The voice of banking & financial services

Rt. Hon. George Osborne MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
Westminster
London
SW1A 2HQ

16th January 2014

Dear Chancellor,

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

This is the British Bankers' Association's ('BBA') response to HM Treasury's 'Balance of Competences' review in relation to financial services and the free movement of capital[1]. The BBA's membership includes 240 organisations, of which more than 170 are banks and 70 are providers of professional services. Our member banks make up the world's largest international banking cluster, operating 150 million accounts for UK customers and contributing over £50 billion annually to UK economic growth. The opportunity to provide our views is welcome.

In summary, our response makes the following points:

- The Single Market for financial services is a significant factor in the success of the UK as a financial centre and therefore of considerable value to the UK economy.
- It is in the UK's interest to promote reforms to complete the Single Market for wholesale financial services, including the creation of a single supervisory culture and Single Rule Book. Not least given the reliance which is placed on home-country authorisation of European institutions undertaking activities in London and the critical nature of this in providing the cluster effect which reinforces the UK's position as a global financial centre.
- Wholesale markets are global and the UK has a clear interest in working through the European Union ('EU') to seek international standards which provide a level playing field for EU headquartered institutions. The EU also enhances the ability of the UK to achieve beneficial agreements with Third Countries that facilitate the development of global markets and effective regulatory standards.
- EU action, particularly in the area of retail financial services, should be governed by a rigorous assessment of subsidiarity and proportionality with action only being taken where the benefits can be clearly demonstrated.
- The UK retains a significant degree of influence in the development of financial services policy both within Europe and internationally, making what is agreed more likely to be informed and appropriate. The move towards a Banking Union to complement Economic and Monetary Union is an important (and welcome) development but reinforces the need for the UK to engage effectively in European discussions. The European Banking Authority ('EBA') should be seen as a key ally in protecting the Single Market from protectionist interests and the UK should therefore champion its role and promote enhancements to the European policy-making process to deliver better quality outcomes.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251514/PU1568_BoC_FSFMC_CfE_proof4.pdf

British Bankers' Association
Pinners Hall
105-108 Old Broad Street
London
EC2N 1EX
T +44 (0)20 7216 8800
F +44 (0)20 7216 8811
E info@bba.org.uk
www.bba.org.uk

Our responses to the questions posed in the call for evidence are enclosed. Please do not hesitate to contact me should you wish to discuss any of the points raised in further detail.

Yours sincerely,

Anthony Browne
Chief Executive

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

– Observations from the British Bankers' Association –

Introduction

The introduction to the paper provides a useful summary of the contribution the financial services sector makes to the UK economy and the degree to which this activity is linked to the EU: indeed, £15.2 billion of the £46.3 billion trade surplus generated by the sector arises from trade with other Member States. In this context, the distribution of competences between the UK and Europe and the functioning of the Single Market are matters of significant importance to the members of the BBA, although the importance is somewhat correlated with the business model of individual institutions. As our response demonstrates, it is very important for the providers of wholesale financial services to operate in an environment where there are consistent rules. Whether banks' business models are more orientated to retail or wholesale markets; all are affected by, and therefore highly attentive to, the development of the balance of responsibilities between the UK and EU and how this settlement shapes the market.

As is noted in Chapter 2, the Single Market in financial services is complex and subject to radical change in response to the financial crisis, following a sustained period during which the primary objective was to remove obstacles to the free movement of services. Perhaps more than in any other policy sphere, the mapping of the existing and still evolving proposed allocation of competences between the EU and Member States is therefore of considerable importance. Before responding to the questions identified in the call for evidence, the BBA response therefore considers:

1. The Treaty and legal framework governing the competences;
2. How the competences are exercised; and
3. Whether changes are required to the existing settlement in light of the evolution of the Single Market.

The Treaty and legal framework

The call for evidence provides a good discussion of the distribution of the competences and their legal underpinning. The BBA recognises that the development of a Single Market requires 'top-down' action to drive it but that this is governed by the application of the principle of subsidiarity. The BBA's assessment is that there is a marked difference between the characteristics of the markets for wholesale and retail financial services and therefore the allocation of the competences to legislate in these areas should differ. Wholesale markets are by their nature cross-border and thus require consistent rules for the conduct of business whereas retail markets are characterised by consumers with a home-country bias and are subject to distinct cultural conditions and policy choices. The case for action to drive consistent prudential standards is clearly demonstrated by the financial crisis which highlighted how the use of national discretions in prudential regulation can act as a source of financial instability. For this reason, the BBA continues to support the development of the European Supervisory Authorities ('ESAs') and their mandates to develop a Single Rule Book and converge supervisory practices across the Single Market. The creation of the ESAs, however, has highlighted the importance of establishing an appropriate legal base and the need for legislation to be legally sound, based on a clear and accepted understanding of the Treaty parameters. In this context, the BBA is supportive of the current UK challenges before the Court of Justice of the European Union ('CJEU') which seek to resolve these issues, including the interpretation of *Meroni*.

How are the competences exercised?

