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

This is the response of the International Regulatory Strategy Group (IRSG) to HM Treasury's call for evidence in response to the *Balance of Competences Review – Single Market: Financial Services and the Free Movement of Capital.*

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The International Regulatory Strategy Group

The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK-based figures from the financial and professional services industry. It aims to be one of the leading cross-sectoral groups in Europe for the financial and related professional services industries to discuss and act upon regulatory developments.

Within an overall goal of sustainable economic growth, it seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views.

It is an advisory body both to the City of London Corporation and to TheCityUK.

Key Messages

- Access to the Single Market is vital to the continued success of UK-based financial and professional services firms.
- European regulatory architecture needs to be coherent enough to be implemented at an EU level where appropriate, but flexible enough to allow national implementation to reflect local markets.
- Proposed regulation needs to be subject to more rigorous cost benefit analysis and impact assessment.
- Regulation needs to be properly targeted, and that requires policy makers and regulatory authorities to engage fully with the industry in an appropriate consultative framework.
- Following the regulatory reforms introduced in response to the global financial crisis, policy makers need to enable financial services to support economic growth across the wider economy, across the whole EU.
- The UK government needs to protect the integrity of the Single Market, as the banking union in the euro area begins to take effect.

Introduction

London has long been the most important international financial centre in Europe; a global hub for financial and professional services firms. The reasons for London's history of success as an international financial centre are many and various, including its location, a stable and predictable policy framework, a commitment to open markets, and the ability to attract investors from around the world.

The creation and development of the European Union's (EU) Single Market over the last 20 years has both contributed to and reinforced London's position as the world's leading international financial centre. It has created deeper and more liquid capital markets; provided access to a large pool of skilled labour; and helped to create a larger and more prosperous consumer market.

London's pre-eminence as an international financial centre has meant that the UK has had considerable influence within the EU over the development of financial regulation. The UK has also had influence because of its leading role in global regulatory discussions. The experience and expertise of the regulatory authorities in the UK has always been widely acknowledged in other Member States, even those that do not always share the UK's commitment to open markets, and by the European institutions.

London's standing as a financial centre and the UK's global influence has helped in the development of the Single Market in financial services, particularly the wholesale market. Retail financial services are less harmonised across the EU, reflecting the importance of local factors in determining the products consumers buy. Given local factors are important, the EU needs financial regulatory architecture that is flexible enough to be harmonised at a European level where necessary, but with national flexibility to meet local customers' needs.

The Balance of Competences review is taking place against a backdrop of the UK reflecting on its relationship with the European Union. There are a variety of opinions on this important issue, influenced by many different factors. However, recent opinion surveys demonstrate a large majority of business leaders support the UK's membership of the EU and believe that access to the Single Market is essential for the UK's economic competitiveness.

UK based financial institutions greatly benefit from the ability to employ staff from across the EU. This ability to attract a diverse workforce gives the businesses sectoral-knowledge, familiarity with business and regulatory cultures, linguistic skills and networks across the world, which is vital to ensuring the success of UK based financial institutions.

Business leaders are not uncritical of the EU. They want to see significant reform in Europe to facilitate economic growth and job creation across the whole economy, and in every Member State. This view is shared by the majority of the UK based financial services industry.

Recent surveys which support this position include the CBI's which showed 78% of businesses supported the UK staying a member of the EU, with virtually no distinction between large businesses and SMEs; TheCityUK's survey of financial service business leaders reported that 84% wanted the UK to remain a member of the EU and 95% said access to the Single Market is important for the UK's future competitiveness; and the Engineering Employers' Federation published a report in the autumn of 2013 saying manufacturers supported the UK staying in the EU 'no ifs, no buts'. However, opinion polling in November 2013 by Business for Britain showed many businesses believe the costs of complying with the Single Market outweigh the benefits.

It is useful to consider the UK's influence on the development of financial regulation in the EU, by looking at the development of regulations and competences pre-2008, the international response to the global financial crisis, and the more uncertain situation that has developed since the euro area crisis in 2010.

Before the global financial crisis, the UK played a lead role in shaping the European Union's creation of a Single Market for financial services. Key to this was the Financial Services Action Plan (1999), the central achievement of which was the implementation of the Markets in Financial Instruments Directive (MIFID), which brought the benefits of increased competition and consumer protection in investment services across the Single Market, thus complementing the Single Market in banking which had been achieved earlier in the decade. Another example is the Market Abuse Directive (MAD), where UK experience and expertise led to increased standards in the prevention of market abuse in the Single Market.

In response to the global financial crisis that began in 2008, the G20 and the Financial Stability Board (FSB) have provided the international framework for implementing an ambitious regulatory agenda to improve financial stability and protect taxpayers from the consequences of bank failures. Key elements of this agenda have included addressing the challenge of systemically important financial institutions ("too big to fail"), infrastructure reforms of the over-the-counter (OTC) derivatives market, and compensation in the banking sector.

