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The Impact of the New Financial Services Framework

Part IV

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Malta, Netherlands, Poland, Portugal
Slovakia, Slovenia, Spain, Sweden, U.K.

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MALTA

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Malta

Division of responsibility

1.1 Responsibility for financial regulation and supervision of the banking, securities and insurance markets in Malta is spread across the following three authorities:

(a) **Malta Financial Services Authority (MFSA):** The Malta Financial Services Authority (MFSA) is the supervisor and single regulator for the financial services sector in Malta. The sector incorporates all financial activity including banking, investment and insurance. The MFSA also manages the Registry of Companies and also the responsibility of the Listing Authority. Moreover, the MFSA is responsible for consumer education and consumer protection in the financial services sector.[1]

(b) **Bank of Malta:** The Bank of Malta is responsible for the formulation and implementation of monetary policy and the promotion of a sound and efficient financial system.

(c) **Ministry of Finance:** is responsible for strategic planning and policy co-ordination across the Ministry. It is also responsible for the national economic strategy and matters related to international economic relations.

Key features of banking regulation

1.2 The main legislation affecting the Maltese banking system includes:

(a) **The Banking Act, 1994**, amended during 2002. The law, which replaced the Banking Act, 1970 has adopted European Union directives as the main reference for the regulatory concepts and supervisory practices that it introduced.

(b) **The Malta Financial Services Act**, which established the Malta Financial Services Authority, the agency responsible for the regulation of investment services in Malta. The legislation package regulating investment services, including banking and insurance, is contained in the Investment Services Act.

(c) **Professional Secrecy Act, 1994,** entails provisions ensuring banking confidentiality is respected.

(d) **Prevention of Money Laundering Act, 1994,** safeguards the integrity of the banking system against misuse.

Key features of insurance regulation

1.3 The main legislation affecting the Maltese insurance system includes:

(a) The **Financial Institutions Act, 1994** regulates non-bank financial institutions that do not fund their activities through the taking of deposits. The activities of financial institutions include lending, financial leasing, venture or risk capital and foreign exchange dealing. The Act authorizes the competent authority to issue directives to financial institutions for supervisory, regulatory and prudential purposes.

(b) The **Insurance Intermediaries Act** was enacted by Parliament and came into force on October 1, 2006. The Act, which repeals the Insurance Brokers and Other Intermediaries Act, consolidates all insurance intermediaries' activities carried out in or from Malta and also introduces new provisions reflecting developments both in the domestic and international insurance market. It is now possible for the various intermediaries' activities provided for under the Act to be carried out both by individuals or legal entities – as provided for in the EU Mediation Directive.

(c) The **Special Funds Act** encourages the development of funded "second pillar" and "third pillar" pension arrangements by companies setting up plans for their own employees and by service providers who would create "packaged" plans for individuals and smaller businesses.

Key features of securities regulation

1.4 The main legislation affecting the Maltese securities system includes:

(a) The **Trusts and Trustees Act** creates the trustee following the elimination of the nominee and transparency in the management of trusts.

(b) The **Investment Services Act** provides the basis for the regulation of investment services providers (licence holders providing investment advice and management services including stock broking and acting as trustees and custodians) and collective investment schemes (SICAVs).

(c) The **Securitization Act** (2006) provides companies with the opportunity of raising capital through the transfer of assets and risks to Special Purpose Vehicles (SPVs). The Securitisation Act also regulates the application of a number of laws, including the Companies Act and the Civil Code, in relation to securitisation.

2 BANKING

Headline Overview

Factors specific to Malta

2.1 We have identified the following factors as being important unusual features of the Maltese banking sector. These are:

(a) Relatively small size of Maltese economy.

(b) Strong financial position of credit institutions given their high rate of profitability and the capital held in excess of the minimum regulatory requirements.

(c) Very high concentration ratio.

(d) High level of cross-sectoral activity between the banking, insurance and securities industries.

