

**London Investment Banking Association
International Capital Market Association
ACI The Financial Markets Association
Asociación de Mercados Financieros
Bankers and Securities Dealers Association of Iceland
Bond Market Association
Danish Securities Dealers Association
Finnish Association of Securities Dealers
Norwegian Securities Dealers Association
Swedish Securities Dealers Association**

**COMMISSION GREEN PAPER ON FINANCIAL SERVICES POLICY (2005-2010)
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1 KEY POLITICAL ORIENTATION

The Commission asks:
Whether we agree with the overall objectives for the Commission's policy over the next 5 years;
Whether we agree with the key political orientation described.

We **strongly support the overall objectives and stance** of the paper, which has a welcome emphasis on:

- (a) **implementing and enforcing** rather than legislating;
- (b) **better regulation** disciplines (evidence-based, cost-benefit analysis, input from market experts);
- (c) commitment to **act only where European initiatives bring clear economic benefits** to industry, markets and consumers;
- (d) commitment to evaluate and, where necessary, **to reduce and simplify or remove existing legislation**;
- (e) **support for the Lamfalussy approach and structures**, and the importance of working together to make sure that the spirit and intention of the Lamfalussy report are fully implemented in practice;
- (f) commitment to the **economic and public policy rationale** of financial services regulation and legislation (Annex 1, part 1), which is directly in line with the Lamfalussy Report's focus on 'overarching principles' of regulation;
- (g) commitment to **convergence of supervisory practice**: "tools underpinning supervisory cooperation ... must .. be fully compatible with binding European legislation and must not prejudice the political process." (Annex I, page 11);
- (h) importance of ensuring proper respect for **political accountability and the rights of EU institutions, while also ensuring that technical decisions are right, and taking account of international agreements**;
- (i) **consensus approach**;
- (j) making sure that the **new legal framework that has been recently delivered is given time to function well**;
- (k) Member States avoiding **"goldplating"**;

- (l) promoting **international competitiveness of EU markets**;
- (m) use of **practitioners to signal anti-competitive behaviour and legislation that needs to be repealed**.

We have the following further observations on this section of the Commission's paper:

The Commission is right that decision making and regulatory structures have become more rational and efficient as a result of the Lamfalussy process. However, it is important not to be complacent. Difficulties have arisen as a result of shortcomings in the way the Lamfalussy Report has been implemented. It is vital, through the work of the Inter-Institutional Monitoring Group and others, **to remedy these defects and continue to improve the implementation and application of the Lamfalussy approach**.

In particular, and consistently with the Commission's focus on –

- i. introducing a “better regulation” approach to all stages and all participants in the regulatory process, using adequate, proportionate, evidence-based, market failure analysis, regulatory impact analysis, and cost/benefit analysis;
- ii. seeking as much consensus as possible, while recognising that regulatory approaches may need to differ in different markets;
- iii. keeping in view the key public policy objective of deep, liquid, dynamic financial markets that ensure the efficient allocation and provision of capital and services throughout the European economy by maximising investor returns and minimising cost of capital, laying the foundation for higher long term growth and job creation;

- we think that it is essential to follow the recommendation of the Lamfalussy Committee that the **European institutions should agree overarching principles of regulation**. The fundamental analysis of the objectives of financial services regulation on page 2 of Annex 1 Part 1 would form a good starting point to develop such principles. They would ensure that European policy, and its implementation:

- (a) has a **consistent and coherent public interest rationale**
- (b) works with the market mechanism, **intervenes only where the market fails**, and then adopts the most cost efficient option to address the failure
- (c) properly **reconciles competing interests**
- (d) **adapts quickly and flexibly** when change is needed.

Overarching principles should be used to guide several aspects of the Commission's assessment of financial services regulation over the next few years, including:

- (a) **Reassessing existing legislation**, in particular to evaluate (1) whether regulation of interprofessional dealings and financial services provided to professional clients is overburdened by protections designed for, and more suited to, retail clients, and (2) whether regulation that was drafted with particular market models (e.g. equity markets) in mind has had a negative impact on other types of markets;
- (b) **Coordination at Level 3, and enforcement at Level 4**, of Member States' implementation of existing legislation.
- (c) Assessing **whether retail investors' use of cross-border financial services justifies further work on integrating regulation of retail markets**;
- (d) Identifying **whether or not further initiatives are needed**, for example on risk capital markets, credit-rating agencies, or clearing and settlement.