The UK Government, the Bank of England and the UK regulatory authorities have all been actively engaged in shaping this agenda in the G20, the FSB and the EU.

Given London's role as Europe's international financial centre, it is in the UK's interest to see an internationally coordinated response to the global financial crisis. The UK's membership of the EU means that it is more influential than it might otherwise be in international fora such as the G20, and better placed to shape the EU input to, and implementation of, international regulatory framework agreements.

It is important to remember that the huge number of regulatory changes that have been introduced since the global financial crisis have originated at different levels: domestic, European and international. Often, regulatory change that has been introduced at the European level is the transposition of the G20 and FSB agenda; for example the Capital Requirements Directive (CRD) IV is the EU transposition of the Basel III capital requirements, which is supported by the UK.

Whilst implementing this huge volume of regulatory change has been challenging for both regulators and the financial services industry, a major regulatory response was clearly appropriate given the impact of the global financial crisis.

It is too soon to tell whether the regulatory response to the global financial crisis has been proportionate and effective. From such major change, there is an inevitable risk both to the international coherence of financial markets and to economic growth. However, the EU has not acted alone in implementing major regulatory change. In many cases, the UK has led the way and in some instances, such as banking structures (the Banking Reform Act, based on the Independent Commission on Banking's recommended reforms), has been more radical than either the EU or the FSB. The UK regulators have acted more quickly and taken tougher approaches than the EU regulators, for example with the early implementation of recent reforms, including CRD IV/CRR requirements.

However, there have been some regulatory initiatives originating in the EU that are misconceived and have potentially damaging, unintended consequences, which the UK Government and regulators have opposed. The obvious examples are the proposed Financial Transactions Tax (FTT) and the CRD IV/ CRR restrictions on bank remuneration.

The adequacy of the EU process for developing financial services regulation has also been a widespread concern. Improvements need to be made to the extent of consultation with the financial services industry, and to the thoroughness of impact assessments and cost benefit analysis, including to final users. This is an area where we would support reform of the EU processes.

Since the euro area crisis that began in 2010, the picture has become more complicated. The on-going creation of a banking union has been an important and necessary step to bring financial stability to the euro area. It has also coincided with the establishment of the ESAs, adding to the complexity of the legislative process.

These changes also present important challenges to the UK, and the UK government and regulatory authorities will need to be engaged fully in EU policy developments to ensure the integrity of the Single Market is preserved. The UK's achievement in December 2012 in securing the "double majority" voting system as part of the banking union was a good example of where the UK government was fully engaged with the process, and secured the right outcome for the UK and for London as Europe's international financial centre. On other issues, the UK government could have been more effective at intervening on behalf of UK based financial services, for example in the development of the Alternative Investment Fund Managers Directive (AIFMD).

The UK has an essential role to play within the EU to continue to make the case for open international capital markets, to influence the creation of a Single Rule Book, and to secure an appropriate completion of the Single Market in services. It should also champion a positive agenda for Europe, which will be essential in making Europe competitive in global markets ensuring it is able to deliver the jobs and growth across the continent that everyone wishes to see.

Many Member States share these ambitions and it is a time of tremendous opportunity for the UK authorities and the financial services industry to work together to reform the EU and to deliver economic growth across the whole economy.

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?

The ‘depth’ of the Single Market for financial services will vary depending upon the unique characteristics of each market: such as whether it is retail or wholesale, the impact and use of technology, the sophistication of the end-user and the extent to which market activity is domestically or internationally orientated. Where there are significant differences in local markets (such as in retail markets), it is appropriate to have a set of nationally adjusted rules and it might even be ill advised to apply a one-size-fits-all approach. It is therefore vital that any EU-level action in the area of financial services is demand driven, subjected to a rigorous assessment of subsidiarity and based on a full cost benefit analysis.

UK based financial institutions have, and continue to be, significantly affected by “EU rules”. Prior to the financial crisis “EU rules” were largely targeted at completing the Single Market in financial services and had a largely positive effect on the UK. In particular, the “European passport[1]” for financial services and then the package of reforms contained in the Financial Services Action Plan (FSAP) in 1999, helped pave the way for greater cross-border trade in financial services. It allowed the UK to act as a channel for investment across Europe as well as to create a deep pool of capital and expertise for Europe's businesses.

EU rules implemented pre-2008 were broadly proportionate in nature. Proportionality was an essential platform for the UK’s financial industry growth strategy, ensuring that the UK was an attractive destination for international business, and played its role in fulfilling the needs of final users. While UK based financial institutions may have preferred the details of certain rules to be different, some compromise was necessary to deepen the Single Market and the outcomes were broadly acceptable.

