Balance of Competences Review: Single Market – Financial Services and the Free Movement of Capital

CBI response | January 2014

About the CBI

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce.

The CBI helps create and sustain the conditions in which businesses can compete and prosper for the benefit of all. We are the premier lobbying organisation for UK business on national and international issues. We work with the UK government, international legislators and policymakers to help businesses compete effectively.

With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

The CBI welcomes the opportunity to provide evidence to the Government review of the Balance of Competences between the United Kingdom and the European Union on Financial Services and the Free Movement of Capital. This response is structured as follows:

1. **Introduction**
2. **Summary of the key messages**
   - 2.1. **EU membership has boosted growth in UK financial services, but sustained efforts are needed to ensure UK companies continue to benefit from an open and competitive Single Market** (Questions 1 (in part), 3 and 5)
   - 2.2. **There is a need to strengthen the focus and quality of EU rules on financial services and improve the policy-making process** (Questions 1 (in part), 2, 4, 6, 7 and 9)
   - 2.3. **The UK is an influential player at EU level, but must prioritise continued influence to safeguard the Single Market in a more integrated Eurozone** (Questions 8, 11 and 12)
3. **Annex:** detailed question responses

For more details around the CBI's position on the UK's relationship with the EU, please see our report 'Our Global Future – The Business Vision for a Reformed EU' launched in November 2013.

CBI Centre Point 103 New Oxford Street London WC1A 1DU
T: +44 (0)20 7379 7400 **F:** +44 (0)20 7240 1578 **W:** www.cbi.org.uk
Director-General: John Cridland CBE President: Sir Mike Rake
Registered No: RC000139 (England and Wales) Registered Office: CBI Centre Point 103 New Oxford Street London WC1A 1DU

1. Introduction

The CBI believes the UK's interests are best served as a committed and influential member of a reformed EU

Britain has looked outwards to the wider world for many centuries, but its patterns of trade and investment have constantly evolved. An open economy, combined with robust domestic industries, has long been a crucial part of the British success story.

However, the nature of economic openness is changing. Britain now needs to adapt its global trading role for the 21st century responding to the rise of new economic superpowers in Asia and South America, whilst extensive structural change takes place at our closest trading partner, the European Union, to restore stability to the single currency. Britain must now adapt its open, global approach to reflect the realities of the 21st century.

The CBI published in November 'Our Global Future: the Business Vision for a Reformed EU', after an in-depth study of the UK's global future. As emerging markets become increasingly dominant, the report argued the UK must maximise openness to global trade - and the best way of achieving this is as part of a reformed EU. For the financial services sector in particular, the report found that UK's success has been supported by a strong presence in Europe dependent on unfettered market access and that membership of the EU is the best vehicle to remain a leading financial services centre.

British business is clear that the best way to be outward facing and globally competitive in the modern era is to continue to use and influence the EU as a base from which to build trading links and maximise interdependence with economies all over the world, whilst reforming the EU to ensure that it allows the UK to realise this global future. Attempting to reverse the process of increasing interdependence and return to a system of bilateral ad hoc arrangements will not create and keep the jobs the UK needs in order to maintain and improve living standards for all its citizens or enhance its standing as a global leader.

However, the EU is far from perfect. Business has frequently criticised many aspects of the regulations that the UK negotiates in Brussels. While being part of club of 28 countries inevitably means compromise, there is particular frustration at the sense of a creeping extension of EU authority – regulating on trivial issues, sometimes counter to the wishes of the UK and its citizens, rather than focusing on the big picture issues like growth, trade and the Single Market.

Our report therefore sets out a reform agenda that focuses the EU on doing more of the things it is good at and less of the things that are bad for business.

- The EU must be outward-looking, opening up new trade opportunities for business. This should be done by putting trade at the heart of the EU's strategy, continuing the push for global solutions at the WTO and protecting the market openness of the EU
- The EU must create an open and competitive EU: updating the Single Market for the 21st century, including making further progress on unlocking the Single Market for Services and focusing on sensible progression of the Digital Single Market. It should also be regulating for a modern, globally competitive EU by creating competitive, commensurate and considered rules.
- Business wants an EU rooted in the priorities of member states: striking the right balance between the EU and its member states. The EU needs to continue to work for all its members, better respect

the boundaries set by member states and the functioning of the EU must be improved, prioritising measures to support growth and competitiveness.

- The UK needs to be fully engaged to help create a better EU, reforming how it engages with EU institutions and improve engagement with EU issues at home to underpin influence abroad.

This is an achievable reform agenda. The CBI believes that the right approach is to champion reform for the whole of the EU, not on the basis of negotiating a special deal for the UK. This reform agenda has support from a number of member states in the EU and, if approached correctly, the UK and other EU member states can together secure a global future for the Europe emerging from the crisis. If the UK engages in the right way, it can help shape the EU for the 21st century. Proactive, positive and permanent UK engagement will secure the outcomes that can support Britain's global future.

The CBI focuses on how the financial services sector support private sector growth

The CBI's broad membership, representing companies from across the UK of different sizes and from a number of sectors across the economy, makes us a unique cross-sector voice speaking on behalf of both providers of financial services as well as thousands of their corporate end users.

This diverse membership impacts how we see financial services and the regulation and supervision of the sector. The financial services industry – and the products and services it offers – is a significant part of the UK economy in its own right, and form one of our few world-class sectors. The sector is also valuable asset for the country as a whole. Financial services contribute around 8% of the country's total GVA[1] and has the highest tax burden as a percentage of GVA of all sectors (37%), contributing around 7% of government tax receipts[2]. But more importantly, the financial services sector's impact on the UK economy is greater as the sector plays a critical role in supporting UK businesses and enabling the UK's economy to grow: it underpins economic activity by helping businesses to invest and grow, export to new destinations, undertake day-to-day transactions and manage their risks.

The CBI therefore believes that an appropriate regulatory and supervisory framework is one that enables the financial sector to thrive and play its role in society – that helps to build a competitive and resilient financial system that supports growth and permits innovation whilst ensuring the sector remains free from taxpayer support. This should be at the heart of both the UK and the EU's approach to financial services regulation.

The challenge in financial services is not the balance of competences, but improving the focus and quality of EU regulation and its policy-making process

We note that the consultation document sets out a number of questions that address the UK's relationship with the EU in a broader sense than the simple balance between EU and national-level competences, including the quality of EU laws and policy-making process and the functioning of EU institutions.

The CBI supports this approach, as a restricted assessment of the competences does not capture all aspects of the UK's relationship with the EU. It is important that the limits of the Commission's responsibilities are clearly defined, but British business sees the principle of 'subsidiarity' as the right mechanism to achieve this, rather than unpicking the existing balance of competences. An unrealistic attempt to repatriate powers rather than reform the whole EU could lead to the exit door by default. The changes underway in the EU and global economy represent an opportunity for the UK to push for a more market-orientated EU that can support the UK's global trading future. This reform agenda has support from a number of member states across Europe.

2. Executive summary

2.1. EU membership has boosted growth in UK financial services, but sustained efforts are needed to ensure UK companies continue to benefit from an open and competitive Single Market

Access to the Single Market and its common rules have benefited the UK economy

Access to EU markets, supported by Single Market rules, has helped strengthen the UK's position as the world's leading financial services centre and the most internationally-focused marketplace in the world, which relies on a strong presence in Europe. It has opened up opportunities in Europe for UK financial services companies as well as bringing FDI into the sector, as European and global actors move their operations to London and regional financial centres across the country. In particular, passport regimes have enabled firms to be authorised in London and operate across Europe, enabling companies to streamline corporate structures, using capital more efficiently and retaining one relationship with supervisors in its home state.

Having a strong financial centre is beneficial for the UK economy as a whole. Financial services provide around 8% of the country's total GVA and contribute 7% of government tax receipts and it provides access to well-developed liquid capital markets for UK companies. It should be noted that the benefits of the Single Market are not felt equally across all sub-sectors in the financial services sector, such as the insurance sector.

