The Royal Bank of Scotland Group plc: response to HM Treasury's Review of the Balance of Competences – Single Market: Financial Services and the Free Movement of Capital

Executive Summary

Introduction

RBS welcomes the publication of HM Treasury's call for evidence on the *Single Market: Financial Services and the Free Movement of Capital* as part of its Review of the Balance of Competences. The Key Comments section immediately below outlines our main points; this is followed by more detailed comments on the individual questions posed in the consultation.

We would be happy to elaborate further on any part of this response and look forward to engaging with the Government in this area. In the first instance, please address any enquiries to:

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Key Comments

- **The Single Market -** The principle of the Single Market and a free flow of capital between EU Member States are considered essential to the way that RBS operates. We appreciate the need for a consistent rulebook and coordinated regulation and supervision of financial markets in order to ensure financial stability and the integrity of a single market. It will be vital that the Commission continues to safeguard the Single Market as the banking union develops.

- **Regulation** - RBS notes that much recent EU regulatory reform has been driven by global standard-setters and that the UK has been at the forefront of debate in these fora. EU-level policy action should nevertheless strike an appropriate balance between growth and stability. Continuing work on the coherence of EU legislation and its cumulative impact should be helpful in this context.

- **Impact assessments** - While we support the need for regulatory consistency via the Single Market and Rulebook, it is critical that the EU's policy response is proportionate and evidence-based. An improved commitment to consultation with stakeholders and the development of more robust impact assessments will assist this process.

- **UK representation** - RBS urges the UK Government to continue to ensure that the UK is properly represented in key European institutions, including the European Commission and the European Supervisory Authorities (ESAs). Such representation will be essential to increase the UK's influence over key financial policy areas. Linked to this, it is critical that the UK should continue to build relationships and alliances with like-minded Member States.

- **Coordination** - Whilst we recognise that national regulators will sometimes front-run EU-level dossiers, improved and more timely communication, and ultimately better coordination between national and supranational regulators would help reduce implementation problems.

Detailed Comments

1. How have EU rules on financial services affected you or your organisation? Are they proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

RBS is a leading UK bank anchored in retail and commercial business lines. Our businesses are shaped around customer needs with substantial competitive strengths in their respective fields. We sustain strong capabilities internationally and in financial markets - including within the European Union - to support the needs of our customers and shareholders. EU rules on financial services are therefore an important factor determining the regulatory environment within which RBS operates. The principle of the Single Market and a free flow of capital between EU Member States are considered essential to the way that RBS operates. We therefore appreciate the need for a consistent rulebook and coordinated regulation and supervision of financial markets in order to ensure financial stability and the integrity of the Single Market. While we support the need for this consistency, it remains essential that the principle of subsidiarity is respected. This is especially true when considering the importance of the City of London and the greater impact that financial services legislation has on the UK in comparison to other Member States. We outline in this submission areas for further consideration to ensure that the EU policy response is always proportionate and based on robust evidence.

2. How might the UK benefit from more or less EU action? Should more legislation be made at the national or EU level? Should there be more non-legislative action, for example, competition enquiries?

We would note that much of the EU regulation since the crisis has been driven by the intention to implement guidance directed by the G20, a forum in which the UK has played a leading role. A non-exhaustive list of key initiatives first proposed at G20 level includes measures for hedge funds and private equity (AIFMD), remuneration and prudential requirements for banks (CRDIV), derivatives (EMIR) and Credit Ratings Agencies, resolution of bank crises (BRRD), and shadow banking. In all these areas the UK has - in our view - sought to be at the forefront of the debate. Whilst concern can be expressed on how the EU has tried to implement legislation, it is important to recognise that the principled objective of global policy coordination is one that both industry and the HM Government has supported.

There are of course, alternatives to legislation: 'best practice' and voluntary codes can often develop at a faster pace than EU-wide legislation, and therefore achieve the desired outcome more quickly. For example, the UK Corporate Governance code operates on a 'comply or explain' basis and already contains some of the provisions recently agreed under CRDIV (e.g. separating the roles of Chairman and CEO). Other voluntary codes such as the ABI Principles of Remuneration are updated on an annual basis. The fact that voluntary codes can be regularly updated makes them potentially more responsive and better attuned to changing conditions and expectations. This also avoids the need for prescriptive legislation in every area – to which it is in any case likely to be less well adapted.

Intervention will have a different purpose depending upon whether it is via legislative action or a competition enquiry. Legislative action is forward looking, whilst competition enquiries (either under Article 101 and/or 102 of the Treaty for the European Union) will be backward looking, focusing on any historic anti-competitive behaviour. Sometimes however there will be a cause and effect, i.e. a competition investigation may uncover anti-competitive features of a particular market, which can be remedied by subsequent legislative action.

