STUDY

Policy Department
Economic and Scientific Policy

The Impact of the New Financial Services Framework

Part I

Main Report

IP/A/ECON/ST/2005-86

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PE 385.623

This is Part I of the study requested by the European Parliament's Economic and Monetary Affairs Committee (ECON).

The study comprises four parts:

Part I: Main Report;
Part II: Country Reports Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France;
Part III: Country Reports Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg;
Part IV: Country Reports Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, UK.

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EXECUTIVE SUMMARY

This study

1 This study has considered the impact that the Financial Services Action Plan and the legislative measures of the Financial Services White Paper have already had and should be expected to have in the future. These impacts are considered for the European Union as a whole and for each of the twenty-five individual Member States.[1]

2 This study has been conducted at an early stage, with a number of important FSAP measures not yet implemented and most of the measures proposed in the White Paper still requiring further detailed consideration. This offers the considerable advantage there is yet time to influence the process and future developments, but also the challenge in assessment that many effects are not yet clear. Thus, central to our conclusions have necessarily been many expert judgements.[2]

Headline conclusions by sector

3 Our key conclusions by sector are as follows:

(a) The FSAP has so far had the greatest effect in the banking sector.

- Trade in banking services has already been stimulated by some 1.6 per cent, and that full implementation of the FSAP and FSWP legislative measures will eventually add 3.4 per cent to this trade.
- We have found a mild general tendency for the FSAP to reduce industrial concentration. However, we believe it may have increased concentration in particular Member States, and in some cases this has increased efficiency.
- More generally, the FSAP appears to have stimulated some reduction in cost-to-income ratios (and hence an increase in competitiveness), particularly in New Member States.
- However, the FSAP has not been found to have any general EU-wide impact on employment or merger and acquisition activity.

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1 We emphasize that the study does not aim to produce a comprehensive overview of financial sector developments in all Member States since 1998. Neither does it attempt to assess the impact of individual FSAP measures. Neither does it seek to identify how the FSAP has affected the behaviour of specific firms. The nature of the analysis reflects the nature of the task.

2 The methodology employed has included:
- Desk research, gathering primary data and previous reports;
- Expert analysis of economic mechanisms;
- Questionnaire survey of authoritative stakeholders;
- A small number of selected interviews;
- New econometric modelling;
- Analysis and interpretation of previously-conducted cost of capital analysis;
- Analysis and interpretation of previously-conducted data envelope analysis; and
- Expert judgements and interpretation of data to draw conclusions.

(b) The FSAP will have a significant effect (perhaps its greatest effect) on the securities sector, but the main consequences have not yet been felt. Full implementation of the FSAP and FSWP legislative measures will lead the cost of equity capital to fall by

- 12-28 basis points (bps) for France (i.e. 0.12 per cent to 0.28 per cent);
- 20-45 bps for Germany;
- 60-80 bps for Italy;
- 7-9 bps for the UK; and
- 5-21 bps for the rest of the EU.

(c) The FSAP has so far had limited effect on the insurance sector — we find no measurable general effect on trade, employment, or merger and acquisition activity in this sector; but FSWP legislative measures can be expected to have more material effects.

(d) The effects of the FSAP on Financial Conglomerates, additional to those in respect of banking, insurance and securities, have been limited.

Analysis by Member State

4 The main broad themes to emerge from the country lots are as follows:

(a) Many elements are uncertain or awaiting future developments;

(b) Significant differences in impacts between Member States;

(c) Greater impacts in Banking than other sectors;

(d) Regional groupings visible — of most note is perhaps that development of an integrated Nordo-Baltic capital market seems well advanced;

(e) Gains to France, Germany, and the UK very limited in the short term — but may be greater in the future, as changes in other Member States create new opportunities;

(f) Tendency for impacts to be of relatively similar degree by theme, and to be connected to the extent to which “Openness to foreign firms” has been affected;

(g) Effects on competition, consumer protection, and openness to foreign firms tend to be greater than effects on employment or competitiveness.

Evaluation of the goals of the FSAP and FSWP

5 At this early stage it is natural that some firms in Member States that have had to bear one-off costs of adaptation and increased ongoing costs of compliance are aware mainly of the downsides of the FSAP, and are disappointed in those cases where the original trade liberalising ambitions of the Commission appear to have been thwarted. But in the longer term it is our assessment that the core mission of the FSAP and FSWP remains intact — specifically:

(a) Although (i) for a few of the more established Member States that have had only a limited tradition of contestability of financial services markets and openness to foreign firms, the FSAP has so far not succeeded in integrating them into a Single European capital and financial services market; and (ii) regional activities at the sub-EU level, such as the development of the Nordo-Baltic regional market and the Euronext area, appear to have had a much more substantial impact than the FSAP in driving integration in the short-term (even between Member States in regional groupings in which not all employ the euro); nonetheless, we regard the aspiration, intent, and momentum of the FSAP to be an important factor in fostering other drivers to integration, and in the longer term we believe that the FSAP and future FSWP measures will be well on the way to fostering a market where financial services and capital may circulate freely at the lowest possible cost throughout the EU.

(b) We believe that the above has been (and will be) achieved at the same time as maintaining effective corporate governance and financial stability.

(c) Concerning "investor protection", our view is that insulating investors against downside risk would not be a legitimate policy goal — the effort to assess risk and determine one's own appetite for it are matters properly left to the Market. Instead, "investor protection" should be understood as protecting investors against exploitation of informational advantages, scams and other malpractice. To achieve this, it is important that consumers are aware of, and confident of, the ways in which regulation does and does not protect them. When regulations change considerably, investors may face a period of some loss of trust as they adapt to the new environment.

We suspect that FSAP policy-makers have sometimes treated consumer protection as largely a product of rules, regulations and government intervention, with Market processes not seen as sufficiently significant a potential source of consumer protection. Consequently, policy-makers may not always have paid sufficient attention to the need to keep rules simple and comprehensible to consumers and to ensuring that consumers are properly informed about precisely what those (simple) rules are. With understanding on the part of consumers and information provided to them, Market processes can offer consumers protection. But consumers unsure of the rules are more vulnerable to exploitation.

The future direction of policy

6 Looking ahead, we have found there to be a widespread sense of regulatory fatigue (i.e. exhaustion with the need to adapt to changes in regulation), especially among Member States on the Northern periphery. Such fatigue may even be visible among consumers. This fatigue appears to be having an impact even on plans within the FSWP, let alone looking forward beyond that. For example, at the time of the White Paper, it was envisaged that there would be a Clearing and Settlement Directive. However, more recently, a Code of Conduct on Clearing and Settlement has been agreed.

7 There would seem to be a strong case for a period of bedding down of the regulations implemented and announced. However, it will be important not to lose momentum, and this bedding down period should not be viewed as a regulatory development "holiday". Instead, mechanisms such as voluntary cooperation should be used to make continuous progress, and to test the strengths and limitations of the framework now (or shortly) in place — the FSAP may have (or will have, once completed), at least for the moment created a sufficiently common understanding and sufficiently robust framework to make a period of voluntary cooperation productive.

8 Regulations could be used to express principles, and to be enacted through a less cumbersome process than that associated with directives. On the other hand, the danger with simply expressing principles and leaving it to the discretion of regulatory authorities how to implement, is that if principles are expressed too tightly and generally then they will not allow of those practical exceptions that inevitably arise, whilst if they are expressed too loosely, there will be the opportunity for national regulatory authorities to use their discretion to negate the process — thereby undermining the objectives of the Single Market.

9 The way forward that we propose is, in the forthcoming period, to combine a set of regulations and communications, clarifying principles in those (few) areas in which further clarification of principles is currently needed, with a robust process of voluntary cooperation.

10 We emphasize that we are not arguing that the process of integration has gone "far enough" (recommending "regulations combined with voluntary cooperation" is not some code for ending integration). Neither are we suggesting that no further directives will, in due course, be appropriate. Rather, we are attempting to provide a mechanism that can maintain the momentum of integration, during a period of bedding down of the very significant set of changes already introduced, without creating further regulatory fatigue.

11 Even a complete Single Market will require methods by which regulation can evolve. One possibility would be to observe developments in financial services regulation elsewhere in the world — in the US, say, or in East Asia — and learn from these experiences, eventually implementing what seems to be best practice in those jurisdictions. However, the undesirable implication of this would be that regulatory practice in the EU would lag always behind that in other major financial services markets.

12 An alternative route is for the EU to learn internally what is best practice, drawing lessons from diversity of regulatory practice within the EU. Indeed, the FSAP itself has applied the lessons of past regulatory competition. In the future, as new innovations arise and consumer needs evolve, it is likely that allowing sufficient scope for regulatory competition within a sufficiently common framework that such competition offered limited (if any) scope for national protectionism — a framework already largely established by the FSAP — would again reveal which of various different possible regulatory approaches actually works best in other, as-yet-unforeseen areas. In due course further directives and regulations might apply these new best practice lessons more widely.

1 INTRODUCTION

This Report

1.1 This report was commissioned by the Economic and Monetary Affairs Committee of the European Parliament in December 2005.

1.2 The aim of the project was to assess the impact of the Financial Services Action Plan (FSAP) and the legislative proposals in the Financial Services White Paper (FSWP), jointly constituting the New Financial Services Framework, on individual Member States and the European Union collectively.

Motivation for the study

1.3 The EU financial services sector is a vital component of the EU economy, not only in terms of its direct contribution to GDP and gross value added, but also because of its contribution to the smooth running of other sectors. The level of development is also a central factor in national competitiveness — for example, because of its role in supporting small firm formation and in reducing the cost of capital for investment.

1.4 In this respect the internal market for financial services might offer significant potential benefits to the EU economy if its promotion would lead to increasing efficiency and performance of a key sector, but could also succeed in improving the wider dynamism and factor productivity of the EU economy.

1.5 In this study we provide an assessment of the impacts of current policy towards these objectives and reflections on future policy development.

Key Elements of the Terms of Reference

Scope of the study

1.6 The scope of the study has two key dimensions:

(a) Subject-matter scope — The project was to assess the impact of the FSAP measures and FSWP legislative proposals on four “horizontal themes”: Banking; Insurance; Securities; and Financial Conglomerates. The last theme, Financial Conglomerates, is recognised as at least partially a hybrid, including elements of the previous three themes.

(b) Member State scope — The study covers the EU25, i.e. Bulgaria and Romania are not included.

1.7 The study was to include consideration of impacts on people-focused issues such as competitiveness, consumer protection, growth and employment, as well as standard regulatory concerns such as market functioning, competition, trade and the cost of capital.

Methodology

1.8 The methodology employed in this study is set out in Appendix 1.

1.9 As explained in detail there, the methodology employed has included:

(a) Desk research, gathering primary data and previous reports;

(b) Expert analysis of economic mechanisms;

(c) Questionnaire survey of authoritative stakeholders;

(d) A small number of selected interviews;

(e) New econometric modelling;

(f) Analysis and interpretation of previously-conducted cost of capital analysis;

(g) Analysis and interpretation of previously-conducted data envelope analysis;

(h) Expert judgements and interpretation of data to draw conclusions.

Key methodological challenges

1.10 It is useful, in what follows, to note that a study of this sort involves a number of key methodological challenges, including:

(a) **Establishing the counterfactual to the FSAP measures and FSWP legislative proposals**. Defining the appropriate counterfactual (an essential component of the impact assessment process) is particularly challenging for this study. For example if the counterfactual is the continuation of trends apparent before the FSAP then we need to identify what these trends are. Further, the counterfactual varies between the Member States, for example according to their pre-existing legal and financial services framework.

(b) **Identifying the contribution of the FSAP measures and FSWP legislative proposals to the achievement of an internal market for financial services**. Here it can be argued that the contribution of the FSAP measures and FSWP legislative proposals are of key importance, for example if the FSAP measures and FSWP legislative proposals are indispensable to this process then some of the benefits of the internal market as a whole should be allocated to the FSAP measures and FSWP legislative proposals.

(c) **The effects of differential transposition of the Directives**. The FSAP measures and FSWP legislative proposals have not been fully applied across the Member States and in fact some elements of the FSWP legislative proposals, such as Solvency II, remain under discussion. In this respect, whilst the FSAP measures and FSWP legislative proposals may have had impacts in shaping the expectations of market players even where it has not yet been applied, clearly such impacts will be affected by the level of application.

(d) **Establishing causality**. This is often a problem in impact assessments particularly when inference must be drawn from econometric analysis. In the case of this assessment we have identified market trends and direct impacts (such as those clearly arising from application of the Community framework) and then considered also how far market trends and the shape of the financial services development appears to have met our expectations in terms of the expected impacts of the FSAP measures and FSWP legislative proposals.

(e) **Data problems**. Full disaggregated and consistent data are not always available (and, even when they are, do not always cover sufficient years), and we have worked to rectify this in our methodology through intensive research methods. These are detailed later.

(f) **Ongoing nature of the process**. Producing an impact assessment whilst the process of implementing the FSAP measures and FSWP legislative proposals is still ongoing has the considerable advantage that there is still the opportunity to influence the processes — this is, of course, a key reason why the Parliament has commissioned the study at this stage. This does, however, create the challenge that conclusions, forecasts and recommendations might, if they are acted upon, change the path of future developments away from our forecasts. In addition, clearly the very recent and ongoing nature of the FSAP measures and FSWP legislative proposals makes causal analysis and trend analysis more challenging.

Structure

1.11 The remainder of this document is comprised of a non-technical main body supported by extensive technical appendices.

(a) The main body describes the FSAP measures and FSWP legislative proposals in Section 2; then

(b) summarizes what we believe are the key impacts of the FSAP measures and FSWP legislative proposals in Section 3; and then

(c) gives our evaluation in Section 4.

1.12 This main body is designed to be read, having first read the Summary, without the need to refer to the technical appendices. However, the figures exhibited and conclusions drawn are entirely dependent upon the technical analysis in those appendices and in the 25 lots considering individual Member States. The technical substance of this document appears in the appendices, as follows:

(a) Appendix 1: sets out the methodology employed in this study.

(b) Appendix 2: lists the key FSAP measures, and when they were implemented in each Member State.

(c) Appendix 3: sets out the Lamfalussy process.

(d) Appendix 4: sets out the key and indispensable task of analyzing the rationale for the FSAP measures and FSWP legislative proposals — no regulation or regulatory framework can be assessed without understanding the rationale for government involvement in that area. It notes alternative arguments sometimes put forward for regulation and comments on the rationale for EU wide regulation and the interplay between this and national regulation.

(e) Appendix 5: moves on to consider the policy objectives and options for the FSAP and FSWP and, drawing on insights from other sectors, examines the options open to policy makers concerned with the most appropriate regulatory framework for financial services.

(f) Appendix 6: sets out and assesses the expected effects of the FSAP measures and FSWP legislative proposals, in particular detailing the key economic mechanisms by which the FSAP measures and FSWP legislative proposals was expected to have its effects, and giving our assessment of whether these mechanisms are operational.

(g) Appendix 7: quantifies the impact of the FSAP on financial development and on growth rates in France, Germany, Italy, Spain and the UK.

(h) Appendix 8: quantifies the impact of the FSAP on trade.

(i) Appendix 9: quantifies the impact of the FSAP on securities market costs and on the cost of capital (this is based principally on a study we recently conducted for the UK Financial Services Authority).

(j) Appendix 10: considers our attempts to quantify the impact on other variables, such as competition and competitiveness (for which small effects are, perhaps, identified), and employment and takeovers (for which no overall measurable EU-wide impact is identified).

(k) Appendix 11: considers a data envelopment analysis (by other authors) of the efficiency of banking sectors in the EU15, and the relationship with concentration.

(l) Appendix 12: and the Annex exhibits the questionnaire we sent to relevant stakeholders.

(m) Appendix 13: is a glossary of terms used throughout this report.

1.13 There are also 25 associated individual “country lot” reports, considering the impact on particular Member States.

2 THE NEW FINANCIAL SERVICES FRAMEWORK (FSAP AND FSWP LEGISLATIVE MEASURES)

2.1 As defined in this document, the New Financial Services Framework consists of the Financial Services Action Plan (FSAP) and the new legislative measures proposed in the Financial Services White Paper (FSWP). However, it is important to recognise that the FSAP and the FSWP have very different legal status: the former reflect specific decisions that the EU has agreed to implement, the latter is a series of proposals designed to complement the FSAP, but which have yet to be agreed.

The Financial Services Action Plan

2.2 The Financial Services Action Plan (FSAP) measures are summarised in Appendix 1: These 42 measures were intended to create a legal and regulatory environment supporting the integration of EU financial markets. Some FSAP measures take the form of EC Regulations, which apply directly in all Member States. Most take the form of EC Directives, which have to be transposed into the law of each Member State. Of these, some replace earlier Directives (e.g. on investment services), which are now out-of-date. Others recast earlier proposals (e.g. on takeover bids). Some of the FSAP measures (e.g. on mutual funds) were already under negotiation when the FSAP was launched; others have been added to the list since then.

2.3 An important aspect of the FSAP was the decision that legislation should be determined on the basis of wide consultation and agreement with all bodies in the field. In July 2000, Baron Alexandre Lamfalussy, together with the Committee of Wise Men, was given the task of identifying how to achieve the urgent integration of financial services regulation.

2.4 The Lamfalussy Report of 2001 set up a four-level approach to elaborating legislation, and details of this are set out in Appendix 3:

The Financial Services White Paper

2.5 The Financial Services White Paper (FSWP) aims to facilitate the dynamic consolidation of European financial services markets. It states that the FSAP and FSWP legislative measures, as implemented through the Financial Services Action Plan, have been essentially sound but that there is now a need:

(a) To consolidate unfinished business;

(b) To enhance supervisory coordination and convergence; and

(c) To remove the remaining economically significant barriers to the internal market.

2.6 The FSWP aims to install regulatory best practice, for example through open and transparent decision making, impact assessments, firmer implementation and enforcement of Community law (including Transposition workshops), ex post evaluation, simplification, codification and clarification, closer consultation (for example through the FIN-USE forum and with UNI-EUROPA and firmer interaction with other areas.

2.7 A key aim is to make the Lamfalussy process work.

2.8 The FSWP sets out a number of ongoing and future legislative activities. These included:

(a) A White Paper to be released in 2006 on mortgage credit, the modified proposal for a Directive on consumer credit and the proposal for a Payments Services Directive;

(b) The Solvency II process which aims to overhaul EC regulation in the insurance area;

(c) Review of qualifying shareholdings (to revise Article 16 of the Banking and Article 15 of the Insurance Directives); and

(d) A possible Framework Directive on Clearing and Settlement.

2.9 The European Commission intended to propose a new framework directive on clearing and settlement with the aim of removing regulatory and competitive impediments to improved efficiency and lower costs in cross-border securities trading. The Directorate-General Internal Market and Services worked on an Impact Assessment, scheduled to be finished in the last quarter of 2006. However, subsequently a voluntary cooperation model has been pursued instead, and it now seems unlikely that there will be a directive — see paragraphs 4.37ff.

2.10 Other areas under review include the elimination of unjustified barriers to cross-border consolidation and ways in which to remove barriers to cross-border retail banking.

Key Components

2.11 Our analysis in this study, arising from the responses of stakeholders, our interviews, and our own judgement, has identified the following as the key elements of the FSAP measures and FSWP legislative proposals:

(a) For the Banking sector:

- Directives relating to money laundering (particularly 2001/97, the "second money laundering directive");
- The Capital Requirements Directive (2006/48/EC and 2006/49/EC);

(b) For the Insurance sector:

- The Insurance Mediation Directive (2002/92);
- The Solvency I framework (particularly 2002/13 and 2002/83);
- The Solvency II framework (part of the FSWP);

(c) For the Securities sector:

- The Markets in Financial Instruments Directive (2004/39);
- The UCITS directives (2001/107 and 2001/108);
- The Prospectus Directive (2003/71);
- The Clearing and Settlement framework (part of the FSWP);

(d) For Financial Conglomerates:

- The Financial Conglomerates Directive (2002/87).

2.12 In some cases these feature because of the significant compliance costs they entail (e.g. the money laundering directives[3]). In other cases the market impact is the key (e.g. the Insurance Mediation Directive). And a third condition placing Directives on this list was their impact on the regulatory framework (e.g. the CRD, Solvency II, MiFID).

2.13 Clearly the identification of these as the most significant elements potentially has implications for later judgements formed, and readers that would prefer alternative lists of key elements may be interested to note that we have conducted explicit sensitivity analysis on weighting these elements in alternative ways — see, in particular, paragraphs A8.34ff, where we found our results fairly robust to alternative formulations.

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[3] Note, for example, that of all the directives for which compliance cost is quantified in the December 2006 Open Europe "Review of the EU's Financial Services Action Plan", the money laundering directives are ascribed a total compliance cost estimate for the UK of £1.2bn, exceeded only by MiFID, the CRD and the Consumer Credit Directive, where this last Directive does not feature on our list because its text is not finally determined and because the estimates for its cost include substantial mortgage credit-related costs — mortgage credit falling outside the scope of our study. The money laundering directives were also considered a key driver of increased compliance cost for UK financial firms, over the 1998-2003 period, in the 2003 Europe Economics report for the UK FSA, "Costs of compliance", http://www.fsa.gov.uk/pubs/other/cost_compliance.pdf

3 MAIN RESULTS

3.1 This project has involved extensive technical analysis, including econometric modelling, quantification of analytical models, and other technical techniques, as explained in Appendix 1: and detailed in the technical appendices. Here we report the main results, as follows.

Overall EU-Wide Impacts

Economic growth

3.2 We forecast full implementation of the FSAP measures and FSWP legislative proposals to have raised the sustainable growth rate of the EU15 by 0.1 per cent.[4]

Banking

Trade

3.3 We forecast that full implementation of the FSAP measures and FSWP legislative proposals will have raised trade in banking by 3.4 per cent.

Industry structure and competition

3.4 The period of the FSAP has seen a non-trivial growth in industrial concentration in the EU15, though not in the New Member States. However, perhaps surprisingly, our econometric modelling suggests that FSAP may have had a mild general tendency to reduce concentration (though this does not rule out its having encouraged concentration in specific Member States — see below).[5]

3.5 On the other hand, we have found FSAP to have had no measurable impact on general merger and acquisition activity in the period (though there may have been an effect in specific Member States — again, see below).

Competitiveness/Productivity/Efficiency

3.6 We believe there is some limited evidence that may suggest the FSAP has driven some reduction in cost-to-income ratios in banking, thus increasing efficiency and competitiveness. [6]

Employment

3.7 We find there to have been no measurable impact of the FSAP on overall employment in banking.[7]

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4 Details can be found in Appendix 7.
5 See Appendix 10.
6 See Appendix 10.
7 See Appendix 10.

Insurance

Trade

3.8 We find that the FSAP has so far had no measurable effect on trade in insurance. We forecast that full implementation of the FSAP measures and FSWP legislative proposals will have raised trade in insurance by 2.7 per cent.[8]

Industry structure and competition

3.9 We have found FSAP to have had no measurable impact on general merger and acquisition activity in the period (though there may have been an effect in specific Member States — see below).

Employment

3.10 We find there to have been no measurable impact of the FSAP on overall employment in the insurance sector.

Securities

Trade

3.11 We forecast that full implementation of the FSAP measures and FSWP legislative proposals will have raised cross-border trade in securities business by 3.4 per cent.[9]

Impacts by Member State

Banking: general overview and commentary

3.12 Perhaps not surprisingly the largest impact of the FSAP on the regulatory environment has been seen in the New Member States, but even here it is difficult to disentangle the impact of the FSAP from broader preparations for Accession.

3.13 Similar considerations apply to a number of existing Member States which were all affected by financial liberalisation that gained pace from the mid-1980s. In some respects those countries that embraced the changes (for example Ireland) had anticipated some of the benefits claimed for the FSAP while for others (for example Italy) the impact appears to have been more significant. The Netherlands established a single banking regulator in the wake of FSAP. Deregulation of the UK banking sector was well-established before FSAP and the impact of the FSAP on the UK stems mostly from its potential to open up markets in other Member States.

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8 Details can be found in Appendix 7.
9 Details can be found in Appendix 7.

3.14 The increasing openness of the banking system has been reflected in the increase in the number of branches and subsidiaries of a bank of one Member States that were established in another. Between 1999 and 2004, in the EU15 the number of cross-border branches increased from 529 to 621 and over the same period the number of subsidiaries branches rose from 405 to 507.

3.15 Banking systems have become more concentrated across the EU, though there is limited sign of any convergence across Member States and the overall figure can serve to disguise differences between countries and between different regions of the EU.

Table 3.1: Number of Cross-border (other EU) bank branches and subsidiaries 1998-2005

	*1998**		*1999**		*2000**		2001		2002		2003		2004		2005	
	B	S	B	S	B	S	*B*	*S*	*B*	*S*	*B*	*S*	*B*	*S*	*B*	*S*
Belgium	**25**	**17**	**30**	**21**	**34**	**21**	35	22	36	22	38	21	36	20	*B*	*S*
Denmark	**7**	**4**	**9**	**5**	**9**	**5**	9	10	8	10	16	10	15	8	41	23
Greece	**14**	**-**	**13**	**-**	**13**	**-**	13	3	14	3	14	3	19	5	17	7
Germany	**44**	**32**	**55**	**23**	**60**	**22**	57	21	62	22	64	10	62	21	19	5
Spain	**35**	**38**	**41**	**34**	**41**	**37**	48	43	50	39	49	43	53	42	69	22
France	**52**	**129**	**56**	**134**	**59**	**159**	55	162	51	146	52	126	55	108	57	41
Ireland	**18**	**24**	**26**	**24**	**28**	**24**	32	25	31	25	31	20	31	21	55	107
Italy	**31**	**5**	**39**	**6**	**51**	**7**	50	7	47	7	49	7	50	6	31	22
Luxemburg	**61**	**96**	**60**	**99**	**55**	**96**	55	86	48	82	41	80	38	79	59	10
Netherlands	**0**	**0**	**3**	**0**	**5**	**0**	5	2	7	2	7	0	7	0	36	0
Austria	**6**	**10**	**12**	**9**	**13**	**10**	15	12	15	12	18	12	18	11	7	0
Portugal	**15**	**8**	**15**	**6**	**15**	**8**	23	9	21	9	22	11	26	9	25	14
Finland	**6**	**3**	**7**	**3**	**5**	**3**	18	3	19	3	18	3	19	5	24	9
Sweden	**14**	**6**	**16**	**7**	**19**	**7**	17	7	16	7	15	9	17	9	19	11
United Kingdom	**98**	**15**	**97**	**15**	**95**	**16**	86	16	84	16	79	14	81	19	18	17
Czech Republic							9	16	8	18	8	18	9	19	12	17
Estonia							1	3	1	3	1	3	3	3	6	4
Cyprus							5	7	5	10	5	9	4	9	4	9
Latvia							1	3	1	3	1	3	1	5	1	6
Lithuania							3	2	3	3	2	3	2	5	2	5
Hungary							0	25	0	21	0	22	0	20	3	20
Malta							0	7	0	7	0	8	0	8	0	9
Poland							0	34	0	35	0	35	3	32	7	33
Slovenia							1	4	1	5	1	5	2	5	3	6
Slovakia							2	13	2	14	3	15	3	15	5	15
Total EU15/EU25	**426**	**387**	**479**	**386**	**502**	**415**	**540**	**542**	**530**	**524**	**534**	**490**	**554**	**484**	**520**	**412**

*Notes: B=branches; S= subsidiaries; * Figures for 1998 to 2000 are Europe Economics estimates*

Source: ECB, Europe Economics

Table 3.2: CR5 asset ratios, 1999-2005 (%)

	1999	2000	2001	2002	2003	2004	2005
EU15							
Austria	41	43	45	46	44	44	45
Belgium	76	75	78	82	83	83	85
Denmark	71	60	68	68	67	67	66
Finland	86	87	80	79	81	83	83
France	43	47	47	45	47	45	54
Germany	19	20	20	20	22	22	22
Greece	67	65	67	67	67	65	66
Ireland	41	41	43	46	44	44	46
Italy	25	23	29	31	27	26	27
Luxembourg	26	26	28	30	32	30	31
Netherlands	82	81	83	83	84	84	85
Portugal	44	59	59.8	60.5	63	67	69
Spain	41	46	45	44	44	42	42
Sweden	56	57	55	56	54	54	57
UK	28	28	29	30	33	35	36
New Member States							
Czech Republic			68	66	66	64	66
Estonia			99	99	99	99	98
Cyprus			62	58	57	57	60
Latvia			63	65	63	62	67
Lithuania			88	84	81	79	81
Hungary			56	55	52	53	53
Malta			81	82	78	79	75
Poland			55	53	52	50	49
Slovenia			70	68	66	65	63
Slovakia			66	66	68	67	68
Weighted averages (GDP weights)							
EU25			**40**	**40**	**41**	**41**	**43**
EU15	**37**	**38**	**39**	**39**	**40**	**40**	**42**
Euronext	**54**	**53**	**58**	**57**	**59**	**58**	**64**
Nordo-Baltic			**69**	**78**	**77**	**77**	**78**
Mediterranean/Iberian			**38**	**37**	**34**	**33**	**33**
New Member States			**61**	**59**	**58**	**57**	**56**

Source: ECB, Europe Economics

3.16 Table 3.2 illustrates that concentration has increased considerably over the period of the FSAP. Across the EU15 the CR5 ratio (i.e. the percentage of the total market assets controlled by the largest five firms) for credit institutions has risen from 37 to 42, but individual countries still vary a great deal with Belgium, the Netherlands and Finland most concentrated and (for very different reasons) the UK and Germany on the lowest ratios.

3.17 Among New Member States concentration is higher than in the EU15. In contrast, the Mediterranean/Iberian bloc[10] is less concentrated, though this is largely driven by low concentration in Italy. The highest concentration bloc is the Nordo-Baltic group[11], whilst the Euronext bloc[12] is also quite concentrated.

3.18 The structure of the German banking system is very different from that elsewhere: the private sector administers only about 30 per cent of the assets while the other two sectors — the local banks and the co-operative banks — are very diffuse. The UK banking sector is dominated by nine major groups (all of which can be classed as financial conglomerates) but the UK banking sector as a whole is one of the most diverse and open in the world.

3.19 A similar picture emerges from the Herfindahl index.

Table 3.3: Herfindahl Index, 1997 and 2005

	1997	2005
Austria	515	560
Belgium	699	2108
Denmark	1431	1115
Finland	2150	2730
France	449	758
Germany	114	174
Greece	885	1096
Ireland	500	600
Italy	201	230
Netherlands	1654	1796
Portugal	577	1154
Spain	285	487
Sweden	830	845
UK	208	399

Source: ECB

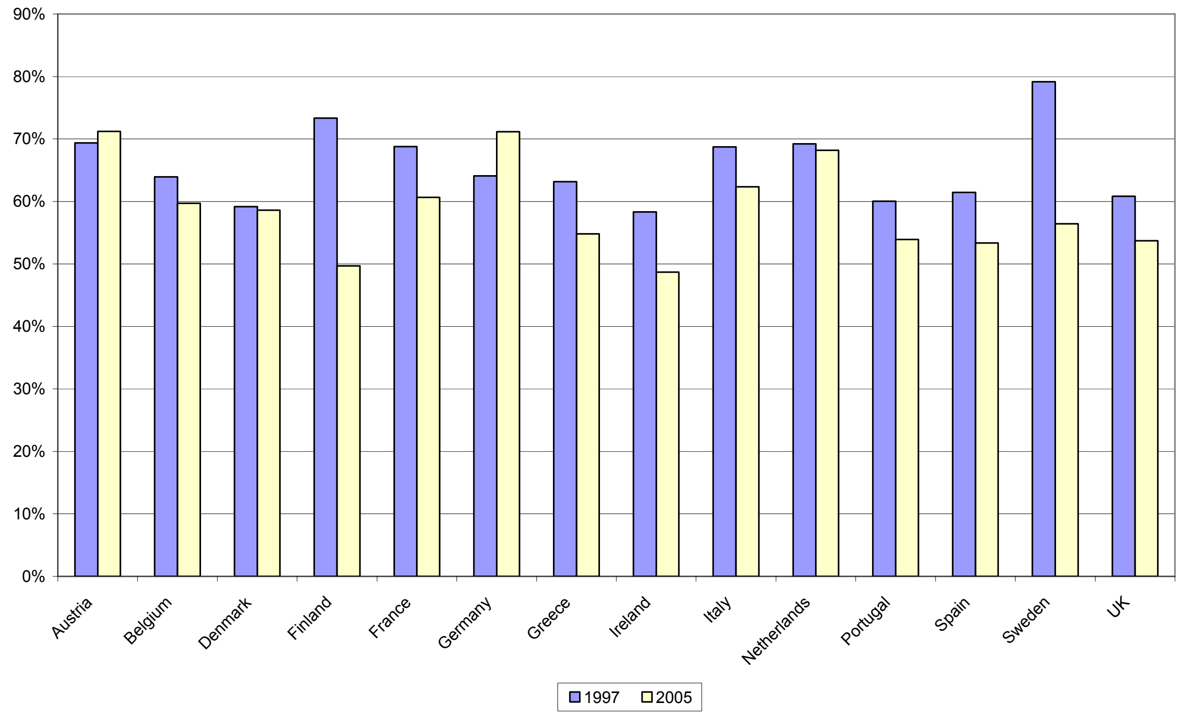
10 The Mediterranean/Iberian bloc consists of Greece, Spain, Italy, Portugal, Cyprus, and Malta.
11 The Nordo-Baltic bloc includes: Denmark, Finland, Sweden, Estonia, Latvia, and Lithuania.
12 The Euronext bloc consists of Belgium, Netherlands, France and Portugal — note that for our purposes here we exclude the UK, even though in 2002 Euronext acquired the London International Financial Futures and Options Exchange.

3.20 This Herfindahl index is a measure of the size of firms in relationship to the industry and is an indicator of the scope for competition among them. Decreases in the index generally indicate a loss of pricing power and an increase in competition. In broad terms an index below 1,000 indicates an un-concentrated industry, between 1,000 to 1,800 indicates moderate concentration, and anything above 1,800 indicates high concentration.

3.21 The table shows that, across the EU15, credit institutions are relatively un-concentrated (under 1,000) but this hides some significant differences between countries and regions that were more visible in the CR5 ratios.

3.22 We can identify no direct relationship between concentration and cost-to-income ratios, but (as illustrated in Figure 3.1) with the exceptions of Germany and Austria, all Member States have seen a reduction in cost-to-income ratios in their banking sectors during the period of the FSAP, with Sweden and Finland exhibiting the largest cost-reducing change, and Austria and Germany actually exhibiting increases.

Figure 3.1: Ratio of Operating Expenses to Income, 1997 & 2005, selected Member States (expressed as %)



Source: EU Banking Structures

3.23 Returns on Assets (ROA) are summarised for 1998-2005 in Table 3.4.

Table 3.4: Return on assets before tax for credit institutions, 1998 & 2005, selected Member States (%)

	1998	2005
Austria	0.5	*0.4*
Belgium	0.3	*0.7*
Czech Republic	-1.0	*1.8*
Denmark	1.0	*1.0*
Finland	0.5	*1.5*
France	0.4	*0.6*
Germany	0.1	*0.0*
Greece	N/A	*1.04*
Ireland	1.4	*0.8*
Italy	0.9	*0.7*
Luxemburg	0.6	*0.5*
Netherlands	0.6	*0.6*
Poland	1.6	*0.9*
Spain	N/A	*0.88*
Sweden	0.9	*0.7*
UK	1.2	*1.3*

Source: ECB, OECD, Europe Economics estimates

3.24 Noteworthy increases in returns can be seen in the Czech Republic and Finland, whilst in Poland and Ireland there are material decreases.

Banking: specific analysis by Member State

Trade

3.25 The estimates of our quantitative model of effects on trade in banking for individual Member States are reported in Table 3.5.[13]

[13] Details can be found in Appendix 8.

Table 3.5: Effects of the FSAP measures and FSWP legislative proposals on trade in banking services by Member State

	Effect up to mid-2006 (% rise)			Further effect of full implementation of rest of NFSF (% rise)		
Country	Trade in other Fin. Services	*Imports*	*Exports*	Trade in other Fin. Services	*Imports*	*Exports*
Austria	**2.2**	***1.8***	***2.2***	**1.2**	***1.0***	***1.3***
Belgium	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Cyprus	**2.1**	***1.7***	***2.1***	**1.3**	***1.1***	***1.4***
Czech Republic	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Denmark	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Estonia	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Finland	**1.6**	***1.3***	***1.7***	**1.8**	***1.5***	***1.8***
France	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Germany	**1.4**	***1.2***	***1.4***	**2.0**	***1.6***	***2.1***
Greece	**2.0**	***1.6***	***2.0***	**1.4**	***1.2***	***1.5***
Hungary	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Ireland	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Italy	**1.3**	***1.1***	***1.4***	**2.1**	***1.7***	***2.1***
Latvia	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Lithuania	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Luxembourg	**1.4**	***1.1***	***1.4***	**2.0**	***1.7***	***2.1***
Malta	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Netherlands	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Poland	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Portugal	**1.8**	***1.4***	***1.8***	**1.6**	***1.4***	***1.7***
Slovakia	**1.7**	***1.4***	***1.8***	**1.7**	***1.4***	***1.7***
Slovenia	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Spain	**1.4**	***1.2***	***1.5***	**2.0**	***1.6***	***2.0***
Sweden	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
UK	**1.7**	***1.4***	***1.8***	**1.7**	***1.4***	***1.7***

Source: Europe Economics

Openness to foreign firms

3.26 We find that the FSAP has tended to increase openness to foreign banks in the following Member States: Austria; Cyprus; Germany; Greece; Hungary; Italy; Lithuania; Poland; Spain; Sweden.

3.27 We find that the FSAP has had slight, limited or no effect on openness to foreign banks in the following Member States: Czech Republic; Denmark; Estonia Finland; France; Greece; Ireland; Latvia; Luxembourg; Netherlands; Portugal; Slovakia; Slovenia; United Kingdom.

3.28 In Belgium the FSAP is considered to have changed the form of access by foreign firms, without having a material impact on the degree of openness.

3.29 Member States unaffected fall into three broad categories:

(a) those that already had an established tradition of being extremely open — e.g. the UK;

(b) those that were, independently of the FSAP, already striving to be considerably more open — e.g. Czech Republic, Ireland; and

(c) those that were not open prior to the FSAP, and remain not open — e.g. France.

Industry structure and competition

3.30 We find that the FSAP has tended to increase competition in banking in the following Member States: Cyprus; Hungary; Ireland; Italy; Latvia; Lithuania; Malta; Spain.

3.31 We find that the FSAP has had little or no effect on competition in the following Member States: Austria; Belgium; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Luxembourg; Netherlands; Poland; Portugal; Slovakia; Slovenia; Spain; Sweden; UK.