An essential part of evidence-based policy-making is the **gathering of evidence** as to the existence or otherwise of a problem, and as to the mechanisms which markets (in a voluntary or self-regulatory or co-regulatory capacity) or regulators across Europe currently use in response to it. Too often in the past policy has not been developed well because it has been developed in the abstract, without reference to, or even sometimes full knowledge of, existing market structures and methods of regulation.

The Commission should also as far as possible **apply better regulation principles to the completion of outstanding FSAP legislation**, such as the Level 2 measures under MIFID.

The Commission is right to stress that the **European Parliament and Council should properly justify amendments to Commission Proposals**, and to raise concerns about **Member States' 'gold-plating'** legislation when they implement it. Significant change to Proposals or measures which have been developed in accordance with better regulation principles and agreed overarching principles of regulation should be subject to similar disciplines. But it will also be **important to ensure that the justification required is proportionate to the circumstances**. For example, when change is clearly needed to bring a Proposal or a Member State's implementation into line with agreed overarching principles of regulation, it would be disproportionate to require a full consultation and cost-benefit analysis. Agreed overarching principles of regulation should help to identify when full better regulation disciplines are appropriate and when they are not needed or inappropriate. It is also important to emphasise that the European Parliament already has a transparent process that allows public scrutiny of the evolution and justification of its positions.

The Commission is right to propose to modify or repeal measures that are not delivering the intended benefits. We have identified in the Annex to this response some measures which at present may fit into this category. The multi-annual evaluation programme referred to in Commissioner McCreevy's 18th July 2005 speech is most welcome. The Commission should publish more detailed proposals on the **procedures and resources it will use to identify legislation that is not functional or outdated**. It should actively review legislation, in consultation with market participants, but not relying solely on them to identify bad or outdated measures.

We support the drive towards European **supervisory convergence**, and we comment in more detail under Section 3.2 below. Continued and enhanced cooperation between the competent authorities needs to be based on the existing CEBS and CESR structures, and national accountability of competent authorities. Enhanced co-operation and in some cases delegation of specified tasks and responsibilities to the most competent authorities among the present Member States will provide the necessary support for supervisory convergence by building regulators' trust in each others' work, without the need for alternative structures. Democratic accountability to the European Parliament is important to ensure consistency with relevant legislation, but should not extend to the day to day process of supervisory convergence.

We do not fully understand what the Commission means by '**synergies with different policy areas**'. It will be important for any such development to be consistent with overarching principles of regulation. For example, the Commission should make more **use of competition policy to remove barriers** to the single market if enforcement of financial services policy is ineffective. The Commission would like market participants to play a more effective and active role in consistently signalling clear infringements or anti-competitive behaviour. Clearly it will be helpful for the Commission to encourage more whistleblowers, but the

Commission should also itself take responsibility for identifying infringements and failures, and for creating a more favourable environment for market players to contribute to this work without adverse consequences. The Commission should commit itself, and the necessary staff, to seeking out and pursuing clear infringements or anti-competitive behaviour, developing mechanisms to enable it to receive and coordinate reports of such behaviour from market participants, and enabling market participants to provide such information without the risk of retaliation by the authorities concerned. Additionally, the Commission should bear in mind the competitive impact of proposed legislation.

We welcome the Commission's commitment to apply better regulation principles to policy development relating to **corporate governance, company law reform, accounting, and statutory auditing**. It is particularly important to adopt a right approach to the development and application of international accounting standards. Public oversight of global standard setting bodies such as IASB needs to be fully effective. But it is also vital to recognise the improvements that such bodies have made to their governance arrangements and processes, and not to allow political pressures to undermine the process of reaching the right technical solutions.