Weak prioritisation of growth and competitiveness will hit the sector and its end users unless this changes post elections

The EU has, however, struggled to strike the right balance between ensuring financial stability and consumer protection against the need to support growth and promote competitiveness. Although new rules were necessary post crisis to secure financial stability, the CBI believes the wide-ranging reform agenda has swung the pendulum too far, threatening the industry's capacity to support the economy and hitting its corporate end-users directly. One example is the Financial Transactions Tax (FTT), which the Commission argues will help financial stability[3]. Yet, in addition to potentially infringing the Treaties according to the EU Council legal service, it will substantially hit growth and competitiveness without supporting financial stability or protecting consumers.

As the EU currently enters a new mandate following Parliamentary elections in 2014, growth and competitiveness should be put back at the centre of the next Commission's work programme and the UK should work actively towards achieving this, without compromising financial stability and consumer protection.

A restrictive approach to third countries will close off the EU as a place to do business at a time when the EU needs to be open and outward looking

The European Commission's approach to third countries in financial services legislation was for many years open, with AIFMD being a good example. However, in recent years a more restrictive approach from the Commission, supported by a number of member states and MEPs, has been identified in the draft rules of the Markets in Financial Services Directive. The CBI believes an overly strict equivalence regime, including the use of reciprocity and branch requirements risks limiting investment in or growth of European businesses. Policy makers should instead focus on achieving equivalent 'outcomes' through 'substituted compliance', recognising each other's' collective regimes in the interest of efficiently functioning financial markets and ensuring a global level playing field. The UK has allies in Europe that is supportive of this approach and should work with them to highlight the benefits of keeping Europe open for business.

2.2. There is a need to strengthen the focus and quality of EU rules on financial services and improve the policy-making process

EU institutions must pay greater attention to the principles of proportionality and subsidiarity

Although the overall benefit of the Single Market in financial services is clearly positive, experience indicates a need for greater attention to the principles of proportionality and subsidiarity to strengthen the quality of laws and improve accountability of the EU. The following examples highlight the difficulty of following these principles in practice:

- Post-crisis a number of non-financial companies have found themselves included in the scope of rules intended for financial services companies, such as in the European Market Infrastructure Regulation. Although this might be justified in some cases to level the playing field, most non-financial companies operate in financial market as an ancillary service to their main business and would be disproportionately hit were they to satisfy the same level of rules as financial services companies.
- The CBI agrees with the call for evidence that the nature of retail markets might mean that national authorities might be better placed to regulate them. EU rules, both to strengthen consumer protection and to open cross-border, might therefore add cost to domestic providers who will not benefit from cross-border consumption.

The CBI believes member state leaders and governments must help to restore these principles, by signalling to the Commission that it should refocus its activities based on a more limited interpretation of its remit, and ensure rules are more appropriately designed.

The EU should focus on tailoring action to achieve the intended aim, whilst avoiding overloading the policy-making process

The quality of rulemaking has been hampered by the large number of EU initiatives introduced post-crisis, creating particular difficulty for stakeholders trying to engage in the process. However, the CBI believes that assessing the EU's effectiveness should not be about whether we need more or less EU rules, but about getting the right EU action where it is necessary to support growth and competitiveness in the Single Market. The challenge of the post-crisis reform programme is not just that there have been too many initiatives, but that effective prioritisation has not taken place, taking up the time of policy-makers and reducing the focus put on the necessary rules to get Europe onto a path of sustainable growth. One example is the review of the Insurance Mediation Directive, which has been substantively delayed in internal discussions in both the Parliament and Council, and thus doesn't seem to be a priority amongst policy-makers, while it continues to create uncertainty for business until it is agreed.

In some areas better targeted EU action might mean increased use of non-legislative action, as 'best practice' and voluntary codes can often develop at a faster pace, and more flexibly, than EU-wide legislation. In other areas it might mean putting a larger focus on effective implementation and enforcement of EU rules so that existing rules are being followed in all member states. This includes competition inquiries to ensure the EU's competition framework and the CBI is supportive of a continued focus on competition in financial markets. When EU-level rules have been deemed necessary, setting the right level of harmonisation should be dealt with on a case by case basis to ensure rules support growth and competitiveness.

EU supervisory authorities in financial services are widely supported but must be appropriately resourced. Greater clarity around roles and better engage with stakeholders are necessary.

The CBI has supported the role that the EU authorities play in safeguarding the Single Rulebook and implementing a credible peer review process. We are nevertheless cautious as to the powers given to these European authorities because of the lack of clear lines of accountability provided for in the regulations establishing the ESAs. Many of our members, particularly those outside the financial services sector, struggle to interact with the European authorities for several reasons, such as lack of knowledge of their work and powers or lack of capacity to deal with European authorities in addition to national one.

We also believe there is a need for the UK to bolster its participation in EU institutions, including these authorities, to enhance both its influence at EU level but also the effectiveness of EU policy making. A greater use of secondments into European institutions is a good example.

The EU policy-making process is in need of reform, as EU rules on financial services are too often poorly assessed, developed and evaluated.

The CBI believes that the EU financial services policy making process could be made more effective and accountable, which would ultimately improve trust in EU rulemaking across Europe. This could be done by taking action in three key areas:

- The Commission must take a new look at its impact assessment and processes for evaluation. It should improve its assessment of the impacts of FS legislation on businesses and the wider economy and introduce an independently verified annual statement of the total net cost to business of regulatory proposals issued by the Commission – and consider a move towards a more independent impact assessment structure. It should also strengthen the role of the Impact Assessment Board, increase transparency of the process and look at ways to better assess amendments put forward during negotiations.
- The EU must improve its procedures for evaluating existing rules. A first priority should be to do a fitness check on the existing stock of financial services regulations, including those adopted in the last reform programme, to determine whether the framework – its accumulated impact, overlaps, inconsistencies and/or obsolete measures – sufficiently enables the financial services sector to perform its role in providing capital and financial services to businesses across Europe.
- The consultation process at EU level is open and gives many routes for input from companies, but there are still parts of the policy-making process where lack of transparency makes it difficult to participate for those impacted. In financial services rule-making, policymakers are consistently

under-aware of the views of corporates. End-users of financial services are often not able to contribute due to time and resource constraints, lack of awareness of initiatives, or genuine lack of understanding about the way in which new rules will impact them (hence the need for more effective impact assessment).

2.3. The UK is an influential player at EU level, but must prioritise continued influence to safeguard the Single Market in a more integrated Eurozone

A modern economy is dependent on regulatory cooperation to achieve the desired policy outcomes. At an EU-level, influence is made difficult due to the complex nature of the policy-making process through which compromises are made. However, the UK is an influential player on financial services, particularly due to our expertise and position in international forums such as G20 and Basel which set the direction for a large part of EU's legislation.

To ensure our influence is continued in a future EU, the UK must strengthen its presence in EU institutions where the UK is significantly under-represented and build closer links with European partners. It also needs to continue to work to regain credibility in the area of financial services, as one of the biggest threats to UK influence in the EU in this area came from the reputational hit the UK took as a result of the financial crisis.

This becomes even more acute as a more integrated Eurozone poses challenges to the functioning Single Market in financial services, and, some have argued, to the UK's place in Europe. After a careful assessment of the likely developments of Eurozone integration, the CBI report 'Our Global Future' concluded that the EU is likely to integrate, but only to the extent that the UK can still influence the openness of the whole EU to its advantage if it approaches this changing Europe in the right way. Securing continued support for agreed safeguards for those outside the currency area as well as restating a Europe-wide political commitment to the maintenance of a European Union that works for all its members will be important.

Although it has been suggested by some that it would be better for the UK's financial services sector if the UK was solely responsible for them, the CBI believes that being influential in Europe is preferable to being outside the EU and having to comply with EU rules to gain access to the Single Market, but not having any influence over these rules.