It is clear that the outcomes from some of the earlier FSAP Directives have fallen short of the stated objectives largely as a result of the Member States’ differing approaches to harmonisation, which has led to uneven transposition and enforcement by national authorities. For example, the slow adoption of the MiFID regime in Spain prevented the full benefits of market reforms from materialising, in terms of increased pan-EU competition and improvements in the quality of trading and execution.

Since the global financial crisis many “EU rules” have been mainly reactive in nature, driven by G20 commitments and targeted towards correcting the problems that led to the financial crisis. The European Commission has tabled a comprehensive framework for financial regulatory reform, including regulations introducing more stringent capital standards at banks and the mandatory clearing of standardised over-the-counter (OTC) derivatives through central counterparties.

[1] The “European passport” is based on the principle of mutual recognition and allows financial services operators legally established in one Member State to establish/provide their services in the other Member States without further authorisation requirements.

Current EU legislative reforms

Asset Management: the recast of the UCITS directive (UCITS V) intends to address issues relating to the depository function, manager remuneration and administrative sanctions.

Capital markets: short-selling restrictions, enhanced transparency rules, regulation of financial benchmarks, clearing obligations for standardised OTC derivative contracts (known as EMIR), enhanced framework for securities markets (MiFID II/ MiFIR), shadow banking regulations, enhanced framework to prevent market abuse (MAD II/MAR) and new regulatory regime for hedge funds and private equity (AIFMD).

Banks: single rulebook of prudential requirements for banks, including capital, liquidity and leverage requirements and stricter rules on remuneration and improved tax transparency (CRD IV/CRR). Rules around deposit guarantee schemes and structural reform proposals (Liikanen proposals).

Single market: creation of the Single Euro Payments Area, strengthened regime for money laundering (AML 4) and proposals for long term investment funds.

Investors/Consumer: responsible lending (Mortgage Credit Directive), investor compensation schemes, access to basic bank accounts, improved investor information for complex financial products (PRIPS).

Insurance/Pensions: new prudential regime for insurers (Solvency II) and strengthened rules on the sale of insurance products (Insurance Mediation Directive II plus PRIPS).

Crisis management: requirement on banks to prepare recovery and resolution plans (Recovery and Resolution Directive).

Banking union: creation of the Single Supervisory Mechanism, the Single Resolution Mechanism and common deposit guarantee scheme.

It is unclear what the cumulative impact of these reforms will be or whether they are proportionate in nature. However, some reforms require particular attention. For example, the financial transaction tax (FTT) proposal does not seem to be appropriate or proportionate, given the lack of clarity about its objectives, the anticipated economic impact and the probable unintended consequences.

The FTT, as currently proposed, will mean that even parties outside the FTT area, like UK pension funds, will be taxed when they trade financial instruments issued in FTT countries. In addition, institutions in the FTT countries are likley to impose a surcharge when they buy financial instruments issued outside the FTT area, on the grounds that they will be taxed by their home country. This will make financing of private and public debt more expensive even for parties outside the FTT area. A study by London Economics[2], on behalf of the IRSG, estimates that the cost impact is likely to be greater on Member States not participating in the FTT, such as the UK, because debt securities represent a greater proportion of their corporations' capital structures.

Given the sheer volume of legislation, it is inevitable that in some areas regulation overlaps bring the risk of creating conflicting or duplicating requirements, and also the potential for consumer confusion or even detriment. For example, as our upcoming analysis of the implications of the FTT for the European regulatory reform agenda finds, there are several compatibility issues with existing and proposed regulatory initiatives.

Where this is likely to occur, legislators need to explore these issues ahead of proposals being tabled. If two separate regulations are still introduced, continual efforts need to be made to ensure consistency where appropriate as the two dossiers proceed. Conversely, where one regulation is introduced covering a number of sectors or products, it will also need to acknowledge where precise exceptions or alterations should be included to take into account the differences of certain products or markets.

An example of where this has proved challenging is the approach taken to MiFID II and the revision of the Insurance Mediation Directive (IMD II), which both address the provision of advice for certain financial products, investment products and insurance products respectively. Initially, these two directives were treated separately, which presented challenges in ensuring the texts evolved consistently. A recent move towards a possible inclusion of IMD II into MIFID II as the latter reaches final agreement, could risk there being insufficient time to ensure the specifics of insurance products are taken into account in these investment rules.
Common rules and standards are not always appropriate across the financial systems of 28 Member States and should therefore meet the subsidiarity principle.

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 UK would benefit from regulations aimed at completing the Single Market for wholesale markets and other financial services which are easily tradable across borders.

