

The European Commission's Green Paper on Financial Services: The return of realism?

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The Financial Services Action Plan (FSAP) was developed at the end of the 1990s to enable providers, issuers and investors to transact business at a pan-European level without undue legal impediment, so as to improve efficiency, growth and choice. Approximately forty pieces of legislation were introduced over six years. This article looks at the next phase of the Commission's plans for the internal market.

After this headlong run to legislate, the Commission has decided on a new direction. Its Green Paper on Financial Services policy (2005-2010)¹, published on May 3, 2005, announced a new focus for Commission policy over the next five years:

- to consider progress towards an integrated, competitive and efficient financial market and to remove remaining barriers;
- to encourage the free circulation of capital and services with effective supervisory control, financial stability and consumer protection;
- to enforce and evaluate current legislation, employ a "better regulation" approach to new initiatives, improve supervisory convergence and strengthen the EU's influence in global financial markets.

The emphasis is therefore on improving what is in place already. Fewer new initiatives will be introduced, though there are several that have yet to be finalised.

The Green Paper covers a number of themes and invited comment from stakeholders. Some of the key issues are discussed below.

Better regulation

This means, *inter alia*, improved consultation before launching a proposal. The consultation process should be open and transparent, and evidence-based, with submissions being available publicly. There would be a thorough and convincing impact assessment, reviewing the need for EU-level legislation and its impact and cost; in other words, the Commission must be able to demonstrate that legislation is necessary and will add value, in spite of the cost to financial institutions of implementation. Coupled with this would be evaluation of legislation once in place. This is already a feature of several Directives, and in particular the "Lamfalussy" Directives.

The Commission wishes to ensure there is coherence across financial services legislative provisions. Thus, it is considering the possibility of a single "Financial Services Rulebook" which could result in the simplification or even repeal of some legislation.

Certain measures could be repealed if they do not meet the "better regulation" criteria. In this context, certain commentators have recommended the repeal of the Distance Marketing Directive², which imposes an additional regulatory regime for distance sales of financial products but adds little to existing consumer protection rules.

The Commission has several ideas on how to improve transposition of Directives by Member States. It wishes Member States to speed up the implementation of Directives into national law, by increasing public information. It also aims to discourage "gold-plating" of legislation by the Member States when transposing Directives. Further, it intends to provide guidance on correct implementation. It has already put in place workshops to encourage a more consistent interpretation of legislation by the Member States.

In addition, it has published a Recommendation³ in which it sets out seven recommendations for timely, correct implementation through legislation which does not go beyond what is required to transpose the Directive concerned.

Mechanisms are also in place to facilitate more consistent interpretation by Member States. For example, the IORP Directive⁴ requires Member States to cooperate with each other and with the Commission in the uniform application of the Directive's provisions, with a view to developing best practices and thereby avoiding distortions of competition.

In addition, CEIOPS⁵ has issued a draft protocol which provides a framework for the Member States to interpret consistently certain provisions of the Directive, particularly in relation to communication between supervisors. This approach is not new; the "Siena Protocol" has for several years provided a similar, but more detailed, framework for cooperation between supervisors in the context of the insurance Directives⁶.

The Commission already reports annually on the

state of financial integration; it will review the implementation of the FSAP in the next two to three years. Many Directives also provide for post implementation review; the Commission has recently announced a study into the E-Money Directive and the Deposit Guarantee Schemes Directive. Ultimately, the Commission may bring proceedings against a Member State which it considers has not implemented a Directive correctly; the Green Paper restates this option.

The Commission's proposals for better regulation could provide a solid platform for future consistent application of legislation. However, they rely significantly on Member States' own wish to move towards a more integrated and convergent EU. The Commission's power to ensure consistent implementation of legislation is limited by the structure of the Single Market legislation (principally constructed on the basis of minimum harmonisation, where Member States have latitude to introduce more stringent or restrictive measures within a framework created by the relevant Directive) and the lack of enforcement capability before implementation.

Effective supervision

The Commission seeks greater consistency between regulators and supervisors, to better reflect the requirements of an integrated market. This requires convergence of supervisory provisions and the maintenance of high standards. Thus the Commission wishes to improve cooperation between supervisors within and beyond the activities of the three Lamfalussy committees, CESR, CEBS and CEIOPS. The Commission intends that there should be more cross-sectoral coordination so that regulatory and supervisory measures for one sector do not conflict with those of another. This is particularly important, for example, in the context of financial conglomerates.

An obvious consequence of greater cooperation between supervisors, both within sectors and cross-sectorally, is increased confidence in the principle of home State control.

