

Tel: 020 7066 9346

E-mail: enquiries@fs-cp.org.uk

Commissioner Frits Bolkestein
European Commissioner for the
Internal Market
Taxation and Customs Union
European Commission
B – 1049
Brussels
Belgium

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Our ref: Europe

Dear Commissioner

EXPERT GROUPS' REPORTS ON THE FINANCIAL SERVICES ACTION PLAN : COMMENTS FROM THE UK'S FINANCIAL SERVICES CONSUMER PANEL

I am writing to you on behalf of the UK's Financial Services Consumer Panel to comment on the reports of the four Expert Groups, which you set up last October to make recommendations on what further actions might be needed to complete the single market in financial services.

The Panel particularly welcomes the opportunity to comment on these reports, not least because we have expressed concern in the past at the lack of consultation of consumers on the FSAP and on earlier financial services Directives. For the same reason the Panel is also glad to see that all four Expert Groups underlined the need for full consultations of all market-participants – consumers as well as producers – on any future Commission initiatives affecting financial services whether they emanate from the Internal Market Directorate General or from the Consumer Affairs Directorate General. The Panel strongly supports that recommendation and trusts you will particularly endorse it, when you present the reports to the incoming Commission.

Benefits and costs to retail consumers from the single market

The EU's Single Market Programme is intended to benefit consumers. If it does not do so, it will have failed. It may therefore be helpful to set out the Panel's general views on the likely benefits and costs of the single market to retail consumers. We agree that the achievement of a single market in financial services should, in principle, benefit consumers through a wider range of products and through lower prices and/or higher returns on financial assets, as a result of the sharper

competition and the economies of scale available to producers in a larger market. It is important, however, not to take for granted that opening up EU financial markets to cross-frontier competition will automatically deliver these benefits and competition authorities at both EU and Member State level should keep this aspect under regular review. However, the potential gains need to be balanced against the risks that the removal of apparent barriers or the harmonization of EU legislation may weaken safeguards, which are needed to protect the consumers of financial products, given the well-known asymmetries of information in financial markets and the long-term character of many savings, insurance, pension and mortgage products.

Against this background we believe the Commission needs to be particularly cautious in any efforts to harmonize or simplify consumer protection legislation because the costs arising from a loss of consumers' confidence are likely to be greater than those arising from the differences in Member States' legislation in this area.

Future approach to EU legislation on financial services

All four Expert Groups are united in recommending that any future EU initiatives on financial services must be carefully targeted, justified by a thorough cost-benefit analysis and with the emphasis given to quality rather than speed. We fully agree with these sentiments. The same criteria should apply to new consumer protection legislation affecting financial services. It should go without saying that the principles of subsidiarity and proportionality will be rigorously applied.

More generally, we endorse the Group's recommendations that the Commission should apply the following principles and priorities in relation to the future regulation of financial services at EU level:-

- priority should be given to the implementation and enforcement of existing legislation rather than to new initiatives;
- any new legislation should be evidence-based;
- both the initial and any subsequently amended proposal for new legislation should be accompanied by published regulatory impact assessments and cost-benefit analyses, but with reservations - please see our comments below;
- harmonization of law should be limited to the minimum needed to achieve market access;
- there should be full and transparent consultation of all interested parties, including consumers, both on the prior question of whether legislation is needed and at all subsequent stages of the legislative process. The parties consulted should be provided with the evidence and cost-benefit analyses underlying the proposal, so that these can be challenged and discussed;

However, it is difficult to identify in monetary terms the benefits to consumers, particularly where consumer confidence in the financial services industry is concerned. Cost-benefit analyses are in practice somewhat crude tools. What is needed is a clear and explicit assessment of any proposal, which includes costs of

compliance and immediate benefits to consumers, but which also identifies elements like promoting confidence in the market and deferring unethical behaviour.

We would add three further suggestions to the above. First, the cost-benefit analyses and regulatory impact assessments of any new Commission proposal should be carried out independently of the Commission, perhaps under the aegis of the CESR or its banking and insurance equivalents or even by the European Court of Auditors. Second, the cost-benefit analyses should include clear and, where possible, quantified, assessments of the compliance costs to producers, of the expected benefits to consumers and also of the likely impact of the measures proposed on existing consumer protection arrangements in the Member States. Any proposals aimed at further integration of retail markets must be justified by clear net benefits to the mass consumer. In this context, we agree with the specific questions listed in paragraph 45 of the Banking Experts Report. Third, we also suggest the Lamfalussy Committees should in future consult and enter into dialogue with consumer organizations on any proposals affecting consumer protection.

Consumer protection: whose rules should apply?

Paragraphs 47 – 49 of the Banking Experts Report recommend in favour of a move away from the general rule that “host country” control should apply to rules on consumer protection and conduct of business in favour of “home country or country of origin control” at least for selected financial products. It is argued that, on the basis of a fairly minimum harmonization of the key features of these products:-

“providers complying with the set of harmonised requirements will not be subject to additional requirements in other EEA countries” and that “the principle of mutual recognition should be applied vigorously”.

The line of argument put forward here appears to be similar to proposals put forward in a recent pamphlet published by the European Financial Services Round Table (“Consumer Protection and Consumer Choice”). The suggestion in the Insurance Experts Report that consideration should be given to developing a “26th regime” to facilitate the cross-border sale of insurance products appears to go in the same direction.

It is not clear to the Panel whether the Banking Experts Group envisages that “country of origin rules” should apply solely for pure “freedom of services” business, as in the case of the E-Commerce Directive, or that they should also apply for products sold by the branches of EU financial institutions located in other Member States and by intermediaries acting on their behalf. The language used together with the precedent of the European Financial Services Round Table 47- 49 points to the second alternative.

