

European Financial Services action plan

In June, members were presented with an update on a range of EU financial services directives. Lucy Calderwood reports.

■ On 24 June Dr David Doyle, ACCA's head of EU Parliamentary affairs, gave members of the financial services network an update on the European Financial Services Action Plan, a raft of directives designed to increase the EU's productivity and competitiveness in the years up to 2005.

The Action Plan was formulated in 1999 when the EU commission identified our lack of competitiveness as a single market, when compared with the US. Divergent levels of investor protection, coupled with an underdeveloped investment market at citizen level, resulted in a disjointed, fragmentary financial services market that was confusing to foreign investors. The action plan that emerged was an ambitious programme of 42 separate legal measures covering everything from banking, securities, insurance, accounting standards and auditing practices, with a view to creating a single financial market for these areas by 2005. This deadline was missed for three main reasons:

- divergent interpretation of directives. Seemingly simple directives, interpreted as frameworks in UK law, were deemed to require 'to the letter' adherence by some

jurisdictions, for example the interpretation of the roles of home and host regulators in MiFID

- late implementation of directives across Europe. Some states lagged behind in implementing those directives that were most controversial to a domestic audience
- 'Gold plating'. Some states added their own procedures and requirements, making compliance times longer and more complicated.

all giving the same message. For example the FSA has considerable sanctioning and investigatory power, but this is not the case in many states, for example some of the newly created Central and Eastern European countries

- more competition, particularly in retail markets. The current Commission's mandate includes greater powers for the Directorate General for Competition, and this has already produced an impact

'In mainland Europe the culture of 'legislative imperative', as opposed to UK common law, required legislation on some important issues'

Faced with these issues, EU Commissioner Charlie McCreevy came up with a largely acclaimed white paper suggesting the following steps:

- dynamic consolidation. Addressing the widely-acknowledged gaps and inconsistencies in some existing directives, for example UCITS and some IFRS
- better regulation. A fundamental principle, given the volume of new regulations that had been developed up to this point. An essential part of this was that all new directives would have to pass an obligatory economic impact test. Directives that failed, or have been shown through testing to be unworkable or ineffective, have been dropped
- enhanced supervisory convergence. This aimed to bring into line all EU supervisory and regulatory bodies, to ensure they are

in the form of breaking down barriers in the telecomms market. Next on the list are barriers in the European banking and insurance markets

- the external dimension and a cross-Atlantic approach. The UK and the City of London does not operate in a vacuum, but works in conjunction with Hong Kong, New York and other principal financial centres; however, the rest of Europe does not operate in this way.

Although McCreevy was keen to give less emphasis to legislative initiatives, he recognised that in mainland Europe the culture of 'legislative imperative', as opposed to UK common law, required legislation on some important issues. The Directive on Payment Issues (SEPA) is one such piece of legislation. This was intended to amend regulation 2560/2001, stating that any payment made

action plan (continued)

in Euros must cost the same as a domestic payment. The amendments included credit and debit card payments, which must be processed on the same day as the payment is made, and directives opening up competition to a wider range of payment service providers. As part of the SEPA, consumer protection for customers making cross-border payments has been tightened. This will be extended to direct debits in a proposal to be submitted by Autumn 2008.

directive on cross-border consolidation in the financial services sector

The European banking system is at the moment a very insular culture, with deep-rooted protectionism. Whilst the Commission does not endorse hostile takeovers per se, it recognises that takeovers do create more choice and lower costs for consumers. As a result, this directive introduced a 60-day rule – where central banks and financial regulatory bodies across Europe have just 60 days to approve cross-border banking takeovers or mergers, improving the previous situation of long drawn-out approvals.

UCITS

Dr Doyle described UCITS as a work in progress. In the last two years the Commission has moved closer to clarifying the respective roles of home and host countries; however, the most important issue is the question of what will happen to the management company passport. The Commission is keen to liberalise this aspect so that a fund manager in any country can disperse his management company expertise anywhere in the EU. This is understandably facing resistance from the two most important management company transaction jurisdictions, the Republic of Ireland and Luxembourg.