Annex: CBI's specific responses to the questions set out in the call for evidence

1. EU membership has boosted growth in the UK's financial services sector, but sustained efforts are needed to ensure UK companies continue to benefit from an open and competitive Single Market

Section summary

EU rules on financial services have on balance benefitted our members through opening up opportunities helping UK companies and boosting growth. However, although new rules were necessary post crisis to secure financial stability, the CBI believes the wide-ranging reform risks threatening EU's growth and competitiveness. We therefore urge EU institutions to evaluate the impact of its post-crisis reform package and make sure its future financial services strategy keeps the EU open and outward looking, including towards third countries.

Parts of Question 1: How have EU rules on financial services affected you or your organisation?

Rules have on balance benefitted CBI members by opening up new opportunities

The Single Market and its single rule book has contributed to the UK being today the world's leading financial services centre and the most internationally focused marketplace in the world: a global leader in cross-border bank lending, foreign exchange operations, interest rates OTC derivatives, maritime insurance and the leading western centre for Islamic finance among others. This global reach relies on a strong presence in Europe. The EU's Single Market has opened up opportunities in Europe for UK financial services companies as well as bringing FDI into the sector as European and global actors move their operations to London and regional financial centres across the country. For the sector as a whole, Europe is the largest single destination for exports and the UK's financial services trade surplus with the EU has doubled in the past decade[4]. The UK's insurance industry is the largest in Europe, and the UK accounts for 85% of European-based hedge funds' assets[5].

Having a strong financial centre is beneficial to the UK economy as a whole. It has substantially improved access to well-developed liquid capital markets for UK companies, assisting domestic investment and export ambitions. Integration has also helped consumers and businesses through a reduction in cost of cross-border payments – for instance average charge for a payment of €100 fell from €24 to €2.50 between 1999 and 2004[6].

A particularly great advantage for the UK's financial sector are EU rules that have opened up European markets, such as for securities markets and banking, by offering firms the ability to use a single 'passport' across all member states to deliver services. This has allowed companies authorised in the UK to use London and other financial centres as a 'hub' from which to conduct business across the EEA – the 28 EU plus the 3 EEA EFTA states. It enables companies to streamline corporate structures, using capital more efficiently and retaining one relationship with supervisors in its home state.

Although the benefits are on balance positive, it should be noted that the benefits of the Single Market are not felt equally across all sub-sectors in the financial services sector. Insurance is an example where progress on opening up the Single Market has naturally been more difficult because factors influencing the uptake and use of insurance heavily depend on national regulation that falls outside the EU competence, such as tax or social security. This does however not mean that a change of competencies is needed in this area – but it highlights that the impact of financial services rules varies across the industry.

The regulatory landscape is continuously changing and there is no guarantee that the positive net balance will continue. The UK therefore needs to influence in Brussels to ensure the overall benefits of EU membership remains as the EU moves forward.

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

The EU has struggled to strike the right balance between objectives

It will always be a difficult act to balance the various objectives that financial services rules are seeking to address. However, these objectives should not be seen as mutually exclusive. Rather, rules at international, EU and national level should aim to strike the right balance between financial stability, growth and competitiveness, and consumer protection. Moreover, the political challenge is the same for EU and UK policy-makers and regulators alike, and EU rules are not solely responsible for achieving these objectives as they operate in tandem with national and international rules.

The CBI nevertheless believes that, to date, EU reform of the regulatory framework for financial services has not struck the right balance. Before the financial crisis, rules were geared towards improving growth and competitiveness, but the crisis highlighted the weakness of this framework to appropriately regulate and supervise the sector. Post-crisis the pendulum swung rightfully towards improving financial stability and consumer protection. For instance, the CBI has been a strong supporter of a proportionately designed Recovery and Resolution Regime and a pan-European approach to deposit guarantees to achieve stability and protecting tax payers and consumers in the event of bank failure. However, the scope, volume and type of rules have not adequately taken growth and international competitiveness in the sector into account risking hitting the European economy.

One example is the financial transaction tax which the Commission argues will help financial stability[7]. In addition to potentially infringing the Treaties according to the EU Council legal service, it is not evidenced to support financial stability nor protect consumers, but will substantially hit growth and competitiveness. In fact, Oliver Wyman recently estimated the total costs to end users at €30–50bn per annum[8].

Another important example is the revision of the Directive for Institutions for Occupational Retirement Provision (IORP Directive) from 2003, which governs how occupational pension schemes are to be regulated at national level. Currently, the Directive states that defined benefit schemes need to be funded prudently. It quickly became clear that the revision would include higher capital requirements for occupational pension funds, in a 'Solvency II' styled regime. Business believes plans will damage long-term growth and destabilise markets, as increased requirements would increase scheme liabilities, which in a British context could mean additional costs for businesses of up to £450bn. Funding would be locked away in the pension fund diverting it away from business investments and job creation. A CBI/Oxford Economics report showed that business investment would be 5.2% lower than otherwise in the mid-2020s, with a shortfall of 1.4% still being felt in 2040[9]. We therefore welcome signals from the Commission that the new regime will not introduce such requirements, and urge the Commission to ensure this remains the case in its final proposals.

An example of where growth and competitiveness was in part taken into account is the CRD IV, where the originally proposed rules on trade finance and Credit Valuation Adjustment would have hit corporates, but were improved during negotiations. This highlights both the lack of consideration for growth and competitiveness in the Commission, but also the value of engaging with policy-makers to highlight the impact on the economy.

Measures have also been put forward that are misleadingly classified as consumer protection rules, but which may in fact negatively affect consumers. One example is the Insurance Mediation Directive, where it was discussed to prohibit tied and bundled services, arguing consumers were paying for services they didn't want or didn't understand. Tying and bundling insurance products with each other and related services, such as bank account or credit cards, are a common practice in the insurance industry. Businesses agree that transparency about the content of services provided must be at the heart of the intermediary-consumer relationship. However, in the case of both tied and bundled services, provided this clarity exists, consumers stand to benefit from a greater choice of products and services, and therefore better protection. Banning bundling and tying outright would not be to the benefit of consumers.

As the EU currently enters a new mandate post 2015 elections, growth and competitiveness should be put back at the centre of the next Commission's work programme and the UK should work actively towards achieving this without compromising financial stability and consumer protection. We therefore welcomed the Commission's Green Paper on Long Term Investment and hope this will continue to shape the agenda for financial services reform for the coming years. The UK should through the Council, its MEPs, as well as allies across the EU, put more pressure on the European Commission to focus its rulemaking on what is essential, leaving other "nice to have's" for later.

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

Financial services are a global industry; UK financial services interlink with other financial centres, and EU based corporates link with financial services providers from third countries. Rules at EU and national level must therefore keep the EU open and outward looking.

The approach to third country by the European Commission was for many years open, with AIFMD a good example where third country providers of alternative investment products could provide their services in the EU without being established inside the union. However, supported by some member states, the Commission has over the last years taken a more stringent tone, with proposals introducing stricter rules of equivalence including reciprocity, such as in the review of MiFID.

An overly strict equivalence regime, including the use of reciprocity and branch requirements risks limiting investment in or growth of European businesses. The CBI therefore favours a more pragmatic and open approach to support the EU's global competitiveness. Equivalence should be based on a principles based approach to "substituted compliance", recognising each other's' collective regimes in the interest of efficiently functioning financial markets and ensuring a global level playing field. Policy makers should focus on achieving equivalent 'outcomes'. The question should be whether the third country has a regulatory framework that strives to achieve reasonably similar objectives and whether it has authorities that are reasonably effective in achieving this. Equivalence assessments can play an important role in facilitating international supervisory harmonisation and cooperation and encouraging beneficial developments in third country supervisory regimes. However, they cannot be the sole basis of interaction with non-EU countries on financial services legislation and do not replace the need for appropriate regulatory dialogue with relevant countries.

We would also caution any attempt at forced subsidiarisation for third country providers. For instance, the CBI welcomed the announcement from the Chancellor to reconsider restrictions put on Chinese banks setting up branches in the UK, and we believe EU rules should not be able to restrict such moves.

