Call for Evidence: Response by Graham Bishop on behalf of the European Movement (UK)

16 January 2014

Graham Bishop is a member of the National Council of the European Movement (UK) and is a consultant on European Integration (link to CV)

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?

N/A

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 we are regularly reminded by the Chancellor of the Exchequer and Prime Minister, the UK is a major beneficiary of the single market. Correspondingly, it must be in the UK's interest to have a legislative system at EU level which enhances the single market. Indeed, the influence of UK Prime Minister Thatcher was pivotal in ensuring that the 1985 Single European Act brought in majority voting on single market matters, and abolished the national veto that had stymied economic progress for years.

Legislation at national level on tradable goods and services has a proven track record over the centuries of setting up barriers to new competitors – whether other locals or, even more so, foreigners. There is no reason to expect vested interests to miss an opportunity to protect themselves. The intensity of the struggles in many EU states to reform themselves is often an indication of the strength of vested interests trying to maintain their grip on their domestic legislature. So the best chance of reform probably lies in taking decisions for the public good well away from such regulatory capture.

Enhancing competition via suitable enquires should certainly remain fully in the arsenal of citizens who want reform. But there have been many such enquiries in, say, the UK yet many industries have become steadily more concentrated – often to the frustration of citizens. For financial services, the basic message of the global, European and UK reactions to the magnitude of the crisis that erupted from the financial sector is that self-regulation there is no longer acceptable. EU-level action against illegal `state aid' remains a powerful mechanism to promote competition including, for example, in the UK banking market.

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

At the macro-economic level rather than financial services, the EU has made revolutionary changes to its economic governance structure since 2010 (Six pack/Two Pack/TSCG) to help each State identify the impediments within its own economy to improving its competiveness and thus growth. The European Semester Process – now in its fourth iteration – produces a set of Country Specific Recommendations for each State. That State then commits to the other members of the EU that it will take the necessary action to rectify the problems that have been identified – and accepted by the relevant State. The positive results of this process for growth and competitiveness are already showing through in a good number of States.

In the financial services field and crucially in banking, the rule changes are a work in progress. At the end of this year, the ECB will produce the results of its Comprehensive Assessment of major euro area banks. It is likely that some banks will find they are required to raise additional capital but, according to ECOFIN, banks have already raised around €200 billion of capital. That compares with the €700 billion of capital (as at June 2013) reported in the EBA's transparency exercise by the largest euro area banks. So EU rules have already had a major positive impact. However, that impact is still not enough and more needs to be done to make a single rule book for banks a reality that enables savings to flow freely around the euro area to fund SMEs and citizens.

(For comments on consumer protection, see 6)

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 dramatic rise in the volume of measures – as well as the enormous increase in the length of the documents – is the logical corollary of moving regulation progressively to the European level. However, the financial crisis also had the effect of causing a global response that entails regulation (or oversight) of every aspect of financial services. That global reaction superceded the light touch, self-regulation of the past when society could trust the financial sector to behave properly. Inevitably, the combination of all three strands has produced a multiplicative impact flowing from the EU level.

The Lamfalussy Process (c. 2001) recognised the need for a single market in finance to operate via legislation that was correspondingly single – pointing to the need for more Regulations, rather than Directives that were always prone to erratic implementation in national law. The pressure to achieve the economic efficiencies of the single market also points to the use of maximum harmonisation measures so that a financial services firm in say London is not impeded in its activities in say France by local measures that are, in truth, intended to make it difficult for the foreign entrant.

From a French standpoint in this example, national objectives would be frustrated by this approach but Britain would argue this is exactly what the single market is meant to achieve. Logically, Britain cannot object to the <u>concept</u> if it happens to be a UK objective that is caught on another occasion. But this approach does not prevent any State arguing about the principles of a measure and whether it will genuinely produce the most `single' market to maximise the common good.

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

I am not aware of any case so far where there has been a substantial, negative impact, but the key battles with the US are yet to play out in the derivatives markets. The extra-territorial approach of the US can only realistically be countered by a bloc that has such overall trade attractions to the US that it does not want to cut itself off from such possibilities. The bargaining power that flows from having the world's largest single market should not be underestimated. The UK as a stand-alone negotiator would have little chance of achieving anything once the US Congress has decided the rules that will apply to any entity that does business with US firms anywhere in their global operations.

The unsung success story of the EU's exporting of its standards such as IFRS, UCITS (and in due course perhaps Solvency II) has been a major benefit to say a UK-based fund manager. The ability of investment firms to sell securities around the world issued by companies with globally acceptable, IFRS–compliant accounts is another major benefit for London.