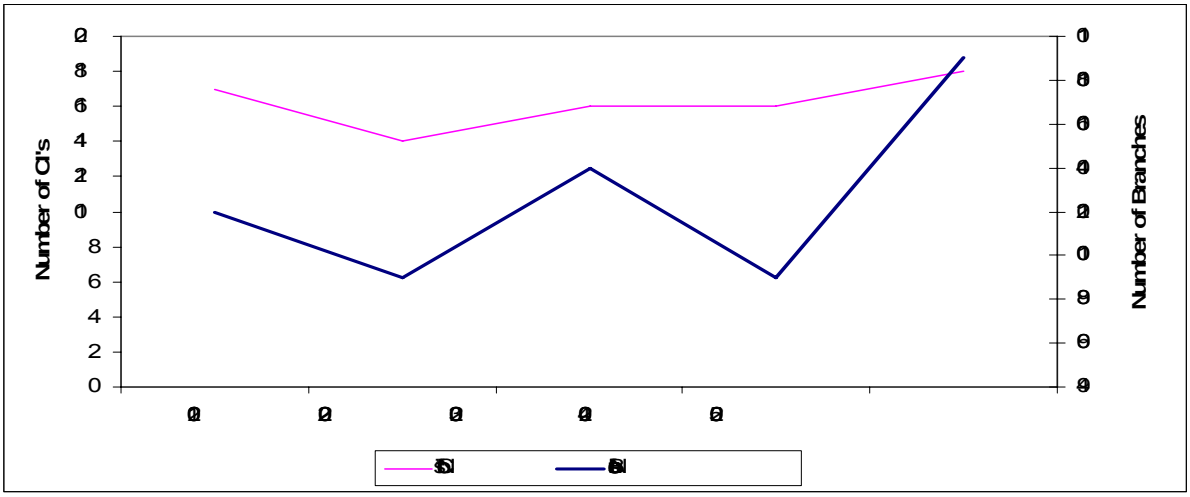
(e) The creation by the Maltese Government of an offshore sector which became more welcoming to external investment in 1998, after the introduction of the International Business Activities Act 1988. Indeed, a special authority known as the Malta International Business Authority was set up in order to expand offshore business sectors.

(f) The Malta Development Corporation offers a range of attractive investment incentives. Also, there is now a modern legislative structure for most of the main financial sector activities.

Number of players

2.2 The Maltese banking sector is one of the largest segments of its financial system. The major banks in Malta are Bank of Valletta and Mid Med Bank. They have branches in most towns and villages in Malta and Gozo, and offer a wide range of services, including non resident offshore account facilities.