Substituting EU legislative action with more competition enquiries is not a straightforward change of approach and will ultimately depend on the subject in question. That said, there have been instances of interaction between the two i.e. the cause and effect approach mentioned above. One current example is in relation to interchange fees. The interchange competition investigation has been ongoing for many years and in recent months a draft regulation has been proposed for the capping of both cross border and domestic fees. After such a long-running investigation (and also court proceedings) the move towards legislation is welcome, in principle, in providing future clarity for stakeholders (notwithstanding the ongoing consultation process focusing on possible amendments to particular content and the scope of this regulation).

Clarity and the efficient use of resources (for both legislators and other financial services stakeholders) are important factors in deciding if a legislative intervention or competition enquiry is the most appropriate intervention measure. Duplication often creates an unnecessary burden on such stakeholders. For this reason, the subject matter in question should dictate which option is most appropriate.

A general point is that greater harmonisation and speed of EU guidance on legislation would assist companies. For example, there is a requirement to comply with CRDIV from 1 January 2014, but technical guidance in some areas is not due to be finalised until the end of Q1 2014, or in some cases not until 2015. This process can be further complicated when national regulators choose to front-load the EU implementation timetable; a case in point here would be the implementation of CRDIV guidelines in the UK.

3. How have EU rules helped or made it harder to achieve objectives such as financial stability, growth, competitiveness and consumer protection?

RBS would like to emphasise the importance of striking an appropriate balance between growth and stability when designing future regulation. In this context we welcome the ECON Committee's recent Own Initiative Report that set out the Parliament's forward-looking views on *'Enhancing the Coherence of EU Financial Services Legislation'*. We note in particular the report's statement that *'Reviews of related pieces of legislation should be more coordinated, taking account of linkages between policy objectives and effects of legislation*.*'* We look forward to seeing how this report will inform work to be undertaken by the next European Parliament.

4. Is the volume and detail of EU rule-making in financial services pitched at the right level? Has the use of Regulations or Directives and maximum or minimum harmonisation presented obstacles to national objectives in any cases?

We welcome the role that EU rule-making in financial services plays in safeguarding the Single Market. Where possible, financial services legislation should fit together seamlessly. We accept, however, that a balance must be struck between ensuring an appropriate level of discretion for Member States when implementing Directives, and achieving uniformity via EU Regulations to ensure a level playing field.

There are very clearly some areas - such as the Bank Recovery and Resolution Directive - where appropriately calibrated EU legislation is essential to ensure the integrity of the Single Market and the financial system. These reforms are necessary and will provide the long term basis for recovery.

In other legislative areas, the case for change being prioritised is less clear, there are concerns about overlap, or that the legislation may result in unintended consequences. Potential examples in each case include the Liikanen proposals; the Distance Marketing Directive and the E-Commerce Directive; and the Insurance Mediation Directive 2 (which would in effect have banned 'tying' within financial products).

From a legal standpoint, we would note that in some cases, prescribed terminology (e.g., in Key Investor Information Documents for UCITS) can be less accurate than the terminology that would otherwise have been used. In other cases, EU law refers to concepts that have no direct equivalent in the legal systems within the UK (e.g., gross or serious negligence). Whilst EU legislation can appear overly prescriptive, this does not mean that it necessarily compares less favourably with UK legislation.

The potential for overlap and the volume and detail of rulemaking in financial services means that the cumulative impact of EU legislation is relevant. The practical use of this assessment could be to help determine the need for and calibration of future legislation. We note the current work underway in the European Parliament in this area (see question 3 above) and believe that it would merit early attention following the election of the new European Commission in 2014.

5. How has the EU's approach to Third Country access affected the ability of UK firms and markets to trade internationally?

6. Do you think that more or less EU-level regulation in the area of retail financial services would bring benefits to consumers?

In our view the question is not really one of whether there should be more or less EU-level regulation, but how well it is attuned to customers' and firms' needs. This means that the Commission should listen carefully to Member States' feedback, and engage carefully with other stakeholders when proposing new legislation.

As a general point, we would note that RBS welcomes EU proposals that promote growth in EU Member States and benefit customers. However, retail markets in Member States are by their nature *sui generis*, differing greatly in their size, sophistication and technological abilities. When the EU legislation aims for a level playing field, it should focus on setting minimum standards where there may be real gains for consumers. When this focus occurs, beneficial outcomes are more likely; if it does not, the chance of unintended consequences is increased. Some examples below illustrate this point.

