EUROPEAN PARLIAMENT

STUDY

Policy Department
Economic and Scientific Policy

The Impact of the New Financial Services Framework

Part II

Country Reports

Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France

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Part I: Main Report;
Part II: Country Reports Austria, Belgium, Cyprus,Czech Republic, Denmark, Estonia, Finland, France;
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1 INTRODUCTORY OVERVIEW

Introduction

1.1 The Austrian financial system is well supervised, robust to shocks, and is perfectly in line with the high international financial sector standards which cover banking, insurance, securities, and anti-money laundering. This was achievable because of a comprehensive legal framework and because of Austria's strong institutions which have successfully managed external shocks and global slowdowns.

1.2 The financial sector is mainly dominated by banks. The insurance sector is well developed whereas the securities markets only play a small role in the financing of enterprises.

1.3 Although major insurers are associated with banking groups, it is perhaps not best described as Bancassurance. Indeed, alliances are changing and competition between banks and insurers is intense.

1.4 Although the implementation of the FSAP regulations has been undertaken, the Austrian financial system faces a number of challenges which need to be dealt with. These challenges include among others:

(a) High branch and bank density which results in lower efficiency and profitability in the market. This implies more restructuring and consolidation.

(b) Growing competition, particularly from Central Eastern European Countries (CEECs). This has introduced new risks that must be monitored vigilantly. It also increases the need to improve banks' cost structures in order to remain competitive.

(c) Weak risk management in the insurance sector.

Division of Responsibility

1.5 The *Austrian Financial Market Authority* (FMA) is meant to contribute to the stability of the financial market. It is charged with the supervision of: credit institutions, insurance undertakings, pension funds, staff provision funds, investment funds, investment service providers, companies listed on the stock exchange as well as stock exchanges themselves.

1.6 The aim of the FMA is to:

(a) Protect consumers as well as creditors within the legal framework.

(b) Punish any violation of the law.

(c) Make preventive efforts while respecting supervisory standards.

(d) Grow confidence in the ability of the Austrian financial market to function.

1.7 The FMA monitors and takes necessary measures to ensure compliance with the law. It defines minimum standards and publishes regulations to make legal provisions concrete. It also engages in dialogue with market participants and works out proposals that ensure that the Austrian financial market always respects high standards. The FMA also represents Austria's interests in the EU as well as in other international bodies. It cooperates with other supervisory authorities.

1.8 In 2002, the independent (Bundeswettbewerbsbehörde) Federal Competition Authority (FCA) was established. It has broad investigative powers and can take-up all types of competition cases (including financial services) in Austria.

1.9 The Public Prosecutor in Cartel Matters (Bundeskartellanwalt) was also set up in 2002, within the Federal Ministry of Justice. Though an Official Party, the prosecutor is bound by the Federal Minister of Justice. The prosecutor is also responsible for the take-up of competition cases and may have recourse to the investigative powers of the FCA.

1.10 The Competition Commission (Wettbewerbskommission) (CC) set up in 2002, advises the Federal Competition Authority. This does not bind the FCA to follow the CC's recommendations. The CC's main task is to offer expert opinions in selected national merger cases.

1.11 The Central Bank of the Republic of Austria known as Österreichische Nationalbank (ÖNB) contributes to the development of monetary and economic policies in Austria as well as in the eurozone. It is also a stock corporation, and plays a minor role in the supervision and regulation of the Austrian financial market.

1.12 The Bureau of Consumer Affairs acts as the coordinator of consumer-related affairs. It is part of the Federal Ministry of Social Security, Generation and Consumer Protection. Its original responsibility was to control quality, prices, price marking and product information. Its competencies have now extended to the coordination of capacity in General Consumer Protection Laws, General Law of Contract, Financial Services, Law on Competition, Trade Laws and many other fields.

2 BANKING

Headline Overview

Features of the industry

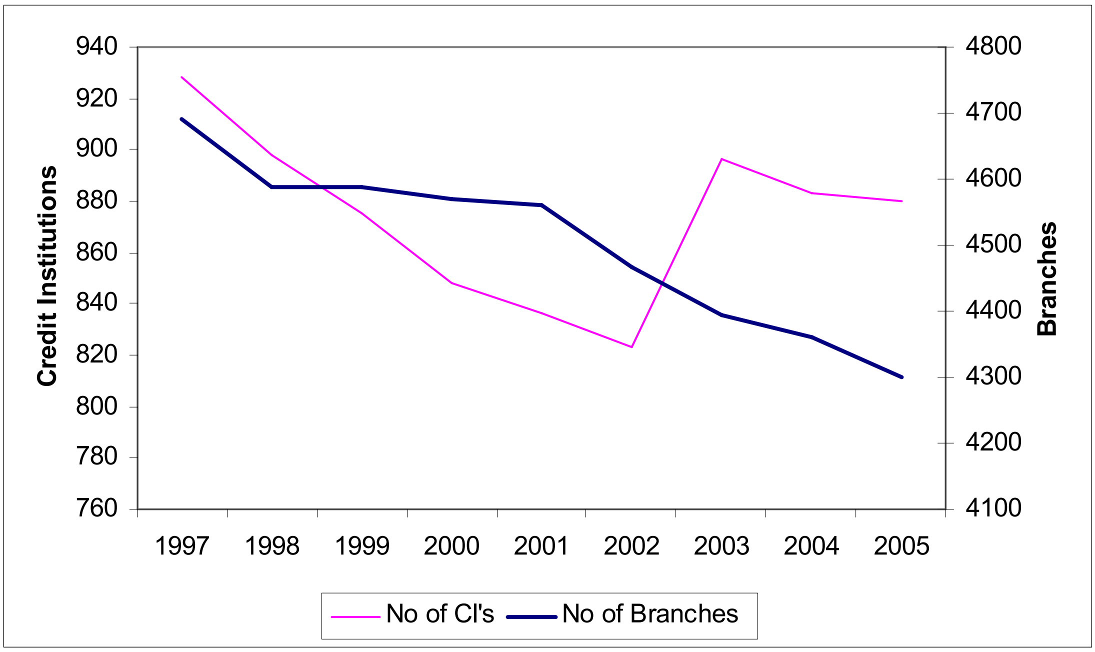
2.1 With nine hundred banks in Austria for eight million inhabitants, the banking sector is considered very dense. In recent years, there has been major restructuring and consolidation. Only four of the largest ten banks which existed in 1990 have remained. Nevertheless, there is still room for more consolidation in the Austrian banking sector.

2.2 The last ten years saw the formation of clusters of smaller banks which resulted in the creation of relatively large banking groups.

Number of players

2.3 As can be seen in Figure 2.1, in 2005, the number of credit institutions was lower in the Austrian banking industry than in 1998, and the number of branches had significantly decreased.

Figure 2.1: Number of Credit Institutions and Branches (1997–2005)



Source: ECB "EU Banking structures, 2006"

Table 2.1: Breakdown of credit institutions by type (2003)

Type	Description	Number of banks
Raiffeisen and Volksbanken banks (Regional structure)	Regular banking operations. Their focus is on industrial and commercial enterprises. Supplying trades and commerce.	665
Special purpose banks	Their banking activity is limited to the investment fund business.	91
Joint stock banks	Financing of large industrial projects. Banking services to corporate customers.	63
Savings banks	Full range of banking products and services.	63
State mortgage banks	Universal banks. Can perform all type of banking transactions.	9
Housing construction savings fund and loan associations	Specific tasks normally defined as of public interest.	5

Source: ÖNB

2.4 The Austrian banking sector was traditionally multisectoral, however since the mid-1990's, the Austrian banks have started to change in order to operate as universal banks.

2.5 Although the Austrian banking sector is very dense, some banks hold more market shares than the rest. The main banks are:

(a) Bank Austria Creditanstalt

(b) Erste Bank AG

(c) BAWAG

(d) RZB

(e) Kontrollbank

(f) ÖVAG

(g) PSK

(h) RLB OÖ (Raiffeisenlandesbank OÖ)

(i) RLB NW (Raiffeisenlandesbank Niederösterreich-Wien AG)

Turnover, employment and profitability

2.6 In comparison with the other EU25 Member States, Austria's banking industry has a major structural deficit. The sector is" over-banked", with very high density, competition is stiff and banking secrecy rules are tight. The result of this is that the cost-to-income ratio of Austrian banks is among the highest in Europe and their profitability is below the EU15 average.

2.7 According to the ÖNB, the situation described above is mainly linked to:

(a) The conservative provisioning of Austrian banks,

(b) The better service they provide, with high business and regulatory standards, and

(c) The historical legacy of a sector dominated by cooperative banks.

2.8 The Austrian authorities agreed that ongoing cost-cutting efforts were needed in order to the greater cross-border financial integration, especially as this integration intensifies competition on the European Single Market.

2.9 The high level of density in the Austrian banking market has made it difficult for the numerous competing banks to reach high levels of profitability. From the mid-1990's their level of revenue grew until 2001, and in 2002 it decreased. As seen previously, the number of branches has almost continuously decreased since 1997.

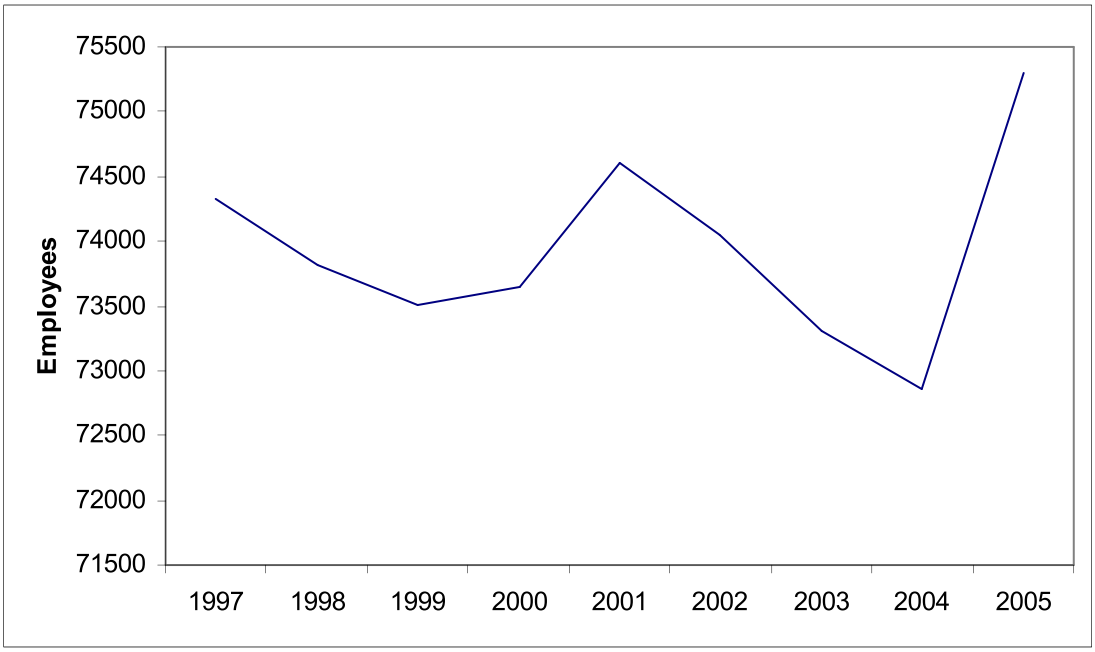
Table 2.2: Income and branch numbers of Austrian Banks (all banks)

	1997	**1998**	**1999**	**2000**	**2001**	**2002**
Income before tax (€ m)	1544	1661	1797	2618	2125	1919
Net interest income (€ m)	3912	4222	4595	4698	5106	5073
Number of branches	4691	4587	4589	4570	4561	4466

Source: OECD

2.10 The level of employment in the Austrian banks decreased in the late 1990's and rose during two years from 1999 to 2001. It significantly dropped between 2001 and 2004. Since 2004 it has continuously risen.

Figure 2.2: Employment in Austrian banks, 1997-2005



Source: OECD

2.11 Austria's framework for its employment policy was provided by the following:

(a) Setting employment as one of the priorities of the Amsterdam treaty in 1998,

(b) implementing a National Action Plan for Employment (NAP), and

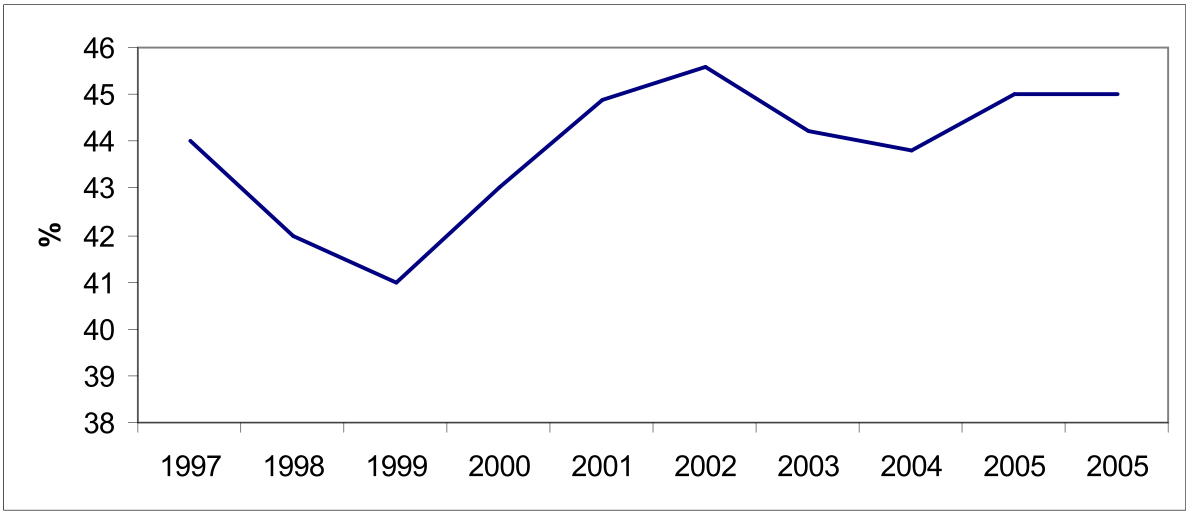
(c) committing to the Lisbon and Stockholm Council employment policy objectives have provided. Austria has made significant efforts to implement the NAP.

2.12 These efforts may have stimulated the rates of employment in all sectors which may have transpired in the banking sector after 2004, regardless of the FSAP.

Market shares and concentration

2.13 The degree of concentration in the Austrian banking sector is relatively normal among the EU25.

Figure 2.3: Share of the 5 largest credit institutions in terms of total assets (%)



Source: ECB "EU Banking structures, 2006"

2.14 The Concentration ratio of the five largest credit institutions (CR5), represents the percentage of market shares the five largest credit institutions hold in the banking sector. For instance, In 1999, the five largest credit institutions held approximately 41 per cent of the Austrian banking market.

2.15 The Austrian CR5 is generally slightly above the EU25 weighted average. This may be verified in the Main Report (Table 3.2: CR5 ratios, 1999-2005). The general level of concentration in the Austrian banking sector can be qualified as relatively low.

2.16 A similar picture emerges from the Herfindahl index, which is a measure of the size of firms in relationship to the industry and is an indicator of 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, 1,000 to 1,800 moderate concentration and anything above 1,800 indicates high concentration.

Table 2.3: Herfindahl-Hirschman Index

	1997	1998	1999	2000	2001	2002	2004	2005
HH Index	515	515	511	548	561	618	552	560

Source: ECB "EU Banking structures, 2006"

2.17 In recent years the German HypoVereinsbank acquired the largest Austrian bank, Bank Austria Creditanstalt (BA-CA) which still remains a market leader in the Austrian banking sector. BAWAG bank acquired the Austrian Postal Savings Bank, PSK, and BAWAG P.S.K. became Austria's fifth-largest bank.

2.18 Today, technological advances present a threat to employment in the banking sector. The use of the Internet is becoming popular since the cost of customer transactions is less than 10 per cent of that for traditional banking. Call centres, the Internet and more intelligent bank cards that transfer more transactions to machines might start reducing the number of employees.

2.19 According to the IMF, Austrian banks suffer from relatively low domestic profitability and efficiency. Those factors are linked on the one hand, to strong competitive pressures (high density) and on the other, to unfavorable cost-income ratios, with some banks that are still absorbing the costs of:

(a) recent domestic consolidation,

(b) expansion into Central and Eastern Europe, and

(c) major investments into upgrading information technology platforms and risk management systems.

Trade and international penetration

2.20 Austria is home to a number of foreign EU and third country banks. Relative to its size and population and compared to other EU countries, Austria has a relatively average number of foreign branches and subsidiaries.

Table 2.4: Credit Institutions from EU and third countries

	2001	2002	2003	2004	2005
EU branches	15	15	18	18	25
Third countries branches	0	0	0	0	1

Source: ECB "EU Banking structures, 2006"

Table 2.5: Subsidiaries from EU and third countries

	2001	2002	2003	2004	2005
EU subsidiaries	12	12	12	11	14
Third country subsidiaries	11	11	11	8	9

Source: ECB "EU Banking structures, 2006"

Table 2.6: Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005
Domestic M&A's	1	2	2	0	2	1
EU M&A's	1	2	0	0	0	1
Third country M&A's	0	1	0	0	0	0

Source: ECB "EU Banking structures, 2006"

Competitiveness

2.21 The level of competitiveness of Austrian banks has originally been very high and so far, the situation remains unchanged.

Table 2.7: Key performance indicators of the banking sector (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1992	-	26.5	8.8
1993	3.2	30.8	9.2
1994	2.6	27.0	7.4
1995	2.3	28.5	7.7
1996	2.3	33.3	7.7
1997	2.2	39.5	9.1
1998	2.1	39.3	7.6
1999	2.1	39.1	6.9
2000	1.8	55.7	8.8
2001	1.9	41.6	6.3
2002	1.8	37.8	5.4
2003	1.6	42.7	5.6

a: Net interest margin: net income before tax to average capital and reserves.

b: ROA: net interest income to average total assets.

c: ROE: net income before tax to average total assets.

Source: Europe Economics calculation

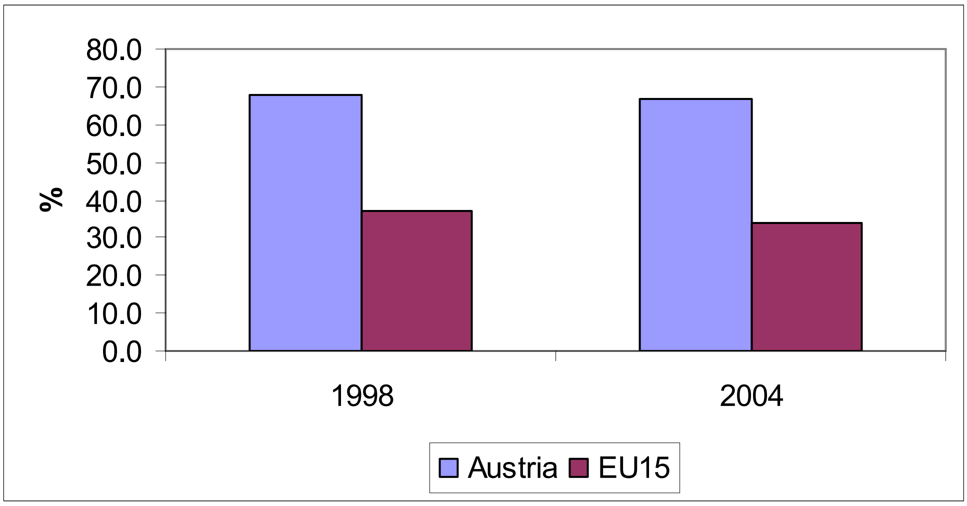
2.22 The figure below illustrates the evolution of the Data Envelopment Analysis (DEA) efficiency scores of the Austrian banks between 1997 and 2003. DEA allows us to measure the efficiency of multiple Decision Making Units when the production process presents a structure of multiple inputs and outputs.

Table 2.8: DEA efficiency scores for Austrian banks

	1997	1998	1999	2000	2001	2002	2003
DEA score	71.3	85.3	81.3	84.4	78.6	73.1	76.3

Source: Casu and Giradone, "Bank competition, Concentration and Efficiency in the Single European Market" (2003)

Figure 2.4: Cost-to-income ratio (expressed as a %)



Source: ECB, "EU Banking structures, 2006"

Perception of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.23 Switching is notoriously difficult to assess, and subjective judgement by those close to the industry is often the main source of data.

Dimensions of price and quality competition

2.24 Since 2000, the number of banks in Austria has steadily declined, largely as a result of a wave of mergers and acquisitions which affected Europe as a whole. For this reason, although the number of banks has fallen, their total assets have continued to rise.

Table 2.9: Number and Aggregate Balance Sheets of Austrian banks

	2000	2001	2002	2003	2004	2005
Number of banks	923	907	897	896	883	880
Balance sheet totals (in € million)	553,796	562,476	575,667	590,691	629,963	689,295

Source: ÖNB

Consumer protection

2.25 The level of consumer protection in Austria is perceived by Austrians to be higher than elsewhere in the developed financial markets of the EU15. Figures from Eurobarometer put customer satisfaction significantly above the average for the EU. The index decreased from plus 31 (52 per cent positive to 21 negative) in 1999, to nine in 2003 (40 per cent positive to 31 negative).

The potential future role of technology

2.26 By their very nature, financial products lend themselves particularly well to distance selling. The percentage of Austrians who ordered goods or services over the Internet during the last year has risen by over a half since 2004 to 32 per cent of individuals. The number who ordered shares/financial services/insurance over the Internet during this period has however not risen above 1 per cent which is low compared to the EU15 average of 4 percent, indicating that Austria's banks have some way to go to increase online banking penetration to the level already attained in other EU15 countries.

Impact of the FSAP and FSWP Legislative Measures on the Austrian Banking Sector

Cross-border business, takeovers and the development of a regional market

2.27 In recent years, some of the mergers (such as the takeover of Bank Austria Creditanstalt by the German HypoVereinsbank), have been of cross-border nature. However, there has been no evidence of a developing trend. This could be explained by the very high density and the relatively low level of profitability on the Austrian banking market. Indeed, such characteristics might not be very appealing to foreign companies that wish to increase their profitability.

2.28 Having said that, our view is that the implementation of the FSAP will eventually have a slightly positive impact on cross-border developments, by opening up other EU markets which may lead to more penetration of the Austrian banking market, and in turn to more consolidations.

2.29 Austrian banks have successfully developped a cross-border diversification strategy, particularly in Central and Eastern Europe (CEE). According to the ÖNB, Austrian banks today account for a market share of approximately 20 per cent in CEE (Russia excluded). In 2004, some Austrian credit institutions had reached market shares that ranged from 32 per cent in the Czech Republic to 44 per cent in Slovakia. That same year, 42 per cent of the net profits of Austria's five largest banks originated from operations in CEE.

2.30 Our judgement is that the FSAP is likely to have had a slightly positive impact on the development described above. Indeed, the general tendency of EU Member States to open up their banking markets, partly as a result of the implementation of the FSAP, has created opportunities for Austrian banks to penetrate foreign markets. Such developments should persist.

Competition

2.31 With nine hundred banks for eight million inhabitants, Austria's banking sector should be expected to have strong competition for when a sector has a large number of suppliers, in order to remain attractive to clients, banks have to compete against one another through prices, level and range of services. In a less 'crowded' market, the chances of companies coordinating in price is higher than in a sector which has many agents or competitors. Regardless of the structural changes and consolidations among smaller credit institutions in recent years, the Austrian banking market remains very dense and therefore competition should be relatively effective.

2.32 It is difficult to confirm that the FSAP has had an impact on competition. However, since 1999 there have been cross-border mergers and their has been an increasing number of foreign branches entering the Austrian banking market. New competition and the threat of contestability will naturally enhance competition. Therefore, since the FSAP appears to have had a slightly positive impact on cross-border developments, a natural view would be that it may also have had a sligthly positive impact on the level of competition in the Austrian banking sector.

2.33 However, since competition was already intense before the introduction of the FSAP, our judgement is that the FSAP is likely to have had little if any, impact on competition in the Austrian banking sector.

Competitiveness

2.34 Between 1997 and 2000 there was a significant improvement in the efficiency scores of Austrian banks (see Table 2.8). However, in 2001 that score significantly dropped. These indicators have decreased by nearly 10 per cent. This may be due on the one hand, to the 2001 bear market effect, and on the other, to the strong competitive pressure from the high density of the Austrian banking market. Also, some banks are still absorbing the costs of:

(a) recent domestic consolidation,

(b) expansion into CEE, and

(c) some major investments into upgrading information technology platforms and risk management systems,

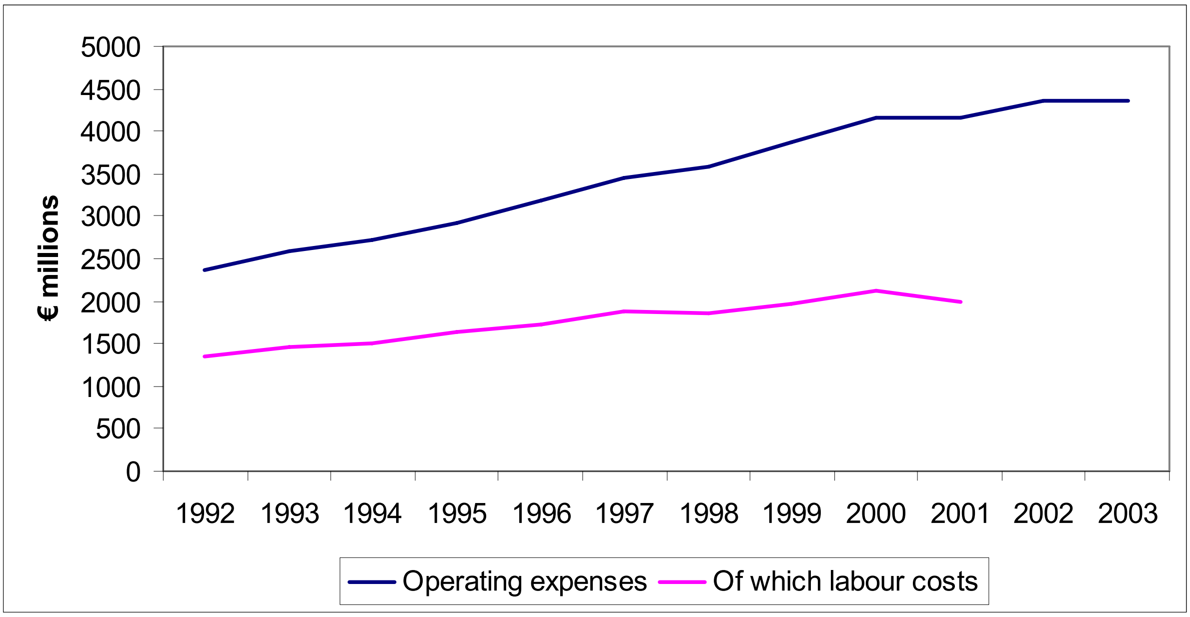
which gives them an unfavorable cost-income ratio (see Figure 2.4). It appears that so far, the FSAP has played a minor negative role in the competitiveness of the Austrian banking market, as it has brought about costs of compliance to its directives.

2.35 Overall, since 1999 the operating costs of Austrian banks have increased. This may be partly attributed to the application of FSAP directives which have partly lead banks to centralize their services and reduce their costs in certain sectors (liquidity management, payment and settlement, and funding structure). Such changes naturally imply more spending for the bank, to restructure and reorganise its activities; however, such costs would only arise at the start, in the relatively short term, because eventually those extra costs will be assimiliated by the banks and the changes will be completed.

2.36 Even though staff costs had followed a slightly increasing trend which could be linked to inflation, they have remained relatively stable.

2.37 Despite the above, since 2001, banks appear to have stablised their operating costs. A possible explanation would be that the first few years of the implementation of the FSAP, Austrian banks had to face compliance costs in addition to other costs of different nature. However, after a few years into the period of implementation of the FSAP, Austrian banks are absorbing compliance costs. Therefore, our view is that so far, the FSAP has had a slightly negative impact on competitiveness because of the compliance cost but in the future, it should have a slightly positive impact since it will increase competition and in turn raise the level of competitiveness.

Figure 2.5: Operating costs of Austrian commercial banks



Source: OECD. 2002–2003 data absent from labour cost series

Employment

2.38 As illustrated in Figure 2.2, regardless of the cyclical changes there has been a general increase in the number of employees in the Austrian banking sector since 1997. It is unclear as to what may have increased the level of employment in the Austrian banking sector. Efforts of the Austrian government have been made to implement the National Action Plan for employment, which may have resulted in the increase since 2004.

Consumer Protection

2.39 The level of consumer protection in Austria is perceived by Austrians to be higher than elsewhere in the developed financial markets of the EU15. Figures from Eurobarometer put customer satisfaction significantly above the average for the EU.

2.40 In a sector which has had a very high level of competition for decades now, prior to the implementation of the FSAP, it is to be expected that consumer protection would be relatively high. Indeed, competing banks in the Austrian banking sector will naturally do their best to remain competitive and therefore offer their clients better 'deals'. In the case of consumer protection in the Austrian banking sector, it is reasonable to say that the FSAP has not had any significant impact.

3 INSURANCE

Factors specific to Austria

3.1 Austria has a generous social insurance system. In the 1990's a new pension system was established which introduced a new category of institutions known as pension companies (Pensionskassen). These joint stock companies complete very similar roles to life insurers. Most of these Pensionskassen are owned by banks or insurers.

3.2 Over the last ten years, the Austrian life insurance sector has followed a rather conservative investment policy with a relatively low minimum guaranteed crediting rate (the interest rate offered on investment type insurance) which in recent years was reduced from 4 per cent to 3.25 per cent.

Features of the industry

3.3 The Austrian insurance sector has achieved a considerable level of stability in its structure and openness. Among the four dominating insurers two are foreign, from EU Member States. However, there is still room for improvement in its stability, structure and openness.

3.4 According to the IMF, the Austrian insurance sector has managed well the recent international and national market slowdowns as well as the catastrophic 2002 floods. According to the same source, the result of all these factors showed:

(a) Strong levels of reserves at the onset of the slowdown;

(b) Reasonably conservative investment in equity, which helped limit the impact of the fall in international equity prices;

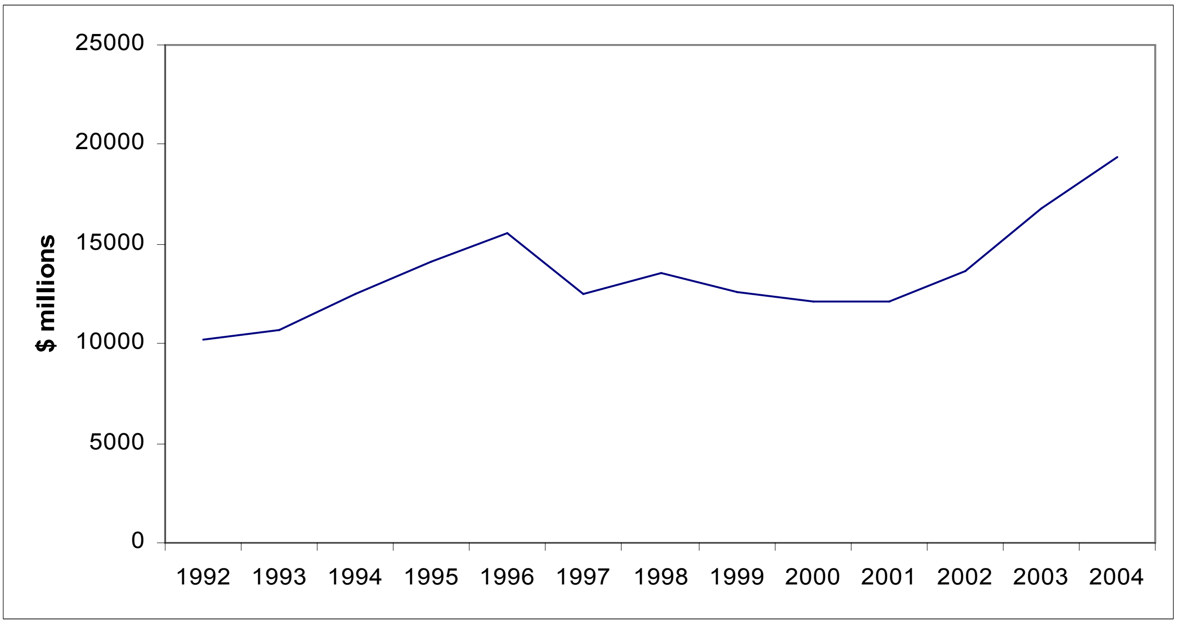
(c) Heavy reliance for non-life insurers on reinsurers, especially for natural disasters; and

(d) Timely reduction in the minimum guarantee rate.

Turnover

3.5 Between 1992 and 2001, the gross premium income did not grow significantly. However, since 2001 the total gross premiums of insurance companies operating in Austria grew by 23 per cent and 15 per cent in 2003 and 2004 respectively.

Figure 3.1: Gross premium income 1992-2004



Source: OECD

3.6 The insurance sector is mainly divided between the life insurance and the non-life insurance.

3.7 The table below illustrates the evolution of life insurance in the insurance sector between 2000 and 2004. It appears that life insurance is not dominating the insurance market, unlike non-life insurance which is dominant.

Table 3.1: Life insurance premium volumes in Austria

	2000	2001	2002	2003	2004
Premium level (€ millions)	5388	5785	5650	5705	6188
Share of total business (%)	42.3	46.9	44.7	43.9	44.2

Source: Swiss Re

3.8 Non-life insurance was the major contributor to this growth. Since 2000 the level of premiums has steadily grown, except for 2004 which saw a minor decrease of 0.3 per cent.

3.9 Since the profitability of non-life insurance gross premium depended less on the returns from investments, the development of non-life insurance premiums was more constant.

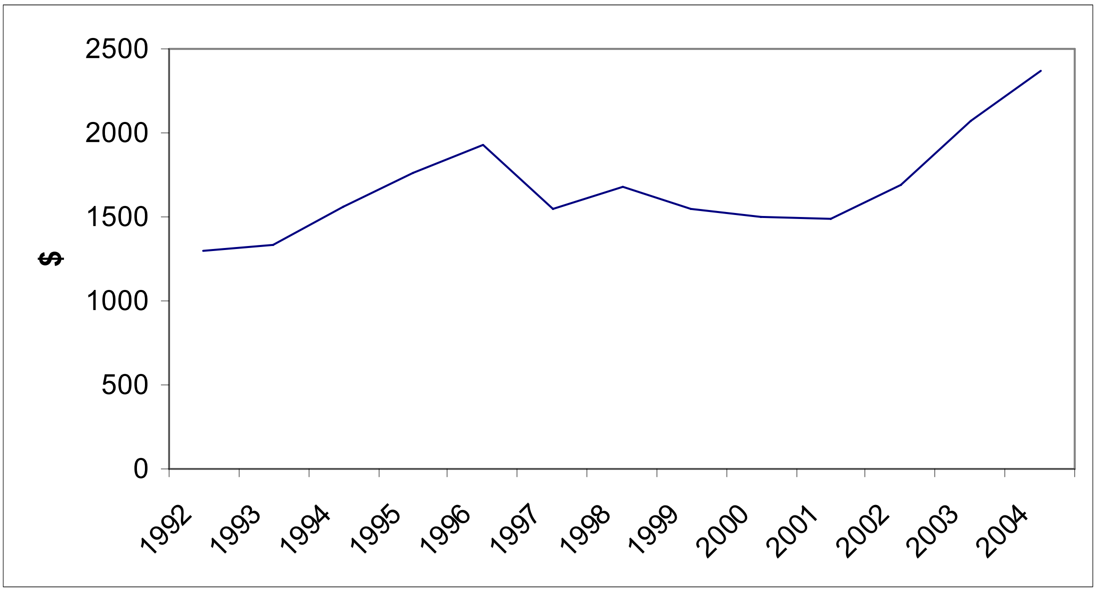
Table 3.2: Non-life insurance premium volumes in Austria

	2000	2001	2002	2003	2004
Premium level (€ millions)	6268	6561	6997	7424	7801
Share of total business (%)	51.1	53.1	55.3	56.1	55.8

Source: Swiss Re

3.10 After a slow down and a slight decrease between 1998 and 2001, the Austrian insurance industry witnessed a significant increase in its density after 2001.

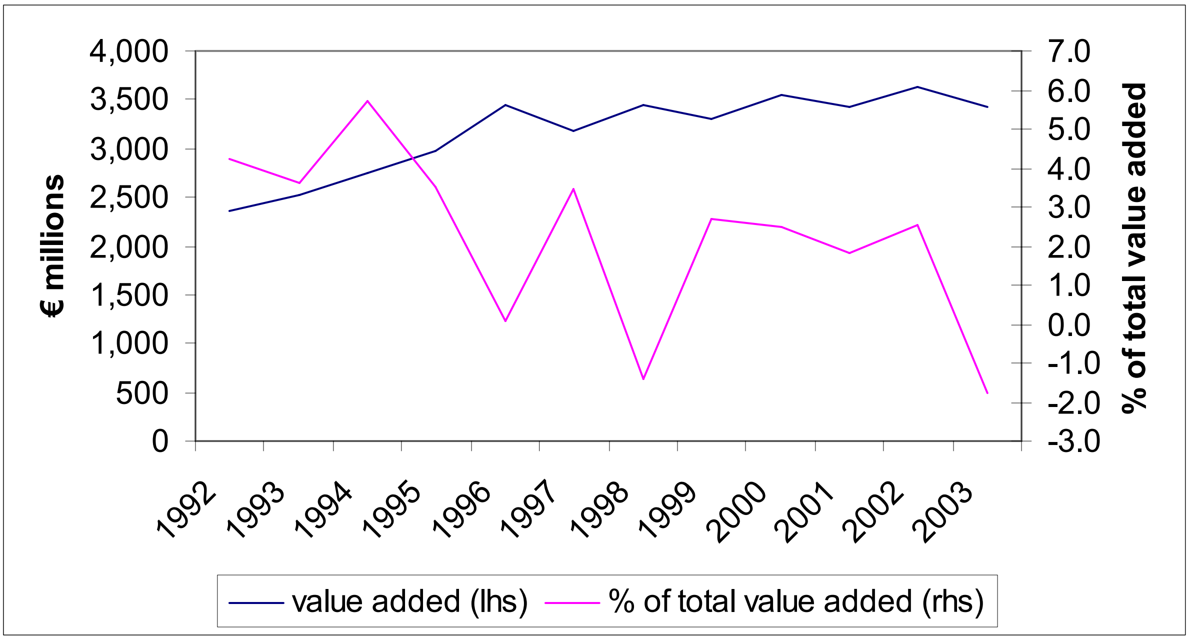
Figure 3.2: Insurance density (gross direct premiums/population)



Source: OECD

3.11 Despite the cyclical variations, overall, the value added of the Insurance and Pensions sector has been increasing since 1992.

Figure 3.3: Value added of the insurance and pensions sector



Source: University of Groningen

Table 3.3: Investments of Austrian Insurance companies (€ millions)

	2003	2004
Life enterprises	6284	58404
Non-life enterprises	6949	12643
Composite enterprises	52424	6424
Total	65656	77471

Source: CEIOPS, Annex 2005 Report

3.12 Profit/loss in life, non-life insurance and composite enterprises for 2003 and 2004 are represented in the Table 3.4.

Table 3.4: Insurer results (€ million unless otherwise stated)

Year	Life enterprises			Non-life enterprises			Composite enterprises		
	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/ loss by balance sheet assets
2003	11	6104	0.18%	13	6602	0.20%	86	50818	0.17%
2004	210	49235	0.43%	268	19287	1.39%	-	-	-

Source: CEIOPS, Annex 2005 Report

3.13 According to the IMF[1] report, although in recent years the Austrian insurance industry has shown a satisfactory performance relative to other developed countries, it seems to suffer from a reduced safety cushion. With new financial pressures, life sector margins have been reduced.

Market participants and market shares

3.14 The Austrian insurance sector contains a diverse range of insurance companies which includes life, non-life, composite and reinsurance enterprises. The non-life and composite insurers represent the largest sector, with 84 per cent of the national enterprises. Reinsurance is the smallest sector by number of companies.

Table 3.5: Number of insurance companies (2004)

	Life enterprises	Non-life enter.	Composite enter.	Reinsurance enter.	Total
National enterprises	5	16	28	3	52
Branches of third (non-EU/EEA) countries	0	2	0	0	2
Branches in EU/EEA countries	0	3	3	0	6
Branches of EU/EEA countries	5	15	0	1	21
Branches in third (non-EU/EEA) countries	0	0	0	0	0

Source: CEIOPS

3.15 The table above illustrates the number of insurers in Austria. More than 28 per cent of the insurance companies are international. Also, more than 7 per cent of the national enterprises have branches in the EU/EEA. This was made possible through the EU's single passport system. With this system, any European company may operate in another EU country while remaining subject to the control of their own regulatory authorities. Having said that, companies still need to notify the authorities of the country in which they are establishing a branch.

3.16 The largest Austrian insurers are Allianz, Generali, Wiener Staedtische (which is part of the Vienna Insurance group since 2006) and UNIQA. Allianz and Generali are both subsidiaries of foreign owned companies.

3.17 Overall, foreign presence is relatively high in the Austrian insurance sector, and it appears to be still increasing.

3.18 According to the IMF, the Austrian insurance sector is well developed. Its level of insurance premium per capita is ranked 12th highest in the world. Even though the non-life sector is mature, the life insurance penetration remains relatively low, at 2.75 per cent in 2001. Insurance penetration is the level of insurance used in an economy[2].

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1 IMF report, 2004, Austria: Financial System Stability Assessment

2 As measured by total insurance premiums collected by the insurance market divided by Gross Domestic Product (GDP).

Employment

3.19 In 1999, the Austrian Federal Government, acting in cooperation with both sides of the industry, presented a National Employment Action Plan, in agreement with the priorities set out at the Luxembourg Employment Summit. The suggested measures were aimed at increasing employment by 100,000 jobs and reducing the unemployment rate to approximately 3.5 per cent by the end of 2002.[3]

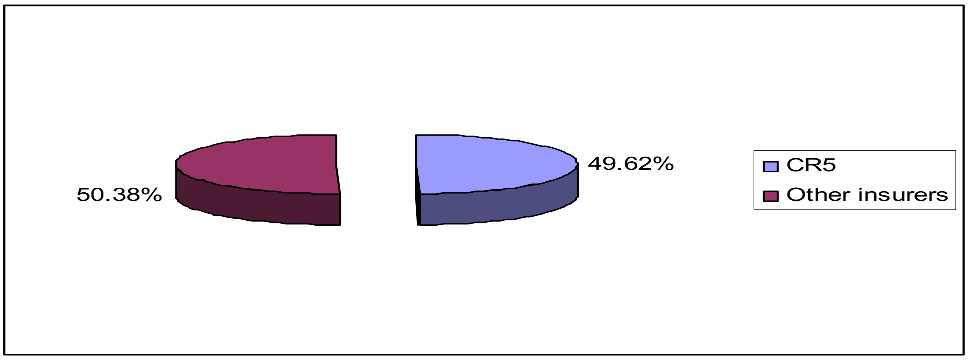
Competition

3.20 The market share among the four biggest insurers in the Austrian insurance market is very different depending on the nature of the insurance. Indeed, there is a major difference between the life insurance and the non-life insurance industry.

3.21 As illustrated in the figures below, the five major companies in life insurance hold 49.62 per cent of the life insurance market. Where as the four largest companies in non-life insurance hold 83.69 per cent of the non-life insurance market.

3.22 The market shares in the non-life insurance sector do not necessarily imply that the level of competition is low, or that there is collusion. Indeed, the presence of many other insurance companies as well as the threat of contestability may put matters into perspective for insurers and dissuade any collusion or uncompetitive behaviour.

Figure 3.4: Concentration ratio 5 in the Austrian life insurance industry (2005)



Source: Lorenz Jedlicka, Adusei Jumah "The Austrian Insurance Industry: A Structure, Conduct and Performance Analysis"

3.23 The 49.62 per cent market share for the concentration ratio of the five largest insurance companies in Austria implies that the Austrian life insurance industry is characterised by normal concentration within the EU15, with a significant number of firms.

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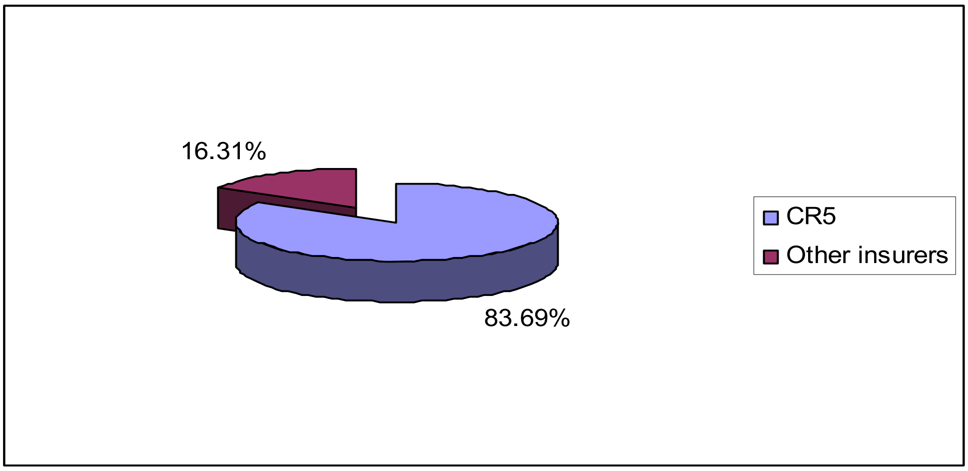
3 We were not able to find relevant data on employment in the Austrian insurance sector. The OECD data showed an increase of 60 per cent, in the level of employment in the Austrian Insurance sector, in one year between 2001 and 2002. Such an increase is implausible and indicates to us some change in definition or other such issue.

Figure 3.5: Concentration Ratio 5 in the non-life Austrian insurance industry (2005)



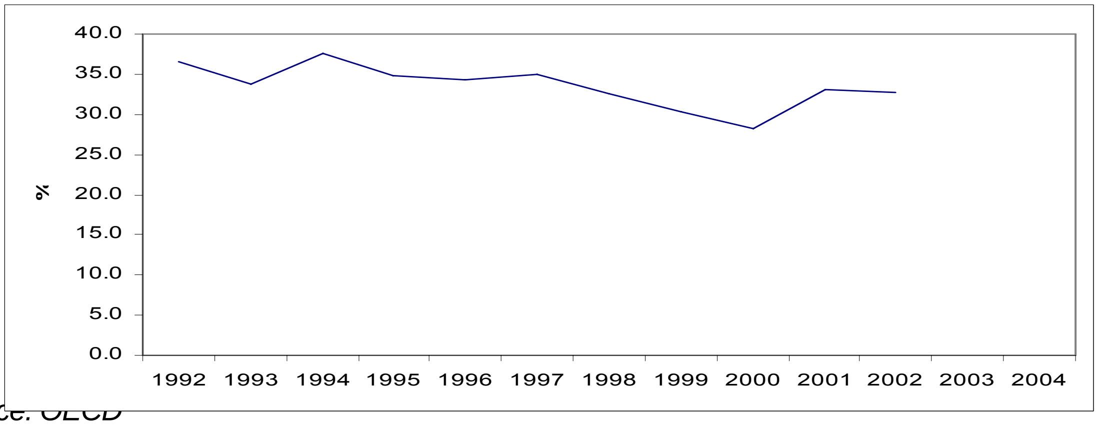
Source: Lorenz Jedlicka, Adusei Jumah "The Austrian Insurance Industry: A Structure, Conduct and Performance Analysis"

International trade

3.24 As previously noted, out of the four largest insurers in Austria, two are foreign. Furthermore, 28 per cent of the insurance companies are foreign and more than 7 per cent of the national enterprises have branches in the EU/EEA.

3.25 There is no reason to believe that this trend will not develop, since the harmonization of the European insurance market as well as globalization will naturally encourage international trade.

Figure 3.6 : Market share of branches/agencies of foreign undertakings as a % of total domestic business



Source: OECD

Competitiveness

3.26 Despite some cyclical variations, productivity has been increasing since 1999. There is no reason to believe that this trend will not be maintained. Indeed, an increasingly open European insurance market should naturally increase openness to foreign firms and therefore competition, which in turn should make companies that wish to remain in the insurance market, more competitive.

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[4] The OECD has no observations for 2003 on.

Figure 3.7: Productivity per employee in the Insurance and Pensions sector

Source: University of Groningen

Impact of the FSAP and FSWP Legislative Measures on the Austrian Insurance Sector

Market entry, cross-border business and takeovers

3.27 From the information gathered previously we cannot make definitive judgements about the level of impact the FSAP has had on the Austrian openness of the insurance sector to foreign firms. However, the recent cross-border consolidations involving major companies hint at the further opening of the Austrian insurance market. Indeed, similarly to the banking sector, in recent years there has been an increase in cross-border activity. Such an increase may be partly related to the implementation of the FSAP which has had a positive impact on the harmonization of financial services across the EU Member States.

3.28 Furthermore, as previously mentioned, Austrian insurance companies are penetrating foreign EU markets. Such internationalisation can be partly regarded as a result of the harmonization of the European markets through the implementation of the FSAP.

3.29 Therefore, our judgement is that the FSAP is likely to have had a slightly positive impact on the openness of the Austrian insurance market to foreign firms.

3.30 Interestingly, respondents to our survey were of the view that the FSAP “created legal certainty to operate in other countries”.

Competition

3.31 The results of the paper “Production efficiency in the Austrian Insurance Industry: A Bayesian Examination” by Ennsfelher, Lewis and Anderson, suggest that the life and non-life companies were less efficient between 1994 and 1996 and significantly more efficient between 1997 and 1999 as a result of the deregulation of the EU market. The FSAP, which is considered as further deregulation of the European financial services market, appears to have partly had a positive impact on the level of competition in the Austrian insurance market.

3.32 Indeed, we argued above that the implementation of the FSAP has positively influenced the degree of openness of the Austrian Insurance market and enhanced cross-border activity. Although national competition was already very present prior to the implementation of the FSAP, we may conclude that as a result of foreign and national competition and the threat of contestability, the level of competition in the Austrian insurance market has further increased. But, in an already very competitive environment it is unclear that this change should be considered material.

3.33 Furthermore, the internationalisation of Austrian insurers characterised by their penetration of foreign EU insurance markets, and more so in Central and Eastern European markets, may also be a sign of increasing openness of the EU insurance market, perhaps partly as a result of the implementation of the FSAP.

Competitiveness

3.34 The FSAP may have had a slightly positive effect on competitiveness in the Austrian Insurance sector as greater exposure to foreign techniques may have lead to cost-reducing innovation.

Employment

3.35 The information we have is not sufficient to establish any link between the implementation of FSAP directives and the level of employment.

Consumer protection

3.36 An increase in the level of competition and competitiveness would naturally increase consumer protection. More competitive firms are bound to offer clients better services or products. As a result, clients will be better protected from abusive practices from companies. Indeed, it is in the companies' best interest not to have abusive practices when faced with competition, if they wish to remain in the market, because disappointed clients will easily switch to companies that will provide them the same service without having abusive practices. In the case of the Austrian insurance sector, although it is not obvious that the FSAP has had a significant impact on competition, it does appear to have had a positive impact on the level of openness and on competitiveness. Therefore, if the FSAP has slightly increased openness and competitiveness in the Austrian insurance sector, it should logically have also slightly increased consumer protection in the Austrian insurance market.

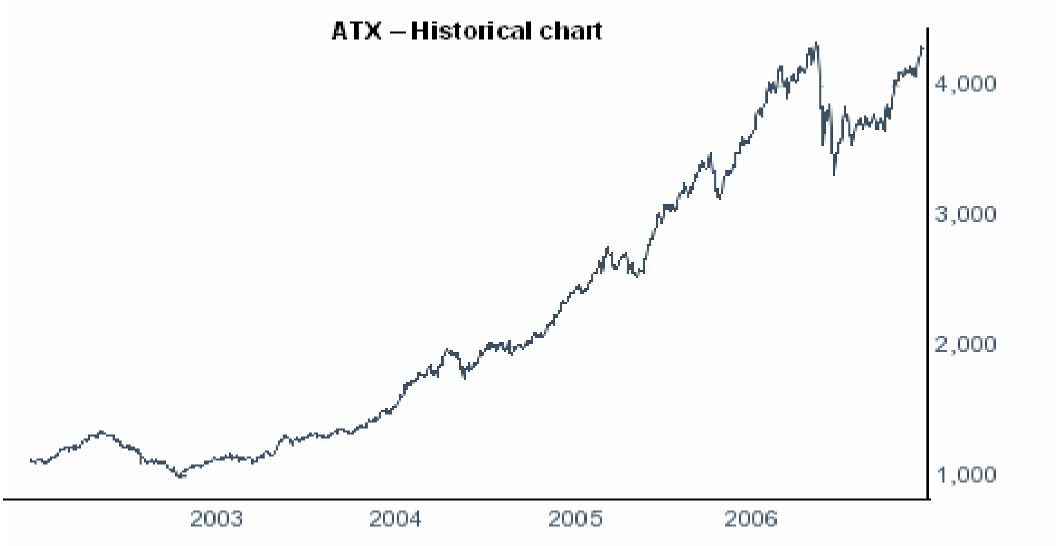
4 SECURITIES MARKETS

Austrian Securities Markets

4.1 The main exchange in Austria is the Vienna Stock Exchange (Wiener Börse). Originally, the Austrian Traded Index was meant to accomplish the descriptive and operative functions of a representative stock market index. In December 1997, the stock exchange was merged with the futures exchange Österreichische Termin und Optionboerse (ÖTOB), forming the new exchange operating company, Wiener Börse AG.

4.2 The main Vienna Stock Exchange index is the ATX which stands for Austrian traded index. It reflects the variations in price that are caused by market fluctuations. It also documents the price dynamics of the most liquid market segment of Austrian stocks. Furthermore, it serves as an underlying for futures and options contracts. The ATX tracks the market performance of the top 20 and most actively-traded stocks on the exchange.

Figure 4.1: Austrian stock market indices, 2002-2006



Source: Wiener börse

4.3 In 1995, the ATX became the heart of the newly established ATX-family which includes the following:

(a) ATX, (the Austrian traded index documents the price dynamics of the most liquid market segment of Austrian stocks)

(b) ATX 50,

(c) ATX 50 Performance Index (ATX 50P), and

(d) ATX-MidCap (Austrian Futures and Options Exchange, 1995b).

4.4 The ATX 50 and the ATX 50P represent the portfolio of all investible Austrian stocks. Both indexes cover the ATX stocks as well as the following most attractive stocks. The 50 stocks included in the indexes represent 81 per cent of the total capitalization of the official market segment and 97 per cent of total stock market turnover. The ATX-MidCap index sample integrates the ATX 50 sample minus the ATX sample minus all stocks with a market capitalization exceeding ATS 7.5 billion.

4.5 In 2002, a new market segmentation was introduced and the prime market emerged. As a result, transparency and liquidity on the Vienna Stock Exchange significantly improved. Indeed, compliance with more rigorous criteria for the prime market (i.e. in accordance with IFRS or US-GAAP) led to higher disclosure requirements and free float.

4.6 In March 2002, the Energy Exchange Austria (EXAA) was established and electricity became tradable. The Austrian stock exchange played a major role in the establishment of a platform for trading in energy products.

4.7 The 2002 international market slowdown did not affect the Austrian stock exchange. On the contrary, after 2002, investors started looking into smaller stock exchanges.

4.8 Initial public offerings, privatisations and capital increases led to the rise of market capitalization in Austria. Moreover, after the EU enlargement, Austrian companies strengthened their position in Eastern Europe which has positively influenced price trends of ATX stocks. As a result, Wiener Börse started attracting more domestic and foreign investors.

4.9 In 2004, a majority stake in the Budapest Stock Exchange was acquired by HVB (Hypo Vereinsbank) Hungary, Wiener Börse AG, Erste Bank, RZB (Raiffeisen Zentralbank Österreich) and ÖKB (Österreichische Kontrollbank Aktiengesellschaft). This lead to the foundation of a network of exchanges, which has steadily developed. It now incorporates cooperation agreements with many East European exchanges. Indeed, Wiener Börse has links with eight Southeast European exchanges, including: Bucharest, Zagreb, Belgrade, Sofia, Sarajevo, Montenegro, Banja Luka and Macedonia.

4.10 The expansion of the Austrian capital market was illustrated by the 2000 point mark the ATX reached for the first time in July 2004, followed by the 3000 point mark reached in June 2005 and the 4344 points in May 2006.

4.11 In 2005, a product cooperation between the Shanghai Stock Exchange and Wiener Börse was reached. This was a worldwide first. By the end of that year, the two exchanges went ahead with the joint publication of the China Traded Index (CNX). Also, the share of foreign investment firms in trading on Wiener Börse had grown by 50 per cent.

4.12 One of the most important directives from the EU is the Markets in Financial Instruments Directive (MiFID), which is expected to come into force in November 2007. This directive will place extensive demands on securities institutions active within the EU, for example regarding the obligation to report completed securities transactions to the respective supervisory authorities. MiFID is also intended to create competitive neutrality between various trading forms, as well as to secure efficient and transparent securities trading.

Impact of the FSAP and FSWP Legislative Measures on the Austrian Securities Market

Cross-border activities

4.13 The foundation of a network of exchanges which now incorporates cooperation agreements with many East European exchanges is believed to have already laid the foundations for further integration, independently from the implementation of the FSAP. However, the FSAP may help Wiener Börse expand into other European countries.

4.14 Arguably the most important point of the MiFID is the expansion of cross-border activities to create a well-functioning single European market for securities.

4.15 Our econometric study suggests that the impact of the FSAP on trade (to mid 2006) has been a rise of 2.2 per cent in securities (imports increased by 1.8 per cent and exports by 2.2 per cent). Thus, the FSAP has had a relatively small, but nonetheless, positive effect in increasing the openness of the sector. Full implementation of the FSAP is projected to lead to a further 1.2 per cent rise (imports to rise by 1.0 per cent and exports by 1.3 per cent).[5]

Competition

4.16 Further openness of the Austrian securities market to foreign firms should naturally enhance the level of competition in the market, due to the increase in the number of competing firms and the threat of contestability. Therefore, since we have established that the FSAP has had a slightly positive impact on the openness of the Austrian Securities market to foreign firms, our view is that it has also had a slightly positive impact on competition in that market.

4.17 The MiFID (soon to be implemented) is likely to expose the Austrian securities market to more competition, which in turn is likely, over time, to decrease transaction costs and thus enhance competitiveness in the Austrian securities market. Therefore, the FSAP is likely to have a positive impact in the future on competitiveness in the Austrian security sector.

Competitiveness

4.18 An increase in competition should lead to higher competitiveness on the Austrian securities market. The same reasoning as above applies in this case. Indeed, since we have established that the FSAP has had a slightly positive impact on competition, we may conclude that it has also had a slightly positive impact on competitiveness in the Austrian securities market.

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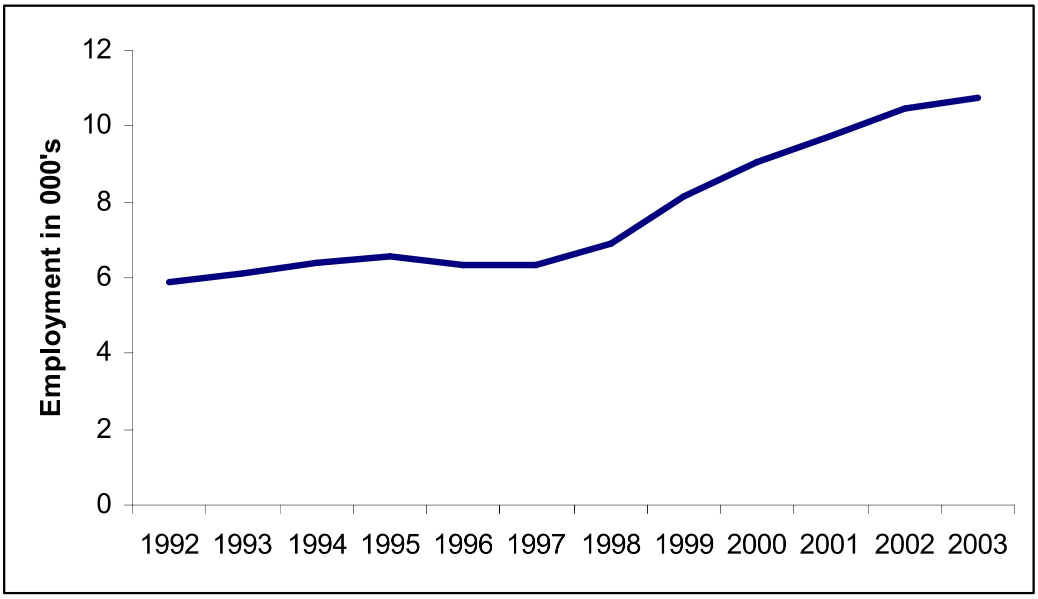
[5] Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

Employment

Figure 4.2: Employment in the activities auxiliary to financial intermediation



Source: University of Groningen

4.19 If the aim of the FSAP of de-segmenting the EU market is achieved, and if (as a result) Wiener Börse expands, then in the short term, the level of employment in the Austrian securities market should rise slightly. Therefore, our view is that the FSAP may have had a slightly positive impact on the level of employment in the Austrian securities market.