The CBI does not believe that a regulatory tendency itself is a reason for altering the balance of competences through repatriation. The more protectionist approach has support from parts of the European Commission, some member states and some MEPs. However, many member states and MEPs are of the belief that an open approach is a better solution. Strengthening this coalition, whilst convincing those favouring closing Europe to the world, is a better solution than altering the balance of competences. It is important that the UK uses its influence at EU level to keep its third country approach open and pragmatic.

2. There is a need to strengthen the focus and quality of EU rules on financial services and improving its policy-making process

Section summary: The quality of the rules should be further improved by showing greater attention to the principles of proportionality and subsidiarity. When rules are justified, it is important to make sure the rules are made by effective EU institutions in a way that enables quality policy-making and active stakeholder engagement. In many cases EU rules are poorly assessed, developed and evaluated. Moreover, although the EU's stakeholder engagement opens up many avenues for interaction, there are parts of the policy-making process that remains difficult to access for those impacted, such as the impact assessment and the trilogue process. This has been further complicated by the large number of EU initiatives post-crisis, which risks hitting the quality of EU rules. A particular concern is the role of the European Supervisory Authorities, which although widely supported by industry needs to be strengthened through increased resources, improved clarity around its roles and better stakeholder engagement. The UK should play a key role in reforming EU institutions and policy-making process.

Part of question 1: Are they (EU rules on FS) proportionate in their focus and application? Do they respect the principle of subsidiarity? Do they go too far or not far enough?

Although the overall benefit has been clearly positive, experience indicates a need for greater attention to the principles of proportionality and subsidiarity to strengthen the quality of laws and improve accountability of the EU.

The two Treaty principles of subsidiarity and proportionality are important tools to regulate the exercise of powers by the EU. Subsidiarity is an important way to ensure the EU only intervenes in a particular policy area of shared competence if it is able to act more effectively than member states. Proportionality, on the other hand, relates to the chosen approach *where* the EU does take initiative; EU involvement must be limited to what is necessary to achieve the objectives of the Treaties – as set out by member states, and the content and form of the action must be aligned with the aim pursued. Though strong principles in theory, they are more difficult to apply in practice.

EU 'mission creep' has led member states to start a necessary discussion about subsidiarity

On subsidiarity, evidence shows the Commission struggles to get the balance right; in 2012, the Commission's internal Impact Assessment Board comments on issues of subsidiarity were included in more than one third of its opinions[10]. Moreover, judicial reviews of the subsidiarity principle – a limited few – highlights the difficulty of holding the EU institutions to account on subsidiarity grounds, as they have taken a very narrow view of what the Commission must do to show it has respected the principle.

One example concerning the principle of subsidiarity is the European Parliament's suggestion to introduce position limits at a European level in the review of the Markets in Financial Instruments Directive (MiFID II/MiFIR); trading in specific commodities tends to be concentrated in certain markets and there is limited trading in the same commodity in different countries, so the justification for setting limits at a European level does not seem to be evidenced. Another example is the detailed setting of professional requirements for insurance intermediaries in the ongoing review of the Insurance Mediation Directive; the setting out of the number of hours required during a set period is overly prescriptive and should instead be determined by member states, who can more appropriately tailor this to what is required based on the complexity of products and distribution channels in their jurisdiction. A final example is the review of EU's pension regulation (IORP). Prudential requirements for occupational pension funds should be regulated at the national level taking into account national specificities, such as the legal framework and labour laws, as well as traditions. The UK has a tough regulatory system, and the European Commission should therefore leave individual EU members to deal with their own retirement saving systems, as they do at the moment – rather than imposing a new system from the centre.

Examples like these and many others in other policy areas have led several member states to discuss whether the EU institutions, particularly the Commission, are attempting to regulate in areas, and in ways, where member states are better placed to act. The CBI's report 'Our Global Future' highlighted the Dutch Subsidiarity Review, which concluded there was a need to pursue "Europe where necessary, national where possible"[11] highlighting life style regulation as an example of an area that should be left to member states. This view is also present in Germany, where Wolfgang Schmidt, a member of the German Parliament, said: "We're not always happy with the way Brussels works and what comes out of the system. It seems like many Commissioners are just doing business as usual and want to pass their "nice-to-have" laws rather than concentrating on what is really necessary in these times of crisis. One could get the impression that we'd need a moratorium on new initiatives, at least until the Euro-crisis is properly sorted"[12].

The CBI believes member state leaders and governments must restore the principles of subsidiarity in EU policymaking by signalling to the Commission that it must refocus its activities based on a more limited interpretation of its remit. The Commission's should be a non-political executive whose task is primarily to ensure the Single Market is maintained, deepened and respected, and take political direction from the member states. The UK parliament can also improve its scrutiny of the principles by using the yellow card procedure and improve its engagement with other national parliaments.

It is worth noting that with nearly half of UK businesses perceiving UK 'gold plating' as the main challenge with EU regulation, the government must use the flexibility where it is given at EU level when transposing legislation and ensure that it does not put the British economy and businesses at a disadvantage. Although progress has been made in this area, the government must address new legislation on a case-by-case basis to ensure that transposition does not put UK firms at a competitive disadvantage.

The policy-making process should remain open to stakeholder input to avoid rules affecting entities or activities with disproportionate cost

Achieving proportionality is another challenge for EU rules. Examples of where this has not been the case, include:

- Rules are sometimes put forward with a weak or unquantifiable cost benefit analysis, suggesting the benefits are not worth the costs. One example is the recent move to look at the potential for EU Insurance Contract Law, where it still remains unclear whether there is solid evidence to suggest consumer demand for a cross-border insurance market, which would overcome and warrant the inevitable business costs associated with the supply of cross border business.
- Equal or similar requirements are sometimes introduced for entities and activities with highly differing characteristics. For instance a number of non-financial corporates are finding themselves disproportionately hit with rules aimed at financial services companies – such as in the draft European Markets Infrastructure Regulation (EMIR). Although it might be justified in some cases to level the playing field, non-financial companies usually operate in the market as an ancillary service to their main business, and we welcomed the recognition of this principle in the final EMIR. Another example is the proposed uniform training requirements in the ongoing review of the Insurance Mediation Directive where those providing simple, short-term and low cost products, such as travel insurance, on an ancillary basis were to have the same requirements as intermediaries providing complex insurance products, such as pensions, as a core service.
- In other cases strict requirements are being put at actors without a solid risk assessment. This was the case with the first draft of the recently proposed rules on benchmarks, which would have included almost all types of benchmarks having to comply with detailed rules with no real risk sensitivity applied. Another example is the recently proposed rules on Money Market Funds, which applies a mandatory capital buffer to constant net asset value funds (CNAVs), which would effectively undermine the economics of this type of fund representing around half of the European market.

Question 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?

The CBI found in its 'Our Global Future'-report that the Commission could pay more attention to non-legislative action where this can achieve the intended aim of EU action. 'Best practice' and voluntary codes can often develop at a faster pace than EU-wide legislation, and therefore achieve the desired outcome more quickly – especially in novel areas. 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. For example, alternative sources to finance, particularly novel ones like crowd funding, is an area where non-legislative action at EU level (gathering evidence and coordinating national initiatives) is the best approach.

There is a particular opportunity for the EU to ensure effective implementation and enforcement of EU rules so that existing rules are being followed in all member states. This includes competition enquiries ensuring the EU's competition framework and the CBI is supportive of a continued focus on competition in financial markets.

Question 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?

The CBI believes that assessing EU regulation should not be about volume, but about getting quality regulation in the areas where EU action is necessary to support growth and competitiveness in the Single Market. However, it is important that the volume of EU rules does not exceed the capacity of policy-makers and stakeholders to ensure quality in rule making.