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

After the colossal, sustained failure of UK-level regulation to protect British consumers from waves of rapacious mis-selling, it is difficult to foresee anything worse from EU rules. In terms of the IMD and PRIPS, these will be created with the intention of (i) preventing such mis-selling again and (ii) creating a single market in retail financial services.

SEPA enables UK consumers who have activities in the euro area to pay for these easily so raising the possibility of competition in retail financial services. However, the great bulk of UK consumers are effectively cut off from any such competitive benefits by the volatility of sterling and the inordinate charges levied by banks and credit card companies to make foreign exchange transactions of retail size.

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?

The concept of a single market – as regularly extolled by the Chancellor of the Exchequer – logically requires a single set of rules that are uniformly enforced. Only then can a firm seeking to do business anywhere in the EU be sure of equal treatment. For the euro area States that have signed up to far-reaching economic integration to boost their competiveness (see 3), this logic points to a `single rule book' and `single supervisor'. For euro area banks (and those in states that decide to join the `banking union' – probably all except the UK over the next decade), they will soon benefit from a Single Supervisory Mechanism (SSM).

Clearly, these regulatory bodies will need to be equipped with the necessary powers to fulfil their new responsibilities. Naturally, such powers must reach down to the level of enforcement against individual miscreants and it is a welcome development that all EU States have just agreed (In MAD/MAR) to have similar definitions for the relevant criminal offences and harmonise minimum jail sentences. The natural result of a wide banking union soon - and a euro area that steadily broadens to match the contours of that banking union – is that the rules will be set increasingly at the level of that group to maximise the common good for their 450 million citizens.

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?

I have the strong perception that UK influence is rapidly slipping away as the political debate in the UK is widely read on the other side of the Channel as a prelude to the UK leaving the EU. As the European Parliament develops the effective power that comes from the co-decision arrangements of the Lisbon Treaty, I expect it to have an ever-greater influence on the choice of European Commissioners.

If the European Parliament election in May produces the widely-discussed shift in UK representation to an anti-European fringe, then we should expect the UK Commissioner to be given a minor portfolio and have negligible influence on financial services. The European Parliament has already indicated that it will set up an EMU area sub-Committee. The Parliament is unlikely to have a great willingness to listen to non-euro states pleading special concerns rather than maximising the common good of the broader Europe. The process of shaping Commission proposals by Parliament setting a policy envelope in advance (via an own-initiative report) is already well established. When that envelope is set by the EMU Committee, the diminution of UK influence will be visible to all.

If the UK were solely responsible for financial rules, it would be able to exercise this independence for all firms doing business with UK-resident customers. However, any export of such services/products would undoubtedly be on the basis that the product/service complied fully with rules in force in the state where the trade is to take place. The US has already demonstrated its willingness to extend its legal reach beyond its own territory (see 5 above) and there is little reason to expect the EU to be different. So these UK rules would only apply to a small fraction of the business currently done in the City of London.

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 Lamfalussy Process set out the framework for a great improvement in consultations: at the initiation of the concept of new legislation, on the proposal itself and then finally on whether the text actually produced the intended legal effects. The principle was that there should be a space of three months between the consultation opening and closing. However, the London G20 Summit of 2009 – chaired by the UK Government - laid down aggressive timetables for achieving the G20's regulatory goals and consultation deadlines had to shrink. The spread of secondary legislation that had to be in place by the time the Level 1 measures came into force has exacerbated this trend.

Impact assessments are of the same banality as those from the UK and are not read by the industry. As an example, I asked for a show of hands at a recent meeting in London of about 100 industry practitioners. The question was: who had read at least one impact assessment? If these assessments were valued, every hand should have gone up. Instead, no more than 25% had read just one.

There is a further consequence of the rush to get the G20 programme enacted to ensure that such a financial crisis cannot happen again. This is the drive to agree legislation in a First Reading between the Parliament and Council. The result is the process known as `trialogue' where MEPs can be bombarded with proposals for amendments. In controversial drafts, the number of amendments can now top 2000. The formal process may well be respected, but the result is not a proper scrutiny of legislative proposals. But the Dodd-Frank process in the US showed a corresponding weakness in legislative systems that are called upon to deal rapidly with vast swathes of enormous technical detail. However, the original sin was not in the legislatures but in the financial services industry that let society down so comprehensively that a massive change in scope and detail of almost every item of financial legislation became necessary.

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

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

See 7 and 8 above for detailed comments

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