3.32 Where it enhances competition, the single most important mechanism is that the FSAP increases openness to foreign firms, and hence either actively leads to entry and an increased number of players, or else creates a threat of entry, thereby increasing contestability.

3.33 Those states for which the FSAP did not increase competition fall into three basic categories:

(a) Those for which openness was not high and was not enhanced — France, Netherlands;

(b) Those that were open before the FSAP or were becoming more open independently of the FSAP — Czech Republic, UK, Denmark, Finland, Sweden;

(c) Those for which openness was increased, but there was already a highly competitive banking sector before the FSAP — Germany.

Competitiveness/Productivity/Efficiency

3.34 We understand "competitiveness" in terms of the relative efficiency and attractiveness of the output of domestic firms compared with foreign firms. Thus competitiveness is intimately connected to efficiency and productivity.

3.35 On state-by-state analysis we find that the FSAP has tended (or will in the future tend) to increase competitiveness or increase efficiency or productivity in the following Member States: Czech Republic; France; Germany; Ireland; Italy; Latvia; Poland; Spain; UK (though the short-term impact in the UK is assessed as negative).

3.36 We find that the FSAP has had little or no effect on competitiveness, productivity or efficiency in the following Member States: Austria; Belgium; Cyprus; Denmark; Estonia; Finland; Hungary; Lithuania; Luxembourg; Malta; Netherlands; Portugal; Slovakia; Slovenia; Spain; Sweden; UK (in the short-term).

3.37 Our econometric model of impacts gives the (weak) result that, so far, there has been no overall general measurable impact on cost-to-income ratios in the EU15, but that there may be some evidence of a material effect for New Member States.[14]

3.38 We emphasize that this is not a statistically strongly significant result, and that it can properly be interpreted only as indicative of a direction and materiality of effect, and point us at the group of countries involved. Thus we consider it inappropriate to present a table applying our numbers to individual Member States.

3.39 We should emphasize that an important distinction arose in this area between the short term and the long term. In certain Member States (most notably the UK) openness was already high, the market subject to competition and regulation functioning well, so that the main short-term impact has been to raise compliance costs and thereby to damage competitiveness. However, in the longer term the process will open up new opportunities for industry players in these Member States to operate more vigorously (or at all) in certain other Member States for which FSAP measures have been liberalising and increased openness.

3.40 On the other hand, in other cases Member States (particularly certain of the post-Communist New Member States) have gained competitiveness in the short term because of increased access to EU15 capital markets, but in the longer term it seems likely that the FSAP will be de-liberalising for these Member States, because before EU Accession they had already set themselves on a more open and liberal regulatory path than it seems likely the EU will achieve for many decades.[15]

Employment

3.41 We find that the FSAP has not yet tended to increase employment significantly in any Member State. We expect a future increase in Malta.

3.42 We find that the FSAP has tended to slightly decrease employment in the following Member States: Belgium; Italy; Sweden.

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14 A hypothetical extreme case of a Member State that joined the EU and in its Accession year implemented the whole of the FSAP and FSWP legislative measures would deliver (on our model) a fall in the cost-to-income ratio of 31 percentage points, but each year over which the implementation process is spread reduces this effect by one percentage point. So, for example, if the FSAP and FSWP legislative measures were to be implemented over a ten-year period, the reduction in the cost-to-income ratio for a New Member State would be 21 percentage points.

15 It is perhaps worth remarking that in these cases greater regulation may also mean greater consumer protection — though this is by no means universally clear.

3.43 In other Member States the effect so far is assessed as negligible or slight. Of interest is Germany, where the possibility is raised that a future consequence of the FSAP may be some transfer of jobs out of banking to the securities sector, as equity becomes a more significant source of business finance.

Consumer protection

3.44 We find that the FSAP has tended to increase consumer protection in the following Member States: Belgium; Cyprus; Czech Republic; Denmark; Finland; France; Germany; Hungary; Italy; Lithuania; Slovenia.

3.45 Consumer protection has tended to be affected negatively in the following Member States: Netherlands; Sweden; UK.

3.46 Member States for which there was an improvement appear to divide between those in which the previous degree of consumer protection may have been inadequate — a group that includes Czech Republic, Finland and Lithuania — those in which the FSAP measures have tended to focus consumer protection more appropriately — a group including Belgium, Cyprus, France, and Germany — those in which the FSAP enabled consumers to become better-informed about products — including Denmark and Hungary — and those in which greater competition enhanced consumer choice and hence provided consumers with greater means to protect themselves — including Slovenia.

3.47 Member States for which consumer protection was affected negatively appear to divide between those in which consumer protection was traditionally very strong (probably too strong) — those in which market processes to provide consumer protection may have been undermined by FSAP measures — the UK — and those in which the complexity of FSAP measures has reduced consumer understanding and made consumers more vulnerable — Sweden.

3.48 These drivers of negative impact on consumer protection and the interaction of informed consumer choice and consumer protection seem to us of particular interest, and are discussed at more length below (paragraph 4.6(c)).

Summary table

3.49 Table 3.6 summarizes the findings of our country lots by Member State.

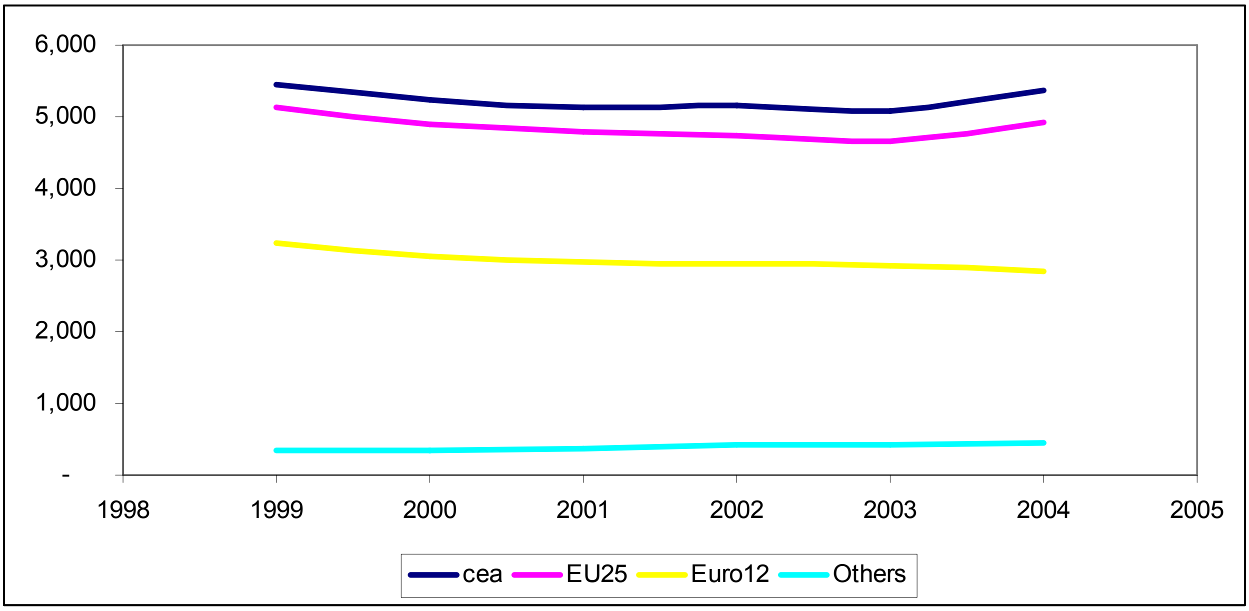
Table 3.6: Summary by Member State of impacts in Banking

	Impact of FSAP measures and FSWP legislative proposals on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Austria	Slightly positive	Slightly positive	Slightly positive	Unclear	Slightly negative in short term, perhaps positive in the long term
Belgium	Affected form of entry	Slightly positive	Positive	Unclear	Perhaps slightly negative
Cyprus	Positive	Positive	Positive	Unclear	Limited in short term. Perhaps positive in the long term
Czech Republic	Limited	Slightly positive	Significantly positive	Positive	Slightly positive
Denmark	Limited	Negligible	Positive	Negligible	Negligible
Estonia	Limited	Limited	Negligible	Negligible	Negligible
Finland	Limited	Negligible	Positive	Limited	Limited
France	Limited	Negligible	Perhaps positive	Positive	Limited
Germany	Positive	Slightly positive	Positive	Positive	Negligible in short term (negative in future)
Greece	Slightly positive	Slightly positive	Positive	Unclear	Slightly negative in short term, perhaps positive in the long term
Hungary	Positive	Positive	Positive	Slightly positive	Unclear
Ireland	Slightly positive	Limited	Limited	Positive	Limited
Italy	Positive	Positive	Perhaps positive	Positive	Somewhat negative
Latvia	Slightly positive	Positive	Slightly positive	Positive	Slightly positive
Lithuania	Positive	Positive	Positive	Limited	DNA
Luxembourg	Limited	Limited	Limited	Limited in short term. Unclear in long term.	Limited in short term. Unclear in long term.
Malta	Limited	Positive	Unclear so far, positive in future	Unclear so far, net positive in future	Positive
Netherlands	Limited	Almost none	Negative in short term (perhaps less negative in longer-term)	Limited	Unclear (perhaps positive)
Poland	Positive	Limited	Slightly positive	Positive	Perhaps negative in the short-term; Perhaps positive in the long-term
Portugal	Slightly positive	Slightly positive	Slightly positive	Slightly positive	Unclear
Slovakia	Negligible	Limited	Limited	Slightly negative in the long run	Negligible
Slovenia	Slightly positive	Slightly positive	Positive	Limited. Perhaps negative in the future	
Spain	Positive	Perhaps positive	Negligible	Perhaps positive	Negligible
Sweden	Positive	Negligible	Perhaps negative	Limited	Negative
United Kingdom	Negligible	Negligible	Negligible (or perhaps slightly negative)	Negative in the short-term (perhaps positive in the longer-term)	Negligible

Insurance: general commentary and overview

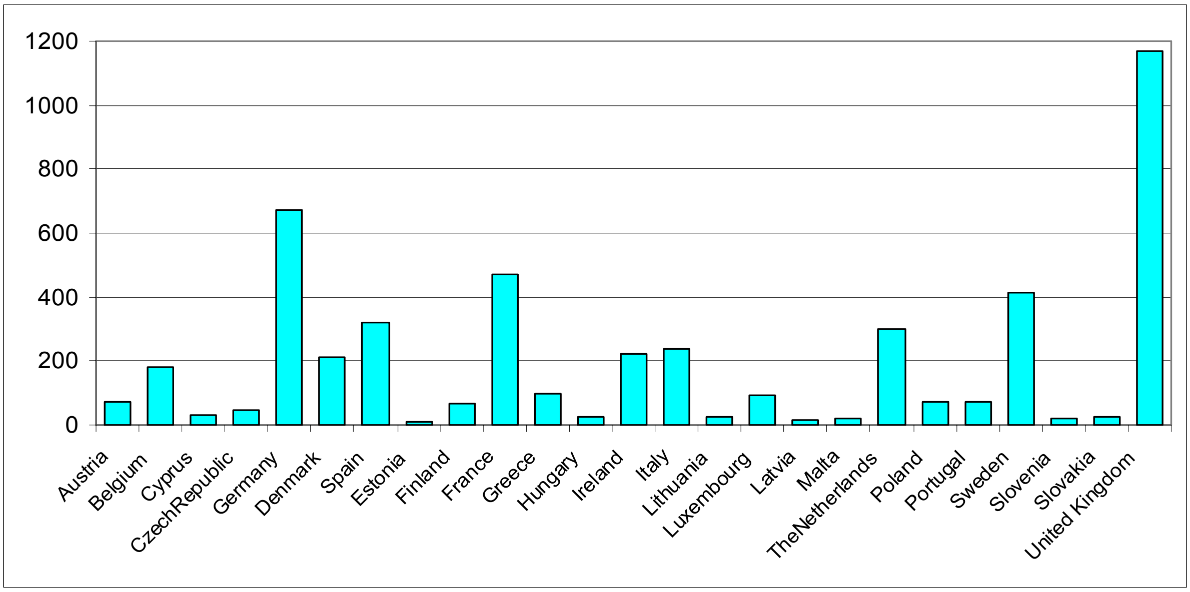
3.50 During the period of the FSAP there has been a rise in the number of insurance companies in the EU25, but a reduction in the Eurozone, reflecting scope for consolidation in the former as well as moves by EU insurance companies to establish operations (branches and subsidies) in New Member States. However, the number of insurance companies in operation varies markedly across Member States.

Figure 3.2: Total number of insurance companies EU 1999-2004



Source: CEA, European Insurance in Figures 2006

Figure 3.3: Number of insurance companies in EU (2004)



Source: CEA, European Insurance in Figures, 2006, http://www.ceiops.org/media/files/publications/reports/SA2004p.pdf.

Table 3.7: Total premiums held: 1999-2004 (€[16] million)

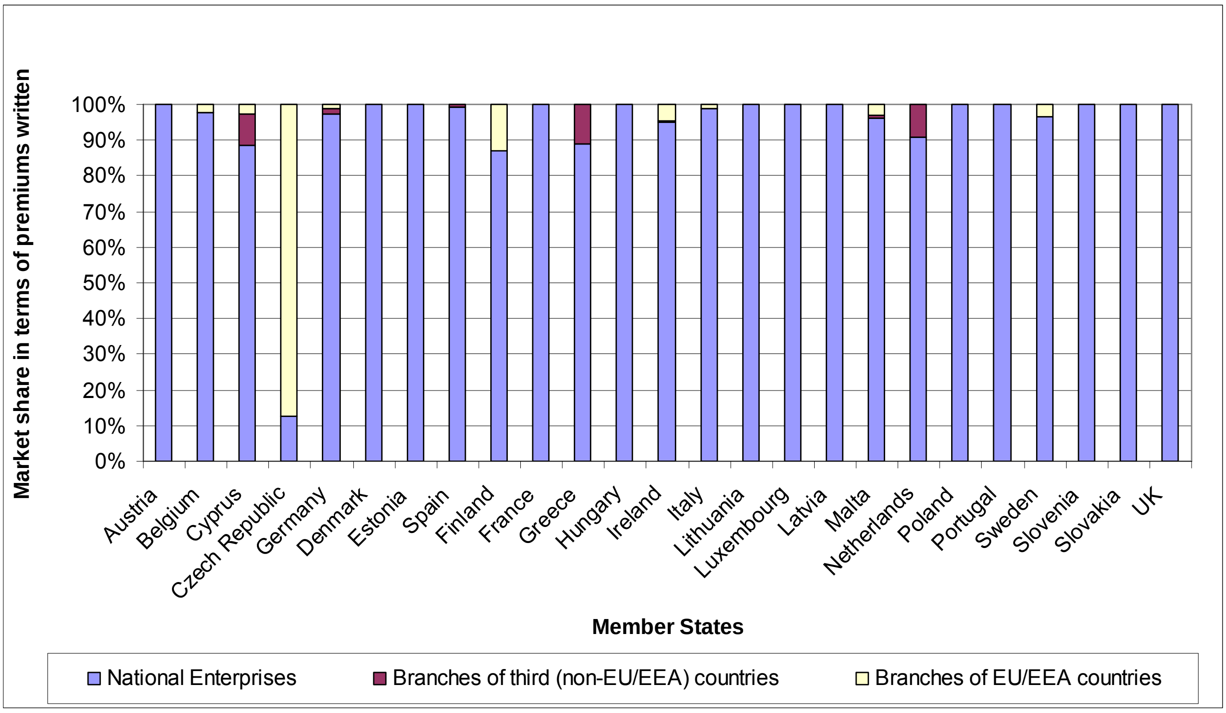
	1999	2000	2001	2002	2003	2004
Belgium	16,936	20,031	20,354	22,275	25,784	19,891
Czech Republic	1,824	2,013	2,502	295	3,286	3,499
Denmark	10,562	1,143	1,275	13,426	14,754	15,756
Estonia	91	106	117	140	168	189
Finland	10,398	11,748	11,819	12,247	12,674	13,191
France	114,023	131,335	128,059	131,998	142,028	158,226
Germany	127,833	13,182	136,124	141,335	14,711	152,124
Ireland	6,787	8,321	10,518	11,208	11,884	11,998
Italy	61,843	67,659	76,255	87,709	96,993	101,038
Lithuania	118	111	126	224	236	269
Luxembourg	5,777	6,854	6,333	6,444	7,333	8,972
Netherlands	35,803	39,546	43,469	44,117	46,042	48,695
Poland	4,849	5,414	6,358	6,006	5,646	6,091
Spain	32,327	40,851	42,063	48,223	416	45,224
Switzerland	15,374	18,787	17,401	1,696	19,264	19,169
United Kingdom	201,081	247,663	234,471	233,333	206,351	219,845
EU 15	**658,801**	**757,387**	**762,718**	**793,294**	**797,625**	
EU 25	**669,228**	**768,908**	**77,613**	**807,534**	**812,388**	

Source: CEA, European Insurance in Figures 2006 and FIM report

3.51 The markets in the EU insurance sector are still dominated by national companies. In the Life sector in 2004, in only three Member States (the Czech Republic, Cyprus and Greece) did foreign companies have a market share of premiums written of more than 10 per cent.

[16] The euro, US dollar and UK pound sterling are referred to throughout our reports by their symbols: €, $ and £ respectively. All other currencies are referred to using three letter codes, preceding the value and/ or units as appropriate, e.g. SEK 1.2 million in respect of the Swedish Kroner.

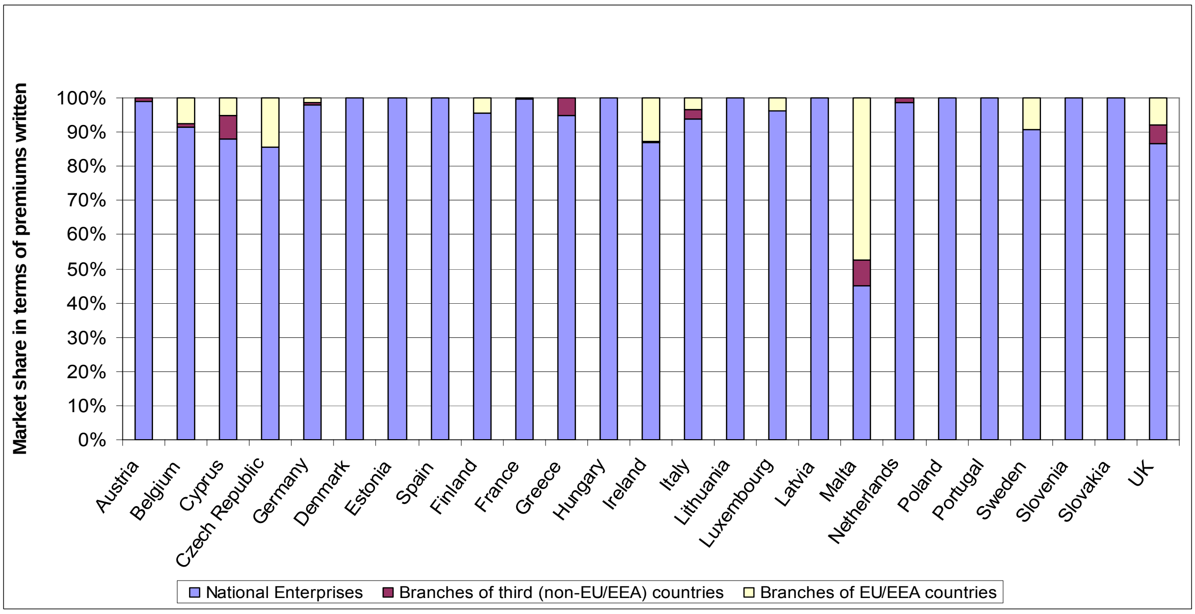
Figure 3.4: Market share (%) of foreign and national life insurance enterprises (2004)



Source: CEIOPS

3.52 The markets for Non-Life insurance were rather more open to foreign competition at the time. In six Member States the market share of foreign companies was higher than 10 per cent.

Figure 3.5: Market share (%) of foreign and national Non-life insurance enterprises (2004)



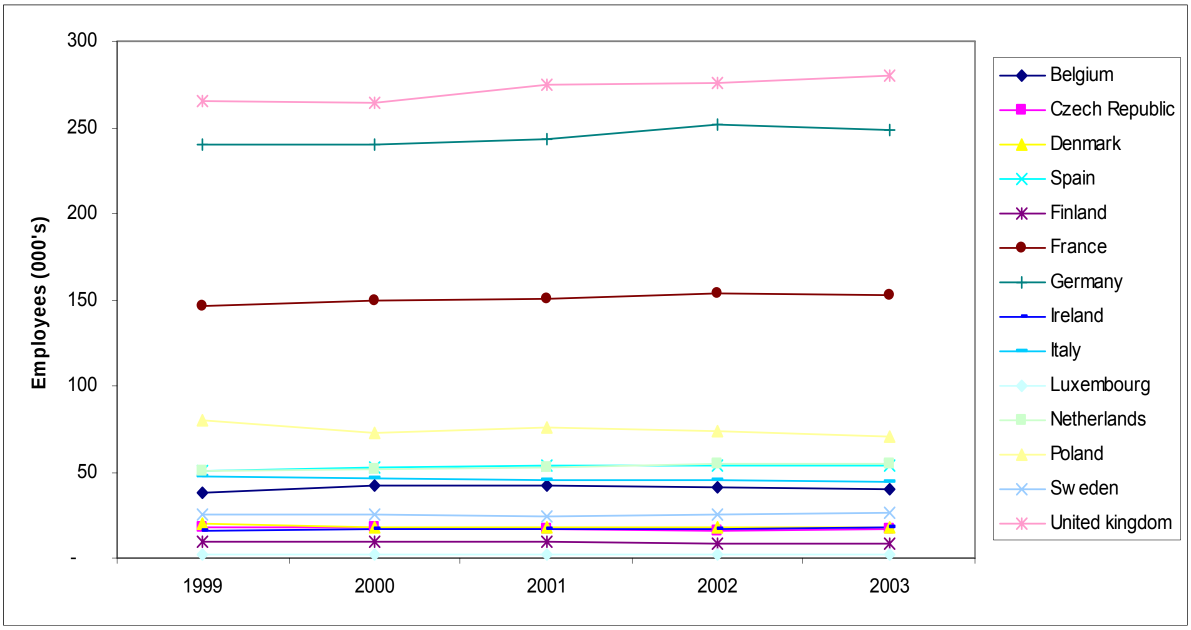
Source: CEIOPS

3.53 Growth in the Irish insurance market has occurred through increase in local suppliers and the share of foreign undertakings fell from more than 35 per cent at the beginning of the 1990s to less than 5 per cent in 2004.

3.54 Insurance is a concentrated market in some countries, but this is not always a straightforward picture. For example, the Belgian insurance industry is very concentrated, the top five companies accounted for over 70 per cent market share in 2004 and the top three for just under 54 per cent, but most of these are part of multinational groups and these groups are also active in overseas markets. In Ireland the ten largest companies controlled 90 per cent of the market and the largest five about 65 per cent, but membership of the five biggest players has changed over time.

3.55 Figure 3.6 gives employment in the insurance sector, 1999-2003, in selected Member States.

Figure 3.6: Employment in the Insurance sector in selected EU Member States 1999-2003



Source: University of Groningen

3.56 Ireland and Sweden have maintained trends for insurance sector employment going back to before the FSAP. Italian insurance sector employment has been falling since 1993, and in Finland since 1995. In Spain there was a sharp rise from the late 1980s to 1998, but stable since then.

3.57 More recently, in UK the IMD has had a significant effect in reducing intermediaries on a scale that must be presumed to reduce competition (as is explained in more detail below).

Insurance: specific analysis by Member State

Openness to foreign firms

3.58 We find that the FSAP has tended to increase openness to foreign insurance firms in the following Member States: Belgium; Czech Republic; Estonia; Italy; Latvia; Lithuania; Netherlands; Poland.

3.59 We find that the FSAP has had limited or no effect on openness to foreign insurance firms in the following Member States: Austria; Cyprus; Denmark; Finland; France; Germany; Greece; Hungary; Ireland; Luxembourg; Malta; Portugal; Slovakia; Slovenia; Sweden; United Kingdom.

3.60 In Spain the FSAP is considered to have changed the form of access by foreign firms, without having a material impact on the degree of openness.

Industry structure and competition

3.61 We find that the FSAP has tended to increase competition in insurance services in the following Member States: Belgium (in the long term); Czech Republic; Ireland (in the long term); Italy; Latvia; Poland; Slovakia; Spain.

3.62 In addition the impact is thought to be slightly positive in the Netherlands.

3.63 We find that the FSAP has had limited or no impact on competition in insurance services in the following Member States: Denmark; Lithuania; Sweden.

3.64 The most important driver of increased competition in insurance appears to be increased openness to foreign firms — apart from Spain, every case of increased competition is also one of increased openness to foreign firms, whilst only in the case of Lithuania is there increased openness to foreign firms but negligible impact on competition. This positive impact on competition is, of course, one of the key advantages of opening up markets to foreign entry and to trade.

3.65 In the UK, the FSAP is considered to have had a negative impact on competition — specifically because implementation of the Insurance Mediation Directive is believed to have led to a very significant fall in the number of small firms offering, as a sideline, specialist insurance brokerage services (e.g. pet insurance, insurance of musical instruments, and so on) — some 80-90 per cent of firms are believed to have exited the market.[17]

[17] Our understanding is that there is some debate as to whether this is not, strictly, a result of the Directive itself, but, rather, occurred because the UK Financial Services Authority implemented the IMD in a form not required by the Directive. We do not propose to enter into this debate here. For our purposes it is enough to regard this outcome as a consequence of the FSAP, regardless of whether it was strictly a requirement of the Directive concerned.

Competitiveness/Productivity/Efficiency

3.66 We find that the FSAP measures and FSWP legislative proposals have tended to increase the competitiveness of insurance services firms in the following Member States:

(a) Czech Republic (note that in this case increased competitiveness is an anticipated effect of Solvency II (increased cross-border business allowing greater opportunity to exploit economies of scale), and that no increase in competitiveness is believed yet to be observable).

(b) Italy (in this case, our view is that the FSAP has tended to encourage restructuring (specifically consolidation) in the Italian insurance industry, and that this consolidation has tended to improve efficiency).

(c) Slovakia (here it appears that the FSAP has reduced the regulatory burden and levelled the playing field versus other Member States).

3.67 In addition, it is considered possible that competitiveness in France may be enhanced in the long-term, since the FSAP may create greater opportunities for French insurers to operate in other EU markets.

3.68 For the UK, the impact on competitiveness is assessed as negative, but it should be emphasized that this is not (mainly) because the FSAP is believed to decrease efficiency for UK insurers. Instead, the results arises because our view is that, first, prior to the FSAP the regulatory environment in respect of insurance services was superior (from the point of view of firms) in the UK to that in other parts of the EU, and, second, the FSAP represents a material improvement in the regulatory environment for most parts of the EU whilst leaving the UK environment relatively less affected.[18] As a consequence, the UK's regulatory advantage is reduced, as the regulatory "playing-field" is levelled. This means that the UK's relative competitive advantage is reduced.

3.69 For certain New Member States (e.g. Malta) the assessment is that competitiveness is reduced by the FSAP, principally because the scope for gaining business through regulatory competition is undermined whilst other positive competitiveness gains are not realised.

Employment

3.70 We find that the FSAP has tended to increase employment in insurance services only in Ireland, with potential future positive impacts in Germany and Spain.

3.71 Negative impacts on employment in insurance services are found for Belgium; Denmark; Italy; Malta; Poland; UK.

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[18] The effect for the UK may have been slightly negative, but this is less significant than the playing-field-levelling effect we are discussing.

3.72 With the exception of the UK (where the key driver is the IMD-related effect discussed above at paragraph 3.65) the attributions of these effects to the FSAP are speculative. In the case of Belgium, the driver is believed to be enhanced competition in the future, increasing labour efficiency in the sector (but without increasing overall volumes of business).[19]

Consumer protection

3.73 We find that the FSAP has tended to increase consumer protection in insurance services in the following Member States:

(a) Belgium (the FSAP has led to increased understanding of products);

(b) Cyprus (greater competition with enhance consumer protection);

(c) Czech Republic (the FSAP appears to have stimulated the creation of an ombudsman by the end of 2008);

(d) Estonia; Latvia; Lithuania; Malta (the FSAP provides a regulatory minimum level of consumer protection, reducing the pressure for these Member States to undercut regulatory protections to attract financial services firms wishing to avoid regulation);

(e) Hungary (enhanced transparency, reduced information asymmetry, and greater credibility of regulation);

(f) Ireland (in this case, consumer confidence seems to have grown);

(g) Italy (consumer understanding of products seems to have increased as a consequence of the FSAP);

(h) Slovenia (here the view is that the FSAP has provided a norm to which domestic regulatory and market trends have converged);

(i) UK (the elimination of many diverse non-specialist insurance advisors, some of whose advice might have been of doubtful worth and who may have lacked the ethical culture normal in more regularised parts of the insurance industry, may have added to consumer protection).

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[19] We note that our view in this diverges from that of respondents to our survey, who believed that the impact of the FSAP would be positive.

Summary table

3.74 Table 3.8 summarizes the findings of our country lots by Member State.

Table 3.8: Summary by Member State of impacts in Insurance

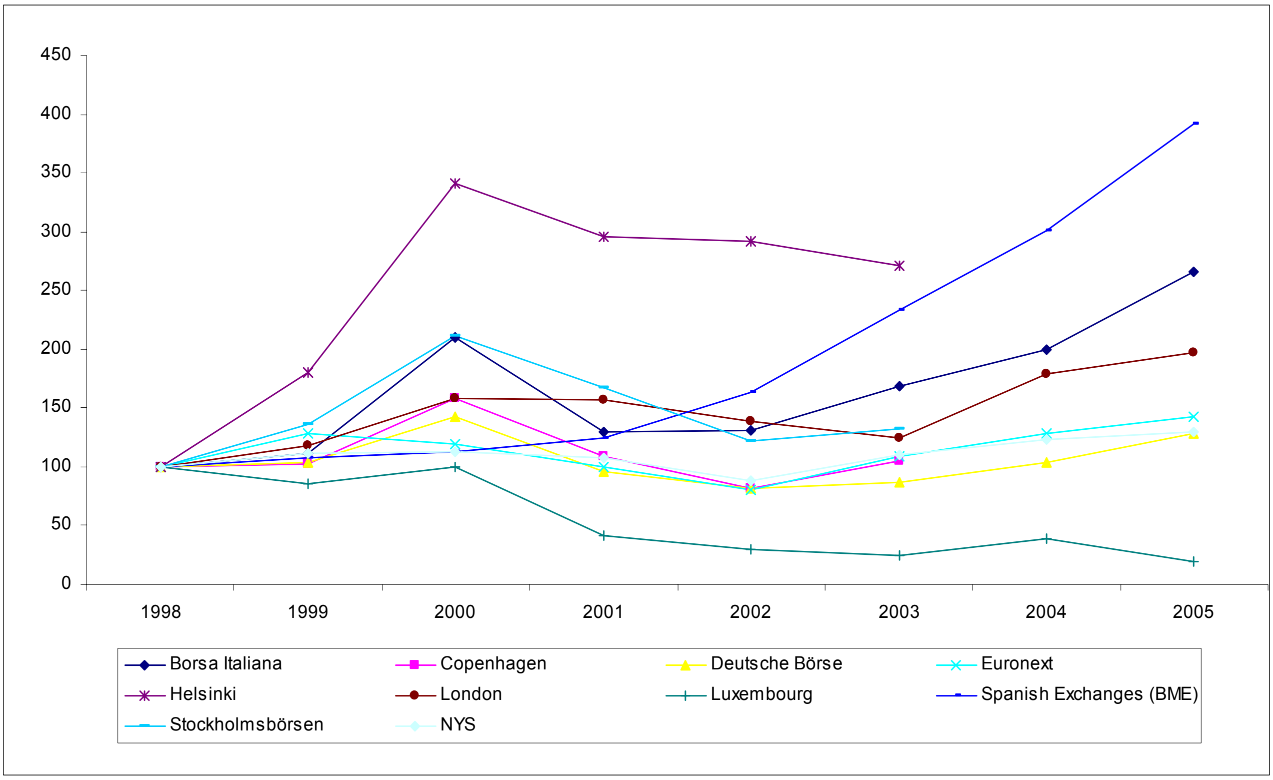
	Impact of FSAP measures and FSWP legislative proposals on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Austria	Slightly Positive	Slightly positive	Slightly positive	Unclear	Slightly positive
Belgium	Probably positive in long term	Probably positive in long term	Positive	Limited	Limited — perhaps slightly negative
Cyprus	Unclear. Perhaps positive in the future	Unclear	Positive	Unclear	Unclear. Perhaps positive in the future
Czech Republic	Positive	Positive	Positive	Positive	Unclear
Denmark	Limited (Perhaps slightly positive)	Limited, if any	Unclear	Limited	Perhaps negative
Estonia	Positive in future	Positive in future	Positive	Negative	Negligible
Finland	Slightly Positive	Limited	Negligible	Limited	Limited
France	Negligible	Unclear	Limited	Limited (perhaps slightly positive)	Negligible
Germany	Limited	Negligible	Limited	Negligible	Negligible (perhaps positive in the future)
Greece	Unclear. Perhaps positive in the future	Unclear. Perhaps positive in the future	Unclear. Perhaps positive in the future	Unclear	Unclear. Perhaps positive in the future
Hungary	Limited	Limited	Positive	Limited	
Ireland	Limited	Perhaps positive in the future	Limited	Limited	Limited
Italy	Positive	Positive	Positive	Positive	Perhaps negative
Latvia	Positive	Positive	Slightly positive	Negligible	Positive
Lithuania	Positive	Negligible	Positive	DNA	Negligible
Luxembourg	Limited	Limited	Limited	Limited in short term. Perhaps negative in long term.	Limited in short term. Perhaps negative in long term.
Malta	Limited	Possibly positive	Negative in future	Negative in future	Positive
Netherlands	Positive	Slightly positive	Perhaps negative	Negative (perhaps positive in the future)	Limited
Poland	Positive	Positive	Positive in some respects, but negative in others	Limited in short-term; Probably positive in longer-term	Perhaps negative
Portugal	Slightly positive in future	Slightly positive in future	Slightly positive in future	Slightly positive in future	Unclear
Slovakia	Negligible	Positive	Slightly positive	Positive	Negligible
Slovenia	Limited, perhaps positive in the future	Limited	Positive	unclear	Limited
Spain	Affected form of entry	Positive	Limited	Negligible	Perhaps slightly positive
Sweden	Negligible	Negligible	Limited	Limited	Negligible
United Kingdom	Negligible	Negative	Perhaps slightly positive	Negative	Strongly Negative

Securities: general overview and commentary

General commentary

3.75 During the period of the FSAP stock markets in Europe have been subject to considerable volatility, but, in almost all Member States, have risen over the period.

Figure 3.7: Selected EU exchanges 1998-2005 (1998 = 100)



Source: World Federation of Exchanges, Europe Economics. Data not available for Copenhagen, Stockholmbörsen and Helsinki 2004-2005.

3.76 As mentioned above, the period has seen a number of significant developments in exchange infrastructure:

(a) Development of OMX;

(b) Development of Euronext;

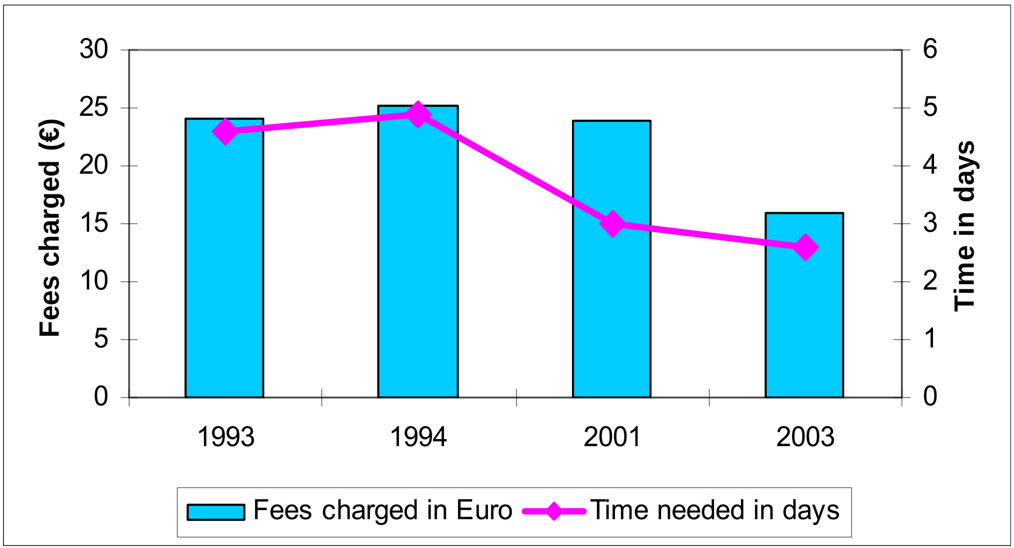
(c) The rise and fall of Nasdaq Europe;

(d) Various takeover activity;

(e) A further, potentially significant, development was reported on 15 November 2006 — so-called “Project Turquoise”. Citigroup, Morgan Stanley, Goldman Sachs, Merrill Lynch, UBS, Credit Suisse, and Deutsche Bank were reported as being about to create a new pan-European system for trading shares to rival Europe's top stock exchanges, as a response to MiFID.[20]

3.77 We can also see progress towards the pan European market through the erosion of barriers to cross-border trade. Figure 3.8 below shows that average fees have been reduced.

Figure 3.8 Average fees for €100 cross-border transfer 1993-2003



Source: Commission Services, 2004

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20 This group of firms stated its intention to create a system "within months", before MiFID comes into force in November 2007. The firms are said to feel that they are paying too much on the LSE, with sources quoting trading costs being 80 per cent higher than in the US. Also, they feel that the business on the LSE has been soaring and they want their share ("we're paying for that").

They have signed a letter of intent to pool their trade transparency data, which would in effect create the pan-European platform for the collection and sale of trading data (pre- and post-trade reporting, and market data). Under MiFID the banks are no longer required to report trades to LSE (or any other exchange), and they pay LSE for listing the information (this is very much like one of the possible benefits of MiFID requirements regarding data, and the elimination of the home exchange rules). Initial reports about this use of MiFID by the banks came out in August. In its first phase, the system will capture, aggregate, distribute and display pre-trade quotes and post-trade reports for over-the-counter European equity deals. The system will be available to use by any qualified market participant to comply with MiFID.