Whilst we therefore believe the allocation of competences to be broadly appropriate, there is evidence that the competences are not always exercised consistently. We share the EU's

commitment to raising standards and helping customers, however markets for retail financial services are at different stages of their development across Member States. This divergence makes the achievement of consistent European standards challenging. Furthermore, it is not always clear that EU intervention in retail markets is fully justified by the principles of proportionality or subsidiarity or on the grounds of cost-benefit analysis. Our response highlights the Consumer Credit Directive 2008 and Data Protection Regulation as examples where this is the case and how local cultural preferences can justify different treatments.

In terms of UK engagement in European policy-making, we note that the UK's influence has decreased as a result of the expansion of the Union (as the voting modalities have evolved to reflect a larger membership). Nevertheless the UK retains the ability to shape negotiations and remains a key source of technical expertise for financial services. Given the importance of the Single Market to the UK financial services industry and the UK economy, UK authorities must ensure that this continues to be the case. It should also be recalled that much EU legislation implements standards agreed by the UK through the international fora, such as the Basel Committee on Banking Supervision, where the UK remains a leading voice. That being said, the significance of financial services to the UK economy and the importance of access to the Single Market calls for the UK authorities to devote greater resource and expertise to engaging in the European process to deliver reforms and desired policy outputs from within. For this reason, we note with concern that there has been a marked reduction in the relative proportion of UK nationals serving in the European institutions and believe there is a strong case for looking to address this imbalance.

How to respond to the evolution of the Single Market?

The European policy making process has come under tremendous strain in the wake of the financial crisis. Indeed, the comments below identify the challenges which have flowed from the volume of legislation and the tensions which have arisen from the choices made between Directive and Regulation. Our response sets out a number of steps we suggest could be taken to enhance the transparency and effectiveness of this policy-making process. These include in particular the functioning of the trilogue process and the approach to the assessment of access by institutions domiciled in Third Countries. There must, however, also be a focus on the balance between measures to promote financial stability and those related to competitiveness and growth. The balance has rightly been weighted towards the former in the aftermath of the crisis but the EU must now be encouraged to focus on the latter to keep EU markets and firms globally competitive and deliver long-term growth.

The development of the Banking Union poses a number of questions for the UK. The BBA supports the objectives of establishing Banking Union but nevertheless we consider it important to remain alive to the potential for this to alter the way the Single Market for wholesale financial services operates. For this reason, it is vital that the European Commission acts to protect the Single Market and the freedoms of movement and establishment across all 28 Member States. The BBA believes that the EBA will have an important role in this regard and it is therefore to be welcomed that the UK has secured safeguards to govern its operating procedures. On its own, however, this may be insufficient to prevent the emergence of dual markets. Our response therefore identifies additional measures that could be taken to prevent the interests of one or more Member States harming the Single Market. By way of example we highlight the need to safeguard the allocation of tasks between the EBA and European Securities and Markets Authority ('ESMA'). It is encouraging that the Chairman of the EBA has spoken publicly about the role the EBA can play in safeguarding the Single Market[2]. It is in the UK's interest to support such initiatives and to view the development of the Single Market as being in the UK's economic interest. Fundamentally, however, the UK will need to remain vigilant and challenge inappropriate steps which could impinge the Single Market – including through legal avenues where necessary.

[2] Enria, A, *'The Single Market after the Banking Union'*: 18th November 2013

Detailed comments

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?**

Before answering the question, it is useful to recall our understanding of the principles of subsidiarity and proportionality and how they apply in this context. As the call for evidence notes, the principle of subsidiarity limits the ability of the EU to act in an area where it does not have an exclusive competence to circumstances where it is better placed than Member States to do so. In the context of the Single Market, the principle relates to the location at which rules are formulated and set and how they are operated and enforced. The principle of proportionality limits EU action to what is necessary to achieve the objectives of the EU Treaties. In the context of the Single Market, this relates to the intensity to which rules are applied and the degree to which this varies to accommodate differences in size and complexity of firms.

The members of the BBA are greatly affected by the EU rules on financial services. These impacts arise from measures to:

- deliver consistent rules to govern the operation of markets for wholesale financial services;
- open and secure markets for retail financial services; and
- implement necessary prudential and market reforms in response to the financial crisis.

These are addressed in turn below.

Wholesale financial services

The members of the BBA believe the Single Market for wholesale financial services to be a key factor in the attractiveness of the UK as a global financial centre and a significant asset for the EU as a whole. The UK is responsible for a 36% share of the Single Market in wholesale financial services[3] but significantly more of certain markets (for example foreign exchange and OTC interest rate derivatives trading[4]). The success of the UK as a global financial centre is highly correlated with the development of the Single Market and therefore we firmly believe that its further development is in the economic interest of the UK, consumers and banking industry. For example, between 2001 and 2013 the share of the interest rate OTC market has increased from 35% to 49%, the share of the Forex market from 33% to 41% and hedge fund assets have doubled to 18%[5].