4.20 In the long term, the MiFID (with respect to systematic internalising) is likely to create a tendency for securities related jobs to migrate particularly to London, because of its head-start in such activities. On the other hand, a portion of the expected general expansion of the European securities markets might also increase the aggregate level of employment in the Austrian securities market.

Consumer Protection

4.21 Consumer protection issues are of relatively limited importance in the securities market. Indeed individuals involved in it are specialised and experienced, and are therefore more aware of their rights and of the way the market works, unlike in other financial sectors. Therefore, since so far the agents involved in the securities market are limited to specialised and experienced individuals, the short-term impact of the FSAP on consumer protection in the Austrian securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Austrian securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

4.22 Due to the dynamism of the securities markets, because of the nature of its activities, which in essence, involve international trading, the benefits of cross-border trade had been reaped independently of and in advance of the FSAP. The full implementation of the FSAP is important to maintain, develop and regulate the cross-border security trade, to ensure a sufficient degree of competition.

4.23 Respondents of the survey thought that trade on the home stock exchange will further decrease due to the FSAP. It seems that cross-border trade may have increased. Additionally the respondents attributed some of the increase in electronic trading to the FSAP.

5 FINANCIAL CONGLOMERATES

Table 5.1: Financial conglomerates operating in Austria

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
ABN AMRO	Netherlands	Banking	Banking
Allianz	Germany	Insurance group with asset management and banking	Insurance with some banking
Barclays	UK	Banking with insurance	Banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Securities
Fortis	Belgium	Banking with insurance	Banking
Gruppo Banca Intesa	Italy	Banking	Banking
Mediolanum	Italy	Pensions, investments, loans, banking, insurance	Investment banking
Old Mutual	UK	Asset management, life assurance, banking, offshore trust and company services	Banking and insurance
RBS	UK	Banking firm with insurance	Banking
Societe General	France	Corporate and investment bank	Investment banking with some securities
Standard Life	UK	Banking firm doing investments and pensions	Banking
Svenska Handelsbanke n	Sweden	Banking with insurance	Banking

Source: EU Mixed Technical Group on Supervision of Financial Conglomerates, Europe Economics

Impact of the FSAP and FSWP Legislative Measures on the Austrian Financial Conglomerates

Openness

5.1 We have seen that the entry by banks into Austria has been slightly positively affected, and that openness in the insurance sector has probably increased. In addition, the FSAP measures for regulation of Financial Conglomerates should create a more standardized regulatory environment, reducing costs of compliance for large firms operating across multiple jurisdictions.

5.2 Further, we should, in general, expect a programme such as the FSAP to be of greater short-term benefit to existing larger players than smaller players, since larger players will more obviously gain from a standardized cross-border environment.

5.3 Since our previous assessment on the impact of the FSAP in the banking and insurance sector was slightly positive, and since the financial conglomerates in Austria are dominated by banking, our assessment is that the FSAP will slightly encourage greater openness.

Competition

5.4 We have seen that competition is expected to be slightly enhanced in both banking and insurance, and this can be expected to apply to financial conglomerates as well, since the activity in the Austrian financial conglomerates is significantly focused on banking.

Consumer protection

5.5 Effects on consumer protection in both banking and insurance are expected to be slightly positive. Therefore, since the financial conglomerates are a combination of those sectors, and predominantly banking, then we may establish that the FSAP has had a slightly positive impact on consumer protection in financial conglomerates.

Employment

5.6 We assess the effects on employment in both banking and insurance sectors as unclear.

5.7 The view of respondents to our survey was that the FSAP will contribute to a growth in the number of jobs in financial conglomerates. However, our own view is that, since conglomerates mainly incorporate elements of banking, we assess the net effect as unclear in the short term. The respondents to our survey may have not distinguished the effects of the NAP from the impact of the FSAP when drawing their conclusions about the impact of the FSAP on the level of employment in the banking and insurance sector.

Competitiveness

5.8 As pressures of competition from abroad and domestically are expected to be increased by the FSAP, we would expect this to lead to greater competitiveness of Austrian conglomerates.

6 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Employment**	**Competitiveness**
Banking	Slightly positive	Negligible	Negligible	Unclear	Slightly negative in short term, perhaps positive in the long term
Insurance	Slightly positive	Negligible	Slightly positive	Unclear	Positive
Securities	Slightly positive	Slightly positive	Limited in short term, perhaps positive in the long term	Slightly positive	Slightly positive
Financial Conglomerates	Slightly positive	Slightly positive	Slightly positive	Unclear	Slightly positive

BELGIUM

1 INTRODUCTORY OVERVIEW

Introduction

1.1 In Belgium, both the banking and insurance sectors have been the subject of consolidation. An interesting feature of this consolidation has been the number of cross-border mergers, especially between Belgian, French and Dutch companies. This is perhaps not surprising when one takes into consideration the geographical location of Belgium. There are now few completely “domestic” Belgian firms in the financial services sector.

1.2 The most popular financial services model remains bancassurance, where one company offers a range of financial services including insurance, banking and even in some cases, brokering.[6] In response to the increasing blur in the insurance and banking sector, the Belgian authorities created a unified financial services authority to regulate the sector. Indeed, a number of existing, traditional, categorisations in the financial services sector are no longer sustainable due to market developments and global trends.

1.3 One of the main changes in the sector has been the shift from a bank-based system of finance to a more varied one.

Financial Services regulation in Belgium

Division of responsibility

1.4 In response to the rise in the number of financial conglomerates, the existing regulators for the banking sector and the insurance sector were merged at the start of 2004 into the Banking, Finance and Insurance Commission (CBFA). The new authority has a wide remit which covers a number of financial sectors including:

(a) Credit institutions;

(b) Investment firms;

(c) Public issues and take-over bids;

(d) Insurance companies and intermediaries; and

(e) Financial markets.

1.5 The CBFA also has responsibility for consumer protection. The most relevant piece of legislation is the Law on the Supervision of the financial sector and on financial services (2002).

[6] The bancassurance model can take many forms. They may be in the form of a distribution agreement between banks and insurers; a strategic alliance between different financial entities; a joint venture where both companies pool capital and share responsibilities; and full integration into a financial conglomerate.

1.6 The other main state actor is the National Bank of Belgium (NBB). Despite not having a formal role in financial sector regulation and supervision, the NBB remains an important source of information for markets. It also requires the submission of annual accounts from domestic firms, which it in turn makes available to selected third parties. Additionally, the NBB administers a settlement system for securities.

1.7 In the language of regulation, the Belgian style can be described as a system of direct, rules-based regulation. This limits the discretion of financial institutions by explicitly prescribing what is permissible. In an ever-changing environment this approach requires constant "fine-tuning" to remain in touch with market realities.

Stakeholder views about FSAP implementation

1.8 Generally the respondents to our survey provided a positive feedback. Many thought that a general conclusion on the costs and benefits can only be drawn when all measures are implemented but that the consultation process was very effective. Critical points mentioned were:

(a) The timetable was ambitious leaving national regulators not much time for implementation.

(b) Steps 2 and 3 of the Lamfalussy procedure had already an excessive level of detail leaving not enough room for the next steps of consultation.

(c) The timeline of implementation in the different Member States created inequalities.

We understand these comments as indicating a concern that in the FSAP too many measures have been introduced too quickly, thereby creating a risk of regulatory fatigue.

2 BANKING

Headline overview

Specific Facts in the Belgium Banking sector

2.1 In order to attract the finance centres of multinational companies, the Belgian Government established financial incentives in the form of favourable tax treatment to entities known as co-ordination centres. Up to 2003, such co-ordination centres benefited from fiscal advantages as follows:

(a) "Corporate Income Tax on Profits". Co-ordination centres were taxed between four and ten per cent of their total "business expenses" instead of being taxed on their trading profits.

(b) "Withholding taxes". Co-ordination centres benefited from the absence of a withholding tax levy in their activities, which was a significant concession.

(c) "Share Capital Duty". Co-ordination centres did not have to pay any capital duty on any increase of share capital.

(d) "Real Estate taxes". Co-ordination centres did not have to pay real estate taxes. This gave them a considerable advantage over other corporate entities in Belgium.

(e) "Corporate Income Tax on Ongoing Dividends." Five per cent of the dividends sent from co-ordination centres to Belgian corporate shareholders are taxed at 33.9 per cent. A Belgian corporate shareholder would not be taxed on dividends received unless that shareholder held five per cent or more of the share capital of the co-ordination centre.

(f) "Work permits and Special Income Tax Allowance". Non-national executives and researchers working for co-ordination centres were not required to obtain work permits. They also benefited from different income tax rates and concessions.

2.2 According to the City Monitor Annual Survey (Cushman and Wakefield, 2004), in 2004, Brussels was the fourth most important European business city. Furthermore, more than 1600 foreign companies had bases in Brussels, including giants such as Coca-Cola, IBM and Toyota. The tax incentives attracted many European as well as non-European foreign companies wishing to establish their headquarters in the EU.

2.3 After a case in the European Court of Justice, in 2004 the Belgian authorities put the co-ordination centre regime in line with the EU directives. The development of coordination centres has been affected more by tax harmonisation than by the FSAP.

Comparison with other EU states

2.4 Another prime example of a preferential tax regime has been the Irish International Financial Services Centre, established under the Finance Act 1987. This has proved to be the successful centrepiece of the Irish Government's appeal to the international financial community over the past decade. The fiscal advantages offered by the IFSC included:

(a) Corporation tax at 10 per cent on trading profits.

(b) A 10 year exemption from municipal taxes.

(c) No withholding taxes on dividends or interest.

(d) Double rent allowances for leased property.

2.5 While its original purpose has now largely disappeared now that the overall 12.5 per cent corporation tax is effective in Ireland (2003), Dublin's IFSC has developed into a significant world financial centre largely due to the stimulus afforded by the availability of the aforementioned fiscal advantages.

Number of players

2.6 The Belgian banking sector is highly integrated with the wider European banking sector. In response to the changes in market conditions, a number of mergers were finalised, many of which were of cross-border nature. In 1997, Internationale Nederlanden 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). Such a high level of integration has led the sector to become dominated by a number of Belgian-Dutch and Belgian-French banking groups.

Table 2.1: Number of banks based in Belgium

	Banks governed by Belgian law			**Banks governed by foreign law**			**Total**
	Belgian majority interest	**Foreign majority interest**	**Total**	**EU**	**Other countries**	**Total**	
1990	85	37	122	20	15	35	157
1995	66	38	104	24	16	40	144
1999	47	28	75	30	14	44	119
2000	44	28	72	34	13	47	119
2001	38	29	67	35	11	46	113
2002	36	29	65	36	10	46	111
2003	34	27	61	38	10	48	109
2004	33	26	59	36	9	45	104

Source: ABB-BVB

2.7 As the above table shows, the number of Belgian banks (in terms of majority shareholding) has been steadily declining since the mid-1980s. It is instructive to note that the number of banks has increased steadily throughout the period, but particularly after the early 1990s, perhaps reflecting the introduction of the EU single passport under the ISD.

2.8 A number of in-house banks of multinational companies acting as co-ordination centres for foreign banks operate in Belgium. For example, Volkswagen and Caterpillar Finance France both have banking subsidiaries in Belgium for their treasury management operations.

2.9 Despite the decline in the overall number of banks, it has been argued that Belgium remains over-banked when considering the number of banks and the number of branches. This may also be a factor in the Belgian banking sector's lower-than-average profit rates.

2.10 The leading Belgian banking groups by balance total are: Fortis Group, DEXIA Group (Crédit Communal, Crédit Local France and ARCOFIN), KBC Bank and Insurance Holdings, ING Group and AXA Group. All the major banking groups offer both retail and wholesale banking functions. In addition, they have links to insurance, brokering and factoring companies — the bancassurance model.

2.11 The close proximity of Luxembourg to Belgium means that a number of Belgians use Luxembourg's banking facilities. However, this can be classed as tax evasion under Belgian law.

2.12 Apart from banking groups there are a number of other institutions that offer similar services in Belgium. Through its Participate Fonds, the Government provides subsidies for low-cost loans to micro-enterprises. Though no longer a Government entity, the Post Office Bank is a significant player in the retail, small business and insurance sectors.

Turnover, employment and profitability

2.13 Bank typology is enshrined in Belgian legislation.[7] Domestic banks are divided into four categories: commercial, savings, securities and local-authority savings banks. In practice, the categories are not exclusive, and the distinction between the first two in particular has become increasingly blurred.

2.14 In recent years, Belgium's banking sector has witnessed a period of consolidation after a decade of extensive restructuring. The 1990s saw major structural changes, including liberalisation measures, privatisations, de-mutualisations, cross-border mergers, and the rise of bancassurance and entry of foreign banks. The sector has seen the decline in foreign exchange activity following the introduction of the euro. An additional pressure affecting profitability was the need of Belgian banks to invest in new technologies in response to the dot.com boom.

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7 Law of 22 March 1993 – subsequently amended.

2.15 The State has largely withdrawn from the banking sector. It now has only an indirect role in the sector via the supply of mortgages to low income groups. Globalisation forced a shift away from traditional intermediation activities towards greater involvement by Belgian banks in market financing. However, after these changes, in recent years the sector has enjoyed stability and profitability.

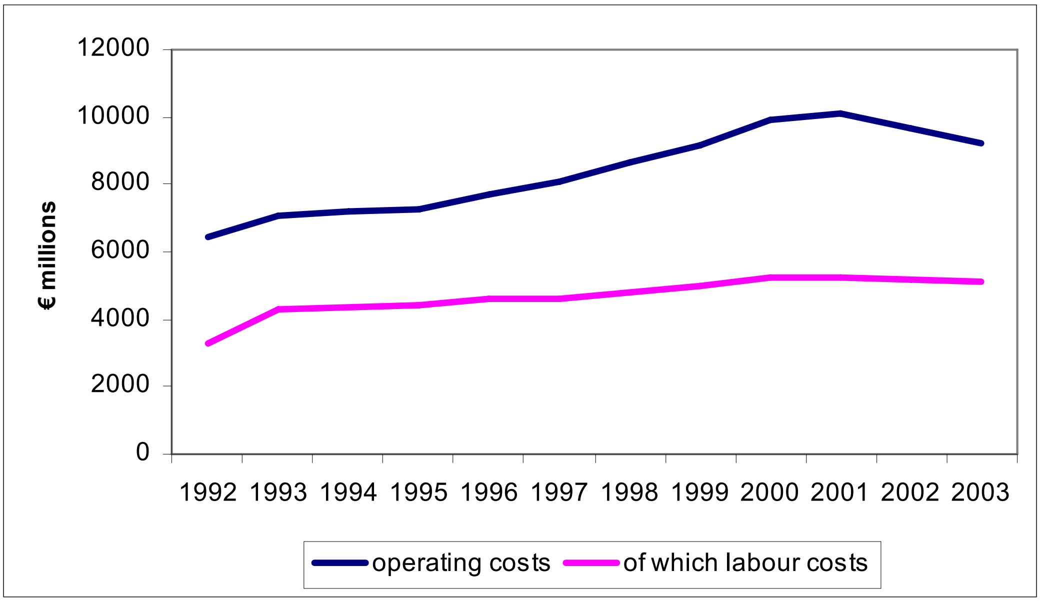
Table 2.2: Belgian bank profitability (€billion)

	1997	1998	1999	2000	2001	2002	2003
Financial intermediation	8.5	9.0	9.4	8.1	8.2	8.3	8.5
Other	4.8	6.3	5.7	8.9	8.5	7.2	6.8
Total	**13.3**	**15.3**	**15.1**	**17.0**	**16.7**	**15.5**	**15.3**

Source: ABB-BVB

2.16 The average profitability of banks stood at 9.77 per cent (2004) according to ABB-BVB. This is lower that the EU25 average of 12.21 per cent (ECB).

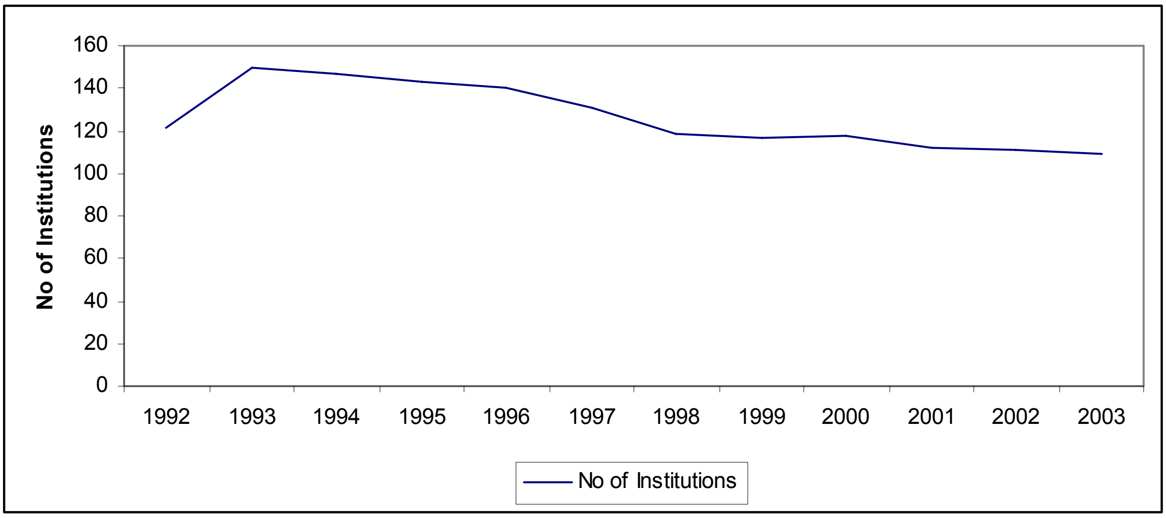
Figure 2.1: Operating and labour expenses



Source: OECD

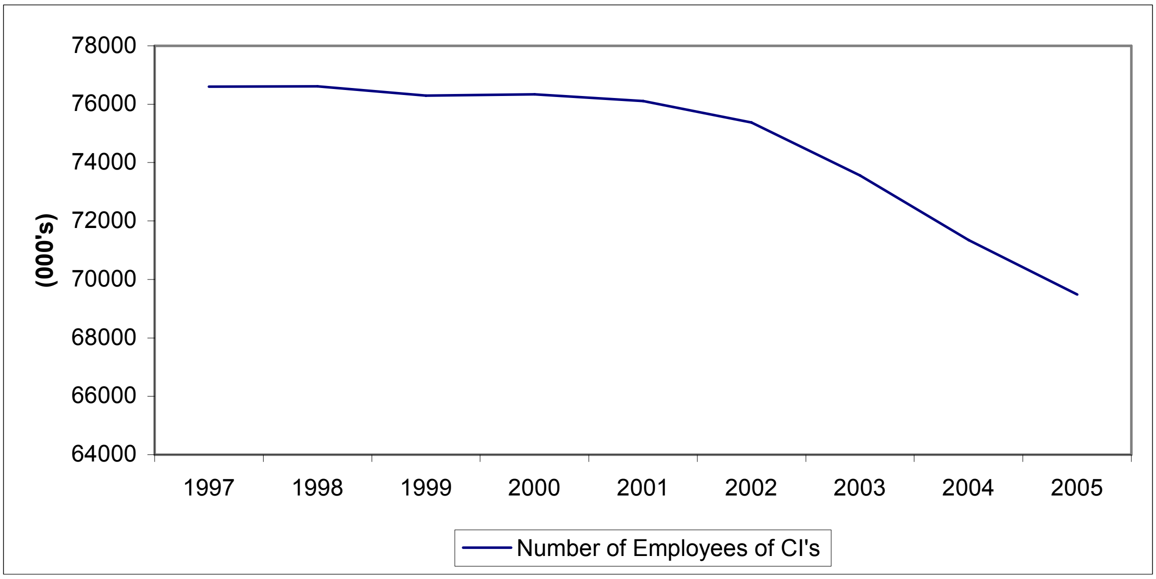
2.17 The sector employs over 70,000 employees representing 4 per cent of the country's total workforce. Per 100,000 inhabitants the Belgium banking sector employs over 700 employees, which is very close to the EU15 average.

Figure 2.2: Number of credit institutions in Belgium



Source: OECD

Figure 2.3: Employment in the credit institution sector

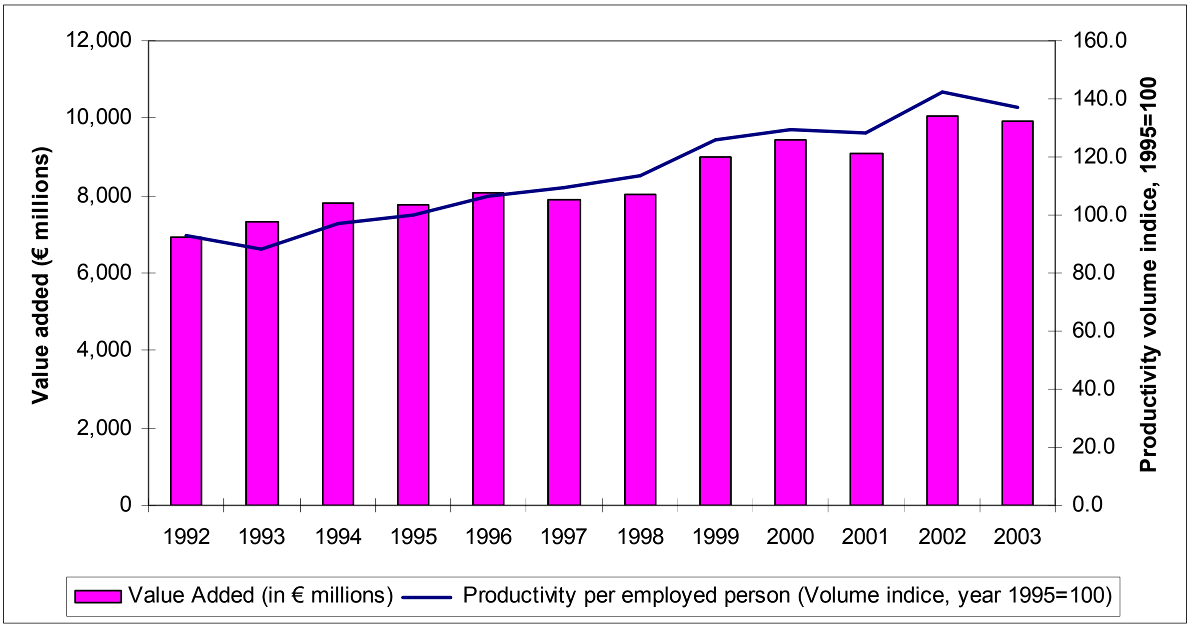


Source: OECD

2.18 As Figure 2.2 illustrates, the number of credit institutions has been steadily declining. This may be due to a combination of factors including cost cutting, mergers and a shift to alternative banking mediums such as the Internet. The number of total employees has also declined.

2.19 Value added in the industry increased from €6.4 billion in 1990 to €8 billion in 1998 and some €10 billion by 2002 and 2003. Productivity per worker also increased significantly, so that by 2003 it was more than 60 per cent higher than in 1990 and more than 20 per cent higher than in 1998.

Figure 2.4: Value added and productivity in the Belgian banking sector



Source: University of Groningen

Market shares and concentration

2.20 Belgium has a significantly higher concentration rate than the average EU15 member state. The five largest credit institutions own some 83 per cent of the assets compared to only 53 per cent in the EU15 average.

2.21 This can only partly be explained by size. If one compares the Belgian concentration rate with the five countries of similar size (the Netherlands, Greece, Portugal, Austria and Sweden) only the Netherlands with 84 per cent has a higher concentration rate. All other countries have significantly lower rates (between 44 and 67 per cent).

Trade and international penetration

2.22 It is interesting to note that a number of Belgians use neighbouring Luxembourg as an offshore banking centre.

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.23 According to the Health and Consumer group, 80 per cent of the Belgian consumers have not changed banks in the last ten years although 65 per cent of consumers were not satisfied. The Belgian banking industry is mainly dominated by large banks that offer more or less the same services for more or less the same prices.[8] According to the Health and Consumer group, when consumers switch banks, they very often switch from one big bank to another big one.

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8 Source: Health and Consumer Group.

Dimensions of price and quality competition

2.24 In some cases, consumers are charged twice for cross-border transfers, as senders and as beneficiaries. Indeed, a beneficiary may be charged between € 1.50 and 25 for a transfer.

Consumer protection

2.25 The perceived level of consumer rights in Belgium appears to have improved in the past few years. Eurobarometer data (exhibited in the Main Report) suggest that Belgians had higher satisfaction with consumer protection in 2003 than in 1999.

The potential future role of technology

2.26 Internet banking has started to develop, and will continue on doing so. Over time, this is likely to reduce the level of fixed costs incurred (in keeping a physical branch) by reducing the number of branches.

Impact of the FSAP and FSWP Legislative Measures on the Belgian Banking Sector

Assessment by category

Cross-border business, takeovers and the development of a regional market

2.27 Foreign entry has significantly increased in Belgium since 1997. The number of branches and subsidiaries from EEA countries has increased from 41 to 58. On the other hand, the number of branches and subsidiaries from other countries has receded from 30 to 16.

2.28 This new formation may well have been significantly driven by the Single Market legislation of the EU. However, the specific role of the FSAP, as opposed to other Single Market provisions such as the ISD, is more difficult to judge. Having said that, it could be argued that the FSAP has affected the form of openness to foreign firms. EEA countries seem to have a growing interest in the Belgian banking market.

2.29 Our econometric study suggests that the impact of the FSAP on trade (to mid 2006) has been a rise of 1.6 per cent in banking (imports increased by 1.3 per cent and exports by 1.6 per cent). Full implementation of the FSAP is projected to lead to a further 1.5 per cent rise (imports to rise by 1.0 per cent and exports by 2.0 per cent).[9]

[9] Note: effects are additional to any associated with membership of EU or other global or domestic trend towards openness.

Table 2.3: Non-Belgian credit institutions

	1997	1998	1999	2000	2001	2002	2003
Number of branches of credit institutions from EEA countries	25	25	30	34	35	36	38
Number of subsidiaries of credit institutions from EEA countries	16	17	21	21	22	21	20
Number of branches of credit institutions from third countries	15	14	14	13	11	10	10
Number of subsidiaries of credit institutions from third countries	15	10	6	6	7	8	6

Source: Eurostat

2.30 Merger activity was especially strong in the period of the FSAP.

Table 2.4: Mergers and acquisition activities

	2000	2001	2002	2003	2004	2005	2006*
Number of domestic M&A's	1	1	1	1	1	5	0
Number of EU M&A's	0	2	3	0	2	3	0
Number of third country M&A's	0	0	0	0	0	0	0

*Source: ECB; * first half*

2.31 Respondents to our survey took the view that FSAP measures have slightly improved the issue of disparities in tax treatment and slightly improved the openness of the retail banking market.

Competition

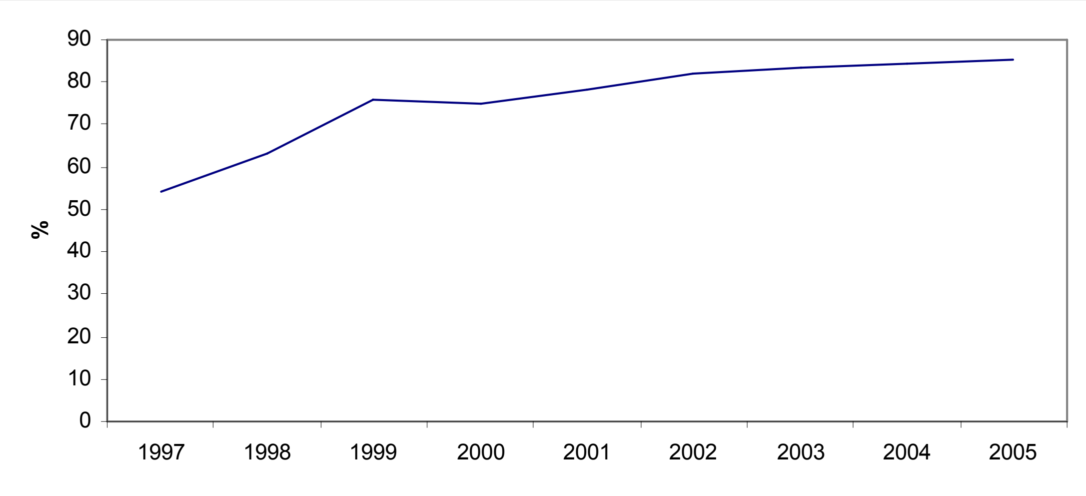
2.32 If measured by the CR5 (market share of five biggest banks) competition in Belgium is relatively low and has recently weakened. While in 1997 the largest five credit institutions had only 54 per cent of the market, by 2005 the ratio had risen to above 85 per cent (compared with an EU15 average of 54 and a Euronext area average of 64). A similar pattern emerges if one considers the Herfindahl Index; this suggests that whilst in the late 1990s Belgium had relatively low concentration, by 2005 it had the second most concentrated banking sector in the EU. Other things being equal, an increasing Herfindahl index coupled with an increasing C5 ratio over the same period would seem to suggest that this sector may be characterised by a reducing level of competition.

Table 2.5: Herfindahl- Hirschman index[10]

1997	1998	1999	2000	2001	2002	2003	2004	2005
699	909	1518	1506	1587	1905	2063	2102	2108

Source: ECB

Figure 2.5: Share of total banking sector assets held by the five largest banks



Source: ECB

With such a level of concentration, it is especially important for Belgium to maintain an open market in order to preserve competition — perhaps taking the form of contestability (the threat of entry by a major international group) rather than active competition. It is likely that the FSAP contributed to the increase in the number of branches and subsidiaries operating in Belgium from 1997, through the reduction of technical and regulatory barriers to trade. Even if this did not transpire into active competition, the reduction in entry barriers are themselves an important factor in increasing contestability in the sector and thus preserving competition. To the extent that the FSAP reduced entry barriers, it has prevented what might otherwise have been a reduction in competition.

2.33 With an increasing level of openness to foreign banks, since 1997, one may conclude that the FSAP has had a positive effect on competition in the Belgium banking sector, due to external pressure which was in the form of contestability.

2.34 In the future, the FSAP may continue to have a significant effect on competition if it enables foreign banks to provide their services cost effectively even with only small outlets in Belgium.

10 The Herfindahl- Hirschman index is defined in the main report.

Employment

2.35 As Figure 2.3 illustrates, the number of employees in the Belgian banking sector declined during the period of the FSAP. In 2005 the total number of employees in the sector was down to 69,000 compared with 77,000 in 1998. This is perhaps not surprising given the level of restructuring that has occurred during the period in question. The consolidation and convergence towards best practice, partly facilitated by the greater openness of the sector to international entry, would have contributed towards the shedding of excess labour (rationalization, substituting labour for capital) in this sector in striving to improve efficiency and growth. At least until 2001 total wage bills of Belgian banks increased at about 1.5 per cent per year.

2.36 From the information given above, i.e. the general economic slowdown and the convergence of banks in Belgium towards best practice, one may conclude that the FSAP has only had a slightly negative impact on employment in this sector. Given the impact of the macro-environment, namely slow economic expansion, and the scope for increased mechanisation in this sector, a decrease in the level of employment would have been expected, even in the absence of the FSAP.

Table 2.6: Wages in the Belgian Financial Services industry

	1996	**1997**	**1998**	**1999**	**2000**	**2001**
Labour compensation (€ millions)	5066	5171	5154	5315	5468	5476

Source: OECD

Note: Data for 2002-2004 are not available.

2.37 From the wages given in the table above, it is difficult to establish what impact the FSAP may have had on wages. However, it is perhaps worth noting that respondents to our survey took the view that that the FSAP should make a small positive contribution to employment in the future.

Consumer protection

2.38 Eurobarometer found that improvement in the perception of consumer protection has been especially positive in Belgium. In 1999 the net assessment of Belgian customers was more negative than the average EU15 consumer (plus three with 40 positive and 37 negative compared to plus 21 with 45 positive to 24 negative). By 2003 this situation had reversed, with Belgian customers becoming more positive (plus ten with 44 positive and 34 negative) while the EU-average customers had become more negative (minus seven 34 positive and 41 negative). This seems to indicate that the perception of consumer rights has significantly increased in Belgium.

2.39 Greater harmonization of regulatory requirements of the sector with regard to consumer protection, such as the CRD and more rigorous accounting controls, will have largely contributed to what has clearly been an improvement in the perceptions that consumers have with respect to their rights and protection. The FSAP can thus be seen as having had a positive effect on consumer protection in the banking sector.

2.40 We note that respondents to our survey likewise took the view that the level of consumer protection has increased due to the FSAP.

Competitiveness

2.41 Primarily driven by downward cost pressures imposed by the bear market of the early 2000's, the rate of growth of operating costs on Belgian banks has slowed since 2000.

Table 2.7: Key profitability indicators (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1995	10.1	0.2	5.7
1996	10.4	0.4	14.7
1997	9.1	0.3	13.2
1998	9.2	0.3	12.9
1999	8.2	0.4	15.3
2000	8.1	0.4	15.1
2001	8	0.4	14.8
2002	7.2	0.4	14.7
2003	9	0.7	20.5

a: Net interest margin — net interest income to average total assets., b: ROA — net income before tax to average total assets.,
c: ROE —net income before tax to average capital and reserves.

Source: Europe Economics calculation of data from OECD (2005) "Bank profitability"

2.42 Efficiency scores of the Belgian banks relative to the rest of the EU15 slightly diminished up to 2003, although this change was not very large.

Table 2.8: DEA efficiency scores for Belgian banks

1999	2000	2001	2002	2003
81.3	84.4	78.6	73.1	76.3

Source: Casu and Giradone "Bank Competition, Concentration and Efficiency in the Single European Market" (2003)

2.43 We may conclude that the FSAP has brought about some compliance costs for Belgian banks, but once compliance has been achieved, it has the potential to facilitate further efficiency improvements.

3 INSURANCE

The Belgian insurance sector

Turnover

3.1 As was the case in a number of other countries, the Belgium insurance sector suffered a severe downturn in 2001 and 2002. Following restructuring, the sector has now recovered. The sector witnessed consolidation in 2004 and improving solvency.

3.2 However, despite increasing stability and potential for premium growth, the Belgian insurance sector is not seen as very profitable. Whilst the number of loss-making insurers has declined in recent years due to mergers, a large proportion of insurers' income is still derived from interest payments and other financial investments. For example, in 2004 Fortis recorded revenues of €60 million which represented an increase of 21.2 per cent when compared to 2004. However, the revenue increase was primarily due to a rise of 54.3 per cent in income from interest income.

3.3 Belgium nevertheless is home to a significant insurance sector. According to Swiss Re, in 2004 it was ranked eighth in the world in terms of insurance density measured by premiums per capita.

Table 3.1: Total insurance premiums in Belgium (€ millions)

Year	Gross Premium income
1994	12,764
1995	15,400
1996	15,308
1997	14,399
1998	17,777
1999	17,412
2000	18,444
2001	18,473
2002	19,553
2003	29,038
2004	35,536

Source: OECD

3.4 From 2000 to 2001 increases in premium volume were modest, whilst in 2002–4 growth picked up. This was mainly driven by the Life insurance sector which grew very modestly in 2002 but significantly in the following years.

Table 3.2: Insurance Density (premiums per capita) in Belgium

	Premiums per capita €	Premiums as % of GDP
Year	**Total**	**Total**
2000	1395.70	8.40
2001	1330.38	7.92
2002	1507.28	8.42
2003	2164.11	9.77
2004	2465.06	9.52

Source: Swiss Re

Table 3.3: Life insurance premiums in Belgium

Year	Premium volume (€millions)	Increase on previous year	Share of total business
2000	12,965	n/a	60%
2001	13,435	4%	59%
2002	14,736	10%	58%
2003	17,904	21%	61%
2004	19,390	8%	n/a

Source: Swiss Re

3.5 Being less influenced by the bear market, growth in the Non-Life insurance sector was more stable.

Table 3.4: Non- Life insurance premium volumes in Belgium

Year	Premium volume (€millions)	Increase on previous year	Share of total business
2000	8,632	n/a	40%
2001	9,499	10%	41%
2002	10,618	12%	42%
2003	11,297	6%	39%

Source: Swiss Re

3.6 Table 3.5 summarizes profitability and asset holdings in 2003 and 2004.

Table 3.5: Insurer results (€millions unless otherwise stated)

Year	Life enterprises			Non-life enterprises			Composite enterprises		
	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets
2003	31	16,544	0.19%	341	16,050	2.12%	279	110,631	0.25%
2004	4	19,950	0.02%	500	18,190	2.75%	1,218	125,513	0.97%

Source: CEIOPS

Market participants and Market shares

3.7 The total number of insurance providers in Belgium declined during the period of the FSAP mainly as a result of mergers.

Table 3.6: Number of Belgian insurers

	2000	2001	2002	2003	2004
Belgian					
Corporations	98	93	90	84	85
Co-operatives	7	7	7	7	6
Mutuals	21	21	19	19	19
Other	4	4	7	8	8
Foreign					
E.E.E.	73	71	72	66	60
Outside E.E.E.	6	6	6	5	3
Total	**209**	**202**	**201**	**189**	**181**

Source: CBFA

3.8 All significant insurance providers in Belgium are part of bancassurance companies. In most companies the banking business is more important then the insurance business. Of the six biggest insurance companies only one company (AXA Royale Belge) has a bigger insurance branch than banking branch.

Table 3.7: Market share of the five largest groups (%, 2004)

Group	Total	Non-life	Life
Fortis	19.6	15.0	21.5
Ethias	16.0	13.0	17.3
KBC	13.1	8.7	15.0
AXA Royale Belge	12.8	16.7	11.1
Dexia	7.2	4.0	8.5

Source: Professional Union of Insurance Companies

3.9 The Belgian insurance sector is heavily concentrated. The CR5 figure for 2004 is 73.4 per cent. The top three companies have a combined market share of 53.8 per cent — although this represents a decline since 2002 where the figure exceeded 60 per cent.

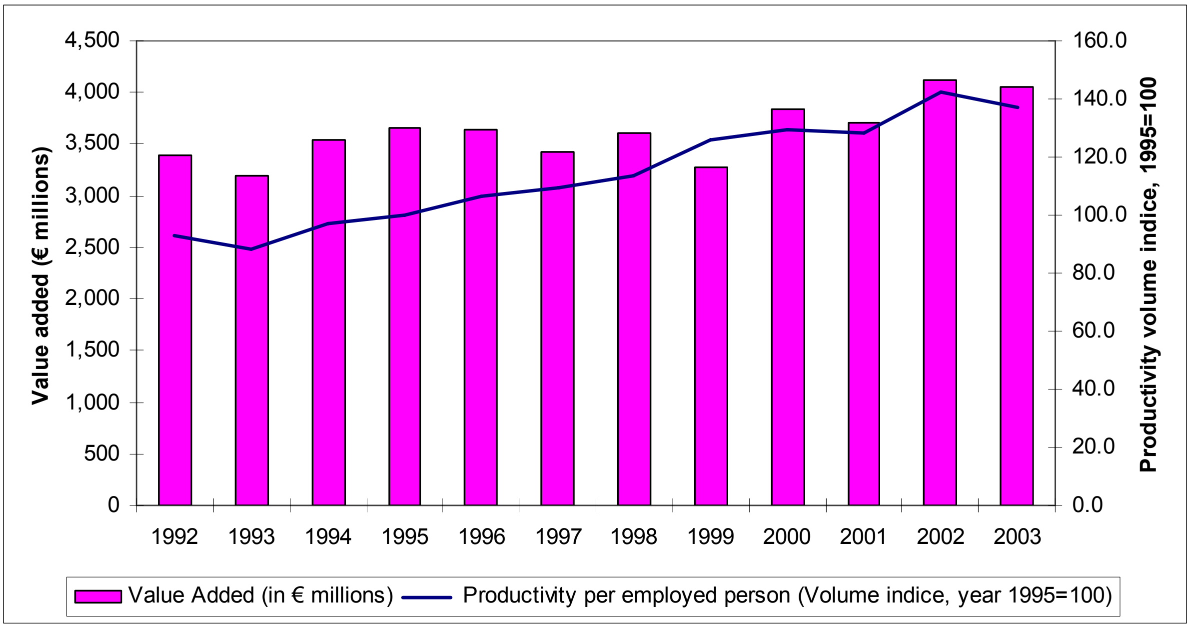
Employment and productivity/competitiveness

3.10 Employment in the Belgian insurance sector receded from 47,000 in 1992 to 40,000 in 2003. Total hours worked, however, stayed fairly stable.

3.11 The value added of the industry grew, with a transitory setback in 1999/2000.

3.12 Labour productivity increased.

Figure 3.1: Value added and productivity in the Belgian insurance sector



Source: University of Groningen

International entry

3.13 Most of the above groups 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.

Competitiveness

3.14 Improvements in the degree of labour efficiency, up to and during the period of the FSAP, would imply an improvement in the international competitiveness of the insurance industry. However, increases in the scope of regulatory supervision as a direct result of the FSAP may have had counteracting effects on competitive levels, making the overall effects of the FSAP on the competitiveness of this sector unclear. For example, Reinsurance was previously unregulated at the European level and Belgium in fact, had chosen not to regulate at all. The associated compliance costs with such regulation of risk may prove burdensome for previously unregulated reinsurers in the market. This may precipitate exits from the market and ultimately reduce availability of reinsurance products and indeed the competitiveness of the sector as a whole.

3.15 Thus in the longer term, the overall effect of the FSAP on the competitiveness of the Belgium insurance sector is unclear.

Impact of the FSAP and FSWP Legislative Measures on the Belgian Insurance Sector

Assessment of impact by category

Market entry, cross-border business and takeovers

3.16 Generally, the insurance market in Belgium is dominated by bancassurance companies of which some have a foreign headquarters. The big insurance companies of the continent (Allianz, Generali, AXA, Swiss Life) are present in Belgium but have relatively low market shares.

3.17 It seems to be the case that the process of international competition is only starting. In the long run the big continental companies will probably not be content with not being able to earn some economies of scale and will undertake to expand, as it seems has been happening recently.

3.18 Further standardisation of regulation will improve the chances of international competitors to do so. Thus, the FSAP is likely to have a greater impact in the future.

Competition

3.19 As already mentioned the Belgian insurance market is heavily concentrated and mostly dominated by bancassurance companies with a dominating bank branch.

3.20 This means that competition might be different from markets where specialist insurance companies dominate. It seems likely that companies that do not obtain a sufficient return from the insurance market in the short term are unlikely to exit the market or become bankrupt, but instead may tend to receive cross-subsidizing support from their banking parent companies.

3.21 One indicator for this behaviour could be the relative low returns that the average insurance company has recorded in Belgium.

3.22 Cross-subsidizing, if this is indeed what has been happening, softens the hard budget constraint that typically characterises competitive firms, and thus may act as a form of potential barrier to entry, since it allows established players to bear losses, for a time. In the long run however, the FSAP may well increase competition as it will become easier for insurance companies from abroad to enter the market and obtain economies of scale.

This would mean that one could expect that the consolidation process, which was particularly stimulated during the bear market, is likely to be continued with eventually more foreign participation.

3.23 One indicator for this is the receding market share of the top three companies in recent years.

Employment and productivity

3.24 Overall employment in the insurance sector has decreased in the period in question. If our prediction of increased competition is correct, this may mean a further reduction in employment, since greater competition might contribute to increasing labour efficiency in the sector. Given the relatively limited scope that the FSAP has had thus far in increasing competition in this sector, as discussed above, it so far seems not to have had a positive effect on employment in this sector either. Indeed, to the extent that FSAP has provided the impetus for increasing efficiency, for example through improving the rigour of internal controls, it may have had a somewhat negative effect on employment in the insurance sector.

3.25 We note that our view in this diverges from that of respondents to our survey, who believed that the impact of the FSAP on employment would be positive.

Consumer protection

3.26 As described in more detail in the corresponding banking section, Belgium was one of the countries where the perception of consumer rights became more positive in recent years. The FSAP appears to have played a positive role in this.

3.27 Respondents to our survey likewise took the view that consumer protection and consumer understanding of insurance products have increased due to the FSAP.

4 SECURITIES MARKETS

Belgian securities markets

4.1 The main exchange in Belgium is Euronext Brussels. For much of the period of the FSAP there were two exchanges — the European arm of the NASDAQ exchange (sometimes known as EASDAQ) operated in Belgium. However, from its creation in 2000 (before that there was the Brussels stock exchange), Euronext Brussels was always by far the larger — total market capitalisation on NASDAQ Europe in 2002 was only 4 per cent of that for Euronext Brussels.

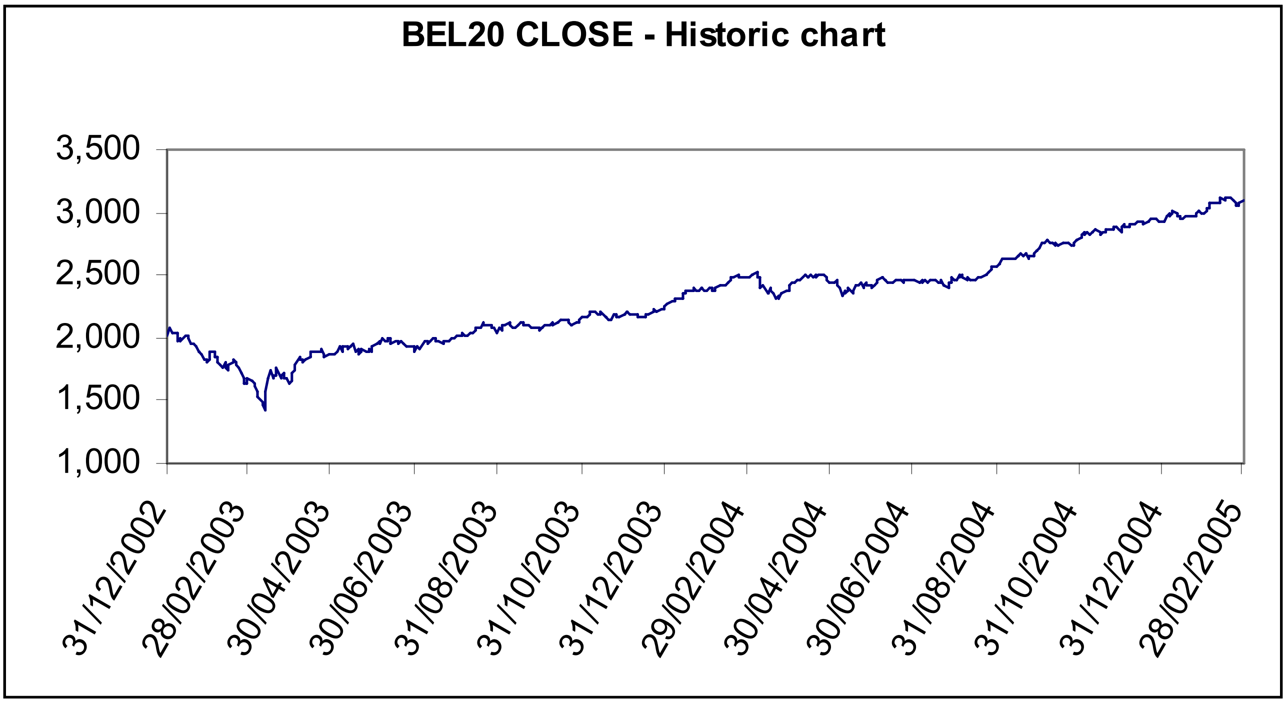
4.2 The main Euronext Brussels index is the Bel-20, which tracks the market performance of the top 20 domestic listed companies. Of the entire Euronext, Brussels has a relatively small share (11 per cent of the number of quoted domestic companies and 6 per cent of annual transactions).

Table 4.1: Volume of shares and number of warrants on Euronext Brussels

	2003 (Dec)	2005 (Dec)
Volume in number of shares		
Belgian	61,945	274,559
Foreign	6,129,420	7,441,748
Total	**6,191,365**	**7,716,307**
Number of warrants listed		
Belgian	22	8
Foreign	166	66
Total	**188**	**74**

Source: Euronext

Figure 4.1: Belgian stock market index 2002–2006



Source: Euronext

4.3 One consequence of the Euronext has been falling costs for carrying out cross-border trades. This has also been aided by the adoption of the euro. However, another effect has been that Belgian investors have diversified their portfolios beyond the domestic market and now have large shareholdings in non-Belgian companies.

4.4 In order to create a competitive advantage, Euronext Brussels launched NextPrime and NextEconomy in 2002. The NextEconomy focuses on high-tech companies, whereas the NextPrime has companies from more traditional sectors. The purpose of the exchanges is to address the needs of investors, with companies seeking to raise their profile by complying with a number of additional rules for disclosure and liquidity.

4.5 Belgium also contains the world's largest clearing and settlement housing for traded securities: the Euroclear.

4.6 The NBB has identified two features of Belgian stocks that serve as a hindrance to their growth. In the first instance, there are very few technology shares. In addition, Belgian bank stocks are regarded unfavourably when long-term rates rise, because of the fact that Belgian banks tend to hold a much larger proportion of their assets in long-term bonds than do banks in other countries. Under recent market conditions this was a disadvantage as long term bonds had relatively low rates of return compared to short and mid-term bonds. This is part of the competitive context within which the effects of FSAP are felt.

4.7 The brokerage sector is highly concentrated. Although there are over 100 brokerage firms who are members of Euronext Brussels, 10 account for over 80 per cent of all business.

Impact of the FSAP and FSWP Legislative Measures on Belgian Securities Markets

Impact by category

Cross-border activities

4.8 The integration of the Brussels stock market into Euronext is assumed to have already achieved a significant position of feasible integration, independently from the implementation of the FSAP. However, the FSAP may help Euronext expand into other European countries.

Competition

4.9 An increase in cross-border activity and trade should of itself enhance the level of competition in the Belgium securities market. Since, *a priori,* further implementation of the FSAP may have a small positive impact on the level of competition and trade in the Belgium insurance sector, we may conclude that for the future, further implementation of the FSAP is likely to have a slightly positive impact on competition in the Belgium securities sector.

4.10 In the long term, the MiFID (with respect to systematic internalising) is likely to create a tendency for securities related jobs to migrate to London, because of its head-start in such activities.

Competitiveness

4.11 So far, the FSAP has had a limited impact on competitiveness. However, MiFID (soon to be implemented) is likely to expose Euronext to more competition, which in turn is likely, over time, to decrease transaction costs and thus enhance competitiveness in the Belgian securities market.

Consumer protection

4.12 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Belgian securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Belgian securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Employment

4.13 So far, it is difficult to draw a definitive conclusion about the impact of the FSAP on the level of employment in the Belgian securities sector. However, one might suggest that in the medium term, a portion of securities jobs are likely to migrate to London as systematic internalisers take advantage of the opportunities MiFID brings and as London (in particular) takes advantage of its lead in systematic internalising. Unlike in other countries, our view is that this will not reinforce or develop a culture of equities in Belgium.

Other objectives of the FSAP in the securities sector

4.14 Due to the dynamism of the securities markets, the benefits of cross-border trade had been reaped independently of and in advance of the FSAP. The full implementation of the FSAP is important to maintain, develop and regulate the cross-border security trade, to ensure a sufficient degree of competition.

4.15 Respondents of the survey thought that trade on the home stock exchange will further decrease due to the FSAP. It seems that cross-border trade may have increased. Additionally the respondents attributed some of the increase in electronic trading to the FSAP.

5 FINANCIAL CONGLOMERATES

Financial conglomerates in Belgium

5.1 As mentioned earlier the biggest banks of Belgium are also the biggest insurance companies and therefore the subject of financial conglomerates is particularly important for Belgium.

5.2 The supervision of financial conglomerates in Belgium is the responsibility of the department of the CBFA that is responsible for banking supervision. The cause of this organisation was probably that most of the Belgium financial conglomerates are dominated by banks.

Table 5.1: Conglomerates with Head Office in Belgium

Name	Countries in which it operates	Characterization
Fortis	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%

Table 5.2: Other financial conglomerates operating in Belgium

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Barclays	UK	Banking	Banking
HSBC	UK	Personal, commercial, corporate, institutional and investment, and private banking	Banking
Societe General	France	Corporate and investment banking	Banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Banking: Corporate and Investment Banking (Advisory & Capital Markets, Specialised Financing,

Name	**Head office base**	**Characterization of Conglomerate**	**Characterization of Subsidiary**
			Corporate Banking)
ABN AMRO	Netherlands	Banking	Banking
ING	Netherlands	Banking, insurance and asset management	Banking
Allianz	Germany	Insurance group doing asset management and banking	Retail Banking
Gruppo Banca Intesa	Italy	Banking	Banking
San Paolo-IMI	Italy	Retail and Commercial banking group and insurance	Private Banking & Asset Gathering and Management
BANCO Bilbao Vizcaya Argentaria	Spain	Finance and Insurance	Banking
Grupo Santander	Spain	Insurance, Banking, Asset Management	Banking

Source: EU Mixed Technical Group on Supervision of Financial Conglomerates, Europe Economics

5.3 As mentioned earlier, financial conglomerates are losing market share in the insurance sector in recent years.

Impact of the FSAP and FSWP Legislative Measures on Financial Conglomerates

5.4 As we can see in Tables 5.1 and 5.2, although conglomerates operating in Belgium do engage in insurance activities, and there are also some securities activities, much the most important conglomerate activity is banking. Thus, the conclusions for financial conglomerates in Belgium are close to those for banking.

Assessment by category

Openness

5.5 We have seen that the form of entry by banks into Belgium has been affected, and that openness in the insurance sector has probably increased. In addition, the FSAP measures for regulation of Financial Conglomerates should create a more standardized regulatory environment, reducing costs of compliance for large firms operating across multiple jurisdictions.

5.6 Further, we should, in general, expect a programme such as the FSAP to be of greater short-term benefit to existing larger players than smaller players, since larger players will more obviously gain from a standardized cross-border environment.

5.7 Thus our assessment is that the FSAP will encourage greater openness.

Competition

5.8 We have seen that competition is expected to be slightly enhanced in both banking and insurance, and this can be expected to apply for financial conglomerates, also.

Consumer protection

5.9 Effects on consumer protection in both banking and insurance are expected to be positive.

Employment

5.10 We assess the effects on employment in both banking and insurance sectors as slightly negative. Furthermore, our view is that the FSAP may be a factor in conglomerates in Belgium losing market share to more specialised players (particularly in the insurance sector).

5.11 The view of respondents to our survey was that the FSAP will contribute to a growth in the number of jobs in financial conglomerates. However, our own view is that, over time, the effect of the FSAP is likely to be somewhat negative.

Competitiveness

5.12 As pressures of competition from abroad and domestically are expected to be increased by the FSAP, we would expect this to lead to greater competitiveness of Belgian conglomerates.

6 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Affected form of entry	Slightly positive	Positive	Unclear	Perhaps slightly negative
Insurance	Probably positive in long term	Probably positive in long term	Positive	Limited	Limited. Perhaps slightly negative
Securities	Perhaps slightly positive	Limited	Limited	Limited	Unclear. Perhaps negative
Financial Conglomerat es	Limited. Slightly positive in the future	Slightly positive in the future	Limited. Perhaps positive in the future	Limited. Positive in the future	Unclear

CYPRUS

1 INTRODUCTORY OVERVIEW

Financial Services Sector in Cyprus

1.1 The Republic of Cyprus joined the EU in May 2004. Along with the accession came a number of changes to the regulatory structure in order to harmonize local legislation with the EU requirements. Some of these changes are briefly described below and are expected to affect the financial sector.

1.2 The financial sector has exhibited rapid growth in recent years, both in the level of financial intermediation and in the range and quality of services. This is associated with good performance of the economy, stable macroeconomic conditions, the development of Cyprus as an international business centre and gradual market liberalisation over the past few years.

1.3 Preparation for EU membership has propelled a series of major financial reforms:

(a) In 1999, the Central Bank of Cyprus embarked on capital account liberalization measures. In December 2000, one of the most important liberalization measures was the abolition of restrictions on domestic banks extending loans in Cyprus pounds to non-residents who are economically active in Cyprus, and, on 1 January 2001, the abolition of restrictions on both domestic banks and International Banking Units extending medium term (over two years) and long-term loans in foreign currencies to residents.

(a) The statutory interest rate ceiling has been abolished.

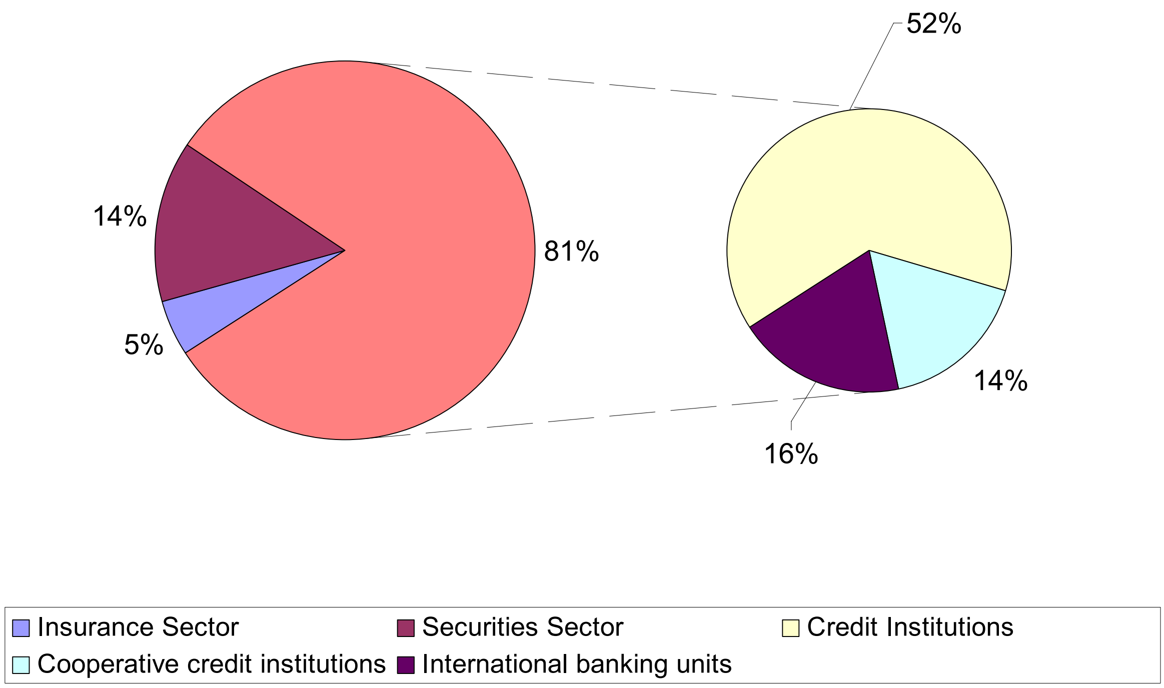
(b) The statutory independence of the Central Bank of Cyprus was strengthened. The Monetary Policy Committee was set up in December 2000, pursuant to an amendment to the Central Bank of Cyprus Law in July 2000.

(c) The government removed all restrictions on the ability of Cypriot entities, including offshore companies, to conduct business in Cyprus and abolished the "ring-fencing" of offshore entities: International Business Companies were subject to a profit tax rate of only 4.25 percent, while domestic companies were taxed at a rate of 20 percent, or 25 percent for chargeable income over CYP 40,000.

1.4 In 2003, financial intermediation in Cyprus contributed 5.7 percent of GDP.

1.5 Banking plays a dominant role in the Cypriot financial sector. The contribution of non-bank financial firms such as insurance companies, investment companies and mutual funds is still very limited. As illustrated in Figure 1.1, the weight of banking in the Cypriot financial sector is high. Banking is the major contributor to the financial sector's total assets, with a share of 81 percent in 2004.

Figure 1.1: Overview of Cypriot Financial Sector, 2004



Source: IMF

1.6 The composition of the banking sector is also shown in the figure above, with banking institutions having by far the most assets. The contribution of cooperative credit institutions and that of international banking units is almost balanced, accounting for 14 and 16 percent respectively.