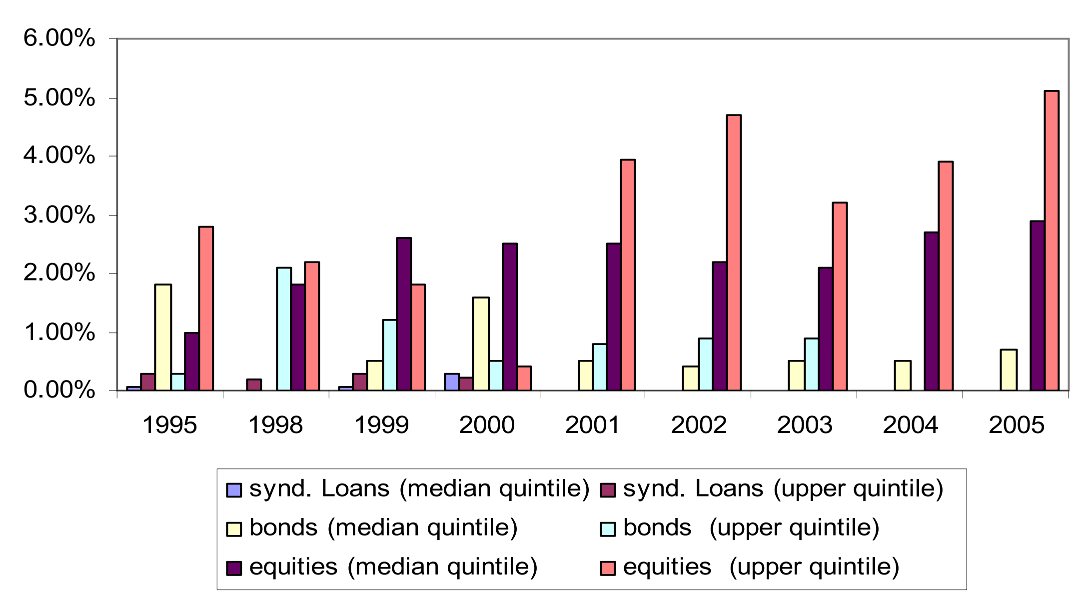
These firms are reported to believe that competition from their new system will drive down charges as well as delivering better buying and selling prices. The new system would be "guaranteed" large amount of business, as the banks setting it up estimate they handle about 50 per cent of all trading in leading European companies. The LSE is apparently worried about this, as it is already under pressure from NASDAQ (attempting to buy it) and this move could undermine LSE's ability to remain independent.

The banks consider that, despite failures of previous exchange start-ups, theirs will succeed party due to pressure for lower charges following developments in the hedge funds industry. They are looking to be set up and running by August 2007.

However, at the time of writing the banks are refusing to quantify costs of setting it up, which has led some commentators to take the view that this move by the banks is merely an extreme way to force European exchanges to cut their charges.

3.78 We can also see that this is reflected in a reduction of fees on securities issues and syndicated loans in euro by Eurozone firms. This is shown in Figure 3.9.

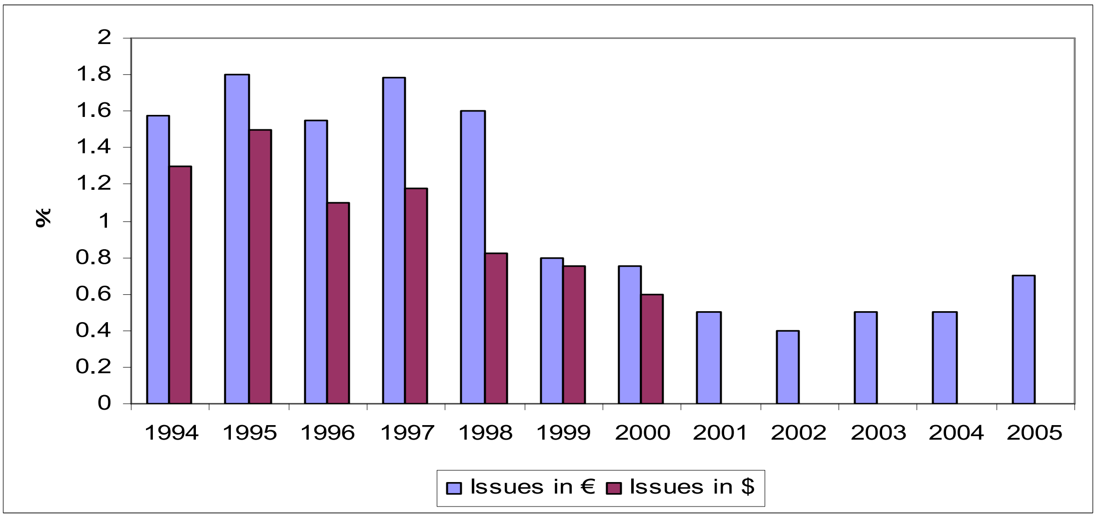
Figure 3.9: Fees on securities issues and syndicated loans in € by Eurozone firms 1995-2005 (as % of issuance/ loan as applicable)



Note: Loans data not available after 2000
Source: Europe Economics, ECB

3.79 Average gross fees for international bond issuance have also gone down from 1999 through to 2004. This is shown within Figure 3.10.

Figure 3.10: Average gross fees for international bond issuance 1994-2005 (by denomination of bond, as % of bond issue value)



Note: Data not available for $ denominated issues after 2000

Source: ECB, Europe Economics

3.80 However, despite these reductions, the level of fees remains a considerable barrier to consumers to using cross-border financial services. Whilst businesses have established presence in national markets through acquisitions of existing providers and thereby purchased customer goodwill and trust, they do not yet appear to see a market in remote cross-border provision.

3.81 In part, this may well be due to barriers which are external to the FSAP measures and FSWP legislative proposals and may also reflect regulatory uncertainty and customer inertia, given that we are still in the fairly early stages of regulatory reform.

Securities: specific analysis by Member State

Trade

3.82 Effects on cross-border trade in securities business for individual Member States are reported in Table 3.9.[21]

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[21] Note that these figures are the same as those for banking above. Our models were not able to provide separate predictions for trade effects for banking and securities.

Table 3.9: Effects of the FSAP measures and FSWP legislative proposals on cross-border trade in securities services by Member State

	Effect up to mid-2006 (% rise)			Further effect of full implementation of rest of NFSF (% rise)		
Country	Trade in other Fin. Services	*Imports*	*Exports*	Trade in other Fin. Services	*Imports*	*Exports*
Austria	**2.2**	***1.8***	***2.2***	**1.2**	***1.0***	***1.3***
Belgium	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Cyprus	**2.1**	***1.7***	***2.1***	**1.3**	***1.1***	***1.4***
Czech Republic	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Denmark	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Estonia	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Finland	**1.6**	***1.3***	***1.7***	**1.8**	***1.5***	***1.8***
France	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Germany	**1.4**	***1.2***	***1.4***	**2.0**	***1.6***	***2.1***
Greece	**2.0**	***1.6***	***2.0***	**1.4**	***1.2***	***1.5***
Hungary	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Ireland	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Italy	**1.3**	***1.1***	***1.4***	**2.1**	***1.7***	***2.1***
Latvia	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Lithuania	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Luxembourg	**1.4**	***1.1***	***1.4***	**2.0**	***1.7***	***2.1***
Malta	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Netherlands	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
Poland	**2.0**	***1.7***	***2.1***	**1.4**	***1.1***	***1.4***
Portugal	**1.8**	***1.4***	***1.8***	**1.6**	***1.4***	***1.7***
Slovakia	**1.7**	***1.4***	***1.8***	**1.7**	***1.4***	***1.7***
Slovenia	**1.7**	***1.4***	***1.7***	**1.7**	***1.4***	***1.8***
Spain	**1.4**	***1.2***	***1.5***	**2.0**	***1.6***	***2.0***
Sweden	**1.6**	***1.3***	***1.6***	**1.8**	***1.5***	***1.9***
UK	**1.7**	***1.4***	***1.8***	**1.7**	***1.4***	***1.7***

Openness to foreign firms

3.83 We find that the FSAP has tended to increase openness to foreign securities firms in the following Member States: Finland; Germany; Italy; Lithuania; Sweden.

3.84 We find that the FSAP has had limited or no effect on openness to foreign securities firms in the following Member States: Belgium; Denmark; France; Netherlands; UK.

Industry structure and competition

3.85 We find that the FSAP has tended to increase competition in securities services in the following Member States: Denmark; France; Germany; Ireland; Lithuania; Netherlands; Spain; Sweden; UK. However, it should be noted that in almost all cases this positive effect is small, speculative, and anticipated as arising in the future.

3.86 In no Member State is there expected to be a negative impact on competition in securities services.

Competitiveness/Productivity/Efficiency

3.87 We find that the FSAP has tended (or will tend) to increase competitiveness in securities services in the following Member States:

(a) Italy (a combination of the abolition of concentration rules and other FSAP measures tending to open up the Italian market to international competition is expected to have the effect of increasing Italian competitiveness — as is typical in markets that become more open to international competition);

(b) Lithuania (integration of Lithuania into the Nordo-Baltic capital market will enhance Lithuania's securities services offering);

(c) Sweden (although Sweden may have increased its integration into the Nordo-Baltic regional capital market even without the FSAP, nonetheless its position as a key player within that market and thence to offer securities services more competitively to other parts of the EU, is adjudged to have been enhanced by the FSAP);

(d) UK (though in the UK's case the short-term impact is expected to be negative, because of non-trivial compliance costs, in the longer-term our judgement is that enhanced access is likely to enable the UK better to exploit its well-established comparative advantage in the provision of securities services, and thus to increase its competitiveness).

Employment

3.88 Our analysis suggests that the FSAP has so far had fairly limited impacts on employment in securities, but later developments might have quite significant impacts. These arise from two key components:

(a) We believe that MiFID and other measures will create scope for more pan-EU securities services provision, and that in particular there may be some significant growth in systematic internalising-related business through ventures such as Project Turquoise. The biggest gainer, in job terms, from this process is like to be the UK, because of its established lead in systematic internalising (though other Member States with strong financial services traditions, such as Luxembourg, may also be gainers). This means that, of current securities-related jobs, the UK is, in the future, likely to hold a larger share.

(b) At the same time, we believe that the creation of a more pan-EU market for securities services provision, and the consequent falls in transactions costs and improvements in efficiency, may play a role in stimulating greater use of securities — particular of equities — to some extent at the expense of bank finance (indeed, creating more of a "culture of equity" among EU Member States was an important goal of the FSAP). This expansion in the aggregate use of equities is likely to lead to increases in securities employment.

3.89 For existing states with significant securities employment (such as Germany, Italy, France, and the Netherlands), the net effect of these two processes is not completely clear. Our view is that in Germany and Italy the scope for greater use of equity is quite high, and so in these Member States, on balance, it seems likely that securities employment will increase. In contrast, we suspect that the net effects on securities employment in Belgium and the Netherlands are more likely to be net negative.

3.90 In contrast, in a number of Member States in which securities are currently very underdeveloped as a financing form, our view is that the FSAP will tend to contribute sufficiently to more rapid growth in total volumes that the migration of a portion of jobs to London will not offset the wider gains — i.e. securities jobs will increase in the future as a consequence of the FSAP, even though the effect up to now may typically have been limited.

Consumer protection

3.91 We find that the FSAP has tended to increase consumer protection in securities services in Lithuania (through regularisation of business) and in Sweden.

Cost of capital

3.92 We forecast the full implementation of the FSAP measures and FSWP legislative proposals will lead to a fall in the cost of equity capital of[22]

(a) 12-28 basis points (bps) for France (i.e. 0.12 per cent to 0.28 per cent);

(b) 20-45 bps for Germany;

(c) 60-80 bps for Italy;

(d) 7-9 bps for the UK;

(e) 5-21 bps for the rest of the EU.

3.93 The key drivers of this are seen as being reductions in transactions costs as competitive pressures increase and reductions in servicing costs as liquidity increases. It is worth noting that the scope for reductions is an order of magnitude higher in Italy, where transactions costs are relatively high and liquidity low, than in the UK, which is much closer to the international efficiency frontier. Our view is that falls in the cost of equity at the upper end of the scales suggested for Germany and Italy could well have an impact on the use of equity in these Member States: brute price attractiveness may succeed in creating a culture of equity where urging and state action have previously failed.

Summary table

3.94 Table 3.10 summarizes the findings of our country lots by Member State.

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22 Details can be found in Appendix 9.

Table 3.10: Summary by Member State of impacts in Securities

	Impact of FSAP measures and FSWP legislative proposals on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Austria	Slightly positive	Slightly positive	Limited so far, perhaps positive in future	Slightly positive	Slightly positive
Belgium	Perhaps slightly positive	Limited	Limited	Limited	Limited so far, negative in future
Cyprus	Unclear	Unclear	Unclear	Unclear	Unclear
Czech Republic	Unclear	Unclear	Negligible	Slightly positive	Unclear
Denmark	Perhaps slightly positive	Perhaps slightly positive	Limited	Negligible	Negligible
Estonia	Perhaps slightly positive	Positive	Positive	Positive	Negligible so far, positive in the future
Finland	Positive	Limited	Limited	Limited	Limited
France	Limited	Probably slightly positive in the future	Negligible	Positive	Negligible so far, unclear in the future
Germany	Probably positive in future	Limited so far; Probably significantly positive in future	Limited	Limited so far; Potentially significantly positive in future	Limited so far, positive in the future
Greece	Slightly positive	Slightly positive	Limited in short term, perhaps positive in the long term	Slightly positive	Slightly positive
Hungary	Slightly positive	Positive	Positive	Unclear	Unclear
Ireland	Perhaps positive in the future	Perhaps slightly positive in the future	Perhaps slightly positive in the future	Perhaps slightly positive in the future	Perhaps slightly positive in the future
Italy	Significantly positive	Limited so far; potentially significantly positive in the future	Negligible	Negligible so far; potentially significantly positive in the future	Slightly positive, probably more positive in the future
Latvia	Positive	Slightly positive	Positive	Negligible	Slightly positive, more positive in future
Lithuania	Significantly positive	Positive	Positive	Significantly positive	Positive
Luxembourg	Limited	Limited	Limited	Limited so far. Possibly positive in future.	Limited in short term. positive in future
Malta	Positive	Slightly positive	Limited	Limited	Positive
Netherlands	Perhaps small positive in future	Probably slightly positive in the future	Negligible	Limited	Limited, perhaps negative in future
Poland	Negative	Positive	Positive	Negative	Unclear
Portugal	Slightly positive	Slightly positive	Limited, perhaps positive in future	Limited, perhaps positive in future	Limited, perhaps positive in future
Slovakia	Positive	Positive	Positive	Unclear	Negligible, positive in future
Slovenia	Limited	Positive	Positive	Negative	Limited, positive in future
Spain	Positive in future	Positive	Possibly positive	Possibly positive	Negligible
Sweden	Positive	Perhaps positive	Positive	Perhaps positive	Unclear
United Kingdom	Negligible	Slightly positive	Negligible	Limited and perhaps negative so far; probably strongly positive in future	Limited so far, positive in the future

Financial Conglomerates

3.95 The Joint Forum on Financial Conglomerates of the Bank of International Settlements defines financial conglomerates as “any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors (banking, securities, insurance).”

3.96 Table 3.11 summarizes the financial conglomerates this study has found to be operating in Europe, and gives what we have identified as how best to characterize their mix of activities.

Table 3.11: Financial Conglomerates in the EU

Financial conglomerate in operation	Head office base	Countries in which it operates	Characterization of Conglomerate
Fortis	Belgium	Belgium, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Poland, Spain, Switzerland, Turkey, UK, Portugal, Denmark, Austria	Banking and Insurance: Contribution to net Profit: Retail Banking 23%, Merchant Banking 27%, Commercial/Private Banking 13%, Insurance Belgium and Netherlands 28%, International Insurance 6%
Ceska pojistovna	Czech Republic	Czech Republic	Insurance
Cespo	Czech Republic	Czech Republic	DNA*
PPF Group	Czech Republic	Czech Republic	Retail financial services, primarily insurance, and consumer loans
Alm. Brand	Denmark	Denmark	Non-life insurance, banking and life and pension insurance
Bank of Ireland	Ireland	UK, Ireland	Banking
Irish Life and Permanent	Ireland	UK, Ireland	Banking and Insurance
OP Bank Group	Finland	Finalnd	Banking and Insurance
Sampo	Finland	Finland, Estonia, Latvia, Lithuania, Sweden	Banking and Insurance
Banques Populaires	France	France	DNA
Societe General	France	Austria, Belgium, France, Germany Ireland, Italy, Norway, Portugal, Poland, Portugal, Spain, Sweden, UK, Switzerland	Corporate and investment bank
Credit Mutual	France	France	DNA
Credit Agricole	France	France	Banking Group doing insurance
Caisses d'Epargne	France	France	Equal focus on Banking, Insurance, asset management
BNP Paribas	France	Austria, Belgium, Czech Republic, Cyprus, France,. Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland Portugal, Slovakia, Spain, UK,	Equal focus on retail, corporate and investment banking, asset management
Allianz	Germany	Germany, Austria, Belgium, Cyprus, Greece, Ireland, Netherlands, Spain, Switzerland, UK, Czech Republic, Hungary, Poland, Romania, Slovakia, Estonia, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Sweden,	Insurance group doing asset management and banking
DEBEKA Group	Germany	Germany	DNA

Financial conglomerate in operation	**Head office base**	**Countries in which it operates**	**Characterization of Conglomerate**
DZ Bank Gruppe	Germany	Germany, Ireland, Luxembourg, Spian, Poland, Switzerland, UK	Investment Banking
Inter Group	Germany	Germany	DNA
Munich Re	Germany	France, Germany, Greece, Italy, Poland, Spain, UK, Switzerland	Reinsurance
Wuestenrot und Wuerttembergische	Germany	Germany	Banking and Insurance
Gruppo Carige	Italy	Italy	DNA
Gruppo Banca Intesa	Italy	Italy, Austria, Belgium, France, Hungary, Ireland, Luxembourg, Poland, Slovakia, Czech Republic, UK	Banking
Holmo	Italy	Italy	DNA
Mediolanum	Italy	Italy, Spain, Austria, Ireland, Luxembourg, Germany	Pensions, investments, loans, banking, insurance
San Paolo-IMI	Italy	Ital, Spain, Ireland, Germany, Hungary, Poland, Belgium	Retail and Commercial banking group doing insurance
ABN AMRO	Netherlands	France, Austria, Belgium, Denmark, Czech Republic, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland Portugal, Slovakia, Spain, Sweden, UK	Banking
ING	Netherlands	Netherlands, Belgium, France, Spain, Greece, Germany, Austria, Italy, UK, Poland, Luxembourg, Romania	Banking, insurance and asset management
Rabo-Interpolis	Netherlands	Netherlands	DNA
Robein	Netherlands	Netherlands	Insurance
SNS-Reaal	Netherlands	Netherlands	Banking and Insurance
VVAA	Netherlands	Netherlands	Financial advice, insurance for people in health care profession
Danske Bank	Norway	Denmark, Finland, France, Germany,Ireland, Luxembourg, Poland Spain,Sweden, UK	Insurance, mortgage finance, asset management, brokerage, real estate and leasing services - mostly banking
BANCO Bilbao Vizcaya Argentaria	Spain	Spain, Portugal, Belgium, France, UK, Germany, Italy, Switzerland	Finance and Insurance
Agrupacion Mutua/bankpyme	Spain	Spain	DNA
Grupo Santander	Spain	Spain, Portugal, Belgium, France, UK, Germany, Italy, Switzerland, Poland, Netherlands, Czech Republic, Hungary, Switzerland, Luxembourg	Insurance, Banking, Asset Management
Caja Madrid	Spain	Spain	Banking
Caixa Terrassa	Spain	Spain	Banking and Insurance
La Caixa	Spain	Spain	Savings Bank

Financial conglomerate in operation	Head office base	Countries in which it operates	Characterization of Conglomerate
Lansforsakringar	Sweden	Sweden	Banking and insurance - market leader in Swedish non-life insurance - market share exceeding 32.2 per cent. Also has 12.0 per cent of market for life assurance and pension insurance, and 3.0 per cent of bank market.
Nordea	Sweden	Denmark, Norway, Sweden, Estonia, Lithuania, Latvia, Poland, Finland, Germany, UK, Luxembourg	Banking, Asset Management, Insurance. Contribution to net profit: Retail Banking 66%, corporate and institutional banking 25%, asset management 5%, life insurance 3%
Resurs	Sweden	Sweden	DNA
SalusAnsvar	Sweden	Sweden	DNA
SEB	Sweden	Luxembourg, Sweden, UK, France, Spain, Finland and Denmark, Germany, Poland, Estonia, Latvia, Lithuania	Banking firm doing insurance and asset management
Svenska	Sweden	Austria, Estonia, France, Denmark, Finland, Norway, Germany, UK, Luxembourg, Netherlands, Poland, Spain, Switzerland,	DNA
Abbey	UK	UK	Mortgages and savings, bank accounts, loans and credit cards, long-term investments including pensions and unit trusts, life, critical illness and unemployment cover and household insurance
Barclays	UK	France, Spain, Portugal, Italy, Germany, the Netherlands, Switzerland, Austria, Belgium and Luxembourg	Banking and insurance
Cooperative Bank	UK	UK	Banking firm doing insurance and pensions
HBOS	UK	Ireland	Banking firm doing insurance, brokerage and asset management
Hermes	UK	UK	Fund management, investment
Julian Hodge Bank Group	UK	UK	Banking firm doing insurance
Liverpool Victoria	UK	UK	Banking, investment, insurance
Lloyds TSB	UK	UK	Personal, business, private banking, insurance
Old Mutual	UK	Austria, Cyprus, Denmark, Finland, France, Germany, Ireland, Italy, Poland, Portugal, Spain, Sweden, UK	Asset management, Life assurance, Banking, Offshore trusts and company services
Provident Financial	UK	Poland, Czech Republic, Slovakia, UK, Hungary	Lending company whose speciality is home credit
Prudential	UK	UK, Holland, Ireland, Germany	Personal banking insurance, pensions and retail investments, to institutional fund management and property investments
RBS	UK	UK, France, Italy, Germany, Austria, Greece, Spain, Portugal,	Banking firm doing insurance

Financial conglomerate in operation	Head office base	Countries in which it operates	Characterization of Conglomerate
Standard Life	UK	UK Austria, Germany, Ireland	Banking firm doing investments and pensions
HSBC	UK	Belgium, Czech Republic, Cyprus, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, the Netherlands, Poland, Slovakia, Spain, Sweden, Turkey, UK	Personal, commercial, corporate, institutional and investment, and private banking

*Notes: * DNA = Data Not Available*

Source: Europe Economics

Openness to foreign firms

3.97 We find that the FSAP has tended to increase openness to foreign financial conglomerates in the following Member States: Hungary; Ireland; Latvia; Lithuania; Netherlands; Poland; United Kingdom.

3.98 We find that the FSAP has had little or no effect on openness to foreign financial conglomerates in the following Member States: Austria; Belgium; Cyprus; Czech Republic; Denmark; Estonia; Finland; France; Germany (NB the effect for Germany may even be negative); Greece; Italy; Luxembourg; Malta; Portugal; Slovakia; Spain; Sweden. We can not pass comment where in those countries where no financial conglomerates currently operate.

Other impacts

3.99 Other impacts were assessed as a hybrid combination of the impacts from other themes, depending on the nature of the financial conglomerates operating in that Member State.

Summary table

3.100 Table 3.12 summarizes the findings of our country lots by Member State.

Table 3.12: Summary by Member State of impacts in Financial Conglomerates

	Impact of FSAP measures and FSWP legislative proposals on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Austria	Slightly positive	Slightly positive	Slightly positive	Unclear in short term. Perhaps negative in long term	Slightly positive
Belgium	Slightly positive	Positive	Positive	Positive	Negative
Cyprus	Slightly positive	Slightly positive	Positive	Unclear	Perhaps positive in the future
Czech Republic	Negligible	Negligible	Negligible	Negative	Slightly positive
Denmark	Limited	Negligible	Negligible	Negligible	Negative
Estonia	Limited	Limited	Negligible	Negligible	Negligible
Finland	Limited	Limited	Limited	Negative	Perhaps positive
France	Limited	Limited	Limited	Negligible	Perhaps slightly positive
Germany	Slightly positive	Limited	Limited	Positive	Negligible
Greece	Slightly positive	Slightly positive	Slightly positive	Unclear in short term. Perhaps negative in long term	Slightly positive
Hungary	Positive	Positive	Positive	Slightly positive	Unclear
Ireland	Positive	Limited. Maybe positive in the future	Limited	Slightly Positive	Limited
Italy	Negligible	Positive	Negligible	Positive	Perhaps positive
Latvia	Positive	Positive	Slightly positive	Negligible	Positive
Lithuania	Positive	Limited	Positive	Limited	Limited
Luxembourg	Limited	Limited	Limited	Limited in the short term and unclear in the long term.	Limited in the short term and unclear in the long term.
Malta	Limited	Negligible	Slightly negative	Slightly negative	Limited
Netherlands	Positive	Limited	Slightly Positive	Slightly Positive	Perhaps negative in the short-term; Perhaps positive in the long-term
Poland	Positive	Limited	Positive	Limited	Limited
Portugal	Slightly positive	Slightly positive	Slightly positive	Slightly positive	Unclear
Slovakia	Negligible	Limited	Positive	Limited	Negligible
Slovenia	No presence	No presence	No presence	No presence	No presence
Spain	Limited	Limited	Positive	Limited	Negligible
Sweden	Limited	Impact on form of conglomerates	Limited	Positive	Perhaps positive
United-Kingdom	Perhaps positive	Perhaps positive	Negligible	Perhaps negative	Positive

Source: Europe Economics

Summary of key themes emerging from country lots

3.101 The main broad themes to emerge from the country lots and the discussion by Member States in this section are as follows:

(a) **The impacts assigned arise from judgements we have produced within the study — Many elements are uncertain or awaiting future developments.** The FSAP is still under implementation, and the FSWP lies ahead. As is discussed in more detail elsewhere in this report, even of those parts of the FSAP that have been implemented, many of the most material parts have only been in place since 2004. Thus even though we have attempted to assign impacts wherever possible, it should be understood that a considerable degree of judgement is involved.

(b) **Significant differences in impacts between Member States.** As one would expect, the impacts of the FSAP measures and FSWP legislative proposals differ materially, both in form and degree, between Member States.

(c) **Greater impacts in Banking than other themes.** It appears that, so far, the most important impacts have been in the banking sector. This is unsurprising given that many of the most significant FSAP and FSWP measures affecting insurance and securities are yet to be fully implemented (e.g. Solvency II; MiFID).

(d) **Regional groupings visible.** In particular, impacts on Nordo-Baltic Member States appear to take a form relatively more similar to each other than to Member States outside that grouping.

(e) **Gains to France, Germany, and the UK very limited in the short term.** Gains to these Member States may be greater in the future, as changes in other Member States create opportunities for French, German and UK financial services firms.

(f) **Tendency for impacts to be of relatively similar degree by theme, and to be connected to the extent to which "Openness to foreign firms" has been affected.** When the impact on openness to foreign firms is limited or negligible, the impacts on competition, consumer protection, and so on likewise appears typically to be limited, slight, or negligible — sometimes leaving a purely negative impact on competitiveness arising because in these cases compliance costs are imposed with no corresponding benefits. In contrast, when openness to foreign firms is assessed as having been positively impacted, then other factors are also often positively impacted.

(g) **Effects on competition, consumer protection, and openness to foreign firms tend to be greater than effects on employment or competitiveness.**

The Development of Regional Markets

3.102 We have noted that regional markets have begun to develop and appear quite well established in some parts of the EU. Two interesting cases are the Nordo-Baltic regional market and the Euronext area. Our intention in these case studies is not to add to the analysis above — thus, much of the material is descriptive. Rather, we aim to illustrate some important forms of cross-border activity and integration in these regional markets, and draw out certain differences of degree and form between them.

Short case study I: The Nordo-Baltic regional market

3.103 A particularly clear example of a regional market appears to be a Nordo-Baltic regional market encompassing Sweden, Finland, Denmark, Estonia, Lithuania, and Latvia with respect to financial services markets.[23] It may also encompass Norway and Iceland (however, these countries fall outside the scope of this study).

3.104 Nordo-Baltic countries have been characterised by large mergers of financial institutions and formation of financial conglomerates over the last 20 years. Institutions from the Nordic countries have been particularly active in mergers and acquisitions across the Nordo-Baltic region.

3.105 The financial services markets in the Nordo-Baltic countries consist of a number of local and savings banks — dominated by a few large banks — other credit institutions, insurance companies, and well developed capital markets. The local markets are widely integrated and offer a wide range of financial products, affording customers to do their financial business in one place. The financial industry is well equipped with modern information technology, and home banking used more widely in the Nordo-Baltic countries than anywhere else in the world (mostly due to geography). Financial intermediation is significant in all of the Nordo-Baltic countries.[24]

3.106 Domestic financial markets are becoming increasingly integrated across banking, insurance, and capital markets. This is also true for cross-border financial conglomerates. Table 3.13 reports the main financial indicators for banking and insurance in a sample of Nordo-Baltic regional countries.

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23 It is acknowledged that in other aspects, there may not be such developed regional markets.

24 IMF Regional Financial Conglomerates: A Case for Improved Supervision (2005).

Table 3.13: Financial sector indicators in Nordo-Baltic countries (2004)

	Macroeconomic environment	Banking	Insurance
	GDP (€ Million)	Bank assets/GDP (€ Million)	Gross Premium (€ Million)
Denmark	194,421	607,107	15,935
Sweden	279,008	582,918	19,265
Finland	149,725	212,427	13,217
Estonia	9,043	8,537	189
Lithuania	17,926	8,509	236*
Latvia	11,024	11,167	214

Source: ECB 2005, OMX, CEA

*Note: *2003 figure*

Banking

3.107 Investment banks were the pioneers in facilitating cooperation in this region and for the formation of a Nordo-Baltic regional market. The Nordea Group, which comprises four Nordo-Baltic banks — Merita Bank, Nordbanken, Unibank, and Christiania Bank of Kreditkasse, from Finland, Sweden, Denmark, and Norway, respectively — is the largest financial services group in the Nordo-Baltic countries. Nordea Group is the clearest example of the structural change that has characterised the Nordo-Baltic banking and insurance operations during the last decade.[25]

3.108 In Denmark, Danske Bank — including Danske Bank, BG Bank, Realkredit Danmark, Danica Pension and a number of subsidiaries — is the largest bank and a leading player in the Scandinavian financial markets. Danske Bank has a strong position throughout the Nordo-Baltic countries and particularly in Sweden where it is among the four largest banking groups present into the market. The group also includes SkandiaBanken — an internet bank based in Sweden and owned by the Skandia.[26]

3.109 Nordea's Swedish business includes one of Sweden's largest finance companies and major players in fund management and mortgage credits. SwedBank — one of the four largest banking groups in Sweden with over 490 local branches — also has a strong position in the Baltic region through its subsidiary bank Hansapank. Swedish banks own the majority of the Estonian and Latvian banking sectors.

[25] Nordea is also represented in China, Iran, Singapore, Brazil, and the United States.
[26] Skandia is a Swedish insurance company that was started in 1855. It has now operations in Europe, Latin America, Asia and Australia.

3.110 In Estonia the trends have been for Scandinavian banks to move into Estonia and for Estonian banks to also seek expansion by moving into others new markets, most particularly those of Lithuania and Latvia. Hansapank now has the largest market share in the three Baltic countries. Both Hansapank and Eesti Ühispank are indigenous products of the frenzy of banking activity that occurred when Estonia gained independence. In 2005, Hansapank was fully taken over by its strategic investor — Swedbank.

3.111 Sampo is the Finnish leading bank specialising in long-term savings. Sampo Bank operates in Finland, Estonia, Lithuania and, most recently, Latvia.

3.112 In Lithuania, a majority shareholding in the Lithuanian Savings Bank was acquired by Sweden's Hansapank in 2001. Vilniaus Bankas was acquired by the Swedish banking group Skandinaviska Enskilda Banken (SEB) by 2003. According to the Bank of Lithuania, foreign capital dominated the Lithuanian banking industry, and by 2002 the share of foreign capital accounted for 81 per cent.

3.113 By 2003, the privatisation process in the Latvian banking sector was almost complete, with nearly two-thirds of banks' share capital in the hands of foreign investors, most of which were from the Nordic region (e.g. Unibanka and Hansapank).

Insurance

3.114 In the insurance sector Nordea operates as the leading company throughout the Nordo-Baltic countries. In Sweden, Denmark, and Finland this is through TrygVesta A/S — this was formed in 2002 in connection with the acquisition by TiD of the general insurance activities of Nordea.

3.115 TrygVesta's Estonian subsidiary was sold to the Australian insurance group QBE International in December 2004. In Lithuania, the largest non-life insurance company, Lietuvos Draudimas, is now majority-owned by Codan of Denmark. Within the Lithuanian life sector Hansa Gyvybes Draudimas (owned by Hansabankas) dominates the market with a 40 per cent market share.

Securities

3.116 Capital markets in Nordo-Baltic countries are rapidly integrating: the Nordo-Baltic stock exchanges already have the same trading system, same member rules, and have harmonized rules and practices in many other areas. The main objective of integration is to prevent marginalisation and to increase the attractiveness of the marketplaces.

3.117 Equity trading has become increasingly integrated in recent years via the NOREX Alliance in Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden. The NOREX Alliance has resulted in uniform rules for membership of the different stock exchanges. This entails, for instance, that a member in one of the stock exchanges can become a member of the other stock exchanges without undergoing a formal admission procedure. All stock exchanges within the Alliance use the same trading platform.

3.118 Integration has also been furthered by a consolidation of ownership. Stockholmsbörsen is operated by OMX Exchanges, which in turn is a division of OMX AB. Besides Stockholmsbörsen, OMX owns and operates the stock exchanges in Helsinki, Copenhagen, Tallinn, Riga and Vilnius, as well as the securities register centres in Estonia, Latvia and Lithuania. Combined, OMX offers access to around 80 per cent of the Nordo-Baltic securities market. The links between the six exchanges are further facilitating cross-border trading by having a common trading system and harmonised rules and market practices. At the same time, NOREX members are deepening their cooperation by making access even easier.

3.119 The OMX expects the combined effect of the measures, self-regulation and the harmonisation of corporate governance structures (quotes 90 per cent as being harmonised within the Nordic region) to lead to increased competition across industry and national borders. Further, it has been reported by the Bank of Finland that the integration of the Swedish and Finnish exchanges resulted in annual cost savings of SEK 150 million — with savings from the other exchanges not yet fully realised.

Conglomerates

3.120 As regards the Nordo-Baltic financial conglomerate sector Nordea Group operates through three business areas: retail banking, corporate and institutional banking, and asset management and life assurance.

Comment

3.121 Although this overview has been extremely brief, the common pattern across the horizontal themes should emerge — firms in Nordo-Baltic Member States are working together, merging, and/or engaging in significant cross-border activities. If such a pattern were extended across the European Union, the level of integration achieved could be profoundly deeper than is currently the case.

Short case study II: The Euronext area

3.122 Euronext was formed on 22 September 2000 when the main exchanges of Amsterdam, Brussels and Paris merged. The merger was a response to the globalization of capital markets and the desire to create a competitive pan-European exchange which would increase liquidity and reduce transaction costs. The Euronext group was expanded in 2002 with the acquisition of LIFFE (London International Financial Futures and Options Exchange) and the merger with the Portuguese exchange BVLP (Bolsa de Valores de Lisboa e Porto). According to the Euronext web-site, “Euronext was formed … in response to the globalisation of capital markets and to create a pan-European exchange offering its participants increased liquidity and lower transaction costs”.

3.123 The existence of a group of consolidated exchanges will undoubtedly have an impact on other horizontal themes.

3.124 For this case study we focus on the four countries that make up the Euronext exchanges: Belgium, France, the Netherlands and Portugal.[27]

3.125 The Euronext area differs from the Nordo-Baltic region in that it cannot yet be recognised as a fully integrated regional market. Simply having a common regional exchange does not necessarily imply that there will be a regional market for the four horizontal themes, as was the case in the OMX region. If one examines the Euronext area, one notices that it is less integrated compared to the OMX area. However, between certain Euronext member countries there are higher levels of integration — for example between the Benelux countries and France. These different levels of integration are a reflection of different economies' sizes, legal and institutional cultures, and the fact that some members of the Euronext area are relatively new.

3.126 Within the Euronext members, the financial services sector has been characterised by mergers of financial institutions and formation of financial conglomerates over the last 20 years. These mergers and acquisitions have created global conglomerates operating in multiple countries, not just within the Euronext region. The integrated Euronext exchange is one of the largest bourses in the world.

Table 3.14: Financial sector indicators in Euronext countries (2004)

	Macroeconomic environment	Banking	Insurance
	GDP (€ Million)	Bank assets/GDP (€ Million)	Gross Premium (€ Million)
Belgium	283,752	914,391	28,482
France	1,648,369	4,415,475	156,800
Netherlands	488,642	1,667,583	48,530
Portugal	141,115	345,378	10,432

Source: ECB 2005, CEA

[27] Although Euronext acquired the London based Derivative Market LIFFE in 2002, we do not include the UK as part of the Euronext area. Similarly, although in November 2005, Euronext entered into a 51:49 joint venture with Borsa Italiana to obtain a major stake in MTS, the leading electronic market for European wholesale fixed income securities, Italy is likewise not included within the Euronext region.

Banking

3.127 Within the Euronext Area, the Belgian banking sector is highly integrated with the wider region. A number of alliances have been formed in response to changed market conditions. In 1997, Internationale Nederlandse Groep (ING) acquired Banque Bruxelles Lambert (BBL), and in 1998 the Belgian-Dutch services group Fortis took over the country's largest bank: Generale de Banque (G-Bank). Both Fortis and ING are important in the Benelux region. This high level of integration has led to the sector becoming dominated by a number of Belgian-Dutch and Belgian-French banking groups. A number of these banking groups are very old and pre-date the FSAP by many years.

3.128 Within the Netherlands, cross-border activities in the banking sector have increased in recent years. Dutch banks may also have become more interested in expanding their activities in countries other than those to which they have been historically linked (Belgium, Luxembourg and France). An example of this is ABN-AMRO acquiring Banca Antonveneta in Italy.

3.129 In contrast, there are fewer foreign banks or alliances in France — or at least those in which the French partner is not dominant. Many foreign banks operating in France concentrate on specialist activities, although there are notable exceptions which have significant retail operations: HSBC CCF, Barclays and GE Money Bank. A number of major French banks (e.g. BNP Paribas) are active in other Member States.

3.130 There would appear to be less cross-border integration in banking between France, Belgium and the Netherlands on the one hand, and these Member States and Portugal on the other.

Insurance

3.131 Perhaps as a result of the EU "single passport" scheme, which allows insurers to operate in a third party country, but still be subject to home country control, there are a number of cross-border insurers operating across the Euronext region. In the Netherlands, it is reported that 15 per cent of the Dutch insurance markets was controlled by foreign undertakings in 2004 — this is largely due to foreign acquisitions.