The Commission rightly identifies the importance of **considering EU legislation and regulation in a global context**. We support a better EU-US dialogue, and similar dialogues with other significant global markets, to avoid unnecessary burdens on either side due to excessive legislative measures such as the requirements of the Sarbanes-Oxley Act on overseas companies not listed in the US. It is important to **ensure that these dialogues are open and accessible to all relevant parties**. It is also essential to ensure that the EU's ability to influence the regulatory framework of the emerging global financial market is supported by **EU legislation and regulation which themselves promote and maintain EU markets' international competitiveness and attractiveness to global investors and issuers**. We comment further on these issues under Section 3.4 below.

2. BETTER REGULATION, TRANSPOSITION, ENFORCEMENT AND CONTINUOUS EVALUATION

The Commission asks:
Whether we agree with the priority measures identified;
Which additional measures should be taken to foster consistent application and enforcement of European legislation.

We broadly agree with the priorities that the Commission lists.

It is not apparent from the Green Paper precisely what the Commission envisages by 'simplifying and consolidating all relevant (European and national) financial services rules' and the reference in Annex I, Section II to a feasibility study to 'find out if over time all rules (at European, and also national level) can be fused into one body of consistent law'. Commissioner McCreevy provided helpful clarification in his 18th July 2005 speech. The task of **collecting together in a coherent and consistent format the rules contained in FSAP and other relevant EU measures, removing conflicts, overlaps, duplication, and ambiguities**, is an important one. It should be linked to the evaluation programme to identify legislation which is outdated or redundant. We welcome the Commissioner's assurance that there is no intention to try to harmonise national rule books. It is of course important not to

disturb the accepted Level 1 and 2 legislative process and Level 3 coordination of regulators' approach.

As discussed under Section 1 above, the **first priority** in the Commission's list is not so much a priority for specific action, but **a principle that should underpin all the Commission's actions, whether initiating, implementing, enforcing, reviewing, or repealing**. It should embrace not only open and transparent policy-making and consultation, but also the other facets of the better regulation approach discussed under Section 1 above, including rigorous assessment by reference to overarching principles of regulation.

Of the **remaining priorities** in the Commission's list, it is important to consider their order in the light of the natural sequence of events, which we would expect to be:

1. Working with Member States to improve transposition and to ensure consistent implementation;
2. Ensuring proper implementation and enforcement, if needed, by infringement procedures building on existing legislation and case law;
3. Converging standards and practices at supervisory level, while respecting political accountability and current institutional boundaries.

The evaluation of whether directives and regulations are delivering the expected economic benefits, and repealing measures that do not pass this test, should start now for existing legislation, and continue with new FSAP measures as items 1 to 3 above take effect. It is important not to put ensuring proper implementation and enforcement at the bottom of the Commission's order of priorities.

As regards the evaluation of directives in force, it is important to specify unambiguously the **relationship between internal review clauses and reviews which take place as part of a broader, external reevaluation** such as the Commission's planned 2006-2008 evaluation. If, for example, a new piece of legislation is not eligible to be examined within the context of a general review, internal provisions to keep it fully responsive to market needs will be vital. But internal review clauses should not override a decision in the light of experience of applying legislation that the legislation itself should be amended or repealed. As regards the Commission's statement on page 8 of Annex 1 Section II that not all measures need to deliver direct economic benefits, it is however possible to measure other benefits, such as consumer protection and strengthening financial stability, by reference to their indirect economic effects. If consumer protection measures do not result in better overall investment returns for consumers, or if financial stability measures do not result in better overall returns for investors or lower overall cost of capital for issuers, they should be amended or repealed. We have identified in the Annex some measures which the Commission could repeal now or in the near future.

It is also important to be clear that **it is for the Level 3 structures, not the Commission, to deliver supervisory convergence**.