Figure 2.1: Banks in Malta, 2001-2005

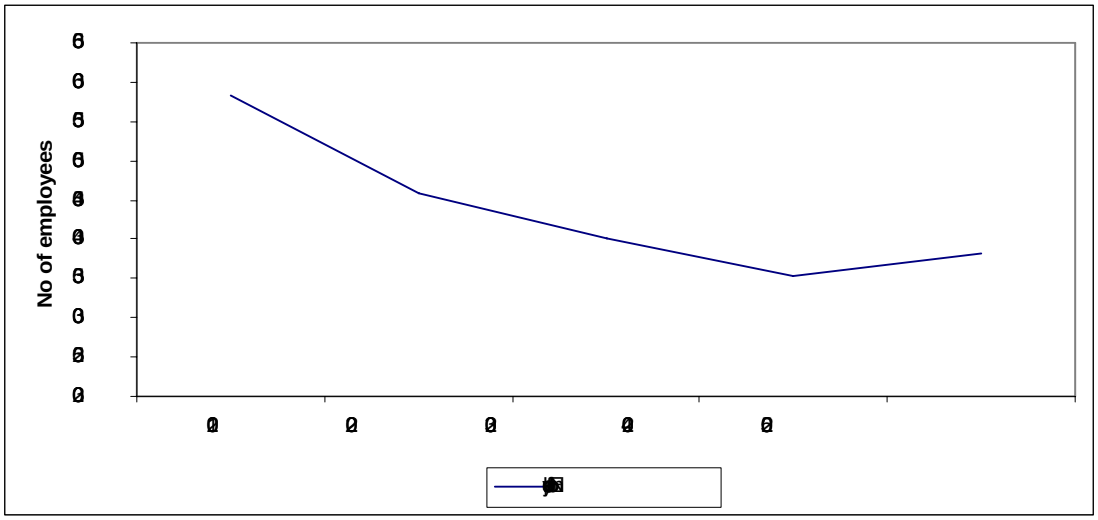


Source: OECD

Turnover, employment and profitability

2.3 Figure 2.2 illustrates employment in Maltese banks.

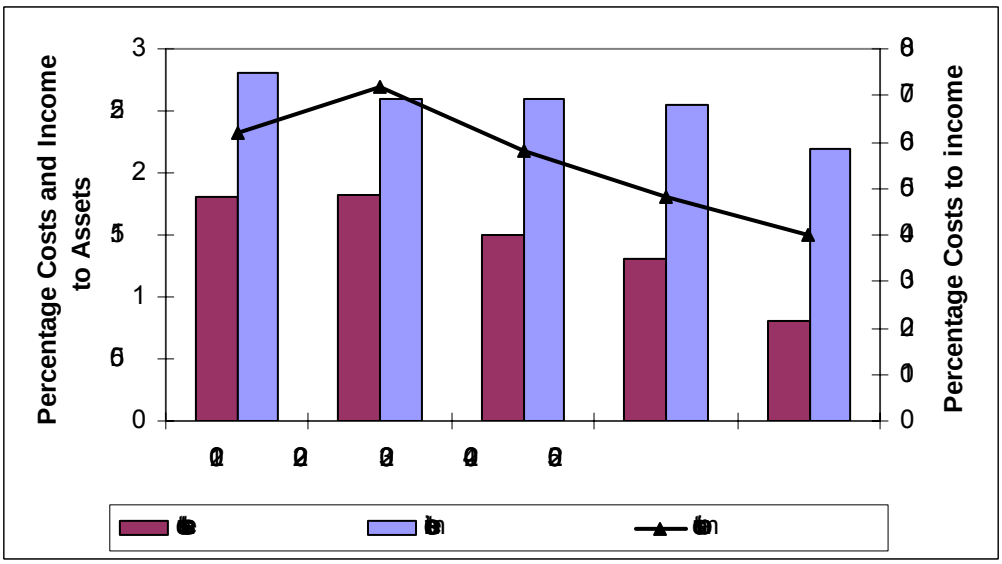
Figure 2.2: Employment in Malta banks, 2001-2005



Source: ECB

2.4 Bank profitability is very high given the small size of the economy and it has increased in recent years as illustrated below. The level of profitability of Maltese banks is comparable to many of the EU Member States. As reported by the Central Bank of Malta, during 2005, the Maltese economy improved in an environment of low interest rates where credit institutions maintained strong financial positions. This was mainly through holding capital in excess of the minimum regulatory requirements and registering higher profits.