3.132 The largest French insurers are AXA, CNP Assurances (which is affiliated to the Groupe Caisse des Depots), AGF, Groupma and Prédica/Pacifica. Of these, AGF is the only foreign owned company, being a subsidiary of Allianz of Germany (which is outside the Euronext region).

3.133 Most of the insurance groups in Belgium are part of multinational groups. For example, the Fortis group is a Belgo-Dutch venture and the Dexia Group is Belgo-French. Many of these groups are also active in overseas markets, both in the EU and beyond.

Securities

3.134 Perhaps the most integrated segment of the financial market in the Euronext region is (unsurprisingly) the securities markets. This confirms a wider trend for exchanges to be consolidating.

3.135 Euronext NV (the holding company) markets itself as the first genuinely cross-border exchange, providing international services for regulated Cash Markets and Derivative Markets in Belgium, France, the UK (derivatives), the Netherlands and Portugal.

3.136 Euronext holds a major stake in MTS, the leading electronic market for European wholesale fixed income securities, which was acquired through MBE Holding, a 51:49 joint-venture between Euronext and Borsa Italiana.

3.137 On 2 June 2006, it was announced that the New York Stock Exchange (NYSE) had agreed to buy Euronext, creating the first transatlantic stock market. The deal created a business — NYSE Euronext — worth €16 billion, with a US base in New York and international headquarters in Paris and Amsterdam. On 15 February 2007, it was announced that NYSE Euronext, Inc (through its wholly-owned subsidiary NYSE Euronext (Holding) N.V.) would commence an exchange offer for all outstanding shares of Euronext. The settlement and delivery of the offer, as well as the admission of the NYSE Euronext shares on Euronext Paris and on NYSE, was expected to take place on April 4, 2007.

3.138 The aim of Euronext is provide users with a single market that is broad, highly liquid and cost-effective via the integration of local markets. The constituent exchanges are technologically integrated and have harmonised market rules and regulatory framework.

3.139 In terms of volume of electronic transactions and their value, Euronext is now rated the largest stock market in Europe. It is second only to the LSE with regard to overall market capitalisation in Europe. At the end of 2003, Euronext ranked fifth among world bourses with a stock-market capitalisation of $ 2.1 billion.

Conglomerates

3.140 Most French and Belgian-Dutch financial conglomerates are active across the Euronext region. For example, Fortis is a market leader in the bancassurance market in Portugal.

Comment

3.141 Although this overview has been extremely brief, one can see that compared to the Nordo-Baltic region, the Euronext region is not uniformly integrated across the financial markets. Whereas, Belgium, out of necessity, is home to a number of cross-border firms across all four horizontal themes, this is less so in the instances of insurance in France. Indeed, while there is a high degree of integration between Belgium and the Netherlands (presumably due to historical reasons) this is less the case in France. Further, at present, it would seem that Portugal has yet to reach any substantial level of integration across the region.

3.142 It would seem, therefore, that it is easier to develop regional integration in the theme of securities than in other areas.

3.143 However, if the example of the Nordo-Baltic region is followed, then it would seem that with time, the level of integration between all members of the Euronext region could be profoundly deeper than is currently the case.

The Role of the euro

3.144 It is important to emphasize that the results discussed above are additional to the impact of the introduction of the euro. Although assessing the impact of the euro on the financial services sector has not been the main focus of this study, given that the period of the FSAP overlapped considerably with the introduction of the euro it is at the same time a considerable challenge and also vital to disentangle the two effects in forming a judgement about the impact of the FSAP and future impacts of the FSWP legislative proposals.

3.145 Crucially, our analysis attributes a number of developments in the period principally to the euro, rather than to the FSAP, whilst in other cases the euro and FSAP are assessed as having had opposing effects.

3.146 So, for example, we find that

(a) **The euro seems to have driven a significant increase in concentration in the banking sector (including stimulating enhanced mergers and acquisitions activity),[28] whilst the FSAP appears to have reduced concentration slightly.[29]** Thus, although concentration has increased over the period of the FSAP, and in particular Member States we attribute the FSAP as making a causal contribution to this, overall our finding is that the FSAP has tended to reduce, somewhat, the extent to which the euro has driven consolidation. This is perhaps the result to be expected — liberalising measures can be expected to promote competition, whilst measures driving structural change may more promote consolidation.

(b) **The euro has tended to reduce trade in non-insurance financial services, whilst the FSAP has increased it.[30]** One possible explanation of this finding might be that the euro tended to reduce trade in financial services because the adoption of the euro entailed the disappearance of exchange transaction costs and of exchange rate risk (in the case of transactions between EU15 Member States that were also members of the euro). If this is correct, then our model suggests that the euro is achieving one of the objectives its architects had in mind — reducing financial transactions costs. Alternatively, it could be that the introduction of the euro led to some changes of definition in data, or perhaps more strict collection criteria.

(c) **Although the FSAP has had no measurable impact on employment in Insurance, the euro may have had some negative impact.** Again, it seems natural to interpret this in terms of the euro achieving its goal of reducing risk, and hence reducing the need for hedging through various forms of insurance.

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28 Particularly as measured by the H-H index.
29 See Appendix 10.
30 See especially paragraphs A8.26ff in Appendix 8.

Interpreting the Results: The Counterfactual

3.147 Impacts of a regulation can only sensibly be compared with a counterfactual — a picture of how the world (how the horizontal theme in that Member State) would have been without the regulation. In our country studies the main counterfactual has been how matters would have been in the absence of the FSAP/FSWP measures for that Member State.

3.148 This contrasts, for example, with an approach that considers simply how the world was before the FSAP was introduced. In such a case we might then say that the impact on employment was simply the difference between how many people were employed today with 1998. But suppose that in 2006 the number is lower, but that it had been falling rapidly from 1985 to 1998, and fallen only slightly since — in that case, it seems more appropriate to suggest that the impact of the FSAP has been positive, in reducing what would otherwise have been a larger fall, than saying that the impact of the FSAP was negative, "causing" the fall between 1998 and 2006.

3.149 In many cases Member States had well-established trends that pre-dated the FSAP. For example, it appears that financial integration between Nordo-Baltic Member States was already well underway before the FSAP. In that case, although over the period of the FSAP the penetration of foreign companies may have increased in Nordo-Baltic Member States, it seems inappropriate to attribute all of that to the FSAP.

3.150 Similarly, there have been a number of important technological developments over the period, such as an increase in the use of the Internet, which it seems inappropriate to attribute to the introduction of the FSAP in any one Member State.

3.151 On the other hand, any overall perspective requires taking into account a slightly different counterfactual: namely how matters might have been in the EU as a whole without the FSAP and FSWP — some important international trends may have been at least partially enhanced by the FSAP. For example, the use of the Internet for cross-border transactions in financial services relies on foreign entities being permitted to market and sell their products in this way, so that the Internet might not have developed as it has in the absence of the EU.

3.152 Again, although Nordo-Baltic countries have pursued integration with each other, and New Member States have pursued integration with Central and Western European economies, in both cases that was part of processes that included applying to, complying with the rules of, and ultimately joining the EU. In such cases EU membership and subsequently implementation of FSAP measures has been the *mechanism* whereby Member States have chosen to pursue integration. To say that Member States would have found some other regulatory mechanism to pursue their ends misses the point. EU membership and the FSAP *were* the mechanisms chosen, and they had the impacts they had. It will rarely make sense to evaluate the effects of EU-level measures by taking a counterfactual in which international action was pursued by bilateral or multi-lateral sub-EU negotiation. If the counterfactual for a regulation is "another regulation achieving much the same thing" (even assuming that some other regulation to achieve the same thing is available, which in the case of EU-level action is typically highly debateable) then the costs and benefits of all regulations will tend to be very small, and their assessment/evaluation uninformative.

3.153 Thus, viewed globally, we might say that trends within Member States and between regional partners to pursue greater financial integration may best be viewed as part of an ongoing process of integration in which the activities of the European Union in general and the FSAP and FSWP in particular have been a central (and perhaps, in some cases, essential) part — especially in the maintaining of momentum.

4 EVALUATION AND PROPOSED WAY FORWARD

4.1 From our study of the FSAP measures and FSWP legislative proposals we have seen that the move towards the internal market for financial services remains ongoing and that it has already begun to create benefits both in terms of greater trade and of improved and harmonised regulatory arrangements in the Member States. Furthermore, in the future the impacts are expected to be much larger, particularly effects on the cost of equity (potentially stimulating more of a "culture of equity" in a number of Member States lacking such a tradition). Further, the Community framework for financial services is now largely adopted in the Member States surveyed. This represents a substantial regulatory reform in each of the Member States with a corresponding cost in adaptation for market players — a substantial achievement within a short timescale.

4.2 This has occurred at the same time as other significant market developments, such as the introduction of the euro and the bull and bear markets of the late 1990s and early 2000s.

4.3 However, implementation of the FSAP has varied across Member States, with delayed or less-than-vigorous compliance reducing positive impacts in some cases. Further, as the counterfactual to the FSAP measures and FSWP legislative proposals has differed in each Member State, so too has its impacts. In this respect it is also important to consider that the FSAP measures and FSWP legislative proposals are one part of the broader progress of sector reform and liberalisation which may also include other elements such as the move away from state ownership or involvement in financial services providers. In this respect we would expect that as practical compliance with FSAP measures and FSWP legislative proposals and wider sector reform in the Member States advances, positive effects will continue to be seen over the next period.

Assessment of the Core Mission of the FSAP and FSWP

4.4 As mentioned above, and demonstrated in the individual country studies, impacts across Member States are not evenly distributed. Some horizontal themes in some Member States have already started to benefit materially from FSAP measures (most notably in the case of banking) whilst for other themes in the same state (and, in a few cases, for certain Member States as a whole — perhaps most notably the UK) the effects so far appear to have been principally the creation of compliance costs with little corresponding regulatory gain.

4.5 However, in the longer term, even for those Member States for which, in certain of the horizontal themes, significant benefits are yet to arise, in the longer term our assessment is that material benefits will arise. This is because the changes to those Member States already benefitting will provide opportunities for trade to those Member States that began with regulatory or competitive or competitiveness advantages. This was always the central purpose of the FSAP — not, in the main, to improve upon the domestic regulatory framework of Member States, but, rather, to provide a common framework that would, in the longer term, allow trade to flourish.

4.6 At such an early stage it is natural that firms in Member States that have had to bear one-off costs of adaptation and increased ongoing costs of compliance are aware mainly of the downsides of the FSAP, and are disappointed in those cases where the original trade liberalising ambitions of the Commission appear to have been thwarted. But in the longer term it is our assessment that the core mission of the FSAP and FSWP legislative measures remains intact — specifically, our view may be summarized as follows.

(a) Although,

- first, for a few of the more established Member States that have had only a limited tradition of contestability of financial services markets and openness to foreign firms, the FSAP has so far not succeeded in integrating them into a Single European capital and financial services market; and
- second, regional activities at the sub-EU level, such as the development of the Nordo-Baltic Regional market and the Euronext area, appear to have had a much more substantial impact than the FSAP in driving integration in the short-term (even between Member States in regional groupings in which not all employ the euro);

nonetheless, we regard the aspiration, intent, and momentum of the FSAP to be an important factor in fostering other drivers to integration, and in the longer term we believe that the FSAP and future FSWP measures will be well on the way to fostering a market where financial services and capital may circulate freely at the lowest possible cost throughout the EU.

(b) We believe that the above has been (and will be) achieved at the same time as maintaining effective corporate governance and financial stability.

(c) Concerning "investor protection", we first note our view that insofar as this is a legitimate policy goal, it should not be understood as insulating investors against downside risk — the effort to assess risk and determine one's own appetite for it are matters properly left to the Market, and policy that insulated investors against downside risk would have the inevitable result that many very poor investment decisions would be made, significantly undermining the efficiency of investment, reducing growth and damaging the workings of the economy in general. Instead, "investor protection" should be understood as protecting investors (including investors in insurance products) against exploitation of informational advantages on the part of firms and also against scams and other malpractice.

In that aspect, it is important to understand that when there is a regulator, the economic behaviour of investors is likely to change. If they believe they are protected by regulatory oversight, investors will naturally tend to be more trusting than they would in a pure market setting — for example, they will more naturally assume that they are receiving good advice from advisors, that their assets are managed to the best of their agents' ability, and that their buy/sell instructions are implemented efficiently. When regulations change considerably, investors may then face a period of some loss of trust as they adapt to the new environment.

It happens that the introduction of the FSAP has coincided with considerable market shocks, particularly in securities and insurance markets, which would naturally have tended to create challenges for investors anyway. Nonetheless, we believe that Figure 4.1, which identifies whether consumers agree with the statement that they are adequately protected, should give pause for thought.[31] As we shall discuss further below, we believe that, in addition to reflecting market shocks in the period, the loss of confidence in consumer protection that Figure 4.1 indicates may be evidence of regulatory fatigue on the part of consumers. However, there is an additional aspect that should be borne in mind, as follows.

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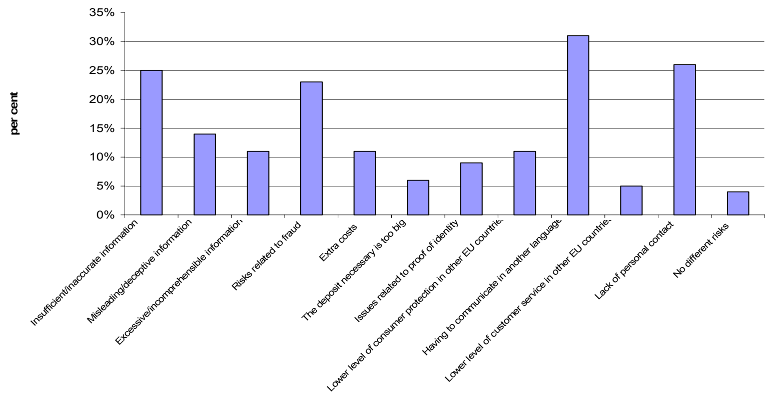
31 We note that the data series in Figure 4.1 runs only until 2003 — unfortunately Eurobarometer data in this form are not available for later years as at the time of writing. However, we have obtained a more recent Eurobarometer study considering these issues as at March 2006 — *Consumer protection in the Internal Market*, Special Eurobarometer, European Commission, fieldwork February – March 2006, published September 2006. *Consumer protection in the Internal Market* is a survey of EU consumers' attitudes and experiences on cross-border transactions. The survey was based on information gathered in interviews in February and March 2006 in each of the 25 Member States. The results indicated that, for a number of reasons, consumer confidence in cross-border shopping is not very high.

Respondents were asked to state up to three factors that they saw as main barriers in the purchasing or signing up for financial services from providers in other Member States from a choice of: insufficient/ inaccurate information; misleading/ deceptive information; excessive/ incomprehensible information; risks related to fraud in purchasing financial services in other EU countries; extra costs related to purchasing financial services in other EU countries; the deposit necessary is too big; issues relating to proof of identity; lower level of consumer protection in other EU countries; having to communicate in another language; lower level of service in other EU countries; lack of personal contact.

The following chart gives the average percentage responses for the 25 Member States:



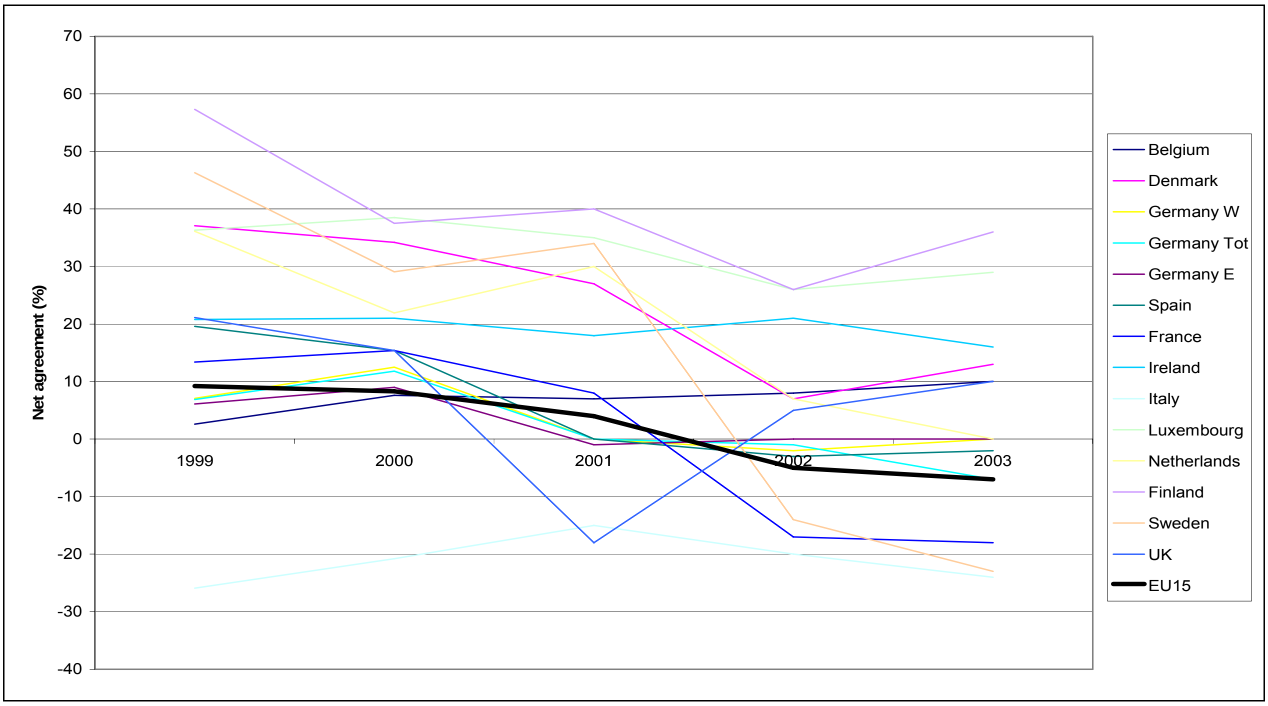
As can be seen, the most common barrier cited was that of having to communicate in another language (31 per cent). Also deemed important were: lack of personal contact (26 per cent); insufficient/ inaccurate information (25 per cent); and risks relating to fraud (23 per cent). This suggests (i) that there would be considerable barriers to cross-border trade in this area that go beyond the reach of standard regulation — e.g. language barriers; and (ii) that a lack of confidence amongst consumers that regulatory authorities will protect them from fraud and ensure that they have the information needed to conduct transactions remains a significant barrier to cross-border trading. Only 4 per cent of respondents stated (spontaneously) that there were no different risks from purchasing financial services from companies located in other EU countries.

There were, however, significant differences in responses between Member States, for example, the percentage of respondents who considered risks related to fraud to be a main barrier ranged from 40 per cent in the former East Germany to 11 per cent in Spain.

The percentage of respondents that considered there were no different risks in purchasing financial services from companies located in other member states ranged from 9 per cent in Hungary to only 1 per cent in Slovakia; Lithuania; France and Estonia.

However, consumers' opinions concerning cross-border purchases of financial services should not be taken out of context as consumers indicated a reluctance to purchase from a different Member State across all goods and services. Across all goods and services only 32 per cent of respondents agreed that they were prepared to purchase from Member States using another EU language; and sixty four per cent did not know where to get information and advice about cross-border shopping. Sixty eight per cent agreed that they were less interested in cross-border shopping because they preferred to shop only in person and not by post, phone or through the internet.

Figure 4.1: Consumer perceptions about protection of consumer rights in relation to financial services



Source: Eurobarometer

As we have mentioned above, consumers will naturally tend to adapt to the presence of a regulator by becoming more trusting. This has the result (true of many forms of regulation) that the ways in which the Market itself would tend to counter the issues regulation seeks to address tend to be undermined — the regulator stands in the place of the Market, believing that regulation can more efficiently address the issues involved. But if consumers have become used to trusting that certain kinds of things "won't be permitted" in their country, and then at the EU level a harmonizing directive prevents the national regulator from outlawing these practices (e.g. because they are normal in other Member States), it may be necessary to engage in a considerable education campaign to make consumers aware of how the rules have changed. Otherwise practices that might be perfectly acceptable if consumers were aware of them might instead create risks of exploitation. And even if this is not so, consumers may fear that, unknown to them, the rules have changed in ways that now do create risk of exploitation, and therefore lose confidence — undermining growth in the market.

As we have seen in Section 3, our view is that the FSAP measures and FSWP legislative proposals have not in general undermined consumer protection (with the exception of markets in a few Member States where traditionally consumer protection was very strong (probably too strong) and a few where Market processes that were a relatively important source of consumer protection may have been somewhat undermined), and in many Member States has led (or will lead) to material improvements in the degree of (formal) consumer protection.

However, we have not been convinced in this study that consumers have always been adequately informed and reassured about the ways in which rules have changed, and we feel that this is an area in which more work could be done. Furthermore, the detail and complexity of certain FSAP elements may have increased the difficulty for some consumers in some Member States in understanding precisely what the rules are. (It is, however, important to emphasize that this is not universally true — for example, we have found that Belgian and Italian consumers have become better informed about insurance products as a result of the FSAP.)

Our suspicion is that FSAP policy-makers have sometimes tended to regard consumer protection as entirely or almost entirely a product of rules, regulations and government intervention, and have not taken the view that Market processes are as significant a potential source of consumer protection as we consider them to be. If we are correct, then policy-makers may not always have paid sufficient attention to the need to keep rules simple and comprehensible to consumers and to ensuring that consumers are properly informed about precisely what those (simple) rules are. With understanding on the part of consumers and information provided to them, Market processes can offer consumers protection. But consumers unsure of the rules are more vulnerable to exploitation.

Regulatory fatigue

A sense of regulatory fatigue is widespread

4.7 Though much has been achieved, looking forward, there appears to be a widespread sense of regulatory fatigue.[32] Market participants and national regulatory agencies have become exhausted by the pace of change under the FSAP.

4.8 It is occasionally thought that the idea that the FSAP has given rise to a feeling of regulatory fatigue is a perspective specific to one or two particular Member States. However, our survey illustrates decisively that this is not so. The comment that there was "regulatory fatigue", "legislative fatigue" or the sentiment that the FSAP process had involved too many (or a great many) changes introduced too quickly (or very quickly) was clearly expressed in Belgium, the Czech Republic, Denmark, Estonia, Finland, Greece, Malta, Poland, Sweden, and the UK (ten of the twenty-five Member States in our sample). Regulatory fatigue or a concern about the transitional impacts of dealing with a large volume of regulatory change have also been mentioned at meetings of the CEBS and the EBIC.

[32] By regulatory fatigue we understand exhaustion with the need to adapt to changes in regulation. This is distinct from the view that there is too much regulation.

4.9 In addition, in Germany, Hungary, and Ireland (as well as in Belgium, Denmark, Finland, Greece, Poland and Sweden — Member States mentioned above), survey respondents mentioned concerns about excessive detail or excessive prescription, whilst in Cyprus the concern was that implementation deadlines were too tight. We regard concerns about whether there is "too much" regulation or deadlines that are too tight as separate from the concern that there is too much change too quickly. Nonetheless, it is possible that comments about excessive detail, excessive prescription, or excessively tight deadlines are a diplomatic way to express a sense of regulatory fatigue in these Member States also.

4.10 It is perhaps worth noting that the sense of regulatory fatigue is (with the exception of Belgium) not emphasized among the "core" original EU6, most of the New Member States, or among the Western Mediterranean Members. It is, instead, a sentiment of the Northern periphery and the Eastern Mediterranean — but is nonetheless widespread among these groups.

Regulatory fatigue affects consumers as well as firms and regulators

4.11 Even consumers may be exhibiting a form of fatigue — if we consider, again, Figure 4.1, we note that in 1999 9.2 per cent more consumers felt their rights were adequately protected in relation to financial services than felt they were not adequately protected, whilst by 2003 this position had reversed — by then, 7 per cent more consumers felt their rights were *not* adequately protected than those that thought they were.

4.12 Although this turnaround occurred during the period of the FSAP, and against a background of considerable regulatory change, it seems reasonable to assume that the main driver was the stock market turmoil in this period and the consequent loss of value in financial products such as endowment policies, unit trusts and pensions.

4.13 However, this does not mean that there was no impact of the FSAP. It seems plausible that, during a period in which the rules change considerably (as has happened in a number of Member States), consumers may take time to become comfortable with the new rules, and in the interim feel less confident that their rights are protected. Continuous change in the rules does not allow time for the Market to adapt.

The impact of regulatory fatigue is already having an impact on the FSWP

4.14 This fatigue also appears to be having an impact even on plans within the FSWP, let alone looking forward beyond that. For example, at the time of the White Paper, it was envisaged that there would be a Clearing and Settlement Directive. However, on 7 November 2006, a Code of Conduct on Clearing and Settlement was signed by the underwriting organisations, and welcomed by the President of the FESE and the European Commissioner for Internal Market and Supervision (we shall set out more details below).

The importance of maintaining momentum

4.15 There would seem to be a strong case for a period of bedding down of the regulations implemented and announced. However, it will be important not to lose momentum, and this bedding down period should not be viewed as a regulatory development "holiday". Instead, mechanisms such as voluntary cooperation should be used to make continuous progress, and to test the strengths and limitations of the framework now (or shortly) in place. One way to facilitate this is to incorporate into the process of voluntary cooperation a "roadmap" giving specific dates by which milestones should be achieved.

4.16 As we shall explore further below, to be successful, voluntary cooperation must be conducted with a sufficiently common understanding among the parties to the cooperation, and a sufficiently robust underlying framework. In our view, in the areas of Banking and Securities, full implementation of the FSAP will mean that this is already largely achieved. In Insurance there may be a need for further Directives (in particular, those implementing the Solvency II framework), but perhaps also some scope for additional clarification of high-level principles (where the fundamental principles are those arising from the Treaty).[33]

4.17 If the practical outworking of the principles of the underlying framework is to be delivered mainly through voluntary cooperation models in the period ahead, there is a case that further specification of that underlying framework might most effectively be delivered through regulations and communications, rather than directives. We shall return to this below.

From Legal Harmonisation to Voluntary Cooperation and Back Again

4.18 We have noted that sector regulatory reform at European level has traditionally taken the sequence of framework harmonisation leading to a deepening of regulatory practice.

4.19 Typically the first phase of harmonisation has been formalised by Community Directives defining the application of Treaty principles in the sector, with later harmonisation being achieved through greater regulatory and practitioner cooperation between the Member States. Such a deepening harmonisation has sat alongside the development of regional markets and closer cooperation between regulators at regional level particularly in relation to issues of cross-border supply or inter-operability.

4.20 Insofar as framework harmonisation is already achieved in the Member States, then the scope to achieve further legal harmonisation is (by definition) limited. This does not however, necessarily mean there is no need to achieve greater practical harmonisation, but it is less clear that Directives are the ideal instruments to achieve this.

4.21 This is of course reflected in the adoption of the Lamfalussy process and the process of Level III cooperation which remains at a fairly early stage.

[33] We note that commenting on the need for further regulatory development in the areas of mortgages or pensions falls outside the scope of this study.

White Paper actions

4.22 The FSWP has identified the following key actions in this regard:

- Comitology reform;
- Improving the process of accountability and transparency of the Committees, (for example in relation to the European Council and Parliament) ;
- Developing the cross-sectoral regulatory cooperation in an increasing number of cross sectoral financial issues;
- Ensuring that the four levels of the Lamfalussy process respect the better regulation agenda (with possibly adding a panel of expert economists to assist the Level III Committees);
- Working with major partners towards global convergence of standards where practical.

4.23 These actions in themselves appear well suited to increase the effectiveness of the Lamfalussy process.

Voluntary Cooperation

Advantages and disadvantages of voluntary cooperation

4.24 As a mechanism for achieving a common regulatory framework, voluntary cooperation has a number of key advantages, including that:

(a) it allows for an exact reflection of local factors — this contrasts with harmonising measures which, by nature, tend to offer only limited scope for the reflection of local factors;

(b) it allows for a process of iteration, whereby measures can be put in place, shown not to work as well in practice as anticipated (often revealing that some slight change might have improved things), and then amended — this contrasts with a Directive, for example, which, once in place, is very cumbersome and slow to amend; and

(c) it allows for interaction only between those for which changes are most relevant — in contrast, a Directive must take account of the views and interests of many parties, potentially including Member States in which the affected sector is very small.

4.25 On the other hand, voluntary cooperation may lack credibility — national interests may dominate, change may simply not occur at all, and contentious changes may become infeasible.

4.26 In order for voluntary cooperation to be employed successfully, there needs to be a sufficiently common understanding among the parties to the cooperation, and a sufficiently robust underlying framework. Thus, a period of voluntary cooperation might naturally be preceded by a period of harmonisation. It may be that the FSAP has (or will have, once completed), at least for the moment, created a sufficiently common understanding and sufficiently robust framework that it is appropriate now to have a phase in which voluntary cooperation becomes a more central tool of the regulatory process than has been the case recently. We believe that this is largely true in the areas of Banking and Securities. Further development of the framework, including through directives but perhaps also through regulations and communications, is probably necessary in the area of Insurance.

Voluntary cooperation, regulations and communications

4.27 As we have noted, if the practical outworking of the principles of the underlying framework is to be delivered mainly through voluntary cooperation models in the period ahead, there is a case that further specification and clarification of that underlying framework might most effectively be delivered through regulations and communications, rather than directives.

4.28 Regulations could be used to express principles, and to be enacted through a less cumbersome process than that associated with directives — speaking to the concern mentioned above about the excessive detail of FSAP measures. On the other hand, the danger with simply expressing principles and leaving it to the discretion of regulatory authorities how to implement is that if principles are expressed too tightly and generally then they will not allow of those practical exceptions that inevitably arise, whilst if they are expressed too loosely there will be the opportunity for national regulatory authorities to use their discretion to negate the process — thereby undermining the objectives of the Single Market.

4.29 The answer we propose is to combine a set of regulations and communications, setting principles in those (few) areas in which further clarification of principles is currently needed, with a robust process of voluntary cooperation, on the model of the Clearing and Settlement framework (explained in more detail below).

4.30 We emphasize that we are not arguing that the process of integration has gone "far enough" (recommending "regulations combined with voluntary cooperation" is not some code for ending integration). Neither are we suggesting that no further directives will, in due course, be appropriate. Rather, we are attempting to provide a mechanism that can maintain the momentum of integration, during a period of bedding down of a very significant set of changes already introduced, without creating further regulatory fatigue.

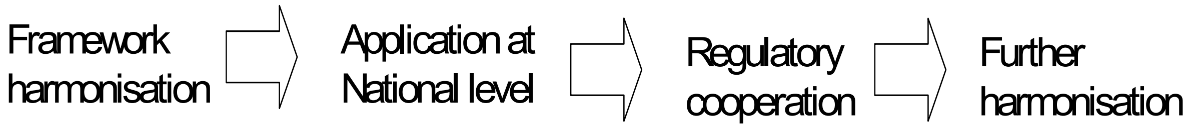
Voluntary cooperation leading to more harmonisation…?

4.31 One possibility is that the process of regulatory cooperation itself may expose areas in which further explicit legal harmonisation would be beneficial, either because there are clear benefits from a particular type of approach or because of a failure of Member States to reach agreement on an approach despite clear benefits. This further legal harmonisation might take the form of regulations in the short-term in some limited areas, and directives in the longer-term where more fundamental further developments are necessary.

4.32 In this sense it could be argued that Lamfalussy may not fully take benefit from the process of consultation and partnership in the evolution of Community policy. For example, it can be argued that in practice the process of consultation with practitioners still comes too late in the decision making process and that practitioners should be more involved in policy formation at an earlier stage, in the formulation of Directives and again through the impact assessment process.

4.33 In its most simple expression such a revised process is outlined in Figure 4.2.

Figure 4.2: The process of regulatory reform



4.34 In this respect we could see that voluntary cooperation itself could become a key driver of further harmonisation and that this cooperation could also help ensure that such harmonisation takes benefit from best practice in the regulation.

Voluntary cooperation leading to less harmonisation…?

4.35 Although the above process cannot be ruled out, it seems to us that an alternative (perhaps more plausible) possibility is that a phase of voluntary cooperation will expose (i.e. help to identify) areas in which there is current insufficient scope for discretion to allow voluntary cooperation to achieve all that it could.

4.36 It that case, a phase of voluntary cooperation may suggest areas in which there need to be future Directives (or other measures) that extend the scope of discretion.

Voluntary cooperation in action: Clearing and Settlement

4.37 At the time of the White Paper, it was envisaged that there would be a Clearing and Settlement Directive. However, on 7 November 2006, the organisations represented by the Federation of European Securities and Exchanges (FESE), the European Central Securities Depositories Association (ECSDA), and the European Association of Central Counterparty Clearing Houses (EACH), agreed upon a Code of Conduct for Clearing and Settlement. This won the approval of the Internal Market and Services Commissioner (McCreevy), who earlier this year expressed his preference for an industry led approach to achieving a more efficient and integrated post-trading market in the EU as opposed to having to propose a Directive.

4.38 In line with the objectives of the European Commission, the overall objective of the Code of Conduct is to allow investors to trade European securities within a consistent, coherent, and cost-effective European framework.

4.39 Key features of the Code of Conduct include:

(a) It is an industry rather than Directive led approach.

(b) Compliance with the code will be achieved through voluntary self commitment.

(c) Initially, the Code will apply exclusively to cash equities.

(d) The European Commission has proposed to the organisations to extend the self-regulatory approach to other asset classes, such as bonds and derivatives. This review will take place at the same time as the implementation of Markets in Financial Directives Instrument (MiFID).

(e) The Commission welcomes any extensions where practicable before this review.

4.40 The Code of Conduct will focus on the following areas:

(a) Price transparency — facilitating the comparability of prices and services.

(b) Standard unilateral access and interoperability between organisations — expanding the freedom of choice for market participants through enhancing the ability of organisations to interconnect.

(c) Service unbundling and accounting separation — to facilitate competition, increase consumer choice, and providing relevant information on the services provided.

4.41 Acknowledging that the more complex measures will need more time to be implemented, the European Commission announced a phased implementation process with specific deadlines for each of the measures[34]:

(a) By 31 December 2006, price transparency will be in place.

(b) By 30 June 2007, access and interoperability will be in established.

(c) By 1 January 2008, service and unbundling will be implemented.

4.42 Speaking on the occasion, Commissioner McCreevy noted the following:

(a) While the Code is voluntary, a strict monitoring mechanism will be installed to ensure that measures are implemented both properly and on time. This will rely on external auditors reporting to an ad hoc monitoring committee chaired by the Commission.

(b) The Code, while necessary, is not sufficient in achieving the desired integrated market in post trading services. For this end it is imperative that concerted action be taken on the part of the Commission, the Member States, the ECB, the EU securities regulators, the infrastructure provider, and users.

(c) Further actions are needed to address the remaining obstacles to an integrated market, including:

- Competition between actors in this market is essential and thus stressed the role that the EC will play in the strict enforcement of competition law that will accompany the process of elimination of the remaining Giovannini barriers.[35]

- More progress is needed with regards to the removal of barriers created by Member States; namely the discrepancies between national legal and fiscal compliance measures.

- Role of the Commission: Two expert groups to deliver initial advice on the problems and how to tackle them have been set up: the FISCO group and the Legal Certainty Group.

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[34] We note that this constitutes a roadmap of the sort mentioned above.

[35] On behalf of the EC, the Giovannini Group identified 15 technical, legal, and tax barriers as the main causes of the remaining inefficiencies and fragmentation of European capital markets.

– Role of the Member States: National and regulatory authorities will need to devise jointly, a set a coherent measures that will provide the relevant regulatory and supervisory framework to bring about an integrated post- trading market and ensure an adequate mitigation of risks.

4.43 The President of the FESE noted the following:

(a) The Code must adhere to the EC's aim of making the concept of "cross-border" redundant for transactions between Member States.

(b) The Code is a measure of mutual trust and voluntary in nature and thus grants no legal rights to, or indeed duties for, the signatories to this Code.

(c) The dismantling of the remaining Giovannini barriers is a precondition for obtaining full interoperability in the provision of cross-border post-trading services.

(d) The organisations will assess the impact that the TARGET 2-Securities initiative will have on the code.

Capturing Regional Cooperation Through Lamfalussy

4.44 We can also see the development of regional markets, which should encourage regulators to look at regional barriers and interoperability issues on a common basis. This too could become a means of achieving longer term European harmonisation. Lamfalussy does not appear to build in this type of regulatory cooperation which can be seen for example in the regional groupings of energy regulators.

The difficulties of practical harmonisation

4.45 However we should not underplay the difficulties inherent in the process of moving towards a common regulatory framework and common regulatory treatment for very different financial services markets, with different legacies of legal and contractual arrangements.

4.46 In this respect as the level of harmonisation of regulatory practice is deepened so the adoption of common regulation implies greater compromise from Member States in relation to their current practices. Here there may well be genuine sacrifices for some Member States as changes in regulatory practice may in some cases dilute or at least change existing relative regulatory advantages enjoyed by their national providers.

4.47 In such a process there is also a risk that regulatory harmonisation and the adoption of the Community framework can become delayed due to protectionist or national champions strategies pursued by Member States. Whilst such strategies are not consistent with the Community Acquis, it is important that the European Commission continues to provide momentum to this process and that there is sufficient consensus to ensure progress.

Greater political involvement to ensure consensus

4.48 In this respect it is important to maintain the political consensus underpinning the Community reform. Under traditional institutional arrangements the Commission is entrusted with the sole right of initiative for policy making.

4.49 Here the FSWP raised the issue of whether other Community institutions such as the European Parliament and the Council should be more involved at earlier stages in the legislation.

Dynamic Regulatory Development in the Single Market

4.50 If we knew the ideal way to regulate the Single Market and the world did not change over time, then there would be a strong case for imposing as much of that ideal regulation as is possible, everywhere, moving steadily towards the ideal.

4.51 However, first, human knowledge is incomplete — views about what is best practice evolve through time as we learn more. Second, and crucially, the world moves on — new products and services are developed, the needs of consumers change, and so on — so that even a perfectly-known best practice would need to change.

4.52 Thus, even a complete Single Market will require methods by which regulation can evolve. One possibility would be to observe developments in financial services regulation elsewhere in the world — in the US, say, or in East Asia — and learn from these experiences, eventually implementing what seems to be best practice in those jurisdictions. However, the undesirable implication of this would be that regulatory practice in the EU would lag always behind that in other major financial services markets.

4.53 An alternative route is for the EU to learn internally what is best practice, drawing lessons from diversity of regulatory practice within the EU. Indeed, this has been an important route by which key elements of the FSAP came to be recognised as best practice — an example would be MiFID, in which, for example, a best execution requirement, following the UK practice, was seen as superior to a concentration rule in delivering efficient price discovery, and in general the specification of many elements of MiFID reflect a widespread view that the UK has had a regulatory advantage in the relevant sectors.