The EU Payment Accounts Directive ensures that nationally consumers can have access to the Banking sector, and can take advantage of competition between providers through an efficient, speedy and safe switching mechanism. The UK has already delivered this, pre-dating the EU proposals, and fully supports its introduction elsewhere for the benefit of consumers.

The conduct of business requirements introduced by the Markets in Financial Instruments Directive (MiFID) created a level-playing field in customer protection across the European Union. MiFID set out the basic information requirements and fiduciary duties of investment firms towards their customers. The fact that these rules apply across Europe means it is easier for the banks to operate in those markets and know the standards that should be applied for their customers.

The recast of the Insurance Mediation Directive (IMD2) is a good example of the unintended consequences that can affect some European legislation. The Commission sought to ban the practice in some Member States where the provision of certain banking facilities is conditional upon taking a separate product. This legislation would also apply, however, to UK packaged bank accounts where, even by the FCA's own admission, it has been shown that these accounts can be beneficial to consumers as the cost of arranging separate policies or benefits might be greater than the monthly packaged account fee.

7. What has been the impact of the shift towards regulation and supervision at the EU level, for instance with the creation of the European Supervisory Authorities? Should the balance of supervisory powers and responsibilities be different?

An effective Single Market requires a single rulebook and effective single supervisory approach. RBS believes that the European Supervisory Authorities (ESAs) have an important role to play in delivering this - via both the single Handbook and the peer review concept.

The performance of the ESAs will be assessed by the European Commission by January 2014. Already published, the recent *'Review of the New European Supervision of Financial Supervision'* for the European Parliament's ECON committee, makes several noteworthy recommendations. These include: strengthening input from stakeholder groups; enhancing the predictability of regulatory work by publishing a calendar of consultations several months in advance; and the use of concept papers to improve the existing consultation process on possible technical standards. RBS agrees with the importance of setting appropriate and realistic timetables, and ensuring that the ESAs are adequately resourced to meet their stated objectives.

RBS is an international banking group which operates both within and outside the EU through a variety of subsidiaries and branches. The use of branches as the Group's main basis of operation within the EU allows it to maintain a centralised model where risk and controls are actively managed in the 'centre' rather than in each specific location. A similar principle exists for the flow of information between the home and host regulator (for example see CRR Article 415 (5). For this to work effectively RBS recognises that there needs to be a common rule book and reporting methodology.

The single rulebook should bring benefits in terms of standardisation and consistency across the EU Member States and simplify operations for banks that operate in multiple EU countries, although there remains the possibility for home or host Member States to overlay the regulation such with local 'add-ons'. As an example, the Prudential Regulation Authority proposed in CP 5/13 an accelerating of transitional capital requirements and augmenting the level of 'Solo' regulation through local Intra-Group rules. National actions can therefore perpetuate differences against the common rule book. This can risk diluting the consistency benefit that the ESAs seek to promote.

8. Does the UK have an appropriate level of influence on EU legislation in financial services? How different would rules be if the UK was solely responsible for them?

As the pre-eminent financial centre in Europe, the UK is naturally more affected by EU financial services legislation than other Member States.

The outlook will however, remain challenging and it will require ongoing effort to maintain the UK's strong track record. In this context we note the recent House of Commons Foreign Affairs Select Committee report *'The UK staff presence in the EU Institutions.'* This states that the number of UK nationals on the staff of the European Commission has fallen by 24% from 2005 to 2012, standing at 4.6% of the total - and expresses a further concern that *'the UK staff presence at middle-ranking and more junior and entry levels in the Commission is insufficient to compensate for the exit of senior UK officials.'* Increased UK representation within EU institutions, particularly the ESAs and Commission, is therefore critical, and would greatly increase its foresight of and influence over key policy areas. Linked to this, it is essential that the UK should continue to build relationships and alliances with like-minded Member States.

It is difficult to quantify how different rules would be if the UK was solely responsible for them; but as mentioned in response to question two, the agenda for much of the recent EU regulatory reform is set at the global level by institutions where the UK is already very well represented. As such, the broad thrust of rules may not significantly differ under national rules when compared to EU equivalents. We observe however that the timeline for the implementation of EU legislation may be longer than that necessary where only a single Member State sets rules. It is possible to contrast here the relatively rapid implementation of a new liquidity framework and reporting tool the UK introduced in 2009 by the then Financial Services Authority (FSA) with the lengthier process at the EU level, where the EBA will continue to consult into 2014.

9. How effective and accountable is the EU policy-making process on financial services legislation, for example how effective are EU consultations and impact assessments? Are you satisfied that democratic due process is properly respected?