The BBA recognises that a Single Market requires coordinated regulation and was therefore supportive of the goals of the Financial Services Action Plan and the notion that a Single Market requires top-down rules to help it develop. As the call for evidence notes, progress has depended to a large extent on how national competent authorities have given effect to EU-level rules. Despite efforts undertaken by bodies such as the Committee of European Banking Supervisors and the EBA, rules have been implemented differently across Member States as a result of national discretions, different interpretations, 'goldplating' and outright failures to transpose legislation effectively or on time. By way of example, Directive 2008/48/EC 'CRD II' which gave force to Basel II contained 142 national discretions.[6] This resulted in a Single Market with nominally consistent rules but considerable divergences in practice which went beyond what was necessary to accommodate legitimate differences in business structure or activity which could be justified by proportionality. For this reason the members of the BBA recognised that there was a case under the principle of

[3] Graph 4: http://www.openeurope.org.uk/Content/Documents/Pdfs/continentalshift.pdf
[4] REF
[5] Nixon, J, *'The economics of EU membership'*: (TheCityUK)
[6] A summary of how these discretions were exercised can be accessed at:
http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/options-and-national-discretions

subsidiarity for greater action at EU level and therefore supported efforts to drive convergence of supervisory practice through the development of a Single Rule Book and the creation of the ESAs. Although well underway this work is incomplete and is dependent upon Member States ensuring faithful implementation of EU legislation through timely and comprehensive transposition and the appropriate monitoring (and challenge where necessary) of this by the relevant authorities.

Retail financial services

Our strong support for top-down rules to promote the development of a wholesale Single Market and a prudential Single Rule Book contrasts with our position in relation to the market for retail financial services. With regard to the latter, we question whether EU-level action is always fully justified by the principle of subsidiarity or on the grounds of cost-benefit analysis. There is a clear difference between the two markets. Wholesale markets by their nature are cross-border in that there are fewer participants and a need to search for liquidity outside domestic markets. In contrast, retail markets are less concentrated, characterised by consumers with a home-country bias and subject to distinct cultural traditions and public policy choices (an issue discussed further in response to question 6). Retail markets are also at very different stages of maturity across Member States.

The Consumer Credit Directive ('CCD'), which came into force in 2008, highlights the diminishing value of higher levels of harmonisation in the absence of a clear demand or objective to raise standards, where EU level action simply facilitates or re-states existing Member State provisions. The CCD sought to facilitate the development of cross-border consumer credit services by harmonising relevant national rules and regulations within a framework which permitted only minimum flexibility for Member States. Although this achieved a degree of consistency, there remain a number of important differences in the rules governing consumer credit across the EU. For example, Article 14 of the Directive permits a borrower to withdraw from an agreement within 14 days following conclusion. This has been implemented differently in key Member States:

- in the UK, section 66A of the Consumer Credit Act faithfully implements this part of the Directive;
- in France, the law goes further to prohibit the transfer of funds to the borrower for the first seven days; and
- in Germany, the law has been implemented but legal custom has developed to rely on the use of optional industry forms and in some cases the right of withdrawal has been extended to one month.

Responding to the financial crisis

As the paper notes, the financial crisis led to a shift at EU level from a focus on the above issues to an agenda driven by concerns over financial stability and the need to provide consumer protection. The result has been 40 legislative initiatives which have driven regulation itself to the top of the list of the most important challenges facing the banking industry. The initiatives can be sub-divided into three categories: those giving legal force to G20 commitments; those to develop the Single Market; and those to establish Banking Union[7]. Of the first, it must be emphasised that the majority implement international commitments to which the UK is a signatory. For example, in recent months the EU has provided the legislative vehicle through which the UK's commitments in respect of the following key aspects of the G20 agreements are being implemented:

- Basel III – Capital Requirements Directive IV & Capital Requirements Regulation ('CRD IV' & 'CRR')
- FSB Key Attributes for Resolution Regimes – Bank Recovery and Resolution Directive ('BRRD')
- Central clearing of derivatives – European Market Infrastructure Regulations ('EMIR')

[7] http://ec.europa.eu/internal_market/publications/docs/financial-reform-for-growth_en.pdf

That said, delivery of these priority files has been hindered by the legislative time dedicated to important initiatives such as Banking Union as well as those on short-selling or Alternative Investment Funds where the case for immediate action is less clear.

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 enquires?

As explained above, a distinction should be drawn between EU action to foster the development of the Single Market for wholesale financial services and retail markets where there is a less obvious case for action to be taken at a level above Member States.

In terms of the former, whilst legislation is important it is the implementation of rules where there is a need for further EU action. Greater consistency in the implementation of rules would benefit the UK directly as a host country for European banks undertaking activities under the Passport regime and would provide the industry with a level playing field. This requires the development of a Single Supervisory Handbook to promote a single supervisory culture and to foster the confidence necessary to ease existing tensions between home and host competent authorities. This can be supported by the role the ESAs play in monitoring national implementation. We draw particular attention to the peer review process. This has promise but should be enhanced by, for example:

- ensuring reviews take place in a timely manner;
- requiring the Review Panel conducting the exercise to engage formally with the industry and other market participants both by pre-consulting on the areas to be examined and in seeking input to the review;
- linking the recommendations made following the review to robust timelines to enable the Supervisory Board to monitor progress;
- publishing the full report and not just the main outcomes as is currently the case; and
- mandating the ESAs to publish an annual status report identifying implementation issues requiring resolution within the following 12 months.

