

European Commission White Paper on Financial Services Policy 2005-2010

– Brief comments by the Association of German Banks

The Association of German Banks welcomes the financial services strategy for the coming years set out in the white paper. It clearly underscores the Commission's wish to enable both users and suppliers of financial services to reap the benefits of a true single market for financial products. As the Commission quite rightly stresses, implementation of the 1999 Financial Services Action Plan (FSAP) will not in itself bring about a fully integrated internal market for financial services. We, too, believe that the correct strategy is to continue promoting much-needed integration and thus foster growth and employment.

Follow-up to the FSAP

A look at the main focus of the FSAP to date shows that recent years have seen extensive action aimed primarily at moving forward integration in the securities and wholesale markets. A regulatory breathing space and stocktaking of the legislative and non-legislative measures already adopted is most certainly in order in these areas. Implementation of the FSAP requires resources to be invested by the banking industry on a scale which should not be underestimated and the costs of adjusting operational processes for both the banks and, to some extent, their customers are quite considerable. It is therefore important to demonstrate that these investments will ultimately deliver a functioning legal framework for cross-border financial services. We thus welcome the Commission's objective of carrying out a complete economic and legal assessment of the FSAP by 2009.

Better regulation

Regulatory impact assessments are also to play a key role in the Commission's future legislative proposals. Better regulation does not necessarily mean that new legislation will always be called for. Sometimes, effective regulation might also be achieved by means of a market solution or voluntary industry undertaking. Options like these should be examined at an early stage of the consultation process. It is no less important, moreover, to review existing legislation with the aim of cutting back unnecessary bureaucracy. Offending legislation could be repealed or streamlined. We would welcome it if the pilot project launched by the Commission in three sectors were subsequently extended to the entire industry.

Need for “up-front” regulation

Nevertheless, merely focusing on implementing and enforcing FSAP measures will not suffice. A phase of consolidation in segments which have until now been in the spotlight of European regulation in no way justifies a regulatory moratorium across the entire financial services sector. Where further action is required, there is no reason to postpone it. This is by no means a blanket endorsement of new regulation. Yet we are convinced that there are certain areas where “up-front” regulation is needed, above all to clarify the “interfaces” between national legal systems with the aim of enabling new European business models to become established and existing forms of cross-border business to be simplified for users and suppliers. On no account should new regulation impinge on tried-and-tested, efficient and customer-friendly business models, however. We are thinking, in particular, of clearing and settlement and payment systems, where it is essential that neither new nor existing initiatives interfere with infrastructures in a way that would eliminate such business models. The choice of the right business model should always be determined by market forces.

Integration of the retail markets

Measures aimed at integrating the retail markets have until now been based on a concept of minimum harmonisation and mutual recognition of national law. This strategy has not proved successful. In its place, steps should be taken to progressively harmonise the rules and principles underlying contract and consumer protection law in order to solve the problem of diverging requirements once and for all (concept of targeted harmonisation). We generally support, in this connection, the measures set out in the white paper to support the Single Euro Payments Area (SEPA). The customers of Germany’s private banks will be able to use SEPA instruments in the European internal market from January 2008. Details concerning the migration of existing payment systems should be left to the market as far as possible.

Integration of the EU mortgage credit market

We believe there is a need for the Commission to refocus its plans to integrate Europe’s mortgage credit markets, particularly those set out in the separate green paper on this issue. The Commission’s proposals aim at opening up the market primarily by introducing further consumer protection rules. We, in contrast, are convinced that an integrated mortgage market cannot be achieved by harmonising mortgage credit (product harmonisation). A strategy based on competition offers the more promising way forward, in our view.

