Minutes of Franco-British Chambers of Commerce workshop on the "Balance of Competences – Single Market: Financial Services and the Free Movement of Capital" report

Paris, Tuesday 3 December 2013

The Franco British Chamber of Commerce asked its members to participate in a workshop to review and give input to the British Government. The attached notes reflect the opinions of those members of the FBCCI who participated. This is part of a wide dialogue FBCCI is holding with its members and the British Government over different areas of Britain's relationship with the EU.

How have EU rules affected the achievement of objectives like financial stability, growth, competitiveness and consumer protection?

- All participants agreed that there were clear benefits to the UK in being in the Single Market, with some expressing the importance to their firm of being based in a jurisdiction close to the EU.

- Many firms take a zero-risk approach to European regulation, both for prudential regulation and consumer protection legislation, and particularly following the LIBOR and EURIBOR scandals. Logically this adds a large cost burden to firms and they spend hundreds of millions of euro putting internal rules and procedures in place to ensure compliance. Compliance is the biggest growth area in terms of headcount in many banks. An example illustrating the importance and costliness of compliance was given, where a compliance analyst was offered a contract with a 50% pay rise by a rival firm; his current firm offered to double his salary to avoid losing him. This zero-risk approach also leads to fear and a lack of innovation.

- There had also been a large focus by EU institutions on consumer protection which was understandable since the crisis, although there seemed to be a lack of understanding by the EU (COM, EP and Council) of the costs of this to the industry.

- Financial Services firms are happy to pay the price for good regulation, but often they find that the quality of both Commission proposals and finalised legislation is low, or that there is over-regulation. On the prudential front, we are living through a crisis so this regulation can be considered to have failed.

- There is a feeling that although it is yet unproven, the European Systemic Risk Board could be a useful tool.

- For everything else to function well, the EU need to do their job regarding oversight of budget stability.

- Costs due to regulation will always either increase the burden on consumers or reduce investment. If a given piece of legislation is a directive it makes matters worse, as individual countries tinker with it and there is a cost created from interpretative fragmentation. According

to participants from the audit sector, it is navigating the different layers of supervision that is most costly.

- Participants felt that fragmentation of markets has benefited London, and the position of London is key in any financial services reform.

Participants believed that the benefits of being in the single market outweighed these costs. In the bankers' experience, UK participation in the single market is really important for corporate clients. International banks' business models are based on trade – the UK exiting the single market would be terrible for trade: for banks' business model, for the UK, and for Europe.

- Some participants were in favour of maximum harmonisation on the basis that it simplifies regulation and allows for easier cross-border transactions and levels the playing field. That said, maximum harmonisation wasn't a perfect option and still resulted in a mosaic of approaches to some extent. Exceptions would always be needed, for example, to secure agreements or compromises, but these should not distort competition.

- On MiFID, there was praise for the access to clearing houses as a key leveller for the marketplace and would help to meet the G20 commitments. Open competition is important for the common good. However, it was very frustrating that other MSs drew a red line to protect their monopoly, but (despite UK pressure against this) it was the best that could be achieved.

- Important to recognise the differences between MSs, but there was also benefit in trying to establish a common international framework, with a greater shift towards more market-based financing in the EU.

- FS legislation issues were no longer regional but global in nature. Despite strong standard-setting bodies, markets were still fragmented, with notable risks in relation to US. There isn't a sufficiently strong international framework. IOSCO and the FSB come out with good guidelines, but implementation in the EU and US lead in different directions. The lack of consideration of the international dimension of policies had been reflected in the FTT and the COM's response to Liikanen. There continued to be major problems relating to establishing a level-playing field internationally.

- In recent years, the EU had established an increasing reliance on Regulations, though it was unclear whether this was to try to secure a level-playing field (which would be good) or to bind the hands of MSs (less so). The increase in Regulations was a concern alongside the high volume and pace of regulatory reforms, which worked against getting the quality of legislation right which was even more critical for Regulations than for Directives. Regulations done well were the first best option, but they had been far from adequate. If anything, using Regulations should create a higher burden for policy-makers (ie more time and slower pace).

How effective and accountable is the EU policy-making process on financial services legislation?

- There was strong concern among participants at the lack of dialogue between EU institutions and industry. Impact assessments are carried out on legislative proposals, but these are developed without consultation with the industry. The Enhanced Cooperation FTT impact assessment, for example, was considered to be very poor and seemed to have been used as a tool to legitimize a pre-conceived idea. There was broad consensus that the financial crisis had – in some instances – been used a as pretext not to discuss real issues and to rush dossiers through. There were a number of comments about the difficulty in being heard in EU

consultations. When there is no dialogue between industry and the Commission, the only option is to lobby individual MEPs.

Participants thought that there appeared to be a mindset within the Commission (but which also applied to "Brussels" more widely) not to give sufficient consideration to external input. Insurance firms had found that the Commission didn't always understand the difference between banking and insurance, and between life and non-life products. A full-time resource in Brussels was now necessary for firms to communicate with the Brussels machine, as they find it takes time to make themselves understood – a crucial process, particularly for systemically important insurance firms. Similarly, accounting was often put in the same bracket as banking, even though they are completely different professions.

- The process of trilogues often amounts to "horse-trading" without proper consideration of the impact of changes. Poor compromises result from inadequate processes. Possible outcomes can create billions in costs. An example was given where, during the CRDIV trilogues, the question of having a binding leverage ratio was presented to the EP ECON committee as just a technical issue. This was finally modified (somehow after the trilogues had closed) and will be researched further. The leverage ratio will now need further legislation in 2018 to make it a binding requirement.