Furthermore, the UK should use its influence to promote the coordination of EU legislation with measures agreed through the international standard setters and G20. Doing so will ensure that the cross-border (extra EU) international activity of the many wholesale businesses in the UK takes place on a level playing field with firms based in Third Countries. It must also be recognised that membership of the EU enhances the ability of the UK to leverage its influence in negotiations with non-EU countries or in the international fora. For example, the response to the financial crisis has given rise to a number of examples of potentially disadvantageous extraterritorial application of rules. The European Commission has been in a strong position to negotiate with Third Country jurisdictions, notably the US, in these cases given the size and scale of the European market. A good example of this in practice relates to the OTC derivatives markets where the European Commission has negotiated a path forward with the US Commodities Futures Trading Commission to smooth the application of new rules to the cross-border derivatives markets. A further example relates to trade: the current Transatlantic Trade and Investment Partnership negotiations between the EU and US is an example of where the UK is likely to achieve a more advantageous outcome than via bilateral negotiation with the US (even if that were possible).

In terms of non-legislative action, we note that ‘best practice' and voluntary codes can often develop at a faster pace than EU-wide legislation, and therefore achieve the desired outcome more quickly. For example, the UK Corporate Governance code operates on a ‘comply or explain’ basis and acted as a model for some of the governance provisions recently agreed under CRD IV e.g. separating the roles of Chairman and CEO. Other voluntary codes such as the ABI Principles of Remuneration are updated on an annual basis. The fact that voluntary codes can be regularly updated makes them potentially more responsive and better attuned to changing conditions and expectations. This also

avoids the need for prescriptive legislation in every area – to which it is in any case likely to be less well adapted. Outcomes can be monitored by the relevant ESA to identify areas where legislative action may be warranted by the Commission.

Intervention will have different purposes depending upon whether it is via legislative action or competition enquiry. Legislative action is forward looking, whilst competition enquiries (either under Article 101 and/or 102 of the Treaty for the European Union) will be backward looking, focusing on any historic anti-competitive behaviour. Sometimes however there will be a cause and effect, i.e. a competition investigation may uncover anti-competitive features of a particular market, which can be remedied by subsequent legislative action.

As an overarching point, we support greater efforts to promote competition and a level-playing field across the Single Market to enable wholesale and retail consumers to benefit from the most efficient supply of services. Recent efforts to promote competition within the EU have been infrequent and not hugely successful. For example, efforts to enhance the market for benchmarks within the ongoing review of MiFID have met with significant resistance from entrenched domestic lobbies.

As a final point, we note that there is an innate tension between the provision of sufficient information to help consumers to understand risks and protect themselves accordingly, whilst at the same time ensuring that any information provided is succinct enough to be accessible. Any tendency towards a more inclusive approach to reflect local issues can lead to consumers receiving more information than they might take on board, defeating the original objective. Further we observe that there is an increasing frustration amongst consumer advocates that extensive information provision serves less to help consumers, and more to defend firms from accusations of opacity.

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

Clearly, markets can benefit from oversight and rules. In this regard we note that the enforcement of competition policy by the European Commission has benefited European markets, including the UK by promoting choice for consumers. It can also be argued that the development of Banking Union, as an extension of Economic and Monetary Union, will promote financial stability.

At a more practical level, the wholesale Single Market is highly interconnected with large flows of cross-border business. The provision of cross-border services has been a significant driver of growth and competition – including the development of London as a global financial centre – as well as being of benefit to the UK more generally. The EU arrangements for mutual recognition and Passporting are central to this and distinguish the internal market from a customs union or trading bloc. The members of the BBA therefore see the concept of reliance on the authorisation of providers of services in a different Member State as a key benefit of the Single Market. This allows activity to take place in London through branches of institutions located in other Member States (permitting activities to be undertaken which require the full balance sheet of the firm and which would be uneconomic if conducted through a separately capitalised and authorised subsidiary)[8]. The arrangements also facilitate Third Country institutions to establish subsidiaries in the UK and to branch from this legal entity into other Member States, which is beneficial to the UK's wider economy. This combination of activities drives economies of scale and supports the UK's position as a leading financial services market and supports economic growth and competition. As noted in response to question 1, it is noteworthy that the UK share of global financial markets has increased substantially over the period in which the Single Market has evolved.

That being said, it is unarguable that the financial crisis demonstrated failings of regulation and supervision and the attendant consequence of this for financial stability across Member States. For example, in 2008 the Irish Government announced it would guarantee all liabilities of the Irish banks.