Many studies have revealed how continued fragmentation within Europe's capital market results in lower levels of market efficiency and higher costs to financial consumers, when compared with other major economies such as the United States. This has a negative impact on European corporates raising investment finance and on households when accessing everyday financial services or saving for retirement. Achieving greater efficiency and reduced transaction costs within the Single Market is necessary to ensure the long-term

[2] London Economics (2013), for the IRSG: "The impact of a Financial transaction tax on corporate and Sovereign Debt", http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/research-2013/The-impact-of-a-financial-transaction-tax-on-corporate-and-sovereign-debt-ExecSummary.pdf

competitiveness of Europe's economy. So too is the need to ensure that effective third country regimes are put in place which do not hamper market access between Europe and the rest of the world. Nearly two-thirds of the UK's trade surplus in financial services is dependent on trade beyond the Single Market. As measures such as the FTT clearly illustrate, policymakers need to give sufficient regard to the cross-border character of financial services and markets as a key factor in 'better regulation'.

Greater attention needs to be given to the implementation of regulations. This is particularly important as we are now in the implementation phase of many post-crisis reforms. Financial regulations implemented across all 28 Member States need to be applied consistently.

The propagation of the EU Single Rulebook for prudential regulation by the European Supervisory Authorities (ESAs) could help promote regulator consistency in the future[3]. The ability of the ESAs to participate in colleges of supervisors and receive all relevant information is also a key element of improving the quality and consistency of regulatory implementation. So far, the ESAs have not used their supervisory consistency powers to any great extent in identifying divergent applications (peer reviews), policing (opinions or recommendations), enforcing consistency application of EU law, nor have they used their industry stakeholder groups effectively.

There are many actions still to prepare for, for example, the enforcement of CRD IV /CRR, EMIR and Solvency II. At the same time, other initiatives, such as the creation of the banking union, will bring a new dimension to the ESAs' banking supervisory convergence role. In the coming years, it will be important for ESAs to address interactions between regulatory authorities. This is particularly important for high-impact regulatory initiatives such as CRD IV/CRR, EMIR, and Solvency II.

However, regulation can only go so far in promoting the Single Market. Using an effective, independent competition regime to modify behaviour and restructure markets may be more effective. DG Competition has played an important role since the crisis in reducing barriers to competition across the EU financial system. DG Competition should consider using anti-trust intervention in the future where financial regulations threaten to undermine the integrity of the Single Market (e.g. access to clearing in euro-denominated products).

[3] Under the Single Rule book approach, key technical rules are defined at the EU level and adopted through EU regulations, so that they are directly applicable to all financial institutions operating in the Single Market, without any need for national implementation or possibility for additional layers of local rules. A single rule book should help reduce the dead-weight costs associated with cross-border institutions complying with similar rules in a fragmented compliance process across different jurisdictions.

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

Financial Stability

The EU's relatively uneven regulatory framework and the uncoordinated nature of crisis management amongst national regulators undermined financial stability during the global financial and euro area crises. For example, the Irish Government's unilateral decision to guarantee all deposits in September 2008 left many other EU countries with little option but to introduce similar measures to protect their banking systems.

Since the crises, the EU regulatory effort to promote financial stability has been largely successful. EU regulators have adopted a multi-faceted approach to stabilising EU financial markets:

Macroprudential regulation: The creation of a pan-EU macroprudential regulator, the European Systemic Risk Board (ESRB) in 2011, was a step forward in overseeing the build-up of systemic risks in the EU. The ESRB is intended to take into account macroeconomic developments, so as to avoid periods of widespread financial distress. The ESRB also contributes to the smooth functioning of the Single Market and thereby ensures a sustainable contribution of the financial sector to economic growth across Europe. Since 2011, it has issued a number of warnings and financial stability reports.

Recapitalisation exercise: The European Banking Authority's (EBA) recapitalisation exercise in 2011/12 was a key milestone in rebuilding market confidence in the EU banking system. The exercise called for significantly higher capital reserves than required by regulatory standards, to help banks replenish their balance sheets.

CRD IV/CRR: New rules requiring banks to hold more and better capital cushions to absorb losses came into force on 1 January 2014. They have additional requirements for the most important banks to maintain sufficient liquidity to bridge crisis situations, and to limit their leverage.

Central clearing: Since early 2013 and in line with G20 commitments, over-the-counter (OTC) derivatives markets have been subject to European market Infrastructure regulation (EMIR), the first comprehensive European market infrastructure regulation requiring all standardised OTC derivative transactions to be cleared through an authorised central clearing house.

Banking union: Plans to establish a banking union sent a strong signal that EU authorities were serious about trying to break the negative link between sovereign debt and banks. It was part of number of initiatives to stabilise financial markets during the height of the sovereign debt crisis. The transfer of prudential supervision to the European Central Bank, compulsory for the euro area, will build on the single rule book of prudential requirements, crisis prevention, management and resolution and deposit guarantees for banks.

The development of the banking union has important implications for the UK, even though it remains outside the euro area. The UK government needs to actively monitor these developments and engage with other Member States in order to protect the UK's interests and avoid dilution of the UK's influence in the EU.

