Financial Services and the Free Movement of Capital Call for Evidence

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INTRODUCTION

The EU Single Market in financial services is one of the most integrated parts of the single market. The UK benefits considerably from this, as a supplier of financial services to the EU and as a business destination for third countries. As outlined in the call for evidence, the UK has a trade surplus in financial services with the EU of £15.2bn (City UK give £16.6bn) and with the US of £14.5bn, is the world's largest financial centre and the world's largest exporter of financial services which contributes 63% of the UK's trade surplus in services.

Access to the Single Market and the existence of pan EU regulation is fundamentally intertwined with the role of the UK as a global financial centre and the attractiveness of the UK as a place from which to provide financial services into the Single Market by third country providers. Current negotiations with the United States, and looking forward, increasingly those with China and Asia, depend heavily upon the added weight of negotiation from the EU level. This applies, for example, in the negotiations concerning extra-territoriality of US rules on derivatives clearing and swap dealers and for ring fenced capital for EU banks in the US as well as TTIP. Being part of the EU means that UK interests have been strongly represented through the EU. If the UK were not in the EU, much of the legislation would need to be applied anyway, as it is in Norway and Switzerland, in order to gain market access. UK MEPs (and the ECON chair in particular when other calls have fallen on deaf ears) have been asked for help by those countries, for example on the Alternative Investment Fund Management Directive (AIFMD), European Market Infrastructure regulation (EMIR), Central Securities Depositories Regulation (CSDR) and Deposit Guarantee Scheme Directive (DGS), because they have no influence of their own. Significantly, it has mainly been UK MEPs who have been sympathetic which would suggest that if the UK were on the outside of the EU, finding help on the inside would be hard.

As outlined in the call for evidence, the UK plays a large part in international fora like G20, FSB and other standards setting bodies, which has been particularly relevant following the financial crisis. These are seen as the precursors to EU legislation in many areas, which indeed they are, but there is also a wider EU regional dimension brought about by the Single Market and free movement of people and capital. This results not only in legislation in areas beyond those on the international agenda, where there is EU cross border activity, but also impacts on the implementation of international standards within the EU.

There is no doubt that the UK has a huge influence on EU legislation in the area of financial services. However there is no clear evidence that the UK really acknowledges the EU as a prime mover rather than just as a follow on or 'piggy-in-the-middle' between international and UK initiatives. Enhancing UK engagement and using the EU as a prime mover is as important as engagement in the international fora and may also assist coordination of EU members in international standards setting.

The sheer volume and speed of legislative work in the wake of the financial crisis has caused additional problems. In order to make recommendations to address such issues the ECON committee conducted a public consultation and prepared a report on the coherence of EU financial services regulation which also deals with some of the issues raised in this consultation.

This balance of competences consultation poses questions aimed at assessing the impact or effect of the EU's approach to financial services. However, that assessment cannot be divorced from the approach of the UK to the EU legislative process, since that affects outcomes and by that the perception of 'the EU approach'.

QUESTION RESPONSES

***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?*

When EU rules are not the same as pre-existing UK rules there are often concerns expressed, both in public and to legislators, about two sets of rules and about them not having been done at the same time, or with sufficient coordination. This could be attributed sometimes to the UK having moved first and not simultaneously or publicly led calls for EU legislation. The focus and application of EU legislation and UK rules is often very similar, but not identical due to EU wide considerations. International level agreements often suit the UK well due to UK engagement at the international level and the fact that international standards setters are focussed on larger and systemic financial entities that correlates to the structure of much of the UK financial sector. When that is modified for EU purposes, especially for smaller and less developed markets, it will change and that should be anticipated.

The EU does distinguish between those areas that require high levels of harmonisation, such as wholesale capital markets, and those areas where there are local differences such as retail mortgages. Legislation proposed by the EU Commission is changed and refined significantly at the hands of the co-legislators, for the main part favourably to the UK in the sense of adjustment needed to cope with the diversity and complexity of the UK financial sector. Changes to fit with other Member States also take place.