4.54 Thus, the FSAP has applied the lessons of past regulatory competition. In the future, as new innovations arise and consumer needs evolve, it is likely that allowing sufficient scope for regulatory competition within a sufficiently common framework that such competition offered limited (if any) scope for national protectionism — a framework already largely established by the FSAP — would again reveal which of various different possible regulatory approaches actually works best in other, as-yet-unforeseen areas. In due course further directives and regulations might apply these new best practice lessons more widely.

4.55 In contrast eliminating all scope for regulatory competition would bring this competitive mechanism for dynamic development in regulation within the EU to an end. This would seem counterproductive. Regulatory competition, conducted in an environment of close but voluntary regulatory cooperation under a sufficiently common mandatory framework to allow trade to flourish within the Single Market and for financial integration to deepen, could (as it has in the past), provide a spur to regulatory development, to the benefit of consumers, good regulators and competitive firms alike.

APPENDIX 1: METHODOLOGY OF THIS STUDY

Introduction

A1.1 In this Appendix we outline the methodology we have employed in this major study, conducted between December 2005 and February 2007.

A1.2 This study has aimed to provide a rigorous and detailed approach which clearly builds upon existing research and is consistent with current best practice in impact assessment techniques.

A1.3 This is the first major quantitative study of the impact of the overall FSAP and FSWP legislative proposals on the EU Member States and the Union as a whole.

The scope of this study

A1.4 The task was to analyse the impact of the FSAP and FSWP legislative measures on banking, insurance, securities, and financial conglomerates in each individual Member State and in the EU as a whole.

A1.5 The impacts considered were to include people-focused issues such as competitiveness, consumer protection, growth and employment, as well as standard regulatory concerns such as market functioning, competition, trade and the cost of capital.

Our general approach: Impact assessment techniques

A1.6 In the "Communication from the Commission on Impact Assessment", impact assessment is defined as "the process of systematic analysis of the likely impacts of intervention by public authorities."[36]

A1.7 Further, the principles of impact assessment suggest that the depth of any impact assessment should be proportionate to the significance of the likely impacts of any proposal.

A1.8 Typically an impact assessment should consider the rationale of policy, policy objectives and the different policy options available. It should then quantify where possible the impacts of different policy options to assess which of the options best maximises welfare.

Assessing impacts in this case

A1.9 In this case we are undertaking both an *ex post* assessment, in relation to impacts which have already occurred due to the FSAP and also an *ex ante* assessment in relation to future impacts of this process and of measures not yet implemented or agreed which have been proposed in the FSWP.

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[36] COM (2002)276

A1.10 In light of the potential importance and significance of the measures considered we have aimed to provide an assessment which benefits both from qualitative approaches, for example interviews and discussions with, experts and detailed quantitative analysis, including factual research and econometric analysis.

Horizontal analysis and a review of national EU markets

A1.11 In undertaking this study we have been asked to provide detailed analysis of the impacts of Community policy in national financial services markets and then, building upon our findings of national impacts, to provide a consideration of horizontal impacts.

A1.12 This bottom-up approach has allowed us to consider issues such as:

(a) Variance and asymmetry across the Member States in the development of financial services markets and the impacts of the FSAP;

(b) Which impacts have been common across the EU;

(c) Legacy issues in relation to different legal frameworks and levels of financial development on the impact of Community policy;

(d) The effects of differential application of the Community policy in the Member States.

Key methodological challenges

A1.13 Assessing the impacts of the FSAP has involved a number of key methodological challenges, including:

(a) **Establishing the counterfactual to the FSAP measures and FSWP legislative proposals**. Defining the appropriate counterfactual (an essential component of the impact assessment process) is particularly challenging for this study. For example if the counterfactual is the continuation of trends apparent before the FSAP then we need to identify what these trends are. Further, the counterfactual varies between the Member States, for example according to their pre-existing legal and financial services framework.

(b) **Identifying the contribution of the FSAP measures and FSWP legislative proposals to the achievement of an internal market for financial services**. Here it can be argued that the contribution of the FSAP measures and FSWP legislative proposals are of key importance, for example if the FSAP measures and FSWP legislative proposals are indispensable to this process then some of the benefits of the internal market as a whole should be allocated to the FSAP measures and FSWP legislative proposals.

(c) **Identifying the effects of differential transposition of the Directives**. The FSAP measures and FSWP legislative proposals have not been fully applied across the Member States and in fact some elements of the FSWP legislative proposals, such as Solvency II, remain under discussion. In this respect, whilst the FSAP measures and FSWP legislative proposals may have had impacts in shaping the expectations of market players even where it has not yet been applied, clearly such impacts will be affected by the level of application.

(d) **Establishing causality**. This is often a problem in impact assessments particularly when inference must be drawn from econometric analysis. In the case of this assessment we have identified market trends and direct impacts (such as those clearly arising from application of the Community framework) and then considered also how far market trends and the shape of the financial services development appear to have met our expectations in terms of the expected impacts of the FSAP measures and FSWP legislative proposals.

(e) **Data problems**. Full disaggregated and consistent data is not always available (and even when it is it does not always cover sufficient years), and we have worked to rectify this in our methodology through intensive research methods. These are detailed later.

(f) **Ongoing nature of the process**. Producing an impact assessment whilst the process of implementing the FSAP measures and FSWP legislative proposals is still ongoing has the considerable advantage that there is still the opportunity to influence the processes — this is, of course, a key reason why the Parliament has commissioned the study at this stage. It does, however, create the challenge that conclusions, forecasts and recommendations might, if they are acted upon, change the path of future developments away from our forecasts. In addition, the recent and ongoing nature of the FSAP measures and FSWP legislative proposals makes causal analysis and trend analysis more challenging.

Methods employed

A1.14 To overcome these difficulties and to provide the most accurate and comprehensive assessment possible we have used a methodology spanning several methods for assessing impacts.

A1.15 For this study we have used extensive:

(a) Desk research, gathering primary data and previous reports;

(b) Expert analysis of economic mechanisms;

(c) Questionnaire survey of authoritative stakeholders;

(d) A small number of selected interviews;

(e) New econometric modelling;

(f) Analysis and interpretation of previously-conducted cost of capital and growth analyses;

(g) Analysis and interpretation of previously-conducted data envelope analysis;

(h) Expert judgements and interpretation of data to draw conclusions.

Desk research, gathering primary data and previous reports

A1.16 Although no previous official assessment in the style of this study has been conducted, nonetheless the FSAP has been extensively discussed. Furthermore, the areas of interest (e.g. competitiveness, consumer protection, market functioning, trade and so on) are analysed in many other contexts (e.g. macroeconomic analysis for financial or national fiscal purposes, or market analysis for competition purposes). Thus there have been many relevant previous studies on which we were able to draw.

A1.17 In addition to considering previous studies, we have made extensive use of primary data. Again, there was a wealth of official data sources on which we could draw (though it is important to note that, although voluminous, these data did not speak directly to all of the important questions that arose).

A1.18 In reviewing previous studies and gathering primary data, it was important to structure the search so as to prioritise sources that were potentially most fruitful before widening consideration to attempt to capture as much of the best analysis as was feasible. Thus, our research included web-site searches of

(a) International agencies, particularly

- The European Commission: This was particularly useful for
    - Texts of directives and surrounding documents
    - Discussion papers and reports
    - Eurostat data (of particular importance for trade data)
    - Eurobarometer data (of particular importance for data on consumer attitudes)
- ECB: This had particularly useful data on the banking sector, including
    - Numbers of institutions
    - Cost-to-income data
    - Mergers and acquisitions data
    - Concentration indicators
- IMF: This was particularly useful in providing Financial Sector Assessment Programme reports for a number of Member States as inputs into the country lots.
- OECD: This was most useful as a source of primary data
- University of Groningen: This provided data for a number of Member States including on employment, productivity, and value added.

(b) National authorities, including

- National financial regulators
- National central banks
- National competition authorities

– Finance ministries

These websites were sources particularly of national data and of analytical reports. In a few cases they were also a source of important cross-country analyses.

(c) Associations, including

– Industry associations

– Consumer associations

A1.19 It should be noted that, where data were available, our standard base year for reporting purposes was 1992, so that 1992 to 2006 would cover 15 years. Such a period includes enough years prior to the FSAP to give a sense of pre-existing developments and trends, but without being cluttered by now-irrelevant history. However, for a number of figures and tables in the country lots, different base years are employed. The reasons for this were typically either:

(a) Data as far back as 1992 (or for that particular year) were not available; or

(b) Developments prior to 1992 might be relevant. The main country lots in which this was a factor were those Member States joining in 1995, for which it was important to be able to disentangle developments associated with the FSAP from those arising in the period shortly after Accession.

A1.20 We have also reviewed the existing economic literature on the issues connected with the impacts of the FSAP, for example of the economic effects of differential financial development.

Expert analysis of economic mechanisms

A1.21 In attempting to disentangle the effects of the FSAP and future effects of FSWP legislative proposals it is important first to understand *how* the FSAP and FSWP proposed measures should have been expected to have impacts. From there we are able to investigate whether such effects have actually been observed in practice.

A1.22 It is important to emph+asize that we have included within the scope of this analysis not only the effects expected by supporters of particular measures and proposals, but also certain “negative” mechanisms alleged by opponents. As sources for expected effects we have used, among others

(a) The preambles to the directives themselves;

(b) Impact assessments and evaluations conducted by the Commission and in certain Member States;

(c) Views expressed in our own survey, in other consultation exercises;

(d) Critiques and discussions in academic literature, consultancy reports, and on the web-sites of stakeholders.

A1.23 Our general assessment of these mechanisms appears in Appendix 6: . Our assessment draws both on our own economic reasoning and on our analysis of the situations in Member States.

Stakeholder survey

A1.24 As part of our qualitative analysis in undertaking this study, we have aimed to allow key stakeholders across the EU Member States to express their views on the FSAP process which we could then reflect in our findings. One element of this process has been a questionnaire survey, accompanied by a small number of selected interviews. This is set out in more detail in Appendix 12: .

A1.25 We contacted stakeholders across all Member States and distributed questionnaires. Whilst many stakeholders perhaps understandably felt unable to express an opinion because of the early stage of the process, we nonetheless received generally high quality replies from across all the EU Member States which allowed us to understand more about how impacts are viewed.

A1.26 As part of our qualitative analysis we have also conducted a small number of selected interviews with sector experts.

A1.27 These interviews have provided us with the possibility to discuss in depth our emerging findings and to understand more fully how the FSAP process appears to be impacting in the different sectors studied, and how stakeholders expect matters to develop in the future.

A1.28 It is important to emphasize that, unlike many consultancy studies, the views of stakeholders in the survey was not central to our findings, conclusions or recommendations. These are based largely on original reasoning and modelling from primary data. Nonetheless, we did find the views of stakeholders valuable, and the use to which we put them is set out in more detail in Appendix 12.

New econometric analysis

A1.29 In this study we have provided new econometric analyses to quantify the impact of the FSAP and FSWP legislative measures. These analyses are detailed in Appendix 8 and Appendix 10, with results quoted in the main body of the report.

Analysis and interpretation of previously-conducted cost of capital and growth analyses

A1.30 We have also taken benefit from our previous study for the Financial Services Authority on the benefits of MiFID. As part of that study, we quantified the impact of the FSAP and FSWP actual and proposed measures as a whole on the cost of equity and on economic growth for a number of Member States.

A1.31 We have re-calibrated our growth analysis for this survey (see Appendix 7) and drawn out those elements of the cost of equity analysis that are most important here in Appendix 9.

Analysis and interpretation of previously-conducted data envelope analysis

A1.32 We have also drawn on previous research conducted by Casu and Gagliardone (2006), who provided estimates of the efficiency scores for the banking sectors of the EU15 for the years 1997 to 2003.

A1.33 These data have allowed us, in certain of our country lots, to consider how the relative efficiency of EU15 Member States has evolved.

Expert judgements and interpretation of data to draw conclusions

A1.34 As emphasized in a number of places in this Main Report, to draw conclusions concerning the impact of the FSAP and FSWP proposed measures it is necessary to disentangle the effects of those sources from effects associated with other factors, including the euro, technological developments, the bear market, and non-FSAP-related organisational developments.

A1.35 No "indisputable" disentanglement of such a complex interweaving of factors is possible. Any assessment will rely ultimately on judgements and can be the subject of debate, and this is particularly true of future measures and of future impacts of measures recently introduced. We have used econometric techniques in a number of places, but (even setting aside the other limitations of econometrics for drawing conclusions) the most that econometrics can identify for us is a general tendency. It cannot preclude the possibility that in the specific case (e.g. in a specific Member State, or in relation to a specific merger, say) the effect might be quite different (even the opposite) of the general tendency.

A1.36 To draw conclusions as to impacts we have reasoned from the data we could identify and from our understanding of the regulatory and market context, bearing in mind our assessment of the economic mechanisms concerned, our econometric analysis, and general economic principles. The chains of reasoning leading to our conclusions are set out in the Assessment sections of our country lots.

APPENDIX 2: DETAILS OF THE FSAP

Table A2.1: Main FSAP measures

FSAP Action	EU Measure taken	Details	Consumer Issues	Horizontal Theme	Transposition Deadline (if applicable)
Directive on the taking up, pursuit and prudential supervision of the business of electronic money institutions	Directive 2000/46/EC	E-commerce directive. Conceived and adopted at the height of the e-commerce boom, and was intended to facilitate access by non-credit institutions to the business of e-money issuance. Commission reassessing directive, report due Spring 2006.		All	27/04/2002
Directive amending the insurance directives and the ISD to permit information exchange with third countries	Directive 2000/64/EC	The purpose of this Directive is to harmonise requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State. Exceptions exist.		Insurance	17/11/2002
Directive on the reorganisation and winding-up of insurance undertakings	Directive 2001/17/EC	The Directive provides that the opening of reorganisation measures and winding-up proceedings concerning insurance undertakings shall be decided by the competent authorities of the Member State in which the undertaking is authorised (home Member State) and under the home national legislation.		Insurance	20/04/2003
Directive amending the money laundering directive	Directive 2001/97/EC	The Directive updates 1991 Money Laundering Directive to take account of developments in international crime and the prevention of the use of the financial system for money laundering. The principal change encompassed by the recent regulations is to extend the obligations concerning customer identification, record keeping and the reporting of suspicious transactions to a number of newly designated professions and their associated activities.	To familiarise consumers with money laundering techniques and how to avoid them.	All	15/06/2003
Two directives on UCITS	Directive 2001/107/EC Directive 2001/108/EC	Amends Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS.	Provides greater clarity about regulatory regime (and consumer protection).	Securities markets	13/08/2003 13/08/2003

FSAP Action	EU Measure taken	Details	Consumer Issues	Horizontal Theme	Transposition Deadline (if applicable)
Directives amending the solvency margin requirements in the insurance directives	Directives 2002/12/EC repealed by 2002/83/EC Directive 2002/13/EC	Amends Council Directive 73/239/EEC as regards the solvency margin requirements for non-life insurance undertakings.		Insurance	20/09/2003
Directive on financial collateral arrangements	Directive 2002/47/EC	Five main goals: (1). conceive a legislative apparatus capable of dealing with new legislative challenges; (2). eliminate remaining capital market fragmentation; (3). exploit the commercial opportunities offered by a single financial market; (4). encourage closer co-operation of supervisory authorities; and (5). develop integrated EU infrastructure to underpin retail and wholesale financial transactions		All	17/12/2003
Directive amending the 4th and 7th Company Law Directives to allow fair value accounting	Directive 2001/65/EC	Amends Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions.		All	01/01/2004
Directive on the taxation of savings income in the form of interest payments	Directive 2003/48/EC	The ultimate aim of this Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State.		Banking, securities	01/01/2004
Directive on the reorganisation and winding-up of banks	Directive 2001/24/EC	It ensures that, where a credit institution with branches in other Member States fails, a single winding-up procedure is applied to all creditors and investors.		Banking	05/05/2004
Directive on the supplementary supervision of credit institutions, insurance undertaking and investment firms in a financial conglomerate	Directive 2002/87/EC	This Directive lays down rules for supplementary supervision of regulated entities which have obtained an authorisation pursuant to Article 6 of Directive 73/239/EEC, Article 6 of Directive 79/267/EEC, Article 3(1) of Directive 93/22/EEC or Article 4 of Directive 2000/12/EC, and which are part of a financial conglomerate. It also amends the relevant sectoral rules which apply to entities regulated by the Directives referred to above.		Financial conglomerates	11/08/2004
Directive on the Distance marketing of Financial Services	Directive 2002/65/EC	The object of this Directive is to approximate the laws, regulations and administrative provisions of the Member States concerning the distance marketing of consumer financial services.		All	09/10/2004

FSAP Action	**EU Measure taken**	**Details**	**Consumer Issues**	**Horizontal Theme**	**Transposition Deadline (if applicable)**
Directive supplementing the Statute for a European Company with regard to the involvement of employees	Directive 2001/86/EC	This Directive governs the involvement of employees in the affairs of European public limited-liability companies.		All	10/10/2004
Directive on insider dealing and market manipulation	Directive 2003/6/EC	The Market Abuse Directive sets a common framework for tackling insider dealing and market manipulation in the EU and the proper disclosure of information to the market.	Promotion of clean markets.	Securities, banking	12/10/2004
Directive modernising the accounting provisions of the 4th and 7th Company Law Directives	Directive 2003/51/EC	Amends Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings.	Allows investors to use a consistent set of standards against which to assess firms.	All	01/01/2005
Directive on insurance mediation	Directive 2002/92/EC	This Directive lays down rules for the taking-up and pursuit of the activities of insurance and reinsurance mediation by natural and legal persons which are established in a Member State or which wish to become established there.	Extend supervision of insurance brokers.	Insurance	15/01/2005
Directive on prospectuses	Directive 2003/71/EC	It regulates the laws in relation to the drawing up and the publication of prospectuses when securities are offered to the public and/or admitted to trading on a regulated market in the EU. It is a maximum harmonization directive in relation to the contents and format of prospectuses and as such, Member States may not require disclosure provisions in addition to those required by the Directive.	Sets standards under which companies that issue equity and debt need to publish a prospectus containing details of that issue.	Securities markets	01/07/2005
Directive on the prudential supervision of pension funds	Directive 2003/41/EC	This Directive lays down rules for the taking-up and pursuit of activities carried out by institutions for occupational retirement provision.		All	23/09/2005
Directive on Markets in Financial Instruments	Directive 2004/39/EC. Communication Com(2000)729	MiFID extends the coverage of the current ISD regime and introduces new and more extensive requirements to which firms will have to adapt, in particular in relation to their conduct of business and internal organisation.	Promotes investor protection by revising conduct of business standards for securities firms and exchanges.	Securities, banking, financial conglomerates	30/04/2006

FSAP Action	EU Measure taken	Details	Consumer Issues	Horizontal Theme	Transposition Deadline (if applicable)
Directive on Take Over Bids	Directive 2004/25/EC	This Directive lays down measures coordinating the laws, regulations, administrative provisions, codes of practice and other arrangements of the Member States, including arrangements established by organisations officially authorised to regulate the markets (hereinafter referred to as 'rules'), relating to takeover bids for the securities of companies governed by the laws of Member States, where all or some of those securities are admitted to trading on a regulated market within the meaning of Directive 93/22/EEC in one or more Member States.		All	20/05/2006

Source: Europe Economics analysis

A2.1 Alongside these key measures, the FSAP has also included other measures. These are set out in Table A2.2.

Table A2.2: Other FSAP measures

FSAP Action	EU Measure taken
10th Company Law Directive on Cross-Border mergers	COM(2004)486
14th Company Law Directive on cross-border transfer of sear	COM(2003)703
Amendments to the directives governing the capital framework for banks and investment firms	
Commission Action Plan to prevent fraud and counterfeiting in payment systems	COM(2001)11
Commission communication modernising Company Law and enhancing Corporate Governance in the EU	COM(2003)284
Commission Communication on a single market for payments	COM(2000)36
Commission Communication on an e-commerce policy for financial services	COM(2001)66
Commission Communication on clear and comprehensible information for purchasers. Integrated Communication on an e-commerce policy for financial services	COM(2001)66
Commission Communication on Clearing and Settlement	COM(2004)312
Commission Communication on distinction between professional and retail investors	COM(2000)722
Commission Communication on Funded pension Schemes	COM(1999)134
Commission Communication reinforcing statutory audit in the EU	COM(2003)286
Commission Communication updating the EU accounting strategy	COM(2000)359
Commission Recommendation on disclosure of financial instruments	Recommendation 2000/408 (C(2000)1372)
Commission Recommendation on statutory auditors' independence in the EU: A Set of fundamental principles	Recommendation 2001/6942 (C(2002)1873)
Commission report on Substantive differences between national arrangements relating to consumer business transactions	Informal working paper for "Forum group on Market obstacles"
Creation of two Securities Committees	Decisions C(2001)1493 (ESC), C(2001)1501(CESR)

Source: Europe Economics analysis

A2.2 Table A2.3 gives the years of implementation of FSAP measures by Member States.

Table A2.3: Years of transposition of FSAP measures

Key directives							Money Laund-ering	UCITS	UCITS	Solvency I			Financial Conglo-merates	Solvency I	IMD					Pros-pectus
	2000 / 46	**2000 / 64**	**2001 / 17**	**2001 / 24**	**2001 / 65**	**2001 / 86**	**2001 / 97**	**2001 / 107**	**2001 / 108**	**2002 / 13**	**2002 / 47**	**2002 / 65**	**2002 / 87**	**2002 / 83**	**2002 / 92**	**2003 / 6**	**2003 / 41**	**2003 / 48**	**2003 / 51**	**2003 / 71**
Austria	2002	2003	2003	2003	2004	2004	2003	2003	2003	2003	2003	2004	2005	2003	2004	2005	2005	2004	2005	2005
Belgium	2003	2004	2004	2004	2005	2004 & 2006	2004	2004	2004	2004	2005	2006	2004	2004	2005	2005	2006	2005	2006	2006
Cyprus	2004	2002	2004	2004	2003	2004	2003	2004	2004	2004	2004	2004	2004 & 2005	2004	2004	2005	2006	2005	2005	2005
Czech Republic	2003	2004	2004	2005	2004	2004	2004	2004	2004	2004	2005	2004	2005	2004	2005	2004	2006	2004	2004	2006
Denmark	2005	2004	2006	2004	2002	2004	2005	2004	2005	2004	2003 & 2005	2004	2004	2003	2005	2005	2005	2004	2002	2005
Estonia	2006	2001	2005	2005	2003 & 2004	2005	2004	2004	2004	2005	2004	2004	2005	2005	2005	2005	2004	2004	2003, 2004 & 2005	2005
Finland	2003	2004	2004	2004	2004	2004	2003	2004	2004	2004	2004	2005	2004	2004	2005	2005	2006	2004	2004	2005
France	2003	2005 & 2006	2004 & 2005	2003	2004	2005	2004	2003	2003	2003 & 2004	2005	2005	2004	2003 & 2004	2005	2005	2006	2003	2004	2005
Germany	2002	2002 & 2004	2003	2004	2004	2004	2002	2004	2004	2004	2004	2004	2005	2004		2004	2005	2005	2004	2005
Greece	2003	2004		2006	2006	2006	2005	2004	2004	2005	2004	2005	2006	2005	2005	2005	2002	2005	2006	2005
Hungary	2004	2002	2004	2003	2004	2004	2003	2003	2003	2004	2004	2005	2004	2004	2005	2005	2005	2004	2005	2005
Ireland	2002		2003	2004	2004	2006	2003	2003	2003	2005	2004	2004 & 2005	2005	2005	2005	2005	2005	2003	2005	2005
Italy	2004		2003	2004	2005	2005	2004 & 2006	2003	2003	2004	2004	2005	2005	2004	2006	2005		2005		
Latvia	2004	2004	2004	2004	1993	2005	2004	2005	2004	1998	2005	2004	2005	1998	2005	2005	2005	2005	1993	2005
Lithuania	2004 & 2005	2004	2001 & 2004	2001 & 2004 & 2005	2004	2005	2002 & 2004	2003	2003	2004	2004	2001 & 2004	2004 & 2006	2004	2004	2004	2006	2004 & 2005	2004	2005
Luxem-bourg	2002	2001 & 2004	2004	2004	2006	2006	2004	2003	2003	2004	2005		2006	2004	2005	2006	2005 & 2006	2005	2006	2005
Malta	2002	1989, 1994, 1998, & 2002	1998, 2002, & 2004	2004	1996, 1998, & 2001	2002 & 2004	2003	1994 & 2004	1994 & 2004	1998 & 2004	2004 & 2005	2005	1989 & 2005	1998, 2002, & 2004	2005 & 2006	2005	2002 & 2004	2004	2001 & 2002	2005
Nether-lands	2002	2003	2004	2005	2005	2005	2001	2005	2005	2003	2004	2006	2007	2003	2005	2005	2006	2004	2005	2005

Key directives							Money Laund-ering	UCITS	UCITS	Solvency I			Financial Conglo-merates	Solvency I	IMD					Pros-pectus
	2000 / 46	**2000 / 64**	**2001 / 17**	**2001 / 24**	**2001 / 65**	**2001 / 86**	**2001 / 97**	**2001 / 107**	**2001 / 108**	**2002 / 13**	**2002 / 47**	**2002 / 65**	**2002 / 87**	**2002 / 83**	**2002 / 92**	**2003 / 6**	**2003 / 41**	**2003 / 48**	**2003 / 51**	**2003 / 71**
Poland	2003	2004	2004	2003 & 2004	1995	2005	2001	2004	2004	2004	2004	2000	2005	2004	2004	2005	1998 & 1999	2004 & 2005	1995	2005
Portugal	2002	2000 & 2002	2003	2006	2004	2005	2004	2004	2004	2003	2004			2003	2006	2006	2006	2004 & 2005	2005	2006
Slovakia	2004	2004 & 2006	2005	2004 & 2005	2005	2004	2006	2004	2004	2004	2005	2005	2005 & 2006	2004	2005	2005 & 2006	2005	2005	2005	2005
Slovenia	2006	2003 & 2004	2004	2004	2004	2006	2001 & 2002	2003 & 2004	2003 & 2004	2004	2003		2004 & 2006	2004	2004	2004	2003	2004 & 2006		2006
Spain	2002	2002	2003	2005	2004	2006	2003	2004	2004	2004	2002		2005	2004	2006	2002	2005	2004	2005	2005
Sweden	2002	2000	2006	2006	2004	2004	1999, 2004 & 2005	2004	2004	2004	2005	2002 & 2004	2006	2004	2005	2005	2005 & 2006	2004 & 2005	2005 & 2006	2004, 2005 & 2006
UK	2002	2001 & 2003	2003	2004	2004	2004	2004	2004	2004	2004	2005	2004	2004	2005	2004 & 2005	2005	2005	2005	2004 & 2005	2005

Source: http://ec.europa.eu/internal_market/finances/actionplan/transposition/database/belgium_en.htm (etc.)

APPENDIX 3: THE LAMFALUSSY PROCESS

A3.1 An important aspect of the FSAP was the decision that legislation should be determined on the basis of wide consultation and agreement with all bodies in the field. In July 2000, Baron Alexandre Lamfalussy, together with the Committee of Wise Men, was given the task of identifying how to achieve the urgent integration of financial services regulation.

A3.2 The Lamfalussy Report of 2001 set up a four-level approach to elaborating legislation.

A3.3 It is summarised below:

- ✓ Level 1: Framework legislation setting out the core principles adopted by normal co-decision after a full consultation process.
- ✓ Level 2: Technical implementing measures are delegated to the Commission, advised by Regulatory Committees (Level 3 regulators), and in accordance with the Comitology procedure, assisted by a respective Level 2 Committee as a regulatory Committee.
- ✓ Level 3: Strengthened cooperation between national regulators to improve implementation (Level 3 Committees).
- ✓ Level 4: Strengthened enforcement of Community law (by the Commission)

The timetable for Lamfalussy

A3.4 The Lamfalussy Report was implemented in 2001 for the securities sector and the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) were set up.

A3.5 In December 2002, the Council invited the Commission to extend the Lamfalussy process to the remaining financial services sectors.

A3.6 In January 2004 (Level 3) Committee of European Banking Supervisors (CEBS) and the (Level 3) Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) were set up.

A3.7 In April 2005, the extension of the Lamfalussy process was completed and the Level 2 Committees were set up for banking and insurance, the European Banking Committee (EBC) and the European Insurance and Occupational Pensions Committee (EIOPC).

Decision making under Lamfalussy

A3.8 Under Lamfalussy the decision making process operates as follows:

- ➢ Level One: the Commission decides that legislation is needed and consults with relevant parties, then makes a formal proposal which goes through Co-Decision procedure. Agreement is then reached on essential principles and definition of implementing powers to Level 2 in a Directive.

- Level Two: The Commission, after consulting the relevant Level 2 Committee, requests technical advice from the Level 3 Committee on implementing measures. The Level 3 Committee consults the public on the internet and then produces technical advice and forwards it to the Commission. The Commission draws up a working document or possible draft implementing measures and consults with the public within a given deadline. The Commission forwards this to the European Parliament and the Level 2 Committee and makes it public over the internet.
- Level Three: the third part of the process promotes co-operation and convergence in national implementation of the measures. Here the Level 3 Committees use Market Participants Advisory Groups and issue day-to-day administrative guidelines, joint interpretation of recommendations, comparison and review of regulatory best practice to ensure enforcement at national level and to define best practice and periodic reviews of regulatory practices.

APPENDIX 4: ANALYSIS OF RATIONALE FOR THE FSAP AND FSWP LEGISLATIVE MEASURES

Introduction

A4.1 This section briefly considers the economic rationale for government intervention in markets in general, for financial services and, in particular, for the FSAP and FSWP legislative measures. It notes alternative arguments sometimes put forward for regulation and comments on the rationale for EU wide regulation and the interplay between this and national regulation.

The Rationale for Regulation in General

A4.2 It is usually argued that government should intervene in markets only if they are *not* well-functioning and competitive. The standard notion is that government intervention needs to be justified by demonstrating either a "market failure" or a "regulatory failure". (This is, for example, the standard in the European Commission's guidelines on Impact Assessment, updated in March 2006.[37])

A4.3 Widely-accepted "market failures" include:

(a) Public goods — a classic example is clean air, since this benefits everyone and it is infeasible to exclude from its benefits those who would choose not to pay for it;

(b) Externalities — a well-known example is environmental pollution;

(c) Market power — if firms are dominant, and entry is difficult, markets will not be competitive or contestable;

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[37] The standards covered the profile, role, tasks and resources of the evaluation function within each DG; the management of evaluation activities; the evaluation process; and the quality of reports. The six standards relating to the quality of evaluation reports are:

1. The substance of the evaluation reports shall be relevant, based on rigorous analysis, meet the quality criteria laid down in the specifications and comply with the deadlines.
2. The evaluation reports shall describe the purpose of the evaluation and its context and also the objectives, questions, procedures, results and reasoned conclusion of the evaluation, so as to make available the essential information in an easily understandable form.
3. The report shall describe the information sources in such detail that the correctness of the information can be assessed. The data collected or selected shall be adapted to the methodologies used and be sufficiently reliable for the expected use.
4. The prospects and reasoning on which interpretation of the results is based shall be described and explained. The results should follow on logically and be substantiated by data analysis and interpretations based on carefully-presented explanatory hypotheses.
5. The final evaluation report shall present the results and conclusions of the evaluator and the tenor thereof shall not be amended without his/her agreement.
6. The conclusions and any recommendations shall be rigorous and not distorted by personal or partisan considerations. The recommendations shall be comprehensible, useful, applicable and detailed enough to be brought into effect.

(d) Imperfect information — an example of this is asymmetry of information, which occurs when one party to a market transaction has more information than the other party.

A4.4 It is not, of course, enough to justify any particular policy intervention (e.g. a new regulation) to show that there is a market failure. In addition to showing that there is something wrong, it must also (at the very least) be shown that the policy under consideration will address what is wrong, making things better. In addition, choosing one form of regulatory intervention typically restricts other forms of intervention (e.g. one could not institute two incompatible regulations) — hence it is important to consider which options available will most effectively address the issue.

A4.5 Furthermore, regardless of whether it has a convincing rationale or not, regulation almost invariably imposes costs as well as benefits. Such costs include those imposed

(a) on businesses: Regulation of any industry generates direct and indirect costs of compliance. It also creates risks of:

- Regulatory capture and rent seeking: companies or other vested interested may seek to capture the regulatory process and use it to obtain advantage over rivals with less privileged access.
- Undermining of market punishments (which may be more credible and effective than regulation).

(b) on consumers: Among other things, regulation may

- raise prices (through raising compliance costs);
- change the pattern of products offered (as firms respond to the regulation);
- delay innovation (so that consumers miss out on the benefits of new products).

A4.6 A well-known consequence of the costs of regulation is that, even in some cases in which there is a known market failure and policies can be devised that would address that market failure, the costs of imposing those policies outweigh the gains of the policies, so that in such a case the best approach is not to intervene.

The Rationale for Regulation of Financial Services Markets

Arguments for market failures in financial services markets

A4.7 In practice, there is extensive regulation of financial services markets in the EU and elsewhere. This is mainly because there is considered to be the potential for significant market failures in unregulated financial markets.

A4.8 Potential areas of market failure commonly analysed in financial markets include:

(a) The problem that firms may know more about the value of their products than consumers. Firms (or their salesmen) may have incentives to exploit their informational advantages to the detriment of consumers. Markets may have mechanisms to address these problems. However, market punishment mechanisms are not always effective, and even where they are, they may operate over a sufficiently long-run timescale that failures can arise. For example, in the long term companies that do not exploit their customers may gain a good reputation. But a company that already has a good reputation may exploit that reputation in the short term, and while in the long term that will lead to its losing its reputation, in the short term its customers may suffer.

(b) Many financial products are highly complex, and their value cannot easily be observed by consumers. This gives rise to problems of the value of information — one cannot, by definition, know precisely how much information is worth until one knows what it is. This may mean that proper markets for information are difficult to sustain. Hence instead of relying on direct information consumers may rely on the reputation of a financial firm in general for the quality of its products. However, some financial service products are experienced only once (e.g. pensions), sometimes long after purchase (and even then consumers may rely on experts to tell them how much products are worth). Such products are known as "credence" goods. Hence reputational disciplining mechanisms may be weak.

(c) The managers of depositing institutions face limited liability (even bankruptcy is a limited form of punishment). Therefore they have incentives to engage in risky activities that might return high rewards but also might lead to large losses — or alternatively to engage in many different risky activities, each of which has only a relatively small chance of success. This means that such managers need monitoring by those whose money they invest. However, many depositors are small (in fact a major function of banks is to collect relatively small deposits to use for relatively larger loans) so each depositor faces incentives to free-ride on the monitoring of other depositors. Hence markets may under-monitor banks to the detriment of some depositors. Hence it is argued that there is a need for private or public "representatives" of depositors. This (according to this view) necessitates regulation.[38]

(d) Externalities: failure by one firm might harm not only its depositors, but also other firms by affecting the confidence of investors more widely. For example, because banks operate on the basis of fractional reserves, bank runs can sometimes cause the failure of even the soundest banks.[39] Mis-selling also generates externalities: the fact that mis-selling occurs at one firm — or a group of firms — can lead to a lack of consumer confidence in the market as a whole.

A4.9 Some of these potential market failures have motivated financial regulation, but not all financial markets are the same. Capital markets involve many highly informed agents, often operating in a highly competitive and transparent environment that is usually considered to approximate closely to perfect competition. Retail investment, by contrast, is thought to involve many relatively ill-informed consumers, facing firms and sales staff with incentives not well aligned with those of consumers, who depend on expert opinion to work out the value of products even after they have been experienced but are unwilling to pay enough for such information. Between these two extremes, the market for fund management may have information asymmetry problems, but perhaps not as severe as those for retail savings products.

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38 This is the famous Dewatripont and Tirole "representation hypothesis". See Dewatripont, M. and Tirole, J. The *prudential regulation of banks*.

39 For example, during the US bank runs 1930-32, the Bank of the United States failed, but paid over 92 cents in the dollar to its creditors.

A4.10 The rationale for regulation (and the appropriate forms of regulation) may differ across Member States, reflecting the differing nature of financial markets within the EU.

Other bases for regulation

A4.11 However, as noted at the beginning of this section, some regulations reflect different considerations to those summarised above and these may include social and political objectives, such as:

(a) Protecting jobs;

(b) Protecting consumers;

(c) Protecting regional or national identities;

(d) Promoting national champions;

(e) Reasons of national security.

A4.12 It is not part of our main purpose in this study to challenge or endorse these alternative bases for regulation, but it is important to understand that although they do not (according to best regulatory practice) constitute a *rationale* for regulation, that does not mean that the impacts on jobs, consumer protection, regional or national identities, or national security are *irrelevant*. Quite the contrary: the impacts on all of these factors are key aspects of the assessment of impacts phase, and the impacts on jobs and consumer protection in particular are integral parts of the considerations below and in the individual Member State studies in the Appendices.

Rationale for European-level action

A4.13 Beyond the question of whether there should be regulatory intervention in a market at all, there is also the question as the appropriate level of intervention: Member State, region or European Union.

A4.14 The completion of a genuinely single internal market – involving the free movement of people, capital, goods and services – might be taken to imply greater integration than the more traditional form of open trade agreements. In this respect it can be argued that the internal market and the Treaty imply a common regulation between and across the Member States and, therefore (perhaps) intervention at the EU level to create such a regulation.

A4.15 There are at least two ways in which a single market might be completed. First by allowing competition and “mutual recognition” to operate effectively over time; the second is to introduce so-called “level playing fields” through common regulations.

A4.16 However, the fundamental principle of subsidiarity requires that any action at European level must be justified by a clear added-value compared to that at national level, i.e. regulations should be pushed down to their lowest possible level. In this respect unless there is a clear compelling argument for action at European level it should be up to the Member States to define their own regulation.

A4.17 And just as the rationale for national regulation of financial services may vary from Member State to Member State, so the impacts of Community harmonisation will be different on each Member State.

A4.18 Furthermore, given the different historic legacies of the Member States, for example in their legal and financial framework, and the limited scope of the FSAP and FSWP legislative measures relative to the issues which may affect financial services markets, we may expect that the process of detailed harmonisation may prove contentious.

A4.19 It is also possible that in the short term at least the process of harmonisation may create suboptimal financial services regulation in some Member States.