[8] Recent data shows that there were 106 banks incorporated in the EEA and operating in the UK. See http://www.fsa.gov.uk/static/pubs/list_banks/feb13.pdf

This led to significant distortion of the deposit market at a time of great funding market stress. This was a significant factor in the European Commission acting to 'restore confidence and proper functioning of the financial sector'[9], by accelerating steps to increase the portion of deposits protected by deposit guarantee schemes. The development of the European System of Financial Supervision is an important enhancement to the European architecture with the potential to limit such uncoordinated actions in future. It will also beneficially support the consistent implementation of EU rules which will promote a level playing field thus driving competition and growth and minimising the prospect of systemic risks developing. As noted elsewhere in this paper, there has been a significant regulatory response to the financial crisis which has included measures to strengthen financial institutions, the markets within which they operate and new protections and safeguards for the consumers of financial services.

After a period rightly focussed on financial stability, there is a clear need to consider the trade-off between stability and competition and how this is balanced to deliver growth. The EU must now focus its more of its attention on growth and we strongly encourage the UK to make this case.

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 European policy-making process has been under considerable strain during the response to the financial crisis due to the volume of legislation. The legislative process has also been significantly complicated by the expanded role for the European Parliament. The combination of the volume of change and complex process has inevitably resulted in examples of poor legislation and unrealistic timelines for action at Level 2 or implementation.

In terms of the EU policy process, we believe there are a number of steps that the UK could promote to deliver better quality and more consistent outcomes which have a rigorous grounding in the principle of good regulation and subsidiarity. The Level 1 process, for example, could be enhanced by:

- setting appropriate timeframes for negotiations;
- ensuring that the co-legislators have sufficient access to technical advice before and during the negotiation process – in particular the European Parliament should have the power to commission advice from the ESAs on technical matters;
- permitting the Jurists-Linguists to provide technical legal drafting advice at an earlier stage of the legislative process to mitigate the need for substantive changes to text post adoption which can reduce the clarity of the co-legislators' intent;
- setting standards for issues to be delegated to Level 2 to bring consistency to the areas addressed by the ESAs. This should include a requirement for the co-legislators to consult the relevant ESA ex ante on delegated acts and the wording of the remit given in each delegation. Doing so would ensure that political disagreements are not downwardly delegated to the technical level where ESAs do not have the mandate to find solutions and would also add discipline to ensure the delegation is sufficiently clear, precise and practical to implement; and
- ensuring robust, independent impact assessments are conducted for all proposals, including for proposals introduced during trilogue negotiations, where significant obligations can be imposed without prior impact assessment.

At Level 2, it is evident that the ESAs have been held back by unclear guidance at Level 1, inappropriate timetables for delivering technical standards, insufficient independence from the

[9] 'Commission sets out proposal to increase minimum protection for bank deposits to €100,000': http://europa.eu/rapid/press-release_IP-08-1508_en.htm?locale=fr

European Commission, inadequate resources and a lack of transparency and engagement with stakeholders. Steps to counter these issues, could include:

- setting deadlines for Level 2 standards not in absolute dates but as a drafting period which begins from the date at which the Level 1 text is published in the Official Journal. This period should be no less than 12 months post-adoption, to ensure appropriate consultation with industry;
- clarification regarding the respective remits and roles of the ESAs, the European Commission and the co-legislators;
- providing the ESAs with the resources necessary to fulfil their roles. This includes both funding and staffing arrangements, including consideration of the seniority of staff the ESAs are able to recruit;
- a reconstitution of the ESA consultative committees;
- consultations on technical standards should be subject to standard timetables to permit industry review. This reinforces the first point above that there must be a minimum drafting periods for the production of standards;
- ensuring Level 2 standards do not disproportionately impact any one Member State; and
- a greater focus on high-quality impact assessments.

Fundamentally, any assessment of the use of minimum and maximum harmonisation must focus on the underlying objective of the measure in question. Maximum harmonisation is justified where markets and consumers are cross-border and when differential rules would give rise to undesirable externalities. Minimum harmonisation is appropriate when supervisory judgement is required in the application of rules. The issues underlying current UK challenges before the CJEU are examples of where this balance has not been struck appropriately or where action is being taken at an inappropriate level – the application for the annulment of the EU Council Decision of 22nd January 2013, authorising enhanced cooperation in the area of the Financial Transaction Tax ('FTT') being a prime example. That being said, we note that the UK has successfully negotiated flexibility to meet its desired policy outcomes even within the constraints of Regulations – the Capital Requirements Regulation being a prime example.

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

As the call for evidence notes, there has been a shift in the EU's approach to Third Country access in the wake of the financial crisis. The result has been a less liberal approach than adopted in the past with the common EU approach based on the principles of equivalence and reciprocity. This has given rise to a number of instances of market uncertainty:

- EMIR Article 25 - which prohibits EU bank branches from clearing any product in central counterparties (CCPs) based outside the EU unless and until its home regulatory regime is assessed as "equivalent" by the European Commission and the CCP is recognised by ESMA;
- CRA Regulation - there was a drawn out and uncertain process for Third Country equivalence assessments and ESMA recognition of third country ratings produced outside the EU, before banks could rely on ratings from the biggest agencies for calculation of their capital requirements; and
- Financial Benchmarks Regulation proposal - as currently drafted, the Third Country provisions would effectively prohibit EU financial firms from offering investors an S&P 500 tracker fund.

