consumer contracts with exceptions being made for (i) contracts involving a market risk or price fluctuations, (ii) cases in which the consumer has received full advice, (iii) cases of an opt-out possibility or reduction of the withdrawal period and (iv) cases in which a pre-contractual right of reflection exists.

#### *# 5: Harmonising rules for on-line identification and authentication*

Opening of (cross-border) on-line accounts over the Internet should be made considerably easier. This should be achieved by enforcing existing legislation (the Electronic Signatures Directive) and by establishing harmonised rules for identification and authentication, while respecting the technical options on identification standards that Member States may choose to explore (“uniform rules, not uniform solutions”, i.e. technological neutrality). At present, the procedure customers have to follow to provide proof of identity varies from one Member State to another, but is always a cumbersome and distinctly ‘off-line’ exercise. In Germany, for example, the so-called *Postident* system is used to open an account with a direct bank. After downloading the application forms from the bank’s website and printing them out, the customer has to have his signature verified by an employee at a branch of Deutsche Post AG and then send the documents to the bank by post. Similar systems of identification by the Post (in the Netherlands), or by another trustworthy third party such as a public notary (as, in some cases, in France), or an embassy, exist in other Member States.

This time-consuming and costly procedure could be avoided if the EU established a legal basis explicitly permitting accounts to be opened throughout the EU with an advanced electronic signature. This would allow banks to operate in a more secure environment and would provide them with the legal certainty they need in order to avoid being found in breach of law. Electronic signatures provide a perfectly adequate guarantee of the authenticity, integrity and legitimacy of a declaration of intent by the parties to an “e-agreement”. Existing national rules need to be harmonised with the Electronic Signatures Directive. Requirements for furnishing proof of identity under Member States’ anti-money laundering and fiscal rules should be aligned with those of the 2<sup>nd</sup> Money Laundering Directive. The latter text does not prohibit the on-line opening of accounts; it only requires that adequate measures are put in place in order to establish the true identity of the customer at a distance.

Possible measures include the transfer of money to the new account from an already existing account held in an EU bank (e.g. in UK and Italy), confirmatory certification by another EU bank or supply of additional documentary evidence such as, for instance, a gas or electricity bill (e.g. in UK and Ireland). A medium term option for Member States could consist of providing their citizens with electronic ID cards with authorisation and authentication functionalities.

#### *# 6: Interdiction of contracting on-line*

Some Member States do not allow guarantee agreements or consumer loan contracts to be concluded over the Internet. The German Civil Code, for example, explicitly prohibits such contracts being concluded 'in electronic form'. In other Member States (e.g. in Italy) e-contracting is permitted. This situation results in distortion of competition and is detrimental to banks operating in Member States where e-contracting is prohibited. More importantly the FBE believes that there is no good reason to prohibit consumer loan agreements being concluded over the Internet: the right of withdrawal foreseen in the Directive on Distance Marketing of Financial Services provides consumers with an adequate level of protection. The FBE calls on the Commission and the Member States to lift without delay this restriction on on-line banking throughout the EU.

## **VAT TREATMENT OF FINANCIAL SERVICES: CONCRETE RECOMMENDATIONS**

### ***1. Review of the exemptions***

Legal uncertainty results from the current wording of Article 13(B)(d) of the 6<sup>th</sup> VAT Directive and there are differences in the application of exemptions by Member States. The FBE therefore advocates a review and update of the exemptions at Article 13(B)(d), as further explained in its recent submission to the Commission.

### ***2. Introduction of domestic and cross-border VAT grouping in all Member States***

VAT grouping should be permitted by way of an option for each eligible entity and should be extended to related entities established in different Member States (cross-border VAT grouping). This would allow for the most efficient organisation of group business activities and support operations without the complication of VAT. In addition this would result in tax administrations processing fewer VAT returns and benefiting from the joint and several liability of all VAT group members.

### ***3. Appropriate provisions for sharing of joint costs between related entities and cost sharing entities***

In case 'full' cross-border VAT grouping does not prove to be acceptable for all Member States, we recommend that confirmation be given in the 6<sup>th</sup> VAT Directive that sharing of costs of goods and services between related entities merely gives rise to a financial settlement of accounts. Such settlement would not constitute a supply for consideration subject to VAT and would therefore fall outside its scope. This should be the case irrespective of these entities being established in the same or different Member States. Each of the entities would subsequently deduct the input VAT on its share of the costs to the extent of its entitlement to deduction of input VAT.