Specific rationale for the FSAP and FSWP legislative measures

A4.20 The potential benefits of European financial integration were set out in the Lisbon strategy.[40]

A4.21 Greater integration of financial markets leads to new business opportunities and provides more choice and value for consumers. As the European Commission's Employment Rates Report (COM (98) 572) notes, financial services, which make up 6 per cent of the EU's total GDP and 2.45 per cent of employment, are also one of the sectors with the largest potential growth.[41]

A4.22 Greater integration of financial markets is seen as a necessary underpinning for the euro and since its introduction there has been some progress towards the goal of an integrated European Capital and Financial Services market. At the Cardiff summit of June 1998, the European Council invited the Commission to "table a framework for action … to improve the single market in financial services".[42] The Commission published a Communication setting out a Framework for Action on Financial Services, followed by the Financial Services Action Plan (FSAP and FSWP legislative measures) in May 1999.[43]

A4.23 Similarly, the rationale for the Financial Services White Paper has reflected concerns about the progress of the FSAP and FSWP legislative measures and about its implementation. The FSWP notes that progress has been made through the FSAP and FSWP legislative measures but that there remains untapped potential in the market which can be achieved through a Pan-European market.

A4.24 In particular there is a need for:

(a) A boost in the market for long-term savings in order to assist in tackling the EU pensions deficit ;

(b) Greater progress towards the internal market for retail financial services;

(c) A better functioning risk capital market to promote new and innovative firms.

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[40] See Growth and jobs: A New Start for the Lisbon Strategy, February 2005: http://europa.eu.int/growthandjobs/pdf/COM2005_024_en.pdf

[41] As reported in Financial Services: Building a Framework for Action: http://europa.eu.int/comm/internal_market/finances/docs/actionplan/index/fs_en.pdf

[42] As quoted in FSAP Evaluation Part I: Process and implementation.

[43] COM (1999) 232, 11.05.99

APPENDIX 5: ANALYSIS OF POLICY OBJECTIVES AND OPTIONS FOR THE FSAP AND FSWP LEGISLATIVE MEASURES

Introduction

A5.1 This section outlines the policy objectives which have driven the FSAP and the FSWP. We then look at options which may have been available to policy markers implementing the FSAP and FSWP legislative measures.

Objectives of the FSAP

A5.2 The FSAP set out a number of strategic objectives and outcomes, including:

(a) a single EU wholesale market;

(b) open and secure retail market;

(c) state of the art prudential rules and supervision; and

(d) addressing the issues of (i) disparities in tax treatment and (ii) an efficient and transparent system of corporate governance.

A5.3 In addition, more detailed objectives were set out for Wholesale and Retail markets.

Wholesale markets

A5.4 The objectives of this category encompass the capital and corporate aspects of financial services: i.e. raising capital, investment, securities and corporate regulation. Specifically action was to be taken to achieve the following:

(a) establishing a common legal framework for integrated securities and derivatives markets;

(b) removing the outstanding barriers to raising capital on an EU-wide basis;

(c) moving towards a single set of financial statements for listed companies;

(d) creating a coherent legal framework for supplementary pension funds;

(e) providing the necessary legal certainty to underpin cross-border securities trading; and

(f) creating a secure and transparent environment for cross-border restructuring.

Retail

A5.5 The Commission's objectives in this area focussed on promoting access, providing reliable information and ensuring the availability of redress procedures. Specifically there were measures intended to deal with:

(a) Information and transparency;

(b) Redress procedures;

(c) Balanced application of consumer protection rules;

(d) Electronic commerce;

(e) Insurance intermediaries; and

(f) Cross-border retail payments.

Other areas

A5.6 Two further general areas of importance were also identified:

(a) Corporate governance: in response to international financial scandals and the High Level Group of Company Law Experts' report of November 2002, a Corporate Governance Forum was established in October 2004.

(b) Taxation: the aim in this area, as part of the Commission's EU tax policy strategy, is the elimination of tax obstacles to single market trading.

Objectives of the FSWP

A5.7 The FSWP sets a number of policy objectives:

(a) To consolidate dynamically towards an integrated, open, inclusive, competitive and economically efficient EU financial services market;

(b) To remove the remaining economically significant barriers so financial services can be provided and capital can circulate freely throughout the EU at the lowest possible cost with effective levels of prudential and conduct of business regulation, resulting in high levels of financial stability, consumer benefits and consumer protection;

(c) Implement, enforce and continuously evaluate the existing legislation and to apply rigorously the better regulation agenda to future initiatives;

(d) To enhance supervisory cooperation and convergence in the EU, deepen relations with other global financial marketplaces and strengthen European influence generally.

Policy options for the FSAP

A5.8 There were a range of possible options for the Commission in moving towards the achievement of the internal market for financial services:

(a) Do nothing, leaving national regulation as it was in 1998.

(b) Community harmonisation through legal instruments — whether Regulations or Directives.

(c) Regulatory harmonisation through increased cooperation between national regulators to agree common approaches and applications of Community regulation.

(d) Community harmonisation through non binding agreements.

A5.9 In considering the possible policy options to achieve the internal market for financial services (and to foster financial integration) the following fundamental questions need to be addressed:

(a) What is the appropriate level of regulatory harmonisation for the current stage of financial services sector development?

(b) What are the appropriate mechanisms for best achieving an optimum regulation?

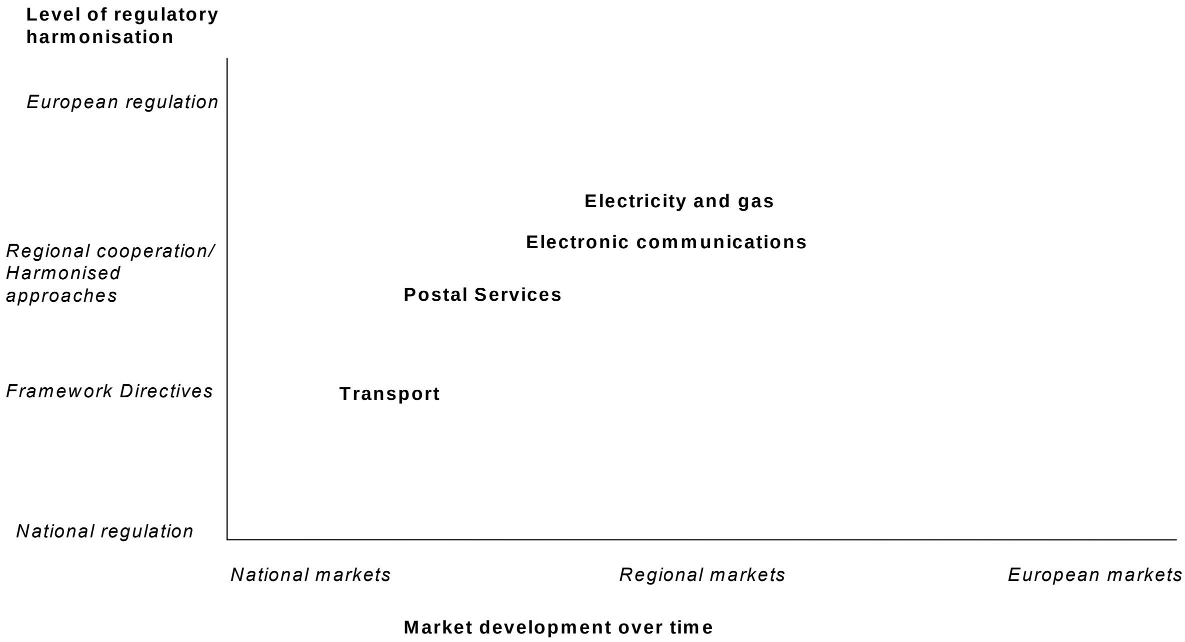
Comparative regulatory approaches and an optimal policy mix

A5.10 Some insights into the regulatory process in the EU can be obtained from sectors other than financial services.

The typical sequence of regulatory reform

A5.11 Figure A5.1 sets out a typical regulatory sequence in other sectors of the EU economy.

Figure A5.1: Market development and regulatory harmonisation



A5.12 The sequence appears to begin with intervention at Community level to establish national application of the Treaty in the sector around a common application of regulatory principles and the opening of competition where appropriate (the Framework Directives). This is followed by further moves to open the market to competition (subject to consumer protections or to safeguarding essential public services (services of general interest) and to fostering harmonised regulatory approaches).

A5.13 This has been consistent with market development in that as markets have moved (through consolidation) towards regional markets, there has also been a move both at Community and regional level towards a deepening harmonisation of regulatory approach. This deepening harmonisation has often involved a Committee of national regulators or of national administrations operating through Community Comitology rules. It can also be argued that this sequence has tended to include a sequence of market opening which begins with wholesale market opening (which includes detailed regulation of third party access for network industries) and then retail market opening — where typically customer inertia has proved a problem.

A5.14 Typically, within the Single Market process, it has been that it is more difficult to achieve competition for retail than for wholesale services.

Removing barriers to the internal market

A5.15 Alongside the sequence outlined above, the European Commission has also pursued a policy of incremental removal of barriers to the internal market in comparable sectors.

A5.16 These barriers can include:

(a) National champions approaches — where the Commission has acted against Member States discriminating in favour of national incumbent via illegal state aids or via inadequate regulatory supervision;

(b) Regulatory barriers — where differential regulations, for example onerous or specific licence obligations or unnecessary safety or customer protection requirements, may impose entry barriers for firms from other Member States;

(c) Customer inertia, where customers prefer to continue using traditional local or national suppliers preventing the emergence of alternative suppliers or of critical mass necessary from cross-border supply;

(d) Interoperability problems — where national specificities in the provision of services may prevent interoperability or entry. (This problem tends to have been have tackled by industry-led standardisation processes such as the CEN). Interoperability for European operators has been considered at international as well as European level for example in the ITU (for telecoms) and UPU (for postal services);

(e) Barriers to cross-border consolidation — where for example Member States may restrict cross-border ownership of national incumbents.

Regulatory cooperation

A5.17 The Lamfalussy process has established a process of regulatory cooperation for financial services sectors which is common also to other comparable sectors such as electronic communications, energy sectors and postal services.

A5.18 In the electronic communications sectors the Community regulatory framework has created new committees and working groups in order to assist the Commission in its task and facilitate a harmonised implementation of the recently adopted regulatory framework.

A5.19 These bodies include the Communications Committee (replacing the Open Network Provision and the Licensing Committee), the Radio Spectrum Committee, the Radio Spectrum Policy Group and the European Regulators Group. Further standardisation issues are considered by the Committee for European Postal and Telecommunications Administrations (CEPT).

A5.20 In the energy sectors (electricity and gas) regulatory cooperation is established through the European Energy Regulators Group (ERGEG) and also through the Council of European Energy Regulators (the CEER). These groups have adopted action plans to increase the scope of their cooperation and regional groupings have developed to create common approaches to interconnection issues and other regulatory questions which cross national borders.

A5.21 In the postal sector regulatory cooperation has been encouraged both through the Postal Directive Committee (of Member States which can decide on issues such as quality of service or adopt CEN standards) and the Committee of European Postal Regulators (the CERP) which is part of the CEPT. This body has a number of committees (for example on economics and accounting) to move towards common approaches in the implementation of the Community framework

A5.22 The Lamfalussy does not yet appear to incorporate all the mechanisms of regulatory cooperation which have developed in other sectors — for example, regional cooperation is not as developed — which may thus provide examples as to how Lamfalussy might develop.

Establishing best practice and the optimal policy mix

A5.23 In one sense the principle of subsidiarity sets out a legal basis for assessment of best practice for regulation, but this legal requirement notwithstanding, principles of good regulation at Community level include:

(a) Proportionality — regulation should be proportionate to its objectives, and where for example there is a regulation which may prevent the normal workings of the internal market then the regulation should be the least restrictive possible (for example in the case of consumer protection);

(b) Consistency — regulation should be consistent across the Member States to ensure a level playing field for market players;

(c) Non-discrimination — regulation should be non-discriminatory between market players;

(d) Objectivity — regulation which is based on objective criteria that is even-handedly applied;

(e) Transparency — regulation should be transparent to allow for regulatory certainty;

(f) Predictability — where possible the application of regulation should be predictable to foster regulatory certainty.

A5.24 In addition to these principles of good regulation, we need to look also to implementation issues in assessing regulations. For example we need to consider also:

(a) Costs of implementation;

(b) Enforceability;

(c) National market or cultural barriers.

A5.25 Further we need to consider impacts of measures within the whole process as well as individually. For example there may be measures which in themselves are burdensome (relative to their immediate benefits) but which create side benefits in creating the conditions for future measures.

APPENDIX 6: EXPECTED EFFECTS OF THE FSAP AND FSWP

A6.1 This appendix considers the effects that the main FSAP and FSWP legislative measures might be expected to have on EU financial services markets.

High-level Considerations

A6.2 The move towards an internal market for financial services and a common regulatory framework for the financial services sector might be expected to encourage the following trends:

(a) Greater cross-border penetration by market players both in terms of presence (through branches and subsidiaries) in other national markets and in terms of cross-border supply;

(b) Greater competition in the national markets and across national markets (with consequent effects on efficiency and structural optimization);

(c) Greater consolidation in the sector within and across national markets;

(d) Greater uniformity and convergence of national markets;

(e) The development of regional markets and regional players.

A6.3 However, it is also likely that the relative impacts of regulatory change as opposed to broader market development will be felt differently across the different sectors. For example, the market development in the banking sector might be expected to be more consistent with these expected trends than in insurance, where barriers to cross-border trading are more significant.

Mechanisms of effect

A6.4 To further isolate these effects at Member State and European level we have considered in greater detail the likely effects of key directives of the FSAP and FSWP legislative measures. One important form this has taken is the consideration of "mechanisms of effect" — the precise economic processes or causal chains whereby the measures of the FSAP and FSWP would be expected to have their effects.

A6.5 In what follows, we do not report all chains for all 42 FSAP measures, let alone for the FSWP. Instead, we focus on the mechanisms of effect associated with those measures we have already identified above (in Section 2) as the key components of the FSAP and FSWP legislative measures. Following the mechanism, we then give our view as to the "Status" of the mechanism, drawing on the insights we have gained from this study. There are seven statuses:

(a) **Effective and functioning** — this is to be interpreted as meaning that, in our view, this mechanism is likely to function as described, and that we believe there is sufficient evidence to justify the view that, in most Member States, it is in operation.

(b) **Ineffective and non-functioning** — this is to be interpreted as meaning that, in our view, this mechanism does not function as described and that there is evidence to justify the view that, in most Member States, it is not in operation.

(c) **Probably functioning, but dominated** — in our view, this mechanism probably does function as described, but its effects are, in most Member States, dominated by other mechanisms, trends or events.

(d) **Probably not functioning, but dominated —** in our view, this mechanism probably does not function as described, but even if it did, its effects would, in most Member States, be being dominated by other mechanisms, trends or events.

(e) **Probably will function, but too early to say** — in our view, this mechanism probably will function as described, but is not yet, in most Member States, fully operational.

(f) **Probably will not function, but too early to say** — in our view, this mechanism probably will not function as described, but even if it did, it would not yet, in most Member States, be fully operational.

(g) **Unclear** — we are unable to offer a view on the functionality or otherwise of this mechanism.

A6.6 It is important to emphasize that the mechanisms express isolated components of cause and effect, rather than overall impacts. So, for example, if a measure induces compliance costs and the mechanism suggests that increased compliance costs will lead to a reduction in growth, that does *not* imply that the overall impact of the measure is to reduce growth. The mechanism in question is only a part of the effects of the measure. If other effects lead to an increase in growth, then it may be that the overall impact of the measure is to raise growth. Nonetheless, we consider that breaking down cause and effect into components in this way delivers useful insights.

The mechanisms used in this assessment

A6.7 We divide the mechanisms by horizontal theme, plus an initial set of general effects cutting across sectors.

General

A6.8 All FSAP and FSWP directives and regulations → level playing field → more competition → more efficient economic activities → higher economic growth. **Status: Probably will function, but too early to say.**

A6.9 All FSAP and FSWP directives and regulations → increased financial integration → better pooling of risks and therefore risk management → higher total factor productivity (dependent on risky undertakings such as capital investment and especially R&D) → higher economic growth. **Status: Probably will function, but too early to say.**

A6.10 All FSAP and FSWP directives and regulations → increased compliance costs for firms already under regulation → higher economic costs → lower economic growth. **Status: Effective and functioning.**

A6.11 All FSAP and FSWP directives and regulations → more firms becoming regulated → increased compliance costs for these firms → higher economic costs → lower economic growth. **Status: Effective and functioning.**

A6.12 All FSAP and FSWP directives and regulations → increased competition → higher system instability → higher systemic risk → lower economic growth. **Status: Probably will not function, but too early to say.**

Banking

A6.13 Effects associated with money laundering directives:

(a) Greater anti-money laundering efforts → less finance for terrorists → less terrorist activities → less loss from terrorism → lower insurance costs. **Status: Probably functioning, but dominated. (Comment: the general increase in terrorist activity is assessed as dominating the effects from anti-money laundering activities.)**

(b) Greater anti-money laundering efforts → reduced reputation risk → increased market confidence → more business activities. **Status: Probably not functioning, but dominated. (Comment: the effect on confidence of other market trends in the period far outweighs the effects of money laundering provisions.)**

(c) Greater anti-money laundering efforts → more rigorous internal accounting and controls → more frauds detected and prevented → less economic loss arising from frauds. **Status: Probably functioning, but dominated. (The effects of Enron & other corporate scandals, leading to Sarbanes-Oxley and consequent greater rigour of internal accounting is likely to dominate money-laundering provisions.)**

(d) Greater anti-money laundering efforts → more rigorous internal accounting and controls → more frauds deterred → less costs incurred on fraud investigation and legal costs. **Status: Unclear.**

(e) Greater emphasis on firms knowing their customers → improved customer databases, systems or record keeping → increased knowledge of customers → more effective marketing and reduced marketing costs. **Status: Probably not functioning, but dominated. (Comment: trends in online business and other increases in IT are assessed as dominating know-your-customer requirements.)**

(f) More stringent anti-money laundering rules → more compliance costs. **Status: Effective and functioning.**

(g) More stringent anti-money laundering rules → more new products being delayed or withheld → less innovation and competition. **Status: Probably functioning, but too early to say.**

A6.14 Effects associated with the Capital Requirements Directive: the Capital Requirements Directive has reformulated the obligations of European banks to hold capital and will thereby cause banks sometimes to hold more capital and sometimes to hold less capital. The new obligations differ in the following ways:

(a) They are more sensitive to the risks that firms face: the new framework includes an explicit measure for operational risk and includes more risk sensitive risk weightings against credit risk.

(b) It reflects improvements in firms' risk management practices, for example by the introduction of the internal ratings based approach (IRB) to allow firms to use their own estimates of credit risk.

(c) It provides incentives for firms to improve their risk management practices, with more risk sensitive weights as firms adopt more sophisticated approaches to risk management.

A6.15 The new framework aims to leave overall capital held by banks collectively broadly unchanged but by tailoring the capital requirements more closely to the risk of different banks they will produce winners and losers (e.g. banks that have to increase their capital holdings and banks which can hold less).

A6.16 The putative mechanisms of effect may be as follows:

(a) Banks hold more or less capital → capital requirements are better adjusted to the default risks of the banks → lower default risk → higher perceived security of savings → more optimal savings. **Status: Probably will function, but too early to say.**

(b) Banks hold more or less capital → capital requirements are better adjusted to the default risks of the banks → lower default risk → higher stability of banking system. **Status: Probably will function, but too early to say.**

(c) Banks hold less capital → decreased costs of holding capital → increased margins → higher lending. **Status: Probably will function, but too early to say.**

(d) Legal obligations become more burdensome to comply with → increase in compliance costs → decreased margins → lower lending. **Status: Probably will not function, but too early to say.**

(e) Harmonisation of requirements → lower entry barriers for cross-border expansion into domestic market → more competition in domestic market. **Status: Probably will not function, but too early to say.**

(f) Harmonisation of requirements → lower entry barriers for cross-border expansion from domestic into foreign markets → more sales into foreign markets. **Status: Probably will function, but too early to say.**

(g) Requirement on firms to use standard risk assessment models that are more sensitive to true risks → assessments move with the business cycle → economic shocks lead firms to increase or decrease their risk assessments in tandem → firms tend to cut or raise loans in tandem so as to meet capital requirements → increase in cyclicality of liquidity availability → increase in amplitude of economic cycles. **Status: Probably will function, but too early to say.**

Insurance

A6.17 Effects associated with Insurance Mediation Directive:

(a) Single market in insurance (including cross-border dispute resolution, common qualification and information provision requirements) → freedom of establishment across EU countries → increased entry and competition → reduced prices and greater choice and quality. (Note: Article 4: insurance mediators should have appropriate knowledge and ability and be of good repute, e.g. clean police record, must not be bankrupt, must hold professional indemnity insurance. Article 11: encourage setting up of out of court complaints redress procedures and encourage these bodies to co-operate in resolution of cross-border complaints. Article 12: all firms must provide certain information prior to concluding a contract, including the complaints procedures and any contractual or financial relationship they have with the insurers they recommend.) **Status: Probably will function, but too early to say.**

(b) Single market in insurance (including cross-border dispute resolution, common qualification and information provision requirements) → freedom of establishment across EU countries → increased expansion and competition in foreign countries → reduced prices and greater choice and quality in other countries. **Status: Probably will function, but too early to say.**

(c) Regulation and restrictions on firms with low standards → exit of firms which offer poor service. **Status: Effective and functioning.**

(d) Exit of firms which offer poor service → increased consumer confidence in products → increased willingness to pay and demand. **Status: Ineffective and non-functioning.**

(e) Costs of authorisation (mostly sunk cost but also on-going due to staff turnover) are heavier (relative to size) for smaller firms and those not already authorised → Smaller firms at a competitive disadvantage with increased entry barriers, but higher costs for all firms → reduced entry and competition. Particularly among firms that offer insurance as service complimentary to their main business (e.g. pet shops) there may be large exit from the industry → reduction in sources of advice and reduced variety with less personal advice. Higher prices → reduction in purchases of insurance. **Status: Effective and functioning.**

(f) Risk transfer option (article 4.1, firms with little insurance business that do not fulfil the qualification requirements themselves can continue to offer insurance services if another undertaking assumes full responsibility for their actions) → insurance providers may limit the brokers they deal with to prevent taking on the risk of infringement → Smaller brokers may be closed out of the market → reduction in competition and increase in prices. **Status: Effective and functioning.**

(g) Optional conditions for ensuring liquidity (article 4.4 where "one or more" of conditions a to d must be implemented, c being segregated client accounts) → costs of complying with the chosen regulations are imposed on all firms operating in the general insurance market → wholesale firms can avoid these costs by basing themselves outside the EU or in EU Member States that do not implement these rules → reduction in wholesale insurance business for economies where these are implemented. **Status: Probably will not function, but too early to say.**

(h) Conditions for ensuring liquidity (article 4.4) → costs imposed on all firms operating in the general insurance market → all retail insurance firms must follow the national rules → higher prices for insurance products. **Status: Unclear.**

(i) Costs of approved persons have the largest effect on firms that cross-sell high risk products (e.g. mortgage intermediaries) → firms engaged in multiple activities are at a competitive disadvantage → increased industry specialisation. **Status: Effective and functioning.**

(j) Independent advisors may be particularly opposed to external (regulatory) oversight → could lead many of these to exit the industry. **Status: Probably not functioning, but dominated. (Comment: Exit of a number of small intermediary firms has tended to reduce the number of advisors.)**

(k) Capital adequacy requirements have the largest impact on medium sized insurance intermediaries → small firms may become unincorporated and medium sized firms may merge. **Status: Unclear.**

A6.18 Effects associated with Solvency II. (N.B. There is not yet any published account of what Solvency II will contain (and the impact assessment will only be published at the same time as the draft directive — first draft due late 2006). There are various areas of concern that industry stakeholders are being asked to discuss and suggest appropriate regulations.

(a) Increased use of market risk evaluation and valuation techniques when calculating solvency margin → firms hold the assets that are most suitable for reducing the risks they face rather than those that the regulation has rated as of relatively low risk → insurance firms' capital requirements more closely reflect their actual risks faced → firms will no longer hold assets that are rated as more risky than they are in practice (require a relatively high amount of capital) and the greater diversity of risks will reduce the overall risk of the portfolio → less capital is needed to maintain the same level of solvency → lower operating costs and thus lower prices in insurance markets. **Status: Probably will function, but too early to say.**

(b) Increased cross-border co-operation by supervisors (regulators) of insurance companies and exchange of information → cost savings in regulation and increased awareness of the international nature of firms or groups of firms and their vulnerabilities or exposure to different markets. Cost savings for international firms because of harmonised regulations reduce the costs of compliance across-borders → quicker and more accurate assessments of the risks facing insurance firms operating in individual Member States → reduced chance of solvency crisis for a given level of capital requirements → improved stability in financial markets and customer confidence. **Status: Probably will function, but too early to say.**

(c) More focussed reporting requirements → increased information for supervisors (regulators) about the risks facing firms → more effective regulation and action to deal with firms that take excessive risk → improved solvency management for lower capital costs → improved stability and lower costs of insurance. **Status: Probably will function, but too early to say.**

(d) Firms forced to use standard risk assessment models → the model that firms use give the same risk revaluation in response to new information → all firms react similarly to a negative event (e.g. an economic downturn) → reduction in willingness to supply finance during downturn → amplification of economic cycle and increased market instability. **Status: Probably will function, but too early to say.**

(e) Move towards evaluating risk over a longer horizon (e.g. over the cycle) → this should prevent rapid increases in risk weightings when there is a crisis and other firms have felt it necessary to sell certain risky asset classes → reduces herd behaviour as the short-term actions of firms do not instantly lead to similar reactions by other firms → increases overall market stability by not reinforcing financial flows in a crisis (when no new information is produced) → reduced risk and lower costs in insurance markets. **Status: Unclear.**

(f) New regulatory capital and reporting requirements are applied to smaller businesses → costs of co-ordinating with regulators, assessing risks, diversifying assets and liabilities, and maintaining solvency will be relatively larger for these companies → smaller firms face higher entry barriers and unit costs → exit of smaller firms and reduced competitive pressure on larger firms → increased concentration and reduced choice in insurance markets. **Status: Probably will function, but too early to say.**

Securities

A6.19 More competition leading to lower transaction costs:

(a) MiFID (access to central counterparty, clearing and settlement facilities, and right to designated settlement system[44]) and Clearing and Settlement framework (CSF) (freer access to, and more choice of, cross-border clearing and settlement locations and systems; levelling playing field between clearing and settlement service providers who are banks and who are not by eliminating the existing disparities as regards access rights and capital requirements; common regulatory framework across the EU) → more competition between clearing and settlement service providers → more pressure on clearing and settlement costs → lower clearing and settlement costs → lower transaction costs → lower Cost of Capital (CoC). **Status: Probably will function, but too early to say.**

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[44] Article 34 and 35

(b) Prospectus Directive (PD) (more harmonised requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State) → easier to list in other Member States → more competition between listing venues → more pressure on listing costs → lower listing costs → lower CoC. **Status: Probably will not function, but too early to say.**

(c) MiFID (access to central counterparty, clearing and settlement facilities, and right to designated settlement system;[45] abolish of concentration rules;[46] regulating systematic internalisers; levelling playing field between trading venues) and CSF (freer access to, and more choice of, cross-border clearing and settlement locations and systems) → easier to use alternative trading venues → more competition between trading venues → more pressure on trading costs → lower transaction costs → lower CoC. **Status: Probably will function, but too early to say.**

(d) MiFID (passporting;[47] access to central counterparty, clearing and settlement facilities, and right to designated settlement system[48]) and CSF (freer access to, and more choice of, cross-border clearing and settlement locations and systems) → more competition between financial intermediaries → more pressure on transaction costs → lower transaction costs → lower CoC. **Status: Probably will function, but too early to say.**

A6.20 Higher liquidity leading to lower transaction costs:

(a) MiFID / CSF / PD / Transparency Directive (TD) → pan-EU capital market → a deeper and more liquid capital market → lower transaction costs → lower CoC. **Status: Probably will function, but too early to say.**

(b) MiFID / CSF / PD / TD → pan-EU capital market → a deeper and more liquid capital market → more access to capital for firms during recession → less firms to fail and higher economic stability. **Status: Probably will function, but too early to say.**

(c) Market Abuse Directive (MAD) / PD (unifying prospectuses format and content and easier for investor to digest information) / TD → higher investor confidence → higher liquidity → lower transaction costs → lower CoC. **Status: Probably will not function, but too early to say.**

A6.21 Better functioning capital market leading to better resource allocation:

(a) MAD (market manipulation rules) → reduced volume of market manipulation → less misallocated capital → better resource allocation. **Status: Probably will function, but too early to say.**

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45 Article 34 and 35
46 Article 34 and 35
47 Article 34 and 35
48 Article 34 and 35

(b) MiFID (pre- and post-trade transparency requirements[49]) / MAD (insider dealing rules and research disclosure rules) / TD (better information provision) → better price formation → more accurately reflecting economic fundamentals → better resource allocation. **Status: Probably will function, but too early to say.**

A6.22 Risk reduction leading to higher economic welfare

(a) CSF → a safer clearing and settlement system → reduces the risk in securities transactions → higher economic welfare. **Status: Unclear.**

(b) CSF → reduces the risk in international securities transactions → in so far as that risk was not diversifiable, reduction in it will lead to a fall in cost of capital → higher economic growth. **Status: Unclear.**

Financial Conglomerates

A6.23 The Financial Groups Directive will require the introduction (from financial years beginning in 2005) of additional prudential supervision of those groups which straddle the insurance and banking/investment business sectors significantly.

A6.24 Supervision: The Directive requires supervisors and groups to measure the prudential soundness of groups with significant business in both the banking/investment and insurance sectors. This may generate the following mechanisms:

(a) Additional supervision for financial conglomerates → companies discouraged from becoming financial conglomerates → fewer financial conglomerates → fewer jobs in financial conglomerate firms. **Status: Ineffective and non-functioning.**

(b) Requirement for supervisors to coordinate and agree on standards and thresholds → increased consistency of treatment of firms and standards of regulation across EU → firms more aware and confident of how they will be treated in different jurisdictions → firms make fewer decisions which are inappropriate given how they will be treated → more firm growth. **Status: Probably functioning, but dominated. (Comment: Potential opportunities to exploit economies of scale are assumed to dominate.)**

(c) Requirement for supervisors to coordinate and agree on standards and thresholds → increased consistency of treatment of firms and standards of regulation across EU → improved transparency of regulation encourages the formation of financial conglomerates and an increase in cross-border activities → more competition both within countries and across-borders → lower prices and more innovation. **Status: Effective and functioning.**

49 Article 27, 28, 29, 30, 44, and 45

(d) Requirement for supervisors to coordinate and agree on standards and thresholds → increased consistency of treatment of firms and standards of regulation across EU → greater understanding by firms of the risks and issues of operating across sectors and borders → less risk → increased market confidence. **Status: Probably will function, but too early to say. (Comment: This may be an area in which the time firms need to adapt to the new regime is particularly important.)**

A6.25 Transparency effects:

(a) Existence and transparency of new conglomerate regime → increased market confidence → consumers buy products whose previous risk level exceeded their risk appetite. **Status: Probably will function, but too early to say. (Comment: This may be an area in which the time consumers need to adapt to the new regime is particularly important.)**

A6.26 Cost of capital requirements:

(a) Sufficient regulatory capital held at EEA group level to cover risks within the group → lower risk of failure of regulated firms → lower costs of capital, lower expenditure on reputation building → more firm growth. **Status: Probably not functioning, but dominated. (Comment: Whether or not this would operate, the effect is probably small since financial conglomerates are likely to have done these calculations anyway.)**

APPENDIX 7: IMPACTS OF FSAP ON FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH RATES

A7.1 This section considers the overall impacts of the FSAP and FSWP legislative measures on financial development, and consequently on the sustainable economic growth rate of EU Member States. This involves quantification of an economic to estimate how much the FSAP and FSWP legislative measures will have increased the sustainable growth rate of the following group of Member States:

(a) France;

(b) Germany;

(c) Italy;

(d) Spain;

(e) UK.

Financial Development and Growth

The Rajan and Zingales tradition

A7.2 Rajan and Zingales (1998) support the view that the quality of financial development, as measured by accounting standards, fosters growth in industries that are dependent on external finance.

A7.3 Cetorelli and Gambera (2001) perform a similar analysis to Rajan and Zingales with the modification that they test for the role of the structure, rather than size, of the banking system in providing finance for industries especially dependent on external finance. They find that industries dependent on external finance grow faster in the presence of a concentrated banking system.

A7.4 Carlin and Mayers (1998) find that industries funding a lot of investments tend to grow faster, and a series of recent papers addresses the question of whether the balance of financial institutions (i.e., bank or market-based), in an economy affects its aggregate growth or growth in industries particularly dependent on external finance.

A7.5 Levine (2002), Beck and Levine (2002), Demirgüç-Kunt and Maksimovic (2002) and Beck, Demirgüç-Kunt, Levine and Maksimovic (2001) report that overall financial development and the efficiency of the legal system rather than financial structure influence growth.

A7.6 In relationships based systems, as Rajan and Zingales argue, the financer makes an attempt to ensure the return on investment by establishing a certain degree of monopoly power at the financed company.[50] With lack of regulation and transparency other players will only have limited access to the market and the cost of entering the market will be significant. In *arm's length systems, Anglo-Saxon, market-based* the financer is protected by explicit contracts and transparency. In such systems, contracts and associated prices determine the transactions that are undertaken. Institutional relationships matter less and the market becomes a medium for directing/governing the transactions.

A7.7 Guiso et al (2004) is a recent paper that has attempted to provide a quantification of the impact of financial development on growth rates in the EU.

A7.8 They regressed the average rate of growth of value added and output – for a sample of manufacturing industries in the EU countries and other developed and developing countries — on different measures of financial development (such as market capitalisation, domestic credit to the private sector, total finance) at country level.

A7.9 In particular, following Rajan and Zingales (1998), Guiso et al (2004) interacted the variables proxying for financial development at country level – which varies across countries but not within industries within the same country- with a variable proxying for the external dependence on finance at industry level – which varies across industries but not across countries.

A7.10 In particular they took the US situation as the relevant benchmark for measuring the sector level dependence on external finance because, assuming that in the US the firms do not face any constraints in their access to funds, any difference at industry level in the reliance on external finance can be interpreted as differences in technology. If we further assume that the relative needs of external finance at industry level do not vary across country, then by interacting the financial development variable with the degree of reliance on external finance variable it is possible to take into account spurious association between financial development and growth due to differences in industry specialisations. Furthermore, the interaction of the two variables allows Guiso et al (2004) to identify the countries and sectors that are likely to benefit more from financial development. [51]

A7.11 The main result of Guiso et al (2004) is that financial development, independently of the exact definition adopted, tends to increase the average growth rates of industry value added and output.

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[50] In the relationship-based system, the bank has a close relationship with the financed company either because of their past contacts or because of its role as a stakeholder.

[51] The regressions controlled for other sources of endogeneity due to the presence of common factors — such as demand side factors — by instrumenting financial development with instruments such as the legal origin of the country, creditor rights and quality of law enforcement. Furthermore they included the beginning of the period industry share in value added — to control for the fact that financial development might explain the pattern of industry specialisation — and country and sector level fixed effects.

A7.12 By using the coefficient for the interacted variable we have described above, the measure of dependence on external finance and the difference between the level of financial development in the US and any other given country, they are able to estimate, for each country, the impact on growth rates of increasing the level of financial development up to the level of the US.

A7.13 They report that, on average, for the EU countries the estimated impact of financial integration on the growth of manufacturing value added would amount to about 0.7 percentage points a year that could be translated, in GDP terms, to about 0.2 percentage points.

A7.14 This figure can be somewhat reduced if we take into account the fact that cross-country differences in financial development reflect only in part differences in policy, but are also related to the different countries' institutions and histories, which cannot be controlled by policymakers.

A7.15 They therefore run some regressions aimed to explain the determinants of financial development: in particular, they regressed financial development on variables such as the legal origin of the country, creditor rights, rule of law, index of private and public enforcement, costs and time of judicial procedure. They used the regressions results to derive, for each country, the maximum level of financial development that could be reached through policy interventions, allowing for the fact that not all countries could achieve a level of financial development equal to that of the US — as some of the financial development determinants are not controllable by policymakers.

A7.16 In this second scenario, the impact of financial development is, as expected, somewhat reduced to about 0.15 additional percentage points of GDP growth.

A7.17 Interestingly, their results show that the EU countries that would benefit the most are Germany, Austria, Italy, and Sweden, while the country that would benefit the least would be, by far, the UK.

The Aghion et al approach

A7.18 In their 25 August 2005 Joseph Schumpeter Lecture at the 20th Annual Congress of the European Economic Association, Philippe Aghion and Peter Howitt consider what they call the "Schumpeterian view" of business cycles and growth, according to which "recessions provide a cleansing mechanism for correcting organizational inefficiencies and for encouraging firms to reorganize, innovate or reallocate to new markets. The cleansing effect of recessions is also to eliminate those firms that are unable to reorganize or innovate."[52]

A7.19 In this process, Aghion and Howitt emphasize the role of efficient capital markets: "if firms could always borrow enough funds to either reorganize their activities or move to new activities and markets, and the same was true for workers trying to relocate from one job to another, the best would be to recommend that governments do not intervene over the business cycle, and instead let markets operate."

A7.20 But the availability of funds for firms to engage in such reorganisation depends on the depth, breadth and liquidity of capital markets. If capital market imperfections prevent firms from reorganising in recessions, it will reduce their incentive to engage in long-term research and development (since there will be the risk of bankruptcy destroying the value of incomplete R & D).[53]

A7.21 But it is plausible that long-term economic growth is related to the degree to which firms innovate (developing new, more efficient methods of production, or new, more valuable products). This means that one effect of capital market imperfections might be to reduce long-term economic growth. Conversely, a deeper, broader, and more liquid capital market might lead to higher long-term economic growth, because it would facilitate more long-term innovation.

A7.22 In their May 2005 paper "Volatility and Growth: Credit Constraints and Productivity-Enhancing Investment", Aghion, Angeletos, Banerjee & Manova (AABM) use country panel data from 1960-2000 to estimate the effect of less deep, broad and liquid capital markets on economic growth.

A7.23 AABM estimate a relation between the average growth rate of per capita GDP in a panel of countries, and variables such as volatility of growth in per capita GDP and the level of financial development. Different specifications were tested. The baseline estimate could be expressed as in Equation (1) below:

$$GDPg = \alpha GDPVOL + \beta FINDEV + \varphi GDPVOL * FINDEV + ... \qquad (1)$$

where $GDPg$ is the average growth of per capita income, GDPVOL is the standard deviation of the rate of growth of per capita income, FINDEV is a measure of financial development which was computed, following Levine et al (2000), as the credit by deposit money banks and other financial institutions to the private sector over GDP.