The difference between UK and EU legislation is sometimes due to proportionality and subsidiarity required for other Member States where the UK has stricter limits. Examples are: changes to capital requirements in the Capital Requirements Directive and Regulation (CRD4) departing from Basel III, to take account of application to savings banks, mortgage banks and other formats; sanction regimes which are in general too weak for financial services and where the UK applies higher fines at a level that would require criminal sanctions in some countries; rolling out bans on inducements for selling tied financial products in the EU to the same scope and as rapidly as in the UK's Retail Distribution Review has proved impossible due to the even higher reliance on banks rather than markets in other Member States.

The UK has been critical of weakening of some of the Basle III provisions in the EU, but that derives from the proportionality needed for application of the rules to all types and sizes of banks not just the large and systemic institutions for which Basle rules were created. There are over 100 discretionary measures in CRD4 and there are significant numbers of those that are for the benefit of the UK, for example to cope with specific nationalised bank capital structures, the Cooperative bank structure, ring-fencing and many others. On the markets side there are many instances where there is more desire for stricter regulation by others, for example in the area of Over-The-Counter (OTC) transactions, short selling, trading waivers and position limits and it is the UK that seeks more exemptions and flexibility.

The fact that the UK is the world's largest exporter of financial services means that there is a lot more concern about what the UK is doing, and exporting, than there is for what other countries are doing. It means that the UK is both always in the spotlight and also having points to make.

It is not surprising that the UK has had to challenge some of the EU legislation. Challenges to legal base are a relatively frequent event and in other subject areas where other Member States are the major players, for example industry and Germany, there are many more cases taken to the court by the most involved Member States. Approximation of laws, which is what EU harmonisation is meant to achieve, does not mean that there are never winners and losers; it means that there should not be disproportion in the way that is shared out. Great efforts are made by legislators to make legislation work well for all Member States and minimise the number of times when it becomes an issue of winners and losers.

In summary, the level of legislation is broadly right, it is correct that it is done at the EU level, additional measures in the UK have not been prevented and subsidiarity in terms of flexibility even within regulations has been achieved. The UK could further develop its engagement techniques especially in seeking legislation at EU level where early influence rather than rear guard actions might prove more constructive.

***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?**

As developed in the introduction and Question 1 above, the UK would benefit from earlier engagement and coordination with the EU when there is new legislation and even to promote legislation. An example is the 'Vickers' ring-fencing proposal. This was an early report in the UK with a commitment to national legislation, although the legislation is not to be implemented until 2019. Protection of the specifics of that legislation became a major concern in the UK's negotiation in the Capital Requirements Directive and Regulation (CRD4), at least as perceived by the European Parliament and during trialogue, using up - indeed exhausting - much goodwill. The reasoning behind the 3% additional capital inside the ring fence has been superseded: it was suggested at a time when the Basel 3 proposals were not yet developed, and it was feared might not emerge, and was a way to increase capital. Now agreed Basel levels subsume the 3% (comments made to the ECON committee in London by member of the ICB) although the ring fence remains. In the meantime there has been subsequent but faster legislation in other EU countries and suggested EU legislation (Liikanen proposals and awaited follow up). The UK is on the one hand seen as having led various aspects of thinking, but on the other to have led fragmentation, which is problematic when arguing for more single market. Structural separation has also seemed disconnected from the discussions on living wills and bank resolution, much of which has been led at the international level by the UK, yet there is significant technical interaction. Hindsight plays a big part, but it is hard not to think that having gone first and alone has not been entirely helpful in getting the best position in EU legislative negotiation and lessons should be taken from that.

More competition enquiries and removal of anti-competitive practices by the EU Commission would be a useful tool. However this does not replace legislation, it addresses different concerns. Restrictive practices should be opposed, but removal of those does not provide financial stability and consumer protection. There is still a need for other prudential and conduct of business rules and for fair competition these have to be applied in a way that is the same or gives the same outcome.

Additionally, when it comes to calls for competition enquires these have often been opposed by the UK, at least until after it has been decided in the UK to take a look. For example the UK has consistently opposed suggestions of EU enquiries into the Big Four on accounting and audit. In that field the UK has actively opposed legislative changes such as audit rotation, then had late changes of heart following national reviews and after having helped to water down EU proposals. There are now even prospects that the end result will be stricter conditions in the UK than the EU when one of the original UK objections was that matters needed addressing internationally. This seems another example of where the desire to do things at the national level or the international level, rather than play a positive role at the EU level, seems far from yielding the best result.