Post-crisis, the high number of rules that have been put forward has weakened the EU's stakeholder engagement process. It has been difficult, sometimes impossible, for companies to assess the impact on their companies, making it hard to feed into Commission consultations. This is particularly true for non-financial companies who do not have the similar resources to monitor financial services rules.

Moreover, we have signals from policy-makers in all institutions that the large volume means mistakes might happen as policy-makers grapple with numerous pages of legislation within a short time period. The challenges are particularly large in the European Parliament who is not supported by expertise in the same way as member states through their national bureaucracy.

When EU-level rules have been deemed necessary, setting the right level of harmonisation is a difficult task. Harmonisation is an important route towards an efficient Single Market and is necessary to break down barriers, but must also in some cases be balanced with national flexibility. This should be dealt with on a case by case basis to ensure rules support growth and competitiveness.

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

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. The CBI agrees with the call for evidence that the nature of retail markets might mean that national authorities might be better placed to regulate them. For instance, consumers are hesitant to choose foreign providers and there are costs and risks related to entering a market which is beyond the EU's competence to address, such as rules on taxes and property. Moreover, retail markets in member states also differ greatly in their size, sophistication and technological development.

EU rules, both to strengthen consumer protection and to open cross-border, might therefore add cost to domestic providers who will not benefit from cross-border consumerism. Thus extensive regulation in this area might breach with the principles of subsidiarity and proportionality. 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.

Question 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?

(All issues relating to Banking Union and its implication for supervision is dealt with under question 11)

The CBI supports the role that the EU authorities play in safeguarding the Single Rulebook and implementing a credible peer review process. With cross border regulation there is a need for cooperation between national supervisors and mechanisms for settling cross-border issues. The establishment of the European Supervisory Framework, setting up the three ESAs and the ESRB, was therefore helpful in improving such cooperation.

We are nevertheless cautious as to the powers given to these European authorities because of the lack of clear lines of accountability provided for in the regulations establishing in the ESAs. Many of our members, particularly those outside the financial services sector, struggle to interact with the European authorities for several reasons, such as lack of knowledge of their work and powers and lack of capacity to deal with European authorities in addition to national ones. We here note the ongoing Review of the New European Supervision of Financial Supervision, where strengthening input from stakeholder groups has been a key issue.

We also believe there is a need for the UK to bolster its participation in EU institutions, including these authorities, to enhance both its influence at EU level but also the competence of EU policy making amongst its civil servants. This supports a broader point that the resourcing of the ESA's should also be increased in line with tasks distributed to them. The ESAs have been presented with highly technical detailed requirements that need to be delivered to national supervisors and the EU institutions in a timely manner. In many instances, they are understaffed for the volume of work that they are being tasked with.

Another challenge is the clarity around the competence of the ESAs and national authorities. Thanks to secondment and various supervisory working groups, there is some cooperation between the NSAs and ESAs, but more can be done in this area.

Question 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?

The CBI believes that EU policy making process could be made more effective and accountable, which would ultimately improve trust and effectiveness of EU rulemaking across Europe.

The Commission must take a new look at its impact assessment

The CBI recognises that there is an inherent tension between ensuring adequate engagement and scrutiny – and achieving appropriate timely legislation. There are occasions where reform of the financial services sector needs to be carried out swiftly in response to an immediate challenge, or as pre-emptive measure, such as in the midst of a financial crisis. However, we have long argued for a strengthening of the EU's impact assessment capabilities as evidence of the potential consequences of any government intervention should be appropriately assessed.

Although some steps have been taken, notably through the establishment of an impact assessment board and improved guidelines for the assessment, we believe the Commission must take a new look at its impact assessment and processes for evaluation; too many rules are being put forward with unconvincing evidence of the overall benefits or with weak assumptions and a weak evidence base.

For instance the Commission chose not to do a new impact assessment when the financial transaction tax moved from being a pan-EU proposal to enhanced cooperation amongst eleven member states, despite the substantial changes to the potential impact of such a change. Moreover, proposals change substantially throughout the legislative procedure, which alters the final impact legislation will have on businesses. Another example is IMD2 where the Commission added a proposal to ban non advised sales after the consultation, which fundamentally changed the basis of the original consultation with a huge impact on our business and on how insurance is conducted throughout Europe. A change of such magnitude should not be possible without a new impact analysis and public consultation.

In our recent report 'Our Global Future' the CBI therefore urged the Commission to improve quality and legitimacy through improving its impact assessments, the Commission should, as part of a continued process for improvement:

- Improve its assessment on the impact of FS legislation on businesses and the wider economy. This is true both on an individual basis, and when dossiers combine to generate a cumulative impact. Capturing this cumulative impact should be seen as an over-arching and on-going exercise as regulation and legislation develops.
- Introduce an independently verified annual statement of the total net cost to business of regulatory proposals issued by the Commission – and consider a move towards a more independent impact assessment structure outside the Commission to avoid bureaucratic capture.
- Strengthen the role of the Impact Assessment Board (IAB) by giving greater consideration to IAB opinions on Commission Impact Assessments before it adopts a proposal, and by making regular use of independent expert knowledge. In particular there should be a requirement for new regulatory proposals to have a positive opinion from the Commission's IAB before they can emerge from the Commission.
- Increase transparency by publishing Impact Assessments during the consultation stage providing estimates of the net cost to business of regulatory proposals, instead of publishing the impact assessment together with the proposal.
- Look at ways of assessing the impact of amendments put forward during the negotiations by the Council and Parliament to ensure the impact of the final legal text has been appropriately assessed. The CBI welcomes the increased use of the European Parliament's Impact Assessment Unit, although we believe that it should be used more as we move forward to assess the impact of amendments.
- Commit to give more serious consideration to alternatives to regulation.

The EU must evaluate the impact of its reform to ensure it is on track to achieves its aims

An urgent priority for the Commission should be to do a fitness check on the existing stock of financial services regulations, including those adopted in the last reform programme, to determine whether the framework – its accumulated impact, overlaps, inconsistencies and/or obsolete measures – sufficiently enables the financial services sector to perform its role in providing capital and financial services to businesses across Europe.

It should work to evaluate and publish the accumulated impact of the regulatory reform post-crisis in a similar manner they monitored the rules put forward as part of the Financial Services Action Plan, and use this evidence to guide further policy-making. The CBI welcomes the Parliament's resolution of 1 July 2013 that urged the Commission to fulfil its commitment to an accumulative impact assessment:

> *Recalls the Commission's commitment to undertake before the end of the mandate a study, comprising a cost-benefit analysis, on the effectiveness and proportionality of the numerous pieces of legislation that have been adopted since the beginning of the financial crisis, the study to be an accumulative impact assessment of all the EU financial market legislation that has been proposed, decided and implemented in the Union since the beginning of the mandate; calls for that process to be launched as soon as possible*[13]*.*

We refer also to the European Parliament's ECON Committee's recent Own Initiative Report that set out the European 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.

EU institutions needs to better enable stakeholders, particularly end users of financial services, to participate in the policy-making process

The consultation process at EU level is open and gives many routes for input from companies. However, there are challenges, as much of the consultation is done at a general level – sometimes through multiple choice answers – with the final legal text often baring little resemblance to the consultation document. Moreover, the lack of transparency throughout the policy-making process, particularly around impact assessment and trilogue negotiations, makes it hard for companies to follow the process and provide input. Finally, the EU should ensure adequate time for stakeholders to actively engage with policy-makers, in order for their interests to be sufficiently understood and considered. In financial services the process regularly fails to get the views of corporates; end-users of financial services are often not able to contribute due to time and resource constraints, or lack of awareness. This is not only the responsibility of the EU institutions; national governments and industry organisations also play a role in ensuring interests are taken into account when policies are made.

A good example is the increased use of consultation and open hearings in the European Parliament, such as MEP Markus Ferber's consultation on MiFID, MEP Arlene McCarthy's consultation on Libor and MEP Sharon Bowles' consultation on Benchmarks. These open a new avenue for formal interaction with MEPs, many of which have a too busy schedule to hold meetings with all interested stakeholders. This is particularly helpful for actors who would otherwise struggle to engage directly with MEPs on all dossiers due to limited resources.