Where the UK participates in negotiations on these legislative provisions it can make an important difference to the outcome, e.g. the progress made on MiFID II Third Country provisions compared to the original European Commission proposal.

That being said, the complexity of negotiating Third Country access issues has increased significantly as jurisdictions have responded to the demands of the financial crisis with domestic legislation to govern activities conducted through global markets. The scale of the EU Single Market endows the European authorities with significant leverage in such negotiations, particularly with the US. We recommend that to maximise this advantage the EU should rely on a Third Country's law in lieu of EU requirements when the regulatory outcomes achieved are broadly comparable but not necessarily identical. This is a matter of great importance not just for UK based banks but to all EU banks seeking to compete in the international financial market place.

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

The starting point must be to acknowledge that the market for retail banking services remains largely fragmented on national lines. This is unsurprising given the legal, political and societal differences between Member States. For example, the markets for consumer credit vary widely as shown below[10].

	France	Germany	UK
Credit cards per head	0.2	0.3	1.2
Savings rate	15.8%	10.6%	5.4%
Consumer credit market size (€bn)	140	250	300

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 full cost benefit and impact analysis.

The recast of the Insurance Mediation Directive (IMD2) is a good example of the unintended consequences that can affect some European legislation. IMD2 sought to ban product tying without recognising that properly regulated packaged bank accounts can benefit consumers. The European Commission sought to ban the practice in some Member States where the provision of certain banking facilities is conditional upon taking a separate product. This legislation would also apply however to UK packaged bank accounts where, as acknowledged by the FCA, it has been shown that these accounts can be beneficial to consumers as the cost of arranging separate policies or benefits might be greater than the monthly packaged account fee.

This problem is compounded when EU legislation is 'horizontal', i.e. not targeted specifically at a given market sector. The case study below on the proposed EU Data Protection Regulation provides a good example of this.

The proposed EU Data Protection Regulation

In January 2012, the European Commission proposed a comprehensive reform of the 1995 Data Protection Directive. The proposal, which is currently being considered by the European Parliament and EU Council, is highly prescriptive in nature, will have a significant impact on the way banks protect customers from financial crime and will impose very significant administrative burdens on both businesses and individuals.

Whilst recent texts published by the EU Council contain some improvements to the European Commission's original text, the text adopted by the responsible Committee at the European Parliament (LIBE), renders the changes proposed by the European Commission significantly worse for both businesses and consumers.

[10] Cited in *'Beyond Boundaries: how to drive regulatory coherence'*, (BBA): Autumn 2013

The key shortcomings could be summarised as:

- **Challenges to London as an International Financial Centre -** branches and subsidiaries of international banks based in the EU will be placed in a difficult situation as they will not be able to comply with requests, e.g. data requests from home supervisors, without risking breaching EU rules. Furthermore, the European Parliament text now explicitly states that when there are conflicting compliance requirements, EU law will take precedence. (Article 43a).
- **Inability to comply with global legal/regulatory obligations -** transfers of personal data to courts or regulators in Third Countries will require prior authorisation (from the ICO and potentially other EU Data Protection Authorities). This is unnecessary and would cause serious disruption and operational delay for businesses. There is no evidence that not seeking prior authorisation to date, when relying on a derogation, has caused any harm to individuals nor lead to unlawful processing in the past.
- **Restricting ability to making sensible business decisions through profiling customer data:** the banking industry is concerned that it will be unable to profile data for legitimate business reasons (such as assessing credit worthiness or potential fraud risk). Article 20 would impact existing activities that currently rely on legitimately given customer consent as the basis for processing. For example the rules on profiling should not prohibit nor restrict practices such as AML and sanctions screening, credit analysis or risk assessments as required under the EU Consumer Credit Directive and by banking supervisory law (Article 20).
- **Banks will be hindered in their ability to protect customers from financial crime –** both European Parliament and European Council drafts allow data processing only if there is a Member State or EU legal obligation to do so. FCA rules and regulations, as well as international standards (e.g. FATF) are not strictly Member State or EU legal obligations. This issue has not been resolved by the LIBE Amendments (Article 6).
- **Banks will have difficulty conducting credit checks –** related to the above issue around a legal obligation, banks will not have the legal grounds to pass customer data onto 3rd parties and so will be unable to use CRAs as they currently do. The consequential difficulty in conducting checks will impact on our members' ability to lend responsibly.
- **Deluging customers with notices** - many of the proposed requirements to notify customers, and the level of detailed required are unlikely to be of benefit, potentially leading to confusion and undue concern for customers. For example, notifying the customer of every Data Breach within 24 hours (72 in the LIBE Amendments), whether or not the customer data is at risk of misuse.

None of the above incompatibilities or issues may have been intended, but serve as a timely illustration of the complexities of international law-making, in particular regarding retail services. The breadth of businesses impacted by the legislation is simply too broad and diverse to allow for a single, comprehensive, one-size-fits-all legislative solution.

An additional factor to consider is the role of good practice guidance and opinions in the implementation of retail directives. For example, the Credit Agreements Relating to Residential Property Directive tasks the EBA with developing guidelines to support the implementation of provisions such as those relating to forbearance[11]. Whilst such guidelines may benefit consumers, they also have the potential to become de facto requirements with potentially differential impacts in different Member States where there may be justifiable differences in policy.