Other priorities include:

- (a) Solving **implementation timetable problems**, and reversing the deterioration in Member States' compliance with implementation deadlines referred to on page 6 of Annex I Section II, by adopting a less rigid approach to setting deadlines:

- i. as a general principle implementation dates for legislation should be measured as a certain period after the last Level 2 measure has been implemented.
 - ii. Implementation deadlines should also be set in an evidence-based way, using better regulation analysis to determine the amount and timing of resources needed, in order to take account of technical and resource constraints both at the level of Member States and regulated entities.
- (b) Identifying measures to be taken to achieve **legal coherence and certainty in dealing with cross-border securities rights and transfers, and associated issues**, building on the work of the Commission's Legal Certainty Group, as set out on page 5 of Annex I Section II. We would be happy to discuss practical arrangements for taking this work forward with the Commission.

3. CONSOLIDATION OF FINANCIAL SERVICES LEGISLATION OVER THE 2005-2010 PERIOD

The Commission asks:

Whether we agree with the identified measures where the Commission might decide to take no action, or if there are other concrete areas where the Commission should not bring forward proposals presently in the pipeline or, indeed, areas where the Commission should consider withdrawing;

Our assessment whether the existing regulatory and supervisory framework is sufficient to tackle the supervisory challenges in the years ahead, what are the gaps and how these can be filled most effectively;

What are the objectives, sectors to be covered and the priority areas in regulatory and cooperative activities on a global scale.

3.1 FINISH REMAINING MEASURES

Our view remains that the **Commission should not propose a directive on clearing and settlement** unless it can be demonstrated through market-failure analysis that barriers to cross-border clearing and settlement cannot be removed by market-led initiatives.

We welcome the Commission's **commitment not to propose legislation if clear economic benefits cannot be demonstrated**. We consider, following this approach, that the **Commission should not propose any legislation relating specifically to credit rating agencies or financial analysts**.

It will take time to determine and assess whether FSAP measures deliver the intended benefits of a single market. Any further measures would need to address the needs of the market at that juncture rather than the position before the effects of the FSAP have been felt.

Prompt **ratification of the Hague Convention on conflicts of law for securities** would considerably help the smooth functioning of securities markets. We support the comments of the International Swaps and Derivatives Association on this topic in its response to the Commission's Green Paper.

3.2 EFFICIENT AND EFFECTIVE SUPERVISION

There are many aspects of the Commission's analysis in this area that we support:

- (a) the analysis of **challenges facing supervision**;
- (b) the proposed **evolutionary approach**;
- (c) **maximising use of the current framework**, with particular reference to ensuring that the newly created Level 3 structures are given the chance to work and develop their full potential;
- (d) **removing overlapping or conflicting legal requirements** placed on firms or regulators;
- (e) the recognition that the **cross-sectoral dimension** needs to be taken into account;
- (f) the need for **clarity in roles and responsibilities of supervisors**;
- (g) **supervisory convergence**: the Commission's proposed possible solutions to differences in supervisory powers and approach need not be mutually exclusive, and could be supplemented by peer review and staff exchanges;
- (h) **maximum cooperation** between authorities;
- (i) the fact that **new structures can only be contemplated when all cooperation and convergence mechanisms and resources have been fully exploited and compelling evidence has found them wanting**. Effective cooperation and convergence will obviate the need for new structures, but it is in any case difficult to see how any new structures could function effectively without effective cooperation and convergence.

We have the following **further observations** on this section of the Commission's paper:

- (a) There have been proposals for **possible future consolidated supervision structures**, such as the lead supervisor concept. We welcome further debate on this subject. Any such arrangement would, of course, need to be compatible with national accountability of competent authorities as regards crisis management and financial support from the public sector, which can be more readily accommodated by less formal and more flexible arrangements between regulators to allocate and coordinate supervisory roles.
- (b) In any **review of the cross-border roles and responsibilities of supervisors**, the Commission should consider carefully the implications for the allocation of responsibility between home and host supervisors, and the legislative implications in the fields of liquidity, crisis management, lender of last resort, deposit guarantee and winding up.
- (c) The **Commission should not seek to undertake the review of supervisory approaches within the EU**. This task, which is a necessary component of convergence, needs to be left to the supervisory authorities in the first instance, consistent with the Commission's stated aim of permitting the Level 3 committees to bed down.
- (d) It is important to **ensure that proper respect for political accountability does not cut across correct technical decision-making**, and takes account of the fact that certain international agreements, such as the Basel Accord, do not fall within the powers of the EU institutions. Indeed, supervisory convergence within EU is only part of the picture. It is vital to take account of supervisory practice in the rest of the world, and to identify where it is appropriate also to seek convergence with the rest of the world. See also our comments on Section 3.4 below.