The Panel’s view is that this recommendation should be treated with very considerable caution. There are two major problems in the way of any general move away from “host country” control in respect of consumer protection in financial services. First, consumer protection legislation cannot be looked at in isolation. In

all Member States it is deeply rooted in the law of contract and may have links with wider commercial and company law. Depending on the financial product, there may also be links with the law of property, the law on pensions and with state social security and health legislation. For these reasons, the effect of an EU harmonizing Directive may well differ significantly from one Member State to another; (the Product Liability Directive is an example of this). So the hoped for outcome (that banks should be able to operate in all Member States on the basis of a single unified body of law) is unlikely to be achieved without a much wider harmonization of national laws than is either desirable or contemplated in the Banking Experts Report.

Second, consumers of financial services need to have confidence in the effectiveness of the regulatory system. Such confidence inevitably rests in the knowledge that the firms they are dealing with are open to inspection and monitoring by a regulator, who understands the local market; and that, in the event of problems arising, they can seek redress from a local regulator, from an Ombudsman or similar informal system or in the last resort in their own courts and on the basis of national law. The Banking Experts Group Report does not even ask, let alone answer how these issues would be dealt with under a “home country” or “country of origin” approach.

For all these reasons the Panel’s conclusion is that the goal of maintaining consumer confidence and the precautionary principle point strongly in the direction of leaving responsibility for consumer protection with the “host country” in the case of mass risks. If, however, the Banking Experts Report is to be interpreted as recommending the application of “country of origin” rules only to pure “freedom of services” business, the amount of business currently done in this way is so small that harmonization of national laws is unlikely to be justified.

We have similar concerns about the recommendations in paragraphs 41 and 42 of the Banking Experts Report on harmonizing national laws relating to bankruptcy, debt recovery and collateral. These are particularly sensitive issues for local consumers and here again the domestic legislation will be deeply rooted in local contract and property law. We note the reference in paragraph 42 of the Report to the Action Plan of DG-SANCO, which envisages a wider harmonization of contract law. Clearly, this project goes much wider than financial services. There would obviously need to be extensive consultations as to the feasibility and necessity of such an ambitious proposal.

Specific recommendations by the four Groups

The Panel is supportive of the following more detailed recommendations made by all four Groups:-

- the need to avoid or eliminate inconsistencies and overlaps between different EU Directives identified in the Banking and Insurance Experts Reports; this should be a high priority;
- the removal of double taxation or discriminatory taxation of financial products when sold across frontiers;
- the prevention of abusive use of the “general good” provisions of the Treaty for protectionist purposes, e.g. to prevent the free circulation of particular products;

- that there is no need at present for EU legislative action on corporate governance issues.

As regards the Groups' recommendations relating to particular sectors, we agree with the recommendation that the Commission should examine whether financial institutions are able to exploit the freedoms of the single market all the operations in their "value chain". In this context, we broadly support the proposals made in the reports of the Asset Management, Securities and Banking Groups for the removal of obstacles, which hamper the more efficient management of their "upstream" financial and administrative operations, subject to consultation on the details in due course. We note, however, that there is no guarantee that cost reductions achieved in this way will be passed on to retail consumers. The Competition and other competent authorities at EU and Member State level will need to keep this aspect under close scrutiny.

We also agree that fund managers and their trade associations should themselves take action to improve the quality of financial advice to the retail consumer. This should also apply to other financial firms, such as banks and insurance companies, which distribute financial products through advisers.

We have reservations about some of the recommendations made by both the Banking and Insurance Experts to extend the role of "lead supervisors" of multi-national financial groups. The Insurance Group recommends that the Supplementary Capital Test as it applies to subsidiaries in other Member States than the parent company should in future be set by the lead supervisor rather than the respective national supervisors. The Banking Expert Group's recommendations on credit risk and operational risk may go in the same direction.

We believe this issue needs careful handling. There are two powerful reasons, which point to leaving the final responsibility for setting the capital requirements for subsidiaries with the national supervisors in the countries where they are incorporated. First, under the company law and jurisprudence of several Member States parent companies are not obliged in all circumstances to stand behind an ailing subsidiary; and there are examples where a parent company has walked away from a subsidiary in difficulties. Second, it will usually be the case that the local supervisors will have a closer understanding of the risks to which a subsidiary in their country is exposed and of the capacity of the local management to control those risks.

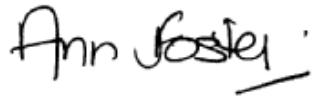
The regulatory capital in a subsidiary is the first line of defence of the depositors' or policyholders' funds. So to allow the lead supervisor to dilute the capital required by the local supervisor would in our view require an overwhelmingly strong justification.

A possible omission?

Finally, although it may strictly have fallen outside the Group's terms of reference, we are disappointed that no reference is made in the Banking Experts Report to the

continuing high costs of cross-border money transfers both within and outside the eurozone. We hope that this will be a high priority for the incoming Commission.

Yours sincerely,



Chairman
FS Consumer Panel

Copies to Alex Schaub
 David Wright
 The Chairman of the European Parliament's Committee for Legal and
 Financial Questions
 The FSA
 H M Treasury
 Bank of England

FS Consumer Panel can be contacted c/o The
Consumer Panel Secretariat at the FSA

Tel: 0207 066 9346 Fax: 0207 066 9728

Email: enquiries@fs-cp.org.uk

Website: <http://www.fs-cp.org.uk>