The UK should improve its engagement with EU issues to strengthen accountability and legitimacy

Finally, to strengthen the EU's accountability and legitimacy, national parliaments must play a greater part in the EU policy making process. In 2011, the UK Parliament attempted to use the Yellow Card procedure once, compared to eight times in Poland and sixteen in Sweden. The House of Lords should continue its extensive scrutiny of EU law-making, the UK government and parliament as a whole should also seek best-practice from other European parliaments, and the government should consider looking at how to give the parliament enough time for parliamentary scrutiny.

3. The UK is an influential player at EU level, but must prioritise continued influence to safeguard the Single Market in a more integrated Eurozone

Section summary: The UK is an influential player on financial services, particularly due to our expertise and position in international forums such as G20 and Basel which sets the direction for a large part of EU's legislation. To ensure our influence is continued in a future EU with a more integrated Eurozone, the UK must strengthen its presence in EU institutions and build closer links with European partners. Being influential in Europe is preferable to withdrawing from EU rules on financial services to set the rules ourselves; the UK would find itself having to comply with EU rules to gain access to the Single Market, but would not have any influence over these rules. The UK can also use the EU to push for global regulatory convergence.

Part of question 8: Does the UK have an appropriate level of influence on EU legislation in financial services?

A modern economy is dependent on regulatory cooperation to achieve the desired policy outcomes

In the 'Our Global Future' report, the CBI argued UK influence in the EU is an integral element of supporting British business ambitions. EU rules have a direct impact on business competitiveness and its ability to create jobs in sectors and regions right across the UK. Moreover, the need to continue to influence these policy outcomes becomes acute when one considers the nature of the modern economy in which many British businesses operate. The challenges business face today – and will continue to face in the future – in a global economy are increasingly insurmountable through purely national solutions. Creating a positive, modern business environment requires co-operation across borders.

A good example from the financial service sector is the move to enhance financial stability after the global financial crisis. The ability to regulate banks' capital requirements at a national level is limited because the global nature of the banking industry allows actors and capital to relocate to less-regulated areas. This risk was in part addressed by the global G20 agreement setting out common global rules of bank recapitalisation after the financial crisis. As the Governor of the Bank of England, Mark Carney, has said, building "an open, integrated, resilient system requires full, consistent implementation of new standards, better information-sharing and co-operation to solve cross-border problems".

At an EU-level, influence is made difficult due to the complex nature of the policy-making process through which compromises are made

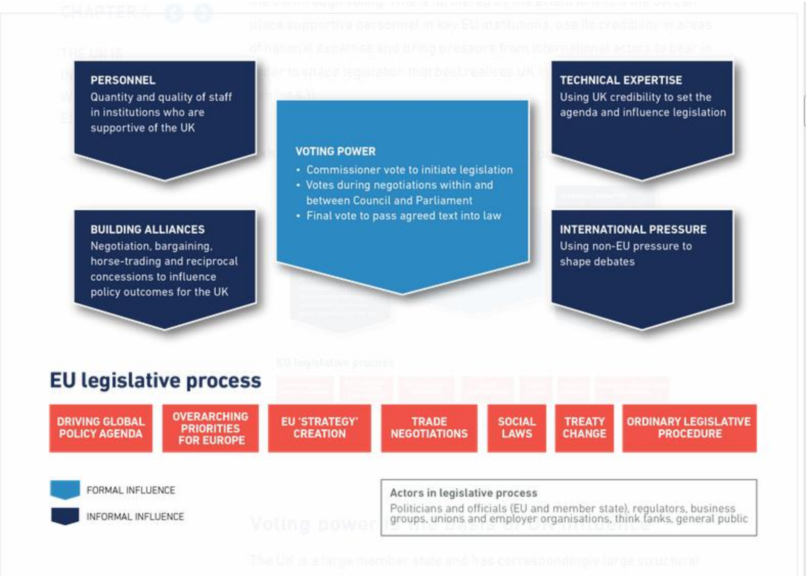
Before addressing UK's influence to date, we would like to highlight that the nature of the EU policy-making process itself – and the number of actors involved – highlights why maintaining influence is crucial. No single country can "get its way" without support. Such a consensus-based system means that the various actors work to find the space for a compromise that everyone can approve. This is made difficult with a large number of actors shaping legislation in the policy process, with the consequence that the UK has to seek to influence right across the board: in European capitals (to get agreement in the Council and at senior Commission level), in the directly elected European Parliament and in the EU civil service (whether the Commission or various agencies). In addition to influencing a large number of players, it is crucial for business that the EU is influential both at a strategic level and in the day-to-day legislative negotiations as well as remaining influential throughout the legislative process as key details added at the last stage might substantially alter the way a proposal impacts on British business.

The UK has successfully influenced EU strategies and rules, but needs to increase its efforts to strengthen its influence for the future

Turning to assessing UK influence, CBI finds that the UK has historically used its influence in Europe to shape the Union to a greater extent than many realise. It drove the establishment of a Single Market to bring down internal protectionist barriers, pushed an external posture that is predicated on a free trade agenda, and spearheaded an enlargement process that widens rather than deepens the EU. British business recognises this success; according to a survey of CBI members, 72% of British businesses believe that the UK currently has a significant influence on EU policies that affect their business.

This ability to influence rests on the successful use of a variety of tools of influence to secure strategic interests (see figure 1).

Figure 1: Tools of influence in the EU policy process



In the financial services space, the UK has successfully used these tools to shape EU policy (for more information, please see Chapter 4 in 'Our Global Future'):

Voting power is the basis of UK influence, but better use of informal channels is necessary

Voting power is the formal basis of UK influence, but as the UK has a particularly strong interest given the size of its financial services compared to other countries, without having a similarly larger voting weight or the ability to veto decisions. We note that the UK has only very rarely 'lost' the argument on a key area of financial services regulation, but that the last few years have brought a few cases where the UK has been side-lined. Better use of informal channels is therefore necessary to ensure rules benefit this important sector.

The UK is effective at building alliances, but needs to strengthen coalitions throughout the policy-making process, particularly in the European Parliament

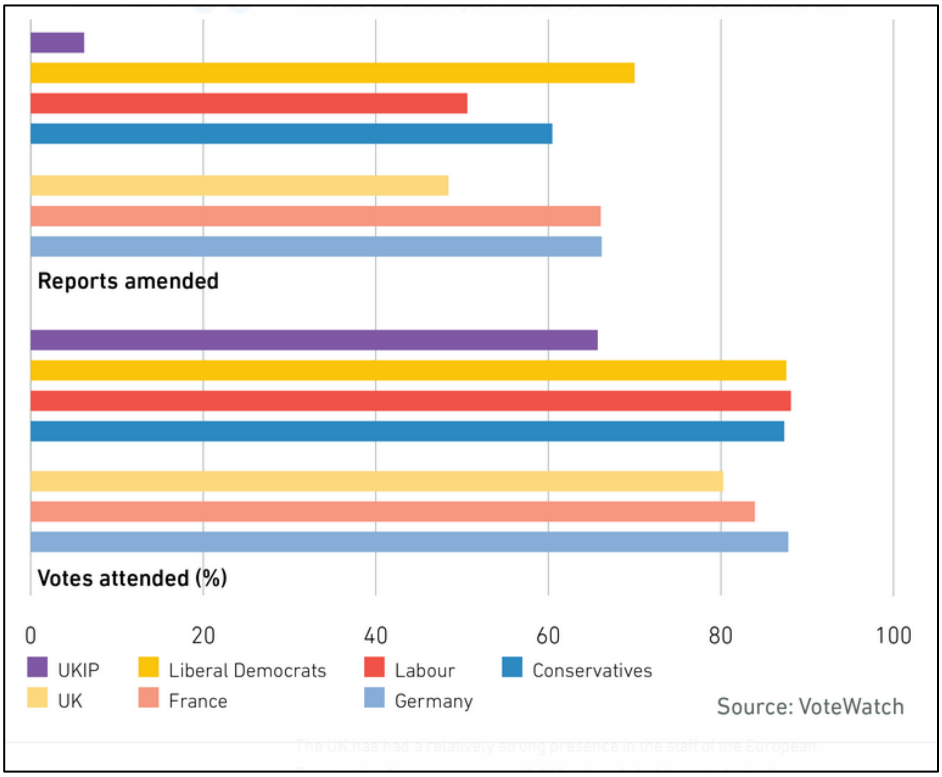
It has been argued that, by choosing to remain outside the Eurozone, the UK may struggle to build alliances within the Council. However, in reality, the ‘opt-out’ countries appear to perform on a par with the ‘in’ countries when it comes to forming alliances. It is important to be seen as credible and co-operative and the UK is effective at building alliances. It does however need to strengthen coalitions throughout the policy-making process, particularly in the European Parliament. The UK’s first ever defeat on a piece of substantive financial services legislation – where proposals on remuneration in the banking sector hijacked a wider vote on the Capital Requirements Directive IV – is an example of this need to increase influence across institutions and throughout the policy process[14]. Building alliances at home is also important to present a united UK position in Europe that can be the foundation of strong pan-EU coalitions.