Figure 2.3: Maltese Banks profitability



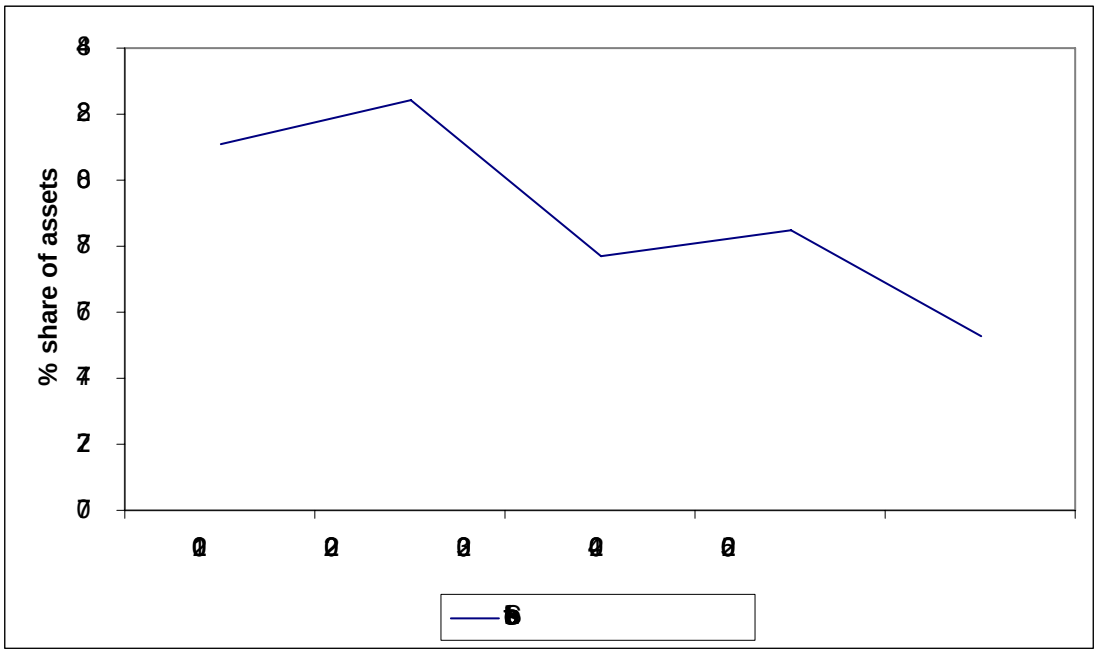
Source: Central Bank of Malta, Annual Report 2005

Market shares and concentration

2.5 The Maltese banking sector is relatively highly concentrated. Two credit institutions hold over 90 per cent of the total banking sector. Also not only do the two largest banks dominate the market but they also dominate the insurance and the security sectors through their subsidiaries and affiliates.

2.6 Figure 2.4 illustrates the evolution of concentration in Malta since 2001.

Figure 2.4: Share of the 5 largest Maltese credit institutions in total assets



Source: ECB

Table 2.1: Herfindahl-Hirschman index[1]

2001	2002	2003	2004	2005
892	856	783	798	795

Source: ECB

2.7 The Herfindahl-Hirschman index indicates a low level of concentration in the banking sector, with relatively little change during the period since 2001.

2.8 The ECB states that there were no Mergers or Acquisitions in Malta in the period 2000-2006, either Domestic, Internal EU or Third Country.

Switching behaviour

2.9 Respondents to our survey suggested that switching behaviour in the banking sector has increased as a result of the implementation of the FSAP measures.

[1] [redacted]

Dimensions of price and quality competition

2.10 It appears that prices have increased and respondents to our survey do not expect prices to increase more in the future. In fact, the FSAP measures are believed to have prevented prices from rising further than they appear to already have

Consumer protection

2.11 In 2002 the MFSA established the Consumer Complaint Manager (CCM) for financial services. At the beginning of 2003, two new regulations came into force concerning the Deposit Guarantee Scheme and the Investor Compensation Scheme. These schemes provide customers of financial institutions with a certain amount of financial compensation in the event of insolvency of such institutions.

2.12 The pattern of complaints from the data collected by the CCM shows that the cause of complaints is generally the lack of adequate information for consumers on financial products: the MFSA also took note of the fact the majority of banking-related complaints processed referred to bank charges and card transactions.

2.13 Malta is participating in various EU projects aimed at enhancing consumers' level of information on financial products.

Table 2.2: Banking complaints received from MFSA

	2002		2003		2004		2005	
	Reviewed	**Pending**	**Reviewed**	**Pending**	**Reviewed**	**Pending**	**Reviewed**	**Pending**
Banking	7	0	22	5	39	4	28	5
Insurance	27	4	85	15	212	10	78	29
Investment services	29	5	44	13	36	5	45	15
Total	63	9	151	33	287	19	151	49

Source: Malta Financial Service Authority

The potential future role of technology

2.14 The variety of products has increased, as have electronic commerce and transparency.

Trade and international penetration

2.15 Cross-border activity has increased during recent years and is expected to further increase in the future. As reported by the MFSA, in 2005, 29 banks from other Member States notified the MFSA of their intention to provide cross-border services in Malta.