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

Having the same rules and obligations helps with regard to competitiveness in the EU, which is important given the EU is the destination for many of the financial services exported from the UK. The creation of the European Supervisory Authorities and the single rule book is good for strengthening financial stability throughout the EU, through tighter legislation, binding technical standards and convergence of regulatory standards of supervision, which is important as rules are only as good as the way in which they are followed. With financial services under challenge from the crisis, all moves to improve stability benefit the UK as the major financial centre. It has often been pointed out that the on-going problems in the Eurozone stemming from an imperfect monetary union have impacted the UK, and hence banking union has been welcomed by the UK as a solution even though it is challenging. However this additional monetary union problem and the need for further solutions does not negate the benefits that have come from a more coordinated and tighter system of financial regulation in the EU.

The UK's application of higher capital provisions is reckoned to have contributed to financial stability in the UK and the tardiness in addressing these issues in the EU to have delayed stability in the Eurozone. However it should be recognised that the crisis also hit much of the EU later than it did in the UK and in the end it has been EU legislation that has forced changes in capital requirements on reluctant Member States to the eventual benefit of general stability and therefore the UK.

Some aspects of UK, EU and international legislation have impeded long term investment. In the UK and the early FSB/Basel debate the concentration on liquidity and highly restrictive qualifying assets was detrimental to growth. The EU and the EU Parliament in particular (especially ECON Chair) were at the forefront of pushing back on this. So in this regard the EU debate and rules have helped growth. In CRD4 there have also been changes made at the insistence of the European Parliament to aid growth such as in the treatment of Trade Finance. Other European legislation has aimed to promote venture capital and social entrepreneurship funds. Not all Member States may use or need those tools, but help to some is help to all in the business of seeking collective recovery and growth.

The EU has also performed with regard to stability and growth beyond the area of financial services, tightening rules on economic governance and statistics and being innovative with regard to projects involving the European Investment Bank, from which the UK has also benefited.

Criticism has been much levelled in the UK and elsewhere at Solvency 2, the insurance directive completed in the last EU mandate but not yet implemented. In the Solvency 2 negotiations the UK achieved all of its objectives with regard to prudential soundness for insurance and was forceful in pushing it through despite concerns raised by MEPs about long term and equity investment. It was only subsequent to its completion that concerns were raised in the UK about this and the impact on annuities that had been completely missed by all involved, including UK industry. It has taken a long negotiation and introduction of amendments in another piece of legislation (Omnibus 2) to correct the problems for long term investment in Solvency 2, but it is unjustified to lay blame on the EU as some do when the biggest hawk in the original Solvency 2 negotiation was the UK under the motivation of the FSA.

Those businesses competing predominantly in third country jurisdictions raise competitive concerns where the EU imposes rules that those other jurisdictions do not. Many of these relate to corporate governance rather than prudential concerns. However the UK Parliamentary Commission on Banking Reform has subsequently and independently come to similar conclusions in many respects. Please see speech on Responsible Banking and Finance by Sharon Bowles for further elaboration on this.

Consumer protection has taken on a stronger cross border focus so that legislation or rules previously done at the UK level are now being dealt with at the EU level too. The reasoning behind this comes from the fact that consumer issues have arisen cross-border with consumers in some Member States purchasing investments cross-border or being affected by actions in other Member States. EU legislation can help achieve a level playing field, and is better than none at the EU level even if at present it does not go as far in the EU as in the UK, for example the Markets in Financial Instruments Directive and Regulation (MiFID2) and Packaged Retail Investment Products Directive

(PRIPS) not going as far as banning commissions and inducements as the UK's RDR does.

It may also be worth pointing out here that the recent agreement on bail-in regimes in the Bank Recovery and Resolution Directive (BRRD) has consequences for investors who might well be buying investment products containing bank bonds from banks in other Member States which will now be subject to bail-in. Whilst the primary purpose of BRRD was to establish a regime for cross border recovery and resolution, there is an impact by way of potential loss on investors, greater transfer of risk to investors and hence the need for clear information.