The German banking associations which together make up the committee known as the Zentraler Kreditausschuss recently proposed a package of measures to create an efficient secondary market for mortgage credit and legal framework for portfolio trading, facilitate the transfer of security interests in real estate and introduce a pan-European mortgage. It is

disappointing that the Commission's green paper contains virtually no consideration of such measures. We reject, in particular, the idea of a legal entitlement to repay mortgage loans at any time. In Germany, mortgage credit normally takes the form of fixed-rate loans which are funded on the capital markets at matching maturities. Allowing these loans to be repaid at any time would undermine the principles of funding by irredeemable bonds and call the German Pfandbrief system into question. Furthermore, it would be a form of product harmonisation and thus impinge on Europe's existing product diversity.

Enhancing the European framework for investment funds

All interested parties are unanimous in their view that the growth potential of Europe's fund industry should be exploited further. We therefore welcome the vast majority of the proposals in the Commission's white paper and in its separate green paper on investment funds. Nevertheless, we believe now is the time to consider a thorough overhaul of the existing UCITS Directive. Specifically, we would like to see the introduction in the near future of a European Passport for depositaries with the aim of promoting their cross-border activities. In addition, the Lamfalussy process should be applied to all future measures in order to accommodate a growing need to regulate technical issues. We would not, in contrast, welcome the retroactive application of the Lamfalussy process to existing UCITS legislation which is currently under consideration.

It is essential, in our view, for any measures to increase the transparency of hedge funds and private equity funds to be adopted at international, not European, level so that offshore centres can also be included.

Obstacles to cross-border mergers and acquisitions

The initiatives to eliminate obstacles to cross-border consolidation have our unreserved support. Discussions should not focus exclusively on regulatory barriers, however. Also significant are obstacles arising from insufficient harmonisation of certain aspects of consumer, company and tax law. While these do not directly prevent mergers and acquisitions, they make them a financially unviable proposition.

Improving the tax environment

The differences in tax rules from one member state to another are evidently among the most intractable remaining obstacles to a single market for financial services. We welcome the fact that, unlike the green paper, the white paper makes some reference to VAT in the context of Community tax law. This is not enough, however, to bring about any significant improvement in the tax environment for cross-border business in financial services. Diverging requirements for calculating profits for tax purposes and tax assessment bases, for example, make cross-

border business and investment more complex, funding more expensive, investment returns lower and the euro area less attractive to international investors.

This is not about differences in tax rates; there should most certainly continue to be competition between tax regimes in this field. What is not acceptable, however, is tax discrimination which impedes the supply and use of cross-border investment products or cross-border investments. Further initiatives are therefore urgently needed to improve Community tax law in the area of company taxation (e.g. allowing groups to offset losses incurred by subsidiaries in one member state against profits earned in another) and the taxation of investment income (such as a substantive alignment of the tax burden and clarification of the term “interest” on which the Savings Tax Directive is based).

Developing Europe’s supervisory structures

We also see a need for action on Europe’s supervisory structures, which must adapt to the increasing internationalisation of the banks’ business practices. We strongly support the Lamfalussy process and the work of CESR and CEBS. The measures set out in the white paper confine themselves to establishing a European “supervisory culture” by organising regular staff exchanges and joint training programmes, etc. Much as we welcome such initiatives, we do not believe they will be enough to meet the challenges of monitoring cross-border financial institutions. What is required, in our view, is a fundamental debate on the allocation of supervisory powers between national authorities and a progressive extension to other fields of the “consolidated supervisor” concept introduced under Basel II.

Dialogue with third countries

It would be welcome if these debates – like other discussions concerning international regulatory and supervisory issues in the context of global financial markets – also increasingly took place with third countries outside the EU. Multiple, contradictory or even blatantly discriminatory national rules make it more difficult for EU banks and issuers to enter international markets. Regulatory dialogues with major global financial centres are therefore absolutely indispensable, in our view. Such dialogues allow problems caused by onerous or discriminatory host country regulation to be addressed and solved or even avoided more easily than do ad-hoc activities. Regular dialogues with important financial markets (such as the US, Switzerland, Japan, China, India and Russia) should therefore be established and deepened and the expertise of market participants should be called on. Furthermore, the EU’s common trade policy should continue to address discriminatory rules in an even greater number of emerging markets than would be possible under the regulatory dialogue.