Article 13 (A) (1) (f) of the 6<sup>th</sup> VAT Directive provides for the exemption of services performed for its members by an independent 'cost sharing' entity (e.g. an association or corporate entity) formed by a group of persons with the goal of sharing the costs of these services (e.g. accounting, marketing, management, research and development, ICT services).

It is recommended that this exemption be moved to Article 13 (B) 'Other exemptions', in order to provide more certainty with regard to the scope of this exemption. It is moreover proposed to adapt the text of the exemption to the requirements of transfer pricing rules. In order to ensure exemption of cost sharing on a cross-border basis, the preconditions for the application of this exemption should be consistent throughout the EU and Member States should not be allowed to impose additional conditions. In this respect it is recommended that the competence to determine whether the exemption for a particular cost sharing entity is likely to cause distortion of competition should be given to a supra-national authority, such as the VAT Committee.

#### **4. Extension of the option to tax**

Member States should introduce the option to tax for all transactions covered by Article 13 (B) (d), (g) and (h) of the 6<sup>th</sup> VAT Directive and this option should be effective in the Member State where the transaction is performed. This should provide the opportunity for the supplier, by exercising the option, to allow for full VAT expense recovery. It would unblock VAT expense currently trapped within the transaction trail. The tax payer should be given the opportunity to opt on a transaction-by-transaction basis or for any pre-defined group or category of transactions.

#### **5. Application of alternative pro-rata calculation of input VAT**

Each Member State should authorise the application of systems of alternative pro-rata calculation according to Article 17 (5) of the 6<sup>th</sup> VAT Directive in order to ensure maximum respect for the principle of VAT-neutrality by avoiding the cascading effect of disproportionate non-deductible VAT and to prevent distortion of competition between businesses established in different Member States.

Other countries have made serious attempts to remove or reduce the blocked VAT expense that arises through a supply chain to the final consumer. The FBE recommends that a detailed study be made of the following countries' alternative approaches: South Africa, Singapore, Australia and New Zealand.

## **HARMONISATION IN EU CONSUMER PROTECTION LAW – TERMINOLOGY**

According to the FBE, one should make a distinction between (1) the degree of harmonisation, (2) the scope of harmonisation and (3) the level of protection that is provided.

### **1. THE DEGREE OF HARMONISATION**

#### **1.1 Minimum harmonisation**

Definition: Member States are permitted to maintain or adopt more stringent national provisions than those laid down in the Directive, i. e. the provisions of the Directive merely set a floor.

Example: Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.

Article 15: «*This Directive shall not preclude Member States from retaining or adopting more stringent provisions to protect consumers consistent with their obligations under the Treaty*».

#### **1.2 Full harmonisation (sometimes also called ‘maximum’ harmonisation)**

Definition: Member States are not permitted to adopt provisions other than those laid down in the Directive.

Example: Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services.

Recital 13: «*Member States should not be able to adopt provisions other than those laid down in this Directive in the fields it harmonises, unless otherwise specifically indicated in it*».

**The term ‘full harmonisation’ should be preferred over that of ‘maximum harmonisation’ as the latter risk being interpreted by some as meaning a high level of consumer protection.**

#### **1.3 Remarks**

- A Directive can contain both minimum harmonisation provisions and full harmonisation provisions.
- In both, minimum harmonisation and full harmonisation cases, Member States are free to regulate any issue that the Directive does not deal with within the relevant area.

## **2. THE SCOPE OF HARMONISATION**

### **2.1 Definition and examples**

The scope of harmonisation means the issues being dealt with in the Directive. It may be more or less wide, i.e. it may cover only some ('limited scope' harmonisation) or all ('exhaustive/extensive scope' harmonisation) aspects of a given area<sup>27</sup>.

There is no definition in EU Law.

Example of 'limited scope' harmonisation: Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 on the Annual Percentage Rate of Charge.

Example of 'extensive scope' harmonisation: Proposal for a Directive on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers (COM (2002)443).

### **2.2 Remark**

The degree of harmonisation is independent from the scope of harmonisation. For example, a minimum harmonisation Directive may contain 25 provisions covering all the aspects of a given area whereas a full harmonisation Directive may contain only 2 provisions.

## **3. THE LEVEL OF PROTECTION THAT IS PROVIDED**

This issue must be distinguished from the first two.

A Directive may provide for a low/medium/high level of consumer protection.