This issue would have been addressed by UCITS IV, which Charlie McCreevy has decided to withdraw. UCITS IV would also have provided clarification on cross-border mergers of funds. At present a fund manager has to domicile his fund operation in the jurisdiction

where he is selling those funds – a cost that is passed onto the consumer. UCITS IV would have clarified the position on this and removed the need to domicile funds where they are sold, on the basis of home state regulation. For example, if the FSA approves a fund as suitable for sale in the UK, in theory it should be acceptable to a regulator in France, Finland or Slovenia. It is hoped that UCITS IV will reappear by the end of 2008, clarifying a number of issues, but principally setting very clear terms for the notification process and the simplified prospectus.

Solvency II

Solvency II represents a revolutionary piece of legislation with three very important dimensions:

- consistent valuations of every insurance companies' assets and liabilities on an annual basis.
- capital requirements to be based on underlining risks rather than volumes of business
- recognition of the importance of risk management internally, in running the business. All insurance companies of all sizes will need to be able to recognise and manage all risks that they are exposed to.

Currently the EU is discussing the notion of the group supervisor in the home member state i.e. should we allow the Finnish regulator to have responsibility for supervising not just the Finnish operation but that company's operations in the other EU member states, including the role of fixing the capital requirements of those operations?

The other issue for concern is that, although pensions are excluded from Solvency II rules, there is a suspicion that once the group supervisory issues are resolved, pensions may be covered by these rules.

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Looking Ahead

clearing and settlement in the EU

McCreevy has warned the stock exchanges in Europe that he wanted to see a voluntary code of conduct to 'unbundle' some services and provide more transparent and separate accounting between the transaction, the settlement and the clearing, and more cross-border access. Good progress is being made on unbundling, but there is very slow progress on accounting separation and on access.



MiFID

Requirements will still be recorded, but there is a question mark over to what extent investment banks and stock exchanges should provide pre-transaction transparency. It's clear that the stock exchanges will not find this difficult, as they have been doing this for years, but many of the smaller investment banks in Europe have commented that it is a great burden on them - providing increasingly detailed transaction information on a regular basis to local regulators.

An interesting issue for many at the moment is that of third party outsourcing, and here MiFID has an interesting provision - that if a company outsources some of its advisory work to a third party, it must be able to ensure that that third party is equally in compliance with all MiFID rules - a time-consuming requirement.

EU-US financial regulatory dialogue

There have been very positive developments here, including a better understanding of each other's regulatory frameworks. There are two basic objectives here - to avoid another Sarbanes-Oxley scenario, with its territorial implications, and ensuring that we have a broad framework for regulatory implications when it comes to issues such as hedge funds and private equity. For now the US and the EU have set up a trans-Atlantic economic council, which will look at a range of regulatory issues, from IFRS/US GAAP convergence, to the recent issuing of a trans-Atlantic securities regulatory framework.

Other issues to address include:

- reinsurance - US companies can currently set up in Europe without too much difficulty, whereas in the US European reinsurance companies need to set up a separate subsidiary, and also have to set aside a substantial capital requirement
- mutual recognition on EU/US securities markets - there is more momentum here given that 80% of the world's capital markets are based between Europe and the US
- lack of progress on IFRS and US GAAP. The US has stated that Europe needs to sign up fully to all aspects and provisions of IFRS

and not include any caveats. Until that happens the US will not dispense with EU companies who wish to list in New York having to report under both IFRS and US GAAP.

in the pipeline

- rating agencies** - in spite of the fact that rating agencies had agreed to form a voluntary code of conduct, it doesn't seem to have worked. Agencies are therefore heading for regulatory oversight
- private equity**, like hedge funds, will probably find itself voluntarily providing more transparency on the nature of the business. Private equity firms will probably be included in the EU capital adequacy requirements directive
- sovereign wealth funds** - the Commission recognises the added value and quality of these investments. They urged these funds to work closely with the IMF, the US and Europe to come up with more transparency rules with respect to their investments
- crisis contingency plans** are still on the agenda, to cope with the prospect of an affiliate bank going bust and dragging down other players. We do not have a fail-safe warning system to deal with this, and progress seems to be slow
- updating the Lamfalussy process** - there is a need to ensure that, once the legislation has been approved by the European Commission, Parliament and Council, the member states don't add any more 'gold plating' to introduce further requirements and vetting procedures
- priorities for the French Presidency** - credit rating agencies will certainly be on their agenda, as well as updating accounting and valuation rules in the banking and insurance sector, encouraging prompt and full disclosure of losses by financial institutions, and improving the early warning system and developing guidelines for crisis management.

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