Table 2.3: Non-Malta Branches and Subsidiaries

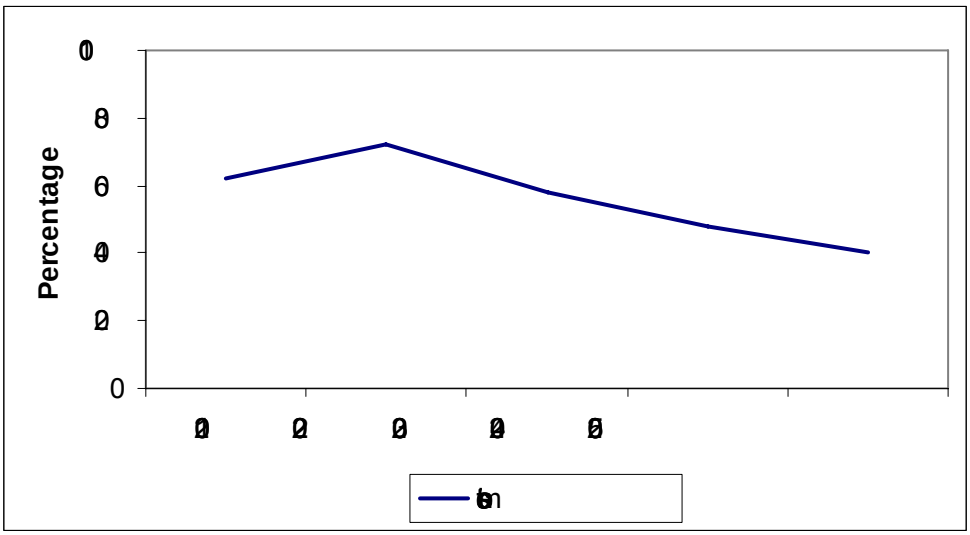
	2001	2002	2003	2004	2005
Branches of CI's from EU area	0	0	0	0	0
Subsidiaries of CI's from EU area	7	7	8	8	9
Branches of CI's from third countries	3	2	2	2	2
Subsidiaries from third countries	4	4	4	4	2

Source: ECB

Competitiveness

2.16 Figure 2.5 illustrates the decrease in the operating expenses to income ratio since 2002.

Figure 2.5: Operating expenses to income, 2001-2005



Source: Central Bank of Malta, Annual Report 2005

2.17 Respondents to our survey believe that the factors driving competitiveness include availability of skilled personnel, the business environment and Government responsiveness.

Impact of the FSAP and FSAP Legislative Measures on the Maltese Banking Sector

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

2.18 There appears to have been an increase in the level of cross-border activity in the Maltese banking sector. However, our understanding is that Malta would have been keen to attract foreign banks if it could, regardless of the FSAP, and so we consider its effects limited.

Competition

2.19 An increase in cross-border activity should lead to a higher level of competition, through greater contestability as well as an increase in the number of competitors.

2.20 However, as mentioned above, our view is that the FSAP's effects on openness will have been and will be limited.

2.21 On the other hand, the liberalising regulatory requirements of the FSAP may tend to increase contestability in what would otherwise be a very small market prone to monopoly. Thus we expect the effects to be positive.

2.22 Interestingly, according to our survey, there is the possibility that in the future, banks will continue to expand their activities not only at a cross-border level but also in retail, with banks seeking entry into that currently concentrated market.

Competitiveness

2.23 Competitiveness in the Maltese banking industry has increased. This is mainly attributable to an extended period of low interest rates which has driven banks to both cut costs and diversify their sources of income, in order to compensate for the loss of net interest income.

2.24 Looking ahead greater competitive pressure should, as is normal, lead to greater cost-reduction pressures and more innovation, and hence to enhanced competitiveness.