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?

11

http://www.eba.europa.eu/documents/10180/16100/EBA+Opinion+on+Good+Practices+for+Responsible+Mortgage+Lending.pdf

The shift towards regulation and supervision at the EU level has been most evident following the financial crisis. On balance, we believe the establishment of the ESAs to have been a beneficially important part of the European response to the financial crisis. This has, however, given rise to important legal questions on the basis and breadth of the ESAs' activities, as evidenced by the UK's challenge to Article 28 of the Short Selling Regulation and the more recent discussion of the proposed Single Resolution Mechanism.

Questions of legal basis notwithstanding, an assessment of the impact of the ESAs should be undertaken in recognition of the fact they were only established in 2011 and have been under tremendous strain to respond to the significant volume of technical legislation adopted during the period. As noted above, we believe there is a strong case for enhancing the role of the ESAs by involving them in discussions at an earlier stage and empowering them to deliver the coordination of consistent supervisory outcomes. This argument is bolstered by the move towards the development of Banking Union. It will be critical for the functioning of the Single Market that there is a strong and credible EBA acting in the interests of the Single Market as a whole. An often overlooked aspect of this is the relative roles of the EBA and ESMA. It is vital to ensure that there is a robust process at Level 1 to be followed when allocating activities which could conceivably be undertaken by either body.

As a final point, we note that the performance of the ESAs will be assessed by the European Commission by January 2014. Already published, the recent *'Review of the New European Supervision of Financial Supervision'* for the European Parliament's ECON committee, makes several noteworthy recommendations. These include: strengthening input from stakeholder groups; enhancing the predictability of regulatory work by publishing a calendar of consultations several months in advance; and the use of concept papers to improve the existing consultation process on possible technical standards.

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's (and all other Member States') influence on EU legislation has reduced following the expansion of the Union and amendment to the decision-making processes. The decisions taken on the UK MEP's participation in the European Parliament also continues to impact the ability of the UK to influence legislation in comparison to comparably sized Member States. That said, the UK maintains a reputation as a source of technical expertise and retains the ability to lead discussions. It should also be noted that much of the EU regulatory agenda has focussed on delivering commitments and standards agreed through the international fora. The UK also, and importantly, maintains a leading voice in these discussions and it can therefore be argued that the UK has materially shaped the parameters of debate before the EU implementation process begins and remains well placed to continue to shape EU policy making. For example, the UK holds leading positions in the Financial Stability Board, Basel Committee on Banking Supervision, IOSCO and the IASB.

For these reasons, it is debatable how different UK rules would be if they were purely a national competence. The UK has managed to secure important flexibility to apply EU rules in a way that fits UK market structures or priorities. By way of example, we highlight the definition of default under the CRR (which permits the UK to continue to follow the existing approach of 180 days). If the UK was to be solely responsible for financial services legislation then it is unlikely that the substance would differ greatly. It is, however, possible that there would be a difference in the timing of the implementation of international standards. Even in this regard, however, the UK has the option to front-run EU rules and has done so. An example would be the introduction of a statutory bail-in regime: the BRRD will introduce this for the EU by 1st January 2016 but the UK is nevertheless proceeding to adopt a regime on a faster timeline. Whilst not always the case, it must be noted that UK 'gold-plating' in terms of requirements or timelines can have a negative impact on the competitiveness of the UK. In this specific example, we note that the cost to the industry – through

higher funding costs for unsecured liabilities - of introducing bail-in on an earlier timeframe than the BRRD is estimated at between £75 and £220 million[12].
Fundamentally, the ability for the UK to influence EU legislation lies not just in the settlement of the balance of competences but in how those competences are exercised. We have been encouraged by the engagement of the UK authorities in recent European negotiations and note there is evidence that the UK continues to be viewed as a source of expertise on financial services. That being said, given the significance of financial services to the UK and the degree to which legislation is set at an EU level, there is an overwhelming case for the UK to devote further resource and expertise to engaging in the European process to increase the level of influence in priority areas. In particular, we believe there should be a significant increase in the number of UK officials appointed to the European institutions – particularly the European Commission and ESAs.

It is disappointing that the UK remains significantly under-represented among the staff of the EU institutions (and that representation continues to shrink). Indeed, the number of UK nationals on the staff of the European Commission has fallen by 24% in seven years and now stands at just 4.6% of the total (against 9.7% for France) when the UK accounts for 12.5% of the EU population. The UK's share of administrator-grade staff in the European Parliament has fallen from 6.2% to 5.8% since 2010 (the share for France has risen from 7.5% to 8.6%). The UK's share of administrator-grade staff in the General Secretariat of the Council has also fallen in the same period from 4.8% to 4.3%[13]. As noted by the Foreign Affairs Committee, the approaching retirement of the cohort of UK nationals holding senior posts within the European Commission is particularly concerning given the reduction in the number of suitably qualified officials available to replace them over the medium term. To remedy this, experience in one of the international or European institutions should become a key factor in the career paths of senior officials, as it is in countries like France.