A7.24 From the equation above, the marginal effect of FINDEV on GDPg, can be expressed as in Equation (2):

$$\frac{\partial GDPg}{\partial FINDEV} = \beta + \varphi GDPVOL \qquad (2)$$

which, for small changes of FINDEV and GDPg, could be re-expressed as:

$$\Delta GDPg = \Delta FINDEV * (\beta + \varphi GDPVOL) \qquad (3)$$

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[52] This quote, and those that follow, come from section 5.2 of http://post.economics.harvard.edu/faculty/aghion/papers/Appropriate_Growth.pdf

[53] Aghion and Howitt put it thus: "Absent credit constraints, and provided the value of innovation is sufficiently high, volatility will not affect innovation and growth as firms can always borrow up to the net present value of their future earnings in order to cover the short-run liquidity costs. But, now, suppose that the borrowing capacity of firms is proportional to their current earnings (the factor of proportionality is what we refer to as the credit multiplier, with a higher multiplier reflecting a higher degree of financial development in the economy). In a recession, current earnings are reduced, and therefore so is the firms' ability to borrow in order to innovate."

New Europe Economics quantification of the effects of increased financial development

A7.25 Although the AABM and Aghion & Howitt results are far from achieving consensus acceptance, they offer, for our purposes here, a way to model a longer-term potential gain from financial integration within the EU through processes such as the FSAP and FSWP legislative measures. Specifically, we can conceive of directives such as MiFID as measures that, because they contribute to increasing the depth, breadth and liquidity of European capital markets, they might address the sort of capital market imperfections that AABM discuss. Thus, using equations (1) to (3) above, populated with data, we can model the scope for increased growth that MiFID might offer.

A7.26 Table 7, column 1 of AABM (2005) gives β and φ equal to -0.00037 and 0.0184, respectively, while for GDPVOL we considered the weighted average volatility in GDP per capita growth in the largest EU economies (Germany, France, UK, Italy and Spain) using data from 1994 to 2005 taken from EUROSTAT and taking as weights the country-shares of GDP over the combined GDP of the above countries.[54] $\Delta FINDEV$ is taken to be the difference between the level of financial development between the US and the weighted average of the largest EU economies (with weights given by the country share of total cross-sample stock markets capitalisations for Germany, France, UK, Italy and Spain) in 2004, taking data from the IFS database.

A7.27 $\Delta FINDEV$ could be in principle be calculated at different years. Table A7.1 shows the actual values for FINDEV in the US and the weighted average of Germany, France, UK, Italy and Spain in different years (for Germany, France, UK, Italy and Spain we computed only an index for 1999 onwards as the dataset did not contain some relevant information for the previous years). As we can see from Table A7.1, financial development increased consistently for the US up to 1999, but then, from 2000 onwards, probably due to effects associated with the bear market of the early 2000s, stalled for the next 3 years (in 2002 the value was 105.1), before rising again in 2003 and 2004. For Germany, France, UK, Italy and Spain we instead observe a slow but steady increase in our measure of financial development.

A7.28 We compute $\Delta FINDEV$ as the difference between financial development in the EU and the US in 2004.

[54] We used the weighted average of the standard deviation of per capita GDP growth over the period 1994-2004, which yielded a value of about 0.92.

Table A7.1: Financial Development

Year	US	EU index
1995	72.2	n/a
1996	79.5	n/a
1997	86.4	n/a
1998	96.5	n/a
1999	108.9	103
2000	108.8	109.8
2001	108.9	113.5
2002	105.1	115.2
2003	121.0	119.0
2004	131.1	124.6

A7.29 We then entered the information for $\Delta FINDEV$ and GDPVOL (computed as explained above), as well the parameters β and φ, into Equation 3, as follows:

$$\Delta GDPg = \Delta FINDEV * (\beta + \varphi GDPVOL)$$

$\Delta GDPg$ = (131.1 – 124.6) x (-0.00037 + 0.0184 x 0.92) = 0.11

A7.30 Thus the estimate is for an increase in the sustainable growth rate of 0.1 percentage points per annum.

A7.31 While we acknowledge that our estimate is based on the parameters derived from a single, although influential, academic paper, we do also consider that the achievement of a deeper, broader, and more liquid capital market could have some potentially beneficial effects on the sustainable growth rate of GDP, and the AABM framework has offered us a route by which we could produce an estimate of the potential importance of this.

A7.32 We note, however, that our estimate is for the scope for full convergence to US financial development. The FSAP and future FSWP measures may be an important material contributor to this, but it would be inappropriate to attribute all such convergence to policy. Hence, this 0.1 percentage point addition to annual growth can be regarded as an (under) estimate of the upper bound of this form of benefit from financial integration for EU Member States. Naturally this benefit is likely to accrue more to those Member States that are relatively less financially developed than those more developed. Thus, for example, since the UK financial sector is relatively more developed than those in certain other EU Member States, much of this aggregate benefit could accrue to states other than the UK. (The main benefit to countries such as the UK from this sort of effect would therefore tend to come in the form of third round benefits as a result of growth in trading partners.)

APPENDIX 8: QUANTIFICATION OF EFFECT ON TRADE

A8.1 In this appendix we report the results of some econometric exercises conducted to assess the impact that the FSAP might have had on trade in financial services between EU Member States. We also project the future impact of further FSWP measures.

A8.2 First we describe the econometric models that we have estimated, as well as the data sources, then we move on to report the results and provide some comments.

A8.3 However, first it should be emphasized that the results of this study concern *trade*. Thus, for example, changes in the volume of business written by subsidiaries of a parent company based in another Member State would not be included.

Data and definitions

A8.4 Our main sources of data were

(a) A constructed variable of the degree of the FSAP and FSWP legislative measures that had been implemented, by Member State. This variable is derived from Europe Economics analysis of the makeup of the FSAP and FSWP legislative measures (including especially which are the most significant directives) and data on when measures were implemented, gathered from the europa web-site.[55] It is constructed as explained below.

(b) Eurostat. Eurostat reports data on trade in "financial services" and in "insurance services". Neither of these data series corresponds precisely to one of our horizontal themes in this study. "Financial services", as defined in Eurostat, has some crossover with both banking and securities, whilst "insurance services" does not map precisely onto our "insurance" theme. However, for the purposes of this study, we shall assume that the modelled results for the effects of the FSAP and FSWP legislative measures on trade in "financial services" provide a reasonable approximation to the effects on the banking sector, whilst the modelled results for the effects of the FSAP and FSWP legislative measures on "insurance services" provide a reasonable approximation to the effects on insurance.

(c) CHRONOS. This is our source for GDP data.

The econometric model

A8.5 The main econometric model that we have estimated is that reported as equation 1 below:

$$\ln TT_{it} = \alpha + \beta \ln(GDP_{it} * GDPEU)_t + \chi EURO_{it} + \delta FSAP_{it} + u_i + t_t + v_{it} \quad (1)$$

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55 For example, the Belgian implementation years, along with links to the implementation years for other countries, can be found at http://ec.europa.eu/internal_market/finances/actionplan/transposition/database/belgium_en.htm.

A8.6 The dependent variable, $\ln TT_{it}$, is the natural logarithm of the total amount of trade that each country i had with the EU15 in a given year in the financial services and insurance sectors: therefore, TT was computed as the sum of total credits and debits, in the financial and insurance services, that each Member State had, in a given year, with the EU15.

A8.7 For a more in depth analysis (and for robustness checks) we also run regressions which consider the financial services sector and the insurance sectors separately, or only credits and debits separately, for the financial and insurance services sector as a whole or for the financial services sector and the insurance sector separately. In particular, TFS and TIS stand for total trade in the financial and insurance sectors, respectively; TD and TC stand for credits and debits in the overall financial and insurance sector, respectively; ID and IC stand for credits and debits, respectively, in the insurance sector; finally, FD and FC stand for debits and credits, respectively, in the financial services sector.

A8.8 The source of data for trade in financial and insurance services of each Member State with the EU15 was EUROSTAT. Unfortunately, for some Member State, we have been unable to find the relevant information necessary to build our dependent variable(s).

A8.9 Therefore, we had to restrict the sample considered in this work to Belgium, Greece, France, Ireland, Italy, Luxembourg, The Netherlands, Austria, Portugal, Germany, Sweden and the UK.[56] Furthermore, ours is an unbalanced panel because for some countries we did not have data for the whole sample period (i.e. 1992-2004). Overall, our sample is therefore made up of about 120 observations.

A8.10 The variable $\ln(GDP_{it} * GDPEU)_t$ is the natural logarithm of the product of GDP in country i and GDP in the EU15, where the GDP data are taken form the EU CRONOS database. This variable has been included into the model in order to try to control for economy-wide developments that might explain trade among countries (see, for instance, the literature review contained in HM Treasury, 2003): *a priori*, one would expect that the larger the GDP in country i and/or the GDP in the EU15, the larger $\ln TT_{it}$ should be, ceteris paribus.

A8.11 $EURO_{it}$ is a dummy variable which takes the value of one for the Eurozone countries from 1999 onwards and zero otherwise (for the non-Eurozone countries included in this analysis, namely Sweden and the UK, the dummy euro is always equal to zero). The dummy euro has been included in the model in order to try to isolate the effect that the FSAP and FSWP legislative measures might have had on trade in financial and insurance services from the effects stemming from the introduction of the euro.

A8.12 $FSAP_{it}$ is a (continuous) variable, taking values between zero and one, which we have built in order to capture the level of implementation of the FSAP and FSWP legislative measures directives in the individual Member States in each year.

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56 For Finland, EUROSTAT's statistics contain many missing values for the financial service sector for the 1999-2003 period. For this reason we decided to drop Finland from the sample. However the main empirical results are not affected by the inclusion of Finland in the sample.

A8.13 Note that we refer to this variable as “FSAP”, since so far the measures covered all fall within the FSAP. However, a value of 1 for the variable would also involve implementation of the key elements of the FSWP, and thus is really a measure of the FSAP and FSWP legislative measures.

A8.14 This is how the $FSAP_{it}$ variable is constructed: in paragraph 2.11 we have listed our judgement as to the most important elements of the FSAP and FSWP legislative measures. Because of the significance of these elements, we have given them special weightings in the construction of our variable, as follows:

(a) First, we ascribed 85 per cent of the effects of the FSAP and FSWP legislative measures to these effects, other FSWP measures, and FSAP measures not implemented by mid-2006.

(b) 5 per cent is ascribed to the Financial Conglomerates directive.

(c) 10 per cent is ascribed to the other FSAP measures implemented by mid-2006.

(d) Next, for each country in our sample, we weight the 90 per cent total impact of major banking measures (and FSWP measures) according to the value added of insurance and of other financial services appearing in the University of Groningen database.

(e) Next, since we lack any other basis, we weight securities and banking equally. (If, as seems likely, in many Member States the banking sector is much larger than the securities sector, this assumption is equivalent to assuming that the ultimate impact of the relevant FSAP measures on the securities sector will ultimately be much larger than those on the banking sector — which does not seem implausible given the extremely significant nature of some of the securities-related measures.)

(f) Next, our judgement is that it is reasonable to suppose that the CRD and future banking related measures should carry twice the weight of the money laundering directives. Therefore, we divide the weighting for banking as follows:

- One third to Money laundering; and
- Two thirds to the CRD and future banking-related measures.

(g) Similarly, we suggest that it is not unreasonable to assign the impact of both IMD and Solvency II twice the weight of Solvency I. Therefore we divide the insurance weighting as follows:

- Forty per cent to IMD;
- Twenty per cent to Solvency I;
- Forty per cent to Solvency II and other future insurance-related measures.

(h) Finally, we suggest that it is natural to consider MiFID alone as significant as UCITS, Prospectus and the Clearing and Settlement framework put together, whilst each of these might reasonably be assigned the same weight. Therefore, we divide the securities weighting as follows:

- One sixth to UCITS;
- One sixth to Prospectus;
- Fifty per cent to MiFID;

– One sixth to the clearing and settlement framework and other future securities-related measures.

(i) The remaining already-implemented FSAP measures carry equal weight among the 10 per cent collective weighting for such measures.

A8.15 With the weightings as set out above, we then used the information from Table A2.3 to build the value of the variable for the years 1999-2004. This information is displayed, for the EU15, in Table A8.1. It should be noted that this is the dataset used to construct the model. Certain Member States that fall within the scope of the study do not fall within this dataset. The data available has guided the form of the model. The tables in the Main Report applying to later years (beyond 2004), do so for all those Member States within the scope of the study.

Table A8.1: "FSAP" values: EU15 (1999-2004)

	1999	2000	2001	2002	2003	2004
Austria	0.003	0.024	0.035	0.044	0.276	0.407
Belgium	0.003	0.024	0.035	0.041	0.053	0.306
Denmark	0.003	0.024	0.035	0.047	0.085	0.229
Finland	0.003	0.024	0.035	0.041	0.181	0.351
France	0.003	0.024	0.035	0.041	0.137	0.338
Germany	0.003	0.024	0.035	0.235	0.247	0.299
Greece	0.003	0.024	0.035	0.044	0.056	0.068
Ireland	0.003	0.024	0.035	0.044	0.230	0.246
Italy	0.003	0.024	0.035	0.041	0.122	0.220
Luxembourg	0.003	0.024	0.037	0.046	0.125	0.290
Netherlands	0.003	0.024	0.141	0.150	0.215	0.229
Portugal	0.003	0.025	0.037	0.047	0.083	0.291
Spain	0.003	0.024	0.035	0.053	0.200	0.297
Sweden	0.040	0.063	0.075	0.085	0.094	0.267
UK	0.003	0.024	0.037	0.046	0.059	0.365

Source: Europe Economics computations

A8.16 As we can see from Table A8.1, the degree of implementation of the FSAP and FSWP legislative measures was very low at the beginning of the period, it gradually increased over years, up to about 30 per cent in 2004, with the highest degree of implementation in Austria.

Other variables

A8.17 The u_i are country fixed effects (freely correlated with the regressors) which we have included in our models in order to control for any time-invariant heterogeneity not controlled for by the regressors.

A8.18 The t_t are year specific time-effects that have been included in order to control for common macro-economic shocks.

A8.19 Finally, the v_{it} represent the usual random error term appended to the regression equation.

A8.20 The regression specified in equation 1 above (and variants of it) have been estimated. To take into account possible heteroskedasticity and serial correlation, all regressions have been run using standard errors robust to both serial correlation and heteroskedasticity.

Results

A8.21 Table A8.2 reports the results for the main regressions we have run.

A8.22 For each coefficient, * stands for variables whose coefficient is significantly different from zero at 10 per cent level, ** stands for variables whose coefficient is significantly different from zero at 5 per cent level and *** stands for variables whose coefficient is significantly different from zero at 1 per cent level.

Table A8.2: Econometric results

Independent Variables	Dependent Variable								
	Ln(TT)	Ln(TIS)	Ln(TFS)	Ln(TC)	Ln(TD)	Ln(Id)	Ln(IC)	Ln(FD)	Ln(FC)
FSAP and FSWP legislative measures	2.66***	1.02	3.40***	3.70***	1.76*	-0.27	1.17	2.78*	3.53***
EURO	-0.83**	0.003	-1.39**	-0.79**	-1.03**	0.22	0.16	-0.90**	-1.24**
Ln(GDP*GDPEU)	1.10	1.33	0.56	1.31	0.95	1.18	1.91	-1.41	1.08
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-sq	0.86	0.89	0.80	0.88	0.82	0.85	0.85	0.744	0.83
F test	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

A8.23 All the regressions reported in Table A8.2 display high R-squared, which means that our models explain a large portion of data variability in our sample.[57]

[57] However we should recognise that, at least in part, the high R-squared might be the result, on one side, of the fact that our models have the dependent variables and one independent variable (Ln(GDP*GDPEU)) which are both related to the size of the countries, and, on the other hand, to the highly significant fixed effects.

A8.24 The key result is thus that, according to our model, the FSAP measures and FSWP legislative proposals have had a statistically significant impact on trade across all financial services (full implementation would raise trade in financial services by about 2.7 per cent). This breaks down further into:

(a) a statistically significant impact on trade in financial services (i.e. in banking and securities) — full implementation of the FSAP and FSWP legislative measures is projected to add 3.4 per cent to trade in banking and securities;

(b) no statistically significant impact on trade in insurance.

A8.25 We explore this key result in more detail below.

Impact of the euro on trade in financial services

A8.26 The euro seems to have, overall, a negative effect on trade in the financial services sector (as was intended by the architects of the project — we explain further below). In fact, it has a negative (and significantly different from zero) impact on TT, TFS, TC, TD, and FC: in other words, the adoption of the euro would seem to have reduced total trade, credits and debits in the overall financial and insurance sector and total trade and credits in the financial services sector.

A8.27 By way of contrast, our results do not show any impact of the euro on the insurance service sector.

A8.28 A possible explanation of this finding might be that the euro tended to reduce trade in financial services because the adoption of the euro entailed the disappearance of exchange transaction costs and of exchange rate risk (in the case of transactions between EU15 Member States that were also members of the euro). The reduction of the exchange rate risk might have in turn reduced the necessity of buying those financial instruments (or engaging in other forms of cross-border transaction) which are in general purchased by individuals and firms as a cover against exchange rate risks. If this is correct, then our model suggests that the euro is achieving one of the objectives its architects had in mind — reducing financial transaction costs.

A8.29 Alternatively, it could be that the introduction of the euro led to some changes of definition in data, or perhaps more strict collection criteria.

A8.30 We cannot test directly whether either of these hypotheses is correct (and indeed assessing the impact of the euro is not the focus of this study). However, our theory seems to be broadly consistent with the finding that the euro does not seem to have had any statistically significant impact on trade in the insurance service sector (i.e. the negative effect is concentrated in the sector that would include the forms of trade used for hedging — insurance of the form covered by the “insurance services sector” would not be a natural instrument to use for hedging).

A8.31 To further explore our theory, we have run similar regressions to that reported in equation 1 to analyse the impact of the euro on total trade in goods and goods and services: in both cases the impact of the euro was positive and statistically significant, which we interpret as a further evidence in favour of our explanation of the finding of a negative euro effect on the trade in the financial services sector and further evidence that our model is not simply picking up chance correlations in the data.

A8.32 For the purposes of this study, it is important to note that the validity of the FSAP variable is unaffected by whether the euro variable is capturing genuine effects of the euro or simply data changes. Either way, the effect of the euro is controlled for in our model.

Impact of other variables

A8.33 We might also note that Ln(GDP*GDPEU) is never significant in our regressions, even if, in the case of total trade, the coefficient is correctly signed.[58]

Further sensitivity analysis

A8.34 We carried out some sensitivity analysis by changing the weights that we attributed to the different directives and that were used to build the FSAP variables. In particular, when deciding the weights to apply for the directives in the case of the banking, insurance and securities sector we followed different strategies. The first alternative scenario involved the most radical change with respect to our baseline scenario: in fact we decided to give equal weight to the directives in each of the three sectors (banking, insurance and securities). In the second alternative scenario we gave equal weight in the banking sector and we maintained the baseline scenario for the remaining two sectors; in the third alternative scenario we gave equal weight in the insurance sector and we maintained the baseline scenario for the remaining two sectors; in the fourth alternative scenario we gave equal weight in the securities sector and we maintained the baseline scenario for the remaining two sectors.

A8.35 In the case of the first alternative scenario, we might note that the results (not reported) show a slight fall in the effect of the FSAP, from 2.7 to 1.9 per cent in the case of the total financial and insurance sector and from 3.4 to 2.6 per cent in the case of the banking and securities sector. A similar pattern is also identified in the case of the other scenarios, which provide results slightly smaller than in the baseline scenario case. Also in the alternative scenarios we can never reject the null hypothesis that the FSAP has stimulated trade in the case of the insurance sector.

A8.36 We therefore believe that the results reported are reasonably robust to the particular judgements we have used in constructing the FSAP variable.

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[58] In the case of the regressions that seek to explain the level of debits and credits it could be argued that the use of Ln(GDP*GDPEU) is not entirely justified and that the country and the EU15 GDP should enter the regressions separately. Unfortunately, the EU15 GDP cannot enter in the regressions because a problem of perfect multicollinearity with the time effects would arise. However, when we have tried to run regression for debits with the country GDP as control variable, the main results were virtually unaltered.

Impact of the FSAP and FSWP legislative measures on trade

A8.37 The FSAP variable is found to have a positive and statistically significant effect in the case of the overall financial and insurance service sector: in particular, the Financial Services Action Plan seems to have positively affected trade in the financial service sector, as the impact on the insurance sector has always been found to have a small magnitude and, above all, to be statistically insignificant.

A8.38 In the overall financial and insurance service sector, the coefficient of the FSAP variable is about 2.7: given that the dependent variable is in logarithms, the interpretation of the coefficient is that a unit increase in FSAP (i.e. an increase from a zero to a full implementation level) would tend to increased trade in the financial and insurance service sector of about 2.7 per cent each year.[59] In other words, an additional 10 percentage points (e.g. from 30 per cent to 40 per cent) in the degree of implementation would tend to increase trade in the financial and insurance service sector of about 0.27 per cent, *ceteris paribus*.

A8.39 The interpretation in the case of the financial service sector is similar: an additional 10 percentage points in the degree of implementation would tend to increase trade in the financial services sector of about 0.34 per cent. In other words, full implementation would tend to raise trade in the financial services sector by about 3.4 per cent each year, compared to a situation of no implementation.

A8.40 It is important to note that this is the impact *in addition* to other measures. For example, if (for example) membership of the European Union enhanced trade in financial services by 5 per cent and the Single Market Programme enhanced trade in financial services by 10 per cent (and if these were the only relevant factors apart from the FSAP and FSWP legislative measures), then full implementation of the FSAP and FSWP legislative measures would mean that the total boost to trade would be 17.7 per cent. (We emphasize that the numbers in this paragraph are given purely for illustration — it has not been part of the scope of this project to estimate the impact of EU Membership or of the Single Market Programme. Our point is to emphasize that a distinction should be recognized between the effect of the FSAP and FSWP legislative measures and the total effect of the EU — we are estimating the *additional* boost to trade in financial services arising from the FSAP and FSWP legislative measures.)

A8.41 It is also important to remember that, as Table A8.1 shows, the degree of implementation in our sample never exceeds 40 per cent (with the exception of Austria which, as of 2004, had a degree of implementation of about 40.7 per cent). Therefore, when we say that full implementation in the financial and insurance service sectors would tend to increase trade by about 2.7 per cent, with respect to a situation of no implementation, we do it on the assumption that the average effect of FSAP and FSWP legislative measures would not change at higher degrees of implementations (that we have not "observed" in our sample).[60]

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[59] We should recall that this is a level effect, not a growth rate effect.

[60] It should be noted that we attempted the construction of models, similar to that employed here for trade, for the impact of the FSAP and FSWP legislative measures on employment and on productivity. However, we were unable to obtain consistent cross-country

APPENDIX 9: EFFECT OF THE FSAP AND FSWP LEGISLATIVE MEASURES ON SECURITIES MARKETS AND ON THE COST OF CAPITAL

A9.1 The UK Financial Services Authority commissioned a study from Europe Economics on the benefits of the Markets in Financial Instruments Directive (MiFID) for the UK. As part of this work, Europe Economics considered effects on the cost of capital both in the UK and in other major Member States. The main substance of the Europe Economics findings, such as are relevant to the purposes of the present study, are reproduced below. Further details can be found in "The Benefits of MiFID — A Report for the Financial Services Authority by Europe Economics", Europe Economics (November 2006).

A9.2 For each class of benefits, Europe Economics considered four scenarios for the impact of MiFID. These four scenarios are:

(a) **"Limited Effect"** — In this scenario it is assumed that MiFID has limited effect, perhaps because the particular measures cannot achieve the integration desired, or are negated by national regulatory authority action, or because markets are already fully integrated.

(b) **"Non-Regulatory Factors Dominate"** — In this scenario it is assumed that MiFID has something more than merely a limited or zero effect, but in terms of achieving particular benefits, its contribution is only a part of a larger picture, with other factors such as cultural differences or differences in tax arrangements being dominant.

(c) **"Contributor to FSAP"** — In this scenario it is assumed that, although FSAP as a whole does indeed materially contribute to achieving a single market in wholesale financial services, MiFID is seen as a partial contributor to this process.

(d) **"Key Measure"** — This scenario, which attributes the highest benefits to MiFID, is based on MiFID achieving its desired effect (wholesale financial market integration) and as being the key measure. Accordingly, the full value of estimated potential benefits can be attributed to MiFID under this scenario.

A9.3 Benefits were divided into three "rounds":

(a) **First-round** (or **"direct"**) **benefits**: These are benefits that accrue to those firms and consumers directly affected by MiFID and related regulation. These were further divided into

- Benefits issuing directly out of the regulation (e.g. improved access, improved prices because of Best Execution requirements, and (most importantly) reductions in transactions costs because of aggregation effects — as explained further below);

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data sets for either of these variables for a time series extending beyond 2003. Since the degree of FSAP implementation was still quite limited in 2003, as discussed above, we were unable to use these data to obtain useful results.

– Competition and industry structure effects (e.g. competition in data publication, and (most importantly) the abolition of concentration rules and consequent growth of systematic internalisation might provide an indirect route of competition between exchanges[61]);

– Innovation effects;

– Effects on related regulation (e.g. fuller realisation of the benefits from measures such as the Prospectus Directive, the possibility that MiFID might represent a watershed moment in regulatory terms, after which protectionist national measures wither).

(b) **Second-round** (or **"indirect"**) **benefits**: These are benefits that arise because MiFID and related regulation may lead to a fall in the cost of capital and more efficiently-directed investment, and hence to a rise in investment, more productive investment, and consequently higher GDP. Specifically:

– Markets may become deeper — that is to say, the total available pool of capital may become greater;

– Markets may become more liquid — that is to say, the volume of capital actually traded in any given period may increase;

– There may be participation of more stocks in given movements of the market (general market sentiment may be more rapidly reflected in the movement of all stocks, rather than some thinly traded stocks changing price only rarely);

– There may be more independently issued price forecasts for any given stock;

– The range of available risk-return tradeoffs in the market may become broader or "span" more completely the possibilities (or, to put it another way, it will become less common for there to be certain levels or types of risk simply "unavailable to buy into"; or, to put it a third way, there will become more stocks available offering any given risk-return trade-off);

– There may also be more sophisticated development in certain particular markets, such as those for credit derivatives and commodity derivatives.

A deeper and more liquid market, that more effectively spans the risk-return possibilities and has further development in certain complex markets, may create additional second-round benefits, such as:

– Reduced costs of diversification in Europe (potentially increasing both investment into the UK (e.g. by US firms) and investment flows between Member States);

– Better risk hedging, which might (inter alia) lead to more willingness to offer fixed rate mortgages, more flexible fixed rate mortgages, and cheaper fixed rate mortgages;

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61 Such an effect may already be in evidence, as it was reported on 15 November 2006 that Citigroup, Morgan Stanley, Goldman Sachs, Merrill Lynch, UBS, Credit Suisse, and Deutsche Bank are intending to exploit the new opportunities created by MiFID to develop a trading platform between them.

– Increased ability of Pension Funds, Investment Trusts, and other Insurers to diversify risks of investment by investing overseas.

(c) **Third-round benefits**: Third-round benefits arise because of the indirect benefits MiFID and related regulation brings to the economies of a Member State's trading partners. Higher GDP and higher growth rates in our trading partners may lead to greater export opportunities for all the businesses of a Member State (across the economy, not just in finance and financial services).

A9.4 However, the Europe Economics study did not accept certain benefits sometimes suggested as arising from integration of European capital markets. In particular, the 2002 London Economics report for the European Commission, "Quantification of the Macro-Economic Impact of Integration of EU Financial Markets" suggested that greater integration might be a driver of greater use of bond finance, as opposed to bank finance, as a sort of debt financing.

A9.5 As an example, for the UK this report argued that greater integration might drive a rise in the percentage of bond financing from 2.0 per cent of all financing to 8.0 per cent, at the expense of bank finance, as a form of convergence to the 10.6 per cent level of bond financing then found in the US.[62] This rise in the share of bond finance was modelled as adding 0.3 per cent to UK GDP.

A9.6 In our view, the differences between bond financing levels in the US and the EU are primarily attributable to historical features of US banking that tended to restrict the ability of retail banks to make commercial-scale loans and thereby encouraged the use of bond financing, rather than because segmentation within Europe limited the feasibility of bond financing (so that a reduction in segmentation would lead to convergence to a more "natural" US-style level).[63] Techniques in bond financing have advanced considerably in recent years, and as a consequence it seems plausible that the importance of bond financing will continue to rise in Europe. However, this change is better understood in "technological development" terms, rather than as arising because of greater financial integration within Europe. Thus we do not attribute any gains arising from this source to the FSAP and FSWP legislative measures.

Quantifying effects

A9.7 The most relevant scenario for the purposes of the present study is the "Key Measure" scenario, since the essence of this scenario is to estimate the benefits of the FSAP and FSWP legislative measures as a whole and then attribute them all to MiFID.

A9.8 Table A9.1 summarizes cost-of-capital effects associated with first-round benefits that apply Europe-wide or to more Member States than simply the UK.

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62 *op. cit.* p122, Table 6.3.

63 In the US, historically, inter-state banking was prohibited and some states restricted, or even prohibited, branching. For many years this restricted the size of US banks and thus their ability to engage in on-balance-sheet transactions.

Table A9.1: Summary of first-round benefits — Key Measure Scenario

Source of first-round benefit	Quantitative estimate (Key Measure Scenario)	Ongoing effect on the cost of capital
Direct Direct effects		
Reduced costs of duplicate complying with regulation	Up to 0.5 per cent of operating cost for affected firms ≈ £ 100M	0 to 1bps fall in the cost of equity
Reductions in transaction costs because of aggregation effects	[% fall in costs, £, % of market cap] London: 8%, £ 1bn, 0.06% France: 26%, £ 0.9bn, 0.06% Germany: 26%, £ 0.7bn, 0.11% Italy: 63%: £ 2.2bn, 0.53%	£ 1bn reduction in cost of transacting ≈ 0.06% of mkt cap ⇒ 6bps fall in cost of equity
Realisation of economic value of data	£ 1.8m to £ 2.5m of "pure gain" (i.e. not simply transfers)	~£ 1m reduction in net cost of transacting ≈ £ 0 effect on cost of capital
Competition and industrial structure effects		
Extension to range of passportable activities and simplified passporting regime	Modest but material increase in supply	"Cost of capital in some markets could be materially affected"
Best Execution may make price a more visible and thence more important dimension of purchaser choice	See below	
Requirements for firms to disclose their execution policies might impose some additional discipline on costs	See below	
Greater ease of comparison might force more competition in those dimensions consumers consider important	See below	
Abolition of concentration rules should allow competition between regulated markets and systematic internalisers and/or MTFs in non-UK stocks. It may also provide an indirect route of competition between exchanges	See below	
Increased entry into the UK market from the EU	See below	
Increased entry into the EU markets from outside the EU	See below	
Above factors, leading to increased price competition bidding down spreads and other transactions costs	[£ fall]: UK: 0 France: 6-22 Germany: 9-34 Italy: 7-27 Other EU: 5-21	
Economies of scale and scope	See above	
Innovation effects		
More rapid and complete exploiting of recent innovations	Unestimated	Unpredictable

Source of first-round benefit	Quantitative estimate (Key Measure Scenario)	Ongoing effect on the cost of capital
New innovations	Unestimated	Unpredictable
Effects on related regulation		
More full realisation of the benefits from other directives already in place	Unestimated	Potentially significant
Possibility of regulatory watershed	Unestimated	Potentially significant

A9.9 The two calculations of most interest here are perhaps the "Reductions in transaction costs because of aggregation effects" and "increased price competition bidding down spreads and other transactions costs". We shall now explain these.

Reductions in transactions costs because of aggregation effects

A9.10 Europe Economics had access to FSA-supplied data on liquidity versus equity bid-ask spreads. These data exhibited a known liquidity-spreads relationship — namely that bid-ask spreads tend to be higher when liquidity is lower.

A9.11 The model then proceeded on the assumption that equities markets are currently segmented and that the FSAP and FSWP legislative measures would lead to full integration — a "virtual Single European Exchange" (each part of this assumption was explicitly acknowledged as an exaggeration).

A9.12 To estimate the effect of aggregating the exchanges Europe Economics calculated the would-be spreads of the market, if all of the liquidity in the data traded on one particular European exchange. (Another way to think about this would be to imagine that providers of immediacy today provide that service to one exchange at a time, but in the future will provide the immediacy service to the entire EU pool of liquidity at once.) This gives us bid-ask spreads on six different "would-be pan-European" exchanges that we can then compare to the current spreads on the same exchanges to get a measure of the benefit from aggregation of the markets.

A9.13 Table A9.2 shows the percentage difference in spreads between the actual spreads in 2002 and the would-be spreads on the pan-European exchange based on different existing exchanges, both for each liquidity decile and as the calculated weighted average improvement as discussed above.

Table A9.2: Percentage change in spreads due to aggregation

Exchange	Percentage fall in effective bid-ask spread in liquidity deciles										
	Average	1	2	3	4	5	6	7	8	9	10
Would-be London	7.90	N/A	7.38	7.83	12.09	9.57	13.43	7.94	9.58	8.39	8.73
Would-be France	26.21	N/A	26.09	51.56	54.75	61.05	62.46	65.52	61.54	62.44	58.48
Would-be Germany	26.06	N/A	42.45	60.73	75.11	83.38	86.93	90.63	92.98	88.92	82.64
Would-be Italy	62.56	N/A	54.71	74.19	89.82	93.73	95.80	97.04	98.14	98.67	98.51

Source: Europe Economics calculations on Capital Markets CRC data

A9.14 These can be translated into savings in pounds sterling using the total turnover for each of the exchange in 2005. Europe Economics did this using data from the World Federation of Exchanges. For London the saving in spread would translate to £1 billion direct annual saving in transacting on the equity market in 2005. The annual saving in France would be £933 million, £748 million in Germany and roughly £2.2 billion in Italy.

A9.15 Total market capitalisation for London, in October 2005, according to the World Federation of Exchanges[64], was £1,682 billion. Thus a saving of £1 billion represents a saving equivalent to 0.06 per cent of market capitalisation.

Increased price competition bidding down spreads and other transaction costs

A9.16 Transaction costs are an important factor when deciding where and with whom to trade in highly competitive equity markets, and increased competition could drive down the costs of operating on markets either by process of convergence between markets or by reduction in absolute levels of costs in all markets:

(a) Increased competition among exchanges will tend to drive down exchange fees — not necessarily to a uniform level, as there may for example be some specialist exchanges, but fees on average will tend to fall.

(b) There will be similar downward pressure from competition on intermediary commissions.

A9.17 Europe Economics attempted three avenues of quantification of impact of competition on the costs of trading. First we used Global Securities Consulting Services data to consider how trade commission costs could converge as a result of competition and the saving this might bring about. Second, we gained indications of the size of the impact from the survey of companies. Third, we analysed what effect competition from systematic internalisers might have on the spread.

Convergence of commission costs

A9.18 Here Europe Economics considered the effects on direct costs of transactions in terms of commissions charged by companies. The data for the analysis come from Global Securities Consulting Services (GSCS) and cover the regulated markets in UK, Germany, Japan, US and France from 2001 to 2004. These data measure the transaction costs in terms of basis points, or in other words hundreds of a percentage point of a trade value. (The data were provided by the FSA.)

A9.19 A possible assumption in measuring the benefits from competition would be that transaction costs tend to converge to the lowest current level available in the European markets. However, the data show that transaction costs, both in terms of commission and indirect costs, had already significantly converged since 2002. Figures A9.1 and A9.2 show the difference in the buy and sell commission on the different markets.

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64 http://www.world-exchanges.org

Figure A9.1: Buy commission

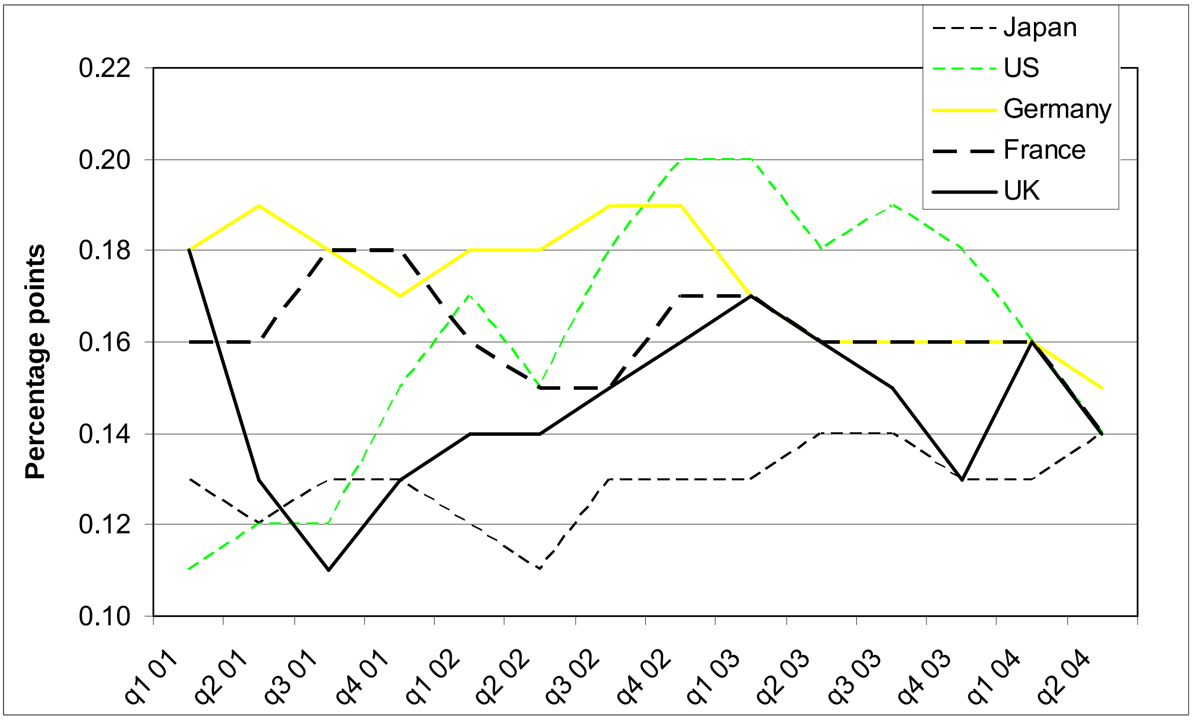
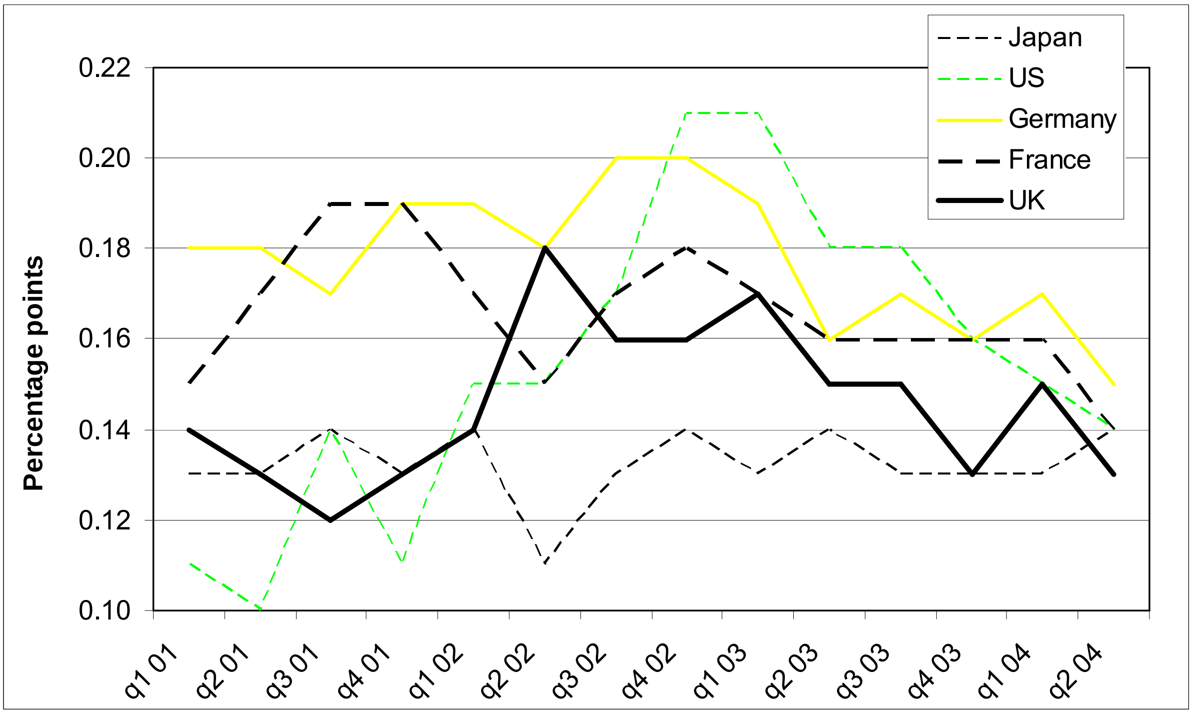


Figure A9.2: Sells commission



Source: FSA analysis of GSCS data

A9.20 Prior to 2003 there seems to be little, if any, trend in the data. However, convergence is evident from 2003 onwards until the end of the data set where all the countries both buy and sell commissions are very close to the 14 basis point mark.