- The quality of MEPs is also very important. There is a perception amongst participants that losers from domestic elections are sent to the European Parliament. However, MEPs were easier to reach and discuss issues with compared to the Commission. The Commission was too political and not sufficiently technical-minded. There also needed to be greater transparency in the policy-making process and mutual respect between the EU institutions and industry. Participants argued that transparency and democratic accountability was entirely lacking in the trilogue process, though thought that the Council would be wary about supporting more openness given the amount of horse-grading that took place at that stage. Participants also highlighted that there was often good dialogue and sharing of information between industry and MSs, but not with Brussels.

- There is a perception that green paper responses are not always taken into account. Early drafting on FS dossiers is often problematic – the FTT impact assessment being an example.

- Where EU policy-making could be more effective is in the articulation between EU FS legislation and US FS legislation. There is confusion, duplication and grey areas. In the first instance, there is a need for effective convergence within the EU, and in the second, there is a need for convergence at the international level. A level-playing field is necessary, but around the globe and not Just in Europe.

    Impact assessments are pretty cursory, and should be based on evidence rather than personal opinion. IAs are hard to conduct in trying to understand very complex behaviours, however the process was imperfect. Better IAs would help the EU process much more.

- Consultations should be better and more measured. It would be hard to conduct during trilogies, yet these were effectively unaccountable.

- Consultation at level 2 isn't good and constrained by level 1 which ties the hands of the ESAs. ESAs have sufficient input to level 1, but don't have enough experience of policy issues to see issues and problems through. This has also led to a degree of abdication of responsibility from the ESAs which wasn't acceptable.

- In terms of objectives for FS legislation, COM has a problem with a certain "illuminate of financial stability" in DG Markt thinking focus should be on financial stability and that growth will always follow (neglecting the fact that zero activity is the most stable). Risks should be managed but not removed entirely. Practitioners need to be able to advise and have their concerns taken into account.

- There have been some good EU reforms: Basel, most of OTCDs and solvency standards. AQR/stress tests under SSM should also reinforce these positive reforms. However, in the long-term these reforms will have reduced profitability and made banks structurally worse than before, with lower returns on equity.

- Some policy-makers should admit that their aim has been to shrink the size of the FS sector. Don't think enough attention has been given to flows from the EU across other markets.

- Not everything should be solved by legislation.

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?

- Having strong ESAs is important, particularly if they have responsibility to negotiate with external partners, e.g. CFTC.

- There are many problems with the European institutions according to participants: the Commission was seen by participants as having a disproportionate amount of power. Small presidencies tend to be dominated by the Commission. European parliament is dysfunctional. EP can make amendments to a Commission text, but the Commission have advantages and can generally defend their position.

- The Commission is political and can sometimes influence other bodies. Last year a technical standard for EMIR produced by ESMA was supposed to be sent to the EP ECON committee for review completion by month-end (December) but was only made available for review on 18th December.

- Participants found ESMA to be a body that could improve its effectiveness. It does not act correctly relative to MS – publishing texts without full agreement and abruptly considering legal action against those MS who do not implement their rules.

- In terms of a level playing field, participants would prefer a European approach of maximum harmonisation (if it is sensible) rather than individual MS "gold-plating" their regulations, which the UK regulator tends to do. They would also prefer regulations than directives, for the same reasons.

- The interaction with US regulations are complex and costly – one of the participants takes the approach of gold-plating the US rules in their organisation so as to avoid risk of breaching US rules. Participants elaborated at some length on the immense problems that the US/OTC derivatives issue was causing firms, and that there was a large need for far better cooperation at the global level between jurisdictions to see off risks of extraterritoriality. There were also

significant problems in trying to prepare for the various structural banking rules in different jurisdictions.

- What would offer most benefit in terms of coordination at a European and global level would be if regulators spoke a common "language", there was consistency of standards internationally, and if regulators were closer to the market.

- One member expressed an opinion that the ESRB and ESAs are still works in progress and building up expertise. ESMA has made more progress than EBA, which was disappointing given the role EBA has regarding markets. EBA had expertise and is at ease on traditional banking issues, but less so regarding its markets role. ESMA has some good people, but some are a bit lacking in pragmatism. In terms of governance, the ESAs shouldn't have the same voting shares/power for all MSs, given the different size of FS sectors in each MS. The ESAs need more time to develop technical binding standards etc – it's a grossly unfair part of the co-decision process that they often have very short deadlines imposed on them.

- There was some strong enthusiasm for banking union, although less about accelerating the SRM; the decks needed to be cleaned before doing the SRM.

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

- Participants thought that the level of UK influence is generally strong, with the exception of the recent question of remuneration in the CRDIV package. Sharon Bowles, chaired of the ECON committee, was complemented and considered someone who it was possible to have an exchange with. While this is good for UK stakeholders, sources of influence are quite random. The nationalities of chairpersons for working groups and committees appears at times to be crucial to the outcome, resulting in "willy-nilly" lobbying from stakeholders sharing a nationality with the chairperson.

- There was an observation from participants that while the place of the UK should be at the heart of Europe, there is often a UK view that underestimates the level of UK influence. UK views are respected because they have sensible views, and they should have more involvement in shaping regulations.

- Some members expressed an opinion that UK had done itself a significant disservice in reducing its level of influence in the last few years. The UK doesn't have as much influence as it used to be – at one point it was far more dominant. This was partly due to: the financial crisis exposing weaknesses in Anglo-Saxon model; the anti-free market lobby; the view from Europe that the Tory party had been following more extreme elements, including calls for a referendum; and the withdrawal of MEPs from the EPP. The remuneration element of CRD4 only went through because of the perceived lack of UK commitment to Europe – that would never have happened prior to the crisis. As a result of the above, the UK has lost its dominant voice.