Looking to the future and international moves to address 'shadow banking' there has been a lot of high profile warning of dangers, including from top UK regulators. The rhetoric has to be handled with care as already there is a tendency for this to portray everything outside banks to be bad or 'shadow'. Much of the so-called 'shadow banking' sector simply means markets and over enthusiastic condemnation delivers the opposite message to that which is so needed in Europe, which is to increase non-bank market activity.

***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 volume of EU legislation has been extraordinary due to the new legislative proposals responsive to the financial crisis, such as EMIR, Credit Rating Agency Regulations (CRAs) , BRRD, review clauses falling due in MiFID and the Market Abuse Directive (MAD), overdue legislation on clearing and settlement, update of CRD to Basel III and a greater focus on cross border consumer protection. The order in which the legislation has emerged from the EU Commission has not always been optimal but on the largest items broadly follows the program of the G20 and international standards setters.

The single rule book and the creation of the European Supervisory Authorities (ESAs) which are major planks in EU wide financial stability means more is done at the level of regulation with binding technical standards from the ESAs. Due to the limitation of discretion for the ESAs it is not possible to create a broad framework to be filled in by the Regulators as is done with UK legislation. This means detail has to be at level 1, or at the Member State level, but the latter runs counter to the notion of a tighter single rule book for a safer post-crisis single financial market and a level playing field. Greater attention needs to be paid in the level 1 text to the recitals and other instructions to the ESAs and Commission for the purposes of binding Regulatory Technical Standards (RTS) and delegated acts.

The ESAs have been given vast amounts of work in very short timescales and are under-resourced for the tasks in hand. Through no fault of their own and due to internationally agreed G20 timetables the ESAs have been left with very short periods for consultations. In general they have done a good job of trying to adhere to the obligations put upon them by legislators but both the European Securities Markets Authority (ESMA) and the European Banking Authority (EBA) have fed back that there are times when the intention of the legislators has not been clear. The European Parliament especially has tried to increase the recitals and specifications around technical standards. AIFMD in particular, as it was both one of the first pieces of legislation to go to ESMA and hard fought in trialogue, was particularly lacking in instruction or ambiguous which left it open to different parties to suggest their own preferred interpretations to ESMA.

It also takes time for confidence to be built and for the independence that is, at least in theory, provided for the ESAs in their establishing Regulations to be fully respected. Reports with recommendations for the review of the ESAs are already under preparation in the European Parliament (EP) and it is reasonable to expect evolution and improvements in their functioning.

The relationship between the ESAs and the EP is a good one and MEPs have input to the level 2 preparation as well as the scrutinising of the final technical standards. The volume of ECON committee work has meant that only problems have been discussed in committee so the scrutiny has not been as debated in public as much as wished. With a lesser workload or reorganisation there are plans to spend more public committee time on scrutiny.

The EP has a strong preference for binding technical standards from the ESAs rather than wider cast delegated acts for the Commission. It has been noticed that the Commission is tending now to recapture some of the ground that it gave away to the ESAs and give itself delegated acts rather than binding technical standards. Parliament and Council frequently amend many of these to binding technical standards and guidelines.

Even the use of maximum harmonising regulations, such as CRR, has not prevented flexibility, for example the constrained discretion allowed in setting extra capital buffers. Maximum harmonisation was a concern to the UK during the legislative procedure as it wanted to retain control in order to ensure sufficiently high levels of capital could be required of banks and that the 3% ‘Vickers’ ring fence already drafted for UK legislation would be possible. This increased tension during negotiations, was nearly lost again in trialogue, but the end result provided the needed levels of flexibility, albeit with some horrendous drafting. Comments made during the course of legislation from industry expressed preference for harmonisation over gold plating from a competitive standpoint.

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

Third country issues are often problematic and inconsistent from one piece of legislation to another, both in terms of what is permitted to come inwardly to the EU from third countries and what happens when EU rules apply to EU institutions operating in third countries. Horse trading agreements in the legislative process are sometimes to blame and there are sometimes different sensitivities.