Financial Services Regulation in Cyprus

Division of Responsibility

1.7 Supervision in the financial sector is divided between different bodies, reflecting the traditional segregation of the various segments of the financial sector.

(a) **Cyprus Securities and Exchange Commission:** responsible for supervising the operation of the Stock Exchange, licensing mutual funds and penalising brokers and investment consultants for not complying with Stock Market legislation.

(b) **Superintendent for Insurance Control:** responsible for the supervision of the insurance market.

(c) **Cooperative Societies Supervision and Development Authority:** responsible for the supervision of cooperative credit institutions.

(d) **Central Bank of Cyprus:** established in 1963, regulates, supervises and monitors the formal banking system. Also supervises both domestic and international banking units.

Key features of banking regulation

1.8 The Central Bank of Cyprus is responsible for regulating the banking sector in Cyprus.

1.9 The main legislation affecting the Cypriot banking sector includes:

(a) **Central Bank of Cyprus Law 1963**: This law determining the establishment of the Bank.

(b) **Banking Law of 1997 (Basic Law)**: This Law provides a regulatory and supervisory framework, which conforms to the banking practices of the EU. The Law defines matters such as bank licensing requirements, limitations on large exposures and shareholdings in non-financial companies, definition of banking activities, minimum capital solvency and liquidity ratios.

(c) **Central Bank of Cyprus Law 2002**: The law ensures the Bank's independence as well as compatibility with the relevant provisions of the Treaty establishing the European Community and the Statute of the European System of Central Banks and of the European Central Bank

(d) **Subsequent amendments of the Banking Law:** (i.e. 1999, 2000 and 2003 amendments as well as No. 4(I) of 2004, 151(I) of 2004, 232(I) of 2004, 235(I) of 2004 and 20(I) of 2005).

1.10 The Central Bank of Cyprus supervises banks which are incorporated in Cyprus, including local subsidiaries, branches and representative offices of foreign banks. In 2005, there were forty-two monetary financial institutions operating in Cyprus. Fourteen of these are locally incorporated banks while twenty eight are international banking units.

1.11 According to the Central Bank of Cyprus Law, the primary objective of the Bank is to ensure price stability, and among its main functions is the supervision of banks.

1.12 During the early years of its operation, the Central Bank acted as a banker to the government and managed international reserves. In the late 1960s and early 1970s, monetary policy became more active, while bank supervision was formalised.

Key features of insurance regulation

1.13 The Insurance Companies Control Service of the Ministry of Finance is headed by the Superintendent of Insurance and is responsible for the supervision of the operations of insurance undertakings and the implementation of the Insurance Services and other Related Issues Laws of 2002-2005 and the Insurance Services and other Related Issues Regulations of 2002-2004. [11]

1.14 The role of the department has historically been to check the compliance of companies in their accounting but was widened to embrace broader issues relating to the industry, notably harmonisation with EU legislation.

1.15 The laws and regulations mentioned above regulate the way insurance undertakings carry out their business and determine the way supervision is to be exercised.

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[11] The Superintendent and the Assistant Superintendent of Insurance are both public officers appointed by the Council of Ministers.

1.16 Within the framework of its responsibilities, the Service examines applications submitted by undertakings for the issue of their licence as insurers, examines and analyses the insurance undertakings' financial statements in order to establish their solvency and their ability to pay their debts, supervises insurance undertakings' investments in approved assets and generally establishes that insurance undertakings operate on sound insurance principles. Moreover, the Service examines applications for the registration of insurance intermediaries, i.e. insurance agents, insurance brokers, insurance sub-agents, insurance advisors and tied-insurance advisors.

Key features of securities regulation

1.17 The main overseer of the securities market in Cyprus is the Cyprus Securities and Exchange Commission. The Commission is governed by a committee of 5 members (President, Vice President and three members).

1.18 The role of the Cyprus Securities and Exchange Commission is to:

(a) Supervise and control the Stock Exchange operations.

(b) Supervise and control the issuers (through inspections).

(c) Conduct investigations where appropriate.

(d) Collect information.

(e) Issue operation licences to mutual funds and companies offering investment services.

(f) Cancel licences in accordance with law.

(g) Determine penalties against brokers, investment companies, investment consultants as well as to anyone who is in breach of legislation relevant to the Stock Exchange.

Key features of financial conglomerates regulation

1.19 Financial conglomerates fall, by definition, under the auspices of various supervisors.

1.20 The Cypriot regulatory system divides the financial sector into three distinct sub-sectors: banking, insurance and securities. In regulatory terms, this implies that financial institutions are regulated on the basis of their core activities. Basing regulation on this distinction rather than on functions performed within the financial sector can result in institutions competing in the same market being supervised by different authorities.

1.21 At present, banks offering investment services are regulated by the Central Bank of Cyprus, while investment intermediaries are generally regulated by the Cyprus Securities and Exchange Commission.

Stakeholder views about the implementation of the FSAP

1.22 Although, there have been a few criticisms of FSAP measures, by and large, the implementation process of the FSAP in Cyprus appears to have been smooth, with the level of implementation of FSAP measures on average the same as in other countries.

1.23 Key issues identified by stakeholders include:

(a) tight implementation deadlines; and

(b) ensuring that the implementation is done in a consistent and proportionate manner, which takes into consideration the different type of credit institutions, the national particularities and still provides a level playing field in Europe's financial sector and in the global financial sector.

1.24 There was also the fear that there was a risk of introducing a 'potential fragmentation', whereby, banks may be confronted with the challenge of achieving approval of their group wide risk management system by both their home and host supervisors.

1.25 There were also a number of minor criticisms regarding the problems of FSAP in action. These, however, were to be expected and are generally associated with any kind of change in the financial sector:

(a) From a business point of view, the need of a business to assess the implications of the changing business environment and be able to adapt to it, both in Cyprus and the EU.

(b) Building up the awareness of senior management about forthcoming changes, in Cyprus and in those Member states where their bank already operates or wishes to operate.

(c) Ensuring readiness of the infrastructure and especially the Information Technology Systems.

(d) Communicating the necessary information and knowledge to the staff via appropriate training.

Consequences of the FSAP for the Regulatory Environment

1.26 In the view of the participants in our survey, prior to the FSAP, the Cypriot regulatory framework was largely rule-based, though there may have been some scope for discretion in certain areas. Respondents are of the opinion that the implementation of FSAP did not reduce the scope for regulatory discretion.

1.27 Survey participants view the level of FSAP implementation and level of regulation in Cyprus as broadly equivalent with that in other Member States.

1.28 The FSAP does not seem to be regarded as having increased interaction through regulator-industry relationships, while it has increased the level of involvement with other financial EU authorities.

2 BANKING

Factors specific to Cyprus

2.1 There are a number of specific factors to the Cypriot banking sector that must be considered. These include:

(a) **Re-orientation of the banking sector.** The banking sector is being transformed, strengthening its presence in the region of Southeast Europe, expanding mainly in the Greek market.

(b) **Low Corporate Tax Rate.** Cyprus has a very low corporate tax rate. This attracts foreign institutions to the island.

(c) **Stability.** Compared to certain other countries in the region, Cyprus enjoys political stability and EU membership. This has attracted businesses from the region.

(d) **High Concentration.** The banking sector in Greece exhibits a very high degree of concentration.

Headline Overview

2.2 The Cypriot banks are small by international standards, but they operate as fully-fledged universal banks. They have an extensive branch network, the leading role in financial intermediation, and they compete aggressively amongst themselves.

2.3 The Cypriot credit institutions sector is divided in three distinct classes:

(a) **Credit cooperatives.** These are mutually owned organisations established to serve their members and their communities on a co-operative basis, not for profit making. Their activities are confined basically to the core banking services. Cooperative credit institutions play a major role in collateralized lending to individuals. Most of the cooperatives are small, but a few are quite large and more sophisticated. Assets held by credit cooperatives are about one fourth of those held by domestic banks. As of 2005, there were 451 branches of the 348 registered co-operative credit institutions. Most of the cooperatives are very small and the picturesque comment that "every village has one" may not be too much of an exaggeration;

(b) **Domestic banks**. The domestic banking sector consists of 14 banks (2005 figure), divided into commercial banks and specialised institutions. Both groups of credit institutions are licensed to carry on banking business; and

(c) **Foreign-owned entities.** International Banking Units (IBUs) are licensed to operate from within Cyprus, and in the past they were taxed at a lower rate than domestic banks but were not allowed to do business with residents. In 2002, these institutions were offered the option of being taxed at either the same tax rate (10 percent) as domestic credit institutions so as to lift the restriction of doing business only with non-residents or continue being taxed at 4.25 percent but without any access to the local market. This measure was to last until the beginning of 2006. Since 1 January 2006, a uniform tax rate has applied to both domestic and international credit institutions, and there are no restrictions on business with Cypriot citizens.

Features of the industry

Number of players

2.4 In 2005, the International Monetary Fund (IMF)[12] reported that there were a total of forty-two credit institutions in Cyprus.[13] Of these, five percent were state owned specialised institutions. The following table details the number of deposit taking institutions, identified by type of ownership, for 2000–2005.

Table 2.1: Number of Non-Cooperative Credit Institutions in Cyprus, 2000–2005

	2000	2001	2002	2003	2004	2005
Commercial Banks	12	12	14	14	14	14
Foreign-owned subsidiaries	2	3	4	4	4	4
Branches of foreign banks	2	1	2	2	2	2
Private specialised institutions	1	1	1	1	1	1
State-owned specialised institutions	2	2	2	2	2	2
International Banking Units	27	24	28	28	29	28

Source: IMF

2.5 As illustrated in Table 2.1, the overall number of players in the market has not significantly changed over the five year period. There has only been a slight increase in the number of banks associated with foreign institutions.

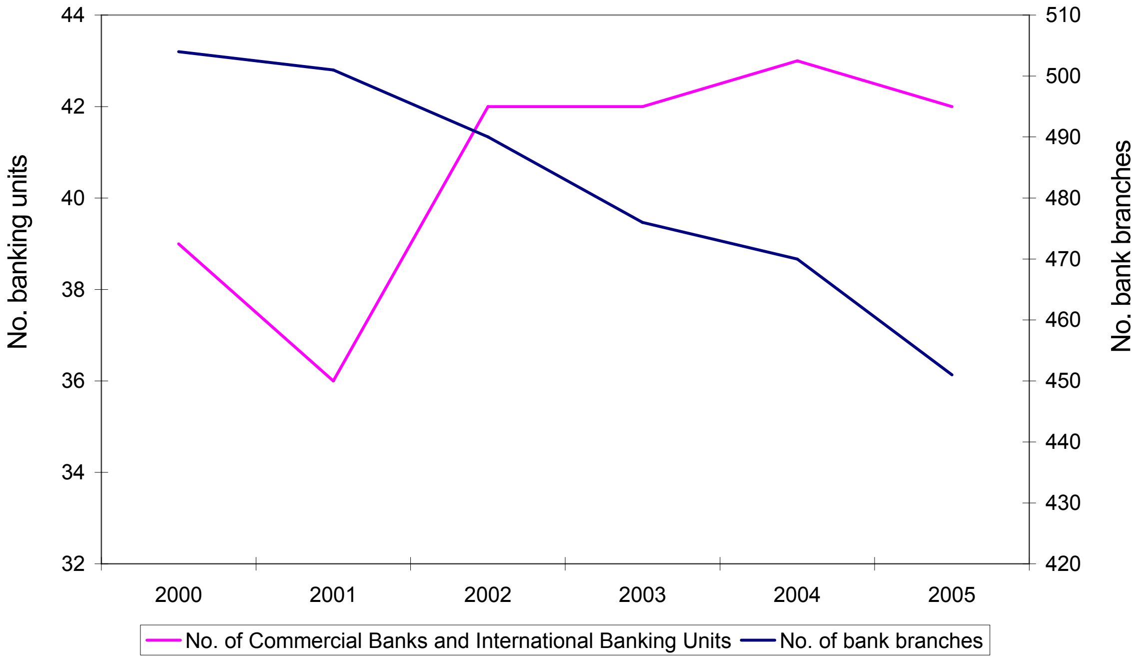
2.6 Despite the relatively high number of foreign banks in Cyprus in 2000, their number has increased, and, according to the IMF report, this trend is expected to sustain itself.

2.7 Figure 2.1 illustrates the trends in the number of commercial banks and international banking units, along with the number of branches since 2000.

12 IMF (October 2006), "Cyprus: Assessment of Financial Sector Supervision and Regulation, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision, Insurance Supervision, and Securities Regulation" – IMF Country Report No. 06/347.

13 This figure excludes the cooperative credit institutions.

Figure 2.1: Commercial Banks and International Banking Units in Cyprus, 2000–2005



Source: IMF

2.8 As shown above, the number of bank branches has been declining. This trend is not surprising given that bank branch penetration within Cyprus is higher than that of most other countries. In particular, Cyprus has many more branches per 100,000 residents than the pre-2004 EU average — in 2003 there were almost 65 banks per 100,000 residents in Cyprus while in the EU there were only 49. The view exists that the reduction in the number of branches would have been bigger if the employees' unions were less influential. In 2002, Moody's reported that "the strong bargaining powers of trade unions limit possible branch rationalisation and workforce restructuring."[14]

Employment

2.9 The following table shows the number of bank employees since 2001.

Table 2.2: Herfindahl index, 2001–2005

	2001	2002	2003	2004
Herfindahl index	964	938	946	940

Source: ECB

2.10 The number of employees has not changed considerably over the past few years, but it has increased slightly.

[14] Moody's Investors Service (April 2002), "Cyprus: Banking System Outlook"

2.11 The implementation of the FSAP is expected to: create new jobs in the Cypriot banking sector, as new products will be introduced; and help facilitate the expansion of Cypriot banks into new markets.

Turnover and profitability

2.12 The three major Cypriot banks (Bank of Cyprus, Cyprus Popular Bank (Laiki) and Hellenic Bank) are the dominant players in the market. However, they are facing increased competition due to capital and interest rate liberalisation, as well as the entrance of foreign competitors, mainly from Greece. Three of the biggest Greek banks (National Bank of Greece, Alpha Bank and Emporiki Bank – recently acquired by Credit Agricole) are active in the Cypriot market, which is threatening incumbents in the Cypriot banking sector.

2.13 In 1999, the Cyprus Stock Exchange General Index soared by almost 700 percent. Benefiting from investor euphoria, Cypriot banks profited from large one-off gains. In 2000 and 2001, the correction that occurred when the index fell sharply negated the gains that banks had earned in 1999.

Market shares and concentration

2.14 In 2005, the combined market share of the three largest banking groups was approximately 75 percent. Among the three largest banks, the largest one is the Bank of Cyprus with 147 branches. Its market share of the total banking system deposits and loans (including credit cooperatives) amounted to 29.5 percent and 25.9 percent, respectively. The other two largest banks are Cyprus Popular Bank (Laiki) and Hellenic Bank.

2.15 Table 2.3 illustrates the evolution of market concentration since 2000.

Table 2.3: Market Concentration in Cypriot Banking Sector, 2000–2005

	2000	2001	2002	2003	2004	2005
Commercial Banks*	3	3	4	4	4	3
International Banking Units*	4	6	8	9	6	5
Cooperative credit institutions**	46	47	50	51	52	51

**Number of institutions with 75 percent of total assets.*

*** Number of institutions with 75 percent of total deposits.*

Source: IMF

2.16 Another measure of concentration is the Herfindahl index. Table 2.2shows how this has moved since 2001.

Table 2.4: Number of employees in the banking sector, 2001–2005

	2001	2002	2003	2004	2005
Number of employees in the banking sector	10115	10613	10480	10617	10799

Source: ECB

2.17 Between 2001 and 2005, the concentration in the banking market was relatively stable, at around the moderate concentration threshold. This may reflect the small market size of Cyprus.

Trade and international penetration

2.18 Two important relevant reforms of recent years were:

(a) From January 2001, in the context of financial liberalisation, International Banking Units are permitted to grant medium and long-term loans or guarantees in foreign currencies to permanent residents of Cyprus, without restriction;

(b) At the start of 2006, the Central Bank of Cyprus lifted all distinctions between domestic and offshore banks.

2.19 Entering a new market requires a foreign bank to develop its network and become a brand name in the new market. Therefore, foreign banks will probably tend to enter the Cypriot market through strategic alliances with Cypriot banks or by acquiring a bank with a well developed network. In Cyprus, though, the trend has mainly been that the majority of foreign banks have been entering the market to serve non-residential customers.

2.20 Cypriot banks have been actively expanding their operations abroad, mainly in Greece and to a lesser extent in Australia and the UK, where many Greeks and Greek-Cypriots reside. These operations are becoming increasingly important for Cypriot banks. Indeed much of their assets come from overseas business. For example, in 2001, Bank of Cyprus' assets from overseas accounted for almost forty percent of its total assets. This was up from twenty-four percent in 1998.[15]

2.21 As Cypriot banks expand abroad they become more attractive acquisition targets for foreign banks. For instance, there have been recent talks of a merger between Marfin Bank and Egnatia Bank of Greece, and Laiki Bank of Cyprus, with the new group's headquarters being in Cyprus. Should the talks prove successful, they would lead to the formation of a powerful banking group in the South-eastern European region. Such a merger would create the largest bank in Cyprus and the second largest bank in Greece, in terms of shareholders' equity.

2.22 Banks from Greece come to Cyprus hoping to enter the local market. However, most of the other foreign Banks in Cyprus enter the market to serve non-residents. Foreign companies, particularly from Lebanon, the former Soviet Union and Eastern European countries are attracted to the island because of relative political stability and more favourable corporate tax rates.

Competitiveness

2.23 Our opinion survey found that respondents believe that banks remained efficient as a result of the FSAP measures. Additionally, further improvements in bank efficiency are expected in the future. Indeed, increasing competition is predicted, and therefore the improvement in efficiency will be one of the key success factors.

15 Moody's Investors Service (April 2002), "Cyprus: Banking System Outlook"

2.24 It appears that operational costs have increased and respondents to our survey predict that these will continue to grow in the future. However, respondents did not attribute this increase to FSAP.

2.25 The survey also gathered information on the factors that allow Cypriot banks to face competition from foreign banks. The availability of skilled personnel and the tax regime were regarded as the most important drivers. A less important factor was customer loyalty.

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.26 Switching is notoriously difficult to assess, and subjective judgement by those close to the industry is often the main source of data. In the case of this report, our main data source is our opinion survey.

2.27 Respondents to our survey took the view that there have been some positive effects on the switching behaviour of bank customers. They have also cited the following as examples of switching: the wider acceptance of credit cards, internet banking and e-commerce.

2.28 Due to the new products offered by existing banks and the possibility of acquisitions, mergers and new entrants in the market, it is reasonable to anticipate that competition for market share will be intensified and an increase in switching will occur.

Dimensions of price and quality competition

2.29 The survey investigated views of price, quality competition and product variety. The main message was that, even though there was a fall in prices of about 20 per cent over the 1999–2005 period, this decrease was not due to the introduction of FSAP; the price fall would have taken place even in the absence of FSAP measures. However, FSAP is expected to affect future prices. In particular, survey respondents believe that FSAP will facilitate easier access to banking products, more choice and reduced prices.

2.30 In relation to product variety, the number of products available on the market appears to have increased over the past years. The trend is expected to continue, with a similar pattern anticipated for e-commerce. However, even though the trend in e-commerce reflects the effects of FSAP, this is not the case for product variety as well. For example, increased product variety would have been observed even in the absence of FSAP measures.

Other factors affecting competition

2.31 According to our survey, the intensity of competition is one of the main determinants of whether a particular bank can be dominant in the banking sector. Another factor regarded as important is buyer power. This latter aspect is clearly related to the size of the firm and is of particular importance given the high level of concentration present in the Cypriot market.

Consumer protection

2.32 Consumer protection appears to have enhanced by the introduction of FSAP through the establishment of Deposit Protection Scheme (2000) and the Investor Compensation Fund for Clients of Banks (2004).

2.33 In April, 1998 and September, 2001, Cyprus's anti-money laundering system was assessed by the Council of Europe. The first evaluation report, published in June, 1998, concluded that Cyprus should be highly commended for the generally sound and comprehensive manner in which it adopted measures in line with international standards and should be congratulated for the very comprehensive legal framework put in place. The Council of Europe's report also noted that Cyprus's anti-money laundering system compares favorably with others in place in larger countries which are members of the Financial Action Task Force (FATF).

2.34 The second evaluation report, published in June 2002, concluded that Cyprus made further progress towards building an effective and robust anti-money laundering regime and noted the strong commitment from all institutions in the system, including the private sector, to join the anti-money laundering effort. The report also commended Cyprus's willingness for international co-operation and highlighted that its legal framework started producing results.

2.35 Cyprus's anti-money laundering system has also been subject to review by the FATF on Money Laundering in the context of the latter's initiative to identify non-cooperative countries and territories in the international fight against money laundering. In its official report published in June, 2000, the FATF recognized that the anti-money laundering system of Cyprus is in line with international standards and excluded Cyprus from the published list of "non-cooperative jurisdictions".

2.36 In March, 2001, the International Monetary Fund carried out an assessment of Cyprus's international banking and financial sector for the purpose of evaluating compliance with international standards of supervisory and regulatory practices. The IMF's report, which was released in August, 2001, proves unequivocally Cyprus' high level of banking supervisory and regulatory standards applied to the international banking and financial services sectors.

Impact of the FSAP and FSWP Legislative Measures on the Cypriot Banking Sector

Cross-border business, takeovers and the development of a regional market

2.37 Cypriot banks have been expanding into other EU markets, which may well have been partly facilitated by the FSAP. Indeed, the FSAP has opened up the European markets and enabled Cypriot banks to penetrate those markets.

2.38 In the future, a greater EU-wide tendency for firms to engage in cross-border activities, driven to an important degree by the FSAP, will eventually lead to even greater foreign participation in Cyprus.

2.39 Interestingly, even though the data do not suggest an increase in the number of foreign banks in Cyprus, respondents to our survey hold the view that cross-border activities in the banking sector will increase in the future. The increase seems likely to be mainly due to the development of international branches.

2.40 From what has been mentioned above, it is reasonable to conclude that the FSAP has had a positive impact on the level of openness in the Cypriot banking sector.

Competition

2.41 The level of concentration in the Cypriot banking sector has increased since the implementation of the FSAP. Indeed, the sector remains highly concentrated. The impact of the FSAP remains unclear. However, despite the relatively high concentration ratios, it is evident that the market is not as dominated by a small number of players as before.

2.42 Also, the opening of the European banking markets, which has partly enabled the expansion of Cypriot banks, has also brought about more contestability and competition. Therefore, our view is that the FSAP has positively influenced the level of competition in the Cypriot banking sector.

2.43 It is interesting to note that respondents to our survey suggested that the degree of switching behaviour has been positively affected by the FSAP, and that this will be true of the future as well.

Competitiveness

2.44 The operating expenses of Cypriot banks increased and are expected to continue increasing.

2.45 So far, the FSAP does not appear to have had any more than a negligible impact on competitiveness in the Cypriot banking sector. However, the increasing level of competition due to the further implementation of the FSAP, which should lead to further harmonisation of the European banking market, should drive efficiency improvements of Cypriot banks that wish to remain operative.

2.46 Interestingly, respondents to our survey were of the view that, the efficiency of Cypriot banks has not significantly changed since the implementation of the FSAP. However, the FSAP has enabled European banks to compete more effectively with their non-European counterparts by levelling the playing field in some respects.

Employment

2.47 So far, there is not enough information to draw conclusions about the impact that the FSAP might have had on the level of employment in the Cypriot banking sector.

2.48 Interestingly, respondents to our survey expect that the FSAP will create new jobs in the Cypriot banking sector, as Cypriot banks will expand more in foreign markets and new products will be introduced.

Consumer protection

2.49 Consumer awareness and transparency (due to requirements prescribed in the new Directives issued) in the system have increased and, as a result, it is expected that the number of consumer complaints will rise in the future. In turn, more information availability, as well as the expected increase in the variety of the products and services offered and anticipated competition, are expected to lead to a better consumer understanding relating to banking products. Therefore, our view is that the implementation of the FSAP has increased consumer protection in the Cypriot banking sector.

2.50 Respondents to our survey believed that the FSAP had a positive effect on consumer protection and that the effects in the future will also be positive.

Conclusions

2.51 The IMF report states that the supervision of the banking sector has been enhanced as a result of the country's accession to the EU due to the required amendments to regulation and legislation so as to meet the EU's requirements for accession. One example was that accession was beneficial for the supervision of the banking sector in making the Central Bank independent.

2.52 In light of the above, it appears that directly observable impacts so far of the FSAP (as compared to the broader process of the achievement of the internal market) on the Cypriot banking sector have been significant in some respects, while their effect was either neutral or ambiguous in other cases.

2.53 Nevertheless, key FSAP aims — to achieve the internal market for financial services, and in doing so to promote a regulatory environment which may foster best practice in the sector and improved financial development — were to some extent being met in Cyprus from this time onwards.

2.54 The Cypriot banking sector experienced or is expected to experience a number of positive effects as a result of FSAP introduction:

(a) Better efficiency and transparency in corporate governance.

(b) Increase of choice and reduction of prices for consumers.

(c) Cheaper finance for business.

(d) Generation of new jobs.

(e) Improvement of consumer confidence in cross-border shopping through putting in place mechanisms for dealing with cross-border breaches of consumer protection laws.

(f) More level playing field.

2.55 Further, some economists believe that one of the key aims of the FSAP, opening up of cross-border retail banking, is about to begin.

3 INSURANCE

The Cypriot Insurance Sector

3.1 In 2004, there were forty-eight companies in the Cypriot insurance industry. Of these, twelve offered life insurance (including three composites) and twelve were registered and supervised locally but were active outside Cyprus. By the end of 2005, the number of insurance companies in Cyprus had declined to forty-three.

3.2 The insurance market's contribution to GDP was equivalent to 6.83 percent. This figure is compared to an EU average of 8.7 percent in 2002.[16]

Table 3.1: Gross Premiums in Cyprus

Year	Gross Premium (CYP millions)	Annual Change (%)	Total Insurance Premiums to GDP (%)
2000	325.9	n/a	5.97
2001	261.3	-20%	4.46
2002	279.1	7%	4.51
2003	419	50%	4.67
2004	492.6	18%	6.83

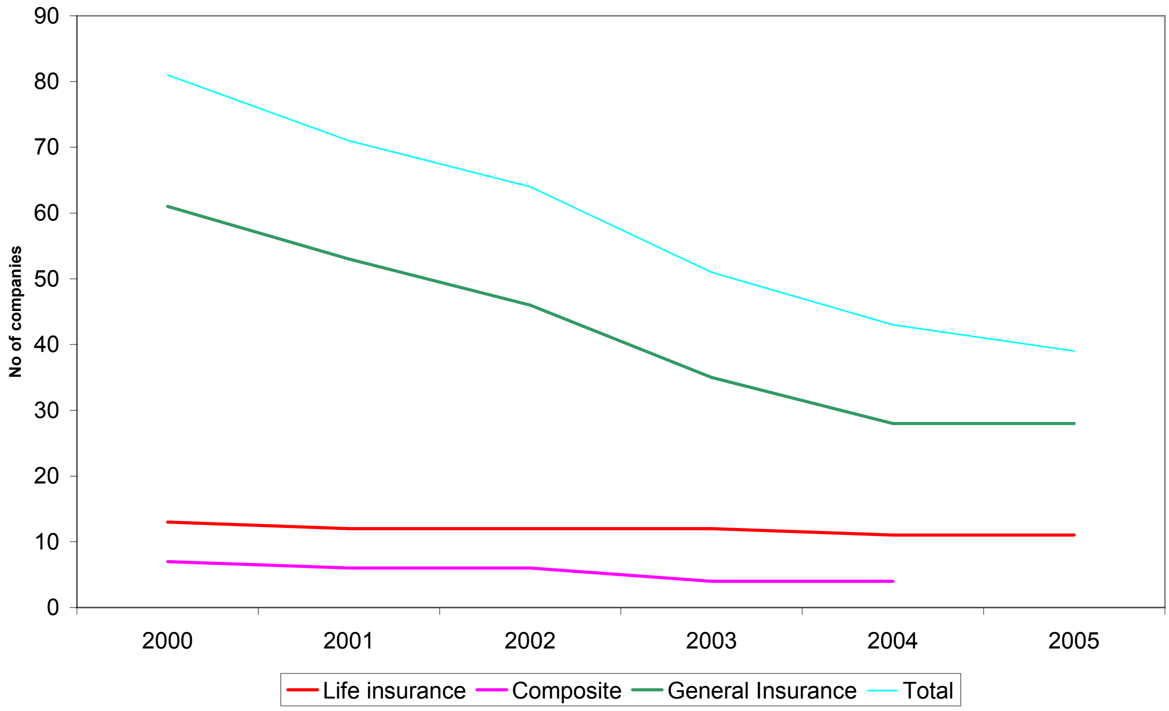
Source: IMF

16 http://www.agroins-capital-market.com/asfalistikos_klados.asp

Number of Insurance Companies

3.3 Figure 3.1 gives the number of life and non-life insurance companies in Cyprus from 2000 to 2005.

Figure 3.1: Number of Insurance Companies in Cyprus, 2000-2005



Data on number of Composite Insurance companies for 2005 are missing. Therefore the Total figure of insurance companies in 2005 understates the true number.

Source: IMF

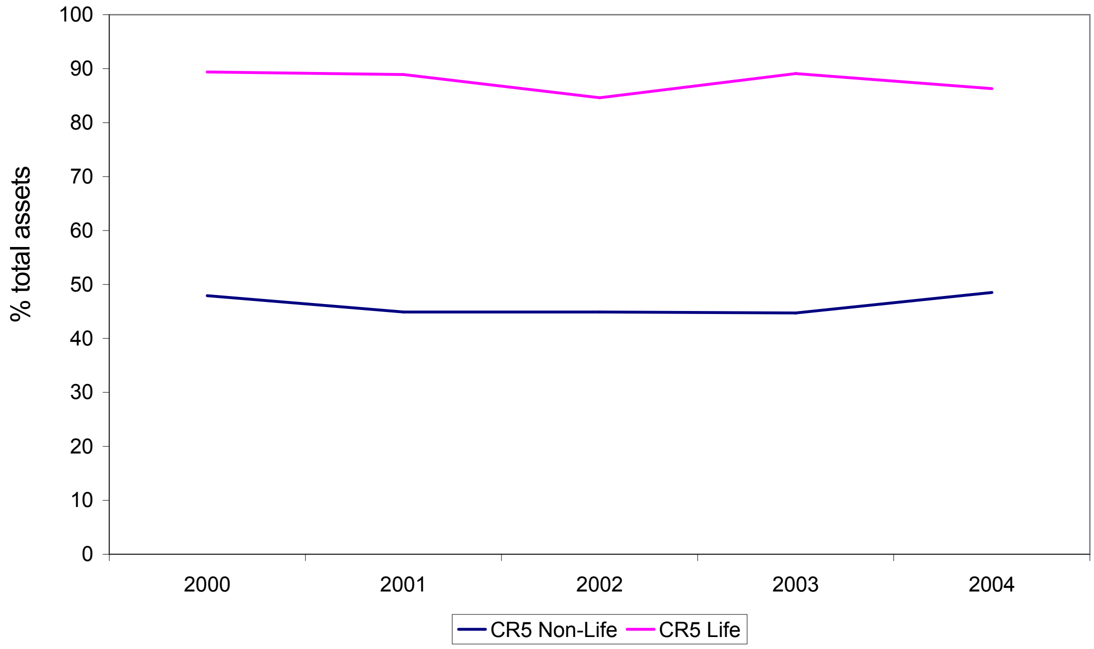
3.4 The Cypriot insurance market has changed significantly in recent years. From a peak of eighty-one insurance companies in 2000, the market shrunk to thirty-nine in 2005. This fall in the number of insurance companies can be largely attributed to the introduction of EU law and regulation. Many companies have exited the non-life Cypriot market in response to the introduction of EU law.

Market shares

3.5 There is a concentration of activity among a few companies and, in 2004, the four largest companies in the life insurance market were controlling two thirds of the business, while seventy-five percent of the general insurance market was controlled by eight companies.

3.6 The concentration ratio of the five largest companies in the life and non-life insurance sectors is shown in Figure 3.2.

Figure 3.2: CR5[17] for Life and Non-Life Insurance Companies in Cyprus, 2000–2004 (%)



Source: Insurance association of Cyprus

3.7 Most of the large insurance companies are partly or wholly owned by banks. Consolidation among banking groups in the past few years has led to bank-related insurance companies increasingly dominating the local insurance market as a whole, but particularly in the life sector where the top three companies (Eurolife, Laiki Cyprialife, and Universal Life) are all bank-related.

3.8 The bank-owned insurance groups are listed in Table 3.2:

Table 3.2: Bank-Owned Groups

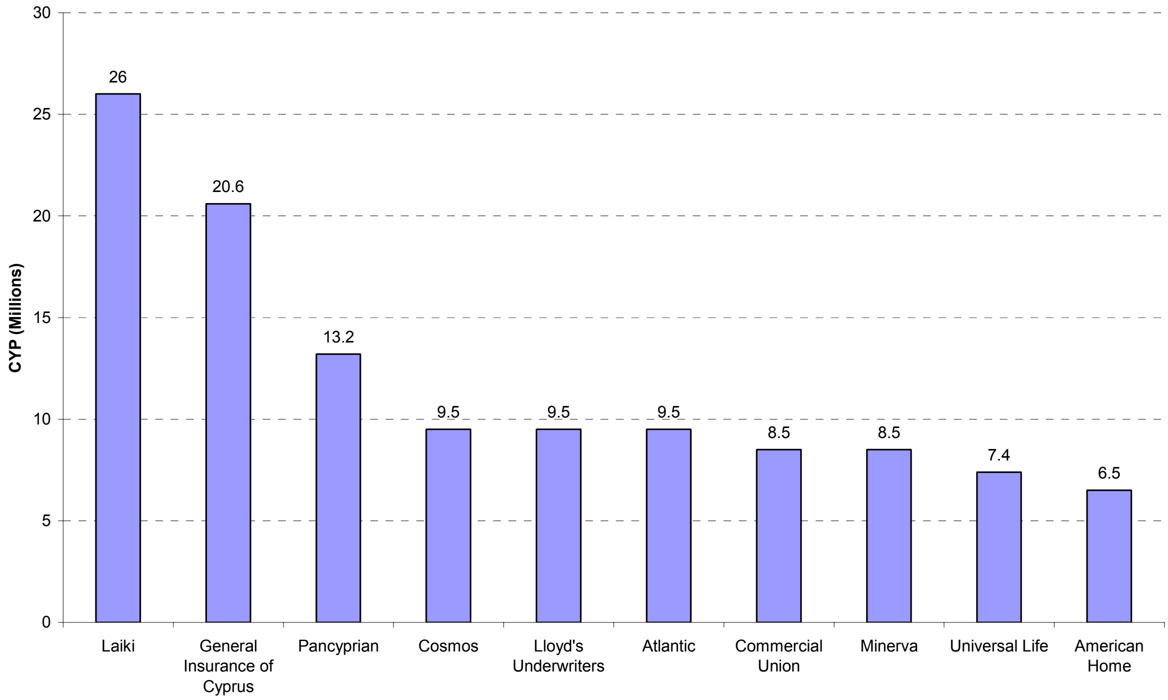
Bank	**Company**
Laiki	Laiki Cyprialife
	Laiki
Bank of Cyprus	Eurolife
	General
Hellenic Bank	Pancyprian
	Hellenic ALICO
Universal Bank	Universal Life
Alpha	Alpha Insurance

Source: Insurance Association of Cyprus

17 CR5 is proportion of total assets held by the 5 largest firms in the sector. Defined in the Main Report.

3.9 Figure 3.3 presents the Gross Written Premiums for each major insurance company in the non-life insurance market in 2004.

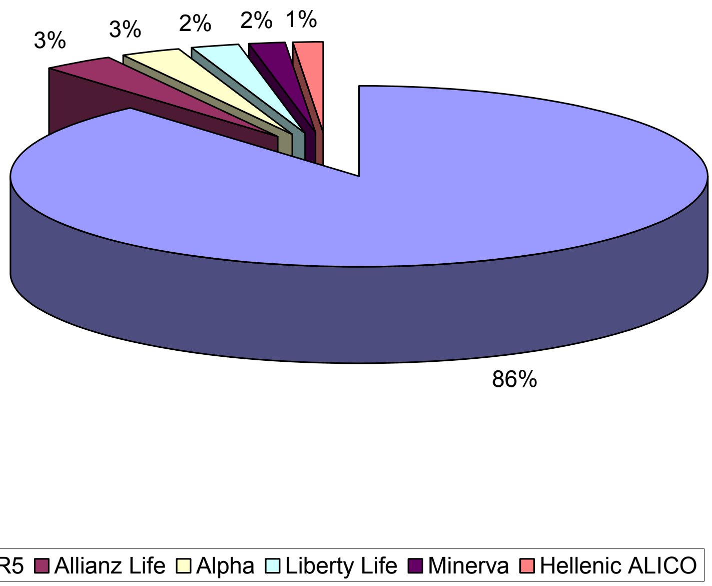
Figure 3.3: Gross Written Premiums for Leading Non-Life Insurance Companies, 2004



Source: Analysis International Insurance Factbook 2006–2007

3.10 Figure 3.4 shows the market shares of the ten biggest life insurance companies in 2004.

Figure 3.4: Market Shares (Gross Written Premiums) for leading Life Insurance Companies, 2004



Aspis and Ethniki are not included in the Figure. Their share is very small.

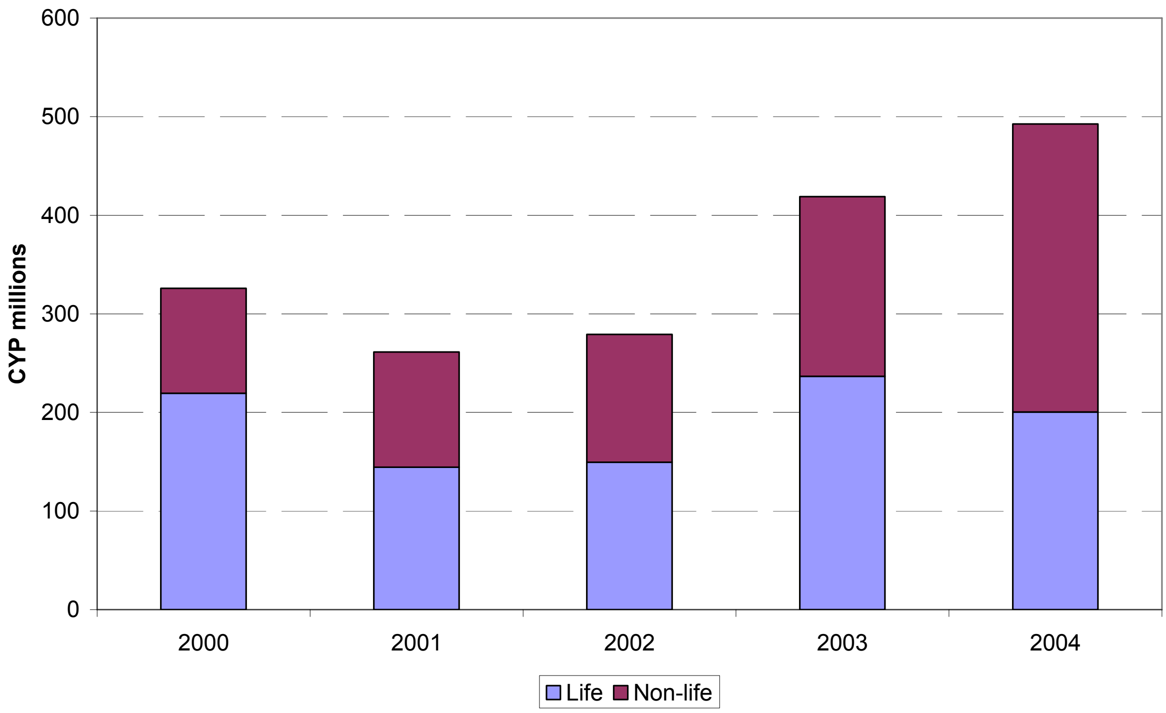
Source: Analysis International Insurance Factbook 2006–2007

3.11 The life insurance sector is more concentrated than the non-life sector. There are twelve life insurance companies in Cyprus and the five largest account for eighty-six percent of total market share.

Turnover

3.12 Figure 3.5 illustrates the development of life and non-life insurance gross premiums in Cyprus from 2000 to 2004.

Figure 3.5: Insurance gross premiums in Cyprus, 2000–2004



Source: IMF

3.13 Premiums written fell at the beginning of the millennium, but shifted dramatically upwards in recent years. However, this upward shift has been mainly due to changes in the non-life sector.

3.14 It should also be mentioned that the observed reduction at the turn of the millennium seems likely to have been connected with the behaviour of the stock market:[18]

International entry

3.15 In 2004, in the non-life sector, seven entities were branch operations of foreign companies, from Germany, USA and the UK, including Lloyd's. There are representatives of the Greek insurance market but these are established as subsidiary companies.

3.16 According to the IMF report, of the twenty-six non-life companies exiting the market as a result of EU entry, ten were international, mainly captive insurers. In 2004, most of the international business was reinsurance (seventy-two percent) and life business (twenty-two percent).[19]

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18 IMF (2001), "Cyprus: Assessment of the Offshore Financial Sector"

19 IMF (2006, "Cyprus: Assessment of Financial Sector Supervision and Regulation, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision, Insurance Supervision, and Securities Regulation."

Impact of the FSAP and FSWP Legislative Measures on the Cypriot Insurance Sector

Market entry, cross-border business and takeovers

3.17 As aforementioned, a number of EU insurance companies provide services in Cyprus. The number of international branches operating in Cyprus declined after accession to the EU. However, this does not appear to be a result of the implementation of the FSAP.

3.18 From the information we have so far, it is difficult for us to draw definitive conclusions regarding the impact of the FSAP on the Cypriot insurance market. However, if the FSAP achieves its aim to harmonise the European insurance market, it should increase the level of cross-border activity among the EU Member States in the future.

3.19 Interestingly, survey respondents hold the view that cross-border insurance trade has increased and is expected to increase further, despite reduced use of international branches.

Competition

3.20 So far, it is too early to conclusively evaluate the impact of the FSAP on the level of competition in the Cypriot insurance sector. However, if the FSAP achieves its aim to harmonise the European insurance market, it will increase the level of cross-border activity and therefore increase the level of competition in the Cypriot insurance sector.

Competitiveness

3.21 The Cyprus insurance market is mainly dominated by domestic insurers.

3.22 The efficiency of insurance firms in Cyprus increased as a result of the application of FSAP measures. The underlying reason, respondents suggested, was that liberalisation of motor rates, for instance, contributed to the application of rates that match the risks covered — motor business is the largest part of general business. Efficiency is expected to increase further in the future because of FSAP, as some insurers may wish to take measures that will make them more efficient in advance of further solvency requirements.

3.23 According to our survey, product variety has increased, but not because of FSAP. However, the effect of FSAP is expected to be felt in the future as life undertakings may move towards offering more products with pension characteristics.

3.24 Respondents to our survey believed that the main determinants of whether a particular insurer can be dominant in the domestic sector are management structure and funds.

3.25 It should be noted that, according to survey respondents, the operational costs insurance companies face have increased and are expected to increase further. However, it is not suggested that FSAP drove this cost rise.

Employment

3.26 The lack of data on the level of employment in the Cypriot insurance sector does not allow for any conclusive assessment of the impact of the implementation of the FSAP on the level of employment in the Cypriot insurance market.

Consumer Protection

3.27 The lack of relevant information concerning consumer protection does not allow us to draw any robust conclusions regarding the impact of the implementation of the FSAP on consumer protection in the Cypriot insurance sector. However, if further implementation of the FSAP does harmonise the EU insurance market, then it would be logical to believe that consumer protection will rise with more competitive markets and better informed consumers.

3.28 Interestingly, survey respondents took the view that consumer understanding of insurance products increased because new legislation requires extensive information to be disclosed to potential policyholders, thereby enhancing understanding.

Conclusions

3.29 From the above we can see that many of the trends we would have anticipated as following from the FSAP have indeed either occurred or are expected to take place in the near future. For example, we can see greater efficiency, more consumer protection, greater concentration and a higher rate of product innovation.

3.30 Nevertheless we can see that the market expects direct impacts of the FSAP to take place in the future. For example, one possible future direct impact may be the stimulation of e-commerce of insurance goods.

3.31 It can also be argued that, in some areas, implementation of the FSAP may have levelled the regulatory playing field with other Member States, possibly helping Cypriot companies compete in the future.

4 SECURITIES MARKETS

Cypriot Securities Markets

4.1 The securities sector is supervised by two regulatory bodies; the Cyprus Securities and Exchange Commission and the Central Bank of Cyprus.

4.2 The Cyprus Securities and Exchange Commission mainly regulates the exchange and collective schemes, while the Central Bank regulates international financial advisors and non-retail investment schemes.

4.3 The development of the securities market started effectively in the late 1970s. The growth of the market, however, was rather slow until the establishment of the Cyprus Stock Exchange (CSE). The CSE is state owned and started operation in 1996 as a regulated exchange, where all transactions concerning corporate and public securities, such as stocks, bonds and warrants, are carried out. Since then there has been fast growth and the CSE has become a source of growing importance for corporate fund procurement.

4.4 From the late 1990's onwards there has been considerable volatility:

(a) During 1999, the CSE General Index rose steeply from below 100 at the start of the year to over 800 less than twelve months later. Following this spectacular rise, correction was inevitable; in 2000, the level crashed to around the 200 level and, until 2005, the overall trend has been gradually downwards. The bursting of the speculative bubble of 1999 has shattered investors' confidence in the stock exchange and resulted in a considerable reduction in activity.

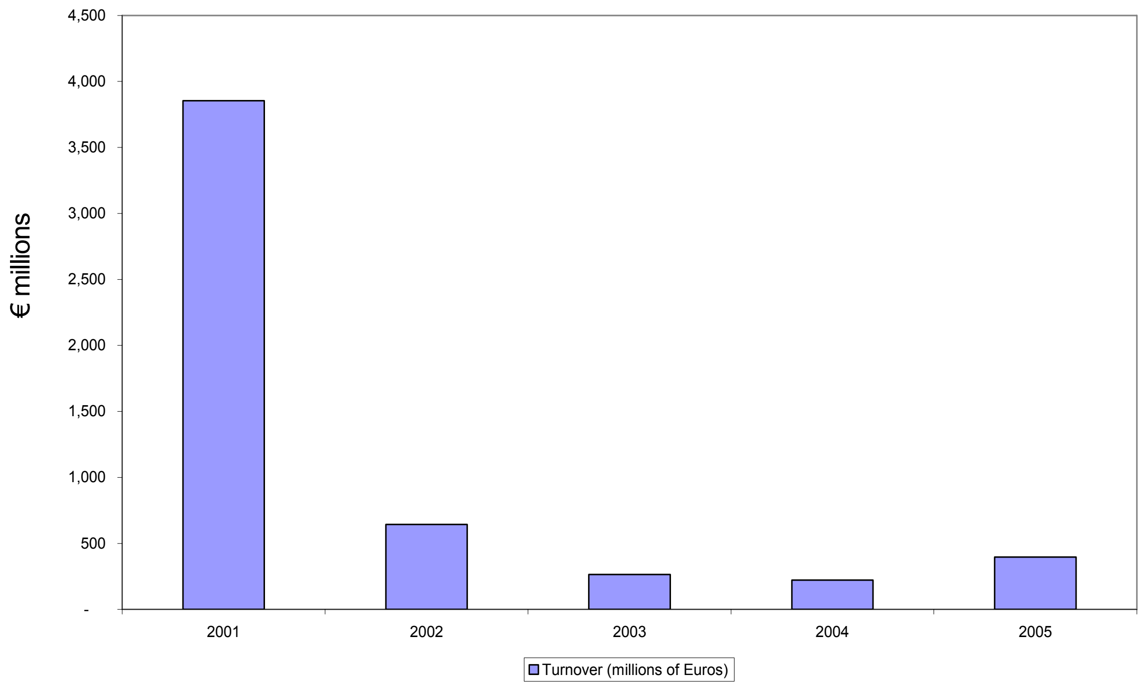
(b) At the end of 2004, the CSE General Index had fallen to 72.6. New indices were launched during 2004, but in December 2005, the old General Index had crept up to 103. As of April 2005, turnover was around $500,000 daily (relatively low).

(c) According to the IMF report, the market is dominated by the large banks and utilities, with about fifty percent of market capitalisation represented by the three largest banks.

(d) In 2001, market capitalisation amounted to the equivalent of € 9.6 billion or 94.8 percent of GDP. In 2004, stock market capitalization was thirty-six percent, which is below European averages (Eurozone: 61.5 percent, EU15: 75.5 percent).

4.5 Figure 4.1 presents data on the turnover of the Cyprus Stock Exchange for the period 2001–2005.

Figure 4.1: Turnover of Cyprus Stock Exchange, 2001–2005



Source: IMF

Factors Specific to Cypriot Securities Markets

4.6 Cyprus is a very small economy by EU standards and its economy is vulnerable to external factors. The Cyprus issue remains unresolved and potentially causes uncertainties to markets.

4.7 The securities market is a developing market. The volatility of the stock market during the late nineties affected the performance of financial institutions. For instance, banks were lending to customers who intended to use the borrowed money to buy shares when the market was rising. After the collapse of stock market prices, banks realised losses.

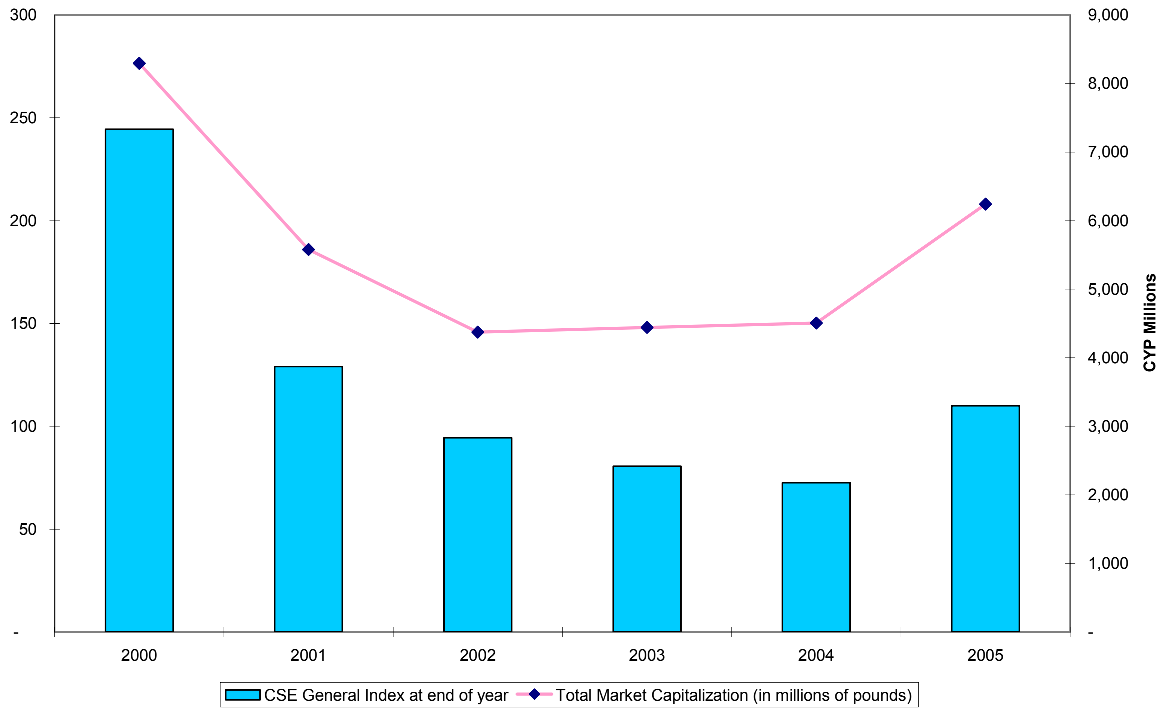
4.8 Stock market trading is heavily skewed towards shares of banks.

Impact of the FSAP and FSWP Legislative Measures on the Cypriot Securities Market

Level of implementation

4.9 Figure 4.2 shows the decrease in both the market capitalisation and General Index of the Cyprus Stock Exchange since 2000. The dramatic fall in the index after the steep rise in 1999 is not shown in the figure, but the effects of this blow to the confidence of investors were to persist until 2004. It is only in 2005 that the General Index started rising again. However, this rise is probably unrelated to FSAP.

Figure 4.2: CSE General Index and Market Capitalization



4.10 The Cypriot market is relatively small and highly dominated by banks. For example, the shares of Bank of Cyprus were the most traded shares in terms of turnover in 2005 (41.93 percent) – the shares of Laiki Bank are the second most traded (15.5 percent).[20]

Impact

Cross-border activities

4.11 There are a number of general objectives that the FSAP measures in the securities market attempt to reach.

4.12 With regards to the increase in the volume of trade both in the past and in the future the most likely scenario seems to be that it will increase. This would probably have happened even without the implementation of the FSAP measures, given that the market was in the process of recovering from the 1999 events, but it would be logical to suggest that the FSAP has contributed to this increase.

Competition

4.13 An increase in cross-border activity and trade should of itself enhance the level of competition in the Cypriot securities market. Since, *a priori,* further implementation of the FSAP may have a small positive impact on the level of competition and trade in the Cypriot securities market; we may conclude that for the future, further implementation of the FSAP is likely to have a slightly positive impact on competition in the Cypriot securities sector.

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[20] "Cyprus Stock Exchange Fact Book 2005", Cyprus Stock Exchange.

Employment

4.14 If the aim of the FSAP of de-segmenting the EU market is achieved, and if (as a result) the Cypriot securities market expands, then in the short term, the level of employment in the Cypriot securities market should rise slightly.

4.15 In the long term, the MiFID (with respect to systematic internalising) is likely to create a tendency for securities related jobs to migrate to London, because of its head-start in such activities. The expected general expansion of the European securities markets will also increase the aggregate level of employment in the Cypriot securities market.

Competitiveness

4.16 So far, the FSAP has had a limited impact on competitiveness. However, MiFID (soon to be implemented) is likely to expose the European securities markets to more competition, which in turn is likely, over time, to decrease transaction costs and thus enhance competitiveness in the Cypriot securities market. Therefore, the FSAP is likely to have a positive impact in the future.

Consumer Protection

4.17 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Cypriot securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Cypriot securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Conclusions

4.18 It is unclear to what extent FSAP has affected the Cypriot securities market. The impact of the late nineties' fall in the CSE General Index outweighed the effect of other factors until recently; the lack of liquidity (due to the 1999 events) and the negative effect on investors' confidence were characteristics of the period following the dramatic index fall.

4.19 The market only started recovering from the impact of the collapse in market prices in 2005, after the FSAP entry and, therefore, the effects of the FSAP remain to be seen.

5 FINANCIAL CONGLOMERATES

Financial Conglomerates

5.1 The Cypriot financial market is characterised by close links between the banking and insurance sectors. Increasingly closer links between the banking and insurance sectors are an international phenomenon and are related to the development and integration of the financial markets (financial diversification and conglomeration). The general aim is to realise economies of scope.

Financial Conglomerates in Cyprus

5.2 On 24 April, 2006, the Mixed Technical Group on the supervision of financial conglomerates issued a list indicating those groups, with their head office in a Member State of the European Union or of the European Economic Area, that have been identified as financial conglomerates under Article 3 of Directive 2002/87/EC.21.

5.3 We have identified the conglomerate headquartered in Cyprus in Table 5.1 and and all other conglomerates operating in Cyprus at Table 5.2.

5.4 The list specified the Universal Life Group as the only conglomerate headquartered in Cyprus.

Table 5.1: Financial conglomerate in Cyprus

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Universal Life Group	Cyprus	Insurance, and major institutional investor	Insurance, brokerage

Source: EU Mixed Technical Group on Supervision of Financial Conglomerates, Europe Economics

[21] Mixed Technical Group (24 April 2006), "Implementation of Directive 2002/87/EC – the Financial Conglomerates Directive, Identification of Financial Conglomerates"

Table 5.2: Other financial conglomerates operating in Cyprus

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Allianz	Germany	Insurance group doing asset management and banking	Insurance with some banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Private and investment banking/securities
Eureko	Netherlands	Insurance group doing asset management and banking	Insurance and securities
Old Mutual	UK	Asset management, Life assurance, Banking, Offshore trust and company services	Insurance with some banking

Source: EU Mixed Technical Group on Supervision of Financial Conglomerates, Europe Economics

Impact of the FSAP and FSWP Legislative Measures on the Cypriot Financial Conglomerates

Openness

5.5 The FSAP measures for regulation of Financial Conglomerates should create a more standardized regulatory environment, reducing costs of compliance for large firms operating across multiple jurisdictions.

5.6 Thus, our assessment is that the FSAP will slightly encourage greater openness in the future.

Competition

5.7 We have seen that competition is expected to be slightly enhanced in banking but unclear in insurance and securities. We thus expect the overall impact of the FSAP on financial conglomerates as perhaps slightly positive.

Consumer protection

5.8 Effects on consumer protection in both banking and insurance are expected to be positive and in securities to be unclear. We therefore expect consumer protection in the Cypriot financial conglomerate, to be positively effected by the FSAP.

Employment

5.9 We assess the effects on employment in banking, insurance and securities sectors as unclear. Therefore, our view is that the effects of the FSAP on employment, in the Cypriot financial conglomerates are unclear.

Competitiveness

5.10 As pressures of competition from abroad and domestically are expected to be increased by the FSAP, we would expect this to improve the competitiveness of the financial conglomerates in Cyprus.

Employment and Wages

5.11 During the 1999–2005 period, the number of employees working for the sole Cypriot-headquartered financial conglomerate increased by more than fifteen percent. However, according to survey respondents, this increase is not associated with FSAP, as the change was expected to have taken place irrespective of FSAP measures. The underlying reason is probably associated with the growth of the banking operations of the group's subsidiary bank.

5.12 There is the expectation that more consolidation is to take place in the Cypriot financial sector. As a result, survey respondents are anticipating that the number of jobs in conglomerates to fall. However, given the existence of only one conglomerate, should further consolidation imply that more groups fall under the definition of a conglomerate, we would expect that more jobs are created (in the sense that in accounting terms more positions will be recorded as jobs in conglomerates). Whatever the overall effect may be though, survey respondents claim that the consolidation is expected to take place irrespective FSAP.

5.13 Wages for employment in conglomerates in Cyprus were not influenced by FSAP because increases in wages and salaries are agreed between the banks and the employees' trade union. Survey respondents expect this to be the case in the future.

Effect on Make-up of Conglomerates

5.14 The effect of FSAP on the make-up of conglomerates is assessed on the basis of the response to our survey.

5.15 As mentioned above, there is only one financial conglomerate headquartered in Cyprus. The group's sole banking subsidiary was acquired in 1996, and its operations were rather small up to 1999. The group would not have been counted as a financial conglomerate in 1999. However, the subsequent floatation of the banking subsidiary helped increase the banking operations.

5.16 The respondents' view is that the FSAP did not have a material effect on the change in the make-up of the conglomerate.

5.17 However, FSAP may be one of many reasons behind expectations that more financial conglomerates will be present in Cyprus in the future. Such an expectation is associated with the expectation that merger and acquisition activity in the Cyprus financial sector is likely to continue increasing. Following the entry of Cyprus into the EU in 2004, the financial sector has been consolidating. There continues to be potential for an increase in the size of the insurance sector and more financial conglomerates are likely to be formed, according to survey respondents.

Efficiency

5.18 Survey respondents believed that efficiency of the sole conglomerate in Cyprus increased as a result of FSAP and they expect this trend to continue in the future.

5.19 In particular, respondents stated their belief that the use of advanced technology, which was introduced in order to comply with some of the requirements of the directives issued under the FSAP, has contributed in increasing the financial conglomerate's efficiency.

5.20 Operational costs increased over the 1999–2005 period but probably the change was independent of the FSAP. Survey respondents explain the increase in reference to the growth of the banking subsidiary of the conglomerate, which, they expected, would have been observed regardless of the introduction of the FSAP.

Conclusion

5.21 Overall, we could not find evidence suggesting that FSAP had a major impact on financial conglomerates in Cyprus. There have been some changes regarding the sole financial conglomerate in Cyprus, but generally these are not thought of as being associated with FSAP.

5.22 The only possible effect may be related to the use of modern technology (required for compliance with FSAP measures) and the associated increase in efficiency.