3.3 ENABLING CROSS-BORDER INVESTMENT AND COMPETITION

The Commission is right to leave it to **market-driven consolidation** to determine what level of cross-border consolidation is appropriate, and to **focus on removing barriers** to such consolidation, ensuring that supervision is not misused for protectionist purposes to prevent ‘foreign’ participation in Member States’ financial sectors.

We do not understand the relevance in this context of the Commission’s statement that “**Transparency in the bond market and how government debt markets function** have also been raised as areas where integration would be beneficial.” We agree that the EU government debt market could benefit from further harmonisation in the primary issuance process (such as in auction procedures) and further integration of the clearing and settlement of secondary market trades. Industry initiatives are in progress, through the European Primary Dealer Association and the CESAME Group that are addressing these issues. As regards greater integration of transparency in bond markets generally, we note that:

- (a) the London Economics study: “Quantification of the Macroeconomic Impact of Integration of EU Financial Markets”, November 2002 identified bond markets as among the most integrated of European markets;
- (b) as was recently announced, a number of associations have sponsored a major project to examine issues of bond market efficiency and transparency.

It is clearly too early to reach an assessment on whether further integration would be beneficial.

Barriers to cross-border investment and competition is an area where **effective application of competition policy** is likely to be the most effective means of removing barriers to cross-border participation.

3.4 THE EXTERNAL DIMENSION

The Commission is right to focus on ensuring **European influence on the global stage**. It has rightly identified that ensuring the **global competitiveness of the EU financial sector** is crucial to being able to exert that influence. It is not possible to consider EU financial services policy over the next five years purely from the perspective of cross-border activity within the EU. To be able to attract investors and issuers from outside the EU, it is necessary but not sufficient to pursue regulatory dialogue with the authorities of other key markets. EU regulation must enable EU institutions to compete in those markets. There are two important consequences:

- (a) A key element of the policy-setting and policy maintenance process discussed in other parts of the Green Paper must be to **consider the economic impact of EU rules vis a vis market participants in the rest of the world**.
- (b) The **Commission needs to be very transparent in its conduct of international dialogues**, with full and appropriate participation of all relevant players, and agreement of agendas, mandates etc in advance, so that there is close alignment between the EU’s policy and the needs of investors, issuers, and other participants in EU markets.

4. POSSIBLE TARGETED NEW INITIATIVES

The Commission asks:
Whether we agree with the new identified priority areas;

What are the (dis)advantages of the various models for cross-border provision of services, whether there is a business case for developing a 26th regime, and which business lines might benefit;

How to enable consumers to deal more effectively with financial products and whether this means more professional and independent advice, improved education or financial literacy training are needed;

Whether we agree with the issues identified in the above list of retail products, or if we would suggest other areas where additional action at EU level could be beneficial.

We do not comment in detail on this part of the Commission's paper, and we do not comment at all on market sectors in which our Member firms do not participate extensively.

The Commission identifies **retail financial services** as an area for possible future initiatives. The Commission is right to propose to work in this and other areas in a bottom-up, consultative way, working in line with the needs of the market. We have the following observations:

- (a) In view of the fact that much of the prescriptiveness of the measures adopted under the FSAP derived from a perceived need to protect retail investors, the Commission should be ready to review at an early stage whether applying those retail-oriented measures too broadly or intensively to wholesale market participants is damaging EU wholesale markets, and whether there is therefore a **need to lighten further the regulatory burden on professional market participants**.
- (b) The Commission should consider carefully **whether further measures, over and above those put in place under the FSAP, are necessary**. The Commission should make this determination at a time when the impact of the FSAP has fully worked itself into the markets.
- (c) If so, the Commission should analyse **whether the current or likely future level of cross-border retail participation in the market justifies further requirements**.
- (d) The Commission should also consider whether, if its analysis shows that there is a low level of cross-border retail participation, it might be necessary, in line with the Commission's policy on repealing unnecessary or harmful legislation, to **amend or repeal some aspects of existing legislation which might act as barriers to cross-border retail participation**.
- (e) In that context, we share the Commission's scepticism about **"26th regimes"**. If prescriptive EU legislation acts as a barrier to cross-border participation, revision of EU legislation is more likely to solve the problem than launching a new and untested "26th regime".
- (f) We do not think that the Commission should deploy resources on policy on **financial literacy and investor education**, since retail investors may be a very heterogeneous group across the EU. The principle of subsidiarity should apply, and policy should be determined at a national level.