With AIFMD there were stages in the debates when the expression 'prison Europe' was used to describe attempts to prevent outward investment in third countries' investment vehicles and 'fortress Europe' to describe not allowing third countries' investment vehicles to operate in the EU. In the end these were largely seen off, but there are still some time-limited barriers that to UK eyes seem protectionist.

During the legislative procedure there have also been concerns about various potential restrictions, or the fact that rules would be discriminatory or unfair for example by virtue of additional capital charges being triggered for corporate transactions in financially lesser developed countries where there is not the same kind of financial market infrastructure. Some of this has actually come about from the international level (for example the Credit Valuation Adjustment charge from Basel III), and in general it has been fixed during the legislative procedure.

When it comes to equivalence decisions, the EU Commission and ESMA have shown themselves willing to improvise, for example by looking at the rules of stock exchanges and central counterparties and supervisory practices as well as legislative requirements in the equivalence decisions, and to take an outcome based approach. It has also become easier during more recent negotiations to get the equivalence language in the legislation to refer to ‘effect’ rather than ‘legislation at least as strict’.

UK MEPs from the three main parties have been very effective on these issues. Recently on the insistence of UK MEPs in trialogue an innovative ‘provisional equivalence’ regime for insurance was agreed to make sure that EU insurance companies in the US were not disadvantaged: the issue here being that there is no Federal Insurance regime in the US, only State ones, and so technically there is nothing to be equivalent to.

Reciprocity has been supported at times by the Parliament as a tool to provide negotiating strength for the EU *vis-a-vis* the extra-territoriality of US legislation. The level of engagement by the US Treasury to try and remove such clauses implies that it has had the desired impact.

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

Cross border retail activity is a potential area of growth, and as a major provider of financial services it would seem relevant to the UK to encourage this business which is more likely to flourish when there are common rules building confidence. Common rules are also a form of protection for those availing themselves of the freedom of movement and working in other Member States: similar rules help prevent investment mistakes. Many ex-patriot UK citizens have encountered problems that end up in the mailbags of MEPs, quite often referred there by MPs too.

Opportunities for cross border internet selling and accounts are much greater now and with it the opportunity for differences in local practices to mean citizens are exploited. Simple things like having to give much longer notice periods to change insurance have caught out many UK citizens when they have moved abroad. Issues such as opening of bank accounts cross border when moving to work is still far from a simple operation with a catch 22 loop of not being able to open an account until you have a permanent address, and not being able to obtain a permanent address by renting a property until you have a bank account. Exemption, non-application or absence of rules has allowed loopholes such as the ‘boiler room’ scams, perpetrated in one Member States with victims in another.

It remains a problem in third country provisions to allow EU passporting for retail services from third country branches in the EU, an issue in MiFID2 where the EP wishes an EU regime but the Council text required branches in every Member State where retail services are to be provided. This prejudices against citizens in smaller Member States in particular which are unlikely to have the choice of consumer providers. Nevertheless whatever the outcome in MiFID2 (still under negotiation at the time of writing) it does seem that there will be an improvement over AIFMD so the direction of travel is evolving to more liberal regimes in the light of experience and as knee-jerk responses to the financial crisis moderate.

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?

Following the financial crisis and the creation of the European Supervisory Authorities and the single rule book, the EU has moved to more prescriptive Level 1 legislation and more prescriptive and coordinated Level 2 legislation. This impinges on areas that previously had been left within the remit of UK regulatory bodies under looser EU directives or national UK rules. In general industry seems to have welcomed greater coordination of rules as providing a level playing field and, under regulations, preventing gold plating. Some adjustment is needed by industry to adapt to this situation. Previously more concerns could be taken to the national regulator and problems solved there, however now it is more necessary to get attention at the EU level and there have been instances where the concerns have been brought to MEPs too late. However in general the information flows have worked in time.

A frequent complaint heard in the UK is about legislation not being enforced in another Member State. For example imperfect transposition of MiFID1 in Spain meant no action was taken to stop perpetrators of ‘boiler room’ scams in Spain with UK citizens as the victims. Enforcement actions by the Commission are a ‘nuclear’ option and difficult to persuade them to start, an issue taken up with Commissioner McCreevy in the last Commission mandate. The single rule book and the ESAs are both a preventative measure and an additional assistance to enforcement. Adjustment to the ‘ESA world’ is not yet settled and is a progressive process, but it is a corollary to the vision of tighter international regulation and preventing the contagion effects witnessed in the financial crisis.