6 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Employment**	**Competitiveness**
Banking	Positive	Positive	Positive	Unclear	Limited in short term. Perhaps positive in the long term
Insurance	Unclear. Perhaps positive in the future	Unclear	Positive	Unclear	Unclear. Perhaps positive in the future
Securities	Perhaps positive	Perhaps positive in the future	Perhaps positive in the future	Perhaps positive in the future	Perhaps positive in the future
Financial Conglomerates	Slightly positive in the future	Perhaps slightly positive	Positive	Unclear	Perhaps positive in the future

CZECH REPUBLIC

1 INTRODUCTORY OVERVIEW

General Remarks

1.1 The Czech Republic is a relatively small country, with a population of 10.3 million. Despite its small size, the Czech Republic is the wealthiest of all the Central European democracies.

1.2 On 1 May 2004, the biggest single enlargement of the EU took place. The Czech Republic was one of ten new countries that joined with varying but considerably lower levels of financial development than was the case in the EU15. In a similar way to other new Member States, the Czech financial systems are largely bank-based. Other financial sectors are still small, but developing fast. The transition of their economies during the past years has taken place with considerable openness towards foreign entry.

Financial Services Regulation in the Czech Republic

Division of responsibilities

1.3 The Ministry of Finance is the main authority accountable for the implementation of FSAP measures. During this work it cooperated closely with other supervisory authorities and relevant associations. The Ministry of Finance also carried out public consultations on EU measures.

1.4 The Česká národní banka (Czech National Bank, CNB) is the central bank of the Czech Republic and the supervisor of the Czech financial market. In March 2006 the insurance regulator and the securities regulator were incorporated into the CNB so that it is now the sole responsible regulatory body for the whole financial market.

Key features of banking regulation

1.5 Banking supervision, as performed by the CNB, comprises two fundamental, interrelated powers: regulatory and supervisory. Within its regulatory capacity, the CNB is responsible for ensuring that the laws and regulations governing the banking sector include rules and conditions to help prevent failings in the activities of individual banks, and that during the preparation of these rules both domestic and foreign experience is fully exploited.

1.6 Supervisory activity is focused on checking banks' competence to engage in banking activities and compliance with the relevant terms and conditions, rules and laws. Linked to this supervisory activity is the power to stipulate remedial measures and to impose sanctions on those banks that do not comply with these measures.

1.7 Act No. 21/1992 Coll. on Banks is the main banking legislation in the Czech Republic. First issued on 20 December 1991, it has been amended some 20 times since then. A crucial step in this area was the harmonisation amendment to the Act on Banks, which took effect on 1 May 2002.

1.8 This Act governs certain relations associated with the establishment, business activities and dissolution of banks having their registered offices within the territory of the Czech Republic, including their activities outside the territory of the Czech Republic, as well as certain relations associated with the activities of foreign banks within the territory of the Czech Republic.

Key features of insurance regulation

1.9 The Ministry of Finance is responsible for the discharge of the state supervision in insurance and pension funds (Section 4 of the competencies Act No. 2/1969 Coll.). In September 2000 the Ministry founded an extra department called the Office of the State Supervision in Insurance and Pension Funds. This office was merged into the CNB in March 2006 making the CNB the supervisory authority for banking and insurance.

1.10 The main parts of the activities of the Office for State Supervision and now the CNB are Licensing and Approval (the CNB continuously has to license every operator providing insurances) and inspection (the CNB regularly insects the operators in order to ensure consumer protection).

Key features of securities regulation

1.11 The Czech Securities Commission was formed on the 1 April of 1998 as an independent regulator for the securities market and ceased to operate on 31 March 2006 being integrated into the CNB. All its responsibilities will be transferred to the CNB as from 1 April 2006.

1.12 Formerly the Czech Securities Commission and now the CNB pursues fulfilment of the three following statutory objectives:

(a) Contribution to the investor protection

(b) Contribution to the capital market development

(c) Promotion of education in the capital market sector

1.13 Powers and jurisdiction of the CNB stipulated by the Law are:

(a) Discharge of state supervision and decision on the rights or titles, legally protected interests and duties or obligations of the legal and natural persons.

(b) Control of compliance with the disclosure duty by the persons subjected to state supervision by the Commission. Control of compliance with the duties ensuing from the prohibition of persons to use confidential information; control of reporting suspected crime of confidential information abuse in business relations.

(c) Information of the public and capital market participants, specifically on the service providers on the capital market, investment instruments and transactions performed on the capital market and co-operation with international organisations within the scope of its jurisdiction.

Key features financial conglomerates regulation

1.14 The regulation of financial conglomerates is coordinated in the Czech National Bank.

The Implementation Process and General Effects of FSAP in the Czech Republic

Survey participants views about the implementation

1.15 According to the CNB, measures aimed to establish the EU-wide legislative base were necessary; however, the FSAP has also already caused the CNB measurable fatigue. Whether the fatigue has been caused by the FSAP measures themselves or rather by the voluminous way they have been implemented in national legislation is unclear. For instance, the added value of the prepared measures on UCITS eligible assets seems controversial since they may raise new questions rather than solve the current issues. Their effective implementation is likely to be very difficult in the Czech Republic.

1.16 Moreover, Directive 2000/46/EC on the initiation, pursuit and prudential supervision of the business of electronic money institutions might be a case of an ineffective measure. It introduced a single licence principle which has until now been used only by one institution. All the other institutions have either stopped their business or kept it at low volume and non-cross-border so as to come in under the waiver provided by the directive.

Consequences of the FSAP for the regulatory environment

1.17 Overall the consequences of the FSAP for the regulatory environment are certainly overshadowed by the extensive reorganisation of this environment due to the accession of the Czech Republic to the European Union. Compared to these changes, which took place in the years 1999 to 2004, the FSAP might be expected to seem relatively less significant than within the EU15.

1.18 Overall international organisations regard the regulation of the banking sector and the overall financial services sector as advanced. The Heritage Foundation gave the Czech Republic a score of 1 (meaning low restrictions in banking and finance) in 1997 and 2003. The world ranking of the foundation put the Czech Republic on rank 18 in 1997 and on rank 32 in 2003.

1.19 Rankings of the ECB show a similar picture with the Czech Republic already having a high standard in 1997 (3.3 out of 4 in banking and 3.0 in other financial institutions) and improving this standard up to 2003 (3.7 out of 4 in banking and 3.3 in other financial institutions). Relatively, other countries (for example the Baltic countries) have been assessed as changing more rapidly within this period.

2 BANKING

Headline Overview

2.1 The Czech banking sector has undergone substantial restructuring over the past few years, and its current situation can be regarded as stabilised. The sector has good financial results and sufficient capital to cover the risks it undertakes. For the first time in several years, no banking licence was revoked in 2004, no bank was under conservatorship, and no other "strong" regulatory instrument was used to regulate imprudent operation of a bank active in the domestic market.

2.2 The Czech Republic's accession to the EU had no immediate impact on Czech banks, as their integration into the European financial system had already been advancing especially after the privatisation of large banks was completed. Most of the rules regulating banking business had also been harmonised with EU rules in previous years.

2.3 In 2004, the total assets of the banking sector rose by CZK 108 billion to CZK 2,636 billion. This was due mainly to an annual increase in loans provided of CZK 77 billion and higher receivables from banks. The increase in loans provided was due to continuing growth in loans to households, which increased by 34.4 per cent in 2004, as well as to an expansion of loans to corporations of 7.5 per cent. The share of loans in banks' assets reached almost 41 per cent at the end of 2004.

2.4 The banking sector recorded a net profit of CZK 33.1billion in 2004, up by CZK 2.9 billion on 2003. The profit was attributable mainly to an annual increase in profit from financial activities of CZK 13.1 billion to CZK 103.4 billion, which, in turn, was due above all to growth in net interest of CZK 5.5 billion and a rise in profit from fees and commissions of CZK 5 billion. Administrative expenses rose by 3 per cent to CZK 48.9 billion. Write-offs and creation of provisions amounted to CZK 10.4 billion, compared to CZK 0.7 billion in 2003. However, the lower creation of provisions in previous years was influenced by the clean-up operations of some banks, connected with the dissolution of past reserves and provisions.

2.5 The steady improvement in the economic situation helped further stabilise the banking sector. CNB Banking Supervision concentrated fully on further harmonising its regulations with European legislation and on strengthening its practical conduct of banking supervision.

2.6 2002 was, in principle, the last year for completing the harmonisation of the Czech banking legislation with current EU law. A crucial step in this area was the harmonisation amendment to the Act on Banks, which took effect on 1 May 2002. The aim of this amendment was to achieve full compatibility with European Community law and with other international banking regulation standards.

2.7 The amendment has introduced the following main changes:

(a) provides for tighter and more transparent licensing proceedings and proceedings to grant prior consent to the acquisition or increasing of qualifying holdings in banks;

(b) extends consolidated supervision (which previously had been applied only to financial groups headed by a bank) to financial groups controlled by a financial holding company or a mixed-activity holding company;

(c) redefines relations between banking supervisors and external auditors;

(d) allows inspections to be carried out on site at foreign banks' branches and subsidiaries by home supervisors;

(e) introduces a single, unified banking licence for foreign bank branches, enabling them to be established in the Czech Republic without having to go through the licensing process; this took effect on the date the Treaty of Accession of the Czech Republic to the European Union entered into force; and

(f) allows a Central Register of Credits to be operated by the CNB.

2.8 The amendment to the Act on Banks (along with the new knowledge and needs of CNB Banking Supervision) has required extensive changes to the prudential rules for banks, which are issued in the form of CNB "provisions" and "decrees". In 2002, three new decrees, six provisions and nine official information notices were issued, dealing with the following areas:

(a) changes in the licensing requirements and the requirements governing new investors in banks;

(b) consolidated supervision of banking groups and groups headed by financial or mixed-activity holdings, in particular by laying down prudential rules for regulated consolidated groups, e.g. concerning the extension of capital adequacy to include the monitoring of market risk, the notification duties of consolidated group members;

(c) harmonising the calculation of the prudential rules on a consolidated and solo basis;

(d) assessing the quality of receivables (with the aim of moving towards a system of classifying receivables according to their level of risk) and the creation of provisions for these receivables (especially in terms of defining non-performing receivables, specifying ways of taking security into account, provisioning, etc) in line with international practice;

(e) laying down minimum requirements for credit risk and market risk management and for the verification of internal management and control systems, including risk-management systems;

(f) content and structure of information disclosed by banks in relation to the changes outlined in the Ministry of Finance decree on financial statements; and

(g) content and use of the Central Register of Credits run by the CNB.

2.9 At the end of 2002, the negotiations between the Czech Republic and the European Union were successfully completed. The CNB played its part in this, stepping up its legislative work in 2002 so that full compatibility could be achieved between the Czech and European legislation in the monetary and financial area by the end of 2002. This work included harmonisation amendments to the Act on the CNB and the Act on Banks, a new Payment System Act, and a Financial Arbiter Act and, jointly with the Czech Ministry of Finance, an amendment to the Foreign Exchange Act. All these amendments have now taken effect and have fundamentally changed the legal framework within which the central bank operates.

2.10 Recent years appear to have seen banks enhancing their competitiveness, offering a wider range of products and broadening their activities. They have come to focus more on lending to households, taking advantage of low interest rates and fairly strong household income growth. In a climate of stable growth of the Czech economy, banks are thus succeeding in making profits to bolster their stability despite growing competition in the financial intermediation sector as a whole. However, Union Bank closed for reasons similar to those underlying the failures of small banks in the past – uncontrolled expansion and insufficiently prudent behaviour.

The Czech National Bank

2.11 Economic and Monetary Union (EMU) involves specific rules ensuring the independence of central banks in Member States, prohibiting indirect financing of the state by the central bank, and disallowing privileged access of the public sector to financial institutions. These rules are to be transposed into the national legislation, despite the Czech Republic not adopting the euro from Accession.

2.12 The primary objective of the CNB is to maintain price stability. Like numerous other central banks, the CNB fulfils this objective by targeting inflation. The target was set to around 6 per cent for 1998 decreasing to around 2 per cent for 2005.

Competitors and Competition

2.13 The banking market in the Czech Republic is dominated by four large banks (total assets of more than CZK 100 billion), which control more than 60 per cent of the assets

(a) Česká spořitelna,

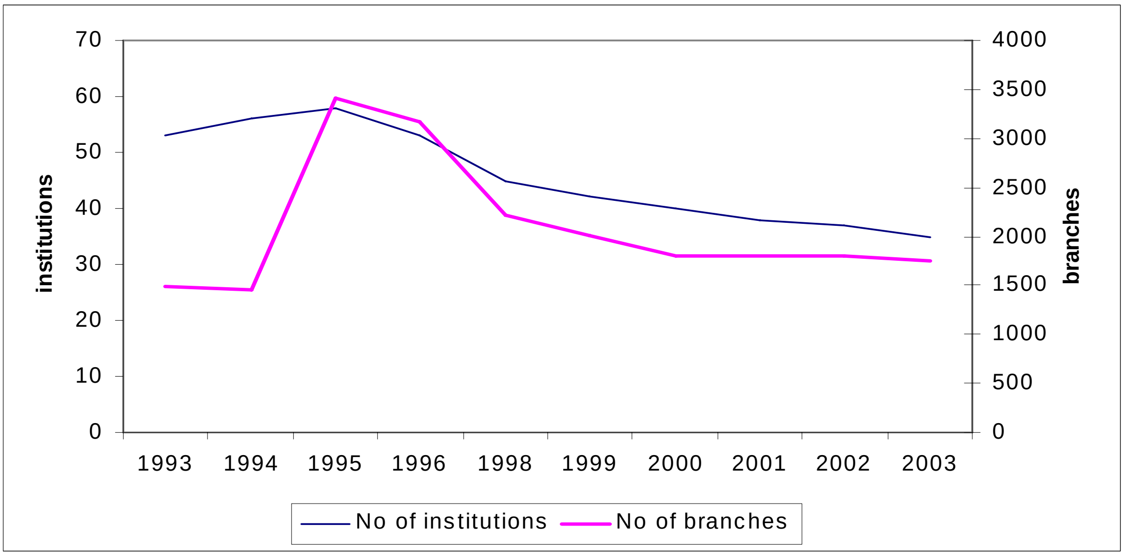
(b) Československá obchodní banka,

(c) HVB Bank, and

(d) Komerční banka

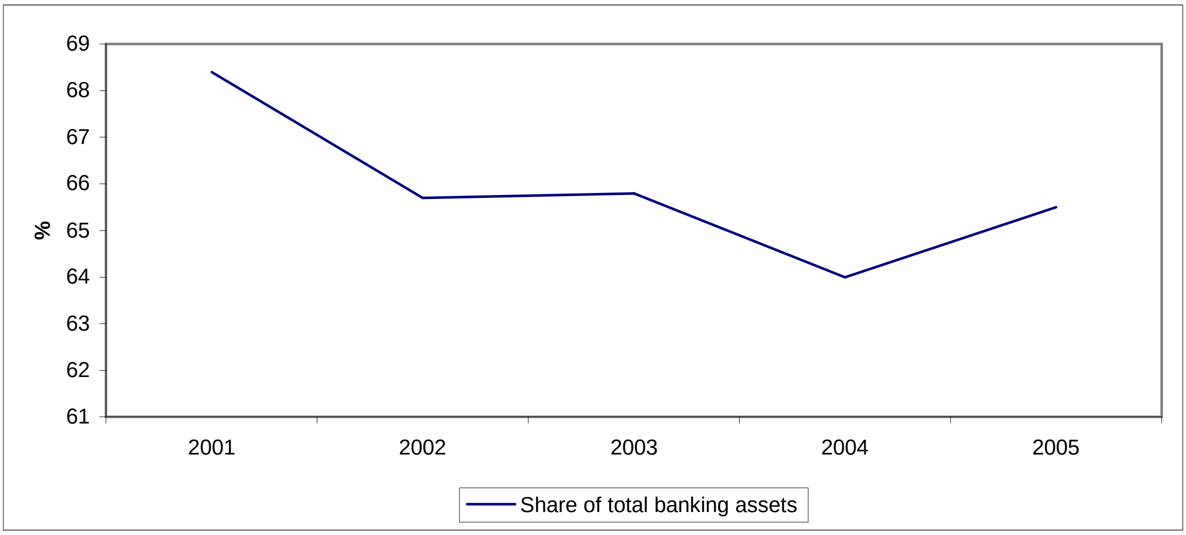
2.14 Additionally to that nine Medium-sized banks (total assets of CZK 20 billion to CZK 100 billion); six small banks (total assets of less than CZK 20 billion); thirteen foreign bank branches; and five building societies were operating in the banking market of the Czech Republic as at 2006.

Figure 2.1: Credit Institutions in the Czech Republic



Source: OECD

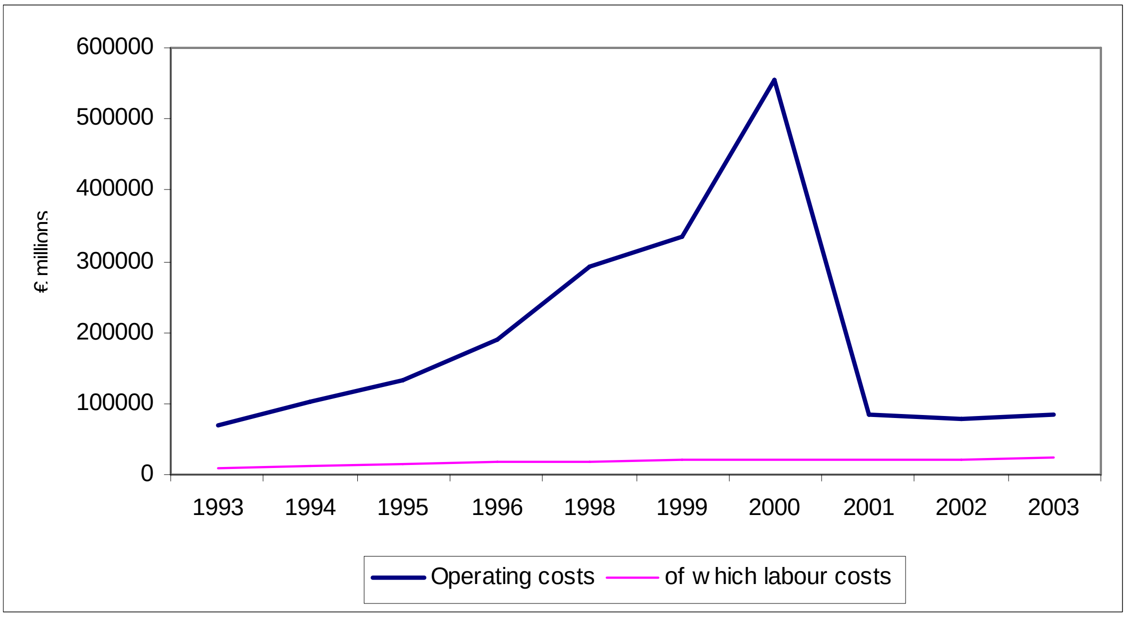
Figure 2.2: Share of total baking sector assets held by the largest five banks



Source: ECB

2.15 The net profits (about 20 per cent) and the efficiency (administrative expenses down by 3 per cent) of the banking sector in the Czech Republic increased from 2003 to 2006 while employment decreased (down by 4 per cent 2004 to 2006). Therefore the profits per employee have grown even stronger (by 35 per cent).

Figure 2.3: Operating and Labour expenses



Source: OECD

Table 2.1: Key profitability indicators (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1993	n/a	n/a	5
1994	3.6	0.5	3.7
1995	3	0.4	2.8
1996	2.5	-0.5	-4.1
1997	2.5	-0.3	-2.7
1998	3.1	-1	-8.4
1999	2.5	-1.9	-18.1
2000	2.2	0	0.1
2001	2	1.1	13.8
2002	2.5	1.8	16.6
2003	2.4	1.8	19.3

a: Net interest margin — net interest income to average total assets.
b: ROA — net income before tax to average total assets.
c: ROE — net income before tax to average capital and reserves.
Source: Europe Economics calculation of data from OECD (2005) "Bank profitability"

2.16 Considering return on equity, the banking industry appears to have enjoyed dramatically improved profitability after 1998. This continued to improve up to 2003.

2.17 Since 1991, the Office for the Protection of Competition has the compliance with rules of fair competition.

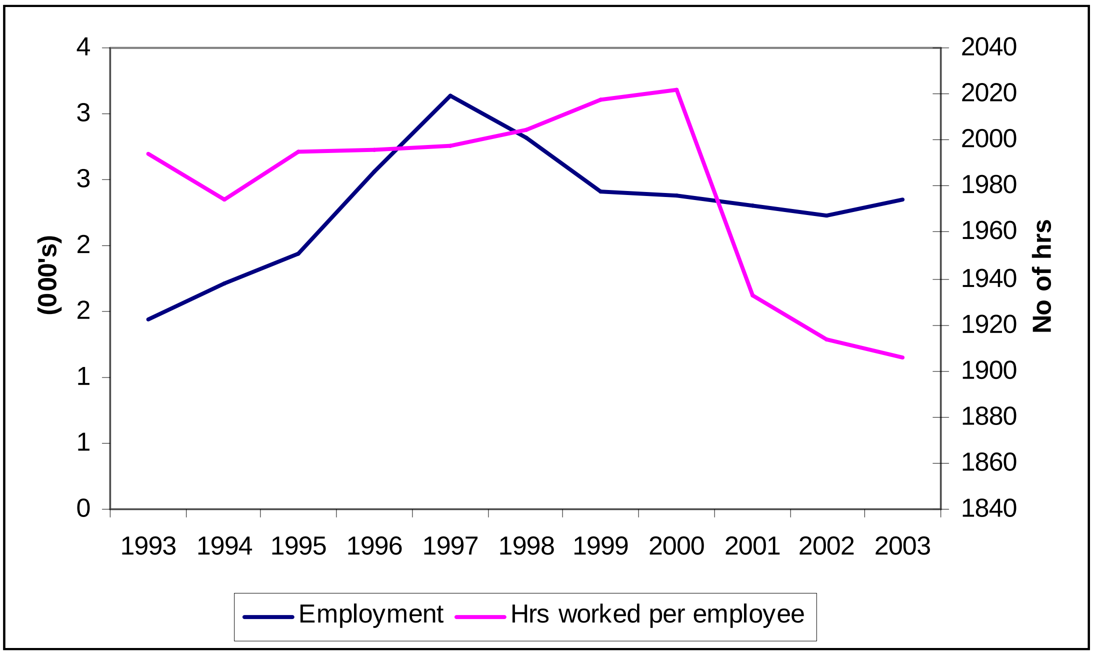
2.18 Comparing the banking market of the Czech Republic with European countries of comparable size like Austria, Sweden, Portugal, Greece, Belgium and the Netherlands, concentration in the Czech Republic (65 per cent) appears fairly typical.

Employment and labour productivity

2.19 As already mentioned employment in the banking sector decreased during the period of FSAP. From 1995 to 2003 employment (in banking and securities) decreased from 64,000 to 59,000 or by eight per cent, and by a further 2.2 per cent in 2004. At the same time the hours worked per worker decreased to from 1,994 in 1993 to 1,906 in 2003.

2.20 Both developments (drop in employment and hours worked) were outstripped by an increase in labour productivity. Between 1995 and 2005 the labour productivity per worker increased by 88 per cent and the productivity per hour even by 97 per cent.

Figure 2.4: Development of employment and hours worked (per annum) in financial services other than insurance



Source: University of Groningen

2.21 Salaries also rose strongly in the last 10 years. The average gross monthly wage rose by 125 per cent in financial institutions, more rapidly than in the overall economy (91 per cent). The increase in salaries was strongest in public and private institutions under Czech control, while the salary increase was slower in the institutions under foreign control (48 per cent). While in 1995 foreign institutions paid much more than Czech institutions this gap had largely vanished by 2002.

Table 2.2: Average Gross Monthly Wages and Salaries (CZK)

	1995	2000	2001	2002	2002/ 1995
All Industries	8,307	13,614	14,793	15,857	**191%**
Financial Institutions	14,016	25,612	29,127	31,563	**225%**
Public Financial Institutions	15,430	29,916	32,203	35,626	**231%**
Private Financial Institutions	13,341	23,264	27,280	30,044	**225%**
Private under foreign control	21,664	33,807	32,353	32,074	**148%**

Source: Czech Statistical Office

2.22 Overall the Czech Republic has fewer bank employees per 100,000 inhabitants (400) than the EU15 average (about 700).

Perception of ease of switching, factors affecting competition and consumer protection

2.23 The CNB is working on a new regulation of consumer protection on the financial market. A financial ombudsman, who would completely take over the issue of consumer protection in all areas of the financial market, should become active in the Czech Republic no later than in 2008.

Competition

Table 2.3: Herfindahl–Hirschman index[1]

2001	2002	2003	2004	2005
1263	1199	1187	1103	1155

Source: ECB

2.24 The Herfindahl index is a measure of the size of firms in relation to the industry and indicates the degree of rivalry between them. Decreases in this index generally indicate a loss in pricing power and an increase in competition. This index for Czech Republic suggests that there has been an increase in the degree of competition in this sector. Concentration in this sector has been falling.

2.25 The number of foreign credit institutions remained roughly constant between 2001 and 2004 (there is a move from third country to EU focus). There have been continuing mergers especially at EU level.

[1] The Herfindahl- Hirschman index is defined in the Main Report

Table 2.4: Non-Czech Credit Institutions

	2001	2002	2003	2004	2005
Branches of CI's from EU area	9	8	8	9	12
Subsidiaries of CI's from EU area	16	18	18	19	17
Branches of CI's from third countries	1	1	1	0	0
Subsidiaries from third countries	4	4	4	3	3

Source: ECB

Table 2.5: Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005
Domestic M&A's	1	0	0	0	1	1
EU M&A's	2	2	2	2	2	0
Third country M&A's	0	0	0	0	0	0

Source: ECB

Trade and international penetration

2.26 In 2001 privatisation of the state-owned stakes in commercial banks was completed. The involvement of foreign banks and capital in this privatisation process was significant.

2.27 By the end of 2002, 82 per cent of equity capital came from abroad, mainly from EU Member States, and 93.3 per cent of total assets were administered directly or indirectly by banks controlled by foreign owners. The majority of the sector is controlled by foreign banks, which act in the Czech Republic via subsidiaries or branches.

Table 2.6: Number of banks by ownership[2]

Year End	Banks total	of which:								
		Czech-controlled banks					foreign-controlled banks			
		total	financial institutions	state-owned banks	Czech-controlled banks	banks under conservator-ship	total	foreign-controlled banks	foreign bank branches	Unlic-ensed banks
1997	50	26	1	6	15	4	24	15	9	11
1998	45	20	1	5	14	0	25	15	10	18
1999	42	15	1	4	10	0	27	17	10	22
2000	40	14	1	4	8	1	26	16	10	24
2001	38	12	0	3	8	1	26	16	10	26
2002	37	11	0	2	9	0	26	17	9	28
2003	35	9	0	2	7	0	26	17	9	30
2004	35	9	0	2	7	0	26	17	9	30
2005	36	9	0	2	7	0	27	15	12	31
2006	37	9	0	2	7	0	28	15	13	31

Source: CNB

2.28 The EU directive on the single licence has been valid in the Czech Republic since Accession in May 2004. The single licence principle means that banks from EU countries are entitled to carry on business for which they have a licence in their home country in another EU Member State without having to apply for consent in the host country.

2.29 As of 31 December 2004, 35 banks and foreign bank branches were active in the Czech Republic, the same number as at the end of 2003. All 9 foreign bank branches active in the Czech Republic automatically switched to the single licence regime. In addition, many foreign banks registered for cross-border provision of services in the Czech Republic under the single licence (i.e. without establishing a branch). As of 31 December 2004, there were 63 such entities.

[2] This set of tables containing basic aggregate data on the Czech banking sector includes information on all banks licensed to operate in the Czech Republic as of the most recent given date, unless stipulated otherwise. Also included are data on the branches of these banks operating abroad. The CNB is not included in the data. In the case of mergers of banks, the data for the respective banks are always added up for the entire time series.

Impact of the FSAP and FSWP Legislative Measures on the Czech Banking Sector

Cross-border business and takeovers

2.30 The impact of the FSAP will be smaller in this area as the Czech banking market is already very open. In 2002, 82 per cent of the assets in the Czech banking market were owned by foreigners. This was well before Accession. However, the FSAP should have reduced the costs of setting up branches as the setting up of the latter had previously been associated by costs than setting up subsidiaries.

2.31 Our econometric study suggests that the impact of the FSAP on trade (to mid 2006) has been a rise of 1.6 per cent in banks (imports increased by 1.3 per cent and exports by 1.6 per cent). Full implementation of the FSWP is projected to lead to a further 1.5 per cent rise (imports to rise by 1.0 per cent and exports by 2.0 per cent).[3]

Competition

2.32 It appears that the effects on the level on competition in the Czech Republic banking sector is likely to be somewhat negative.

2.33 Due to the openness of the banking market to foreign firms, competition was already relatively high. The introduction of the single passport system has certainly decreased compliance costs for foreign operators and branches and will therefore increase foreign competition further. Again, this is something that pre-dated the FSAP. This suggests that the FSAP is likely to have a minimal effect on the level of contestability in the banking sector and thus on the intensity with which firms compete.

2.34 However, the influence the FSAP is and will be stronger in the Czech Republic than in the old member states. As the Czech republic is a relatively small country (still with an independent monetary policy) and a new member state with financial institutions that do not have the standing in the international capital markets as the old member states both set of measures will increase the standing of these financial institutions and with that the liquidity of the bonds issued by them.

2.35 The standardisation of regulatory rules for doing business may make it even easier for Czech banks to form networks with other European countries as many of them already have done (mostly by being purchased by foreign banks).

2.36 Theory suggests that the FSAP should have strengthened these already-existing trends, which so far have mainly been driven by the Accession of the Czech Republic to the EU.

2.37 However, the Heritage Foundation, as discussed earlier, accredited the Czech Republic with a low score in term of restrictions in the banking sector. As such, this suggests that the FSAP will tend to be increasing regulation rather than deregulating, and will therefore tend to increase the compliance costs associated with doing business in the banking sector. Taken together with the minimal effect that the FSAP is likely to have on the contestability in the banking sector, it is likely that the overall effect of the FSAP on competition will be negative.

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[3] Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

Employment

2.38 Overall we would think that the employment effect of the FSAP on employment as the development of employment will be driven by other factors like GDP growth, diversification of the banking market and technological progress.

Consumer protection

2.39 Implementation of the FSAP may have brought improvements in consumer protection. Among other recent changes the CNB will introduce an office for a consumer ombudsman by 2008.

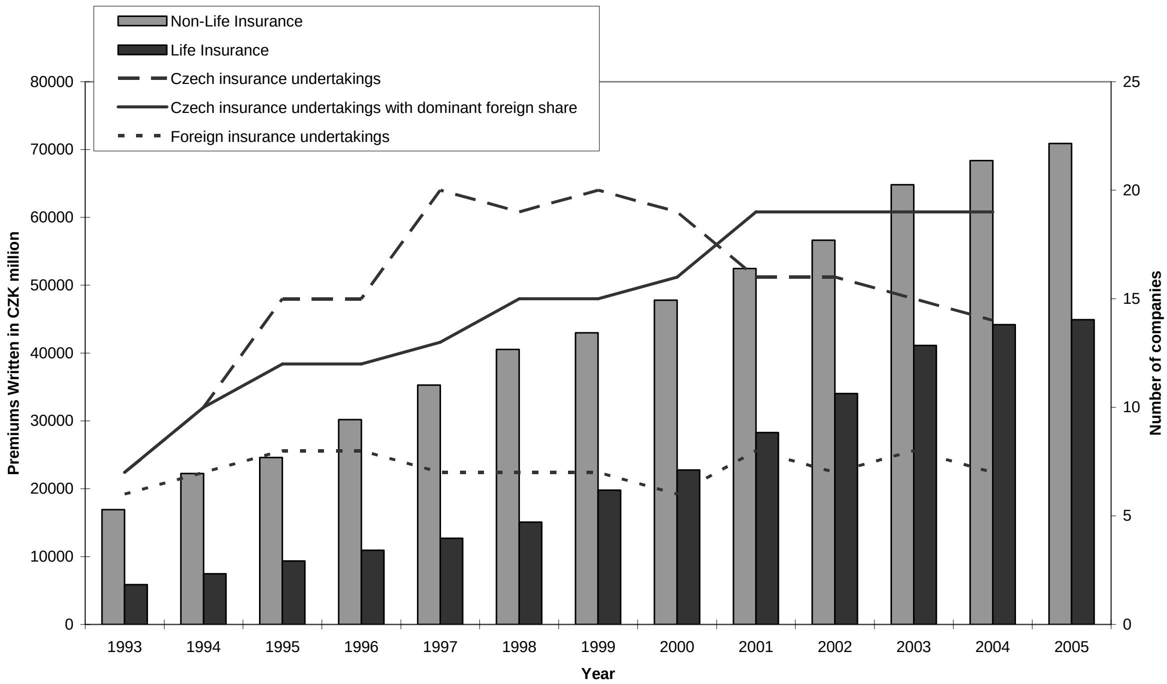
3 INSURANCE

The Insurance Industry of the Czech Republic

3.1 The number of insurance businesses grew in the Czech Republic in the early 1990s, but more recently stabilised at about 40 companies. Foreign influence has grown in that period. In 2004 the majority of companies were either foreign or controlled by foreign capital mostly from other EU Member States.

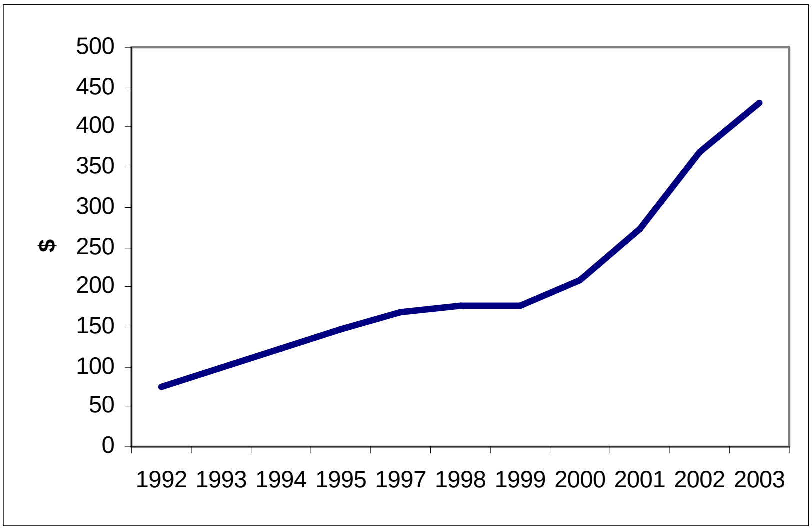
3.2 The insurance sector has grown strongly in the Czech Republic over the past decade. From 1993 to 2005 the premiums written grew by an average of 15 per cent a year from CZK 23 to 166 billion. Life insurance was stronger, averaging 18 per cent per year (non-life insurance 13 per cent). Growth slowed in recent years with life insurance growing only by 4 per cent in 2004 and 2005 (non-life insurance 5 per cent).

Figure 3.1: Premium income and number of firms in Czech insurance



Source: OECD with updates, CNB

Figure 3.2: Insurance Density (gross direct premiums/population, $ per capita)



Source: OECD

3.3 Nonetheless insurance business remains very small in the Czech Republic (which is characteristic for a new member state). Insurance sector assets do not exceed 10 per cent of GDP in the new Member States compared to an average of 55 per cent of GDP in the EU15.

3.4 The Czech Republic, like other new Member States, requires further expansion of the sector (gross premium as a per cent of GDP) alongside a desired increase in the standard of living (GDP per capita).

Employment and productivity

3.5 Since 1998 the insurance industry has lost 2000 employees or more than 10 per cent of the workforce.

Table 3.1: Employees in the insurance industry

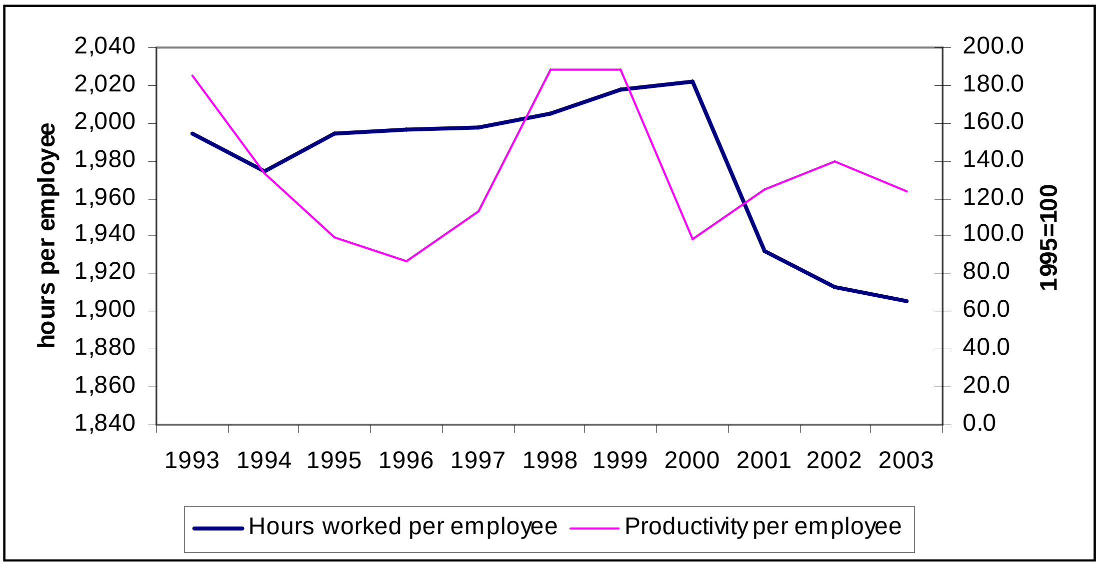
1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
14,825	16,094	16,137	16,123	15,771	15,308	14,915	15,281	14,473	14,119

Source: Czech Insurance Association, 2005

3.6 This loss of jobs was partly related to the stock market boom and bust (of emerging markets) before and after 1998, which had strong implications for the Czech insurance industry. The value added rose from CZK 3 billion in 1996 to over CZK 7 billion in 1998 and went down to CZK 3 billion again in 2000. Since then the value added has consistently increased.

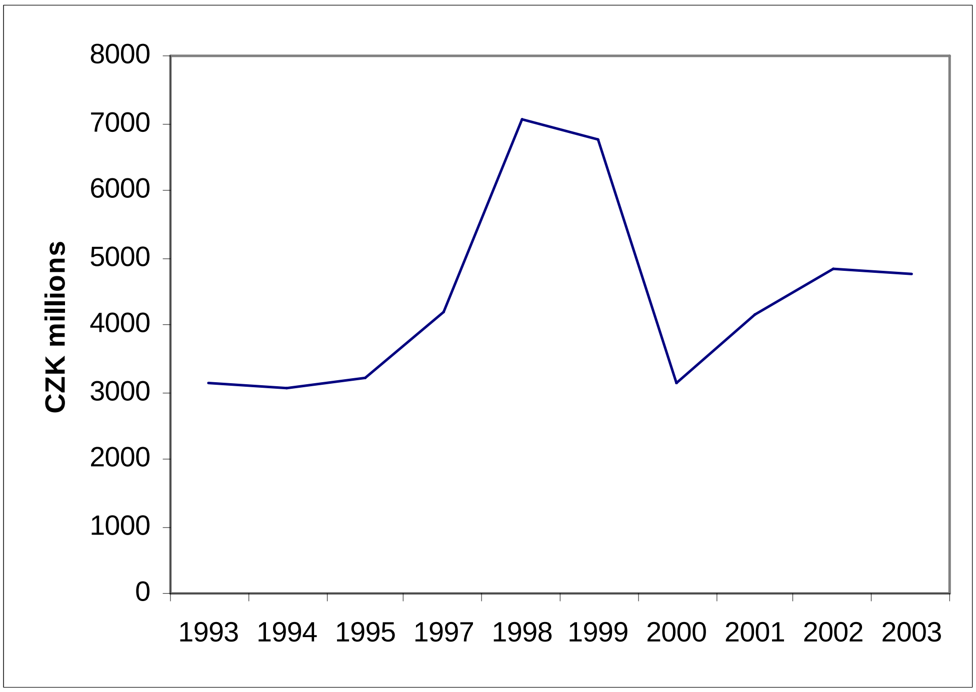
3.7 Labour productivity has grown and fallen with the value added. Per employee labour productivity increased by 20 per cent since 1996. Labour productivity has increased slightly faster (by 26 per cent) as the average hours worked per year have fallen by about 4 per cent since 1996.

Figure 3.3: Productivity and hours worked in the Czech insurance industry



Source: University of Groningen

Figure 3.4: Value added in the Czech insurance industry



Source: University of Groningen

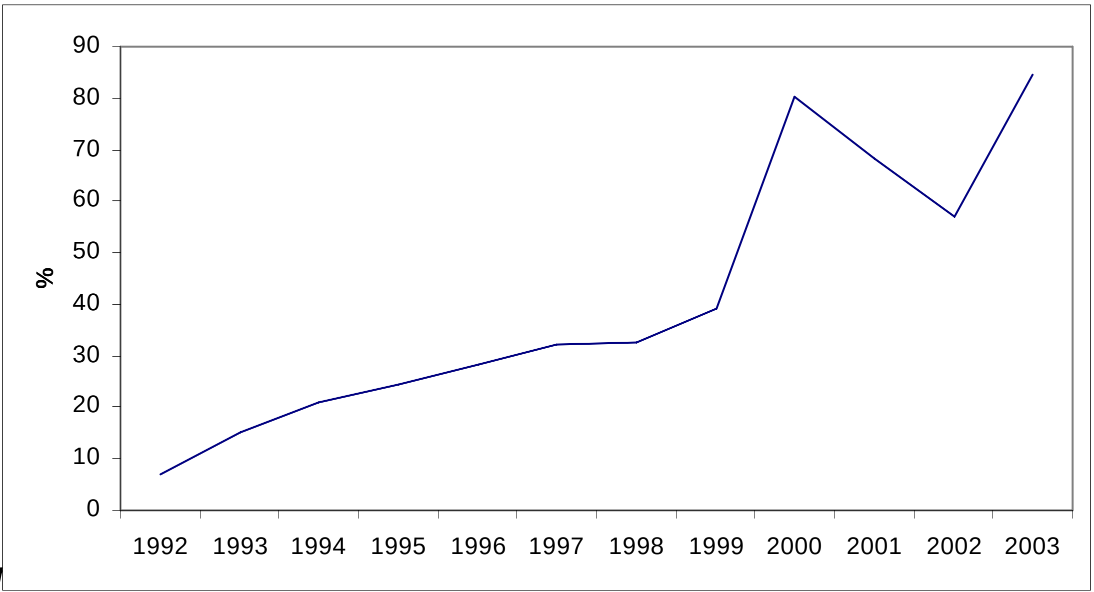
Foreign capital

3.8 Like most of the financial services markets in the New Member States the market for insurance is very open to foreign entry. As mentioned earlier more than half of the operating companies are either branches of foreign companies or companies where the majority ownership is foreign. In the Czech insurance sector as a whole, 65.5 per cent of registered capital is foreign.

3.9 The most important investor countries are Austria and the Netherlands followed by Germany.

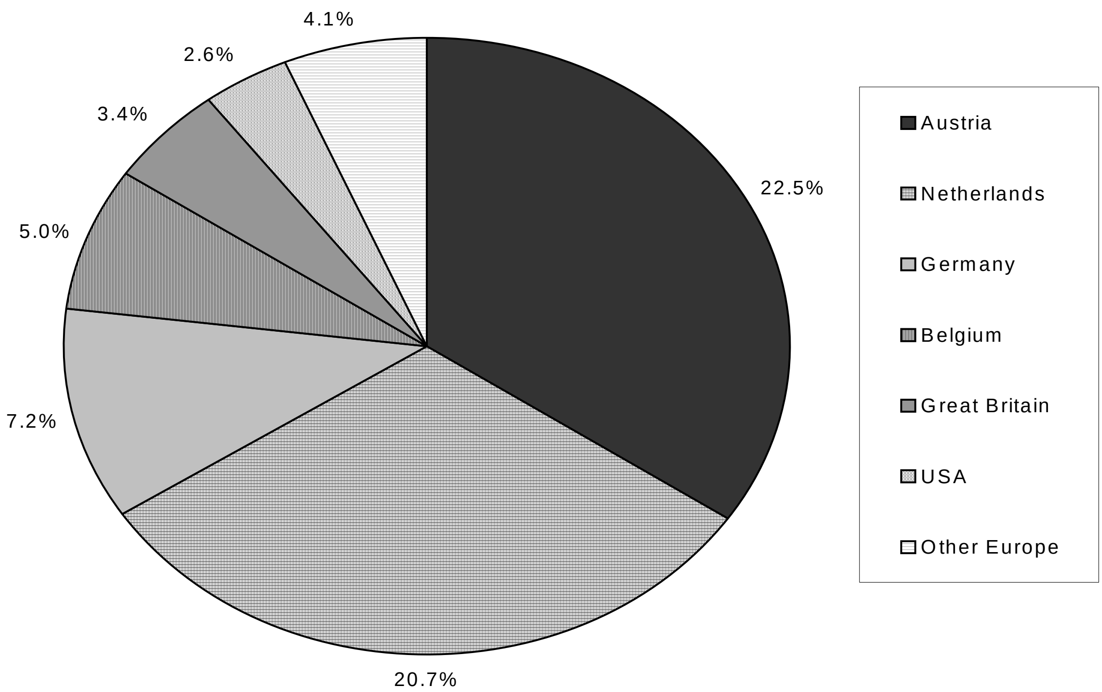
3.10 The share of the Czech insurance industry controlled by foreign undertakings has increased substantially in 1999 and 2002 after the FSAP was introduced in 1998 but this was at the same time as Accession effects started.

Figure 3.5: Market share of branches/agencies of foreign undertakings as a % of total domestic business



Sou

Figure 3.6: Foreign capital in the Czech insurance sector (in per cent of registered capital)



Source: Office of the State Supervision in Insurance and Pension Funds, Annual Report 2004

Efficiency

3.11 In the insurance sector, cost ratios are largely driven by the small volumes and should be expected to improve as volumes in these markets pick up. In the life-insurance segment, a development away from the more traditional high-cost products towards lower-cost savings products can be expected to lower cost ratios.

Impact of the FSAP and FSWP Legislative Measures in the Czech Insurance Market

Harmonisation of rules and Implementation of the FSAP

3.12 In contrast to previous years when it was necessary to harmonize the insurance legislation of the Czech Republic with that of the European Community, by 2004 the process experienced a certain deceleration. The harmonization was reached by enactments and amendments of the following four laws:

(a) The Amendment to Act No. 363/1999 Coll., on Insurance.

(b) The Amendment to Act No. 168/1999 Coll., on Motor Third Party Liability Insurance.

(c) Act No. 37/2004 Coll., on Insurance Contract.

(d) Act No. 38/2004 Coll., on Insurance Intermediaries and Independent Loss Adjusters.

3.13 The harmonization was in process from 2002 to 2004. The last law — the Amendment to the Act on Motor Third Party Liability Insurance — was passed by the Parliament of the Czech Republic at the beginning of 2004. These laws implemented all the valid directives regulating the area of insurance; thus the full harmonization of the Czech legislation with the legislation of the EC was reached.

3.14 The Czech Republic was one of the first countries to incorporate into the national legislation one of the important directives of the EC — Directive 2002/92/EC — on intermediary activities in insurance. It is worth mentioning that by the end of January 2005, the said directive was implemented only in 13 Member States of the EU and EEA.

Assessment by category

Market entry, cross-border business and takeovers

3.15 Overall the Czech insurance market is very open to foreign competition and mergers and acquisitions. As mentioned earlier two thirds of the registered capital is foreign capital most of it from other EU countries.

3.16 The Solvency II directives may increase this trend further as they will make it easier to form companies that do business in several European countries at the same time. This may ease market entry and make the purchasing of Czech companies for that purpose less necessary.

3.17 Overall, however, the FSAP is likely to contribute positively to the further cross-border activity by removing the remaining technical and regulatory barriers to cross-border activity.

Competitiveness

3.18 It would appear that the overall effect of the FSAP has been limited so far however, it is likely that it will play a positive role in the future,

3.19 The implementation of an obligation to register for insurance brokers may have led to a slower increase in the number of insurance brokers. During 2004, the increase in registered insurance and reinsurance brokers was smaller in comparison to the previous year. There were 66 newly registered brokers; the total number of brokers in the Czech insurance market reached 592.

Table 3.2: Total Number of Registered Insurance Brokers

2000	2001	2002	2003	2004
236	337	430	526	592

Source: Annual Report 2004, Office of the State Supervision in Insurance and Pension Funds

3.20 Overall the insurance market in the Czech Republic is still dominated by only three or four major players.

3.21 In the Non-Life insurance business the five largest companies have a market share of nearly 84 per cent and in Life insurance the market share is still 70 per cent. Even between these big players competition is skewed as the two biggest companies hold a combined market share of 64 (non-life) and 48 per cent.

3.22 The market size of the Czech Republic does not particularly allow sufficient economies of scale for more players in the market. Therefore it is relevant whether the Solvency II Directive will make it easier to run a cross-border insurance business, and therefore create economies of scale, and hence greater competition and falling prices.

Table 3.3: Market shares of the 10 most important insurance companies

	Total	Non-Life Insurance	Life Insurance
Allianz pojišťovna, a.s.	7.95	10.59	3.87
Česká podnikatelská pojišťovna, a.s.	3.29	4.25	1.82
Česká pojišťovna a.s.	36.4	36.68	35.95
ČSOB Pojišťovna, a.s., člen holdingu ČSOB	5.38	3.9	7.67
Generali Pojišťovna a.s.	4.46	5.56	2.77
Komerční pojišťovna, a.s.	2.64	0.25	6.35
Kooperativa, pojišťovna, a.s.	21.47	27.36	12.36
Pojišťovna České spořitelny, a.s. L+N	3.46	0.92	7.39
UNIQA pojišťovna, a.s.	2.5	3.34	1.2
CR5	**75.66**	**84.44**	**69.72**

Source: Annual Report 2004, Office of the State Supervision in Insurance and Pension Funds

Competition

3.23 As is the case in the banking sector, it is unlikely that the FSAP will have any significant effect on the level of contestability of the sector, and thus on the intensity of competition, given the high degree of openness in the insurance system in the Czech Republic that predated the inception of the FSAP. It is thus likely to have a limited impact on competition in the insurance sector.

Products variety, e-commerce, and prices

3.24 At the moment the companies tend to create economies of scale by standardising their products more than occurs in bigger and richer countries. More cross-border businesses would mean that they could offer a greater variety of products.

Consumer protection

3.25 As mentioned earlier the CNB will introduce an office for an ombudsman by end 2008 and may create more advanced consumer protection.

4 SECURITIES

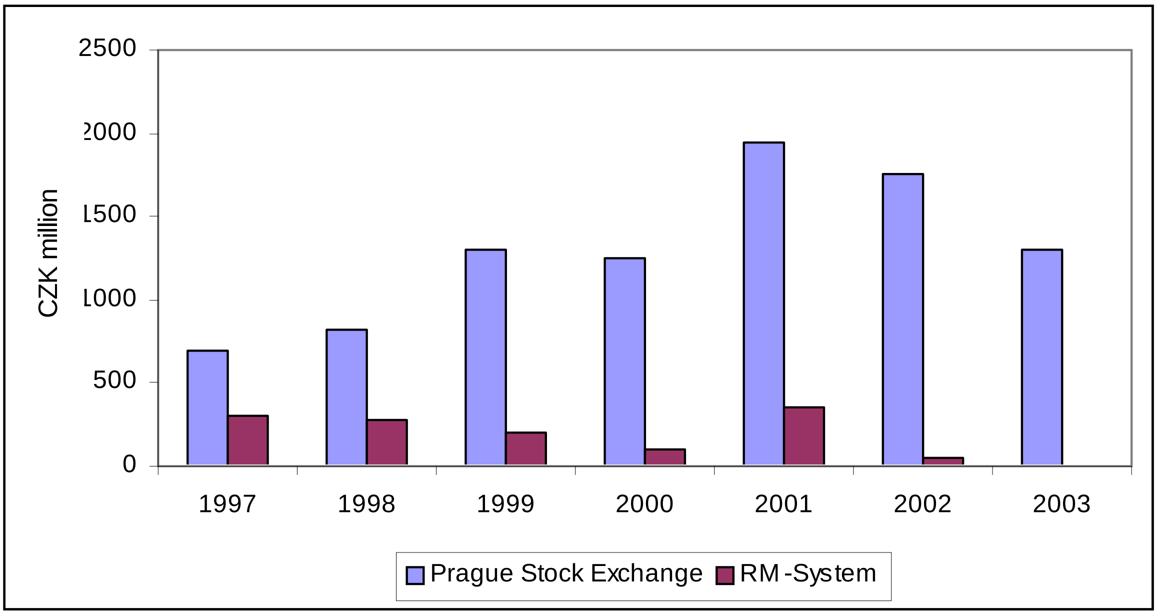
4.1 The Prague Stock Exchange is the main securities market organiser in the Czech Republic. The Exchange is based on a membership principle, which means that only licensed securities traders which are Exchange members have access to the Exchange trading system. Through its members the Exchange organizes the supply of and demand for listed securities, investment instruments, alternatively other capital market instruments of the capital market within the extent of the permission issued by the Securities Commission.

4.2 All activities of the Exchange and its members are under regulation and surveillance of the Securities Commission. Security and reliability of Exchange trading is provided by internal legislative framework (Exchange rules) that are fully harmonised with the EU standards.

4.3 There are ten market-makers: Atlantik finanční trhy, BH Securities, Česká spořitelna, Fio, burzovní společnost, HVB Bank, ING Bank, Komerční banka, Patria Finance, Raiffeisenbank and Wood & Co.

4.4 The Czech securities market is now dominated by the Prague Stock Exchange (which was in the year 2003 responsible for more than 99 per cent of trading). Another exchange market administered by RM called the RM-System was responsible for between 30 and 40 per cent of trading in the years 1997 and 1998 but later lost most of its volume.

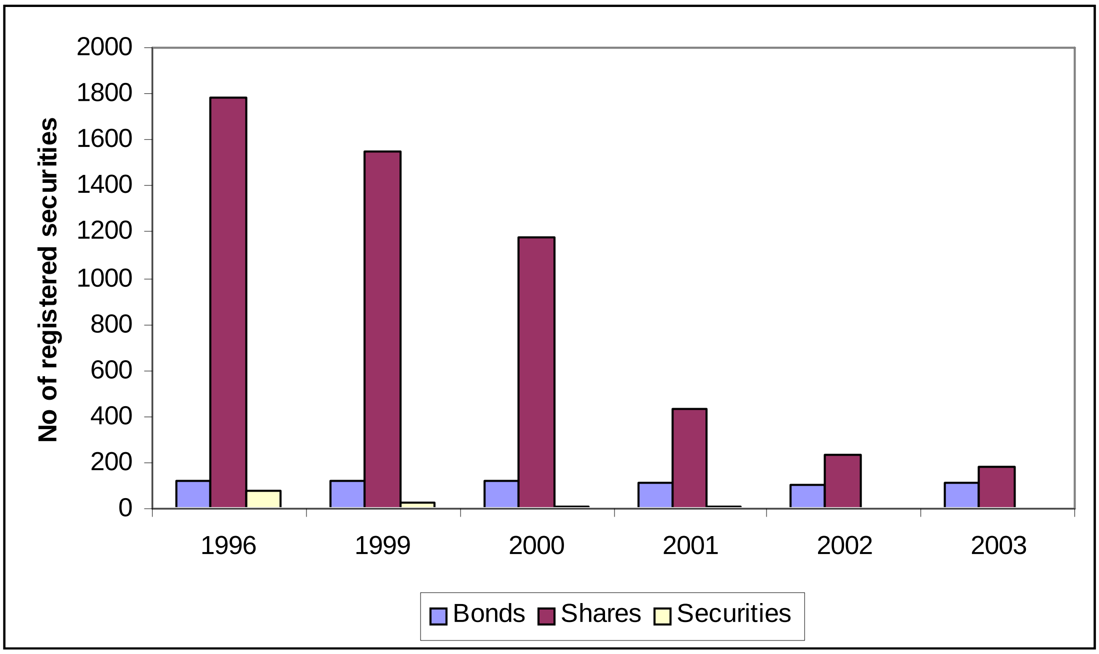
Figure 4.1: Trading volume on Czech securities markets



Source: Annual Report 2003, Czech Securities Commission

4.5 The number of bonds has decreased in recent years due to the tougher regulation of the Securities commission. The number of registered bonds, shares and certificates has decreased from 1,952 in 1998 to only 253 in 2003.

Figure 4.2: Number of registered bonds, shares and certificates



Source: Annual Report 2003, Czech Securities Commission

4.6 The Prague stock exchange is combining, following the model of the Deutsche Börse, management of the market place (listing and trading) with the post-trade management (clearing and settlement, central securities depository). The Prague Stock Exchange owns 100 per cent of the Czech Clearing and Settlement Company (from which the PSE receives at least half its revenue) and was due to merge it with the Czech central securities depository in 2006.

Impact of the FSAP and FSWP Legislative Measures on the Czech Securities Markets

The Czech Securities Commission (now part of the CNB)

4.7 The Czech Securities Commission commenced its operation based upon a special act as of 1 April 1998. The role of the Czech Securities Commission is to strengthen the investor and investment instruments issuer trust in the capital market. The Czech Securities Commission is an independent authority that supervises, in its jurisdiction, compliance with the laws and secondary legislation. Since July 2002, the Commission is authorised to issue some secondary legislation (decrees) in its jurisdiction.

4.8 The Czech Securities Commission pursues fulfilment of the three below statutory objectives:

(a) Contribute to investor protection.

(b) Contribute to capital market development.

(c) Promote education in the capital market sector.

4.9 One of the statutory objectives of the Commission is to contribute to the protection of investors. Important is the expression “contribute to investor protection", which means that investor protection is provided not solely by the Commission, but there exist also other means and possibilities for this protection.

Impact by category

Cross-border activities

4.10 In general it would appear that the FSAP is likely to enhance the volume of activity in the securities market in the Czech Republic through improving the strength and the credibility of the institutional framework underpinning the system as well as strengthening the degree of transparency and investor protection in the sector.

4.11 Arguably the most important point of the MiFID is the expansion of cross-border activities to create a well-functioning single European market for securities. The significant question is if the PSE will be able and willing to go this way alone or if it will be merged with one of the big European players. With an integration of the PSE into a large system the PSE would lose most of its disadvantages as a small exchange. As a consequence, the effect of MiFID would be more limited.

4.12 If the exchange does not integrate into one of the systems, the competition from other exchanges is likely to intensify.

5 FINANCIAL CONGLOMERATES

5.1 Financial conglomerates with their head of group in the Czech Republic are listed in Table 5.1.

Table 5.1: Financial conglomerates operating in the Czech Republic

Financial Conglomerate	Base Country	Co-ordinator	Relevant Competent Authorities (where different from the coordinator)
Česká pojišťovna	Czech Republic	Ministry of finance, OSSIPF (Czech Republic)	Czech National Bank
Česop	Czech Republic	Ministry of finance, OSSIPF (Czech Republic)	Czech National Bank
Petr Kellner	Czech Republic	Ministry of finance, OSSIPF (Czech Republic)	Czech National Bank
PPF Group	Czech Republic	Ministry of finance, OSSIPF (Czech Republic)	Czech National Bank

Source: EU Mixed Technical Group on the Supervision of Financial Conglomerates

5.2 Financial conglomerates dominate all three financial services markets.

6 CONCLUSION

6.1 The Czech Republic has been opening up its financial markets and seen dramatic growth in the size of these sectors as part of its Accession to the EU. The FSAP seems to have acted to encourage this process, although the CNB does claim to be suffering from regulatory fatigue.

6.2 The largest impact of the FSAP on the Czech Republic has been in the area of consumer protection where there was previously relatively little legislation.

6.3 The effect of the FSAP may come through a more open domestic market that allows competition between firms or through increased cross-border activity and entry as firms appreciate the new opportunities available to them. So far there have been few cross-border licenses granted in the Czech Republic.

6.4 The FSAP could reduce one aspect of competition. If cross-border entry becomes feasible the need to acquire domestic firms to enter a market diminishes so this activity may fall. Banks have so far experienced large rises in profitability and it is not yet clear if this is a temporary or persistent phenomenon.