Growth and Competitiveness

The Single Market has had a profound impact on growth and competitiveness in Europe. Larger and deeper capital markets have helped finance businesses and reduce the cost base of the European economy. Various studies have demonstrated that the more integrated financial markets are, the more efficient the allocation of capital is, because investment opportunities and competition are also greater. The UK's large financial and professional services cluster has reduced costs and increased the range of financial products and services available to European businesses and households. In the absence of the Single Market, final users would be faced with wider spreads and higher costs, businesses could find it more difficult to hedge risk and EU governments find it harder to raise debt.

London has long acted as a natural bridge for third countries accessing the EU's large financial market, given its track record for facilitating international trade in financial and professional services. In fact, decision makers specifically cited access to markets in the EU as a core reason for choosing the UK over other financial centres in over 40% of investment cases considered[4]. In over 45% of investment cases that located in the UK, decision makers cited access to skilled staff, including European nationals who have access to work in the UK, as one of the core reasons for their decision. This is especially the case where firms chose the UK as a European hub, rather than maintaining a number of offices across European locations.

Currently there are over 1,400 financial services firms in the UK that are majority foreign-owned, from around 80 countries.[5] The UK is the leading recipient of financial services foreign direct investment in Europe: over 40% of financial institutions new to locating in Europe chose London as their headquarters in the past seven years.[6]

Since the financial crisis, the growth and competition agenda has been overshadowed by prudential and market based reforms. The European Commission has tabled a number of proposals which may facilitate alternative sources of finance in the future (venture capital, social entrepreneurship and long term finance), but the effects will take time to be seen.

[4] TheCityUK (2012), 'Driving competitiveness: Securing the UK's position as the location of choice for financial and related professional services' November, http://www.thecityuk.com/assets/Uploads/Competitiveness-Reportlow-res.pdf

[5] City of London (2013) "An indispensable industry: Financial services in the UK", http://www.cityoflondon.gov.uk/about-the-city/what-we-do/Documents/an-indispensable-industry.pdf

[6] Michel Barnier (2013) "The single market in financial services: we need the UK on board European Commission - SPEECH/13/636" http://europa.eu/rapid/press-release_SPEECH-13-636_en.htm

While regulatory reform has undoubtedly contributed towards creating a more stable financial system, concerns have been raised about the volume of regulation, the interaction between different dossiers and the specific impact on the competitiveness of the European economy[7].

An over-emphasis on regulation aimed at mitigating systemic risk is likely to act as a brake on growth-orientated policies. Regulatory reform in financial services cannot be taken in isolation from wider economic policies. True, sound regulation of financial services is important in itself. But financial services facilitate the functioning of the economy as a whole, by channelling savings towards productive investments. Obtaining the balance between stability and growth is not easy, but the UK has a key role to play to achieve it.

Consumer protection

The UK has had a robust consumer protection framework in place since the 1980s, which has helped influence the EU's response. For example, the Market Abuse Directive (MAD) aimed at transferring a number of UK safeguards to other EU Member States, giving investors confidence that markets would be protected against manipulation or abuse. It updated existing EU legislation and set out a harmonised system for dealing with insider trading and other forms of market manipulation.

Since the global financial crisis, there has been an acceleration in the number of EU implemented reforms which may increase consumer protection in some Member States in the future.

In order to restore lost trust and to create a safe environment for cross-border financial services within the Single Market, the European Commission proposed new rules to ensure retail customers receive full information in understandable terms, proper advice, and advisors act in the best interest of clients. The European Commission also proposed safer rules for retail investment funds ("UCITS"). It has also proposed strengthening national deposit guarantee schemes to ensure depositors have full access to their money in case of a bank crisis, and proposed similar rules for investor compensation. Finally, the European Commission has made proposals aimed at making bank accounts cheaper, more transparent and accessible to all.

[7] TheCityUK (2012), 'Driving competitiveness: Securing the UK's position as the location of choice for financial and related professional services' November, http://www.thecityuk.com/assets/Uploads/Competitiveness-Reportlow-res.pdf

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?

In the last five years, a large number of separate proposals on financial regulatory reforms have been tabled by the European Commission. Policy makers have been put under public pressure to design and implement complex reforms in tight time periods. The sequencing of the negotiations and adoption of framework co-decision legislation (Level 1) with implementing measures (Level 2) has resulted in some bottlenecks and challenging timetables being proposed (e.g. CRD IV, EMIR, Solvency II). It is too soon to say whether good regulatory outcomes have resulted from this process.

At Level 1, we believe there are a number of ways the European legislative process can be improved, including:

G20**:** The G20 agenda, supported by the UK, should be recognised as the international driver of regulatory reform. Agreeing commitments on financial regulation will help financial institutions operate across markets and facilitate greater cross-border trade. It is important that EU legislators keep within the bounds of international standards whenever possible. Deviating from common standards will result in poor outcomes (e.g. loss of competitiveness, instability) for the financial industry, the wider economy and consumers. For example, the EU's action to restrict short selling on EU markets (Regulation on short selling and certain aspects of credit default swaps) could distort equity markets, increase settlement failure, and in time, aggravate falling share prices (especially in financial institutions).