This might result, over time, in removal of certain exceptions to the home country control principle.

Facilitating cross-border consolidation

The Commission launched a survey in April 2005 on why there is little cross-border consolidation in the financial sector. It sees consolidation as an important element in establishing an efficient and integrated

financial services market. It refers to Member States' own measures to discourage or prevent mergers (e.g. through golden share arrangements) with an institution from another Member State. The Commission, launching its survey, was quite explicit in referring to misuse of supervisory powers to block cross-border mergers. At the same time, a recent high profile example of difficulties which can arise is the launch by two banks, based respectively in Spain and the Netherlands, of bids to take over Italian banks.

The Commission cleared the two bids in May 2005, and has threatened proceedings if the Bank of Italy fails to apply EU law in this area. The Bank has shown a particular attachment to retaining Italian ownership in the sector. Similarly, following rumours of a bid by Pepsi Cola for the Danone food group, the French Government has called for "economic patriotism" and drawn up a list of sectors considered "off limits". These attitudes by two of the weakest economies in Europe bode ill for a Single Market "without internal frontiers in which the free movement of goods, persons, services and capital is ensured"⁷.

Currently proposed measures and future initiatives

The Commission states that it will pursue various initiatives already under way. These are the Capital Requirements Directive, Solvency II and (though the Commission is more cautious on these) proposals on payments and on clearing and settlement.

Having previously raised the possibility of introducing regulations for rating agencies and financial analysts, the Commission may conclude that further legislation is superfluous (the Market Abuse Directive, as well as self-regulation, may be sufficient for rating agencies, and the MiFID may suffice for analysts).

As regards future initiatives, the Commission has already come forward with a Green Paper on asset management. In keeping with its approach that legislation will only be proposed if it is necessary, the Commission states in the Asset Management Green Paper that it does not foresee wholesale changes to the UCITS legislation, but will review implementation to ensure that the current legislation operates effectively.

Integration of retail financial services remains an issue. The Commission states that retail markets remain "deeply fragmented"; it seeks to identify significant barriers to cross-border integration and risks for consumers, so as to determine any business case for further integration.

This approach is a reference to the Commission's enquiries, for competition purposes, into the retail banking and business insurance sectors. Whilst the reference to retail banking appears logical, it is less clear

why the reference to business insurance is mentioned.

The Commission also refers to a forthcoming Green Paper on mortgage credit, now published. It considers whether there should be further alignment rules on financial intermediaries, particularly with regard to conduct of business, advice and disclosure.

Respondents to the Green Paper might be reluctant to support this measure, since financial intermediation is covered by MiFID and by the Insurance Mediation Directive.

Finally, the Commission seeks comments on a "26th regime" as a means of providing a uniform approach to overcoming the pitfalls of national law and general good requirements for retail cross-border financial services provision. Support from financial services providers for such a step has been lukewarm, and there are doubts as to whether Member States would support an initiative which would (inevitably) serve in large part as a vehicle for regulatory arbitrage.

Conclusion

The Green Paper is, in effect, a continuation of the Commission's existing approach. It is not radical, but seeks to use resources more effectively, to ensure that

financial markets work better. There is little detail in the paper, which some might regret, but it is a clear statement that the Commission sees coherence and efficiency as being of prime importance over the next five years.

Certain elements are potentially deliverable - cooperation between the supervisors is well-entrenched and, in some cases, provided for in legislation. Much, as ever, depends on the willingness of the Member States to implement legislation in a way which furthers the aims of an integrated financial market; the publication in July 2005 of transposition tables and the state of play in implementation of the "Lamfalussy Directives" shows that there is a long way to go.

Notes:

¹ COM (2005) 177.

² Directive 2002/65/EC of September 23, 2002 on the distance marketing of consumer financial services, OJ L 271, 09.10.02, pp. 16-24.

³ Recommendation SEC(2004) 918 final on the transposition into national law of Directives affecting the internal market.

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- ⁴ Directive 2003/41/EC of June 3, 2003 on the activities and supervision of institutions for occupational retirement provision, OJ L 235, 23.09.03, pp. 10-21.
- ⁵ The Committee of European Insurance and Occupational Pension Supervisors.
- ⁶ That said, such protocols must conform to Community law principles (e.g. they must not be unduly restrictive) and they cannot be a substitute for properly enacted Community legislation.
- ⁷ Article 14 (2) EC Treaty.

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This article appears in the European Single Financial Market 2005/2006, published by Euromoney Yearbooks. For further information please visit www.euromoney-yearbooks.com