Assessment

	Impact on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Limited	Slightly positive	Significantly positive	Positive	Slightly positive
Insurance	Positive	Positive	Positive	Positive	Unclear
Securities	Unclear	Unclear	Negligible	Slightly Positive	Unclear
Financial Conglomerates	Negligible	Negligible	Negligible	Negative	Slightly Positive

DENMARK

1 INTRODUCTORY OVERVIEW

Financial Services regulation in Denmark

1.1 Financial services make a significant contribution to the Danish economy. The sector accounts for around 55,000 employees, which translates into around 2 per cent of the total Danish workforce.

Division of responsibility

1.2 The supervision of Danish financial services rests with three regulators:

(a) **Finanstilsynet** (Danish Financial Supervisory Authority): responsible for the supervision of banking, mortgage credit institutions, securities firms and insurance firms. It has a duty to implement EU standards in the area of financial services.

(b) **Denmark's National Bank** (Central Bank): responsibility for, among other things, currency stability, the stability of the sector and to maintain financial strength through means of consolidation and risk management.

(c) **Danish Consumer Ombudsman**: responsible for the supervision of the Danish Marketing Practices Act and the Act on Certain Payment Instruments. He is entitled to make consultative statements on legal acts and executive orders concerning the financial sector.

1.3 The Supervisory Authority acts as a secretariat for three sectoral councils: the Financial Business Council, the Danish Securities Council and the Danish Pension Market Council.

1.4 The main activities of the Danish Financial Supervisory Authority include:

(a) supervision;

(b) regulation; and

(c) information.

1.5 In this instance, financial undertakings refers to credit institutions, mortgage credit institutions, insurance companies, pension funds, insurance brokers, the Danish Labour Market Supplementary Pension, the Danish Employees' Capital Pension Fund, the Danish Labour market Occupational Diseases Fund, investment companies and investment associations.

1.6 The strategic objectives of the regulator include:

(a) strengthen the market's role as a disciplinary factor through enhanced transparency;

(b) intensify management's consideration of the risk profile; and

(c) improve the consumers' possibilities to compare prices and products among companies.

1.7 An interesting point to note is that due to the rise of cross-border groups and conglomerates in the Nordic region whose activities span multiple jurisdictions, the need for cooperation between the supervisory authorities in Denmark, Sweden, Finland, Norway and Iceland has increased. To this effect, the supervisory authorities have concluded a cooperation agreement to extend practical cooperation in the supervision of credit institutions, insurance and investment companies.

Survey participants views about implementation

1.8 Although, there have been some criticisms of and resistance to FSAP measures, by and large, the implementation process of the FSAP in Denmark appears to have been smooth with few important difficulties, and it can be argued that this may have been due to an existing advanced state of financial development in Denmark.

1.9 Key issues identified by stakeholders include:

(a) Time limits under the Lamfalussy process are too narrow. The time limits neither reflect the amount of work nor the national time limits in the national EU-legislation procedures and the involvement of the national parliaments.

(b) Level 2 legislation is too detailed.

Consequences of the FSAP for the Regulatory Environment

1.10 The relationship between supervisor and industry remain basically unchanged. There is a tradition for formal and informal contacts and consultations in legislative matters. Notably the Lamfalussy process consultations have meant a major increase in the number of national consultations and meetings.

2 BANKING

The Danish Banking Sector

Number of players

2.1 At the beginning of the 1990s, the Danish banking sector, in common with that in several other Member States, experienced a number of disturbances. Structural changes included increased merger and acquisition activities. The motivation for these consolidation activities was similar to that in other countries: a pursuit of improvements in efficiency and steps to retain a competitive advantage over rivals. These mergers led to the number of banks in Denmark falling from 231 in 1989 to 172 in 2004.

2.2 In recent years, the system has stabilised and enjoyed considerable growth in the following years. Within the entire financial sector, banking remains extremely important: commercial and savings banks account for 37 per cent of the total financial sector balance.

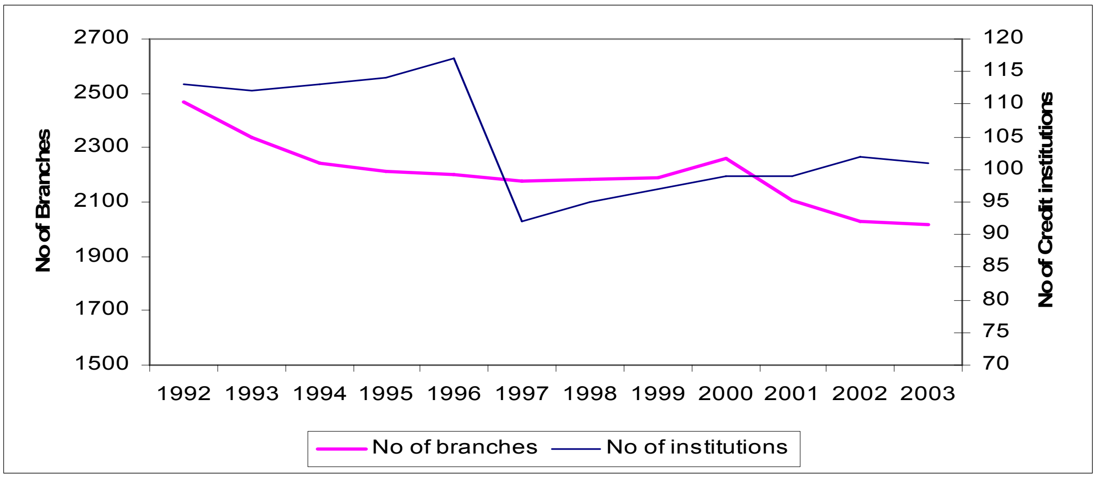
2.3 Table 2.1 below presents the number of banks in Denmark from 2000 to 2004, whilst Figure 2.1 shows the number of credit institutions and branches from 1992 to 2003.

Table 2.1: Number of banks and mortgage credit institutions in Denmark

	2000	2001	2002	2003	2004
Banks	186	186	180	176	172
Mortgage Credit institutions	10	8	8	8	8

Source: Danish Financial Supervisory Authority and Danish Insurance Association

Figure 2.1: Number of Credit Institutions, 1992–2003



Source: OECD

Turnover, employment and profitability

2.4 Table 2.2 below shows the number of employees in the Danish banking sector.

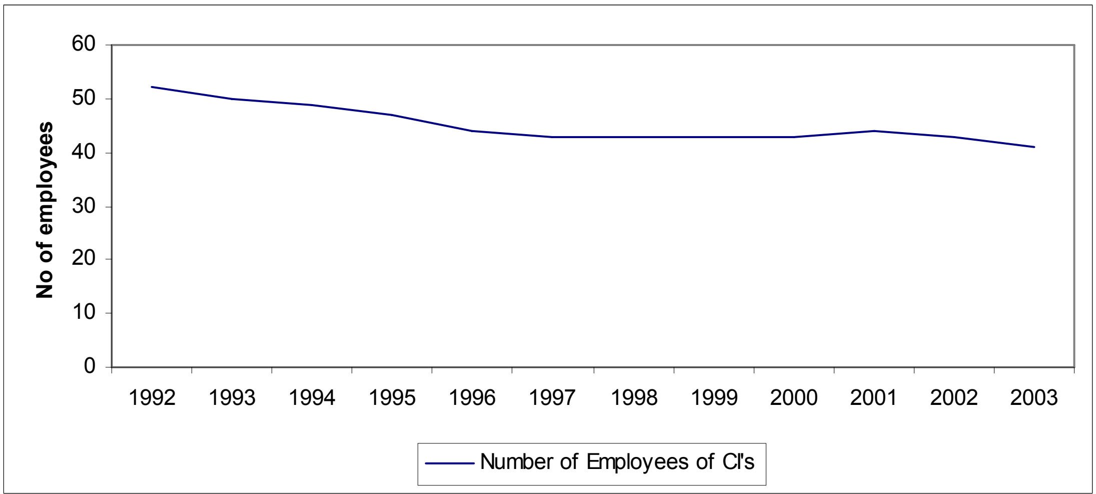
Table 2.2: Labour compensation (DKK millions) and Employment in the Danish banking sector

	1998	1999	2000	2001	2002	2003	2004
Total employment	-	-	40,906	40,933	39,957	38,740	38,685
Labour compensation	18,555	19,583	20,905	21,971	22,690	23,030	-

Source: OECD, Statistics Denmark and Danish Financial Supervisory Authority

Note: labour compensation refers to the financial intermediation sector without insurance and pensions. Labour compensation data not available for 2004.

Figure 2.2: Number of Employees of Credit Institutions (000's)



Source: OECD

2.5 The number of employees in banking has slowly been declining. The number of physical branches has also declined.

Market shares and concentration

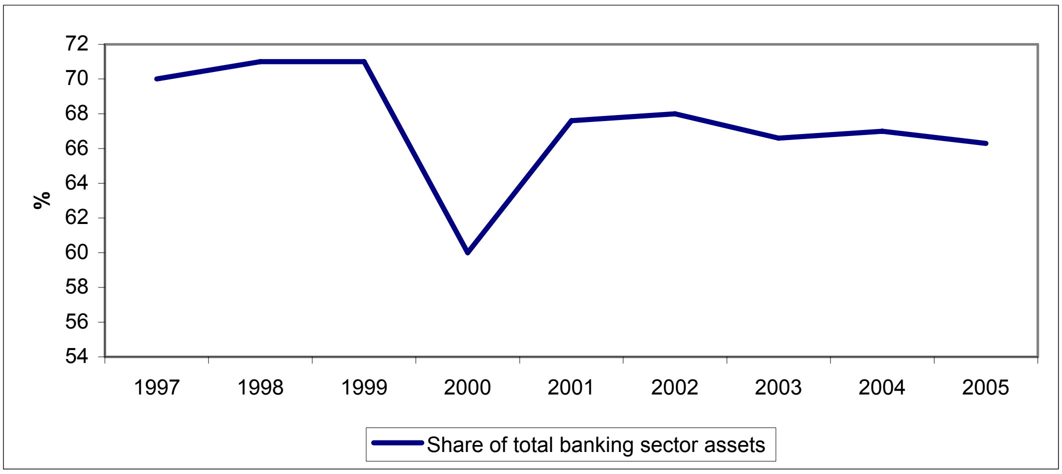
2.6 The Danish economy contains a large number of small to medium sized companies. Within the banking sector, there are a large number of small Danish-owned banks. Traditionally, these small banks have developed ties with the larger banks, for example by partnering themselves with larger banks in the deployment of new technologies, such as credit transfers. However, despite their relatively large numbers, these SME banks do not represent a large proportion of business.

2.7 The reason for SME banks not enjoying a large proportion of the market is that the Danish banking sector (similar to that in several other smaller EU Member States), is characterised by two main features: (a) high concentration of market shares and (b) significant presence of foreign banks. Perhaps unusually, foreign banks are active in both the retail and wholesale banking sectors. However, there is a distinction between Nordic banks (who dominate in the retail sector) and non-Nordic banks who account for larger shares of cross-border lending to Danish customers and capital-market issues by Danish companies.

2.8 The financial sector has become further concentrated due to mergers and acquisitions. For example, in 2000 Danske Bank merged with RealDenmark. This merger followed Danske Bank's absorption of Fokus Bank (a major Norwegian bank). There are also a significant number of cross-border mergers. For example, in 2000 Unibank and the Swedish-Finnish bank, Merita-Nordbanken, merged making Unibank part of the largest financial group in Scandinavia: Nordea.[1]

2.9 The Herfindahl index for banks in Denmark is one of the highest in the EU, and at above 1000 this indicates a moderately concentrated sector.

Figure 2.3: CR5 concentration ratios in Danish Credit Institutions



Source: ECB

Table 2.3: Herfindahl-Hirschman Index2

1997	1998	1999	2000	2001	2002	2003	2004	2005
1431	1442	1499	863	1119	1145	1114	1146	1115

Source: ECB

2.10 Within Denmark, the largest bank, Danske Bank has a 52.4 per cent share of the market (2001). Other major banks include Jyske Bank, Sydbank and SparNord. Whilst these banks are large by Danish standards, they remain small in global terms. Danske Bank ranks only 57 by size globally according to assets in a survey by *The Banker* in 2000.

2.11 In recent years there have been new competitive pressures on the sector. These include the rise of internet banks and the increasing presence of a number of foreign bank branches. The popularity of Dankort, BetalingsService and CallCentre and other home-banking businesses has also led to a rapid rise of electronic facilities.

[1] Within the Nordic region, the largest banks retain very large market shares. In Denmark, Sweden and Finland the five largest banks in 1998 accounted for more than 80 per cent of the sector's total balance sheet. This high concentration can be explained by the wave of mergers in the late 1980s and 1990s.

[2] The Herfindahll-Hirschman index is defined is the Main Report.

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.12 Switching is notoriously difficult to assess, and subjective judgement by those close to the industry is often the main source of data. In the case of this report, our main data source is our opinion survey. Respondents to that survey tended to take the view that the effects on the switching behaviour of bank customers have so far been negligible.

Dimensions of price and quality competition

2.13 Prices of banking products appear to have risen in recent years, despite the competitive pressure from the increasing foreign presence. However, it could well be that due to the wave of mergers that started in 2000 and increased industry concentration, this latter effect may have dominated the competitive pressure from foreign banks. Moreover, the fact that some of these are cross-border mergers reduces the competitive pressure from foreign firms. Nevertheless, prices were expected to be fairly steady over the next few years.

2.14 The number of products available on the market appears to have increased over the past few years, and this trend is expected to continue, with a similar pattern anticipated for e-commerce.

Consumer protection

2.15 It is felt that consumer protection in Denmark has decreased over the past five years, and this trend is expected to persist in the future.

Trade and international penetration

2.16 The Danish banking sector is well integrated with those of other Nordic countries. This is primarily via cross-border mergers and acquisitions, but cross-sector agreements and joint enterprises are also common.

2.17 Traditionally, foreign banks primarily gained access to the Danish retail market via the acquisition of local banks with existing networks. During the late 1980s, cross-border banking activities became easier due to the liberalisation of capital flows. Both cross-border operations and the establishment of local branches were simplified with the adoption of the EU's second banking coordination directive in 1989, so that notification of the host county's supervisory authority was all that was required.

2.18 Table 2.4 shows the market shares of foreign banks. It is interesting to note the large differences between market shares of Nordic and non-Nordic banks.

Table 2.4: Market shares of foreign banks, percentages end-2005

	Nordic	Non-Nordic
Lending – corporate sector	36.1	3.9
Lending - households	18.9	0.7
Deposits – corporate	32.4	2.1
Deposits - households	24.0	0.1

Data covers deposits with and lending by domestic counterparties, Source: Danish National Bank

Table 2.5: Non- Danish Credit Institutions

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Branches of CI's from EU area	7	8	9	9	9	8	16	15	17
Subsidiaries of CI's from EU area	-	4	5	5	9	10	10	8	7
Branches of CI's from third countries	-	-	-	-	2	2	2	2	2
Subsidiaries from third countries	-	-	-	-	1	1	1	3	3

Source: ECB

2.19 The majority of foreign banks in Denmark have a parent company in another Nordic nation. One reason offered is the homogeneity of culture, legislation, traditions and product range in these countries making it relatively easier for a Nordic bank to set up in Denmark with a view to offering standard banking services. At the end of 2005, Nordic banks accounted for approximately 84 per cent of all foreign banks' assets.

2.20 The largest foreign bank in Denmark is Nordea, which controls 19.2 per cent of the domestic market. In 2005 it operated as a banking subsidiary in Denmark, but has plans to convert this subsidiary into a branch of the parent company domiciled in Sweden so that it will be supervised by the Swedish Financial Supervisory Authority.

2.21 At the end of 2005, there were 9 foreign banking subsidiaries and 26 branches of foreign banks in Denmark. An additional 271 foreign credit institutions had provided notification to the Danish Financial Supervisory Authority that they wished to conduct cross-border banking activities.

Table 2.6: Number of mergers and acquisitions in the Danish banking industry

	2000	2001	2002	2003	2004	2005	2006*
Domestic	0	1	1	0	3	0	0
Internal EU	1	1	1	1	0	0	0
Third country	0	1	0	0	0	1	0

** first half, Source: ECB*

2.22 However, it should be noted that despite an increasing level of activities, foreign banks' market share of bank lending has actually been declining since 2003. In contrast foreign bank lending has remained fairly constant, at around 30 per cent since 2000. Foreign banks have experienced growth in their business customers rather than private households. This reflects a deliberate marketing strategy.

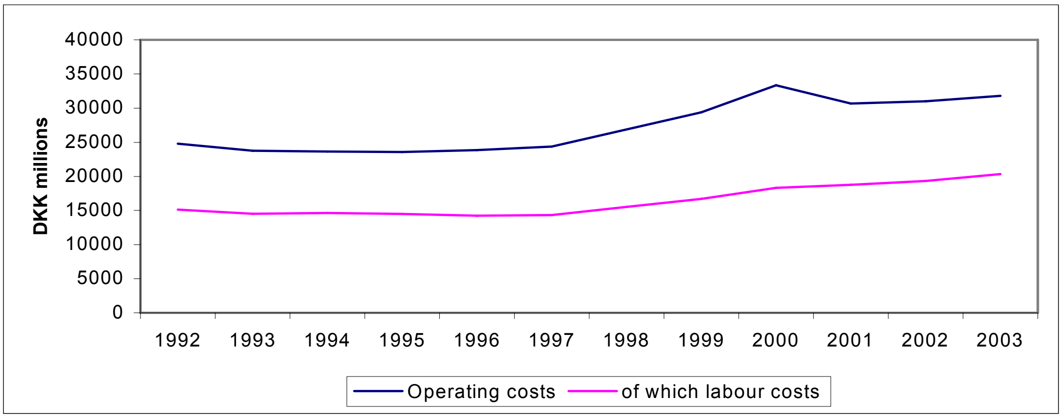
2.23 It is also interesting to observe that while foreign-owned internet-only banks have expanded strongly in other countries, this has not occurred in Denmark.

Competitiveness

2.24 Banks are now more efficient than a few years ago and improvements in bank efficiency are expected to continue into the future. Operational costs are thought to have remained constant over the past five years and expected to remain so.

2.25 The availability of skilled personnel and control of operational costs are regarded as the most important factors to face competition from foreign banks.

Figure 2.4: Operating costs



Source: OECD

Table 2.7: Key performance indicators of the banking sector (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1992	3.6	-1.2	-21
1993	3.9	0.6	10.6
1994	3.9	0	0.1
1995	3.2	1.4	18.5
1996	2.7	1.2	16.1
1997	2.3	1.1	15.1
1998	2.1	1	14.6
1999	1.9	0.9	14.2
2000	1.8	1	15.2
2001	1.9	1.1	16.5
2002	1.7	1	15.7
2003	1.6	1	17

a: Net interest margin — net interest income to average total assets.
b: ROA — net income before tax to average total assets.
c: ROE — net income before tax to average capital and reserves.
Source: Europe Economics calculation of data from OECD (2005) "Bank profitability"

Factors specific to Denmark

2.26 There are number of features of Danish banking which might be of non-trivial importance when conducting an evaluation of the FSAP. These include:

(a) **Large presence of Nordic banking groups:** as noted above there is a large foreign presence in Danish banking. Thus Danish banking may be affected by factors common to other Nordic countries.

(b) **Widespread use of electronic banking.**

Impact of the FSAP and FSWP Legislative Measures on the Danish Banking Sector

Competition

2.27 Table 2.3 shows that the concentration of Danish banking has fallen somewhat during the period of the FSAP, but that the sector remains fairly concentrated. It is unclear that the FSAP has affected this.

2.28 Entry of foreign banks into Denmark has increased, and this is line with FSAP measures which aim to facilitate greater entry from abroad. Indeed, initially high profits stimulated cross-border activity from other Member States. Nevertheless, these high profits are now eroded by the increasing number of entrants, which might explain why the market share of foreign firms in the bank lending sector has decreased over the past several years.

2.29 The degree of switching behaviour has been largely unaffected by the FSAP, and is expected to hold in the future.

2.30 Because of the increased prices, it seems unlikely that any efficiency gains achieved have been passed on to consumers.

2.31 Overall, it appears that any effects of the FSAP on competition in the sector are dominated by other trends and factors.[3]

The effect of FSAP on employment

2.32 Figure 2.2 shows that employment in the banking sector decreased slightly over the period of the FSAP. Overall, the FSAP might have little impact on employment in the Danish banking sector.

Consumer protection

2.33 So far, the FSAP had little effect on consumer protection. However, FSAP has helped consumers gain a better understanding of banking products. This effect is expected to continue in the future. This suggests that the FSAP is likely to have a positive effect on consumer protection over time.

Cross-border business, takeovers and the development of a regional market

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[3] However, it should be noted that pan-EU technological trends, such as growth in e-commerce, might not be completely independent of the FSAP (or other parts of the Single Market programmes). This is an issue considered in more detail in the Main Report.

2.34 Cross-border activities in the banking sector have increased and will continue to do so in the future. This is due to the increasing presence of branches of multinationals, mergers and acquisitions, and other factors. However, the FSAP appears to have had relatively little direct effect on this so far.

2.35 It appears that the main entrants come form Nordic countries and Ireland, rather than from the wider EU. This is perhaps an indication of the development of a Nordic regional banking market.

2.36 Nonetheless, it seems plausible that in the future a greater EU-wide tendency for firms to operate cross-border, driven to a large degree by the FSAP, will eventually lead to greater foreign participation in Denmark.

2.37 Our econometric study suggests that the impact of the FSAP on trade (to mid 2006) has been a rise of 1.7 per cent in banks (imports increased by 1.4 per cent and exports by 1.7 per cent). Full implementation of the FSAP and FSWP legislative measures is projected to lead to a further 1.4 per cent rise (imports to rise by 0.9 per cent and exports by 1.9 per cent).[4]

Competitiveness

2.38 The fact that there still are not a large number of foreign banks suggests that FSAP has not negatively affected the competitiveness of the Danish Banking sector. Most of the entrants in the Danish banking sector are from Scandinavia or Ireland, mainly through mergers, which are unlikely to put pressure on costs, given the relatively high concentration in the sector.

Conclusions

2.39 Key FSAP objectives of creating an internal market for financial services, and in doing so to promote a regulatory environment which may foster best practice in the sector and improved financial development, were to some extent being met in Denmark from this time onwards.

2.40 Such a conclusion is also supported by our analysis of mechanisms (presented in the Main Report). Whilst key expected trends often realised, for example, greater concentration, efficiency and cross-border activity, in practice the direct impact of the FSAP on these trends may have been modest.

2.41 Further, there is little evidence that one of the key aims of the FSAP, opening up of cross-border retail banking, is being achieved with cross-border entrants still providing largely wholesale services.

2.42 However, it can be argued that the relatively pro-competitive regulation of other Nordic EEA and EU Member States' FSAP may have allowed for movement towards a regional market at least in wholesale banking. Further, it would be premature to underplay the potential current and future significance of the FSAP.

4 Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

2.43 On the one hand whilst the costs and benefits of detailed regulatory changes agreed through the FSAP may only become clear over time, the process has nevertheless improved previous regulatory policy, providing added regulatory certainty for market players.

2.44 As for long term impacts in deepening the level of regulatory harmonisation with regional players, i.e. in creating common detailed regulatory structures for regional players it may well be that, in providing a level playing field and greater inter-operability for market players the FSAP will over time foster greater regional and European market development with implications of future opportunities for Danish companies and further cross-border activity and effects on concentration in the Danish banking sector.

3 INSURANCE

The Danish Insurance Sector

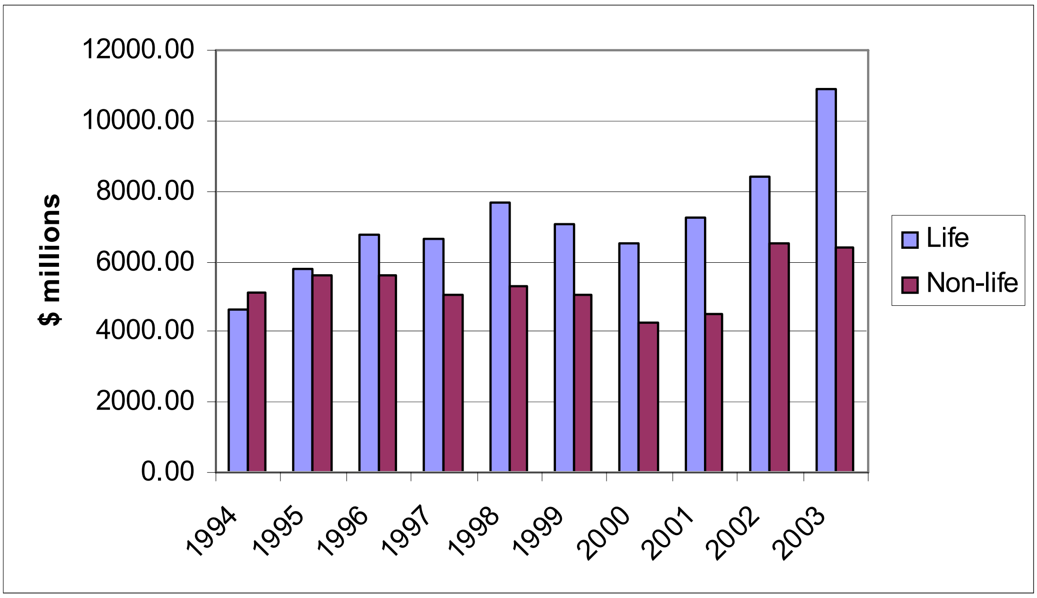
Value added and profitability

3.1 Over the last few years, the Danish insurance industry has experienced a return to financial prosperity. The Danish Insurance Association (DIA) reports that in 2004, non-life insurers reported net profits on core business. This represented a consolidation of net profits from the previous year. The return to profitability has given insurers an opportunity to consolidate and replenish their reserves which were heavily drawn upon for much of the 1990s.

3.2 Prior to 2003, profitability in the Danish non-life insurance sector was patchy. Indeed, over the decade 1994–2004, losses were announced six times out of ten. Over this period, there was a total net loss of DKK 4.2 billion. The reasons for poor profitability in the non-life sector are given as fierce competition and restructuring.

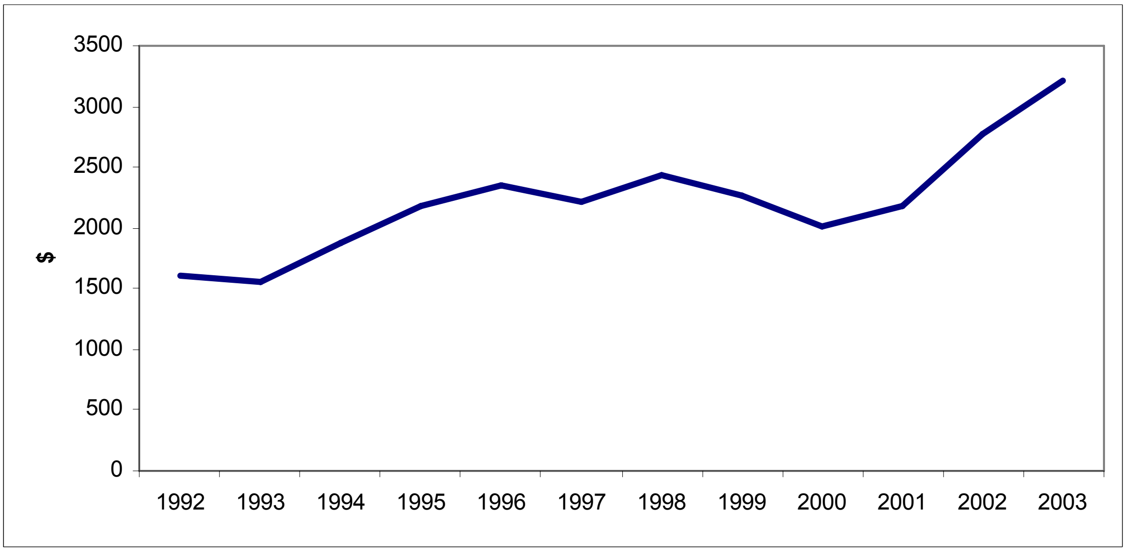
3.3 Figure 3.1 gives the development of life and non-life insurance gross premiums in Denmark from 1994 to 2003.

Figure 3.1: Insurance Gross Premiums in Denmark, 1994–2003



Source: OECD

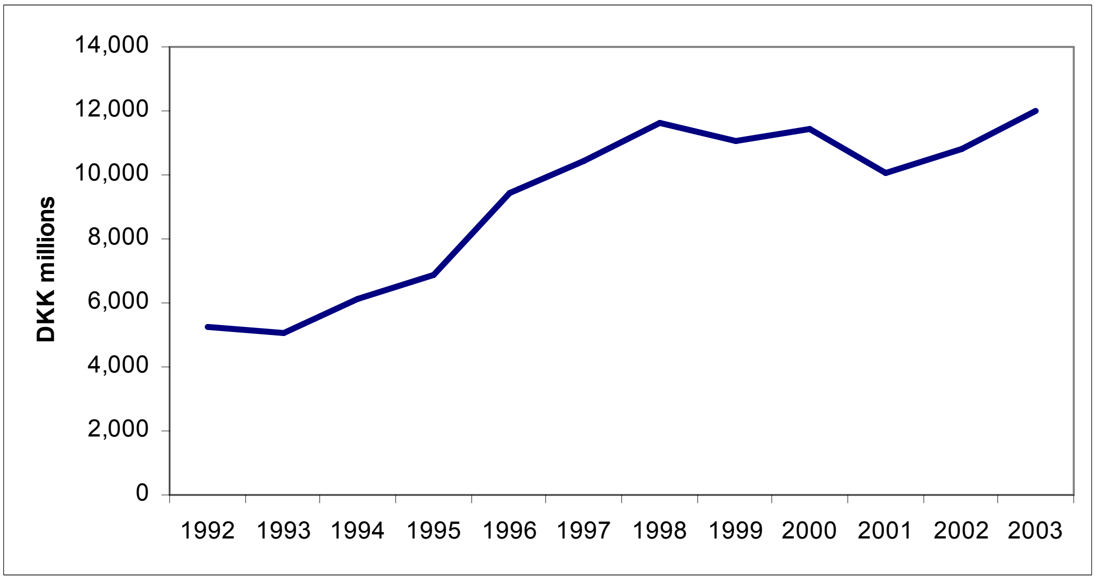
Figure 3.2: Insurance Density (gross direct premiums/population, $ per capita)



Source: OECD

3.4 The value added by the Danish insurance sector has increased significantly over the past couple of decades, including two cycles, as illustrated in Figure 3.3.

Figure 3.3: Value Added by the Danish Insurance Sector (DKK millions)



Source: University of Groningen
Note: Includes insurance and pension funds

Market shares and concentration

3.5 The Danish insurance market is highly concentrated — four companies have market share totalling 85 per cent.

3.6 Within the Nordic region, life assurance companies have typically been part of major financial groups. This feature has been exacerbated recently, with a greater emphasis on pension savings. General insurance is less frequently part of the portfolio of financial groups because the advantages of being able to offer both banking and general insurance products are considered less obvious by some banks.

3.7 Table 3.1below sets out time series of the number of companies in the sector.

Table 3.1: Number of companies in the insurance sector

Company	2000	2001	2002	2003	2004
Non-life insurance incl. indirect life					
Limited companies	63	63	61	62	64
Mutual companies	73	68	67	62	61
Foreign companies	20	21	24	18	18
Total	156	152	152	142	143
Life and pension insurance					
Life insurance companies	63	58	43	41	37
Multi-employer pension funds	31	31	31	30	30
Company pension funds	54	50	47	47	44
Foreign companies (branches)	2	2	2	3	3
Total	150	141	123	121	114
Insurance brokerage activities	-	152	199	199	199

Source: OECD, Statistics Denmark and Financial Supervisory Authority

3.8 Focusing on the total number of insurance companies, one notes that both the number of life and non-life insurance companies has declined since 2000. Within non-life companies the decline has come mainly from mutual companies and the number of pure life insurance companies has also declined. Typically foreign companies operate in the non-life market segment.

Employment

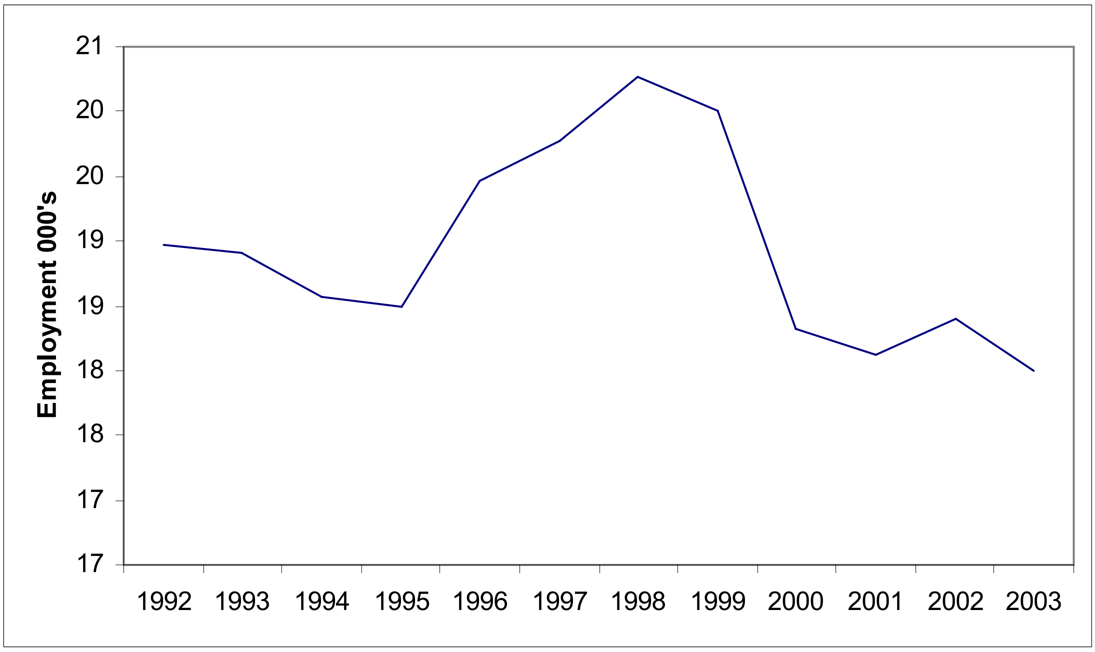
3.9 Table 3.2 below shows the numbers employed in the insurance sector and their corresponding compensation.

Table 3.2: Labour compensation (DKK millions) and Employment in Danish insurance and pension funding, except compulsory social security

	1998	1999	2000	2001	2002	2003	2004
Total employment: life	-	-	1,442	1,606	1,709	1,723	1,456
Total employment: non-life	-	-	11,932	11,622	11,337	9,685	9,003
Labour compensation (all)	6,795	7,047	7,088	7,449	7,693	7,809	-

Source: OECD, Statistics Denmark and Financial Supervisory Authority. Note: Labour compensation data not available for 2004, employment figures missing for 1998–1999.

Figure 3.4: Employment



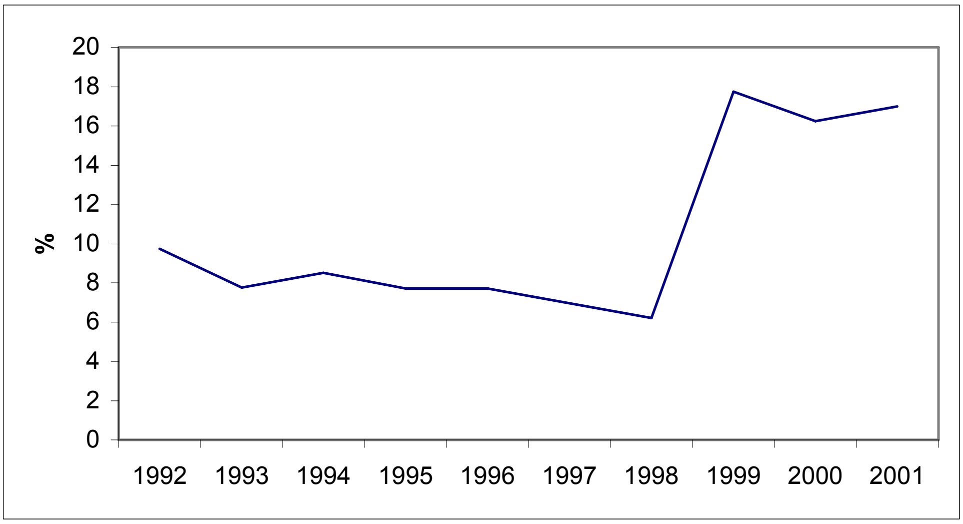
Source: University of Groningen. Note: Groningen analysis differs from that included in Table 3.2 so that figures do not tally.

3.10 As one can readily observe, the non-life sector is much larger than the life sector measured in number of employees. However, while the number of employees in the non-life sector fell from 11,932 in 2000 to 9,003 in 2004; total employment in the life sector remained fairly constant. This may be a reflection of the increased importance of the pensions industry.

International entry

3.11 The market share of foreign insurance companies has increased since the late 1990s, as shown by **Error! Reference source not found.**.

Figure 3.5: Market share of branches/agencies of foreign undertakings as a % of total domestic business

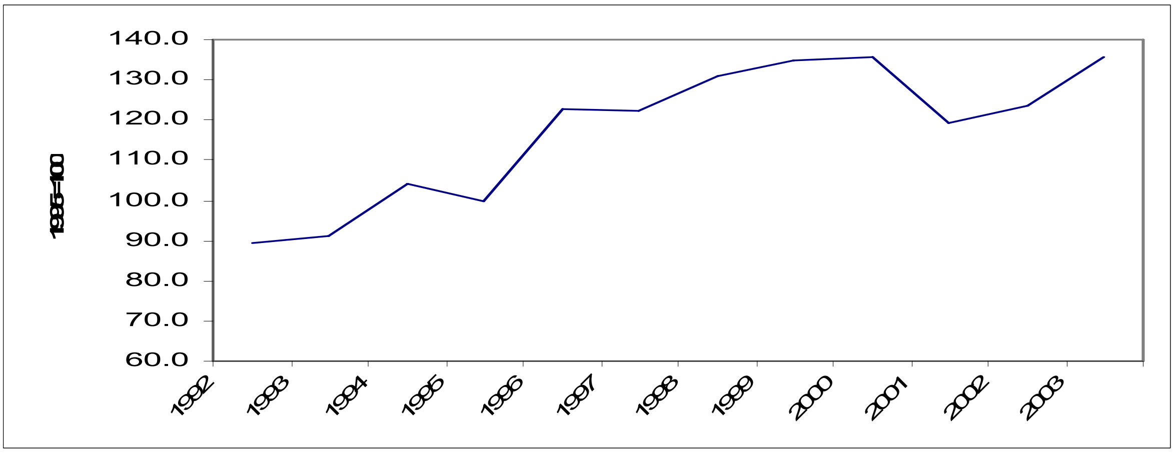


Source: OECD[5]

Competitiveness

3.12 Labour productivity per hour worked in the Danish insurance sector has increased significantly in the past couple of decades. However, there has been great volatility in such productivity growth, as shown in Figure 3.6 below.

Figure 3.6: Labour Productivity per employed person in the Danish Insurance Sector (1995=100)



Source: University of Groningen, Note: Includes insurance and pension funds

[5] The OECD has no observations for 2002–4

Product variety

3.13 An important trend in the insurance sector has been the increasing prominence and importance of pensions. In this respect, Denmark is no different to many other European Member States. What is perhaps different is an increasing demand for pension products with no or reduced guaranteed amounts. One factor influencing this has been political pressure to reduce the number of guarantees relating to future benefits, so as to avoid any future shortfalls. Guaranteeing a minimum amount reduces transparency and creates incentives to invest cautiously to ensure guarantees are met. There has been a demand for greater control of pensions.

3.14 This heightened interest in pensions is reflected in the statistics. Total tax deductible contributions to life insurers and pension funds reached around DKK 64 billion in 2004, a 9 per cent increase compared to the previous year. The Danish Insurance Association notes there has been a steadily rising trend to set aside more personal savings to insurance and pension funds. A second trend witnessed over the last decade in Denmark is that growth in premium contributions has been higher to occupational pension schemes than to personal ones. For each DKK 1 contributed to a pension scheme with a life insurer or pension fund in 2004, DKK 0.13 was paid into personal schemes and DKK 0.87 into occupational schemes. In 1994, the figures were DKK 0.24 and DKK 0.76 respectively.

3.15 Other new products have also been introduced in the marketplace to respond to greater interest in pensions and insurance, such as unit-linked insurance policies.

Consumer protection

3.16

3.17 Table **3.3** below presents a breakdown of complaints statistics for 2004 in the insurance sector.

Table 3.3: General complaints decided by Danish Insurance Complaints Board 2004

Sector	Resolved by conciliation or mediation	In favour of insurer	In favour (in whole or part) complainant / insurer	In favour of complainant	Dismissed by Board decision	Total	Distribution %
Hidden-defects insurance	36	158	19	45	11	**269**	9.6
Household insurance	81	212	16	40	14	**363**	12.9
Building and homeowners' insurance	46	179	3	15	9	**252**	9.0
Life and pension insurance and occupational pension scheme	84	287	5	30	12	**418**	14.9
Motor insurance	97	342	11	37	16	**503**	17.9
Travel insurance	25	125	3	11	1	**165**	5.9
Health and accident insurance	108	301	6	32	4	**451**	16.0
Various	104	240	7	36	4	**391**	13.8
Total	**581**	**1,844**	**70**	**246**	**71**	**2,812**	**100**

Source: Statistics Denmark and Financial Supervisory Authority

3.18 It is important to note that the above refers to complaints resolved, not received. Broadly speaking, complaints are distributed evenly across the insurance sector.

Factors specific to Danish insurance

3.19 The most prominent feature of the Danish insurance sector which might be of non-trivial importance when conducting an evaluation of the FSAP is the high levels of personal responsibility for pensions. Compared to other European nations, due to a combination of policy and changing circumstances, there is much more responsibility among individuals for pensions. This may be a reflection of the agricultural sector being historically important (i.e. a large number of self-employed farmers).

Impact of the FSAP and FSWP Legislative Measures on the Danish Insurance Sector

Assessment of impact by category

Market entry, cross-border business and takeovers

3.20 As can be seen in **Error! Reference source not found.**, the market share of foreign insurance companies operating in Denmark has increased since early 1990s, reflecting a similar general trend in the sector since early 1980s but with greater volatility.

3.21 It is not clear whether the FSAP has contributed to the increased activities of foreign insurance companies in Denmark.

Competitiveness

3.22 As can be seen in Figure 3.6, Labour productivity rose rapidly from early 1990s, but it is difficult to disentangle FSAP effects from other general trends in the Danish insurance sector and economy as a whole.

3.23 Due to the limited time since its implementation, it seems likely that the impact of the FSAP on the competitiveness of the Danish insurance sector has so far been quite limited.

Products variety, e-commerce, and prices

3.24 The variety of relevant products available in the insurance markets in Denmark has increased in recent years and should continue to increase in the future. However, it seems unlikely that the FSAP has had any material impact on this since the FSAP seems to have resulted in limited competition from abroad in the Danish insurance sector.

Conclusions

3.25 From the above we can see that some of the trends we would have anticipated as following from the FSAP have indeed occurred. For example we can see greater efficiency, higher labour productivity, greater concentration and a higher rate of product innovation.

3.26 However, it appears possible that, whilst the broader progress towards the internal market may have had significant impacts on these developments, the FSAP process is taking place after most of these trends have established. For example, it may be the case that efficiency gains were already realized prior to the FSAP.

3.27 It can also be argued that in some areas, implementation of the FSAP may have levelled the regulatory playing field with other Member States, possibly helping Danish companies compete in the future.

4 SECURITIES MARKETS

The Danish Securities Markets

4.1 The Copenhagen Stock Exchange is divided into four sub-markets. Each of these markets focuses on a particular type of security: shares, investment certificates, bonds and derivatives.

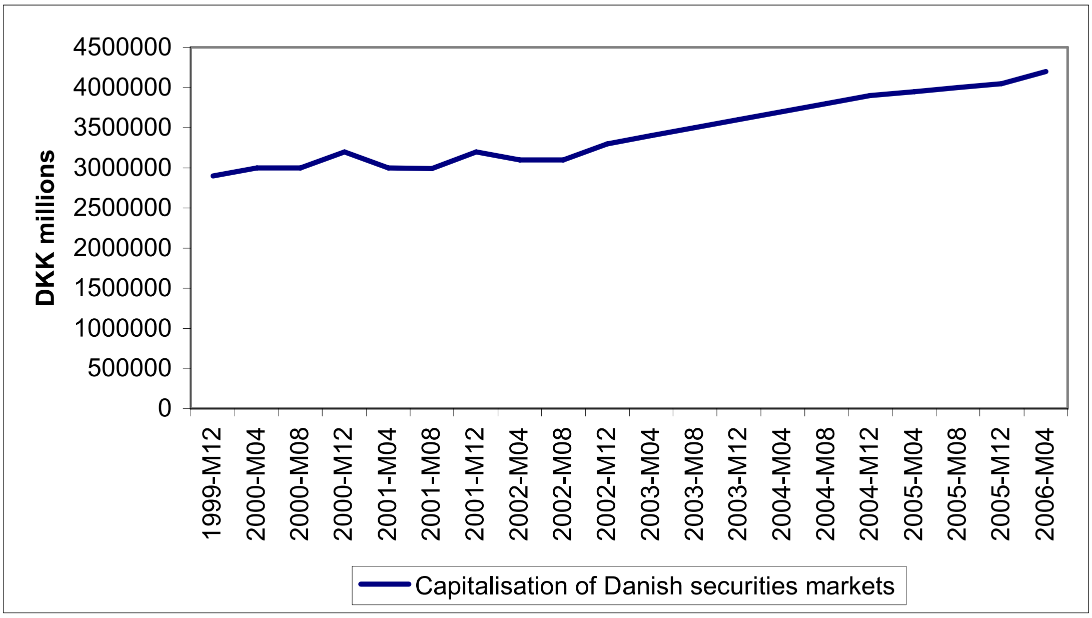
4.2 There are around 200 companies listed on the Copenhagen Stock Exchange, the majority of which are Danish. The bond market is the largest component of the Stock Exchange measured in terms of market value and ranks seventh in the EU.

4.3 The Copenhagen Stock Exchange is owned and operated by the OMX group, which also has exchanges in Stockholm, Helsinki, Riga, Tallinn and Vilnius.

4.4 Security firms (stockbrokers and investment trusts) hold around 4 per cent of total Danish assets.

4.5 Figure 4.1 highlights a positive upward trend in Danish securities markets since 1999.

Figure 4.1: Capitalisation of Danish Securities Markets: December 1999 – April 2006



Source: Danish National Bank

Table 4.1: Labour compensation (DKK millions) and Employment (000's) in Danish activities auxiliary to financial intermediation

	1998	1999	2000	2001	2002	2003
Total employment	35	35	37	37	36	35
Labour compensation	1,357	1,436	1,646	1,730	1,786	1,813

Source: OECD

4.6 As the above table notes, the numbers employed in services auxiliary to financial intermediation (which can be taken as a proxy for securities markets) has remained fairly constant throughout the period in question.[6] There was a temporary rise in 2000 and 2001 which probably reflected the "dot.com" boom.

Impact of the FSAP and FSWP Legislative Measures on the Danish Securities Markets

4.7 Arguably the MiFID, the most important piece of the FSAP on securities markets, is mainly aimed at facilitating the expansion of cross-border activities to create a well-functioning single European market for securities. However, given that the Copenhagen Stock Exchange was owned and operated by the OMX group, which also has exchanges in Stockholm, Helsinki, Riga, Tallinn and Vilnius, it seems unlikely that the FSAP has had significant direct impact on the integration of Danish securities market with other EU Member States.

4.8 Our view is that the Nordo-Baltic exchanges which are part of the OMX group are rather insulated, in the sense that they will probably not be affected by the migration of securities jobs to London (which may take advantage of its lead in systematic internalising). Similarly we do not expect to see any positive repercussions on the level of employment in the Danish securities sector at an aggregate level, as the OMX has already had a positive impact on the level of employment.

4.9 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Danish securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Danish securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

4.10 From Figure 4.1 it can be found that market capitalisation of Danish securities market has increased since 2000, however, it is unclear whether the FSAP has any material impact on this.

Conclusions

4.11 The internal market process is likely to create increased cross-border activity in securities markets, although the FSAP does not appear to be the key agent of this process in Denmark so far.

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[6] It is assumed that employees in securities markets are brokers and exchange operators, and other people involved in securities markets but not based in either a bank or insurer.

5 FINANCIAL CONGLOMERATES

Danish Financial Conglomerates

5.1 With the evolution of a single financial market across Europe, it is natural to expect there will be mergers between financial enterprises across financial sectors and across national borders. This will naturally lead to the establishment of financial conglomerates with activities in several countries.

5.2 Until the 1980s, financial institutions in Denmark typically concentrated on individual sectors. The first multi-sector financial conglomerate was Hafnia Invest A/S in 1984, and subsequently Baltica Holding A/S and TopDanmark A/S. The formation of financial conglomerates was made easier with legislation being amended in 1989 to allow a greater scope for companies to engage in multiple financial activities. In particular, this meant that banks could own subsidiaries operating in other financial sectors.

5.3 The relevant FSAP measure with regard to conglomerates is the Financial Conglomerates Directive. This was enacted in 2004, and was due to come into force on 1 January 2005. The Directive will introduce supplementary supervision of financial conglomerates on a group wide basis. The main objectives of the Directive, as stated, are (I) to ensure that financial conglomerates are adequately capitalised, preventing the same capital being counted twice over and so used simultaneously as a buffer against risk in different entities, (II) to introduce methods for calculating a conglomerate's overall solvency position, and (III) to provide for the establishment of a single lead regulator for financial conglomerates, rather than multiple lead regulators as at present, thereby reducing regulatory duplication.

5.4 In essence, the conglomerates directive aims to create a set of uniform terms of competition for different types of financial groups by imposing a number of common obligations that transcend sectors and national borders. The directive operates with a coordinator who is to coordinate supervisory activities between authorities involved. The coordination primarily involves compiling information on conglomerates. The directive aims to take group risks into account, since simultaneous use of the same capital in several entities of the conglomerate (multiple gearing) is not possible. In addition, the solvency position must be calculated at the level of the conglomerate, and intra-group transactions and risk concentration are regulated. To counteract lack of transparency in the conglomerates there are requirements of risk management and a requirement of close collaboration between the supervisory authorities.

5.5 However, it should be noted that the directive does not require the harmonisation of the actual supervisory provisions, or convergence of supervisory activities. It seeks only to take account of the “extra” risks that may arise as a result of the formation of the conglomerate.

5.6 When analysing financial conglomerates one must ensure that one has the correct unit of analysis. By their nature, these conglomerates will be involved in multiple areas of businesses – thus focusing, say, only on the banking division, will miss other activities. Similarly, one should not analyse each component individually as one is likely to miss overall group effects. A holistic approach to financial conglomerates is required, i.e. analysing them as conglomerates as opposed to the sum of their different divisions.[7]

Table 5.1: Conglomerates with Head Office in Denmark

Name	**Countries in which they operate**	**Characterization**
Alm. Brand	Denmark	non-life insurance, banking and life and pension insurance – emphasis unclear

[7] Their individual components are analysed under the banking, insurance and securities chapters. In these analyses the banking divisions are treated separately from other operations. Here, however, we look at the entire conglomerate.

Table 5.2: Main financial conglomerates operating in Denmark

Name	Head office base	Countries in which they operate	Characterization of Conglomerate	Characterization of Subsidiary
ABN AMRO	Netherlands	France, Austria, Belgium, Denmark, Czech Republic, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland Portugal, Slovakia, Spain, Sweden, UK	Banking	Banking
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	Banking
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%	Banking with some Securities
Old Mutual	UK	Austria, Cyprus, Denmark, Finland, France, Germany, Ireland, Italy, Poland, Portugal, Spain, Sweden, UK	Asset management, Life assurance, Banking, Offshore trust and company services	DNA
SEB	Sweden	Luxembourg, Sweden, UK, France, Spain, Finland and Denmark, Germany, Poland, Estonia, Latvia, Lithuania	Banking firm doing insurance and asset management	Asset management
Svenska	Sweden	Austria, Estonia, France, Denmark, Finland, Norway, Germany, UK, Luxembourg, Netherlands, Poland, Spain, Switzerland,	Insurance, banking and asset management	DNA

Source: EU Mixed Technical Group on the Supervision of Financial Conglomerates, Europe Economics,
Note: DNA = Data Not Available

Impact of the FSAP and FSWP Legislative Measures on Financial Conglomerates

Assessment by category

5.7 As we can see in Tables 5.1 and 5.2, although some conglomerates operating in Denmark do engage in insurance activities, and there are also some securities activities, much the most important conglomerate activity is banking. Thus, the conclusions for financial conglomerates in Denmark are close to those for banking.

Openness

5.8 We have seen that the form of entry by banks into Denmark has not been affected, and that openness in the insurance sector is unlikely to have increased much due the FSAP. In addition, the FSAP measures for regulation of Financial Conglomerates should create a more standardized regulatory environment, reducing costs of compliance for large firms operating across multiple jurisdictions.

5.9 Further, we should, in general, expect a programme such as the FSAP to be of greater short-term benefit to existing larger players than smaller players, since larger players will more obviously gain from a standardized cross-border environment.

5.10 Thus our assessment is that the FSAP will encourage greater openness.

Competition

5.11 We have seen that competition is expected to be slightly enhanced in both banking and insurance, and this can be expected to apply for financial conglomerates, also.

Consumer protection

5.12 Effects on consumer protection in both banking and insurance are expected to be positive.

Employment

5.13 We assess the effects on employment in both banking and insurance sectors as slightly negative. Furthermore, our view is that the FSAP may be a factor in conglomerates in Denmark losing market share to more specialised players (particularly in the insurance sector).

Competitiveness

5.14 As pressures of competition from abroad and domestically are expected to be increased by the FSAP, we would not expect this to lead to greater competitiveness of conglomerates in Denmark.

Major financial conglomerates and their behaviour in Denmark

5.15 The number of jobs in financial conglomerates remained constant in the last five years, and the same in the next five years is expected. The real wage in financial conglomerates is considered to have increased in the last five years, and the same in the next five years is expected. The efficiency of financial conglomerates is considered to have increased in the last five years, and the same in the next five years is expected. The operational cost of financial conglomerates is considered to have increased in the last five years, and the same in the next five years is expected. However, the FSAP is regarded to have impacted on none of these issues.

Conclusions

5.16 Overall, it is considered that the FSAP has had little impact on financial conglomerates in Denmark in the past five years.

6 CONCLUSIONS

Assessment by Category

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Employment**	**Competitiveness**
Banking	Limited	Negligible	Positive	Negligible	Negligible
Insurance	Limited (Perhaps slightly positive)	Limited, if any	Unclear	Perhaps negative	Limited
Securities	Perhaps slightly positive	Perhaps slightly positive	Limited. Perhaps positive in the future	Negligible	Negligible
Financial Conglomerates	Limited	Negligible	Negligible	Negligible	Negative

ESTONIA

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Estonia

Division of responsibility

1.1 Responsibility for financial regulation and supervision of the banking, securities and insurance markets in Estonia is spread across four authorities.

(a) **Ministry of Finance:** responsible for banking and securities market legislation and related national and international co-operation;

(b) **Ministry of Economic Affairs and Communications:** seeks to create overall conditions for growth;

(c) **Financial Supervision Authority:** responsible for the supervision of banks, other credit institutions and the securities market, as well as insurance and pension institutions; and

(d) **The Bank of Estonia:** responsible for monetary policy and its execution, as well contributing to the stability of payment and financial systems.

Key features of banking regulation

1.2 The main overseers of banking in Estonia are the Financial Supervision Authority and the Bank of Estonia.

1.3 The main legislation affecting the Estonian banking system includes:

(a) Credit Institutions Act (1999). This law also sets out rules regarding banks' ownership and capital;

(b) Deposit Guarantee Fund Act (1998), which guarantees the deposits placed with credit institutions by depositors in the event of the credit institution suffering insolvency;

(c) Financial Supervision Authority Act (2001), detailing the tasks of the Financial Supervision Authority;

(d) The Money Laundering and Terrorist Financing Prevention Act (1999) satisfies the requirements of EU legislation (Directive 2001/97/EC); and

(e) International Accounting Standards brought into force by the European Parliament and the European Council.

Key features of insurance regulation

1.4 The operations of insurance companies are overseen primarily by the Financial Supervision Authority.

1.5 The main legislation affecting the Estonian insurance sector includes:

(a) Insurance Activities Act (2004), which regulates insurance activities, insurance mediation and supervision; and

(b) The activities of the Financial Supervision Authority are regulated by the Financial Supervision Authority Act (2001).

Key features of securities regulation

1.6 The Tallinn Stock Exchange is part of the Nordic marketplace (also including Stockholm, Riga, Helsinki, Vilnius and Copenhagen) owned by OMX.

1.7 The main legislation affecting the Estonian Securities Market includes:

(a) Securities Market Act (2001), which regulates the public offer of securities and their admittance to trading on regulated securities markets, the activities of investment firms, the provision of investment services, the operations of regulated securities markets and securities settlement systems as well as the exercising of supervision over the securities market;

(b) The Investment Funds Act (2004) was thoroughly revised in January 2005. The changes concerned the cross-border provision of investment management services, the acquisition of a qualifying holding, and the supervision of investment management companies;

(c) The activities of the Financial Supervision Authority are regulated by the Financial Supervision Authority Act (2001); and

(d) There are also a number of rules of the Tallinn Stock Exchange.

Key features of financial conglomerates regulation

1.8 Financial conglomerates fall, by definition, under the auspices of various supervisors. However, as the Financial Supervision Authority in Estonia has such wide ranging responsibilities it has regulatory responsibility for all aspects of conglomerate activity in Estonia. Further, the conglomerates operating in Estonia are based in Nordic countries and in these cases the final supervision responsibility falls on the home country regulators.

The Implementation Process and General Effects of FSAP in Estonia

Views about implementation

1.9 Although, there have been some criticisms of and resistance to FSAP measures, by and large, the implementation process of the FSAP in Estonia appears to have been smooth with few significant difficulties.

1.10 However, as The Main Report illustrates, transposition into Estonian law of most FSAP Directives has taken place several years later than in some other countries. As a result, it is unlikely that they will have affected Estonia to the same extent as other countries.

1.11 Key issues identified by survey respondents include:

(a) Respondents to our survey were generally of the view that the FSAP measures have been introduced too quickly over too short a timescale and that this has imposed significant resource pressures on both public and private sector actors in small markets, such as Estonia's.

(b) It was claimed that the regulatory powers have been extended and the regulatory environment has become more intense with statutory regulations in fields that were previously covered by self-regulatory rules.

(c) Public and private actors are now required to act upon a greater number of regulations with the same staffing and resource levels as they had previously.

(d) It was feared that Solvency II implementation might increase costs significantly.

(e) It was also feared that MiFID might adversely affect securities trading in Estonia.

Consequences of the FSAP for the Regulatory Environment

1.12 It is the Estonian securities market where the greatest level of involvement with other financial regulators has occurred and is expected to continue. The stated objective is to have similar implementations of FSAP throughout Baltic and Nordic EU Member States. To this end efforts have been made to facilitate and encourage the relevant regulators to cooperate and coordinate their approaches to issues and interpretations stemming from the FSAP.

1.13 Survey participants particularly emphasised the potential impact of MiFID upon the securities market. Some survey participants wished to reserve judgements on the overall impact of FSAP until the full effect of this Directive has been felt. However, other survey participants concluded that the effect of FSAP had been minimal, compared to non-FSAP factors such as trends in the global economy.

1.14 Survey participants viewed the level of FSAP implementation and level of regulation in Estonia as broadly equivalent to that in other Member States.

2 THE ESTONIAN BANKING SECTOR

Headline Overview

2.1 Following the collapse of Communism, Estonia adopted free-market policies more quickly than the other Baltic countries and indeed was doing so before it declared independence in mid-1991, with the establishment of the Bank of Estonia in 1990. By 2005 Estonia was sitting fourth in the Wall Street Journal's global index of economic freedom. The first post-independence government aggressively pursued reform: the Bank of Estonia became the central bank following its merger with the Estonian branch of Gosbank (the Soviet State Bank) in 1992. This merger created a two-tier banking system in which the central bank focused on monetary management and regulation of private-sector banks, while a plethora of institutions, 42 by the end of 1992, took responsibility for deposits and lending.