The ESAs are also given roles in many pieces of legislation for monitoring effects, or sometimes for preparing guidelines, monitoring their impact and then moving to technical standards once more is known.

Many Member States, which from an EP perspective includes the UK, still have mixed feeling about the ESAs: they want others to be put in a tighter discipline but not themselves! There have been complaints from Member States including the UK about the ESAs having been weak, for example with the first round of bank stress tests whereas the truth was that Member States exerted pressure in and on the EBA to weaken the tests, in part because they failed to put backstops in place.

The ESAs are seen as, and at times behave as, a 'mini Council' formation. It is because of this that Member States collectively have been far more willing to accept delegated acts in the form of binding regulatory technical standards within financial services than has been exhibited in other policy areas, where the provisions for delegated acts in the Lisbon Treaty has been resisted in Council, quite possibly illegally.

A great deal of constructive work is done by UK regulators in the ESAs, with engagement by the UK regulators on various panels and working groups and the UK contributions are held in high regard from the feedback that is made by the ESAs to MEPs. The policy divisions when they occur fall over a range of different combinations of Member States from subject to subject and not along Euro/non Euro lines. The constructive engagement of the UK could be built upon to assist in the rehabilitation of the UK reputation among co-legislators if it were more visible, with the UK being seen to suggest legislative initiatives at EU level. Presentations should be made with the EU perspective in mind, that is encouraging action rather than declaiming.

***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?**

The UK has a strong influence, via international bodies, via the Council and European Parliament. There have been negative effects on the UK's reputation from the financial crisis, which has made negotiation in financial services more difficult than previously. This is deeply exacerbated by public suggestions that the world's largest exporter of financial services, which acknowledges its mistakes of the past, should be able to do what it alone decides and have vetoes over EU financial legislation. The point is made 'what if you get it wrong again, you will still have exported it to us.' That is why the EU will impose its rules for market access even if the UK were not in the EU.

As elaborated above, UK effectiveness could be enhanced at the pre-legislative EU stage and also media presentation of UK interventions should take account of how they will be perceived in the EU not just by the domestic observer. Everyone in the EU institutions and financial circles EU wide reads the Financial Times, UK dirty linen is always on display and wrong presentation can and has undermined negotiation positions.

UK rules would be stricter in some areas without EU involvement, for example the changes in CRD4 to the CVA charge and trade finance made by the European Parliament in the interests of growth and global trade would not have been made by UK regulators and the UK Parliament does not get involved at that level of detail. The role of the European Parliament in particular in responding to genuine concerns, often of UK industry, adds a dimension that is not present to the same level in the UK. In other areas the UK would have been weaker, for example in allowing, even promoting, get around of the securitisation 'skin in the game' retention provisions for loan managers that were introduced in Capital Requirements Directive 2 (CRD2). However, as previously commented, it is interesting to see quite a lot of common thinking in the Parliamentary Commission on Banking Reform Report and measures that have been promoted in particular by the European Parliament.

If the UK were outside the EU, as are Norway and Switzerland, then the vast majority of EU legislation would apply without being changed during its progress to suit the UK better. Indeed without UK input to the Commission, Council and Parliament it is likely the legislation would begin to diverge substantially from what suits the UK: that is the corollary of the fact that there is high UK influence now. High level delegations from Switzerland have found it increasingly difficult to influence or hold out against the EU, not just on the matter of financial services but also tax transparency. Recently Norwegian representatives asked UK MEPs to intervene for a transition period on deposit guarantee maximum amounts while the Swiss have rewritten their financial market infrastructure law to ensure authorisation under EMIR and the Central Securities Depositories Regulation and even then are not necessarily going to get passports and are applying to ESMA.

***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 call for evidence explains the way in which the Commission consults and prepares impact assessments. The practical way in which this is done includes public hearings at which stakeholders, industry, regulators from Member States, international bodies and third countries and MEPs participate. The European

Parliament also provides responses to Commission consultative documents, usually in the form of an initiative report. Public discussions, commissioning of policy documents and public hearings, workshops and seminars in the Parliament also inform the Parliament's own work. The Commission proposals are also debated widely within think tank conferences and industry conferences, where MEPs, regulators, Commission and industry participate, including many from the UK. Many of these take place in Brussels and are well covered by technical reporting.