RBS engages regularly with trade bodies, the UK Government, and EU institutions on relevant EU financial services dossiers. Indeed we would observe that EU institutions are relatively open in terms of the ease of stakeholder engagement. The UK's considerable specialism in financial services means that it is necessarily involved at all levels in the debate on key EU financial services proposals. We continue to support the UK Government's ongoing work to develop its engagement with EU institutions. This should include increasing the number of UK nationals working for EU institutions - especially the Commission and the ESAs.

We recognise that there is tension in the policymaking process between ensuring that adequate engagement occurs and ensuring that EU legislation is appropriate and timely. RBS nevertheless considers that legislation that is carefully prepared and subject to adequate scrutiny will be better designed, more workable and appropriate for customers and firms. We therefore welcome the European regulatory bodies' commitment to consulting with affected parties. Industry should have the opportunity to provide views to regulators; this process will be enhanced by having sufficient time to respond to public consultations. This is especially true once the legislation reaches the Level 2 technical stage. Trade bodies - both at the EU and national level - have a key part to play and we welcome their involvement at the earliest possible stage in the consultation processes.

The challenge of keeping pace with change in the industry, particularly technological advances, is substantial. The Payment Services Directive (PSD), implemented in 2009, updated in 2012 and now under review, provides a good example. Customers have received a definite advantage because the amount of time taken to transfer money from one account to another has been reduced and they have been afforded additional protections. However, the current review (PSD2), and related work around security of internet and mobile payments, demonstrates the challenge for EU regulation to keep pace with change. Similar issues exist around the Key Investor Documentation (KID) for Packaged Retail Investment Products (PRIPs). In our view the usefulness of this document for retail investors has been weakened by the extensive requirements that have been placed on it (including the use of synthetic risk and reward indicators to permit comparison) during the course of the negotiations at the EU level.

Impact assessments form a critical part of ensuring an effective and accountable EU policymaking process. Poorly drafted proposals with inadequate impact assessments are more likely to be challenged by participants - the Multilateral Interchange Fee Regulation is one example. A thorough impact assessment should contain an in depth cost-benefit analysis, and should help reduce the risk of unintended consequences mentioned elsewhere in our response. The robustness of the impact assessment is likely to be enhanced if it is undertaken by an organisation that is separate from the institution that proposes the legislation - the European Council and European Parliament might consider whether they should conduct their own studies in this context. The Commission's recent Financial Transactions Tax impact assessment is a further example that would have benefited from this more independent approach.

We would note that the issue of Level 2 details for a Regulation can be useful in that it removes some of the uncertainty for providers over how the local regulator will seek its implementation. The issue of the Level 2 Regulation implementing the AIFM Directive was helpful in this respect in that it created certainty and removed the need for FCA to implement much of the detailed provisions of the AIFM Directive separately.

10. What has been the effect of restrictions placed on Member States' ability to influence capital flows into and out of their economy, for example to achieve national public policy or tax objectives?

11. What may be the impact of future challenges and opportunities for the UK, for example related to non-membership of the euro area or development of the banking union?

We note the various developments driving European governance and regulation in the financial sector since the financial crisis. In our view, the EU's primary objective of resolving the too big to fail problem remains valid. The Bank Recovery and Resolution Directive and a working Single Resolution Mechanism and Single Supervisory Mechanism - with adequate safeguards - will be essential in this respect. A fully operating banking union will change the nature of the UK's relationship with participating countries; it will be vital that the European Commission acts to protect the Single Market as the banking union develops. The safeguards associated with EBA's decision-making process in this respect should be maintained and we welcome efforts by HM Government to this end.

12. Do you have any further comments about issues in addition to those mentioned above?

We would add that good communication and ultimately better coordination between national and supranational regulators and legislators is essential. Whilst we recognise that national regulators will sometimes need to 'front-run' action at the EU level, we would urge coordination where this is possible.

As an example, the then FSA recently conducted a Mortgage Market Review (MMR) in the UK. This started with a Discussion Paper in 2009 and culminated in a Policy Statement and final rules in October 2012. This reform package was aimed at ensuring the continued access to mortgages for the majority of customers who can afford it, while preventing a return to poor lending practices. The reforms were broadly supported by both lenders and intermediaries in the UK and were heavily consulted upon.

However, at the European level a similar review of the European mortgage market produced the Mortgage Credit Directive. This Directive is being discussed by the European Parliament, Council and Commission at present. Once it has been formally adopted and published, it is currently proposed that Member States will have two years to implement it into national law.

The Mortgage Credit Directive will probably require further changes to the regulatory framework that now applies in the UK and is currently being implemented by lenders. This will no doubt lead to increased costs in ensuring compliance with the further regulatory requirements and disclosures. It is questionable whether these changes will assist consumers when the UK financial regulator had already determined what was necessary in the UK market following a comprehensive review.

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