2.2 Serious solvency difficulties, caused by economic contraction and the proliferation of non-performing loans, arose in November 1992 and some 29 banks were either liquidated or forced into mergers because of inadequate capital or bankruptcy in 1992 and 1993.

2.3 Although consumer trust in the Estonian banking system was severely tested by this experience, the Bank of Estonia saw in the events as an opportunity for banks to develop a more cautious attitude with more attention paid to risk analysis and diversification.[1]

2.4 The largest commercial bank had a moratorium imposed in 1994. However, in 1995 the total assets of the sector grew by 47 percent, the share of paid-up share capital of Estonian credit institutions owned by the state fell from 32.6 percent to 18.5 percent and that owned by foreign investors rose from 1.1 per cent to 11.7 per cent and to 32% per cent in 1996 and Hansapank purchased a bank in Riga, Latvia. The trend towards increased concentration and foreign presence continued despite the Russian financial crisis of 1998.

Number and ownership of players

2.5 Figure 2.1 and Figure 2.5 illustrate the intense concentration that is one of the characteristics of the Estonian banking sector.

2.6 The banking system has continued to become more concentrated in recent years. Approximately 95 per cent of the market has been captured by five banks. This concentration was encouraged by three major mergers that were carried out in 1998: one between Hansapank and Hoiupank, another between Ühispank and Tallinn Pank, and the third between Eesti Forekspank and Estonian Investment Bank (to form Optiva Pank).

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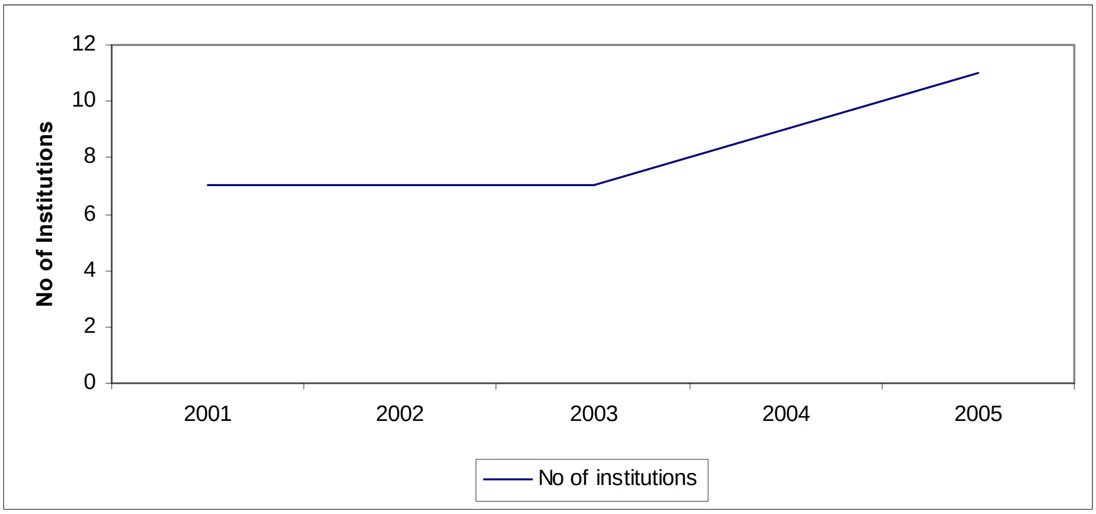
[1] Bank of Estonia, Annual Report 1993

Figure 2.1: Banks in Estonia, 2001-2003

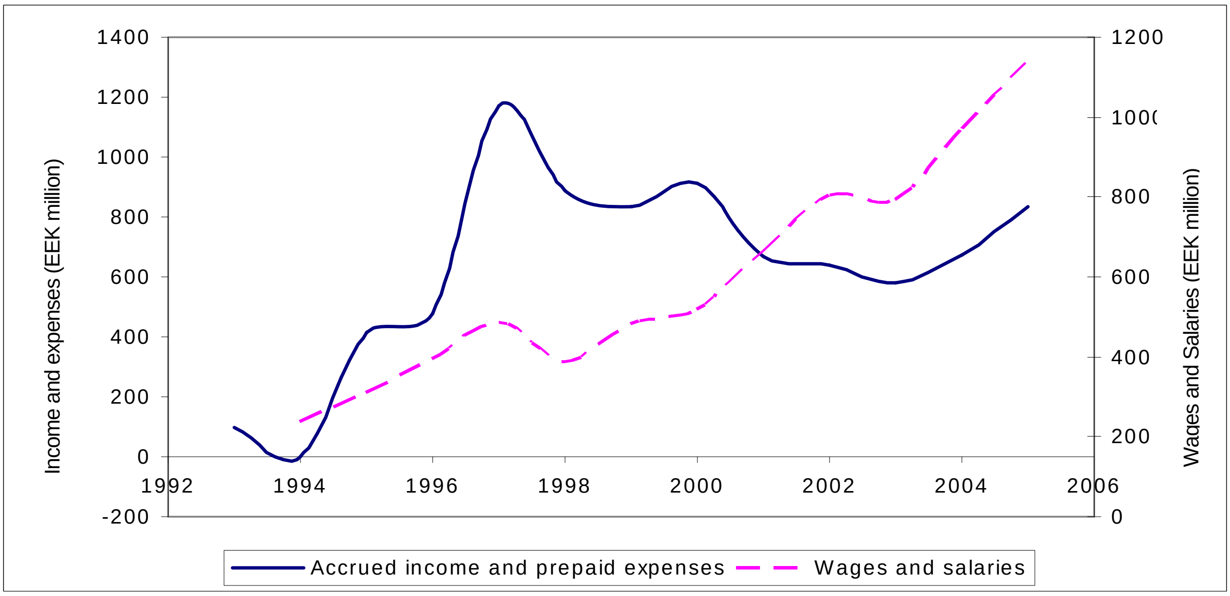


Source: European Central Bank

Turnover, employment and profitability

2.7 Figure 2.2 illustrates the income received by Estonian banks and salaries paid by them. Income may have fluctuated but the value added of the sector to the Estonian economy is illustrated by the steeply rising salaries paid in the sector.

Figure 2.2: Income and Salaries of Banks in Estonia



Source: Bank of Estonia

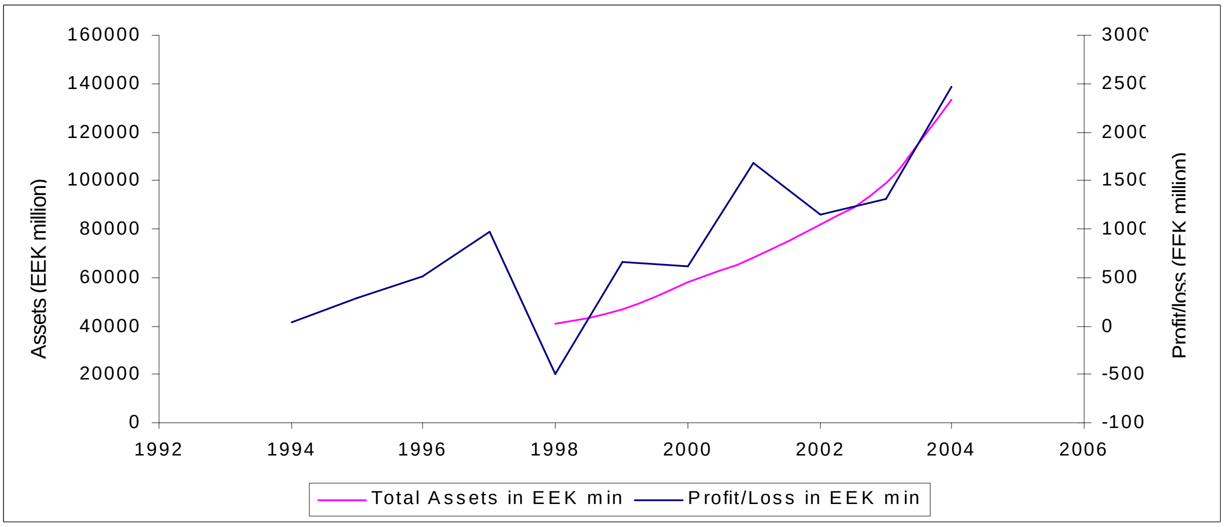
2.8 Salaries are steeply rising and the level of employment in the sector has risen steadily in recent years too, as Figure 2.3 illustrates below.

Figure 2.3: Employment in Estonian Banks (CI's)

Source: European Central Bank

2.9 Income may fluctuate, as noted, but the assets and profits of Estonian banks both show strong growth, as Figure 2.4 illustrates below. The assets of Estonian banks grew by a staggering 326 per cent between 1998 and 2004. This growth, illustrated below, shows why Estonia has become such an attractive location for Scandinavian banks looking to expand, either directly, as in the case of Nordea and Sampo, or through subsidiaries as in the case of Swedbank and SEB. The influence of the Russian banking crisis in 1998 can be seen in Figure 2.4, but so too can the strength of Estonia's recovery. Since 2000 total net profit has increased progressively in each successive year.

Figure 2.4: Assets and Profit/Loss of Estonian Banks



Note: Data for total assets not available prior to 1998

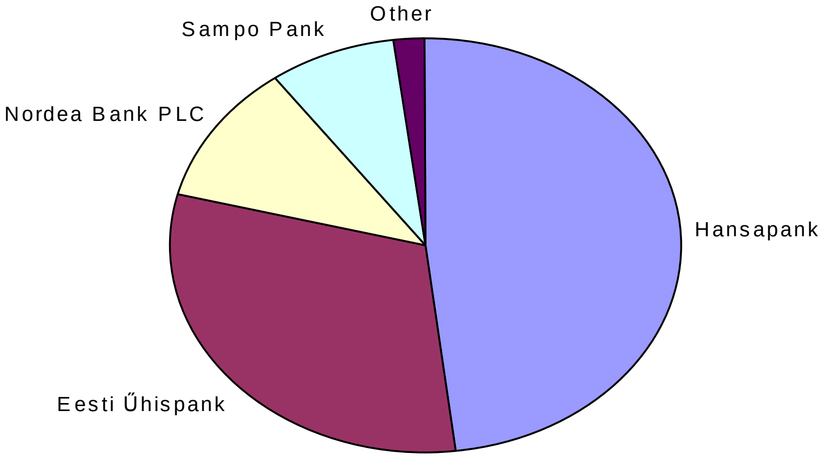
Source: Bank of Estonia

Market shares and concentration

2.10 The combined market share of the three largest banking groups (Hansapank, Eesti Ühispank and Nordea Bank PLC) is approximately 90 per cent.

2.11 Figure 2.5 sets out the market shares of banks in providing housing loans, as at December 2004.

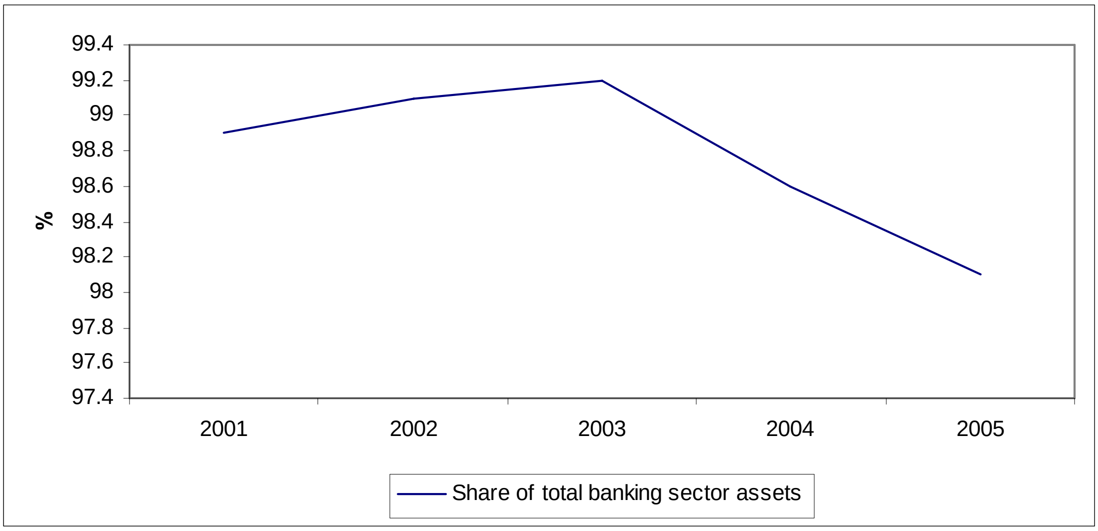
Figure 2.5: Market Share of Banks in Estonia



Source: Bank of Estonia

2.12 Figure 2.6 illustrates the evolution of the concentration ratio of the five largest banks since 2001. In 2005 the CR5 measure fell to 98 per cent from 99.2 per cent in 2003. A rather similar picture of concentration appears form the Herfindahl-Hirschman index, while recent years have also seen some pick-up in the number of branches from other countries of the EU.

Figure 2.6: Market Share of total banking assets of the 5 largest Banks



Source: ECB

Table 2.1: Herfindahl-Hirschman Index[2]

2001	2002	2003	2004	2005
4067	4025	3943	3887	4039

Source: ECB

Table 2.2: Non-Estonian banks in Estonia

	2001	2002	2003	2004	2005
Branches of CI's from EU area	1	1	1	3	6
Subsidiaries of CI's from EU area	3	3	3	3	4
Branches of CI's from third countries	0	0	0	0	0
Subsidiaries from third countries	0	0	0	0	0

[2] The Herfindahl-Hirschman index is defined in the Main Report.

Source: ECB

Table 2.3: Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005	2006[3]
Domestic	1	0	0	0	0	0	0
Internal EU	2	0	2	0	0	3	0
Third country	0	0	0	0	0	0	0

Source: ECB

Trade and international penetration

2.13 The ownership and history of these four main banking players give important insights into Estonian banking. After initially being established by two local entrepreneurs in the early 1990s Hansapank now has the largest market share in the three Baltic countries, with one third of this combined market. In 1998 further concentration took place when Hansapank merged with Eesti Hoiupank, and in the same year, Swedish FöreningSparbanken (Swedbank) obtained over 50 per cent of Hansabank's shares through a share issue. In 2005 Swedbank bought out minority shareholders to gain full ownership of Hansapank, the largest bank in Estonia.

2.14 In December 1992 ten small banks merged to create Eesti Ühispank, the second largest bank by market share in Estonia. The bank merged with Põhja-Eesti Pank in 1996 and with Tallinna Pank in 1998. By the end of 2000 the bank was almost entirely bought out by Skandinaviska Enskilda Banken (SEB).

2.15 Both Hansapank and Eesti Ühispank were indigenous products of the heightened banking activity that occurred when Estonia gained independence. They both grew and consolidated by merging with other Estonian banks and they both ultimately came to be owned by Swedish banks, contributing to the large Scandinavian presence in Estonian banking. Nordea Bank PLC and Sampo Pank, the third and fourth largest banks in Estonia by market share, also contributed to this Scandinavian presence but, in several respects, the history of these banks is distinct from that of Hansapank and Eesti Ühispank.

[3] First half.

2.16 Nordea Bank initially had a presence in Estonia in the form of Merita Bank, a Finnish bank with history back to 1862. Merita Bank, which at the time was the leading financial services provider in Finland, merged with the Swedish Nordbanken in 1997 and formed MeritaNordbanken. By late 2000 the bank had adopted the name of Nordea Bank and is now the leading financial services provider in the Nordic and Baltic region, with 11 million customers, more than 1,100 branch offices and a leading internet banking position with 4.4 million e-customers. Likewise Sampo Pank is part of a large Scandinavian concern. Sampo is a major Finnish bank, specialising in long-term savings, operating throughout the Baltic and in Poland.

2.17 The trends for Scandinavian banks to move into Estonia has been matched by Estonian banks expanding into other new markets, particularly Lithuania and Latvia. Geographical location clearly influences these developments. These trends are reflected Memorandums of Agreement reached by the Bank of Estonia with other Central Banks, and illustrated in Table 2.4, though whether the trends have followed the Memorandums of Agreement, or vice versa is a moot point as far as the FSAP is concerned.

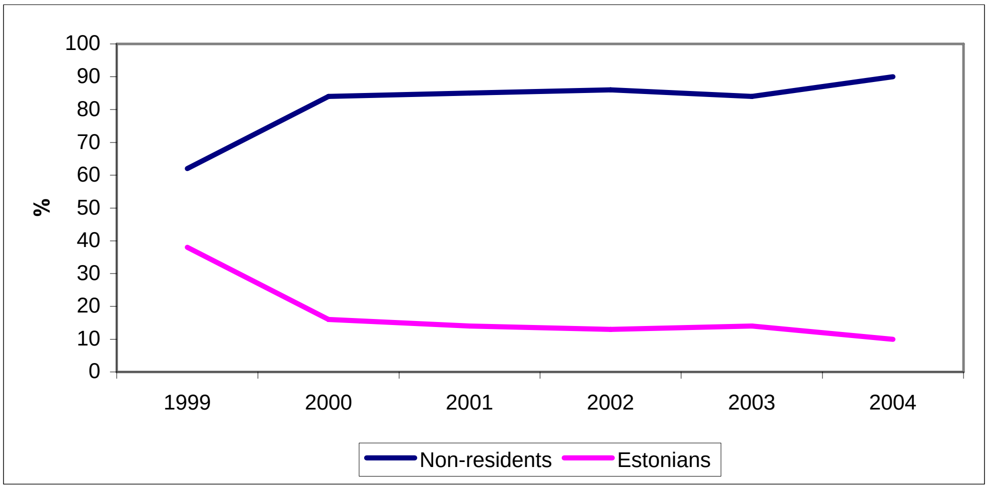
Table 2.4: Memorandums of Agreement reached by Bank of Estonia with other Central Banks

Country	Year of MoU and Supervision area
Germany	2002 banking and investment firms supervision
	2002 insurance supervision
Denmark	2002 financial supervision
Lithuania	2001 banking supervision
	2003 insurance supervision
Latvia	2000 banking supervision
Sweden	1999 securities supervision
	2003 banking supervision
Finland	1995 banking supervision (renewed in 2000)
	2001 insurance supervision
	2002 securities supervision
Baltic coperation agreement (Estonia, Latvia, Lithuania)	1997 securities supervision
	1998 banking supervision (renewed in 2003)

Source: Bank of Estonia

2.18 The high level of international penetration of Estonian banking is illustrated in Figure 2.7 which shows that non-residents owned 90 per cent of banks in 2004.

Figure 2.7: Ownership of Banks in Estonia



Source: Bank of Estonia

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.19 Inspection of historical trends in Estonian banking shows that despite the very high concentration some switching does occur. The market share of Hansapank remains dominant but it has declined from a peak of almost 60 per cent in 2000. Moreover, Nordea Bank has overtaken Sampo Pank to have the third largest market share in recent years. Participants in our survey were of the view that the FSAP has had no effect upon switching behaviour.

Dimensions of price and quality competition

2.20 Likewise, those surveyed thought that the FSAP had not had any influence upon prices or product variety.

Other factors affecting competition

2.21 Participants in our survey said that access to suppliers had been a key factor in driving the competitiveness of domestic banks against foreign banks. Other factors citied in this respect were skilled personnel, access to international markets, business infrastructure and operational costs.

Consumer protection

2.22 Respondents to our survey thought that consumer protection had improved in recent years and was likely to continue to improve. However, they did not see the FSAP either as being a factor bringing this about or hindering this.

2.23 The Bank of Estonia reports that the number of Automated Teller Machines (ATMs) in Estonia almost doubled between 1997 and 2005 from 432 to 841. Over the same period, bank payments by internet bank credit order have also increase from virtually none at all to 17 per cent of all bank payments. Some banks are now developing mobile banking, offering banking services via WAP.

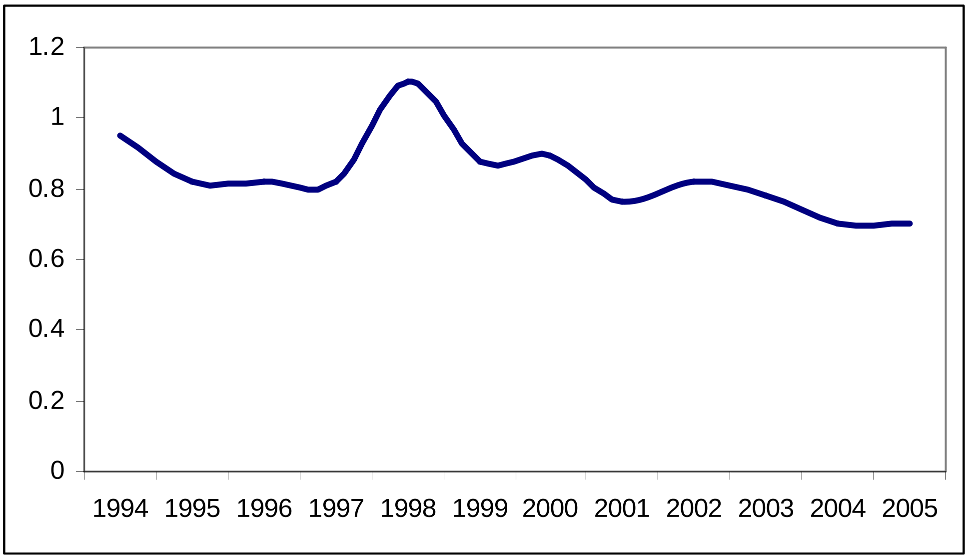
2.24 The history of Estonian electronic banking is almost as old as the history of Estonian banking in general. Hansapank started its first electronic banking service in 1993. The first banks to introduce internet banking services in Estonia were Eesti Forekspank and Eesti Hoiupank in 1996. Market leaders in Estonia are relatively newly established concerns. Thus, electronic systems, particularly the internet, have always been embraced by these leaders rather than feared as potential challenges to their well-established market positions or threats to their long established business practices.

2.25 Participants in our survey took the view that e-commerce had increased and would continue to do so, although, these developments were not seen to be linked to the FSAP.

Competitiveness

2.26 Figure 2.8 gives the cost to income ratio of Estonian banks.

Figure 2.8: Expenses to income ratio, 1994–2004



Source: OECD, Europe Economics. Note: expressed as ratio not a percentage.

2.27 It appears that banking efficiency has improved in general from 1994, despite a brief setback in 1998.

Factors specific to Estonia

2.28 We have identified the following factors as being important unusual features of the Estonian banking sector:

(a) The extent to which the banking sector, making up a total of 80 per cent of the total financial sector, dominates the Estonian financial sector.

(b) At a consistent 99 per cent, the concentration ratio of the 5 largest banks is extremely high.

(c) In 2004 almost 90 per cent of the owners of credit institutions in Estonia were non-residents. Companies partly or wholly owned by foreigners account for one-third of GDP and over 50 per cent of exports.[4] Nowhere is this foreign presence more noteworthy than in the financial sector. By the end of 2004, 33 percent of FDI occurred in the financial sector.[5] Estonian policy has strongly encouraged FDI ever since independence. The Foreign Investment Act, in force since September 1991, was adopted immediately after independence and provided foreign investors with advantages, especially regarding taxation. Although the advantages given to foreigners have now been removed, they face no special restrictions.

(d) Alongside increased government expenditure, the adoption of EU trade policies was one of the reasons cited by *The Wall Street Journal* and the Heritage Foundation for Estonia falling from fourth in 2005 to seventh in 2006 in their global index of economic freedom. Nonetheless, the 2006 index could still report, "Estonia has reduced its flat income tax rate to 24 percent from 26 percent, and the government intends to reduce it to 20 percent by 2006. The corporate tax on reinvested profits is 0 percent". This tax system is unique in the EU. Indeed, Estonia only began levying tariffs on goods at the instigation of the EU. For several years Estonia had a deserved reputation for being a Baltic 'Hong Kong', with, almost exceptionally amongst OECD countries, no law existing that could be used impose tariffs.

Impact of the FSAP and FSWP Legislative Measures on the Estonian Banking Sector

Assessment by category

Cross-border business, takeovers and the development of a regional market

2.29 Since Estonia gained independence its banking sector has seen an increasing number foreign takeovers, while in more recent years Estonian banks have also expanded beyond its borders as the development of a pan-Nordic and Baltic area financial market has gathered pace.

2.30 We believe the effects of the FSAP so far are likely to have been small given that these trends were long established and were being encouraged by local factors and institutions prior to the FSAP.

2.31 Participants in our survey did report an increase in cross-border business and this was thought likely to continue. While FSAP was not credited with accelerating this process, the FSAP was certainly not seen as in any way hindering cross-border trade.

[4] "Doing business in Estonia, A Country Commercial Guide for U.S. Companies", U.S. Department of State, 2005
[5] Ministry of Finance, Ministry of Economic Affairs and Communications, Overview of Estonian Economy, April 2005

2.32 Our econometric study suggests that the impact of the FSAP has been to increase overall trade by 1.3 per cent (to mid-2006) with imports up 1.3 per cent and exports by 1.6 per cent. Full implementation of the NFSF is projected to lead to a further 1.5 per cent rise, with imports up 1.0 per cent and exports by 2.0 per cent.[6]

Competition

2.33 Figure 2.6 illustrates that the concentration of Estonian banking has fallen a little during the period of the FSAP. However, the sector remains highly concentrated, and it is unclear that this has been affected by the FSAP.

2.34 The apparent ease of entry of foreign banks into Estonia might suggest that the market may have become slightly more contestable in recent years. However, given (a) that foreign banks have been permitted to set up branches ever since Estonia gained independence, and (b) that most of the branches that have actually been set up are Nordic, with relatively few from other Member States, it seems most likely that this is a development that would have occurred even without the FSAP.

2.35 The factors noted above coupled with a reduction in the concentration of the banking sector (although still relatively high), suggests that the intensity of competition in the banking sector is increasing. However, for the reasons highlighted above, it is unlikely that the FSAP has played any significant role in this.

Competitiveness

2.36 While the expenses to income ratio have deteriorated somewhat from 1994 this is expected to improve. However, it is interesting to note that the respondents to our survey do not expect the FSAP to contribute to this.

Employment

2.37 Only limited data is available on employment trends in Estonian banking. However, Figure 2.3 shows a rising level of employment over part of the period covered by the FSAP and Figure 2.2 illustrates a long term upward trend in the total salaries paid out by Estonian banks, which suggests an increased demand for labour.

2.38 It would be difficult to attribute these positive effects to the FSAP but nonetheless as they have occurred during the period covered by the FSAP it would seem to be the case that the FSAP is not having a detrimental effect upon employment in the sector.

Consumer protection

2.39 The Estonian banking system is relatively underdeveloped and, as noted earlier, faced serious solvency problems in the early 1990's. The FSAP has provided an impetus for institutional development of the sector that would have otherwise taken longer. It can be regarded as having helped to develop a comprehensive consumer protection regime and indeed foster greater consumer trust in the system, something that had been severely tarnished following the banking problems in the early 1990's.

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6 Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

2.40 An additional avenue through which the FSAP may have contributed to increasing consumer protection is by mitigating the scope for international firms to attempt to engage in international arbitrage through testing the regulatory forbearance of the Estonian banking system.

2.41 A third possible mechanism is the FSAP's consumer protection provisions which may themselves represent an improvement in consumer protection.

2.42 Respondents to our survey were of the view that consumer protection had improved in the last five years and believe that it was likely to continue. However, the general view was that the role that the FSAP had, and would play, in this, was negligible.

2.43 Whilst not claiming that specific changes in the rules have materially improved (rather than simply changed) the mechanism for delivering protection for consumers, we believe that the view of survey respondents (i.e. that the contribution of the FSAP was negligible) underestimates the significance of the contribution to it provides to the credibility of EU institutions.

2.44 The overall conclusion is that the contribution of the FSAP has been and will continue to be positive

Conclusions

2.45 In light of the above, it appears difficult so far to disentangle directly observable impacts of the FSAP on the Estonian banking sector from those broader processes associated with the development of the internal market.

2.46 However, in the banking sector increasing salaries and employment can be observed, which suggests a rising demand for financial services and possibly an increasing level of financial development.

2.47 Further, since 1998 there has been a rapid foreign acquisition of Estonian banks.

2.48 By setting common rules with other Nordic countries and greater regulatory certainty for potential investors, the FSAP may have encouraged this trend and the establishment and deepening of a pan-Nordic and Baltic market for banking services.

2.49 In this respect Estonia remains an attractive location for banks seeking foreign expansion, particularly those from Scandinavia, and the competitiveness and profitability of the sector should ensure that this is likely to remain the case.

2.50 FSAP rules do not appear to be doing anything significant to hinder the long-term competitiveness and profitability of the Estonian banking sector.

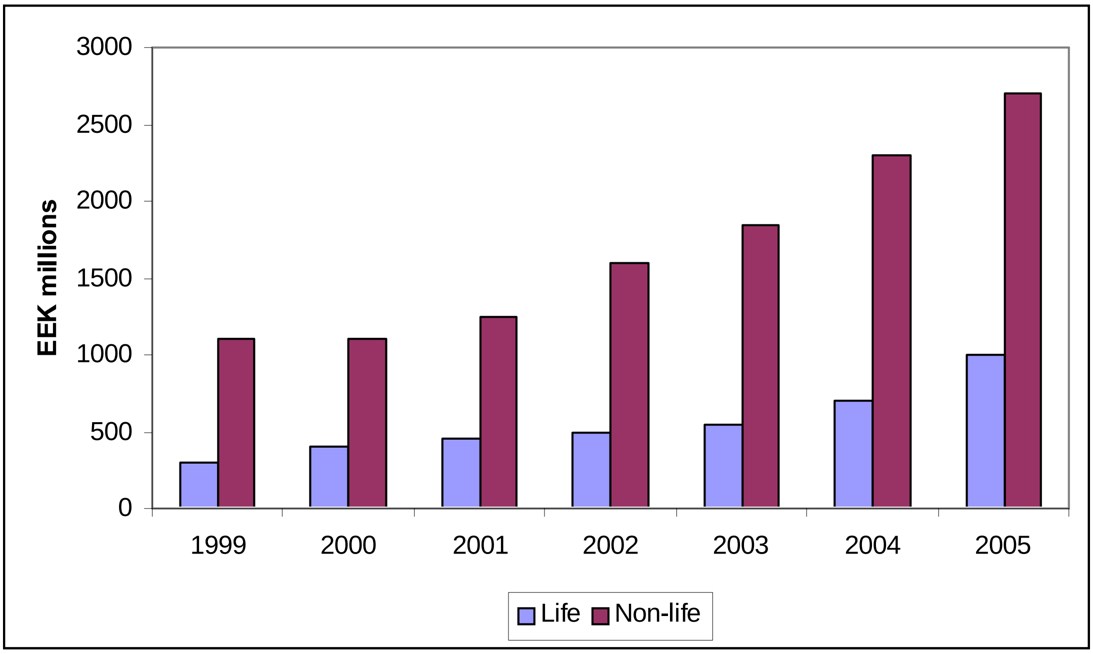
3 INSURANCE

The Estonian Insurance sector

Turnover

3.1 Figure 3.1 sets out the development of life and non-life insurance gross premiums in Estonia from **1999 to 2005.**

Figure 3.1: Life and non-life insurance gross premiums in Estonia, 1999–2005

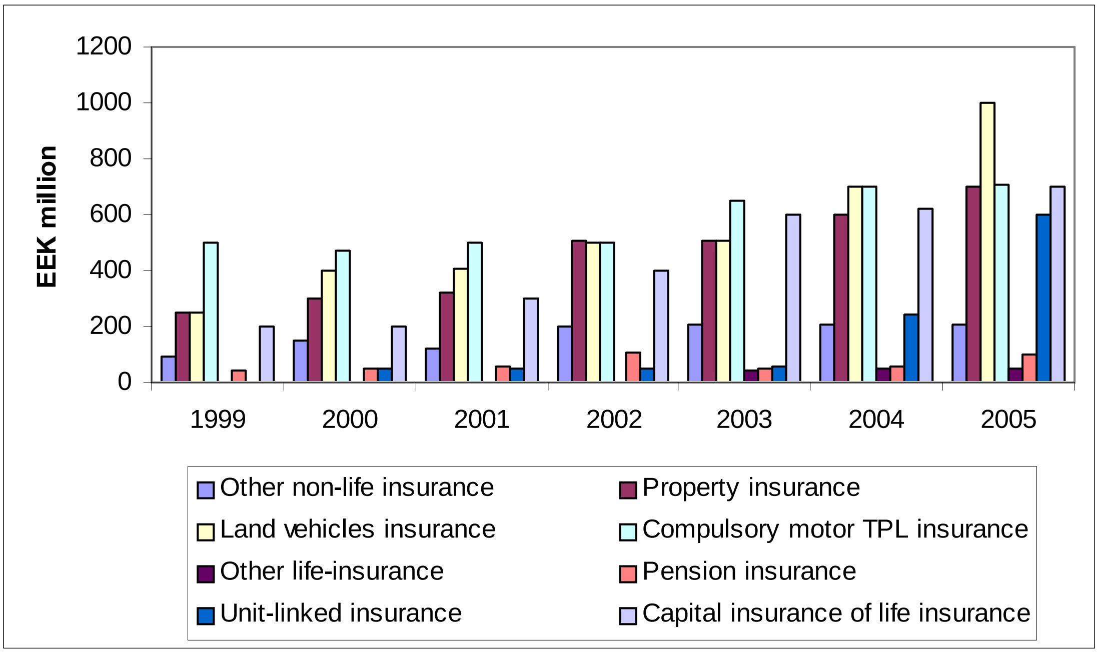


Source: Estonian Financial Supervision Authority

3.2 Both the life and non-life insurance sectors in Estonia have grown strongly and progressively throughout the period 1999 to 2005 with total non-life insurance making up a significantly larger portion of the sector throughout the period. Total gross premiums have increased by over a third in the period 1999 to 2005.

3.3 Figure 3.2 breaks down gross premiums over the period 1999 to 2005 in greater detail.

Figure 3.2: Gross premiums by insurance type in Estonia, 1999–2005



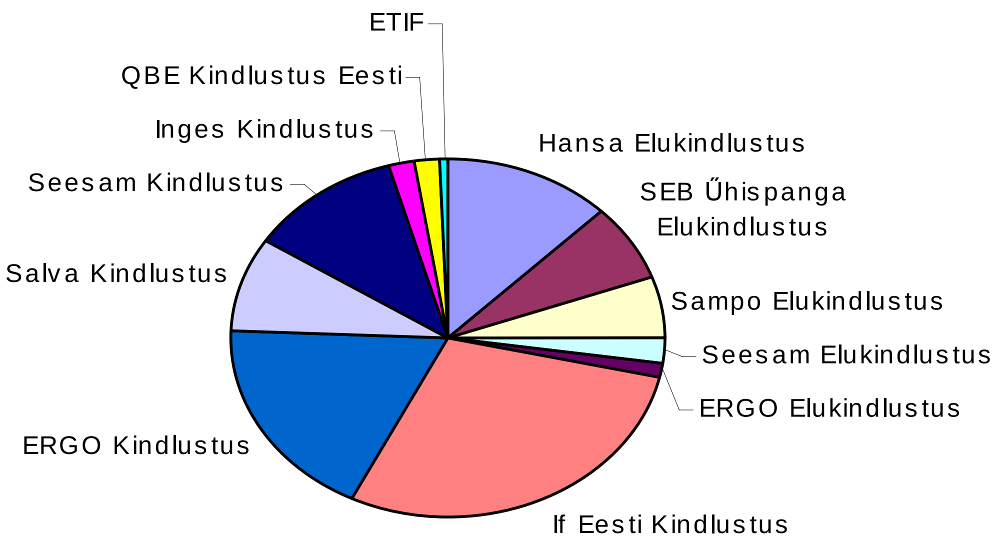
Source: Estonian Financial Supervision Authority

3.4 The relative contributions by the various types of insurance to total gross premiums have been reasonably constant over the period 1999 to 2005. Land vehicles insurance, compulsory motor TPL insurance and property insurance have been the three largest contributors to gross premiums throughout this period. The growth of unit-linked life insurance should be noted. At the beginning of the period this type of insurance was not making any significant contribution to gross premiums, yet by 2005 it was the fourth largest contributor to gross premiums, illustrating the capacity of the sector to provide innovative responses to consumer requirements.

Market shares

3.5 Figure 3.3 sets out market shares of life insurance companies in Estonia.

Figure 3.3: Market share of insurance companies in Estonia by gross premiums



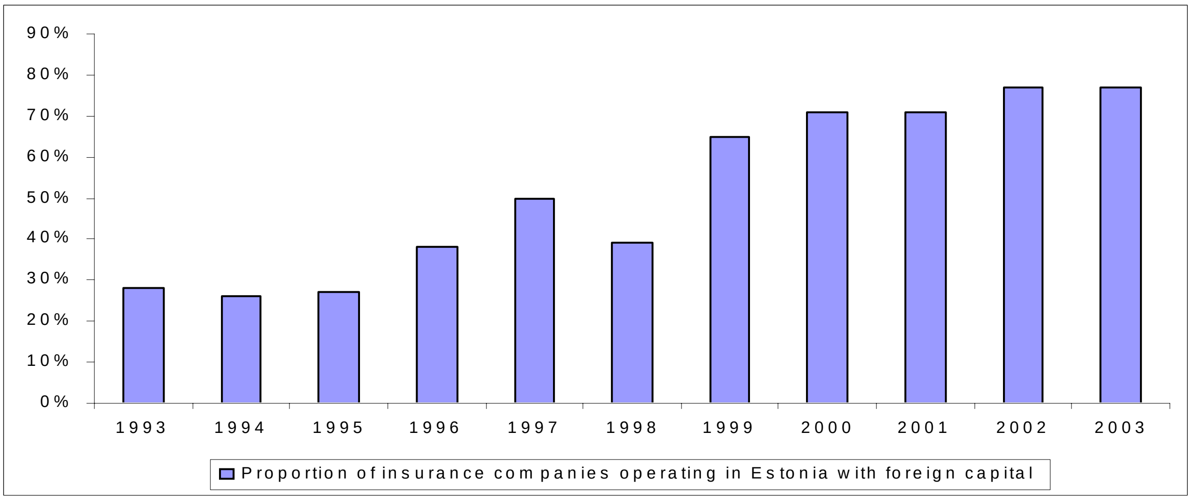
Source: Estonian Financial Supervision Authority

3.6 Companies in the insurance markets are limited to only life or non-life insurance business. Also a high proportion of the insurance business is statutory in nature. This means that the insurance companies in Estonia might be subject to relatively less systematic risk than elsewhere, since high proportions of overall insurance purchases are not demand driven, but legislated.

International entry

3.7 There has been a steady growth in the proportion of companies operating in Estonia with foreign capital as seen in Figure 3.4. The level of foreign capital in the insurance market does not match the very high levels of foreign capital in the banking market but, nonetheless, is very significant.

.Figure 3.4: Proportion of insurance companies operating in Estonia with foreign capital



Source: Estonian Financial Supervision Authority

Impact of the FSAP and FSWP Legislative Measures on the Estonian Insurance Sector

Level of implementation

3.8 It appears that FSAP measures in the insurance sector have been largely implemented in Estonia and market participants have generally adapted to the new provisions.

Assessment of impact by category

Market entry, cross-border business and takeovers

3.9 Figure 3.4 suggests that even prior to the FSAP, the share of foreign undertakings in Estonian insurance business had been high and growing. Despite this there was a consensus amongst our stakeholders that without FSAP, the level of cross-border trade in recent years would have been less. All stakeholders anticipated an increase in cross-border trade in coming years; and some concluded that this would have been less likely without the FSAP; and the FSAP was thought likely to contribute towards increased cross-border trading through electronic trading and partnerships with local intermediaries.

3.10 International firms operating in Estonia have traditionally come from Finland, Sweden and Germany. Additionally, in future stakeholders expect such firms to come from Latvia, Lithuania and the UK. Given its role in generally encouraging cross-border activity this change should not be entirely divorced from the FSAP.

Competitiveness

3.11 A likely consequence of the transposition of the FSAP directives into national legislation is an increase in the level of compliance costs for firms in the sector. Indeed, stakeholders suggested that without FSAP operational costs, which are now thought likely to remain fairly constant, might have fallen in coming years. This suggests that in the short term, the FSAP may be preventing the capture of some potential gains in efficiency.

3.12 A particular concern was that the implementation of Solvency II might prove very expensive. Nonetheless, Estonian insurers were perceived to have become more efficient and this was expected to continue, though any link with the FSAP was less apparent.

3.13 High growth has made the sector attractive to international insurance firms and it seems possible that large mergers, which FSAP has in part facilitated, have proved the most effective means of making the corporate culture within Estonian insurance more efficient and competitive.

3.14 We believe that these developments will outweigh the effects of greater compliance costs so that the FSAP has had a positive contribution to the competitiveness of the Estonian insurance system.

Products variety, e-commerce, and prices

3.15 Recent regulatory reforms may have led to prices in insurance more accurately reflecting costs and it seems plausible that prices will become ever more competitive in coming years as competition, which FSAP has facilitated, becomes more intense.

3.16 Rising cross-border trade may also be contributing towards increased product variety. The growth of unit-linked life insurance illustrated in Figure 3.2 is illustrative of the capacity of the sector for innovation.

3.17 Participants in our survey concurred with the notion that e-commerce had increased and would continue to do so, but this as a result of the high level of local internet usage for business rather than the FSAP.

Consumer protection

3.18 Respondents to our survey considered that levels of consumer protection had risen and the FSAP may have been a factor in this trend, which was expected to continue.

3.19 Furthermore, the improvement in corporate governance and risk management systems, and with them levels of consumer protection, may have come hand in hand with changes in corporate culture brought about by mergers with bigger financial groups, a process enhanced by the FSAP.

Conclusions

3.20 From the above we can see that many of the trends that might be expected to have followed the FSAP, for example greater efficiency, greater concentration and a higher rate of product innovation, have indeed occurred.

3.21 However, the FSAP process has taken place against a background when many of the most significant trends in the market had already become established.

3.22 Nevertheless the impact on the market that might be attributed to the FSAP can be observed, for example, in a significant rise in presence in Estonia by non-Estonian companies.

3.23 So at the very least, it can be argued that the FSAP has provided a consolidation of existing internal market benefits particularly in relation to the growth of a regional Nordic market.

4 SECURITIES MARKETS

4.1 The Tallinn stock exchange is a part of the OMX group exchanges, covering most of the Nordic and Baltic countries.

4.2 The company 2005 annual report refers to global market trends as the driving forces for the OMX, all demanding more efficient securities transactions. The same report also referred to the opportunities and threats presented by self regulation and by the FSAP: [7]

> "One of the most important directives from the EU is the Markets in Financial Instruments Directive (MiFID), which is expected to come into force in November 2007. This directive will place extensive demands on securities institutions active within the EU, for example regarding the obligation to report completed securities transactions to the respective supervisory authorities. MiFID is also intended to create competitive neutrality between various trading forms, as well as to secure efficient and transparent securities trading."

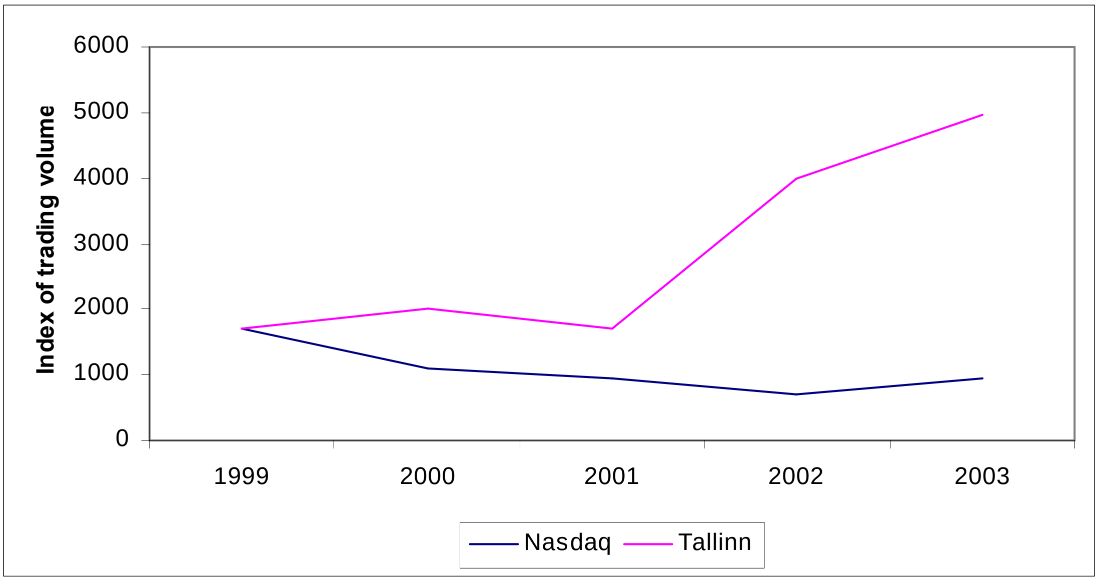
4.3 The OMX expects the combined effect of the measures, self-regulation and the harmonisation of corporate governance structures to lead to increased competition across industry and national borders. The OMX expects the increased harmonisation in the EU to have a major impact on future financial infrastructure and competition, though it singled out technology as the main driving force for growth and efficiency.

4.4 The OMX Tallinn (OMXT) reached its record level on 4 October 2005 at 700 points, following a takeover bid for Hansapank and the listing of shares of new companies on the OMXR. Subsequently, the average daily turnover of stock exchange transactions reached 118 million kroons in 2005, outpacing the previous year's level more than three times.

4.5 Figure 4.1 shows the dramatic increase in the market capitalisation at the Tallinn stock exchange since the late 1990s and is compared with the NASDAQ.

[7] http://www.omxgroup.com/digitalAssets/937_OMX_2005_ENG_web.pdf

Figure 4.1: NASDAQ – Tallinn trading volume



Source: NASDAQ

Factors Specific to Estonian Securities Markets

4.6 The Tallinn Stock Exchange remains small, with only nine stocks listed and only two, Eesti Telekom (Estonian Telecom) and Hansapank, that trade with any regularity.

4.7 In May 1996 the Tallinn Stock Exchange opened for trading with 11 securities listed. The Bank of Estonia reports that in the following year 42 per cent of capitalisation on the Tallinn stock exchange was by non-resident investors. By 1994 this figure had doubled to 84 per cent, with Swedish investors accounting for 55 per cent of this, with another 8.5 per cent from the UK investors, 6.5 per cent from US and 6 per cent from Finland.

4.8 The Tallinn Stock Exchange is a small exchange dominated by foreign investors and banks. The Bank of Estonia reports that almost 80 percent of securities are held by financial intermediation firms and between 1998 and 2003 the share in the turnover of the Tallinn Stock Exchange generated by credit institutions never fell below 60 percent.

Impact of the FSAP and FSWP Legislative Measures on Estonian Securities Markets

Level of implementation

4.9 The Chair of the Financial Supervision Authority reported to Parliament on MiFID on 13 June 2006 and stated:

> "With regard to implementation of MIFID, the Financial Supervision Authority considers it necessary to ensure that investor interests are protected while ensuring that the investment services market continues to operate effectively. Implementation of both Basel 2 principles and MIFID will notably increase the administrative burden on the providers of investment services and direct financial cost of operating on the securities market".

4.10 The Investment Funds Act adopted in 2004 was thoroughly amended in January 2005. The changes concerned the cross-border provision of investment management services, the acquisition of a qualifying holding, and the supervision of investment management companies. This Act made Estonia compliant with a number of FSAP Directives.

4.11 Estonia missed the deadline for implementation of the new Prospectus Directive but subsequently the Securities Market Act, the Investment Funds Act, the Guarantee Fund Act and the Law of Property Act were amended to make Estonia compliant.

4.12 The implementation of the Market Abuse Directive (the MAD) enhanced the Financial Supervision Authority's supervisory powers, specifying the cooperation between it and foreign supervisory authorities, thus affirming the possibility for foreign supervised entities to enter the Estonian market. The rules of the Tallinn Stock Exchange were amended in line with the MAD in 2005.

Impact

4.13 Arguably the most important point of the MiFID is the expansion of cross-border activities to create a well-functioning single European market for securities.

4.14 Given that the Tallinn Stock Exchange is part of the OMX group, which also has exchanges in Copenhagen, Helsinki, Riga, Stockholm and Vilnius, it seems unlikely that the FSAP has had significant direct impact on the integration of Estonian securities market with other EU Member States.

4.15 Our view is that the Nordo-Baltic exchanges which are part of the OMX group are rather insulated, in the sense that they will probably not be affected by the migration of securities jobs to London (which may take advantage of its lead in systematic internalising). Similarly we do not expect to see any positive repercussions on the level of employment in the Estonian securities sector at an aggregate level, as the OMX has already had a positive impact on the level of employment.

4.16 Participants in our survey suggested that integration of Estonian markets evidence an increase of cross-border business that will take place over the coming years but the role played by the FSAP is unclear. Indeed, some participants in our survey, while being both optimistic about prospects for the Estonian market and the level of cross-border trade, feared that MiFID might diversify trade away from the Tallinn Stock Exchange through accelerating the development of off-exchange trading in Europe.

4.17 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Estonian securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Estonian securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

4.18 Participants in our survey were not of the view that the Prospectus Directive has achieved its stated objective of creating harmonisation in relation to the contents and format of prospectuses. They claimed that they came to this view, as it is still too early to say whether the Directive has achieved its objective but they strongly welcomed the Directive and considered it to have the potential to offer a massive step forward in the future.

4.19 However, it was considered that the FSAP has contributed towards an increased ability to diversify risks as currency and interest risks are becoming more absorbable.

4.20 Participants in our survey concurred that the FSAP had contributed to an increased integration of common legal frameworks for securities and derivatives trading but also concluded that the additional contribution that FSAP has made to trade volumes has been insignificant.

4.21 Participants in our survey expect great increases in online trading in the future but see this as a pre-established trend that would have happened in the absence of the FSAP.

4.22 The Transparency Directive may further harmonise the requirements in respect of financial statements for listed companies.

Conclusions

4.23 The integration of the OMX markets is well established and it is hard to attribute specific mechanistic account of the way in which the FSAP has led to this. Nonetheless, the aspirational factors surrounding the FSAP in providing momentum to these trends suggests a more general contribution of the FSAP to the wider regional trends. However, it is unclear whether the FSAP has actually accelerated the process.

4.24 The strong praise for the Prospectus Directive from stakeholders was matched by concern about the impacts of MiFID. It might be that this reflects concerns in Estonia that improved mechanisms for cross-border trade will simply provide more opportunities for business beyond its small stock market. However, this may be an unjustified fear. While the Estonian stock market is small, rates of market capitalisation are very strong.

5 FINANCIAL CONGLOMERATES

Financial Conglomerates in Estonia

5.1 The Estonian financial market is characterised by close links between the banking and insurance sectors. Increasingly closer links between the banking and insurance sectors are an international phenomenon and related to the development and integration of the financial markets (financial diversification and conglomeration). The general aim is to realise economies of scope.

5.2 The Bank of Estonia has previously stated:

> "As for the Estonian financial sector, although largely bank-dominated, it does encompass all main financial activities - banking, leasing, insurance, fund management and stock market operations. The diversity of the financial sector enables it to offer a wider range of financial products to the public. It also helps to diversify risks. The universal banking model prevalent in Estonia makes financial conglomerates major suppliers of different financial services. Highly integrated financial services market calls for a well-designed and comprehensive safety net".[8]

5.3 The World Bank reports that non resident financial conglomerates own about 45 per cent of commercial banks' share capital.[9]

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[8] Andres Sutt, Deputy Governor of the Bank of Estonia, Speech on Insurance and Private Pension schemes, 6 February 2002

[9] http://www.worldbank.org/research/interest/prr_stuff/countries/Estonia.xls

Table 5.1: Conglomerates with Head Office in Estonia

Name	Head office base	Countries in which they operate	Characterization of Conglomerate	Characterization of Subsidiary
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	Banking
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%	Banking with some Securities
Sampo	Finland	Finland, Estonia, Latvia, Lithuania, Sweden	Banking and Insurance	Banking with some Insurance
SEB	Sweden	Luxembourg, Sweden, UK, France, Spain, Finland and Denmark, Germany, Poland, Estonia, Latvia, Lithuania	Banking firm doing insurance and asset management	Private Banking
Svenska	Sweden	Austria, Estonia, France, Denmark, Finland, Norway, Germany, UK, Luxembourg, Netherlands, Poland, Spain, Switzerland	Insurance, banking and asset management	DNA

Source: EU Mixed Technical Group on the Supervision of Financial Conglomerates. Note: DNA = Data Not Available

5.4 None of the conglomerates with a presence in Estonia are based in the country. Nor is the co-ordinating regulator in any of these cases Estonian.

5.5 However, Sampo has a 5.6 per cent market share in the Estonian insurance market and eight per cent of the Estonian banking market. Nordea has a 28.8 per cent share in the Estonian insurance market and an 11 per cent share in the banking market. SEB has a seven per cent share in the insurance market and a 31 per cent share in the banking market. Additionally, the Hansa Group has a 12.5 per cent share in the insurance market and a 48 per cent share in the banking market.

5.6 The extent to which conglomerates operating out of base countries other than Estonia and whose co-ordinating regulators are non-Estonian must serve to harmonise regulatory practices in the Nordic and Baltic region and to deepen the common financial market within this region.

5.7 Participants in our survey dismissed the suggestion that the FSAP had influenced the operation of conglomerates in Estonia to any great extent.

Impact of the FSAP and FSWP Legislative Measures on Financial Conglomerates

5.8 As we can see in Table 5.1, although some conglomerates operating in Estonia do engage in insurance activities, and there are also some securities activities, the most important conglomerate activity is banking. Thus, the conclusions for financial conglomerates in Estonia are close to those for banking.

Assessment by category

Openness

5.9 We have seen that the FSAP has had a limited impact on the openness of the banking sector thus far. Thus we expect that the same will apply to conglomerates in Estonia.

5.10 Thus our assessment is that the FSAP will have a limited impact on the degree of openness.

Competition

5.11 We have seen that competition is expected to be relatively unaffected by the FSAP in both the insurance and banking sector, and this can be expected to apply to financial conglomerates as well.

Consumer protection

5.12 Although the effects of the FSAP on consumer protection in the insurance sector appear to be positive, it seems to be negative in the banking sector. We expect that the latter case will apply to financial conglomerates operating in Estonia.

Employment

5.13 We assess the effects on employment in both banking and insurance sectors as negligible. Furthermore, our view is that the FSAP may be a factor in conglomerates in Estonia losing market share to more specialised players (particularly in the insurance sector).

Competitiveness

5.14 We do not expect that the FSAP has had more than a negligible effect on competitiveness.

6 CONCLUSIONS

6.1 Overall, then, we can see that the regulatory reform in Estonia pre-dates the FSAP, with significant impacts deriving from the process of market liberalisation following Estonian independence.

6.2 The legacy of independence appears to have left potential for strong growth in the market, and with more competitive markets, this has been achieved.

6.3 However, the progress towards the internal market and the expectation of the development of certain harmonised regulation across the Member States has clearly been a factor in providing security for investors in the Estonian market.

6.4 This positive impact cannot be seen easily from direct market data but it can be argued that it underpins Estonian growth.

6.5 It appears that it is in this sense that the FSAP process may have been most beneficial.

6.6 We can see significant cross-border market penetration and ownership from outside Estonia. Further, in Estonia, as in the other Nordic Member States, we can see the development of a regional market for financial services, a development that has benefited from FSAP measures.

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Limited	Limited	Negligible	Negligible	Negligible
Insurance	Positive in future	Positive in future	Positive	Negligible	Negligible
Securities	Limited	Limited	Limited. Perhaps positive in the future	Limited	Limited
Financial Conglomerates	Limited	Limited	Negligible	Negligible	Negligible

FINLAND

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Finland

Division of responsibility

1.1 Responsibility for financial regulation and supervision of the banking, securities and insurance markets in Finland is spread across five authorities.

(a) **Ministry of Finance:** responsible for banking and securities market legislation and related national and international co-operation;

(b) **Financial Supervision Authority:** responsible for the supervision of banks, other credit institutions and the securities market.

(c) **Insurance Supervision Authority:** responsible for the supervision of insurance and pension institutions;

(d) **Ministry of Social Affairs and Health:** responsible for the legislation related to the supervision of the insurance market; and

(e) **Bank of Finland:** responsible within the European System of Central Banks for monetary policy and its execution, as well contributing to the stability of payment and financial systems.

1.2 Processes exist for the above authorities to co-ordinate operation. The boards of the Financial Supervision Authority and the Insurance Supervision Authority include official representation from, among others, the Ministry of Finance, the Ministry of Social Affairs and Health, the Bank of Finland, and the Financial Supervision Authority and Insurance Supervision Authority themselves. Inter-authority working groups are also created on an ad hoc basis.

Key features of banking regulation

1.3 The main overseers of banking in Finland are the Financial Supervision Authority and the Bank of Finland.

1.4 The main legislation affecting the Finnish banking system includes:

(a) Act on Credit Institutions (1994). This law also sets out rules regarding banks' ownership and capital;

(b) Financial Supervision Act (2003) detailing the tasks of the Financial Supervision Authority; and

(c) International Accounting Standards brought into force by the European Parliament and the European Council.

Key features of insurance regulation

1.5 The operations of insurance companies are overseen primarily by the Insurance Supervision Authority (which fell under the responsibility of the Ministry of Social Affairs and Health until it was formally separated from the parent Ministry on 1 April 1999).

1.6 The main legislation affecting the Finnish insurance sector includes:

(a) Insurance supervision is regulated by the Act (78/1999) on the Insurance Supervisory Authority and specific insurance business regulations.

(b) The organisation and business management of the Authority is regulated by the decree on the Insurance Supervisory Authority (102/1999).

Key features of securities regulation

1.7 The Helsinki Stock Exchange is part of the Nordic marketplace (also including Stockholm, Riga, Tallinn, Vilnius and Copenhagen) owned by OMX.

1.8 The main legislation affecting the Finnish Securities Market includes:

(a) The Securities Market Act (26.5.1989/495);

(b) The Act on Trading in Standardised Options and Futures (26.8.1988/772);

(c) There are also a number of rules of the Stock Exchange.

Key features of financial conglomerates regulation

1.9 Financial conglomerates fall, by definition, under the auspices of various supervisors. Further, some of the conglomerates operating in Finland are based in other Nordic countries; in these cases the final supervision responsibility falls on the home country regulators.

1.10 The Annex 5/7 of “Financial Integration” (Bank of Finland, 2004) describes the regulatory arrangements of the main conglomerates:

(a) The Sampo Group is jointly supervised by the Financial Supervision Authority and the Insurance Supervision Authority, with the FSA acting as the coordinating authority.

(b) The Nordea Group is supervised jointly by the supervisory authorities of the Nordic countries, with responsibilities are divided between the authorities of the different countries largely according to the structure of the Group.

(c) In addition to the FSA, the amalgamation of cooperative banks is also supervised by the OKO Bank Group Central Cooperative. The FSA focuses on the group as a whole, while ensuring that latter has a central institution with adequate authority to supervise the individual member cooperative banks.

(d) The Savings Bank Inspectorate supervises the savings banks and the FSA supervises the inspectorate.

The Implementation Process and General Effects of the FSAP in Finland

Views about implementation

1.11 Although, there have been some criticisms of and resistance to FSAP measures, by and large, the implementation process of the FSAP in Finland appears to have been smooth with few important difficulties.

1.12 It can be argued that this may have been due to an existing advanced state of financial development in Finland. One example of this may be in relation to the technology for electronic payments where the creation of the Single European Payments Area (SEPA) by 2010 seems likely to present Finland with relatively few problems compared to other Member States and the e-Money Directive 2000/46 EU which apparently imposed only very small changes to existing Finnish legislation.

1.13 Key issues identified by survey participants include:

(a) Difficulties in implementing the Market Abuse Directive; in particular there was criticism that Level II was too detailed and was being introduced too quickly.

(b) Some market participants believe that Finnish tax laws prohibit them from using the new financial collateral arrangements provided by Directive 2002/47/EC.

(c) There was some criticism that Directive 2002/92/EC on insurance mediation had been supplemented by national measures ("gold-plating") on top of those requested by the Directive.

(d) Some FSAP measures were regarded as being inconsistent with the Finnish constitution.

(e) There is a view that, at times, so many measures have been being implemented at once that simply keeping up with the changes imposes a significant regulatory burden.

1.14 Both items (a) and (e) here offer clear evidence of regulatory fatigue.

Impact of the FSAP and FSWP Legislative Measures on the Regulatory Environment

1.15 In the view of the participants in our survey, set out in more detail in Appendix 1, prior to the FSAP the Finnish regulatory framework was largely rule-based, though there may have been some scope for discretion in certain areas. What scope there was for regulatory discretion may have been reduced in certain areas (though the view is that some measures such as the Capital Requirements Directive leave considerable scope for national options). It has also been argued that the FSAP may, over time, lead to a more risk-based approach in certain areas.