Historically, proactive and positive engagement to craft consensus has led to successful outcomes. The lack of prior diplomatic engagement which led to the December 2011 ‘veto’ was not only ineffective in that the veto did not particularly influence the final outcome (the bulk of policy behind the proposed Treaty for Stability and Growth went ahead), but it also harmed British influence in day-to-day negotiations in Brussels, particularly on financial services. In contrast, the UK’s positive coalition building led to a considerable ‘win’ for the UK in the case of the creation of a new supervisory authority for the Eurozone, where the UK managed to secure a double majority and legal protection for the Single Market against currency discrimination. A similar provision was also included in MiFID to protect provision of investment services against currency discrimination. Another good example of UK influence is in the review on EU’s pension’s regulation (IORP), where the UK was able to build over time a broad alliance with countries such as Germany, the Netherlands and Ireland. This led to changes to funding requirements being dropped from the scope of the Commission’s work on this issue. Business supports a continuation of this positive engagement.

The UK needs to do more to ensure that it has personnel in key positions to help frame the EU debate, particularly in the European Supervisory Authorities

Having national citizens in prominent positions, both political and official, in EU institutions is an important tool of informal influence. In the European Parliament, the UK needs to look to improve the attendance and voting record of its MEP representation, as some MEPs are currently failing to exercise those formal rights they have been given to further British interests. British business is dependent on MEPs who work for the UK in the increasingly powerful Parliament because their activity has a direct impact on the day-to-day operations of companies by deciding issues like product rules, capital requirements or labour market reform.

Figure 2: Attendance and activity in the European Parliament (2009 - October 2013)[15]



The UK has had a relatively strong presence in the staff of the European Commission for many years, with UK nationals holding strategically valuable positions at a senior level, such as Jonathan Faull, Director General for DG Internal Market, which is responsible for financial services policy. However, in terms of the Commissioners themselves, the present division of Commission portfolios among member states does not favour the UK in terms of business priorities.

Moreover, the UK is in danger of a significant reduction in its ability to use this channel of influence. In relation to its share of the EU's population, the UK is now significantly under-represented in terms of staffing levels in the Commission and Parliament, and faces a 'general gap' with junior officials particularly under-represented. Reversing this overall downward trend is essential, particularly in the area of financial services, including in the European supervisory authorities. The UK government's EU Staffing Unit in the Foreign and Commonwealth Office (FCO), established in April 2013, should be a helpful tool, working to place additional seconded national experts in the short term. In financial services HM Treasury can help increase the number of permanent officials in the longer term by promoting recruitment opportunities to students, graduates and professionals.

The UK's technical expertise gives it significant credibility on financial services that allow it to set the agenda

Although the direction of the policy agenda is dictated primarily by political forces, the EU undoubtedly looks to those member states with expertise when deciding policy direction, as well as specifics, in particular areas. The UK's expertise in the area of financial services – based on London's position as a global financial centre and the Bank of England's historic reputation as a regulator as well as central bank – has historically given it significant influence on the direction and development of financial services legislation, from the liberalisation of financial services under the Irish Commissioner Charlie McCreevy at the end of the last decade to forming the EU's response to the recent financial crisis. This importance of having expertise is particularly crucial once legislation reaches the technical specification phase of Level 2. Examples that highlight UK influence through expertise include:

- The UK government put forward their position on the ongoing review of the Markets in Financial Instruments Directive in alliance with other member states through fact sheets and Q&A briefings to other member states about the operations of financial markets and how to best regulate them.
- In the Recovery and Resolution Directive, UK policy-makers were closely involved when the Commission drafted the proposal. The UKs policymaking credibility – both in the Treasury and the Bank of England – ensured that arguments were given prominence.

One of the biggest threats to UK influence in the EU in this area came from the reputational hit the UK took as a result of the financial crisis. Some in Europe have pointed to the failure of the 'Anglo-Saxon' model (as critics term it) as an indication that the UK can no longer be trusted on financial services regulation. Regaining credibility in this area should be a key aim of the UK government and financial services industry, as historic gains in this area have, in part, been built on the European model for deferring authority to those who have credibility and expertise in a particular area.

The UK's role in a number of global institutions relevant for financial services policy making magnifies the international pressure it can bring to bear in the EU

The final 'tool of influence' for the UK is the use of international forums that can shape the strategic direction of policy debates. Global institutions can help set the parameters of financial services legislation at a European level in line with UK objectives, especially as the agenda is increasingly being set at an international level to deliver responses to global challenges, such as the financial crisis.

In fact, a significant amount of EU regulation now stemming from international agreements to which the EU and its member states are signatories. In financial services, the international response to the global financial crisis, and its subsequent impact on EU and UK legislation, highlights this trend. Following the financial crisis, the EU has driven forward comprehensive reform of the financial services regulatory framework. A substantial part of these reforms are the translation of the commitments the EU has made in the G20, with more than half of the 47 pieces of legislation put forward in total since 2009 directly refer to the EU's G20 commitments.

The UK's membership in a number of these global forums that impacts financial services legislation, including G20, Basel and the Financial Stability Board, is a valuable channel for influencing EU rules at an early stage.

UK influence will matter more than ever in the coming period, as the further integration of the Eurozone potentially changes the nature of the EU. The UK must navigate a course that ensures it shapes the EU to preserve the advantages of membership felt by British business.

Part of question 8: How different would rules be if the UK was solely responsible for them?

The UK will always create its rules in a global context to retain access to foreign markets and attract investments from abroad

A situation where the UK is 'solely responsible for financial services regulation' is in practice a situation where the UK has left the EU, or where the EU has moved the competence to a member state level for all member states.

It is difficult to assess the impact on UK's regulatory environment in these situations. Irrespective of which situation this question is referring to, the UK would have a number of options available to shaper its legislative agenda:

- It could opt for removing all EU legislation. However we believe this is less likely for the area of financial services where the UK has been a key driver behind a large part of the EU's current acquis in this area.
- The UK might be likely to keep a number of rules, but redesign them to better fit the UK's situation. The UK would particularly be likely to keep EU rules where they stem from international commitments to which the UK remains a signatory independently from the EU.
- The UK could go beyond EU rules, and this would be likely in the area of financial services as seen in Vickers' bank structural reform and in the work of the parliamentary commission on banking standards.

Whatever path the UK chooses, it is important to note that it would not be free in practice to set its own rules if it wants workable access to financial markets in other EU member states. The decision will have to take into account the choices in other member states in the event where the competence has moved to member state level for all EU member states. Many of them might choose to take a less open and liberal approach to financial services, including strict third country rules, taking away the positive features of the Single Market currently benefitting UK financial services providers and end-users. In the event of an exit from the union, it would have to take into account the actions of a 'new EU' without the UK. Several EU member states, as well as forces within the European Commission and the European parliament, are less open and liberal than the UK. They would be likely to pursue a more stringent approach to market access for third country providers, as the liberal group of member states favouring open markets would have lost an important ally and loose its majority.