A9.21 Analysis of the data caused us to suspect that the convergence could be the result of growing cross-border competition, or that it could reflect certain characteristics of the companies that the data comes from — the convergence seen might be the effect of large institutional investors, who by having operations in more than one country become able to benchmark costs of services. In other words, instead of exhibiting the effect of international competition, these data could reflect the increased bargaining power of institutional clients.

A9.22 Alternatively within Europe, a contribution to the convergence may also be made by the existence and gradual implementation of the FSAP. The international nature of the convergence does, however, suggest that there are also other important reasons at play. In fact, it does seem — for the duration of the convergence — that the costs have been converging internationally towards Japan, rather than towards the lowest average (UK) within Europe.

A9.23 It has to be remembered that the calculations above considered only reductions in commission costs, and only by way of convergence. In addition to these benefits, competition may reduce costs in the exchange which are currently on the efficiency frontier.

Convergence of total transaction costs

A9.24 Commission costs are only a part of the costs of transaction on the markets that competition could have an effect on — costs from timing and impact of the trade might reduce as companies strive to achieve best execution.

A9.25 Data from GSCS, provided to Europe Economics by the FSA, measures the total transaction costs in basis points including the costs of timing, market impact and commission. The data are quarterly running from 1998Q1 to 2005Q1 and covers a sample of companies operating in the equity markets of all EU countries except Luxembourg.[65]

A9.26 Figure A9.3 below shows the evolution of total transaction costs as in the data for UK, France, Germany, Italy and an average for the other EU countries in the sample. The data shown are annual averages except for the last data point for 2005Q1.[66]

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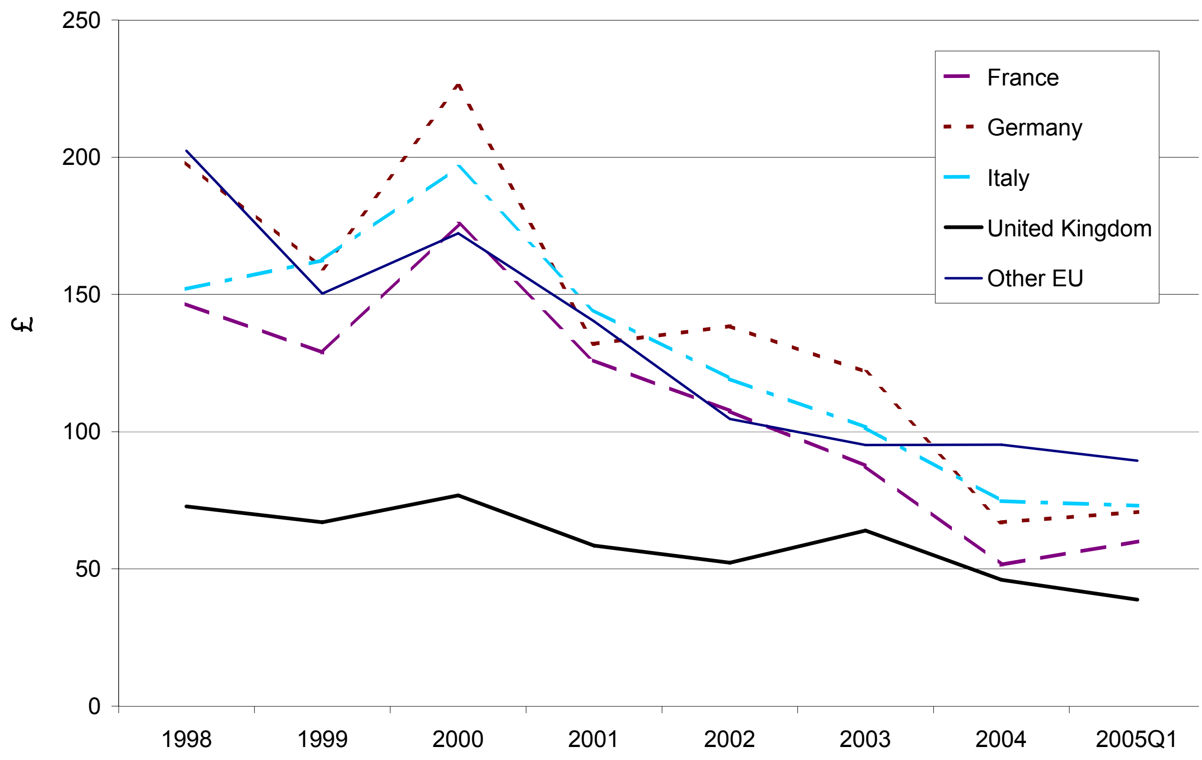
65 Some existing gaps in the data were filled in by applying identified long-term trend across countries to the data points preceding the gap.

66 We note that there was no evidence of systematic quarterly variation in the data.

Figure A9.3: Total transaction costs in EU Member States



A9.27 Transaction costs in the UK have been the lowest among the EU through out the period. All the countries and the other EU average show a declining trend, though this is much stronger outside the UK. Convergence seems to have been stronger since 2002, but it is notable that there still remains significant scope for further convergence.[67]

A9.28 The magnitude of the convergence can be clearly seen in Table A9.3 below, which shows the difference in the total transaction costs relative to the UK in different years and for 2005Q1.

Table A9.3: Remaining scope for convergence (£)

	1998	1999	2000	2001	2002	2003	2004	2005Q1
France	74	62	99	68	55	24	6	21
Germany	125	93	149	74	86	58	21	32
Italy	79	96	120	86	67	38	29	34
Other EU	130	83	96	82	52	31	49	51

Source: Europe Economics analysis of GSCS data

[67] Different trading strategies are a particular issue for different countries, and this may explain some of the differences in the data — the FSA study made particular reference to momentum trading.

A9.29 Convergence beyond a general falling trend exhibited by the UK costs has been strongest in the case of Germany (where the difference in transaction costs compared to the UK has fallen from 125 basis points in 1998 to only 21 in 2004) and weakest in Italy (where, having started at similar levels with France, transaction costs relative to the UK rose for two consecutive years before starting to fall again in 2001). Overall, we can see that there has been a 68 to 104 basis points convergence from 1998 to 2004, with much of it taking place in 2002 and after.

A9.30 There may of course be many different reasons behind the observed convergence, as well as behind the general falling trend of the costs witnessed in Figure A9.3. Europe Economics however, considered it “not altogether implausible” to assume that one of the reasons behind the convergence (over and above the falling general trend) in the time period is the FSAP.

APPENDIX 10: QUANTIFICATIONS OF OTHER EFFECTS

A10.1 In addition to the trade impacts, the effects of the FSAP on a number of additional variables have been considered within a further econometric exercise. Two of the variables concern employment in the banking and insurance sector, although we could obtain sufficient and comparable data on productivity only for the banking sector. We have also assessed the impact of the FSAP on two indicators of competition in the banking sector.

The Econometric Models

A10.2 All the econometric models share the main characteristics of the model that we described in the section on trade. The following equation summarizes the models: $Y_{it} = \alpha + \beta X + \chi FSAP_{it} + u_i + t_t + v_{it}$

A10.3 Where Y represents one of the variables on which we want to assess the impact of the FSAP (either employment or productivity or competition), X is a vector of control variables, FSAP is constructed as specified above, the u_i are country fixed effects (freely correlated with the regressors), the t_t are year specific time–effects that have been included in order to control for common macro-economic shocks and the v_{it} represent the usual random error term appended to the regression equation.

A10.4 We used different control variables for the models depending on which phenomenon we were trying to explain but we always include a dummy variable for the euro given the importance of the common currency in the common market. The variable takes the value of one from 1999 onwards (2001 for Greece) for all the Member States that adopted the euro.

A10.5 In the models that deal with the effects on productivity we included the output gap to be sure that we are able to identify effects that are specific to the banking sector and not a general trend that was present in the economy as a whole. This variable was also included in the models assessing competition as we can expect a competitive system to operate more efficiently than a system where competition is low.

A10.6 When we assess the effects on employment we include a measure of salaries (either in absolute terms or as a share of GDP). However, since we were unable to find a comparable measure for the insurance and banking sectors only, we relied on measures of the level of salaries across the entire economy.

A10.7 It can be argued that the effects of the FSAP on Member States differ with respect to the level of integration among them. Older Member States may have prepared for the integration in different markets over a longer period of time and may have some parts of the market already integrated. On the other hand newer Member States did not experience the same amount of integration. Therefore in some of the specifications that we attempted we have included an interaction term between the implementation variable and the number of years since accession.

Definitions of the Variables and Data Sources

A10.8 Our measure of productivity in the banking sector is the cost to income ratio, i.e. the ratio of operating expenses to the sum of (net) interest and non-interest income. To have a time series that is as extensive as possible we have used data from two different sources i.e. the OECD and the European Central Bank. The OECD[68] reports data on the balance sheets of banks up to 2003, a year in which our FSAP variable still assumes very low values with very little variance. The ECB[69] reports data on variations of cost to income ratios from 2003 to 2005. We use the latter data to expand our time series up to 2005 so that we can increase the degrees of freedom and obtain more precise estimates of the coefficients. Thanks to the merging of the two datasets we are able to obtain a very long time series of data (from 1992 to 2005 for the majority of countries).

A10.9 To measure the level of concentration we have used to different measures: the share of the markets of the five largest players and the Herfindahl-Hirschman (HH) index. This index is calculated as the sum of the squares of all the credit institutions' market shares, according to total assets, and is widely used to measure the level of concentration in a market. The data have been obtained from the ECB.

A10.10 Employment figures represent average for every year and have been obtained either via the ECB or the OECD.

A10.11 Data on the output gap have been obtained via the EU AMECO dataset. The output gap is the difference between actual and potential gross domestic product.

A10.12 The dataset includes all EU15 Member States plus the Czech Republic, Poland and Estonia. Unfortunately it has not been possible to find comparable data for the rest of the EU25.

Results

Competitiveness in the banking sector

A10.13 Our measure of productivity in the banking sector is the ratio of operating expenses to income calculated as we described above. It would have been preferable to use a measure of TFP or even labour productivity but we were unable to find such data for a sufficient number of countries and years. The control variables that we use in addition to the country and year dummy variables are the output gap and an interaction term between the implementation variable and number of year since EU accession.

A10.14 Table A10.1 reports the results of the estimated models. As above * stands for variables whose coefficient is significantly different from zero at 10 per cent level, ** stands for variables whose coefficient is significantly different from zero at 5 per cent level and *** stands for variables whose coefficient is significantly different from zero at 1 per cent level.

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68 OECD Bank Profitability: Financial Statements of Banks, 2004 Edition

69 ECB, EU Banking Sector Stability, November 2006

Table A10.1: Effects of the FSAP and FSWP legislative measures on competitiveness

Independent variables	Dependent variable: Cost to income ratio			
FSAP	-0.22	-0.31*	-0.40	-0.09
OUTPUT GAP	-0.03***	-0.02**	-0.03**	-0.02***
FSAP*YEARACC	--	0.01*	0.01*	--
EURO	0.06	0.06*	0.05	0.07**
Fixed effects	Yes	Yes	Yes	Yes
Time effects	Yes	No	Yes	No
R-sq	0.61	0.58	0.62	0.57
F test	0.000	0.000	0.000	0.000

A10.15 All the regressions have a reasonably high R-squared, implying that our model explains roughly 60 per cent of the variance in cost to income ratios.

A10.16 There is some evidence that the FSAP reduced the cost to income ratio of banks, thereby improving competitiveness. The FSAP variable is significant in only one of the specifications. However, when alternative models are estimated the p-value is never higher than 0.3 and in some cases is close to the 10 per cent significance level. Given the fact that the FSAP variable is measured badly and on the basis of numerous assumptions it is possible to claim that if we had a more precise measure for the level of implementation then we would observe a more significant coefficient.

A10.17 When we specify the model with an interaction term of the FSAP with the number of years since accession (but without year effects) then and only then the variable for the implementation has a negative sign and is statistically significant. The presence of the interaction term implies that the effects of the implementation of the FSAP directives on cost to income ratios depend also on the number of years since accession. To understand more clearly what the estimated coefficients imply we could think of a hypothetical new Member State that implements the FSAP fully in one year. In this case the cost to income ratios of banks would be reduced (on average) by 31 percentage points. However each additional year that passes from accession to full implementation would reduce the figure by one percentage points.

A10.18 A possible theoretical explanation of this is that the more years have passed since EU accession the more national banks are already integrated in the common market and are complying with the requirements of past EU directives, so that the additional effect of the FSAP becomes lower.

A10.19 The euro has a positive effect that is statistically significant in two of the four specifications attempted.

Competition in the banking sector

A10.20 We have used two different measures of competition in the banking sector, namely the share of the market of the five largest players and the HH index. In this case also we use as control variables the output gap and (in some specifications) the number of years since accession and an interaction term.

A10.21 Table A10.2 reports the results of the different models estimated.

Table A10.2: Effects of the FSAP and FSWP legislative measures on banking sector competition

Independent variables	HH Index				Share of 5 largest players			
FSAP	289.8	-188.9	528	-443	1.7	-32.4**	-4.4	-24.3**
OUTPUT GAP	-96.3***	-45.7*	-102.5***	-41.5	-1.1	0.12	-0.92	0.025
FSAP*YEARACC	--	-10.8	-11.86	--	--	0.33	0.31	--
EURO	358**	770.8***	375.2**	759.8***	0.64	7.7	0.08	8.3
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time effects	Yes	No	Yes	No	Yes	No	Yes	No
R-sq	0.93	0.90	0.93	0.90	0.84	0.83	0.84	0.83
F test	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

A10.22 As for the previous model the R-squared is always very high, implying that the explanatory power of the model is good.

A10.23 The implementation variable is negative and significant in 50 per cent of the regressions that have been run when the dependent variable is the concentration index. However it changes sign (and magnitude) when different specifications are attempted. In addition the p-value of the implementation variable when it is not significant are not even close to the minimum level of statistical significance, being higher than 0.55 (and in 3 out of four cases higher than 0.7). The result may be driven by external factors that we have been unable to control for, or it could be picking up a general trend of more competition in the EU market as a whole.

A10.24 The results of the models with the HH index suggest that the euro has had a significant and positive impact on concentration although the models with the simple Concentration Index do not confirm this result.

A10.25 If the FSAP has had a positive effect on competition, then so far it is likely to be very small.

Employment in the banking sector

A10.26 The number of employees in the banking sector has been obtained via the ECB publications and represents average numbers for each year. We use as control variable the gross amount of wages paid in each country. We have tried specifications where the control variable was the share of wages over GDP. However, for this latter variable there are sensibly fewer observations available and therefore we only report results from the models where the former is used and where we are more confident of the results.

A10.27 To estimate employment in a sector one would ideally derive a labour supply curve based on the characteristics of the sector and on the wages in the sector. Unfortunately there are no internationally comparable data on the level of wages in the banking sector in the EU and we had to rely on gross wages in the economy as a whole.

A10.28 The results from the different models estimated are reported in Table A10.3. As usual we report both models that include an interaction variable and models that do not.

Table A10.3: The effects of the FSAP and FSWP legislative measures on banking sector employment

Independent variables	Dependent variable: Number of employees in the banking sector			
FSAP	-9809	11860	12845	-15971**
GROSS WAGES	0.1***	0.13***	0.12***	0.11***
FSAP*YEARACC	--	-1143**	-1121**	--
EURO	-3687	366	-1653	132
Fixed effects	Yes	Yes	Yes	Yes
Time effects	Yes	No	Yes	No
R-sq	0.99	0.99	0.99	0.99
F test	0.000	0.000	0.000	0.000

A10.29 The R-squared of the models is extremely high, however in this case this is most likely due to the fact that fixed effects explain the largest variation in the number of employees between the different groups as scale is clearly the most important factor.

A10.30 From Table A10.3 no clear effect of the FSAP on the number of employees in the banking sector emerges. The implementation variable has different signs when different models are estimated. However we notice that in this particular case the interaction term is always significant while the implementation variable is not when the interaction term is included in the model. It may be the case that the effects of the FSAP and FSWP legislative measures do depend on the degree in which the banking sector is already an integrated market.

A10.31 We also notice that the coefficient of gross wages is always positive and highly significant. Those countries that pay higher wages also have a larger number of employees in the banking sector. This is not surprising as richer economies are characterised by a more developed (and therefore more productive) financial system.

Employment in the insurance sector

A10.32 The data of the number of employees in the insurance sector comes from the OECD 2005 Insurance Statistics Yearbook. Unfortunately the latest version available of this dataset reports data only up to 2003. The time span it is therefore not as long as is desirable.

A10.33 Probably because of the limited number of available observations we also experienced a statistical problem in our analysis of employment in the insurance sector. The variance-covariance matrix of moments conditions necessary to perform the generalised methods of moments maximum likelihood estimation does not fulfil the necessary conditions. This matrix, in turn, would be needed calculate heteroskedastic and autocorrelation consistent standard errors in a panel data framework. The likely explanation is that there is one (or more) singleton dummy, i.e. a dummy with only a zero and all ones (or vice versa) in either the fixed effects or the time effects.

A10.34 Therefore we are forced to rely on estimates that are not robust to arbitrary heteroskedasticity and autocorrelation. Estimated standard errors are likely to represent a lower bound and therefore only variables that are strongly significant are likely to have a true effect on employment in insurance.

A10.35 As in the case of banking we rely on gross wages paid in the economy as a whole as no sector-level data are available. The usual models with and without an interaction term are reported in Table A10.4.

Table A10.4: The effects of the FSAP and FSWP legislative measures on insurance sector employment

Independent variables	Dependent variable: Number of employees in the banking sector			
FSAP	-20781	36054	-24875	36054
GROSS WAGES	-0.0008	0.045	-0.002	0.045
FSAP*YEARACC	--	-1374	134.9	--
EURO	-22074**	-128	-22303**	-128
Fixed effects	Yes	Yes	Yes	Yes
Time effects	Yes	No	Yes	No
F test	0.000	0.000	0.000	0.000

A10.36 It is not possible to detect any significant impact of the FSAP on employment in the insurance sector even before controlling for heteroskedasticity and autocorrelation. The likely reason is that given the limited availability of the data there is not enough variation in the implementation variable as the implementation process gained momentum only in recent years. More data would be needed to assess the impact of the FSAP on employment in the insurance sector.

The FSAP and Mergers and Acquisitions

A10.37 We have tried to assess whether the implementation of the Financial Services action plan had an impact on the euro.

A10.38 To this purpose, we estimated a Poisson regression model which had the total number of M&A in each of the EU25 Member States between 2000 and 2005[70] as the dependent variable and the FSAP variable and a euro dummy as the explanatory factors. We used a Poisson regression because of the count data nature of the dependent variable, which makes the use of Ordinary Least Squares techniques unsuitable (see Woodridge, 2002).

A10.39 We implemented different versions of the Poisson Model: a pooled Poisson Model, which neglects the panel nature of the dataset (i.e. it does not control for possible country specific effects) estimated with quasi maximum likelihood techniques and with robust standard errors, a Poisson random effects model and a Poisson Population Averaged Model with standard errors robust to arbitrary correlation within countries (see Wooldridge, 2002)[71], and a Poisson fixed effects model.

A10.40 All the models we have estimated led to very similar conclusions, so in Table A10.5 we report the Poisson Population Averaged Model, which is likely to provide the more robust results.

Table A10.5: The effects of the FSAP and FSWP legislative measures on mergers and acquisitions

Independent variables	Dependent variable: Number of M&A
FSAP	-0.139
EURO	1.11**
Time effects	Yes
Wald test	0.000

A10.41 The FSAP variable is never significant at the conventional levels of confidence, while the euro dummy is positive. We should bear in mind that in the Poisson Model we cannot interpret the regression coefficients as a marginal effect. The marginal effect of the euro can be computed as E(total number of counts|regressors)*B_{euro} where B_{euro} is the euro regression coefficient and E is the expectation operator, which gives 4.5, i.e. euro countries tend to have about 4.5 more M&As over the sample period than non-euro countries.

A10.42 The results have been robust to the inclusion of additional control variables, such as the HH index of concentration.

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70 For the New Accession Countries we had data for the period 2001-2005 only.

71 We also estimated a Negative Binomial Population Averaged model, which gave very similar results to the corresponding Poisson model.

APPENDIX 11: BANK EFFICIENCY IN THE EU15

A11.1 Economists and practitioners use two main approaches to estimate relative efficiency across units: the parametric approach and the non-parametric approach. The main difference between these two approaches is that the former specifies a particular functional form for the production or cost function while the latter does not. That is to say, a parametric approach imposes a certain equation form to be estimated and examined, whereas the non-parametric approach makes no such *a priori* suppositions.

A11.2 In fact, the degree of "parameterisation" of the production or cost function can have serious implications in comparative efficiency analysis, and can be considered to be responsible for the different advantages and disadvantages that each approach has.

A11.3 The parametric approach relies on econometric techniques and includes simple regression analysis and the more complicated Stochastic Frontier Analysis (SFA). More recently a number of extensions to SFA such as Thick Frontier Analysis (TFA) and Distribution Free Approach (DFA) have also been developed. Whilst simple regression analysis typically seeks to estimate a production or cost function, SFA is an extension of that methodology to estimate the "frontier" of a set of functions with different underlying levels of efficiency.

A11.4 Non parametric methods are based on the assumption of free disposability. This assumption states that if a given level of output y can be obtained using x units of input then y' units of input (with $y' \leq y$) can be produced with x' units of input (with $x' \geq x$). There are two main non-parametric methods used in the literature: Data Envelopment Analysis (DEA) and Free Disposable Hull (FDH).

A11.5 In a recent paper Casu and Gagliardone (2006) provided estimates of the efficiency scores for the banking sectors of the EU15 for the years 1997 to 2003.

A11.6 The main objective of the study was to assess the overall performance of a specific bank system relative to the benchmark rather than the sources of inefficiency and therefore only overall efficiency scores are produced while no decomposition of inefficiency in different sources is provided.

A11.7 The efficiency scores are calculated using Data Envelopment Analysis (DEA).

A11.8 DEA is a technique to estimate efficiency that relies on mathematical programming. By this we mean mainly the resolution of a set of problems via the maximisation/minimisation of a given objective subject to some constraints. DEA uses mathematical linear programming techniques in order to find the set of weights attached to input for each unit that maximises its efficiency score, subject to the constraint that none of the units has an efficiency score greater than 100 per cent at those weights.

A11.9 In this way, DEA builds up an "envelope" of observations that are most efficient at each set of weights. A unit can be shown to be inefficient if it is less efficient than another unit at the set of weights that maximises its relative efficiency. For an inefficient unit at least one other unit will be more efficient with the target firm's set of weights. These efficient units are known as the peer group for the inefficient firm.

A11.10 A DEA model not only allows the weights attached to each performance indicator to vary across units, but is also able to accommodate non-linear relationships between cost and outputs — that is, variable returns to scale (VRS).

A11.11 Table A11.1 reports the DEA efficiency scores for the EU15 banks from 1997 to 2003 and shows that efficiency scores range (on average) between 64.2 per cent for Luxembourg and 87.7 per cent for Greece.

Table A11.1: DEA efficiency scores by year and country

	1997	***1998***	***1999***	***2000***	***2001***	***2002***	***2003***	***average***
Austria	71.3	85.3	81.3	84.4	78.6	73.1	76.3	78.6
Belgium	76.4	74.0	77.1	75.5	74.5	71.2	67.1	73.7
Denmark	76.4	79.4	75.9	70.3	76.9	77.4	70.9	75.3
Finland	97.8	95.3	97.8	69.7	85.4	85.3	68.6	85.7
France	55.7	68.0	55.7	71.2	67.6	78.0	75.7	67.4
Germany	67.2	63.5	67.2	67.0	69.3	68.3	71.8	67.8
Greece	91.6	85.3	91.6	89.3	91.0	88.4	76.7	87.7
Ireland	79.9	91.1	79.9	83.8	79.8	78.5	75.3	81.2
Italy	62.4	66.3	62.4	74.2	79.6	66.5	69.1	68.6
Luxembourg	66.4	66.1	66.4	72.8	54.5	62.3	61.1	64.2
Netherlands	82.4	74.5	82.4	86.3	86.9	84.9	76.2	81.9
Portugal	85.4	85.5	85.4	88.3	90.4	93.5	80.0	86.9
Spain	84.3	75.8	84.3	82.3	80.3	69.8	78.6	79.3
Sweden	91.6	87.4	91.6	57.0	51.2	77.4	59.6	73.7
UK	77.0	79.6	77.0	77.3	66.9	73.2	73.4	74.9

Source: Casu and Gagliardone, Bank Competition, Concentration and Efficiency in the Single European Market, Manchester School, July 2006

A11.12 Casu and Gagliardone (2006) also analyse the effects of efficiency on competition in the EU15 and conclude that the banking system that are more efficient are also those that generate the lowest revenues per euro of assets and claim that this may imply that banks that show the highest inefficiencies and incur the highest costs might be able to generate greater profits than more cost efficient banks.

A11.13 Therefore it may be said that the industry structure *per se* does not affect efficiency. More concentrated banking sectors may well be more efficient than less concentrated ones.

APPENDIX 12: SURVEY OF STAKEHOLDERS

A12.1 As discussed above and reiterated throughout the report, this project involved an opinion survey of financial regulators, industry and consumer associations, and other similar bodies.

A12.2 To maximise the response rate, prior to sending out the questionnaires, each institution was contacted (usually by phone) to seek a named contact to whom the questionnaire could be sent. This avoided sending the questionnaire to a general email address which may have delayed its completion. Once a contact was found and she/he agreed to answer the questionnaire, some introductory material about the FSAP was sent along with a letter of introduction from the European Parliament. The questionnaire subsequently followed.

A12.3 The majority of questionnaires were sent out at the same time. Later questionnaires were sent out in cases where new contacts were found or a particular institution requested it be sent the questionnaire.

A12.4 Reminder emails were sent out close to the deadline, and again just after its expiration to give respondents the maximum change to respond.

A12.5 Separate questionnaires were sent, depending on the nature of the institution surveyed, to

(a) Banking institutions or regulators;

(b) Insurance institutions or regulators;

(c) Securities institutions or regulators;

(d) Consumer associations;

(e) SMEs.

A12.6 Each of these questionnaires was a subset of a full questionnaire, reproduced as an Annex to this report.

Use of questionnaires

A12.7 It is important to emphasize that this project was conducted on the basis of primary research, analysis and conclusions from economists and experts in financial regulation. The results discussed in the Main Report do not depend, in the main, on the results of the opinion survey. That survey was qualitative and did not attempt to be statistically significant or to represent a comprehensive overview of stakeholder opinions.

A12.8 Nonetheless, there were a number of areas in which the survey was particularly useful. The extent to which questionnaires were relied upon depended on a number of key factors, including:

(a) The number and diversity of responses — thus, in country lots for which that Member State had produced fewer returns, the weight placed on questionnaire responses was less than that in Member States where there were more returns.

(b) The nature of the respondent — if the respondent seemed particularly likely to be authoritative about certain issues (e.g. a consumer association in respect of consumer protection issues, a competition authority in respect of barriers to entry, or a financial regulator in terms of compliance costs) then greater weight might be placed on that respondent's answers. So, for example, we would place relatively more weight on the views of a consumer association concerning consumer protection and switching costs than on its views concerning barriers to entry, if these conflicted with the views of a competition authority (say).

(c) The nature of the questions — greater weight was placed on the questionnaire in cases where the questions related to more speculative or subjective issues than where they related to more concrete issues. Thus, for example, greater weight would be placed on answers concerning

- consumer protection;
- the ease of switching;
- barriers to entry;
- expectations about the future;
- impacts of the FSAP

than those concerning

- trends in prices in recent years;
- trends in employment in recent years

and so on.

(d) The availability of other data — where other data were available, answers to the questionnaire served as a challenge/cross-check. Thus, for example, if other data seemed to suggest that employment in banking had risen but questionnaire respondents took the view that it had fallen, that would cause us to re-evaluate the data source. But if we remained confident that the data source was valid, we quoted the data source, rather than the opinions of survey respondents. On the other hand, where the only data available were those offered by the survey respondents, the views of respondents carried a higher weight.

(e) The unanimity of responses — if respondents to the survey took opposing views on the same issue, then the survey results had a lower weight than otherwise (subject to the weightings already mentioned above). Thus, for example, if we had answers from a regulator, a consumer association and a central bank, and all said that consumer protection had fallen, that would have greater weight than if the consumer association said it had fallen, the regulator said it had risen, and the central bank said it was unchanged.

A12.9 Of particular interest was the extent to which the views of survey respondents concurred or not with those of the country lot analysts. Typically, where survey respondent views differed from the conclusion the analyst wished to draw, we have brought the reader's attention to this in the country lot and explained our reasoning.

APPENDIX 13: GLOSSARY OF TERMS

ADEX	*Athens Derivative Exchange*
ALFI	*Association Luexbourgeoise des Funds d'investissment*
AML	*Anti-Money Laundering regime*
AMO	*Protimonopolný úrad Slovenskej republiky / Anti-monopoly Office of the Slovak Republic*
ASE	*Athens Stock Exchange*
ATM	*Automatic Teller Machine*
ATX	*Austrian traded index (Vienna Stock Exchange)*
ATX 50P	*ATX 50 Performance Index*
ATX-MidCap	*Austrian Futures and Options Exchange, 1995b*
BA-CA	*Bank Austria Creditanstalt*
BCL	*Banque Centrale du Luxembourg / Luxembourg Central Bank*
BCP	*Banco Comercial Portugeuês*
BDF	*Banque de France / French National Bank*
BE	*Eesti Pank /Bank of Estonia*
BG	*Bank of Greece*
BI	*Banca d'Italia / Bank of Italy*
BIS	*Bank for International Settlements*
BME	*Bolsas y Mercados Españoles*
BP	*Banco de Portugal / Bank of Portugal*
BS	*Banka Slovenije / Slovene Bank*
BSE	*Budapest Stock Exchange*
CA	*Competition Authority (Ireland)*
CBC	*Central Bank of Cyprus*
CBFSAI	*Central Bank and Financial Services Authority of Ireland (CBFSAI)*
CBI	*Central Bank of Ireland*
CBM	*Central Bank of Malta*
CBS	*Statistics Netherlands*
CC	*Competition Commission (Austria)*
CC	*Conseil de la Concurrence / Raad voor de Mededinging / Competition Council (Belgium)*
CCRL	*Konkurences padome / Competition Council Republic of Latvia*
CCRLI	*Lietuvos Respublikos konkurencijos taryba / Competition Council of the Republic of Lithuania*
CdC	*Conseil de la concurrence / Competition Council (France)*
CEECs	*Central Eastern European Countries*
CIS STAT	*Interstate Statistical Committee of the Commonwealth of the Independent States*
CMA	*Capital Markets Act (Hungary)*
CMVM	*Comissão do Mercado de Valores Mobiliários*
CMVN	*National Securities Market Commission*
CNB	*České národní banky /Czech National Bank*

CNMB	*Comisión del Mercado de Valores, (Spain)*
CNSF	*Conselho Nacional de Supervisor Financeiros*
CNSF	*National Council of Financial Supervision*
CPC	*Commission for the Protection of Competition (Cyprus)*
CR5	*Concentration Ratio 5*
CSB	*Central Statistical Bureau (Latvia)*
CSE	*Cyprus Stock Exchange*
CSOI	*Central Statistical Office (Ireland)*
CSOP	*Central Statistical Office (Poland)*
CSSF	*Commission de Surveillence du Secture Financier*
CZSO	ČSÚ */ Czech Statistical Office*
DB	*Deutsche Bundesbank / German Central Bank*
DEA	*Data Envelopment Analysis*
DGFSP	*Directorate General of Insurance and Pension Funds, Spain*
DIA	*Danish Insurance Association*
DIF	*Deposit Insurance Fund*
DKK	*Danish Kroner*
DN	*Danmarks Nationalbank / National Bank of Denmark*
DNB	*Denederlandsche Bank / Bank of Netherlands*
EC	*European Commission*
ECB	*Konkurentsiamet / Estonian Competition Board (Estonia)*
ECB	*European Central Bank*
ECN	*European Competition Network*
ECOFEX	*European Committee of Options and Futures Exchanges*
ECU	*European Currency Union*
EEA	*European Economic Association*
EESC	*European Economic and Social Committee*
EIB	*European Investment Bank*
EIU	*Economist Intelligence Unit*
ESCB	*European Systems of Central Banks*
FATF	*Financial Action Task Force*
FCA	*Bundeswettbewerbsbehörde / Federal Competition Authority (Austria)*
FCMF	*Financial and Capital Market Commission*
FCO	*Bundeskartellamt / Federal Cartel Office (Germany)*
FMA	*Austrian Financial Market Authority*
FPS	*FPS / Federal finance ministry (Belgium)*
FSAP	*Financial Services Action Plan*
FSM	*Financial Sector Monitor (Netherlands)*
FSO	*Federal Statistical Office (Germany)*
FSWP	*Financial Services White Paper*
GCH	*Gazdasági Versenyhivatal / Hungarian Office of Economic Competition*
GSNSS	*General Secretariat of National Statistical Service of Greece*
HCC	*Hellenic Competition Commission (Greece)*

HCSO	*Hungarian Central Statistical Office*
HFSA	*Hungarian Financial Supervisory Authority*
HHI	*Herfindhal-Hirschman Index*
HSFA	*Hungarian Financial Supervisory Authority*
IBUs	*International Banking Units*
IFC	*International Finance Corporation*
ILO	*International Labour Organisation*
IMF	*International Monetary Fund*
INE	*National Statistical Institute (Spain)*
INEP	*Instituto Nacional de Estatistica (Portugal)*
INSEE	*National Statistical Office (France)*
IOMA	*International Options Markets Association*
ISD	*Investment Services Directive*
ISI	*International Statistical Institute*
ISP	*Instituto de Seguros de Portugal*
ISTAT	*Istituto Nazionale di Statistica (Italy)*
LAB	*Latvijas Banka / Latvian Bank*
LB	*Lietuvos bankas / Lithuanian Bank*
MEFT	*Ministère de l'Economie et du Commerce extérieur / Ministry of Economics*
MNB	*Magyar Nemzeti Bank / National Bank of Hungary*
MOF	*Ministry of Finance (Hungary)*
NAP	*National Action Plan for Employment (Austria)*
NBB	*Nationale Bank van België / National Bank of Beligum*
NBP	*Narodowy Bank Polski / National Bank of Poland*
NBS	*Národná banka Slovenska / National Bank of Slovakia*
NMA	*Nederlandse Mededingingsautoriteit (Netherlands)*
NMS	*New Member State*
NSO	*National Statistics Office (Malta)*
NSOS	*Statistični urad Republike Slovenije / National Statistical Office (Slovenia)*
OCCP	*Urząd Ochrony Konkurencji I Konsumentów / Office for Competition and Consumer Protection*
OECD	*Organisation for Economic Co-operation and Development*
OeNB	*Oesterreichische Nationalbank*
OFT	*Office of Fair Trading (United Kingdom)*
OMX	*Helsinki Stock Exchange*
ON	*Oesterreichische Nationalbank / National Bank of Austria*
ONS	*Office for National Statistics UK*
OPC	*Úřad pro ochranu hospodářské soutěže / Office for the Protection of Competition (Czech Republic)*
ÖTOB	*Oesterreichische Termin und Optionborse*
POS	*Point of Scale*
RLB NW	*Raiffeisenlandesbank* Niederoesterreich-Wien AG
RLB OÖ	*Raiffeisenlandesbank OÖ*

RSE	*Riga Stock Exchange*
SA	*Statistics Austria*
SCA	*Konkurrensverket / Swedish Competition Authority*
SD	*Statistics Denmark*
SF	*Statistics Finland*
SL	*Statistics Lithuania*
SOE	*Eesti Statistika Kuukiri /Statistical Office of Estonia*
SOSR	*Štatistický úrad SR / Statistical Office of the Slovak Republic*
SP	*Suomen Pankki / Bank of Finland*
SR	*Sveriges Riksbank / Swedish Bank*
SS	*SCB / Statistics Sweden*
SSRC	*Statistical Service of the Republic of Cyprus*
STATEC	*Service central de la statistique et des études économiques/ National Statistical Office (Luxembourg)*
TSEC	*Thessanolica Stock Exchange Centre*
UCIT's	*Undertakings for collective investment in transferable securities*
UN/ECE	*United Nations Economic Commission for Europe*
WFE	*World Federation of Exchanges*
WTO	*World Trade Organization*

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