ANNEX

Existing EU legislation which merits review in the near future to establish whether it needs to be amended, or is no longer needed because it is harmful or not beneficial.

Because so many FSAP measures are so recently completed, or still in preparation, relatively few measures at present fall into this category. These include:

- (a) **Electronic Commerce Directive**, Article 3(4) derogation from the country of origin principle for the protection of consumer investors is redundant in view of MIFID, and should be repealed.
- (b) There are likely to be other **provisions in other horizontal Directives which rely on a ‘general good’ exception which should be disapplied because they are incompatible with sectoral Directives.**
- (c) There are several elements of the **Proposal for the Capital Requirements Directive (CRD) – formerly the Consolidated Banking Directive [2000/12/EC]** which we believe would benefit from review. These aspects have not been significantly amended via the recasting approach that has been applied to the CRD, and we believe these issues may well be examined in the context of forthcoming reviews that we believe are already planned:
 - i. CRD Article 35 (CBD Art 22(9)). This article requires host Member States to prevent institutions whose authorisation is withdrawn from initiating further transactions. Given that a key minimum requirement for passporting (namely the authorisation and supervision of the parent) has been removed, we understand this stricture, but it may be possible that under certain circumstances other mutually recognised services could continue to take place under the passport without any detriment to any outstanding depositors who are in the course of being repaid.
 - ii. CRD Article 120 (CBD Art 51): the holdings of institutions in non-financial firms should be re-examined in the context of any forthcoming review of the treatment of Own Funds provisions.
 - iii. CRD Article 41 (CBD Art 27): The role and powers of host supervisors will need to be reexamined in any review that examines or extends consolidated, or lead supervisory structures. We understand that such a review is planned and we also recognise that there may be moves to open the discussion on the possible harmonisation of supervision of liquidity which is the chief outstanding field of host state control.
 - iv. CRD Article 12 (3) and 4 (46) (CBD Arts 7 and 1(26)) re Close Links. A review of the utility and prudential benefits of these requirements should be carried out, in the light of the significant administrative burdens that these provisions have imposed.
- (d) **Prospectus Directive.** We believe that these provisions are too new for us to raise any issues with the Commission at this stage. It is uncertain at this stage whether any of the following issues are fundamentally problematic. Issues that have been raised

include: (1) different administrative requirements among Member States for passporting approved documents; (2) requirement to produce a supplemental prospectus each time financial statements are filed in order to incorporate by reference. We plan to raise these points with CESR or the Commission for Level 3 or 4 action; some might warrant flagging as matters to be dealt with by a review of the PD provisions and their practical effects in due course.

- (e) **Market Abuse Directive.** We believe these provisions are too new for us to raise any issues with the Commission at this stage. It is uncertain at this stage whether any of the following issues are fundamentally problematic. Issues that have been raised include: (1) over-burdensome and vague requirements in some Member States on 'adequate public disclosure'; (2) application of the 5% limit on naked short positions to debt markets, limiting debt syndicates' ability to stabilise debt issues; (3) difficulties in interpretation of research disclosure requirements; (4) the very strict conditions on buy-back programmes, in particular the 25/50% limit on average daily traded volume, make it nearly impossible to book-build in a buy-back programme in less liquid markets, as the 25%/50% limit is reached very easily. We plan to raise these points with CESR or the Commission for Level 3 or 4 action; some might warrant flagging as matters to be dealt with by a review of the MAD provisions and their practical effects in due course.