1.16 The scale of change in domestic regulation is regarded as significant in banking and securities, but perhaps less so in insurance. This is especially visible in: 1) More powers (administrative sanctions) for the FIN-FSA. 2) Significant changes to systems of companies providing investment services (for example the MiFID transaction reporting) 3) Use of fair values being increased in financial statements. Derivative instruments are recognized in balance sheets.

1.17 Even though Regulation (EC) No 1606/2002 (IAS Regulation) created new tasks for the supervisor, relating to the financial statements prepared under IAS/IFRS Standards, the relationships between regulatory authorities have not changed.

1.18 Survey participants view the level of FSAP implementation and level of regulation in Finland as broadly equivalent with that in other Member States.

1.19 The FSAP seems to have been regarded as increasing the interaction through regulator-industry relationships and the level of involvement with other financial EU authorities.

1.20 However, insurance agents have difficulties in understanding the registration requirements and some insurance brokers appear to be discontented with the new national requirements — which are tighter than those of the mediation directive.

2 THE FINNISH BANKING SECTOR

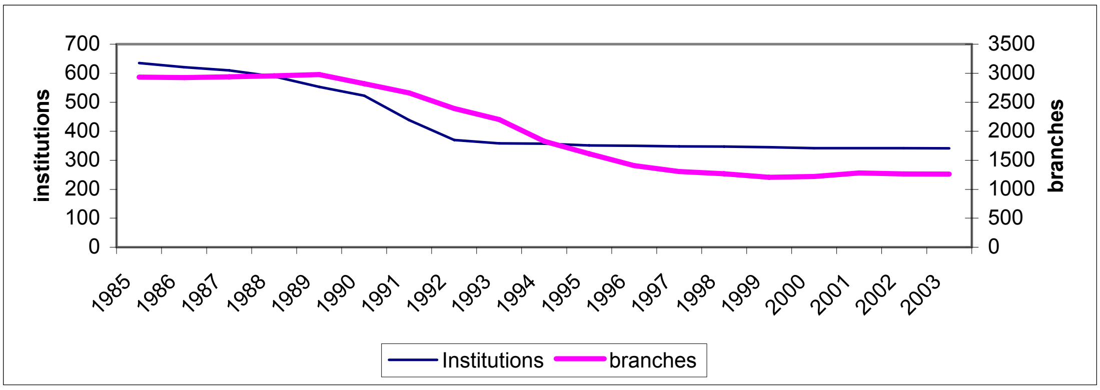
Headline Overview

Number of players

2.1 At the end of 2004, the FIN-FSA reported that there were a total of 344 banks in Finland. Of the total figure, 39 were savings banks which operate under the umbrella of the central Finnish Savings Bank Association.

2.2 Figure 2.1 sets out trends in the number of institutions and branches since 1979. As can be seen, numbers fell considerably during the late 1980s and early 1990s, but have been very stable since the early 1990s.

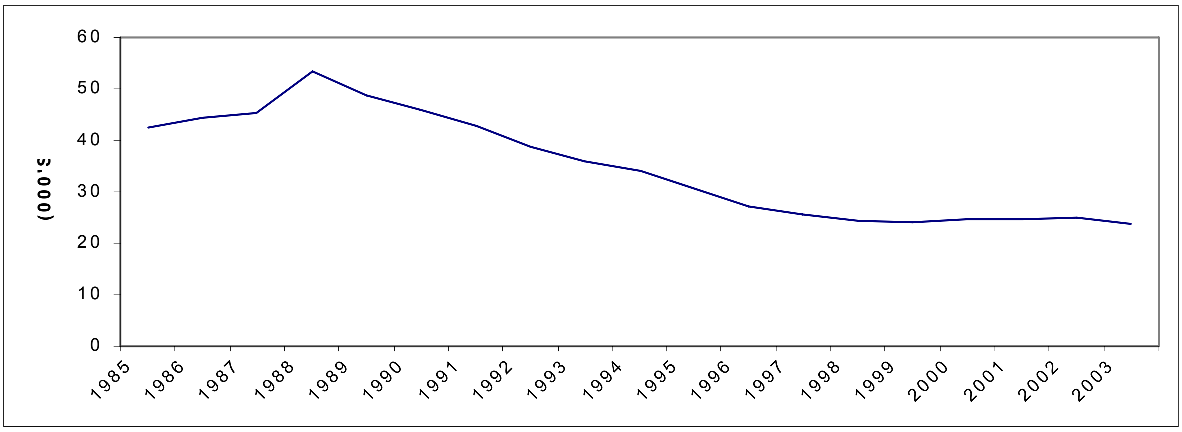
Figure 2.1: Banks in Finland, 1985–2003



Source: OECD

Turnover, employment and profitability

Figure 2.2: Employment in Finnish banks, 1985–2003



Source: OECD

2.3 As illustrated in Figure 2.2, employment in banking has declined in Finland over the past two decades. The results of the survey in Appendix 1 suggest that, in the future, the number of jobs is expected to now remain more stable. Real wages and salaries have tended to increase somewhat in recent years and are predicted to grow further in the future.

2.4 According to the Finnish Bankers' Association the sector made a profit of €1.32 billion in 2004, slightly up on 2003. Low interest rates affected net income from financial operations, but lending was up. Housing credits granted by financial institutions grew by more than 15 per cent, and credits to companies grew by nearly 9 per cent. Bank deposits grew by 5 per cent, the total capital of mutual funds by 36 per cent and insurance savings for life assurance by nearly 9 per cent.

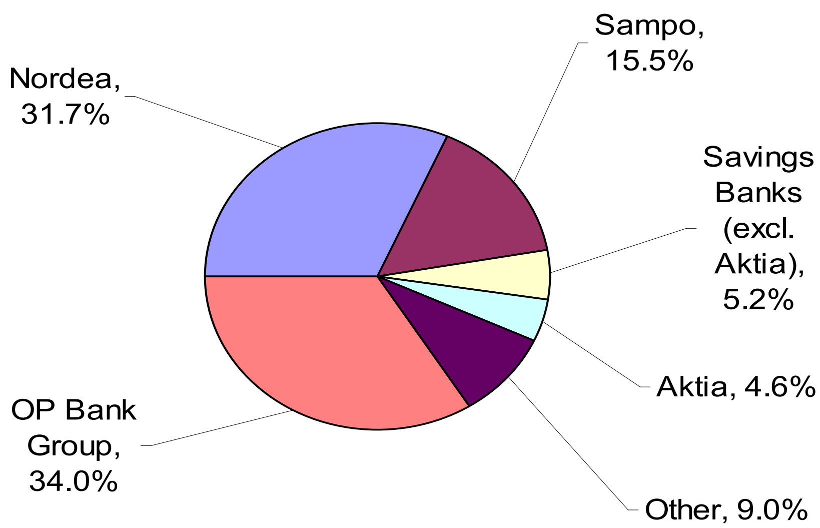
2.5 The Main Report illustrates that in 2004, the Finnish banking sector was among the best-performing within the EU in terms of return on assets and net income. The Bank of Finland attributed this strong showing to low loan losses.[1]

Market shares and concentration

2.6 The combined market share of the three largest bank groups (Nordea, Sampo and the OP Bank Group) was approximately 80 per cent of all deposits and credits.

2.7 Figure 2.3 sets out the market shares of banks in providing housing loans, as at December 2005.

Figure 2.3: Market Share of Banks' Housing Loans, 31 December 2005

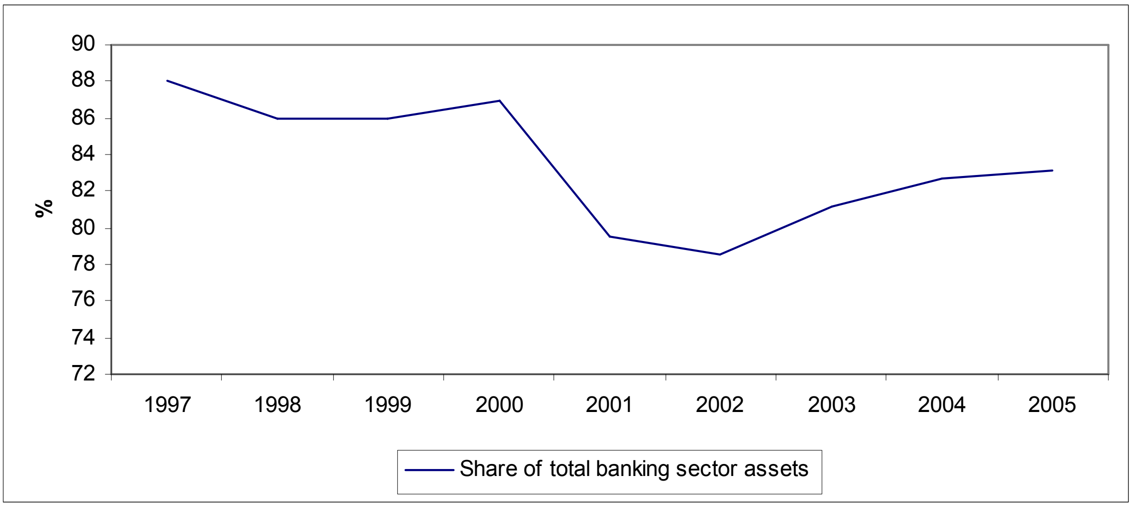


Source: Finnish Bank Association

2.8 Figure 2.4 illustrates how concentration has evolved. The C5 measure has fallen since the 1990's but the Herfindahl index is now at a peak.

[1] Bank of Finland, Financial Stability Report 2005

Figure 2.4: Share of the 5 largest Finnish credit institutions in total assets



Source: ECB

Table 2.1: Herfindahl-Hirschman index

1997	1998	1999	2000	2001	2002	2003	2004	2005
2150	2120	1960	2050	2240	2050	2420	2680	2730

Source: ECB

Table 2.2: Non-Finnish Branches and Subsidiaries

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Branches of CI's from EU area	6	6	7	5	18	19	18	19	19
Subsidiaries of CI's from EU area	3	3	3	3	3	3	3	5	5
Branches of CI's from third countries	0	0	0	0	0	0	0	1	1
Subsidiaries from third countries	0	0	0	0	0	0	0	0	1

Source: ECB

Table 2.3: Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005	2006*
Number of domestic M&A's	0	0	1	1	1	0	0
Number of EU M&A's	0	0	0	0	0	1	1
Number of third country M&A's	0	0	0	0	0	0	0

*Source: ECB, * First Half*

2.9 There was a large increase in foreign bank branches in 2001, but there have not been many mergers (and those that have occurred have been domestic until recently).

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.10 Switching is notoriously difficult to assess, and subjective judgement by those close to the industry is often the main source of data. In the case of this report, our main data source is our opinion survey. Some respondents to that survey took the view that the effects on the switching behaviour of bank customers have so far been negligible. However, there is expected to be increased switching in the future. The extensive use of technology makes account opening in Finland easier than in some other Member States.

Dimensions of price and quality competition

2.11 The survey also investigated views of price and quality competition. Different market players took very different views with respect to the prices of relevant banking products. Some believed that prices have declined or increased only slightly in the past (and predict a similar pattern in the future). Others take the view that prices have increased steeply in the recent past and expect the trend to continue into the future. It is possible that this divergence of view reflects a difference of opinion about what are the most relevant products, or that respondents differ in their views about how much quality has increased (and consequently to what extent price rises reflect relevantly higher-quality output). It is also possible that some respondents are mistaken.

2.12 Our survey also investigated product variety. The view of survey respondents was that the number of products available on the market has increased over the past years and the trend is expected to continue, with a similar pattern anticipated for e-commerce.

Other factors affecting competition

2.13 Survey respondents regard the intensity of competition as one of the main determinants of whether a particular bank can be dominant in the banking sector. Other factors regarded as important include the threat from potential new entrants and buyer power. This latter aspect is clearly related to the size of the firm and is of particular importance given the high level of concentration present in the Finnish economy.

Consumer protection

2.14 The survey results suggested that consumer protection in Finland is widely regarded as having improved over the past five years and respondents envisage it improving further in the future.

The potential future role of technology

2.15 In 2000 the Bank of Finland published a study entitled “Technological Transformation and Retail Banking Competition” that analysed the effects on banking competition of the changes in banking delivery and information collection technologies and of the rivalry from outside the traditional banking sector.

2.16 Two important conclusions of the above study were:

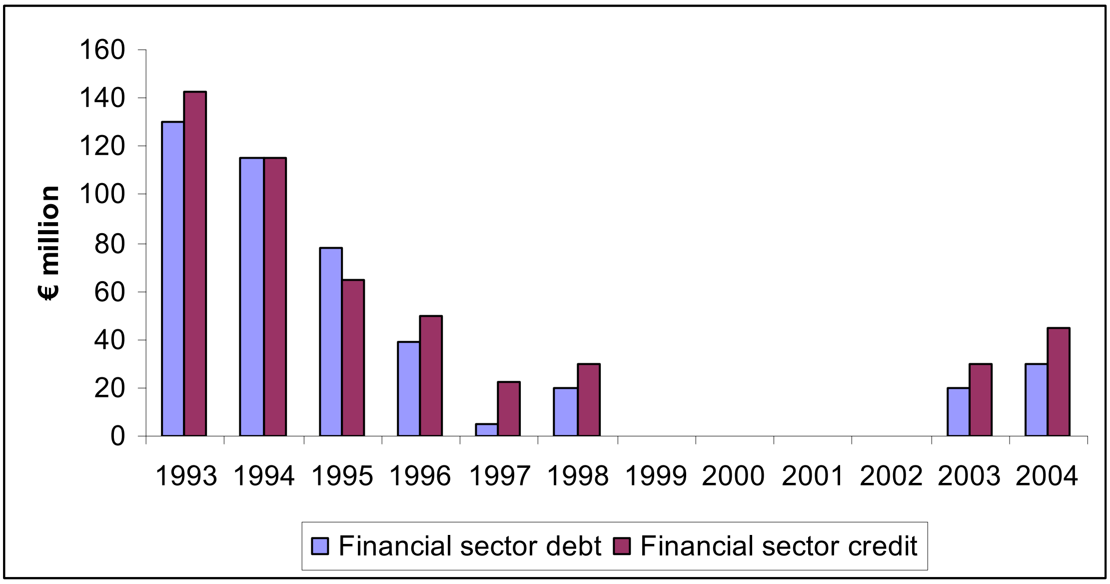
(a) Unless banks are able to regain market power through differentiating in some novel service quality aspects, competition in retail banking will increase considerably, due to the emergence of new remote access and information dissemination techniques.

(b) In the future, banks will increasingly attract customers through price competition and thus allow customers to participate in cost savings due to technological advancements in banking.

Trade and international penetration

2.17 Figure 2.5 gives total non-insurance financial services trade for 1993-2004.[2] Unfortunately, as can be seen in Figure 2.5, we were unable to identify Eurostat data for 1999–2002. Nonetheless, based on the limited data available, it does appear that trade in 2004 was some two and a half times that in 1997.

Figure 2.5: Finnish trade in non-insurance financial services, 1993–2004



Source: Eurostat. Data missing, 1999-2002.

2.18 The first non-Finnish banking groups started operating in Finland in 1982 through the establishment of subsidiaries. The largest foreign bank in Finland is the Nordea Bank Finland Plc, a subsidiary of Nordea Bank AB (publ) Sverige authorised in Sweden.

2.19 Foreign banks have been allowed to establish branches in Finland since 1991. In 2005 there were 21 foreign credit institutions that had branches in Finland. Of these, 13 are authorised to receive deposits, the others are merely engaged in other credit institution activities. Six foreign deposit banks operating in Finland are authorised in another Nordic country, though recently the three German banks operating in Finland have expanded their activities by opening branches.

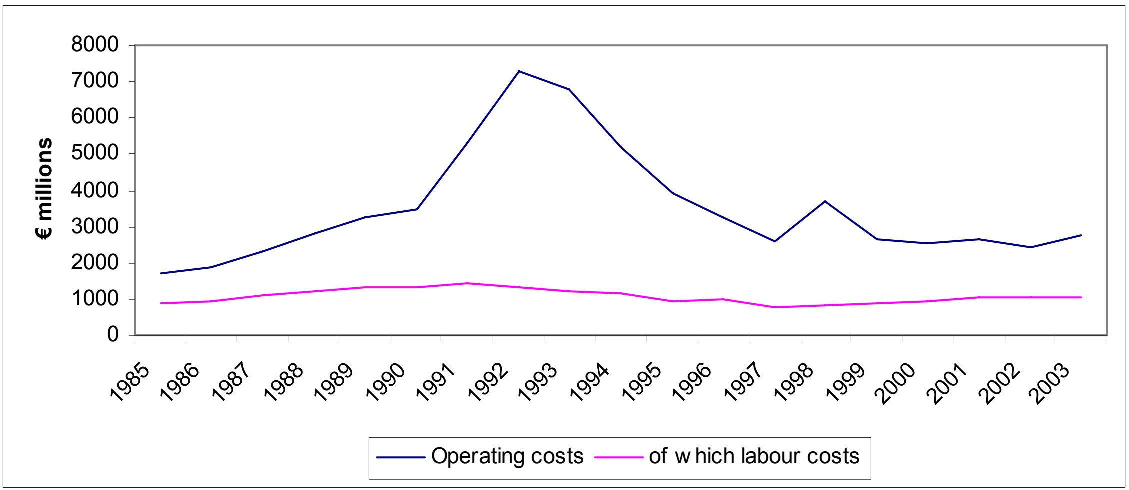
[2] This is defined as the sum of credits and debits, and covers wider services than just banking.

2.20 At the end of 2004, non-Finnish credit institutions loaned about €6.2billion to the public and private sectors or 5.9 per cent of the total; and they took in deposits of €2.0 billion, about 2.7 per cent of the total stock of deposits. Most foreign banks are not engaged in retail banking, rather they serve large customers: the latest survey by the FIN-CBI on business finances found that half of large industrial companies and 40 per cent of large service companies have used services of a foreign bank operating in Finland.

Competitiveness

2.21 Figure 2.6 gives the operating costs of Finnish banks.

Figure 2.6: Operating expenses and labour costs, 1985-2003



Source: OECD

2.22 The survey found the widespread view that banks are more efficient than a few years ago and improvements in bank efficiency are expected to continue into the future. Operational costs are, on average, predicted to vary in the future only within a narrow range, with replies ranging from anticipating a slight decrease to a slight increase.

2.23 The survey also gathered information on the factors that allow Finnish banks to face competition from foreign banks. Business infrastructure is regarded as the most important driver followed by the availability of skilled personnel. Less important factors are operational costs (Finland's wages are among the highest in Europe) and government responsiveness. Some importance is given to the tax regime and to the access to international markets. It may also be that foreign firms face language difficulties operating in the country.

Factors specific to Finland

2.24 We have identified the following factors as being important unusual features of the Finnish banking sector:

(a) The banking crises in the 1990s — in the wake of the banking crisis which accompanied the recession of the early 1990s the banking sector made a combined loss of €3.45 billion in 1992. Significant changes were subsequently introduced to the regulatory and legislative environment of the banking sector as well as its corporate governance.

(b) Finland's accession to the EU only shortly before the commencement of the FSAP (1 January 1995).

(c) Although the international exposure of Finnish banks has started to increase, the most important links continue to be with other Nordic countries.

(d) Particularly high penetration of technology and advanced services (on-line banking, e-money etc). Technology may be of relatively high importance for competition e.g. in reducing switching costs.

Impact of the FSAP and FSWP Legislative Measures on the Finnish Banking Sector

Assessment by category

Competition

2.25 Figure 2.4 illustrates that the CR5 ratio of Finnish banking has fallen a little during the period of the FSAP. However, the sector remains highly concentrated (indeed Table 2.1 shows that the Herfindahl index has actually increased), and it is highly unlikely that the FSAP has tended to reduce concentration.

2.26 The apparent greater ease of entry of foreign banks into Finland, combined with the fact that a number of such banks have actually set up branches (see paragraph 2.19 above) suggests that the market may have become slightly more contestable in recent years. However, given (a) that foreign banks have been permitted to set up branches since 1991, and (b) that many of the branches that have actually been set up are Nordic, with relatively few from other Member States (see paragraph 2.19), it seems most likely that this is a development that would have occurred even without the FSAP.

2.27 Respondents to our survey suggest that the degree of switching behaviour has been largely unaffected by the FSAP, and that this will be true of the future also (the expected increase in switching in the future being attributable to other factors).

2.28 As discussed above, it appears that Finnish banks have become more efficient in recent years. Even in a competitive market one might not expect all such efficiency gains to be passed on into lower prices if, prior to such efficiency improvements being made, banks were not making profits commensurate with risk (which, given the losses of Finnish banks in the early 1990s, seems a potentially relevant case). Although as the losses were mostly due to taking uncovered foreign exchange positions (as well as partly but to a much smaller extent due to the collapse of trade with Russia) these losses may not have affected the motivations or risks of being in the banking industry. The losses on exchange rate risk were due to banks taking inadequate notice of this risk while benefiting from low interest rates abroad. In fact some banks increased their exposure (in order to gain market share by offering cheap loans) while others withdrew after warnings from the Bank of Finland. This meant that losses, when they occurred, were very concentrated.

2.29 However, once profits had recovered to reflect risk more adequately, in a competitive market the tendency would be for additional efficiency gains to be passed on into lower prices. It is unclear to what extent this is actually occurring — the combination we observe in the data, of falling costs and rising profits, might eventually tend to suggest that competition in the market is not fully effective. Eventually, FSAP measures to facilitate greater entry from abroad might mean that rising profits stimulate cross-border activity from other Member States. However, we have not identified evidence that this is yet an important mechanism of competition in Finland.

2.30 Overall, it appears that any effects of the FSAP on competition in the sector are dominated by other trends and factors — including in particular technological developments.[3]

The effect of FSAP on employment

2.31 Figure 2.2 illustrates a fall of more than one third in employment in the banking sector over the decade from 1993 (36,000) to 2003 (23,800). However, the considerable majority of this fall was between 1993 and 1998 (24,400) — prior to the FSAP — and it seems fairly clear from Figure 2.2 that falling employment in the sector was a trend that went back to the mid 1980s. Although it cannot altogether be ruled out that there was some effect of anticipating the FSAP, it seems more likely that the dominant impacts were

(a) a long-term structural trend of falling employment in the sector;

(b) adaptation to the new regulatory and market environment following the early 1990s banking crisis;

(c) adaptation to Accession to the EU in 1995 (incorporation of the Community Acquis and adaptation to the Internal Market); and

(d) technological progress.

2.32 If anything, employment appears to have picked up somewhat, after the commencement of the FSAP (rising back to 24,900 in 2002) and the 2003 drop back may prove to have been more a consequence of the worldwide dip in financial sector employment associated with the bear market, rather than a consequence of the FSAP.

Consumer protection

2.33 Respondents to our survey took the view that the FSAP had a positive effect on consumer protection and that the effects in the future will also be positive.

2.34 However, this positive effect was not thought unambiguous. Some respondents believed that the FSAP might in the future lead to a lower understanding of financial products (perhaps because of the complex regulation required), but other respondents anticipated a small but positive benefit.

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3 However, it should be noted that pan-EU technological trends, such as growth in e-commerce, might not be completely independent of the FSAP (or other parts of the Single Market programmes). This is an issue considered in more detail in the Main Report.

Cross-border business, takeovers and the development of a regional market

2.35 Cross-border activities in the banking sector have increased and will continue to do so in the future. The increase is mainly due to the use of international branches, especially in other Nordic countries including EU accession countries.

2.36 The FSAP appears to have had relatively little direct effect on this so far even prior to the FSAP the Finnish market was opening up more to foreign firms.

2.37 However, it appears that the main form this has taken in practice is for Nordic entrants to have come in, rather than the market being, in practical terms, open to firms from the wider EU. Here then we can see that there may be evidence of the development of a Nordic regional banking market.

2.38 Nonetheless, it seems plausible that in the future a greater EU-wide tendency for firms to operate cross-border, driven to an important degree by the FSAP, will eventually lead to greater foreign participation in Finland, also as competition in their home markets encourages firms to look for opportunities in more distant countries.

2.39 Our econometric study suggests that the impact of the FSAP on trade (to mid 2006) has been a rise of 1.6 per cent in banks (imports increased by 1.3 per cent and exports by 1.7 per cent). Full implementation of the FSAP and FSWP legislative measures is projected to lead to a further 1.4 per cent rise (imports to rise by 0.9 per cent and exports by 1.9 per cent).[4]

Competitiveness

2.40 As illustrated in Figure 2.6, the operating expenses of Finnish banks peaked during the banking crisis when income was very low. However, the cost-to-income ratio started to fall markedly (perhaps because of cost saving programmes instituted by the banks and other structural changes) and reached a low in 2001.

2.41 An alternative measure of competitiveness is total factor productivity (TFP). TFP is derived as an input volume index divided by the output volume index, but its measurement is not without its problems.

2.42 First, there are difficulties in designing the right price index to calculate volume indices from the value data of output and inputs. Secondly, output indices may be affected by opportunities for cross-subsidisation between products and these can be difficult to assess. Third, volume indices need to be adjusted for changes in quality if they are to provide an accurate reflection of efficiency.

2.43 Notwithstanding this drawback, TFP analysis is more informative than simple cost to income ratios as it identifies the contribution of increased productivity to total income, and the chart below (Figure 2.7) sets out some results.

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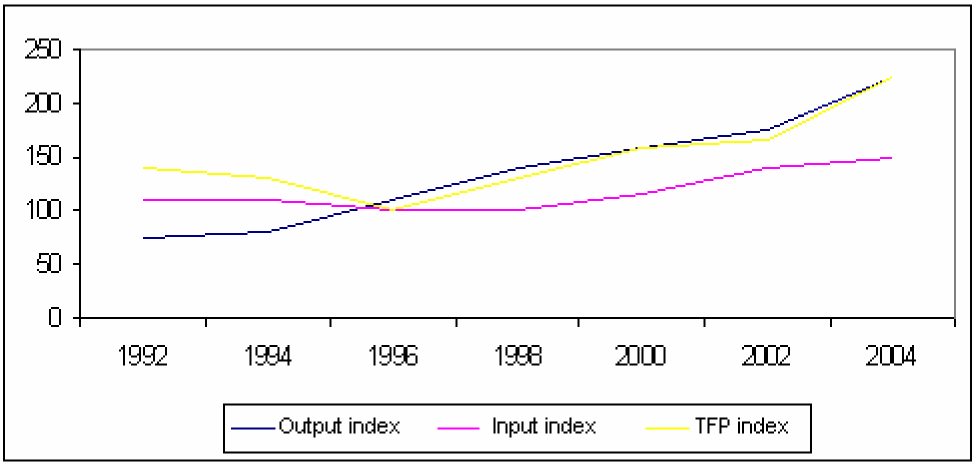
[4] Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

2.44 The Bank of Finland Financial Stability Report of 2005 calculated TFP for Finnish banks. The peak in the input volume index before 1989 reflected the expansion of the sector, which subsequently reversed in the ensuing banking crisis. On the output side, volume levelled off with the banking crisis, but TFP improved, reflecting a sharp decline in input volumes in response to reorganisation programmes. Productivity growth showed signs of deceleration again at the end of the 1990s when the reorganisation cycle came to an end. After the beginning of 2000, banks' productivity rebounded, mainly as a result of a pick up in housing loans. At the time, price deflation also improved productivity, as the low level of interest rates and competition among banks on housing loans narrowed banks' interest margins and that directly lowered the price index used. Banks were also able to slightly reduce input volumes since 2002, which led to a further improvement in TFP.

Figure 2.7: Production of services by Finnish banks (1995 = 100)



Sources: IMF, Statistics Finland and Bank of Finland

Table 2.4: Key performance indicators of the banking sector (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1985	2.4	0.4	5.6
1986	2.1	0.4	6
1987	2.2	0.3	5.3
1988	2.1	0.6	7.8
1989	1.8	0.3	4
1990	1.9	0.4	5.6
1991	1.6	-0.8	-11
1992	1.2	-2.6	-48.9
1993	1.6	-1.4	-28.4
1994	1.6	-1.2	-25.2
1995	1.8	-0.4	-7.9
1996	1.7	0.4	8
1997	1.8	0.9	15.2
1998	1.9	0.5	9.9
1999	1.7	0.9	15.2
2000	1.9	1.3	22.1
2001	1.7	2.9	67.4
2002	1.4	0.9	8.8
2003	1.3	1.5	14.5

a: Net interest margin — net interest income to average total assets.
b: ROA — net income before tax to average total assets.
c: ROE — net income before tax to average capital and reserves.
Source: Europe Economics calculation of data from OECD (2005) "Bank profitability"

2.45 Returns in the banking industry were negative in the early 1990's but have recovered to be significantly above their pre-crisis levels.

2.46 In each of these cases (cost-to-income ratios and TFP), although competitiveness does appear to have improved during the period of the FSAP, it seems natural to attribute the main driving force to developments following the banking crisis — some combination of the banks themselves improving their efficiency in response and perhaps also efficiencies arising through the changed regulatory environment of the 1990s.

Conclusions

2.47 In light of the above, it appears that directly observable impacts so far of the FSAP (as compared to the broader process of the achievement of the internal market) on the Finnish banking sector have been less significant than in some other Member States.

2.48 In part this may stem from the timing of the Accession of Finland into the European Union forcing regulators and market players to adapt to the Community Acquis from the mid 1990s onwards.

2.49 Although these effects may be obscured by the banking crisis in the mid 1990s, key FSAP aims — to achieve the internal market for financial services, and in doing so to promote a regulatory environment which may foster best practice in the sector and improved financial development — were to some extent being met in Finland from this time onwards.

2.50 For example barriers to cross-border activity had already largely been removed, and (in part due to the response to the banking crisis) financial development and broader efficiency in the sector had already been improving.

2.51 Such a conclusion is also supported by our analysis of mechanisms. Here we can see that whilst key trends we would have expected have often occurred, for example greater concentration, efficiency and cross-border activity, in practice the direct impact of the FSAP on these trends may have been modest.

2.52 Further, there is little evidence that one of the key aims of the FSAP, opening up of cross-border retail banking, is being achieved with cross-border entrants still providing largely wholesale services, however it is possible that even the increased threat of potential entry is having an effect.

2.53 However, it can be argued that the relatively pro-competitive regulation of other Nordic EEA and EU Member States FSAP may have allowed for movement towards a regional market at least in wholesale banking. Further, it would be premature to underplay the potential current and future significance of the FSAP.

2.54 On the one hand whilst the costs and benefits of detailed regulatory changes agreed through the FSAP may only become clear over time, at the least, the process has enshrined in law previous regulatory policy, providing added regulatory certainty for market players.

2.55 Further we can see direct impacts, for example in the improvement of consumer protection and some perceived increase in switching.

2.56 As for longer term impacts — in deepening the level of regulatory harmonisation with regional players, i.e. in creating common detailed regulatory structures for regional players — it may well be that, in providing a level playing field and greater inter-operability for market players the FSAP will, over time, foster greater regional and European market development with implications of future opportunities for Finnish companies and further cross-border activity and effects on concentration in the Finnish banking sector.

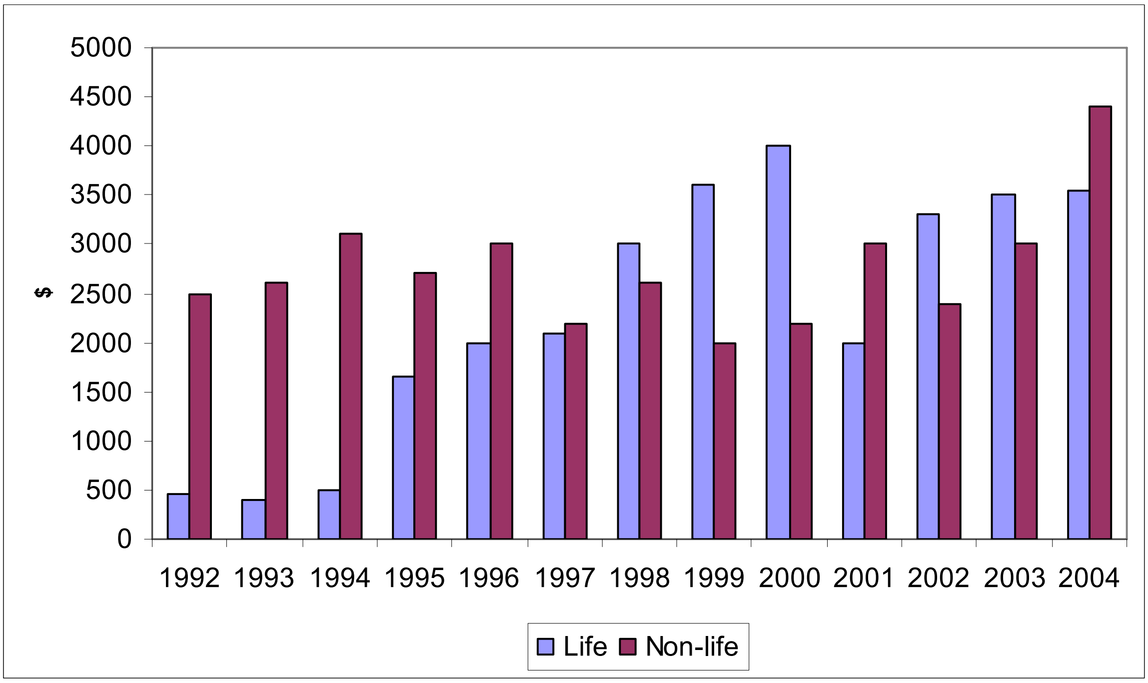
3 INSURANCE

The Finnish Insurance Sector

Turnover

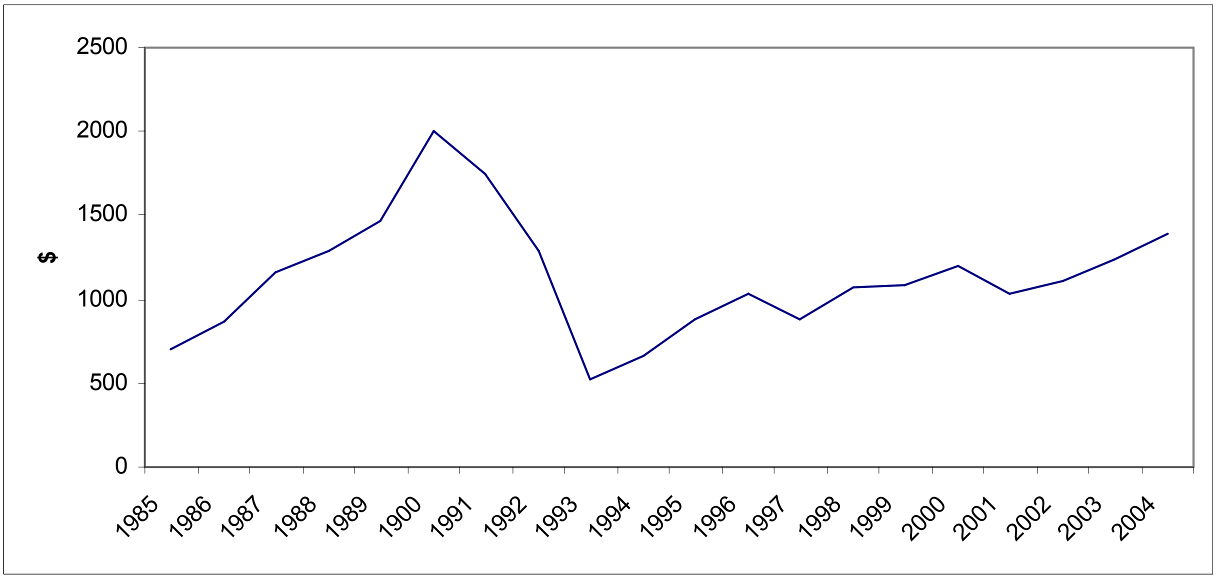
3.1 Figure 3.1 gives the life and non-life insurance gross premiums in Finland to 2004.

Figure 3.1: Life insurance gross premiums in Finland, 1983-2004



Source: OECD

Figure 3.2: Insurance Density in Finland (Premium per unit Population, $ per capita)

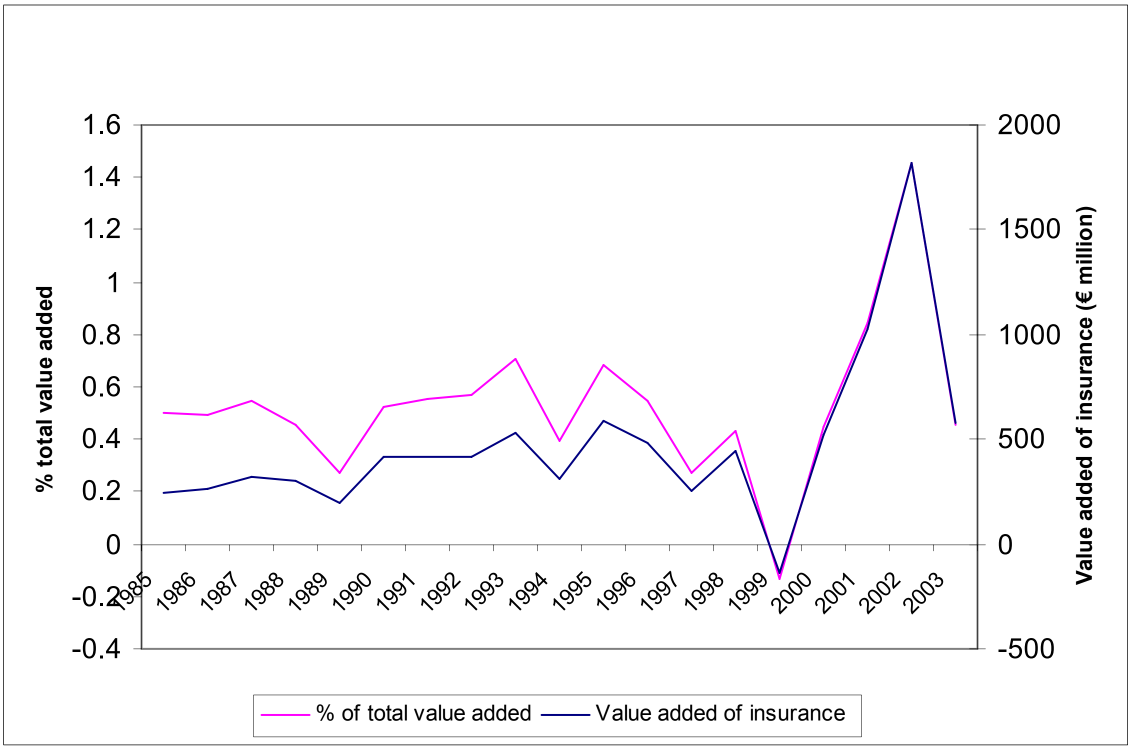


Source: OECD

3.2 It can be seen that premia written fell dramatically during the early 1990s, then recovered somewhat, stabilising in the mid 1990s, with perhaps a minor drift upwards in recent years.

3.3 Figure 3.3 sets out value added. As can be seen, value added was very volatile in the late 1990s and early 2000s.

Figure 3.3: Value added of Finnish insurance

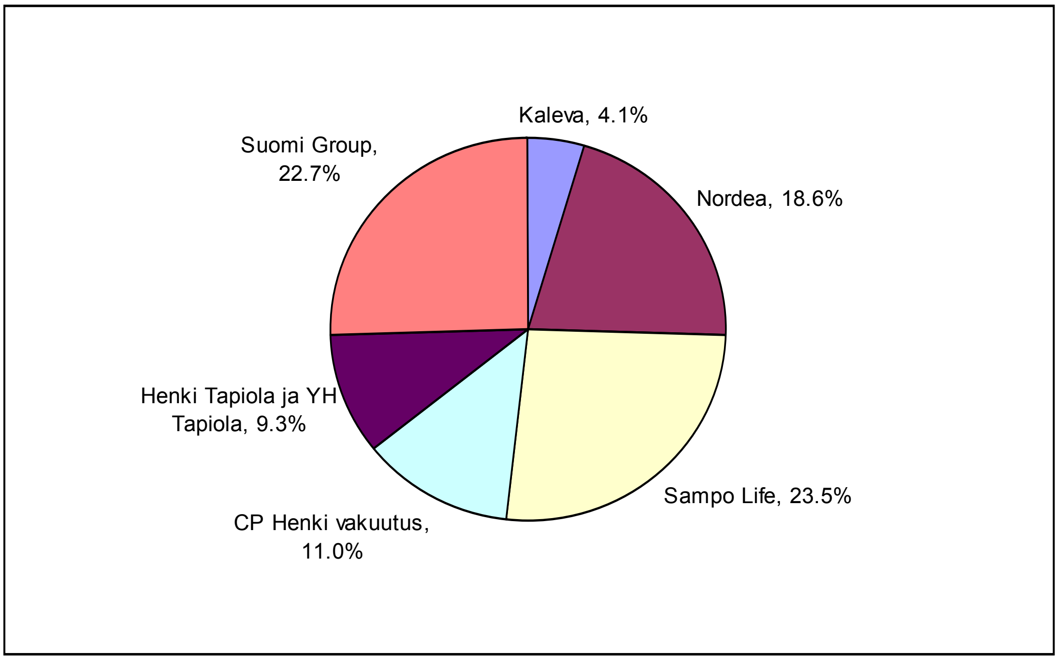


Source: University of Groningen

Market shares

3.4 Figure 3.4 sets out market shares of life insurance companies in Finland.

Figure 3.4: Market share of life insurance companies in insurance savings, 31 December 2004

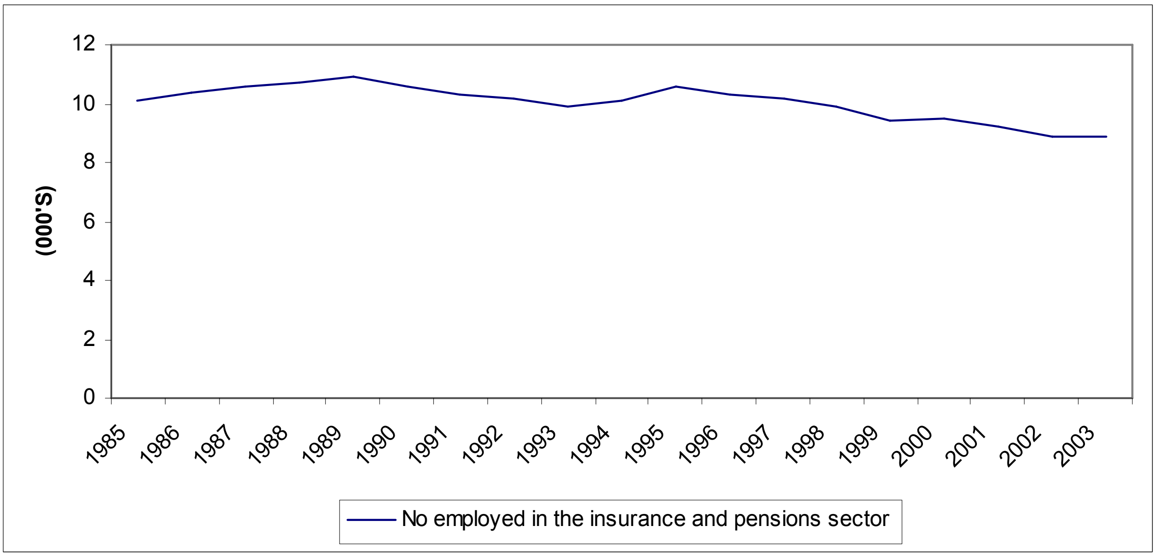


3.5 Companies in the insurance markets are limited to only life or non-life insurance business. Also a high proportion of the insurance business is statutory in nature; employment insurance is one example. This means that the insurance companies in Finland might be subject to relatively less systematic risk than elsewhere, since high proportions of overall insurance purchases are not demand driven, but legislated.

Employment

3.6 Figure 3.5 illustrates a downward trend in employment in insurance going back to the early 1990s.

Figure 3.5: Employment in insurance, 1985-2003



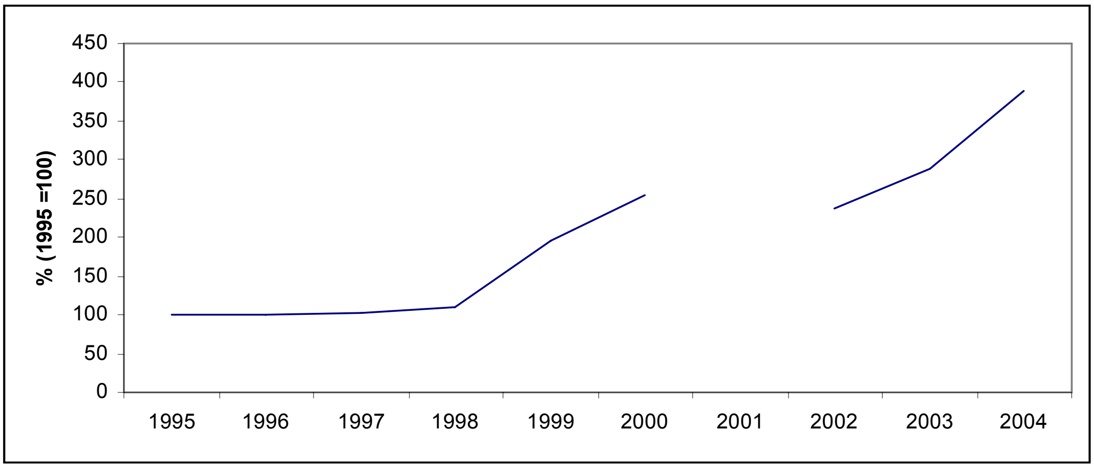
Source: University of Groningen

3.7 Social security related insurance, such as workers' compensation, and liability for motor accident accounts for over 40 per cent of the premium income in non-life insurance.

International entry

3.8 The Finnish insurance market has undergone structural changes that may step up competition in the market. Foreign life insurance companies account for a market share of less than one per cent of premiums written. Figure 3.6 however, indicates that the degree of foreign penetration in the Finnish insurance market has been increasing since the mid 1990's.

Figure 3.6: Market share of (branches/agencies of foreign undertakings) in total domestic business (% gross premium basis)



Note: Data not available in 2001.

Source: OECD[5]

3.9 The number of foreign representative offices of insurance companies domiciled in other EEA countries, but operating in Finland, has increased from 14 in 2000 to 21 at the end of 2004. This has coincided with a substantial increase in the number of notifications on the provision of insurance services filed with foreign insurance companies domiciled in EEA countries, from 302 in 2000 to 415 by 2004.[6]

3.10 Companies operating statutory employee pension schemes must be Finnish owned.

Competitiveness

3.11 Figure 3.7 gives labour productivity in insurance and pensions.

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[5] The OECD has no observations for foreign penetration on the basis of market share of (foreign controlled undertakings) and (branches/agencies of foreign undertakings as a % of total domestic business.

[6] Insurance Authority, Annual Report 2004

Figure 3.7: Labour productivity in Finnish insurance and pensions sector (1995 = 100)

Source: University of Groningen. Data absent from series, 2000-2001.

3.12 As can be seen, productivity rose rapidly from the mid 1990s, but fell back during the period of the early 2000s bear market.

Impact of the FSAP and FSWP Legislative Measures on the Finnish Insurance Sector

Level of implementation

3.13 The results of the survey suggest that FSAP measures in the insurance sector have been mostly implemented in Finland. Market participants have generally adapted to the new provisions.

3.14 Legislation affecting insurance has come in various waves, each of them dealing with various obstacles for integration of insurance markets. The objective of the first wave was to remove obstacles to the provision of insurance between Member States, allowing the establishment of subsidiaries. The second stage aimed to guarantee unhindered cross-border provision of services without having to establish operations in another country, where as the third wave in 1992 adopted the single licence principle, completing the passport based on one authorisation and introducing the principle of home country control.

3.15 The FSAP also included some measures concerning the insurance sector, preparation for some having been started before the plan itself was announced. For instance, in 2003 the Finnish life and non-life insurers were at the time subject to stricter solvency requirements than provided for under EU legislation.[7]

3.16 The minimum capital requirements of life and non-life insurance companies were altered in 2004, when the Insurance Companies Act was harmonized with the respective European Parliament and Council directives.

[7] Bank of Finland, Financial Markets 2003

3.17 Overall therefore, the directives in FSAP seem to have led to significant changes to existing Finnish legislation concerning insurance markets.

Assessment of impact by category

Market entry, cross-border business and takeovers

3.18 Since the onset of the FSAP, there has been a notable rise in the level of foreign penetration, as illustrated by Figure 3.6 and this has been mirrored by the increased number of foreign market participants.

3.19 Although Finnish domestic law and Accession (and consequent absorption into Finnish law of pre-FSAP insurance-related directives) may already have created scope for greater foreign entry, it seems plausible that an EU-wide greater tendency to engage in cross-border business, not unrelated to the FSAP, may have been a factor.

3.20 Over time, a plausible thought is that the relatively small volume increases witnessed so far may eventually become rather larger. It is possible that, after an initial period in which each new foreign entrant achieves a beachhead, business subsequently expands over time.

3.21 The expectation indicated in our survey is that the rise in foreign business will continue into the future. Stakeholders tended to share the thought here that the FSAP may have had a small positive effect.

3.22 Mergers have increased as well but stakeholders do not attribute this to the FSAP.

Competitiveness

3.23 As can be seen in Figure 3.7, labour productivity rose rapidly from the mid 1990s, but it is difficult to disentangle FSAP effects from EU Accession, the aftermath of the early 1990s banking crises, and the financial markets boom-and-bust of the late 1990s and early 2000s.

3.24 Respondents to our survey took the view that little, if any, of this increased operational efficiency is attributable to the FSAP. Finnish solvency requirements were stricter than the FSAP measures, as a consequence of which respondents to our survey believed that the solvency-related effects of the FSAP on competitiveness were likely to have been minimal. However, respondents did take the view that insurance companies in other parts of Europe had a lighter regulatory burden so that a "level playing field" would help Finnish insurance companies.

3.25 Respondents to our survey did not perceive increased vulnerability of Finnish firms to foreign takeovers; however, the availability of skilled personnel, access to international markets, the business infrastructure and the knowledge of the local preferences would be important in facing up to international competition.

3.26 Despite the perhaps limited effect of the FSAP on competitiveness so far, looking ahead it seems plausible to believe that the threat of expanded entry from foreign firms will tend to have a positive effect on Finnish productivity over time.

Product variety, e-commerce, and prices

3.27 Stakeholders believe that the variety of relevant products available on the insurance markets in Finland has increased in recent years and they predict it will increase more in the future. The typical view is that provisions of the FSAP do not play a primary role in the determination of these trends. Where the FSAP is regarded as having had an effect (and as potentially also having an effect in the future) is in e-commerce of insurance products: this trade has increased and this is regarded as having been stimulated by the FSAP.

3.28 The pattern for efficiency, prices and costs resembles that in the banking sector: although insurance companies are improving their efficiency and reducing their operational costs but there is concern that they are not passing the improvements to consumers via a decrease in prices.

Consumer protection

3.29 Stakeholders agree that the level of consumer protection in insurance markets seems to have stayed relatively constant over the last few years. Enhanced consumer protection is anticipated in the future, but there is no evidence of a direct effect of the FSAP.

3.30 The degree of understanding of insurance products remained constant and there are no changes predicted to this pattern according to the majority of interviewed stakeholders. On this point the FSAP seems to be particularly ineffective, as one of the respondents envisages that in its absence the understanding of insurance products would be better in the future. It is probably very complex for the average user of insurance services to have a clear understanding of the different products.

3.31 The effects on switching behaviour of the FSAP are regarded as smaller in the insurance sector than in the banking sector.

Conclusions

3.32 From the above we can see that many of the trends we would have anticipated as following from the FSAP have indeed occurred. For example we can see greater efficiency, higher labour productivity, greater concentration and a higher rate of product innovation.

3.33 However, it appears possible that, whilst the broader progress towards the internal market may have had significant impacts on these developments, the FSAP process is taking place after most of these trends have become established. For example, it may be the case that the most easily available efficiency gains have been made.

3.34 Nevertheless we can see direct impacts of the FSAP on the market. For example, there appears to have been a significant rise in presence in Finland by non-Finnish companies. Other direct impacts include the stimulation of e-commerce of insurance goods.

3.35 It can also be argued that in some areas, implementation of the FSAP may have levelled the regulatory playing field with other Member States possibly helping Finnish companies compete in the future.

4 SECURITIES MARKETS

Finnish Securities Markets

4.1 The Helsinki stock exchange is a part of the OMX group, covering most of the Nordic and Baltic countries. The OMX group covers 80 per cent of securities markets through exchanges in Stockholm, Helsinki, Tallinn, Riga and the Lithuanian stock exchange.[8] OMX was formed in 2003 through the merger of the OM exchange and the Helsinki exchange (HEX). It has around 680 listed companies with a market capitalisation of SEK 7,012 million and average daily turnover in 2005 approaching SEK 30 billion, having grown steadily in the past years. [9]

4.2 The company 2005 annual report refers to global market trends constituting the driving forces for the OMX, all demanding more efficient securities transactions. The same report also refers to opportunities and threats created by self-regulation, increasing with every emerging scandal, and by the FSAP: [10]

> "One of the most important directives from the EU is the Markets in Financial Instruments Directive (MiFID), which is expected to come into force in November 2007. This directive will place extensive demands on securities institutions active within the EU, for example regarding the obligation to report completed securities transactions to the respective supervisory authorities. MiFID is also intended to create competitive neutrality between various trading forms, as well as to secure efficient and transparent securities trading".

4.3 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. The OMX expects the harmonisation efforts ongoing in the EU to have a major impact on future financial infrastructure and competitive situation. Yet, they do single out technology development as the main driving force for growth and efficiency.

4.4 The Bank of Finland comments that the Finnish stock market has been marked by a sharp increase in activity and rapid internationalisation in recent years. The trading volumes of companies listed on the Helsinki Stock Exchange have also been increasing for many years and the internationalisation of investor activity and increase in foreign ownership have improved stock market liquidity. Foreign investors constitute the most important owner group for Helsinki Stock Exchange listed shares.

4.5 Figure 4.1 shows the dramatic increase in the both the market capitalisation and volume of trading at the Helsinki exchange since the mid 1990s, but this is no more than in line with the general boom in the exchanges, particularly for technology stocks (which dominate the Helsinki exchange) as shown by the comparator line for NASDAQ.

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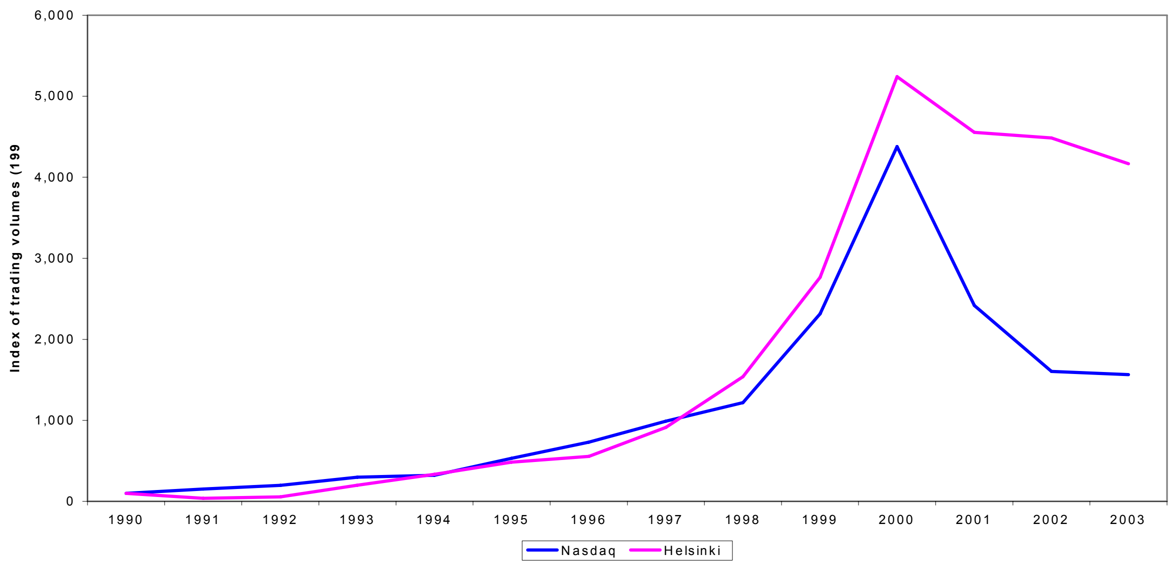
[8] http://www.omxgroup.com/omxcorp/aboutomx/?languageId=1&languageId=1
[9] http://www.omxgroup.com/digitalAssets/937_OMX_2005_ENG_web.pdf
[10] http://www.omxgroup.com/digitalAssets/937_OMX_2005_ENG_web.pdf

Figure 4.1: NASDAQ – Helsinki trading volume



Source: NASDAQ

Factors Specific to Finnish Securities Markets

4.6 Finnish markets are relatively small, and highly dominated by only a few sectors, notably technology and telecoms. For example, between January and September 2005, trading in Nokia shares accounted for more than half of total trading on the Helsinki Stock Exchange, and the share of the five most-traded shares was over 70 per cent.[11]

4.7 These effects have reduced somewhat due to the consolidation among the Northern European exchanges: integration of the Nordic and Baltic share markets entered a new stage during 2005. All the OMX exchanges started using the Global Industry Classification Standard (GICS), developed by Morgan Stanley Capital International and Standard & Poor's. The Bank of Finland anticipated that that the reform should increase demand for shares in Finnish SMEs among foreign operators investing in indices.

4.8 The stamp duty for off-exchange trades encourages trading on the stock exchange. Certain insurance products, competing with securities markets products hold tax benefits and can therefore be more appealing for consumers. The majority of Finnish investment funds belong to banking groups.

4.9 The Bank of Finland suggests that that many benefits of the consolidation have already been realised. However, they judge it too early to assess what impact market consolidation will have on competition. To the Bank of Finland it is nevertheless clear that consolidation can hinder competition and thus reduce the benefits to the users of marketplaces. Authorities in Finland are monitoring the impact of consolidation on competition.[12]

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[11] Bank of Finland financial stability report 2005
[12] Bank of Finland; Financial Markets 2-2005

4.10 Consolidation could bring many benefits, including economies of scale. The Bank of Finland reports that OMX, which owns the Helsinki, Stockholm, Copenhagen and Baltic exchanges reported that the integration of OM and HEX has been completed, resulting in an annual cost reduction of SEK 150 million, with synergy benefits with Copenhagen Exchange to be yet realised. The main objective of integration is to prevent marginalisation and to increase the attractiveness of the marketplaces. This would increase the trading volume and hence liquidity in the Nordic area.[13]

4.11 Comparability between companies quoted on various exchanges will be improved as the result of the harmonisation of industry classification. The Global Industry Classification (GICS), which was already applied on the other exchanges of the NOREX Alliance, was to be introduced on the Helsinki, Baltic and Icelandic exchanges. The real benefits of consolidation will be available to customers only when the list structure and the quotation requirements are harmonised and multicurrency trading starts. [14]

Impacts of the FSAP and FSWP Legislative Measures on Finnish Securities Markets

Level of implementation

4.12 The Ministry of Finance set up a working group in 2004 to prepare for a proposal for amendments required in Finnish legislation to implement the MiFID. It requires the amendment of, for example, the Finnish Securities Markets Act, the Act on Trading in Standardised Options and Futures, and the Investment Firms Act. The working group's proposal was expected to be finalised in spring 2006 but is not yet available at the time of writing this report.

4.13 Several other changes were implemented to securities markets regulation during 2005 to improve the functioning of the market, investor confidence and consumer protection. The Securities Markets Act was amended in July 2005 to implement the amendments required by the Market Abuse Directive and the Prospectus Directive on the prospectus to be published when securities are offered to the public or admitted to trading.

4.14 In 2003, a Government bill on the amendment of the Mutual Funds Act and certain other related acts was introduced to Parliament in October. The proposed changes implemented the amendments to the UCITS Directive concerning the authorisation criteria applicable to fund management companies and the expansion of the company business as well as the requirement to prepare a simplified prospectus for each mutual fund.

4.15 The implementation of the FSAP is likely to reduce the increase in the share of trade on domestic primary exchange that, according to questionnaire respondents, has been very steep over the last years. By creating a more level playing field the FSAP should be able to create more inter-linkages between European markets.