Transparency: The urgency of the legislative response to the financial crisis meant that the usual process of second reading was dropped in some cases to speed up the process. In the absence of the second reading, ensuring that there is sufficient transparency on trialogue negotiations is crucial.

Consultation: The new legislative process warrants re-examination of the current consultation process. In particular, there needs to be greater input from industry, both small and large firms, at the early stage of the legislative process, when the European Commission is investigating problems and considering what, if any, action should be taken. A similar process is essential before legislation is brought forward.

Timetables: The European Parliament should exercise its influence to promote a common sense approach in setting timetables for (1) transposition of Regulations and Directives; (2) implementation of regulatory technical standards; and (3) determination of review periods. This would allow national regulators and regulated firms sufficient time to build systems and operational structures, and then to adapt to new operational requirements. In the past few years, major reforms such as CRD IV, Solvency II and EMIR have all been delayed due to a failure to reach political agreement. Timetables for the legislative process need to be realistic if the results are going to avoid being damaging.

Technical advice: Given the complex nature of reforms which in some cases run to hundreds of pages, it is important that all parties have access to the necessary technical advice, and consult with the industry, before the Level 1 negotiations start. Sufficient time needs to be allowed for this. The European Commission, the ECB, and the ESAs, all need to ensure that they employ people with the relevant technical expertise in the areas where they promulgate regulation. They also need to have access to the relevant expertise and industry knowledge from market participants. To achieve this, we need to have meaningful consultation processes and timeframes.

Impact assessment: There should be a comprehensive assessment of the impact of all proposals before regulations are adopted; including those tabled during the trialogue negotiations.

It should be easier to review, amend or remove poor legislation which fails to achieve its objectives once implemented.

Maximum harmonisation regulations work best if they are applied in markets which are largely homogenous, market participants are cross-border in nature, and where differential rules may give rise to systemic risks (wholesale markets). Minimum harmonisation is appropriate on more nuanced areas which require supervisory judgement (such as risk culture).

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

Third-country access rules in European regulations should avoid limiting the ability of investors to access high-growth emerging markets and of firms to transact with third-country counterparties. It is essential to maintaining and growing levels of market liquidity in the UK financial services sector, and therefore access to investment capital across the EU.

Since the financial crisis there has been a general tightening of third country access to the EU. For example, the delay in finalising equivalence determination for third country regimes under the Credit Rating Agencies Regulation caused some concern amongst market participants. Of particular concern were proposals in MiFID II that have the potential to restrict access to services provided by non-EU countries, and provisions in AIFMD which limited European firms' ability to contract with third party asset managers.

Such restrictions risk violating the EU 's international commitments in multilateral and bilateral trade agreements, as well as disadvantaging emerging markets and developing economies. The regulatory aspects of the Transatlantic Trade and Investment Partnership (TTIP) should include financial services. This is the position of the UK government, and by making the case via the EU institutions, the point carries greater weight than if only made on a unilateral basis.

Where third country rules are put in place, it is important that they are agreed on an objective basis and do not potentially give rise to market protectionism. The effectiveness of the approach that the EU has adopted so far, of determining whether third countries have "equivalent" regulation, is as yet untested. It remains to be seen whether this works in practice while providing adequate protection for consumers.

We welcome initiatives such as the agreement between the European Commission and the Commodity Futures Trading Commission in regulating cross-border derivatives in the *Path Forward* in July 2013. Such measures should be replicated in other G20 commitments where possible.

The UK government must play a central role in promoting third country access and liberalisation of financial markets as a Member State of the EU. The UK is in an excellent position in terms of the scope of its involvement in multilateral organisations which includes the EU, G8, G20, FSB, Organisation for Economic Co-operation and Development and the Commonwealth. This seat at the table in all the major bodies responsible for directing policies with regard to financial markets and international trade is vital for the UK to champion the role of open markets in delivering economic growth, and gives it the appropriate policy weight.

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

Retail banking and retail insurance markets remain largely fragmented along national lines, with mergers predominantly between firms in the same country. Whilst there may be long-term benefits to adopting EU-level regulations in these areas, there are many challenges in adopting harmonised retail regulations across heterogeneous markets.

Apart from regulatory differences, there are many barriers to cross-border retail, including:

- cultural differences (risk profile etc.)
- insufficient tax harmonisation
- administrative requirements
- consumer inertia.

The regulatory architecture in this area needs to be sufficiently flexible to work in local markets. If regulation is adopted, it should be clearly targeted to protect consumers and ensure they have access to an appropriate range of products and services at a competitive price.