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<sup>27</sup> There seems to be a specific concept called 'total harmonisation'. Although there is no official definition, it could be defined as the combination of maximum harmonisation and exhaustive/extensive harmonisation. The Commission seems to use the term 'total harmonisation' pursuant to this meaning in Article 30 of its proposal for a Consumer Credit Directive.

**CONSISTENT INTERPRETATION AND IMPLEMENTATION OF COMMUNITY  
LEGISLATION: THE CASE OF THE COUNCIL DIRECTIVE 2003/48/EC OF 3 JUNE  
2003 ON TAXATION OF SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS**

The FBE has serious concerns about the inability of the Commission and the Council (High Level Working Group on Tax Questions) to provide paying agents with a common and consistent interpretation of the Savings Tax Directive, with detailed implementation guidance and with centralized information, without which paying agents cannot comply with specific provisions of the Directive. The FBE calls on the Commission and the Council to pull together information and to aim at consistent interpretation of the Directive.

In particular, the Commission should draw up a list of the so-called “residual entities” which are submitted to a specific treatment under the Directive. The banking industry has experienced substantial difficulties in identifying such entities on a local basis and found it almost impossible to identify them in a cross-border context. The FBE firmly believes that it is for the Commission to set up, publish and update this list.

Also, the FBE has produced a report on customers’ identification requirements. This report aims at enabling paying agents to establish, in accordance with Article 3 of the Directive, the identity and the residence of the beneficial owners who are resident in a Member State, or who hold a passport or official identity card issued by a Member State. The FBE calls on the Commission and individual Member States to check, endorse and publish this report. The Commission and the national authorities should thereafter make sure that this report is kept up-to-date. It is already becoming quite clear that different interpretations of the Directive are resulting in inconsistent implementation at domestic level. Most Member States appear to adopt minimal legislation with little guidance being provided. Financial institutions have therefore difficulties in developing the necessary systems. Unless the Commission and the Council agree on consistent definitions (including paying agent, contractual relations and interest), there will be major confusion and significant practical differences within the EU.

## **THE NEED FOR A STRONG EU VOICE IN THE ACCOUNTING FIELD**

The FBE supports a global approach to accounting standards and therefore welcomes the EU's decision of requiring all EU listed companies to report according to IASB's International Financial Reporting Standards (IFRS) as of 2005. Given the decision of a number of other countries to also use the IFRS, these standards are set to gradually become the predominant reference for company accounting throughout the world. Companies listed in the US, however, must still report under US GAAP set by the FASB. While the IASB and the FASB have agreed to do their best efforts towards achieving convergence of their respective sets of accounting standards ("Norwalk agreement" of September 2002), there is a feeling that this convergence process might be one-sided and amount to a scenario according to which IFRS are approved only if they are compatible with FASB's views.

Whether or not these fears are justified, there is an urgent need to improve both the contribution of the EU to the elaboration of the IFRS and the IASB's due process for their adoption.

The FBE therefore very much supports the current plans to enhance the role and the working process of EFRAG in order to ensure that European concerns are taken into proper consideration within the international accounting standard setting process. Making additional resources available to EFRAG would allow it to improve the dialogue not only within Europe, but also with the IASB at an early stage of the development of IFRS.

As for the governance of the IASB, the FBE welcomes the recent IASC Foundation's Constitutional review exercise and is hopeful that a balanced European representation on the IASB's Board will be achieved; and that the IASB's due process will be amended in such a way that it brings about transparency at all stages of the accounting standard setting mechanism.

## **THE NEED FOR HIGH STANDARDS OF CONSULTATION: THE IASB EXAMPLE**

The banking industry has serious concerns about the consultation standards applied by the International Accounting Standards Board (IASB). Lack of effective industry consultation undermines the quality of the standards adopted by the IASB and the credibility of the latter.

The IASB does not seem to be willing to look beyond accounting doctrine and to have an informed view of the possible consequences of its proposals.

If an Exposure Draft does not meet with the approval of a large majority of constituents, the IASB should take up the matter again, make an attempt to understand the merits of the criticism raised and re-examine the proposals made with an open mind. In the event that it continues to believe that its initial proposals were indeed appropriate, it should clearly explain the reasons underlying its stance.

In addition, the current standard setting process is too fast. The set timetable does not allow preparers sufficient time to examine carefully the issues and to respond in an appropriate way, a situation made worse by the high number of issues being tackled in parallel.

Finally, broader research studies and field-testings should be undertaken before publishing an Exposure Draft.

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