The UK's financial services sector would be damaged if the UK left the EU, hampering business growth, and a UK FTA would not be enough to address the damage

In the CBI's report 'Our Global Future'[16] we assessed the impact on the financial services sector were the UK to leave the EU and thus be solely responsible for creating the rules. Although it is difficult to make conclusive judgements on the impact of UK withdrawal on the UK's financial services, it is possible to outline some of the potential impacts.

A number of companies could be likely to relocate parts or all of their operations in order to retain market access to EU countries. European banks, currently holding 17% of total assets of banks in the UK (nearly £1.4 trillion), would have a particular incentive to move back home[17]. The UK could lose certain types of financial activities, such as clearing of euro-denominated derivatives which would hit London as twice as many euros traded in London today than in all the euro-area countries combined, while average daily turnover in the UK in euro-denominated over-the-counter (OTC) interest rate derivatives totalled 8bn in April 2011. The impact of these changes would consequently hit UK financial services, broader business and the wider economy.

The UK would also lose its regulatory influence and reduce its ability to be a place to do global business. London's place as a global financial centre rests partly on its position at the crossroads of the competing regulatory regimes of the US and EU, which allows it to be the place where global business can take place. The importance of the UK's regulatory influence in financial services is twofold. First, it allows the UK to shape EU rules to keep the UK (and Europe) competitive in the face of global competition from East and

West. But perhaps more importantly – over the past 20 years but especially in the aftermath of the financial crisis – the UK's position in the EU and subsequent regulatory influence has helped limit regulatory divergence with other important regulatory regimes, most notably the US. This keeps regulation broadly 'global', minimises the expensive regulatory duplication that occurs with divergent regimes, and has allowed the UK to emerge as the modern economy's global financial centre.

Maintaining this position is therefore based in part on retaining the UK's ability to develop market-leading regulatory standards that are globally competitive. Outside the EU, the UK would lose its influence on EU policymaking on financial services issues, which would potentially reduce the importance of London as a global financial centre.

The report also highlighted that although a UK–EU FTA could attempt to offset some of these disadvantages by including market access for financial services as a key element in negotiations, market access – in particular the type of access that passport regimes provide – is unlikely to come without obligations on the regulatory side, including the likely adoption of EU rules without any ability to influence these.

The EU could be willing to deem the UK's regulatory regime 'equivalent' to its own but, following the financial crisis, the distrust in the UK as a suitable regulator for financial services could lead to EU demands for full UK compliance with EU rules, for instance on bankers' bonuses or capital requirements. Moreover, future EU rules would no longer be developed with UK participation, potentially making them less liberal and favouring the 'continental' model.

Question 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?

The CBI has analysed the impact of future challenges of further Eurozone integration in our recent report 'Our Global Future'. It is indeed a fear that as Eurozone integrates to a closer core, it could start pushing through policies and take actions that are not in Britain's interest, hitting the City or other areas of national importance. This concern is exacerbated by the prospect of the Eurozone getting larger – at worst encompassing all member states but the UK – and beginning to develop common interests across policy areas beyond those directly linked to the Eurozone. This could potentially segment the 'ins' from the 'outs' and fragment the Single Market. The process of integration could even move towards a fully federal union of which the UK wants no part.

After a careful assessment of the likely developments of Eurozone integration, the report concluded that member states are unlikely to move any further towards federalism than is necessary to stabilise the single currency and, even in this scenario, the UK can still influence the openness of the EU to its advantage if it approaches this changing Europe in the right way.

The member states looking to further integrate understand that this process has the potential to significantly alter the landscape of the EU. The UK has already managed to secure a number of safeguards as highlighted in the call for evidence – notably on voting rules in the EBA and legal safeguards protecting the Single Market in both rules relating to the ECB's role in SSM and MiFID. Moreover, the EU Treaties already firmly protect the Single Market against harmful initiatives.

Beyond this, securing further safeguards for the Single Market for non-Eurozone members and restating a Europe-wide political commitment to the maintenance of a European Union that works for all its members

– focused on flexible co-operation to take on common challenges and shape effective solutions – is achievable. Moreover, the UK needs to ensure the safeguards achieved are maintained in the future. This is dependent on an active UK that continues to build alliances across Europe, including in the ESAs, to protect the Single Market, as it has done in the past.

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

Global regulatory convergence is important and the UK should use the EU as a vehicle to push this agenda, with trade agreements providing a useful opportunity

The financial services sector is a truly global industry, reliant on a competitive environment in Europe to prosper internationally. A global regulatory consensus with two major regimes – the EU and the US – has emerged after the crisis, influencing the rules for financial services across jurisdictions and reducing the room for manoeuvre for smaller regimes. There are, however, recent signs of concerning divergence between these regimes. The CBI believes it is important for both UK government and the EU to work effortlessly towards regulatory convergence at a global level for this industry where possible. This is important to avoid global fragmentation of financial services rules, as can be seen in the area of capital requirements.

The CBI has put financial services as a key component of our trade strategy, as can be seen in our work on the Transatlantic Trade and Investment Partnership (TTIP). The CBI believes that financial services should be included in the TTIP negotiations – and future trade negotiations – both in terms of market access and regulation. Greater regulatory convergence can help minimising compliance issues for business where regulatory divergence in the exists, remove openings for regulatory arbitrage – and in the TTIP specific situation, enable the EU and US to take leadership in setting global standards for other countries and regions implementing the continuing G20/FSB agenda.

We urge TTIP negotiations to address financial services specifically with the goal of developing a clear & transparent platform/process for regulatory issues to be addressed between the EU and US. Practically this can be used to recognise areas of regulatory convergence between the regimes and reduce or eliminate inconsistent or duplicative requirements. It can also enshrine procedures for cooperation on regulatory approaches and can set the standard for implementing global regulations stemming from the G20/FSB.

The CBI believes that the EU is well placed to improve regulatory convergence at a global level and the UK can use its position in the EU – and in a number of international forums – to influence the EU to take such a role.

---

[1] Haver Analytics UK database/ONS
[2] House of Commons Library, Financial Services: contribution to the UK economy, 21 August 2012
[3] European Commission, *Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM (2013) 71 final*, Annex, page 32.
[4] ONS Pink Book 2012; ONS
[5] TheCityUK, 'Key Facts about UK Financial and Professional Services', 2013
[6] CRA International, *Evaluation of the economic impacts of the FSAP*, March 2009
[7] European Commission, *Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax, COM (2013) 71 final*, Annex, page 32.
[8] Oliver Wyman, *The impact of the EU-11 financial transaction tax on end-users*, September 2013.

[9] Oxford Economics, *The economic impact for the EU of a Solvency II inspired funding regime for pension funds*, 2012

[10] European Commission, *Annual Report 2012 on Subsidiarity and Proportionality*, June 2013.

[11] Press release for the June 2013 Netherlands' Subsidiarity Review.

[12] Senior German official in a Policy Network report for the CBI, The Single Market and Britains future in the EU: where our partners stand, September 2013

[13] European Parliament resolution on financial services: lack of progress in Council and Commission's delay in the adoption of certain proposals (2013/2658(RSP)) (link)

[14] House of Commons Foreign Affairs Committee, The future of the European Union: UK Government policy, May 2013

[15] VoteWatch. Voting records 2009 – October 2013. Date does not take into account that a number of MEPs have arrived in the interim and consequently have shorter voting records for analysis.

[16] CBI, *Our Global Future – The Business Vision for a Reformed EU*, Chapter 6, Exhibit 64: The UK's financial services sector would be damaged if the UK left the EU, hampering business growth

[17] TheCityUK, UK and the EU: a mutually beneficial relationship, 2013.