In principle, EU-wide regulations should focus on markets which are larger, have more players and economies of scale. In practice, the focus should be on those products and services that are most easily tradable across national borders.

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?

There has been a significant shift towards regulation and supervision at the EU level following the financial crisis. The ESAs will play an important role in promoting supervisory convergence across the whole of the EU and in ensuring that new structures, such as banking union, do not unintentionally fragment the Single Market.

The establishment of the new architecture sent an important signal to markets and consumers, helping to rebuild trust and credibility of the European financial market. However, the new EU supervisory architecture has only been in place since 2011. A complete assessment of the new supervisory structures is therefore not yet possible e.g. EIOPA only receives its full powers under the implementation of Solvency II which is currently in train.

The current European Commission review of the ESAs is exploring ways to improve their operation – this is important, as the way these authorities operate in practice is just as important as any ‘balance of supervisory powers’.

Improvements should include using a common set of definitions in their technical standards; this would promote coherence of financial regulation. These definitions should be available online as a single ‘dictionary’. ESAs should produce their own timetables setting out the consultation periods for all the technical standards related to a particular regulation. The industry should have additional opportunities for interaction with the ESAs during the drafting of regulatory technical standards. UK based financial institutions have global experience and can play an important role in raising supervisory standards across the EU.

Expert Advisory Groups have a role to play, but they need to become more transparent in their operation including on the topics under discussion. The ESAs should consult with the Expert Advisory Groups before proposing legislation, to draw on their expertise, before rather than after proposals have been issued, which is their current practice. ESAs resource constraints should also be addressed given the important role they will play in shaping the future direction of the EU financial system.

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 remains a very important voice in the development of EU financial regulation. Member States recognise and respect UK experience and expertise.

The UK’s strategy for financial services needs to take a long-term approach. The UK government and financial institutions need to develop a positive agenda for growth and reform across Europe to help inform regulatory development. The UK government needs to encourage the PRA and the FCA to actively participate in the development of EU legislation.
Widespread UK secondments across the EU institutions and ESAs, to share and develop financial expertise, would be a positive development.

The UK chairmanship of the G20 in 2009 demonstrated how the UK was able to influence the international debate in ways which have been helpful in informing subsequent policy debates in the EU.

The UK is now leading the international debate on reforming corporation tax systems to deal more effectively with the taxation of intangibles and intellectual property, in a way which will ultimately shape how corporates organise their tax arrangements within the Single Market.

The EU needs the UK's influence as a champion for liberalisation and free markets, not just in Brussels, but on the global stage. An economic recovery can be supported by open, competitive and efficient markets. These enable the movement of people, capital and services across borders to drive growth across the whole economy. The increasing internationalisation of the City of London, an asset which serves the whole European economy, demonstrates these benefits in action.

The Single Market has been a major asset to the UK's financial services sector, while in turn the City of London has played a significant role in spearheading the development of a more integrated and cross-border financial market place. It is in the interests of the UK and Europe to have a coherent international financial regulatory framework which can help drive growth and competitiveness. Whilst global reforms have improved financial stability, reform needs to balance stability with promoting growth across the wider economy.

It is unclear how different UK rules would be if they were purely a national competence. In the 1990s and 2000s, the UK spearheaded the package of reforms designed to remove barriers to cross-border trade and boost integration. The UK's regulations on investment services and market abuse enforcement helped shape the subsequent EU Directives, MiFID and MAD, respectively.

Post the financial crisis, reforms have been primarily driven by G20—which the UK government helped shape in the immediate aftermath of the crisis. Undoubtably, there are some areas of EU rules where the UK would have taken a different approach. However, there are many examples where the UK would have taken a tougher stance. Recently, UK rules on financial benchmarks introduced a stringent Approved Persons regime for LIBOR submission and administration, together with requirements around internal controls and governance. Moreover, the UK's new Banking Reform Act (based on the ICB's recommendations) applies tougher requirements on banking structures than the current European proposals (the Liikanen report).

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 EU regulatory reform agenda is at a crossroads. The European economy can reap huge benefits from current financial services reforms, if they are targeted to do the following:

- protect financial investors and consumers
- enhance the financial systems' shock absorption capacity to withstand future shocks
- reduce national divergences and costly fragmentation
- harmonise and strengthen risk management practices
- inject transparency to reduce information asymmetries
- reduce compliance costs of cross-border trade
- guard against the dangers of systemic risk and too-big-to fail financial institutions.

To establish a regulatory framework that can mitigate future crises, while not over-regulating in a way that inhibits growth and innovation, we need to understand how financial services work and what is the real impact of regulation on the wider economy. We welcome the spirit of engagement with the European Commission and the Parliament that informs this process. Engaging proactively with business is essential for policymakers looking for effective solutions to the current set of problems, and that, of course, is a two-way process.