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[13] Bank of Finland; Financial Markets 2-2005

[14] Bank of Finland; Financial Markets 2-2005

Impact

4.16 Arguably the most important point of the MiFID is the expansion of cross-border activities to create a well-functioning single European market for securities. Interestingly, participants to our survey suggest that the integration of Finnish markets evidences an increase of cross-border business that will take place over the next years but again the role played by the FSAP is not the primary one. Some stakeholders believe that the provision of the FSAP may diminish the ability to diversify risks for agents that operate in the securities market.

4.17 Given that the Helsinki Stock Exchange is part of the OMX group, which also has exchanges in Copenhagen, Tallinn, Riga, Stockholm and Vilnius, it seems unlikely that the FSAP has had significant direct impact on the integration of Finish securities market with other EU Member States.

4.18 Our view is that the Nordic-Baltic exchanges which are part of the OMX group are rather insulated, in the sense that they will probably not be affected by the migration of securities jobs to London (which may take advantage of its lead in systematic internalising). Similarly we do not expect to see any positive repercussions on the level of employment in the Finish securities sector at an aggregate level, as the OMX has already had a positive impact on the level of employment.

4.19 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Finish securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the Finish securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

4.20 With regards to the increase in the volume of trade both in the past and in the future the most likely scenario seems to be that it will increase. However it is widely considered that that this would have happened even without the implementation of the FSAP measures.

4.21 A very similar picture emerges with regard to the patterns followed by the exchange of stock and derivatives across national borders: the increase in recent years and the further increase envisaged for the future are not attributed to the implementation of the FSAP.

4.22 Where the stakeholders think that the FSAP had an effect in the past and will have one also in the future is on lowering the barriers on raising capital across EU countries and on the development of a common legal framework for the stock and derivatives market and the establishment of a single set of financial statements for listed companies.

Conclusions

4.23 The internal market process is likely to create increased cross-border activity in securities markets, although the FSAP does not appear to be the key agent of this process. However, it appears that FSAP may be lowering the cost of capital for businesses.

4.24 However, it appears possible that, whilst the broader progress towards the internal market may have had significant impacts on these developments, the FSAP process is taking place after most of these trends have become established. For example, it may be the case that the most easily available efficiency gains have been made.

4.25 Nevertheless we can see direct impacts of the FSAP on the market. For example, there appears to have been a significant rise in presence in Finland of non-Finnish companies. Other direct impacts include the stimulation of e-commerce of insurance goods.

4.26 It can also be argued that in some areas, implementation of the FSAP may have levelled the regulatory playing field with other Member States possibly helping Finnish companies compete in the future.

5 FINANCIAL CONGLOMERATES

Financial Conglomerates in Finland

5.1 The Finnish financial market is characterised by close links between the banking and insurance sectors. Increasingly closer links between the banking and insurance sectors are an international phenomenon and related to the development and integration of the financial markets (financial diversification and conglomeration). The general aim is to realise economies of scope.

5.2 Owing to restrictions imposed by the authorities, insurance business must be conducted in a separately capitalised company within the group. A group typically includes a holding company that owns the subsidiaries engaged in both banking and insurance. There is also a model of cooperation where a bank and an insurance company access the same distribution channels to offer their services.[15]

5.3 The Bank of Finland reports in 2005:

(a) The largest Nordic financial groups have continued to turn in strong performances. They operate in several countries, with foreign operation now (2005) accounting for a significant part of the overall results. Further internationalisation of operations is likely to continue.

(b) The improvement in results is due to favourable developments in income and cost control. The stock of lending has grown rapidly; business has grown in mutual funds and insurance and capital market operations, boosting profits.

(c) In recent years, the importance of international operations has increased for Nordic financial groups, for several reasons: Some groups take advantage of opportunities from strong growth in new Member States, the groups hope to achieve major benefits from modern banking technology, and are looking to benefit from economies of scale from growth.

(d) Growth based solely on the domestic markets may be extremely hard to achieve.

(e) All the largest financial groups have life insurance operations in several countries, and the Sampo Group has significant non-life insurance operations abroad also. The groups do not break down or publish all data by country.

(f) In recent years, Nordic financial groups have expanded their operations to various countries through acquisitions, and establishment of subsidiaries and branches. However, the results of our opinion survey suggest that market participants believe that the effects of FSAP have been minimal on this issue. The expansion would have taken place anyway.

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[15] Bank of Finland Financial Stability Report 2003

(g) OKO Bank, the central bank of the OP Bank Group, acquired a stake of nearly 60 per cent in the insurance company Pohjola in September 2005. The acquisition will create a new financial conglomerate, as specified in the act on the supervision of financial and insurance conglomerates, with the Financial Supervision Authority acting as the main supervisor.

Conclusion

5.4 Key trends which would be expected to link with the FSAP have occurred, for example greater concentration and increased cross-border penetration of the Finnish markets.

5.5 A key goal of conglomerates is to achieve economies of scope and of scale and intuitively one would expect that the FSAP would provide longer term opportunities for greater expansion through a more level playing field. In this sense one would expect that the FSAP in general would increase the trend for conglomerates.

5.6 However, in the short run there may be increased compliance costs, and the costs of implementing the FSAP may be one factor in increasing operational costs for Conglomerates. Further the business rationale for Conglomerates depends very much on them tightly controlling their costs and achieving genuine economies to outweigh the difficulties of increased organisational complexity. On both these issues the FSAP has less impact.

6 CONCLUSIONS

6.1 It appears that directly observable impacts so far of the FSAP (as compared to the broader process of the achievement of the internal market) have been less significant than in some other Member States.

6.2 In part this may stem from the timing of the Accession of Finland into the European Union forcing regulators and market players to adapt to the Community Acquis from the mid 1990s onwards and the banking crisis in the mid 1990s.

6.3 Key FSAP aims, to achieve the internal market for financial services, and in doing so to promote a regulatory environment which may foster best practice in the sector and improved financial development, were to some extent being met in Finland from the early 1990s. For example barriers to cross-border activity had already largely been removed, and financial development and broader efficiency in the sector had already been improving.

6.4 Finland was in general very open to international trade prior to the FSAP. However, several factors inhibit foreign firms' entry: the small size of the economy, the wide dispersion (outside a few centres) of the population, the already high level of technical sophistication, and, an influence not to be underestimated, the language.

6.5 It can be argued that the relatively pro-competitive regulation of other Nordic EEA and EU Member States FSAP may have allowed for movement towards a regional market at least in wholesale banking. It would be premature to underplay the potential current and future significance of the FSAP. There are some direct impacts, for example in the improvement of consumer protection and some perceived increase in switching.

6.6 As for longer term impacts — in deepening the level of regulatory harmonisation with regional players, i.e. in creating common detailed regulatory structures for regional players — it may well be that, in providing a level playing field and greater inter-operability for market players the FSAP will, over time, foster greater regional and European market development with implications of future opportunities for Finnish companies and further cross-border activity and effects on concentration in the Finnish banking sector. There appears to have been a significant rise in presence in Finland by non-Finnish companies. Other direct impacts include the stimulation of e-commerce of insurance goods.

6.7 However, in the short run there may be increased compliance costs, and the costs of implementing the FSAP may be one factor in increasing operational costs for Conglomerates. Further the business rationale for Conglomerates depends very much on them controlling tightly their costs and achieving genuine economies to outweigh the difficulties of increased organisational complexity. On both these issues the FSAP has less impact.

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Limited	Negligible	Positive	Limited	Limited
Insurance	Slightly Positive	Limited	Negligible	Limited	Limited
Securities	Limited	Limited	Limited. Perhaps positive in the future	Limited	Limited
Financial Conglomerates	Limited	Limited	Limited	Negative	Perhaps positive

FRANCE

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in France

1.1 In recent years, the French financial system has been transformed via a series of mergers between banks, brokerages, insurers and asset managers. These mergers have consolidated a number of banks into a small number of large multi-national financial conglomerates which offer both banking and insurance services. The domestic French market is now also host to a number of foreign financial institutions, some of which have achieved considerable market shares in sectors such as investment banking and insurance fund management.

1.2 The most popular financial services model continues to be bancassurance, where one company typically offers a range of financial services including insurance and banking, and often other services such as brokering.[1]

1.3 From the French perspective, a key challenge in the transposition of FSAP directives has been to transpose them into French law faithfully, whilst striking the right balance between

(a) investor protection;

(b) growth;

(c) innovation;

(d) market integrity; and

(e) the competitiveness of the financial industry.[2]

Division of responsibility

1.4 Today, responsibility for financial services regulation is not held by a single authority in France but is spread across a number of overlapping agencies. However, with the passing of the Financial Security Act of 2003, efforts have been made to consolidate responsibility for financial regulation. The Act combined the responsibilities for regulation, authorisation and supervision for investment services into a single agency: the **Autorité des Marchés Financiéres** (AMF).

1.5 The AMF is constituted as an independent public body charged with:

(a) safeguarding investments in financial instruments and other investment vehicles;

(b) improving consumer information; and

(c) maintaining orderly financial markets.

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[1] The bancassurance model can take many forms, including: a distribution agreement between banks and insurers; a strategic alliance between different financial entities; a joint venture where both companies pool capital and share responsibilities; and full integration into a financial conglomerate.

[2] See, for example, the section entitled "Key Issue" in *Financial Regulation Newsletter, 2 Quarter 2006,* AMF — http://www.amf-france.org/documents/general/6591_1.pdf

1.6 In particular, the AMF has been given four main responsibilities: regulation, authorisation, supervision and enforcement. It has the power to conduct inspections and investigations, as well as to adjudicate complaints relating to financial instruments and markets. It has a wide jurisdiction over securities markets, collective investment products, exchanges and market infrastructure and the conduct of business in financial products.

1.7 In addition to the AMF, there are a number of other bodies that play a role in regulating and supervising the overall financial services sector in France. The **Comité consultative de la legislation et de la réglementation financières** is an advisory body covering all aspects of the financial sector. It is consulted about all draft EU and national legislation.

1.8 The **Conseil de la concurrence** is responsible for preventing anti-competitive practices in France. It also provides assessments of the competitive implications of mergers and acquisitions of financial institutions

1.9 Within the banking sector, there is a further sub-set of bodies that have responsibility for financial regulation and supervision. The ultimate responsibility for the sector is shared between the following three organisations:

(a) **The Banque de France**;

(b) **The Ministère de l'economie**; and

(c) **The Ministère des finances et de l'industrie** (MINEFI).

1.10 Other relevant stakeholders in the banking sector include:

(a) The **Commission Bancaire,** which supervises the financial position of credit institutions and ensure that credit institutions adhere to the applicable rules and that investment firms comply with relevant regulations. It is the day-to-day regulator of banks in France.

(b) The **Comité de réglementation bancaire et financière** (CRBF) lays down the regulations governing credit institutions.

(c) The **Comité des établissements de Crédit et des Entreprises d'Investissement** (CECEI), which grants authorisations to any type of credit institution. This responsibility is shared with the AMF.

(d) The **Conseil National du Crédit et du Titre** (CNCT) monitors the operations of the banking and financial system with particular reference to customer relations and the payment system.

1.11 There is a single insurance sector regulator: the **Commission de contrôles des assurances, des mutuelles et des institutions de prévoyances** (CCAMIP). However, companies are licensed by the Ministry of Social Affairs (mutuals) and a Committee of Insurance Companies (commercial insurers).

1.12 Securities regulation is covered by the AMF.

2 BANKING

Headline Overview

Features of the industry

2.1 In its Financial Sector Assessment Programme (2005), the IMF describes the French banking system, after two decades of modernisation and restructuring, as large, sophisticated and internationally important.

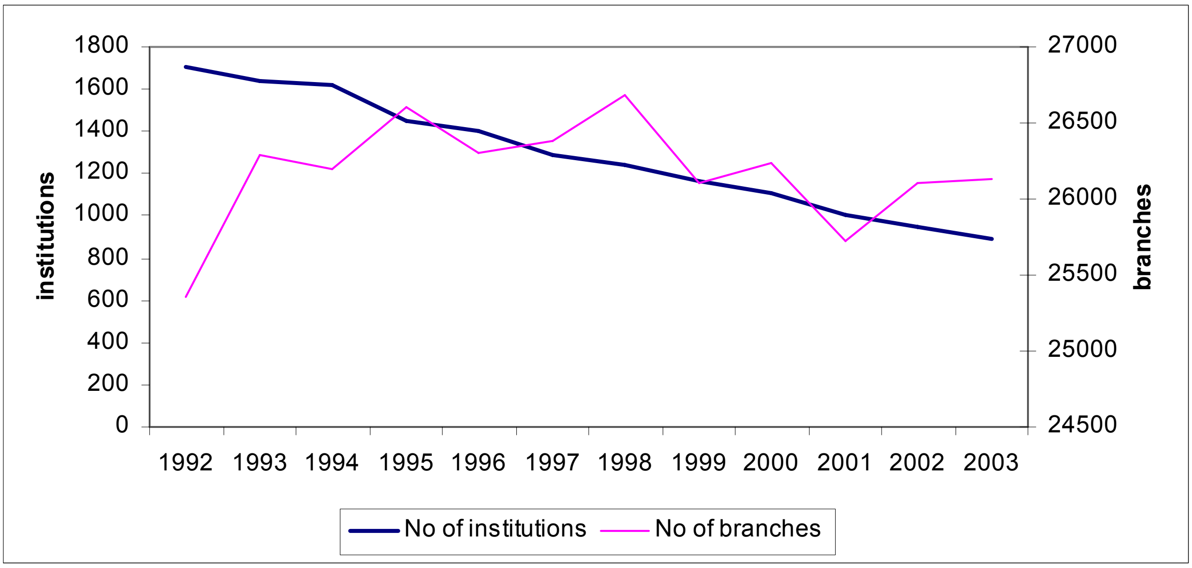
2.2 The French banking sector was the subject of deregulation in the mid-1980s. The Banking Act (1984) began the process of change by placing all banks, whatever their status, under the same set of rules. Some of the most significant reforms included the reduction or elimination of Government's role in bank lending decisions, subsidising bank loans and in the credit markets. Privatisation also had a significant effect. In 1987, several of the major French banks were privatised including *Société Générale, Crédit Commercial de France, Paribas* and *Suez*. Further privatisations were carried out in the 1990s with the sale of *BNP* and *Crédit Lyonnais* in 2002.

2.3 Banks that have the State as their major shareholder no longer exist in France, with the exception of the Bank for the Development of Small and Medium Enterprises (BDPME) and the *Caisse des Dépôts et Consignations* (CDC). The lack of a large state presence is the result of the bank privatisation programme undertaken, as noted above.

2.4 With the onset of privatisation there have been a number of large-scale acquisitions and takeovers. The banking sector is still being restructured; *Crédit Agricole* beat *BNP* in the battle for control of *Crédit Lyonnais.*

Number of players

Figure 2.1: Banks in France 1992 - 2003



Source: OECD

2.5 Credit institutions are defined in the Banking Act as the legal entities that habitually offer banking services on a professional basis. By the end of 2003, there were 959 credit institutions operating in France. This figure represents a significant reduction from 1989 when there were over 2,000 credit institutions in operation.

Table 2.1: Breakdown of credit institutions by type (2003)

Type	Description	Number
Commercial banks	Can perform all types of banking transactions.	334
Finance companies	Can receive neither on-site deposits nor deposits that mature in less than two years.	461
Co-operative banks	Are subject to more specific regulatory rules, but can also perform all banking transactions.	97
Savings banks	As above.	31
Municipal banks	As above.	21
Specialised financial institutions or Finance houses	These are charged with carrying out specific tasks, normally defined as the public interest. Any banking services offered are related to these specific tasks.	15

Source: Banque de France

2.6 However, despite the apparent multiplicity of banks, there are effectively fewer of them than it appears. Most of these banks are actually part of larger banking groups or conglomerates. For instance, the *BNP Paribas* group alone controls 44 banks. The main banking groups are:

(a) Crédit Agricole

(b) BNP Paribas

(c) Société Générale

(d) Groupe Caisse d'Epargne

(e) Crédit Mutuel

(f) Groupe Banque Populaire

2.7 There are a number of other significant financial institutions. Many local authorities, including large cities such as Paris, Lyons and Bordeaux, have their own banks or credits municipaux. These are designed to serve their own employees and, in a number of cases, low-income groups. These institutions have a monopoly in the provision of pawn-broking services.

2.8 Although it performs banking operations, the French Post Office (La Poste) is not officially regarded as a bank, but it is nonetheless one of the most important financial institutions in France, particularly in retail banking and operations for small businesses.

Turnover, employment and profitability

2.9 From the mid-1990s revenue of French banks grew appreciably until 2001 and has remained constant since. The number of branches has remained more or less constant throughout this period.

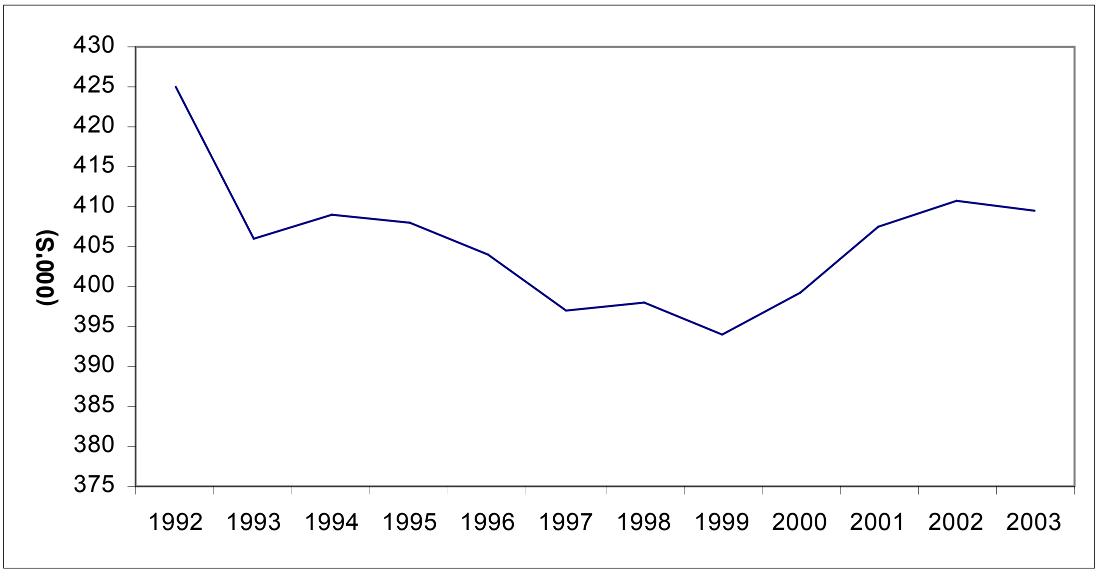
Table 2.2: Income and branch numbers of French Banks (all banks)

	1996	1997	1998	1999	2000	2001	2002	2003
Net income after tax (€million)	2,858	6,525	10,580	12,878	15,602	17,430	17,275	17,304
Number of branches	26,303	26,386	26,689	26,101	26,231	25,724	26,110	26,136

Source: OECD and AFB

2.10 Total employment in French banks fell throughout the 1990s, and rose after 2000. The fact that the number of CI's decreased from 2000 in 1989 to 959 in 2003 (paragraph 2.5) explains why the level of employment fell until 1999. The remaining banks grew bigger and therefore would have raised the level of employment, especially after 1999, when more consolidations were being finalised.

Figure 2.2: Employment in French banks, 1990-2003



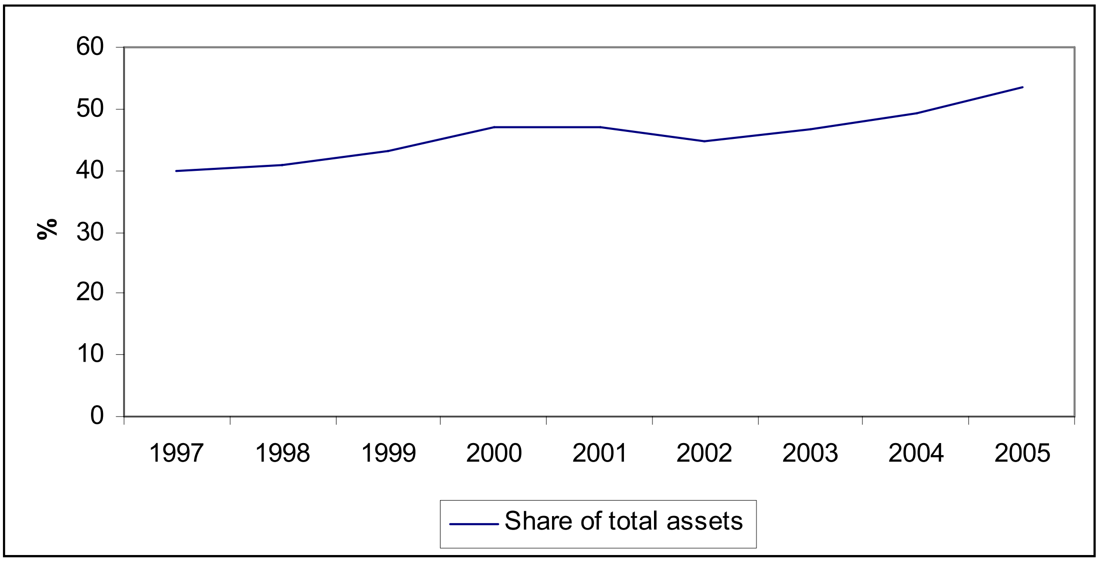
Source: OECD

2.11 The combined effects of activity in the banking sector and a government policy of making substantial reductions in employer social security contributions, stimulated job creation throughout the economy from 1998 onwards.

Market shares and concentration

2.12 The degree of concentration in the French banking sector is one of the highest in large Member States.

Figure 2.3: Share of the 5 largest credit institutions in terms of total assets (%)



Source: ECB

2.13 Figure 2.3 does not capture the full degree of concentration, because it does not include subsidiary banks. As illustrated in the Main Report, in 2005, the CR5 in France was nearly twice as high as in Germany and Italy and significantly larger than in the UK. Nonetheless, the degree of concentration remained below the EU15 average of 54.19 in 2005. [See Table 3.2 in the main report].

Table 2.3: Herfindahl- Hirschman Index

1997	1998	1999	2000	2001	2002	2003	2004	2005
449	485	509	587	606	551	597	623	758

Source: ECB

2.14 The Herfindahl-Hirschman Index has been following an increasing trend since 1997. Despite this trend the indicator of the level of concentration on the French banking market remains “low”. Having said that, if the index continues increasing, the level of concentration may become “medium” in the medium to long term.

Table 2.4: Non- French Branches and Subsidiaries

	1997	1998	1999	2002	2003	2004	2005
Branches of CI's from EU area	52	53	56	51	52	55	55
Subsidiaries of CI's from EU area	109	129	134	146	126	108	107
Branches of CI's from third countries	41	36	32	28	28	27	26
Subsidiaries from third countries	89	102	85	62	58	58	52

Source: ECB

2.15 Another major development in recent years has been the merger of CDC and the Caisses d'Epargne, the savings banks' group. The merger has created Eulia, France's largest institutional investor as well as a major player in wholesale banking.

2.16 French banks face a number of challenges. The rise of internet banking is a threat to banks that are used to being the sole vendors of services. The entry of retailers into the banking sector has also increased competition. Nonetheless, the IMF notes that there is a high degree of concentration in the sector — the banking system being dominated by six vertically integrated banks and their subsidiaries. Further consolidation of the sector could threaten stability, it warns, as these banks are becoming "too big too fail".

Trade and international penetration

France is also home to a number of foreign banks. According to the US-French Commercial Service, there are 184 foreign banks operating in France, complete with extensive branch networks. A number of these foreign banks are actually subsidiaries of non-EEA banks based in the UK and taking advantage of the single passport system. Most foreign banks concentrate on specialist activities, although there are notable exceptions that have significant retail operations: HSBC CCF, Barclays and GE Money Bank. HSBC CCF is the result of the friendly takeover of CCF by the British group HSBC in 2000.

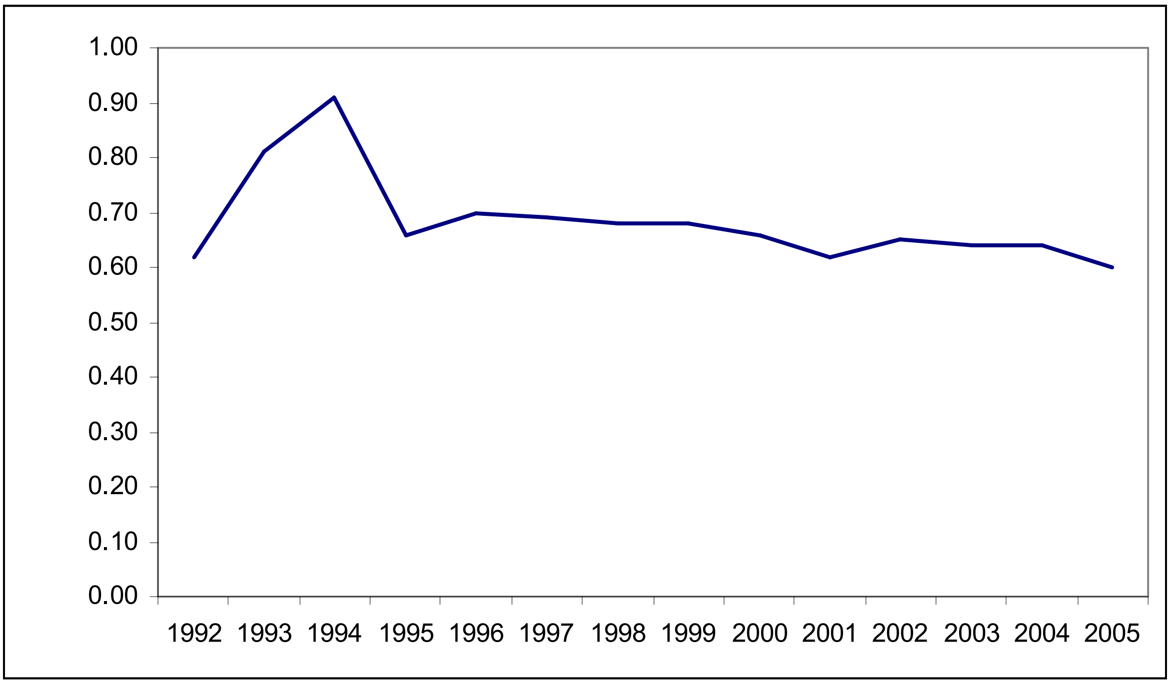
Table 2.5 Mergers and Acquisitions

*Source: ECB, * first half*

	2000	2001	2002	2003	2004	2005	2006*
Domestic M&A's	3	4	5	8	5	2	3
EU M&A's	5	2	2	0	0	0	1
Third country M&A's	0	0	1	0	0	0	1

Competitiveness

Figure 2.4: Cost-to-income ratio



Source: Europe Economics treatment of OECD/ECB data. Note: above expressed as ratio not %.

2.17 The rise in the level of cross-border activity in recent years is expected to increase the competitiveness of French banks, which are facing international competition or, at least, the threat of contestability.

2.18 Despite some cyclical variations, the net income ratios of French banks have increased since 1992, and the cost-to-income ratio has decreased since 1994. This is a sign of growing competitiveness among the French banks.

Table 2.6: Key performance indicators of the banking sector (%)

Year	Net interest margin[a]	ROA[b]	ROE[c]
1992	1.6	0.3	6.9
1993	1.3	0.1	2.9
1994	1.3	0	0.5
1995	1.2	0.2	3.6
1996	1	0.2	4.8
1997	0.8	0.3	7.7
1998	0.7	0.4	9.9
1999	0.8	0.5	10.8
2000	1	0.7	12.1
2001	0.8	0.6	12.7
2002	0.9	0.6	11.3
2003	0.9	0.6	11

a: Ratio of net interest income to average total assets.
b: Ratio of net income before tax to average total assets.
c: Ratio of net income before tax to average capital and reserves.
Source: Europe Economics calculation of data from OECD (2005) "Bank profitability"

Perceptions of ease of switching, factors affecting competition, and consumer protection

Switching behaviour

2.19 According to the Federation Bancaire Française (FBF) in 2005 5 per cent of French customers switched banks (not agencies) during the previous twelve months, which compares with 4 per cent in 2004. 36 per cent of them had more than one bank compared to the 32 per cent the previous year.

Dimensions of price and quality competition

2.20 In 2005, 74 per cent of the French customers felt that there was real competition in the banking industry.

2.21 In November 2004 for the Consultative Committee for the Financial Services Sector (CCSF), French banks committed to making banking simpler and more accessible. This commitment included:

(a) Cancelling fees for bank account closure;

(b) Providing more information on revolving loans and automatically renewing contracts;

(c) Making their branches more accessible to the disabled;

(d) Indicating bank rates for banking services on their websites and brochures;

(e) Reorganising and setting up systems to improve their risk control;

(f) Making it easier for customers to switch their account to a different bank, providing them with a list of all their currents account's transactions, at a reasonable price;

(g) Enabling individuals with high health risks to qualify for longer term mortgage and professional loans and increasing the total amount that may be lent to them.

Other factors affecting competition

2.22 The EU's aim to harmonise the European market with the Free Movement of Services (FMS) implemented in 1993 has, for instance, made it easier for international banks to establish themselves in France (and vice-versa). According to the Comité des etablissements de credit et des enterprises d' investissement (CECEI), in 2005 there were 7.5 per cent more declarations of FMS than in 2004.

Consumer protection

2.23 The confidence of French consumers has declined similarly to the majority of the EU15 Member States. Confidence has fallen from plus 14 (49 per cent positive to 35 negative) in 1999 to minus 18 in 2003 (31 per cent positive to 49 negative).

The potential future role of technology

2.24 The development of internet banking is also increasing competition in the banking industry. It is easier for banks that provide internet banking to establish and develop, fixed costs and physical obstacles being naturally reduced. According to a 2005 FBF survey, more than half of customers were using internet banking, and 90 per cent of them are satisfied with the information and services provided on the websites.

Factors Specific to France

2.25 There are a number of factors specific to the French banking sector that must be considered. These include:

(a) **Relatively high concentration.** The French banking sector is more highly concentrated than others in large Western European states, and this trend has been growing in recent years. This concentration refers to both retail and wholesale banking. The increased degree of concentration is primarily the consequence of merger activity. The scope for future mergers is thought to be limited.

(b) **Influence of state and post bank.** Through its shareholding in CDC the French Government plays a major (indirect) role in the banking sector. The Government also plays a more direct role through the activities of La Poste (the Post Bank).

(c) **The role of Monaco.** Monaco is the second largest financial centre in France. Although it is a separate country with independent banking laws, prudential supervision is the responsibility of the Banque de France.

The Effects of the FSAP and FSWP Legislative Measures on the French Banking Sector

Cross-border business, takeovers and the development of a regional market

2.26 So far, most of the mergers in the French banking sector have been between French companies and there is little evidence that foreign entry into the French market has increased. There could be two reasons for this. Firstly, a number of French banks are either very big or not for sale on the capital market due to specific legal constraints. Secondly, it may be that political hostility to foreign takeovers has deterred foreign companies. In light of this, so far the FSAP has had no significant impact on cross-border mergers.

2.27 France is home to 184 foreign banks that are taking advantage of the single passport system. On the other hand, French banks have started to consolidate abroad. It is not possible to ascertain a direct link between the FSAP and this trend which is expected to persist. However, if the FSAP has succeeded in opening up other markets, then it may have positively affected cross-border activities in terms of French banks entering other EU markets. This may be regarded as an indirect impact of the FSAP.

2.28 Our econometric study suggests that the impact of the FSAP on trade has been a rise of 1.4 per cent in imports of financial services other than insurance and pensions, and a rise of 1.7 per cent in exports. Full implementation of the FSAP and FSWP legislative measures is projected to lead to a further 0.9 per cent rise in imports and 1.9 per cent in exports.[3]

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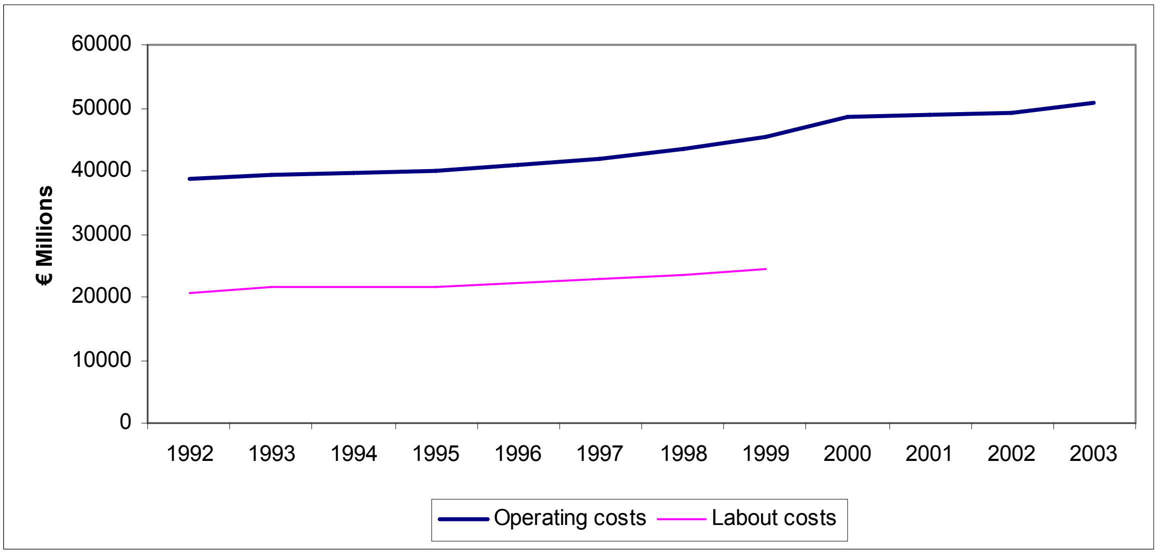
[3] Note that these effects are additional to any associated with membership of the EU or other global or domestic trends towards openness.

Competition

2.29 The mergers in recent years have led to increased concentration in the French banking sector. So far, foreign entry has not significantly increased. From the results illustrated in Table 2.3 and Figure 2.3, the increase in the CR5 and the Herfindahl-Hirschman index do not show any improvements in the intensity of competition. Also, both indicators had already started to increase prior to the implementation of the FSAP. From the previous information, it may be concluded that so far, the FSAP has had a negligible impact, if any, on the French banking sector.

Competitiveness

Figure 2.5: Operating costs of French Commercial Banks



Source: OECD. Note: labour cost series incomplete — data absent 2000–2003

2.30 Since 2000 the operating costs of French banks have barely increased. This is a sign of increasing competitivity which can be attributed to the stock market crash and the consequent pressure on banking margins, as well as to the FSAP which has brought about foreign contestability, even though there has not been significant foreign entry.

2.31 If increased efficiency between 1999 and 2003 is an indicator of increased competitiveness, it might well be that competitive pressure has had a positive impact on the degree of competitivity in the French banking sector. Once again, the FSAP has had a positive impact on the level of efficiency in the French banking sector, mainly because of foreign contestability.

Table 2.7: DEA efficiency scores for French banks

	1999	2000	2001	2002	2003
France	55.7	71.2	67.6	78.0	75.7

Source: Casu and Giradone, "Bank Competition, Concentration and Efficiency in the Single European Market" (2003)

2.32 It is interesting to note that the respondents to the survey were of the opinion that transparency has already increased and product variety will increase, as results of the implementation of the FSAP.

Employment

2.33 As Figure 2.2 illustrates, the number of employees in the French banking sector has marginally decreased over the period in question. It is unlikely that the FSAP is responsible for this change. Indeed, French labour laws are such that the French labour market in general, lacks significant flexibility relative to some of its European counterparts, e.g. Ireland. Any change in the level of employment will be slower to transpire than might otherwise have been the case in a more fluid labour market.

Consumer protection

2.34 It is interesting to note that French consumers feel that protection has decreased. However, it is hard to disentangle whether the FSAP has increased awareness of consumer's rights or whether the quality of protection has decreased.

3 INSURANCE

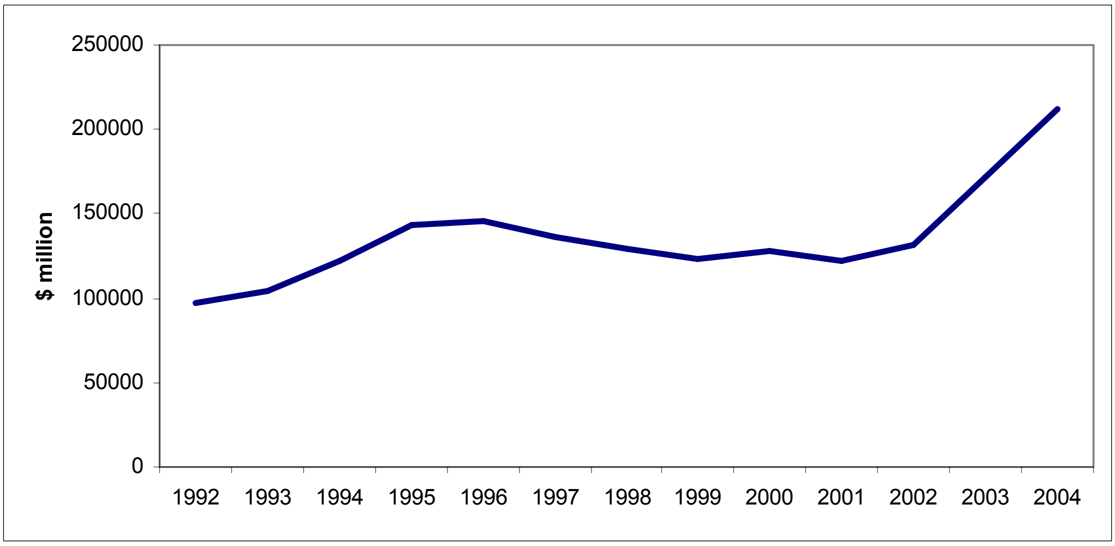
The French Insurance Sector

Turnover

3.1 The French insurance and reinsurance market is one of the largest in Europe (second only to the UK) and one of the largest in the world (5 per cent market share of gross premiums in the OECD in 2001). In 2004, total premium income from primary business was estimated by the FFSA as €158 billion. According to research by Swiss Re, French premiums as a percentage of GDP reached 9.52 per cent in 2004 – the fifth highest in Europe.

3.2 Between 2000 and 2002 premiums did not grow significantly but since then the total premiums of the French insurance industry have grown by seven and ten per cent in 2003 and 2004 respectively.

Figure 3.1: Gross Premium income 1992 - 2004



Source: OECD

3.3 Life insurance was the principal factor in this growth. While premiums were more or less static from 2000 to 2002, they started to grow again in 2003 and 2004.

Table 3.1: Life insurance premium volumes in France (€millions)

Year	Premium volume	Share of total business
2000	90,16	68.7
2001	84,572	65.8
2002	85,385	64.2
2003	91,672	64.4
2004	103,589	66.2

Source: Swiss Re

3.4 The development of non-life insurance premiums was much steadier as their profitability is less dependent on returns from investments. They increased by four and eight per cent per annum.

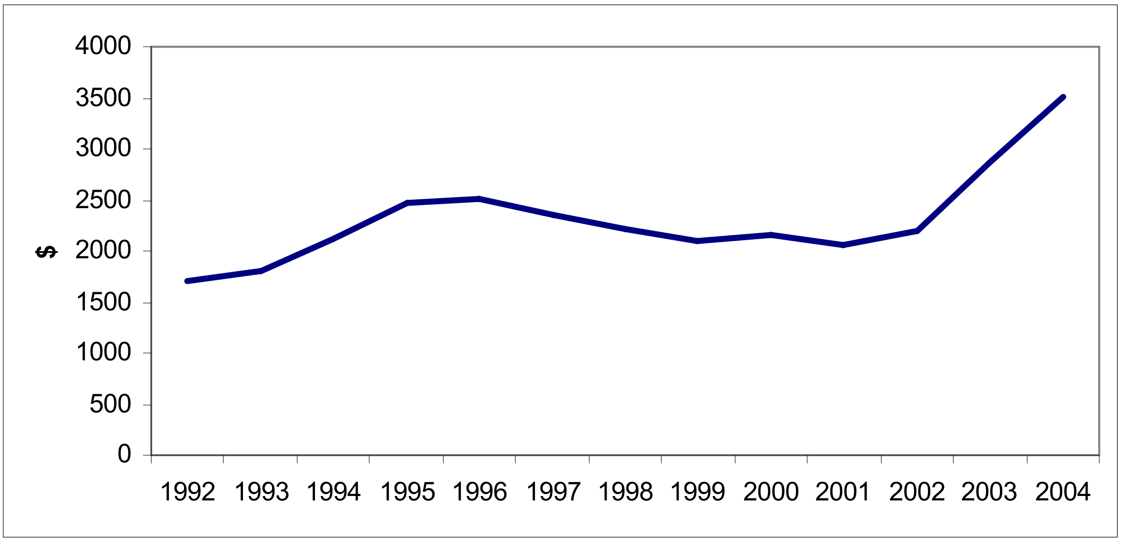
Table 3.2: Non-life insurance premium volumes in France (€millions)

Year	Premium volume	Share of total business
2000	40,976	31.3
2001	43,848	34.2
2002	47,411	35.8
2003	50,742	35.6
2004	52,924	33.8

Source: Swiss Re

3.5 Overall premiums have matched the growth of GDP since 2000. Life insurance premiums grew more slowly than GDP to 2002 but grew faster than GDP thereafter.

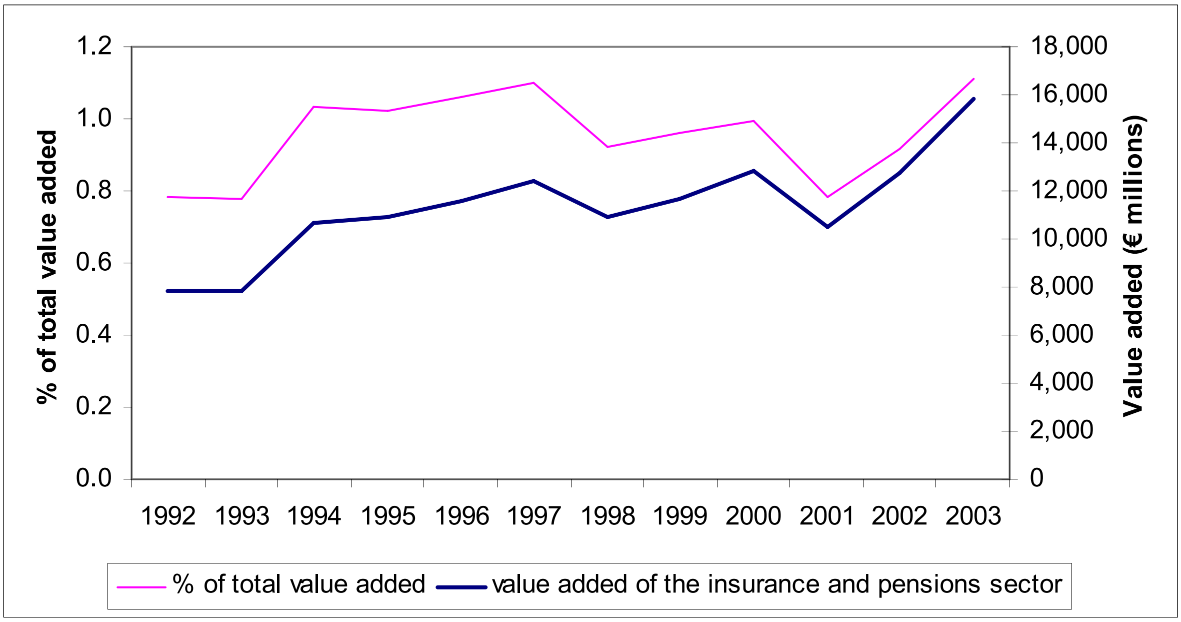
Figure 3.2: Insurance density (gross direct premiums/population, $ per capita)



Source: OECD

3.6 Insurance companies are important investors in the French (and international) share and bond markets. Since 1998 their investments have increased by an average of 7 per cent per annum.

Figure 3.3: Value added of the Insurance and Pensions sector



Source: University of Groningen

Table 3.3: Total investment volume of French insurance companies (mkt. value in €billion)

	1998	1999	2000	2001	2002	2003
Life	615.7	675.2	745.7	782.0	814.9	890.0
Non-life	102.7	113.3	115.9	111.7	111.2	126.0
Total	**718.4**	**788.5**	**861.6**	**893.7**	**926.1**	**1016.0**

Source: FFSA and Paris EUROPLACE

3.7 Profits in life-insurance fell in 2004 while non-life insurance companies increased their profits significantly.

Table 3.4: Insurer results (€millions unless otherwise stated)

Year	Life enterprises			Non-life enterprises			Composite enterprises		
	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets	Profit/loss for financial year	Total balance sheet assets	Profit/loss by balance sheet assets
2003	1,015	322,899	0.32%	2,037	152,239	1.34%	2,493	584,405	0.43%
2004	976	330,662	0.30%	3,433	159,104	2.16%	2,430	655,354	0.37%

Source: CEIOPS

3.8 In its assessment of the French financial sector, the IMF noted that any systemic vulnerability in the insurance sector is well contained. Despite a number of (global) shocks in recent years, the sector has demonstrated a high degree of resilience. The IMF argues that the high degree of product diversification, the ability of the industry to progressively reduce the level of guaranteed interest rates together with a conservative investment portfolio are all sources of stability.

Market participants and market shares

3.9 The insurance sector contains a complete range of insurance company types including life, health and accident, non-life and reinsurance. Of these categories, the life and health and accident sectors are the largest, 80 per cent of total assets in 2002 according to the IMF. Reinsurance is the smallest sector, accounting for 4 per cent of total insurance assets.

3.10 An important distinction in the French insurance industry is made between the commercial and not-for-profit sectors. While the difference may not be immediately obvious to consumers, it is important because the two sectors are subject to separate legislation, different taxation rates and have their own legal codes and rules. However, since 2002, in order to comply with EU policy, there have been moves to make these regulations uniform.

3.11 The table below sets out the number and type of insurance companies with operations in France.

Table 3.5: Number of insurance companies (end 2004)

	Life	Composites	Property and casualty	Total
Companies registered in France				
- Public companies	-	1	2	3
- Private corporations	60	40	137	237
- Mutual societies	13	1	102	116
- Branch offices (EEA)	1	-	11	12
Branch offices (EEA)	17	1	89	107
Total number of companies established in France	91	43	341	475
EEA companies licensed to do business in France under free movement of services	150	7	592	749

Source: Commission de contrôle des assurances, des mutuelles et des institutions de prévoyance

3.12 As the above table illustrates, there are a number of insurers from other EEA countries operating in France. This is made possible through the EU's "single passport" system, which allows them to operate in a third party country while still subject to control of the regulatory authorities in their own country. (They must still notify the authorities of their intention to open a subsidiary or to offer services in France). Companies from outside the EEA must be set up in accordance with the requirements of French law.

3.13 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, a subsidiary of Allianz, is the only foreign owned company.

3.14 Both mutuals and co-operatives play a major role in the insurance industry. Out of the ten largest insurers in France, two are mutuals and one is a co-operative.

3.15 The insurance sector shares a number of features with the banking sector. As well as the presence of mutuals and co-operatives, there is a high degree of concentration and an increasing foreign presence. In addition, the rise of financial conglomerates is breaking down the traditional distinction between banking, insurance and asset management. As the FFSA notes, banking groups accounted for around 60 per cent of all life product sales in 2001.

Employment

3.16 Total employment in the insurance sector has grown from 122,000 in 1979 to 151,000 in 1991 and has stagnated since then (153,000 in 2003). The total hours worked has not increased. Although the average yearly working time in the French economy as a whole decreased from 1,716 in 1979 to 1,520 in 2003.

3.17 Value added has increased significantly since 1979 while productivity (in volume indices) has decreased per employee and per hour in the last 24 years. This means that the growth in value added consists of cost increases.

Figure 3.4: Employment in the Insurance and Pensions sector

Source: University of Groningen

3.18 Figure 3.4 above shows that employment in this sector fluctuated over the period about a rising trend.

Figure 3.5: Productivity per employee in the Insurance and Pensions sector

Source: University of Groningen

International trade

3.19 As noted above only one of the big insurance companies in France is owned by a foreign company (Allianz). It does not appear that this situation is about to change rapidly. As in banking the reasons for this may lie in the large numbers of not-for-profit insurers, recent slow economic growth in France and political hostility to foreign takeovers.

Competitiveness

3.20 Productivity has sharply increased since 2001 but it remains to be seen if this trend is maintained.

The Effects of the FSAP and FSWP Legislative Measures on the French Insurance Sector

Assessment by category

Market entry, cross-border business and takeovers

3.21 There seems to be an increase in foreign entry into the French insurance markets. Moreover, French companies appear to have increased their penetration of foreign markets which could be indirectly attributed to the FSAP. Indeed, as was previously described in the banking sector, this could be an indirect impact of the FSAP on the degree of openness of the insurance markets in other Member States.

Competition

3.22 According to our previous results, the French Insurance market is relatively highly concentrated and has witnessed an increase in foreign presence. According to the FFSA notes, in 2001, banking groups accounted for around 60 per cent of all life product sales in 2001.

3.23 While the relatively high level of concentration in the French insurance market may suggest that the level of competition in the market is declining, the rise in foreign presence suggests the contrary. Indeed, both the increase in the active presence of foreign firms and the increase in foreign contestability should in theory, elevate competition. However, in theory, a high level of concentration is generally expected to diminish the degree of competition. Therefore, given the above, it is unclear as to whether the FSAP has had an impact on the level of competition in the French insurance market or not.

Competitiveness

3.24 We have found no clear data that could support the conclusion that the FSAP has affected competitiveness. However, if it is the case that the FSAP has facilitated expansion into foreign markets this may increase the competitiveness of French insurance companies in the medium term.

Employment

3.25 Overall employment has been relatively stable in recent years. As previously described in the banking sector, any effect of the FSAP on employment is likely to be delayed by the rigidity of French labour laws. Indeed, French labour laws are such that the French labour market in general lacks significant flexibility relative to some of its European counterparts, e.g. Ireland. Any change in the level of employment will be slower to transpire than might otherwise have been the case in a more fluid labour market.

Consumer protection

3.26 As noted above there have been some indications that consumer protection has decreased since 1999. However, the Eurobarometer has produced survey results which suggest that in general the assessments of customers are quite positive.

4 SECURITIES MARKETS

French Securities Markets

4.1 French markets for shares, currency exchange and financial derivatives are some of the most sophisticated in the world. Since October 2000, the main French exchange has been part of the Euronext group of exchanges. Along with Amsterdam and Brussels, the Paris bourse was one of the founding exchanges of the Euronext, which now also includes Lisbon and the London derivatives exchange Liffe. In terms of the 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 $2,076 billion.

4.2 The original intention of Euronext was to allocate different products to different constituent markets. However, this has not occurred in practice, and Paris has become the dominant player. Nonetheless, the partners have steadily begun to integrate trading, clearing and settlement systems.

4.3 The main market segments of Euronext Paris are listed and described below.

Table 4.1: Components of Euronext Paris

Exchanges	Types of securities	Operated by
Eurolist(1)	Equities, debt obligations, warrants and trackers	Euronext Paris
MONEP (Marché des Options Négociables de Paris)	Equity derivatives	Euronext Paris
MATIF (Marché à Terme International de France)	Interest rate derivatives and commodity derivatives	Euronext Paris

Note: (1) Eurolist is the result of the merger of all the regulated markets operated by Euronext: Paris Bourse (Premier Marché, Second Marché) and Nouveau Marché.

Source: London Economics, 2005

4.4 In addition to the three regulated markets shown above, Euronext Paris SA manages two cash markets: the “Alternext”, dedicated to small and medium-sized French and foreign companies and the “Marché Libre OTC”, dedicated to the trading of non-officially listed securities. Euronext Paris SA is a French wholly owned subsidiary of Euronext NV, a holding company governed by Dutch law.

4.5 The Paris market became much more attractive to international investors in the second half of the 1990s as a result of a wave of the privatisation of French state-owned companies that began in 1994. The most recent privatisation was of ASF (Autoroutes du Sud de la France) in March 2002.

4.6 There is now only a single clearing house in France as a result of the merger between SBF (equity trades and options), MATIF SA (exchange-trade derivatives) and BCC (repo and trades on government securities). The single clearing house, Clearnet SA, is the central counterparty for markets operated by Euronext.

Factors Specific to French Securities Markets

4.7 There are a number of factors specific to the French securities market that should be considered. These include:

(a) **Internationally merged exchanges.** This makes it hard to differentiate FSAP effects on French stock exchange from its impact on Euronext.

(b) **The size of the sector.** As the tables above demonstrate, together with Euronext, both the value and volume of securities makes France part of the largest markets in the world.

(c) **Concentration rule:** The implementation of the MiFID will eliminate a rule that forces trade of securities to be conducted on an official stock market. The rule was implemented in order to achieve maximum liquidity and transparency. With the abolition of this rule investment banks will be able to consolidate trade among themselves without using the stock market. To ensure transparency MiFID has detailed rules for pre and post trade transparency, and for the reporting of transactions.

Impacts of the FSAP and FSWP Legislative Measures on French Securities Markets

4.8 Euronext started its international expansion long before the FSAP came into effect. The FSAP will enable Euronext to form new alliances as the greater uniformity of exchange rules will make integration easier.

4.9 Arguably the most important point of the MiFID is the expansion of cross-border activities to create a well-functioning single European market for securities.

4.10 Our view is that since there remain a number of Member States that are likely in the future to become involved with the Euronext system, further implementation of the FSAP measures should have a positive effect, on cross-border activities, by facilitating French penetration into those countries.

Competition

4.11 An increase in cross-border activity and trade should of itself enhance the level of competition in the French securities market. Since, *a priori,* further implementation of the FSAP may have a small positive impact on the level of competition and trade in the French securities market; we may conclude that for the future, further implementation of the FSAP is likely to have a slightly positive impact on competition in the French securities sector.

Employment

4.12 If the aim of the FSAP of de-segmenting the EU market is achieved, and if (as a result) Euronext expands, then in the short term, the level of employment in the French securities market should rise slightly.

4.13 In the long term, the MiFID (with respect to systematic internalising) is likely to create a tendency for securities related jobs to migrate to London, because of its head-start in such activities. The expected general expansion of the European securities markets will also increase the aggregate level of employment in the French securities market.

Competitiveness

4.14 So far, the FSAP has had a limited impact on competitiveness. However, MiFID (soon to be implemented) is likely to expose Euronext to more competition, which in turn is likely, over time, to decrease transaction costs and thus enhance competitiveness in the French securities market. Therefore, the FSAP is likely to have a positive impact in the future.

Consumer protection

4.15 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the French securities market would be limited. However, if the market extends to a more general public, then there could be consumer protection issues, in that a broader range of users would imply more inexperienced users. That said, the MiFID is addressing that long term risk through extensive consumer protection provisions. Therefore, in our view the FSAP has so far had no significant impact on consumer protection in the French securities market; but if less experienced market users were in the future to begin to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

4.16 So far, the impact of the FSAP on the French securities market has been small as Euronext engaged in cross-border trade long before the implementation of the FSAP. However, the implementation of the FSAP may be important in maintaining competitiveness. Furthermore, the abolition of the concentration rule may be of particular importance in this respect.

4.17 Our analysis in the Main Report suggests that there is scope for increased competition (particularly among exchanges) and more extended use of systematic internalising (creating chains of substitution between exchanges) which may be facilitated by MiFID. It appears that bidding down of equity spreads and other transaction costs will, in due course, lead to a fall in the cost of equity capital by 12-28 basis points (0.12 to 0.28 per cent).

5 FINANCIAL CONGLOMERATES

Financial Conglomerates in France

5.1 The Bank of International Settlements Joint Forum on Financial Conglomerates 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)." Thus, financial conglomerates can sometimes be exposed to two or more sector-based regulatory regimes.

5.2 In France, there has been a trend in recent times for banking and insurance groups to consolidate their operations under a single banner. The ties between the groups are often based on cross-shareholding.

Table 5.1: Financial conglomerates with head of group in France

Name	Countries in which they operate	Characterization
BNP Paribas	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
Caisses d'Epargne	France	Equal focus on Banking, Insurance, asset management
Credit Agricole	France	Banking Group doing insurance
Credit Mutual	France	DNA
Societe General	Austria, Belgium, France, Germany, Ireland, Italy, Norway, Portugal, Poland, Portugal, Spain, Sweden, UK, Switzerland	Corporate and investment banking

Source: EU Mixed Technical Group on the Supervision of Financial Conglomerates, Europe Economics. Note: DNA = Data Not Available

Table 5.2: Other Financial Conglomerates operating in France

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Allianz	Germany	Insurance group doing asset management and banking	Insurance
BANCO Bilbao Vizcaya Argentaria	Spain	Finance and Insurance	Corporate Investment Banking
Barclays	UK	Banking	Banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Banking
Danske Bank	Norway	Insurance, mortgage finance, asset management, brokerage, real estate and leasing services - mostly banking	Banking
Eureko	Netherlands	Insurance group doing asset management and banking	Life Insurance
Fortis	Belgium	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%	Insurance
Grupo Santander	Spain	Insurance, Banking, Asset Management	Banking
Gruppo Banca Intesa	Italy	Banking	DNA
ING	Netherlands	Banking, insurance and asset management	Equal focus on Banking and Insurance
Munich Re	Germany	Reinsurance	Reinsurance
Old Mutual	UK	Asset management, Life assurance, Banking, Offshore trust and company services	
RBS	UK	Banking firm doing insurance	Corporate Banking
SEB	Sweden	Banking firm doing insurance and asset management	Banking
Svenska	Sweden	Insurance, banking and asset management	DNA

Source: EU Mixed Technical Group on the Supervision of Financial Conglomerates, Europe Economics. Note: DNA = Data Not Available

5.3 The relevant FSAP measure with regard to conglomerates is the Financial Conglomerates Directive. This was enacted in 2004, and was due to come into force on 1 January 2005. The Directive introduces the supplementary supervision of financial conglomerates on a group wide basis. The main objectives of the Directive, as stated, are (I) to ensure that financial conglomerates are adequately capitalised, preventing the same capital being counted twice and so used simultaneously as a buffer against risk in different entities, (II) to introduce methods for calculating a conglomerate's overall solvency position, and (III) to provide for the establishment of a single lead regulator for financial conglomerates, rather than multiple lead regulators as at present, thereby reducing regulatory duplication.

5.4 The Financial Conglomerates Directive was transposed into French law by a government order dated November 16 2004. The Directive, which was simultaneously transposed into the various codes that govern the industry, establishes new requirements with regard to shareholders' equity, disclosures on related party transactions, business concentration and risk management, and underscores the need for adequate internal control procedures. Conglomerates subject to the Directive will be designated on the basis of criteria related to their structure and their volume of business in each line, and will be informed accordingly by the relevant supervisory authorities. For each conglomerate, a coordinator must be appointed from among the competent authorities of the Member States.

Impact of the FSAP and FSWP Legislative Measures on the French Financial Conglomerates

Openness to foreign firms

5.5 Our assessments for other sectors have suggested that the effects of the FSAP on openness were limited for banking, negative for insurance, and limited in the future for securities. As French conglomerates mainly incorporate banking and insurance activity, we conclude that the influence of the FSAP is likely to be limited.

Competition

5.6 Among the other sectors, only in securities was the effect of the FSAP assessed as being slightly positive, and then only in the future. For financial conglomerates we would see the overall impact as limited.

Consumer protection

5.7 The effects of the FSAP on consumer protection in the banking sector was assessed as perhaps slightly positive, but limited in insurance and negative in the securities. For conglomerates we conclude that the overall impact is likely to be limited.

Employment

5.8 Earlier sections assessed that the main change in employment was limited in the banking sector, negligible in insurance and securities. Since conglomerates mainly incorporate elements of banking and insurance, we assess the net effect as negligible.

Competitiveness

5.9 For banking and securities we have assessed the competitiveness impact as positive, whilst for insurance positive. Conglomerates may perhaps be better placed, than smaller firms, to take advantage of the multi-jurisdictional regulatory efficiencies and other opportunities the FSAP and FSWP legislative measures have brought and will bring. Our overall assessment is that the impact is likely to be slightly positive.

6 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Limited	Negligible	Perhaps positive	Positive	Limited
Insurance	Negligible	Unclear	Limited	Limited (perhaps positive in future)	Negligible
Securities	Probably positive in the future	Probably positive in the future	Probably positive in the future	Probably positive in the future	Probably positive in the future
Financial Conglomerates	Limited	Limited	Limited	Negligible	Perhaps slightly positive