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?

As already noted, the EU policy making process is complex and there is often little transparency or predictability around how decisions are made during the trilogue process. The most notable example of this relates to Articles 92 - 95 of the Capital Requirements Directive, introduced at a late stage in the negotiation process, without the justification of a robust evidence base and regard for the international competitiveness of European headquartered institutions.

The consultation stage of the policy making process, however, is transparent and provides good opportunities for interested parties to engage with policy makers (a principle that must not be undermined or constrained). We welcome the use of cost benefit analysis at this point in the process but are concerned that proposals can be subject to material change during their scrutiny by the EU Council and European Parliament with no requirement for further analysis of the impact. That being said, the emergence of a requirement for a cost benefit analysis within the text of the Payment Accounts Directive, rather than as a necessary preliminary to the publication of the draft directive, is an illustration that improvements can be made.

Impact assessments form a critical part of ensuring an effective and accountable EU policy-making process. A thorough impact assessment should contain an in depth cost-benefit analysis, and should help reduce the risk of unintended consequences. The rigour of the impact assessment is likely to be enhanced if it is undertaken by an organisation that is separate from the institution that proposes the legislation - the Council of the EU and European Parliament might consider whether they should conduct their own studies in this context. The example of the European Commission's recent Financial Transactions Tax impact assessment is one that would have benefited from this more independent approach.

[12] HM Treasury Impact Assessment: 14th January 2014
[13] *The UK staff presence in the EU institutions* (HC 219): 25 June 2013

Furthermore, European legislation would be more effective if greater use were made of review clauses in legislation to establish whether or not the initial objectives of a proposal had been met and whether the costs justify the benefits. Overall, we feel that consistent application of standards similar to those codified by the Hampton Principles and prescribed in the Financial Services and Markets Act would better focus legislation and ensure the rigorous application of the principle of subsidiarity. In terms of the latter, we support the enhanced subsidiarity and proportionality protocol under the Lisbon Treaty, which provides a role for national Parliaments to challenge legislative proposals. It is encouraging that there are signs of national Parliaments beginning to make use of this provision but thought should be given to how the effectiveness of this process might be enhanced to improve the democratic accountability of the policy-making process. We note the Dutch Government has been vocal on the importance of subsidiarity and has indicated it could be a focus for their Presidency of the EU Council in 2016.

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 is fundamental to a Single Market for financial services. We note that the cost of capital is a proxy for the efficiency of financial markets. A recent report commissioned from London Economics by the European Commission[14], which looked exclusively at the integration of bond and equity markets, calculated that the creation of a single EU financial services market would, by itself, lead to significant economic benefits. The report suggested that full integration of EU financial markets would reduce the real cost of capital by 50 basis points for EU businesses, and result in a one off 1.1 per cent increase in GDP, or €130 billion in 2002 prices, over ten years for the EU as a whole.

The most significant change to the ability of Member States to influence capital flows and national policy objective relates to the macro-prudential arrangements provided via the CRR and overseen by the ESRB and EU Council. That being said, we note the proposed power for the EU Council to block a measure proposed by a Member State is intended to be used infrequently. It is also notable that the framework includes a number of important reciprocity provisions – as with the Counter-Cyclical Capital Buffer – to enhance the effectiveness of national measures by limiting the 'leakage' of macro-prudential policy across borders.

As a final point, we note that Cyprus implemented capital controls in response to its banking crisis in summer 2013. To preserve the functioning of the Single Market, it is vital that such measures remain rare and the current restrictions are removed as quickly as is possible.

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?

Although it is unlikely the UK will join the Banking Union, the BBA recognises that it is a fundamental extension of the concept of EMU. It is hoped that it will bring stability and prosperity to these key European markets for UK goods and services. It is evident, however, that Banking Union will fundamentally alter the way the EU operates and there is a risk that there will be a divergence of interests between the 'ins' and the 'outs' and a consequential reduction in the UK's influence or attractiveness for Eurozone business. It is vital that the European Commission acts to protect the Single Market to ensure the Eurozone does not become a market within a market. The safeguards negotiated to the EBA decision-making process are very important in this regard but must be complemented by an increase in UK engagement in the policy-making process to ensure UK influence is maintained.

[14] Quantification of the macro-economic impact of integration of EU Financial Markets - November 2002. Study by London Economics, in association with PricewaterhouseCoopers and Oxford Economic Forecasting.

It is particularly important to ensure that enhanced cooperation procedures are not used in a way that damages the Single Market and the rights of Member States under Articles 332 and 327 TFEU. The FTT is an example where these criteria have not been respected and the UK is fully justified in challenging the decision.

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

It is important to stress that for legislation to be effective it must first be legally sound. Stretching Treaty provisions to accommodate desired political outcomes results in complexity and increases the likelihood of legal challenges and uncertainty.

We would add that good communication and ultimately better coordination between national and supranational regulators and legislators is essential. Whilst we recognise that national regulators will sometimes need to 'front-run' action at the EU level, we would urge coordination where ever this is possible.