We need to ensure that financial services remain an important part of the EU's offering to global business. We should value the support financial services provide to other sectors of the economy throughout the EU: providing better access to finance and lowering borrowing costs faced by households, businesses and governments, and increasing the potential for trade-led growth and investment. This is in line with the aspirations for the Europe 2020 strategy; both tapping the potential of the Single Market and attracting private capital to finance growth.

We are appreciative of efforts by Members of the European Parliament to engage with the sector during the legislative process. However, we are concerned at the closed nature of the trialogue process which makes it difficult for stakeholders to meaningfully engage with the European institutions. Adopting the same arrangements for trialogues as for Council Working Groups would promote transparency.

The mechanics of cost benefit analysis which demonstrate the need for new regulations must be more robust in order to avoid unintended outcomes. In a number of cases, the impact analysis is merely a qualitative comparison of possible approaches, rather than a proper quantified analysis, for example, Central Counterparty requirements as part of EMIR. Moreover, sunset clauses should be incorporated in proposals, so that modifications can be made to deal with any unforeseen adverse consequences.

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 free movement of capital in the EU is vitally important for London as Europe's international financial centre. Free movement of savings and investment flows between Member States has enabled London to position itself as a hub for Euro dominated business. The UK financial services sector attracts more foreign direct investment (FDI), and the UK attracts more FDI, than any other EU Member State. Economic research shows that ease of access to the integrated the Single Market is the lead driver for firms to invest in the UK[8].

In very exceptional circumstances, there is a role for capital controls as a macro-prudential tool to stabilise the economy to address the negative effects of large and volatile capital flows (Iceland in 2008 and Cyprus 2013). However the removal of the controls should be pursued as soon as possible to maintain the integrity of the internal market.

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?

It was feared when the euro was created and the UK remained outside, that business would naturally migrate to centres within the euro area. In fact, these fears proved unjustified, but this was in large part because all the different elements in the Single Market Framework made it possible for business to be conducted in euro-denominated instruments in the UK and the other "Out" countries, on exactly the same legal basis and with the same degree of regulatory protection as within the euro area. This has led to London being the de facto centre of the euro-denominated markets[9] with major portions of the related market infrastructure located in London.

Thus far, the understanding that the UK was a fully collaborating participant in all these arrangements has largely kept at bay political pressure for euro-denominated business and related infrastructure to be relocated within the euro area. Discrimination against business being done outside the euro area, but still within the EU, is illegal under the Treaties. However, that Treaty protection would be removed in the event that the UK was to leave the EU and a large question mark would exist over the future of London as a key centre for euro-denominated business.

We support the creation of a strong banking union as a vehicle to restore credibility and stability to the euro area banking system (i.e. banks whose home country is in the euro area), a large part of which is located in London or is the counterparty of London-based firms.

[8] Source TheCityUK 2013 Statistical database
[9] 44% of all euro denominated foreign exchange trading worldwide in 2013. Source: TheCityUK 2013, "The UK and EU: a mutually beneficial relationship".

The development of the banking union could potentially present a risk to the integrity of the Single Market, if rules were to be developed which only applied to euro area banks or which affected the relationship between activity within the euro area and activity in the rest of the EU.

The ability of the UK to be a ‘gateway’ to European markets may come under threat if additional requirements over product provision were given to businesses inside the Single Supervisory Mechanism (SSM). UK based banks, with subsidiaries in the euro area, will be directly impacted by the proposals. It is vital that banks whose home country is outside the banking union are not disadvantaged during their interaction with regulators or in their business activity inside the banking union. Similarly, it is important that the legal treatment of branches located inside the banking union is the same as it is for branches in other EU Member States.

As a priority, the UK government should seek to protect the integrity of the Single Market.

Many of the potential risks to the Single Market can be mitigated through adequate safeguards. We welcome the double majority voting requirements for the EBA’s decisions on mediation and technical standards which the UK government successfully negotiated in 2012. This measure ensures that decisions are backed by both a majority of the participating and the non-participating Member States, helping to preserve the UK voting voice, and weight, on the future of regulations in the Single Market.

It is vital the UK retains an influential voice in discussions on the future direction of the banking union. In particular, in relation to supervisory models, policies related to the licensing of firms, passporting arrangements, and the treatment of third country banks establishing branches or providing cross-border services. There should be a common interest in the closest possible dialogue between the UK regulators and the SSM, given that a large proportion of the business of banks with their home country in the euro area takes place in London, and much of it is subject to conduct of business regulation by the FCA as host regulator under the Single Market rules.

This commonality of interest is also important in relation to the other aspects of banking union beyond the SSM, namely arrangements for recovery and resolution and deposit insurance.

It will be important to monitor closely for any signs of fragmentation to the Single Market, as banking union develops from 2015 onwards. EU leaders have consistently acknowledged that the Single Market must be protected in any legislative proposals brought forward to strengthen economic and monetary union.

International Regulatory Strategy Group
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