With regard to the legislative stage and the European Parliament, in general it is easier for an interested member of the public, NGO or industry from all sides to get an amendment tabled in the EU via the EP than it is to get an amendment tabled to legislation in the UK Parliament. The Parliament committee discusses legislation in public before amendments are tabled, and as mentioned above most of the time there will have been a prior report prepared after debates and hearings. Public hearings are also usual during the consideration of legislation with the presence of industry, stakeholders, regulators and academic experts. Questions relating to legislation are also frequently discussed in public in committee during the numerous exchanges of views and hearings with representatives from the other institutions, notably including the ECB President, the Commissioners, ESA Chairs and Executive Directors, the Council President in Office, and Government Ministers and also with international bodies, regulators and standard setters.

When problems or possible amendments are suggested, some MEPs take the view that everything should be tabled and available for consideration whatever the source: amendments will not win wide support if the arguments in their support turn out to be weak or misguided but they do promote thought and investigation. All the amendments are published and there is no compromising done by a tabling office prior to publication. Then all the amendments are discussed in open committee and only at this stage are compromises negotiated and compiled by the MEPs leading on the work, usually with further public discussions and sometimes more hearings, followed by votes on compromises and every amendment, though of course many fall due to compromises. A vote is then taken in committee on whether to open first reading negotiations with the Council or whether to take the matter to Plenary first. In hard cases the loop can be gone around again for a second or third reading. It is hard to see what is not democratic in this. Naturally, national governments can and are also approached and amendments suggested for the Council side of procedures and MEPs are also approached by Member States (not just their own) about amendments.

Many of the changes made in the legislative stage are to the benefit of the UK and other Member States. Additional impact assessments are frequently called for, but in practice impact can be hard to define or quantify when the responses are subjective and when legislation is new. The ECON committee found this to be the case in the cumulative impact assessment it commissioned on financial services. The European Parliament has stepped up the resources available for it to do impact studies, which are never-the-less small compared with those of the Commission, and the ECON Committee has commissioned some during the course of legislation.

The desire for financial services legislation always to be done fast and in a single reading, recently as a crisis response, has mitigated against having additional impact assessments but there are very substantive review and revise provisions in most legislation. This is also an area where the ESAs have been given significant tasks for monitoring effects and developments with the possibility to adjust the technical standards and for consistency with international developments. Sometimes where effects need closer watching for unintended consequences the ESAs have been charged with preparing guidelines first as a testing ground before moving to technical standards. In CRD4 public country-by-country reporting had a ‘snatch back’ possibility if, after reporting to the relevant authorities, it was indicated there would be a problem for the next public phase. Larger changes and reviews than can be made by the ESAs can be done through delegated acts from the Commission.

All the ESA technical standards and Commission delegated acts can be stopped by either one of the Parliament or the Council. In Council it requires a qualified majority, in Parliament it requires a committee simple majority vote of those present and then a plenary majority of half the total number of MEPs. The ECON committee did reject one set of technical standards on EMIR in committee and forced changes and clarifications from the Commission before withdrawing the Plenary rejection vote. That episode drew several informal comments to the EP by Council representatives that the institutional procedures meant it was easier for the Parliament to reject than for the Council to do so, showing the democratic power of the Parliament.

There are transparency issues raised at times concerning discussions about legislation when it is in the negotiating stage, but this is not unique to EU procedures. If a slower pace of legislation is settled into now most of the post-crisis work has been done, then more and longer public discussion will be possible in committee sessions in the Parliament. There is as yet no formal agreement as to allowing routine publication on websites of the 'trialogue' tables but discussions about that have taken place. Copies are almost always leaked from numerous sources and universally available it seems, so formal availability is a matter that could be pursued among the institutions.

***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?**

The issue of capital flight has been a concern during the financial crisis, leading *inter alia* to maximum harmonising of deposit guarantees. The matter has also caused concern during the various sovereign debt crises and the emergency provisions under the Treaty have been used by Cyprus. In the European Parliament there has been little appetite for capital controls and the majority of concerns expressed have been in the direction of lifting controls in Cyprus as soon as possible.

There are also concerns about regulators fragmenting markets through additional capital and liquidity demands within their own jurisdiction.

***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?**

There is legitimate concern about the impact of banking union, but the desirability for strong banking supervision over the whole of the Eurozone and the gain in financial stability from that in the markets was seen as of greater value to the UK economy which was suffering from Eurozone instability. The stability gain was also welcomed internationally, including by the US, IMF and in Asia, with all seeing Eurozone stability as desirable for their economies. Concern to prevent negative effects on the single market is widely shared and safeguards are being included in legislation wherever possible. Some of these are dealt with below.

There has been suggestion that Eurozone Member States might 'caucus' and freeze out the UK and other non-Eurozone Member States from decisions. Concern has probably been heightened by the way in which the Financial Transaction Tax gained widespread support when it was seen by Eurozone finance ministers as the salvation to finding tax revenues at the height of the sovereign debt crisis (for example as exhibited during an informal ECOFIN discussion despite opposition from the ECB and IMF).

Changes to the EBA voting procedures to 'double majority' voting provide a useful safeguard during the early stages when it is uncertain whether or how divisions might occur once the ECB takes over as banking supervisor. As mentioned previously the policy divisions within ESAs at present are quite fluid and not Eurozone based. Calls that have been made in the UK for double majority voting to be a new template for all voting have been badly received in the European Parliament and have created a backlash. It is clearly better for the UK if the optional joining into ECB supervision by other non-Eurozone Member States is delayed long enough to allow the situation to settle rather than for it to occur while political tensions are still heightened because of economic troubles.

The way in which strong rules about the single market have been embedded so far in the Single Supervisory Mechanism is very good, with the ECB being given a duty of care for the single market and not allowed to discriminate on the basis of currency or geography. Using the banking union as an excuse to try and opt out, or sneak out, of some EU financial services rules is a dangerous stance. In the first place it is highly unlikely, indeed impossible, for it to succeed and would essentially be saying there should not be a single market in financial services and thereby establishing an excuse for discrimination, the very thing that the UK has sought in legislation and court action to avoid. In the second place, just hinting at it creates animosity against the UK which inevitably reflects into negotiations.

There remain problems within the Single Resolution Mechanism concerning how the resolution fund will be treated for State Aid purposes that is truly analogous to the Treaty state aid provisions and enforceable. These concerns are understood and are being addressed in various ways in the legislative texts by all the European institutions, but the Treaty is flawed when it comes what constitutes ‘resources of the state’. DGComp has a full grasp of this issue. Negotiations are still underway to ensure that such understanding is not in any way undermined by other decisions that might have to be taken by DGMarkt. The Parliament has been clear about this issue in the way it negotiated to help clarify the issue in the trialogue on the Bank Recovery and Resolution Directive. In this the co-legislators are in agreement but the Commission resists being told whether and how it should ensure its internal procedures.

The construction of the banking union, and in particular resolution, has brought about a greater awareness of the interconnectedness of banks with many having subsidiaries and branches both within the Eurozone and outside. Thus whilst in the short term it has forced difficult negotiations over voting rights in the EBA, there are prospects that the realisation and understanding of interconnectedness might assist in the future. Also, although there has been a long term concern over ECB policy on infrastructure, in many other matters the views of the ECB on both banking and markets seems more open and aligned with the UK than with views expressed elsewhere: the Financial Transaction Tax is a good example, so too is the rhetoric on sovereign Credit Default Swaps and securitisation, open markets, the need for strong capital and capital instruments, national aspects of macro-prudential controls and many others.

Thus the role of the ECB in Eurozone banking supervision, whilst an enormous technical challenge to start, has positive aspects for the UK in addition to financial stability. A close relationship between the Bank of England and the ECB is essential and needs to be visible as well as happening behind the scenes. There are public events where there is high level ECB attendance and more high level representation from the Bank of England would help to demonstrate and forge commitment to Europe as well as international standard setting.

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

Covered in introduction.