Employment

2.25 We have not identified significant reductions in employment associated with the FSAP so far. Impacts on employment in the future are less clear. It could be that competitive pressures lead to some re-allocation of Maltese banking staff. On the other hand, Malta may have the opportunity to become an important banking and financial services centre for the Eastern Mediterranean and South-Eastern European Union. Our expectation is that although there may be some employment inefficiency at present, the future growth in the industry stimulated through the FSAP should offset this, so that the net effect of the FSAP on employment will be positive.

Consumer protection

2.26 Although membership of the European Union creates many opportunities for the Maltese banking sector, without the common regulatory framework provided by the FSAP there may have been the danger that Accession would lead to pressures for regulation to become lax and consumer protection to be undermined. Thus our view is that the FSAP will have enhanced consumer protection.

3 INSURANCE

The Maltese Insurance Sector

Factors specific to Malta

3.1 We have identified the following factors as being important unusual features of the Maltese insurance sector. These are:

(a) High level of cross-sector activities. Links between banks and non-bank financial sector are manifested largely through cross-sectoral equity holdings.

(b) High level of cross-border activities.

(c) Very concentrated market.

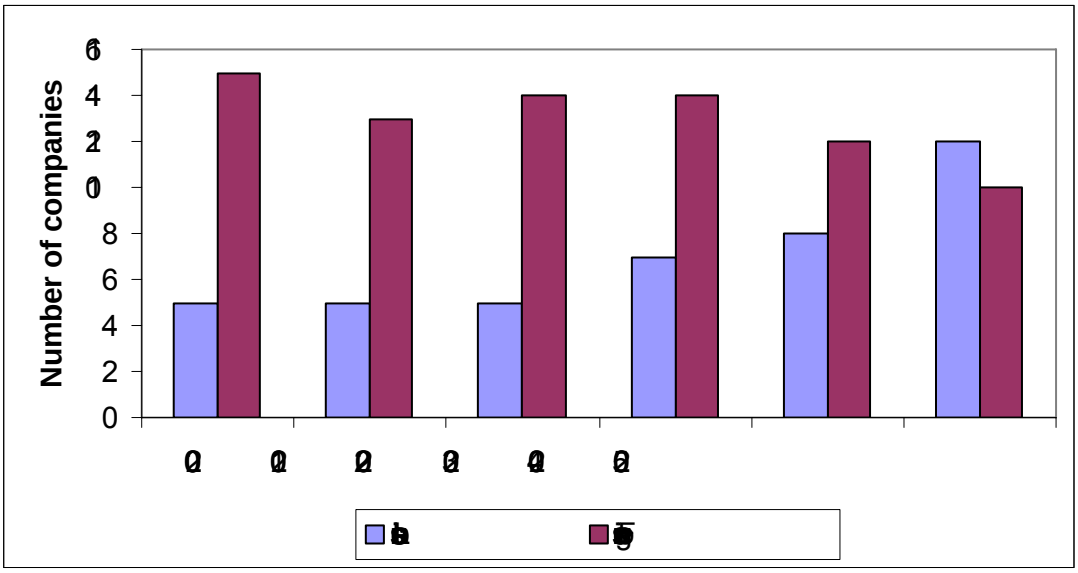
(d) Light touch regulation.

(e) Malta has a modern and competitive tax regime providing an excellent base for setting up tax efficient structures. Features include: Comprehensive double tax treaties with 42 countries; Income from all sources, including capital gains, is aggregated for the purposes of the tax; Individuals are taxed at progressive rates, with the highest rate being 35 per cent; Companies are taxed at a fixed rate of 35 per cent; Tax paid by companies imputed to shareholders upon a dividend distribution.

Number of players

3.2 In 2004 there were 20 companies and almost 1,090 employees within the insurance sector. Figure 3.1 illustrates the number of foreign and local insurance companies present in the market.

Figure 3.1: Local and foreign companies authorised to carry on general insurance business in Malta



Source: MFSA Annual report 2005

3.3 In 1994, legislation was passed that eliminated the legal distinction between offshore and onshore companies engaged in international business operations and registered in Malta.

Table 3.1: Number of offshore companies per category

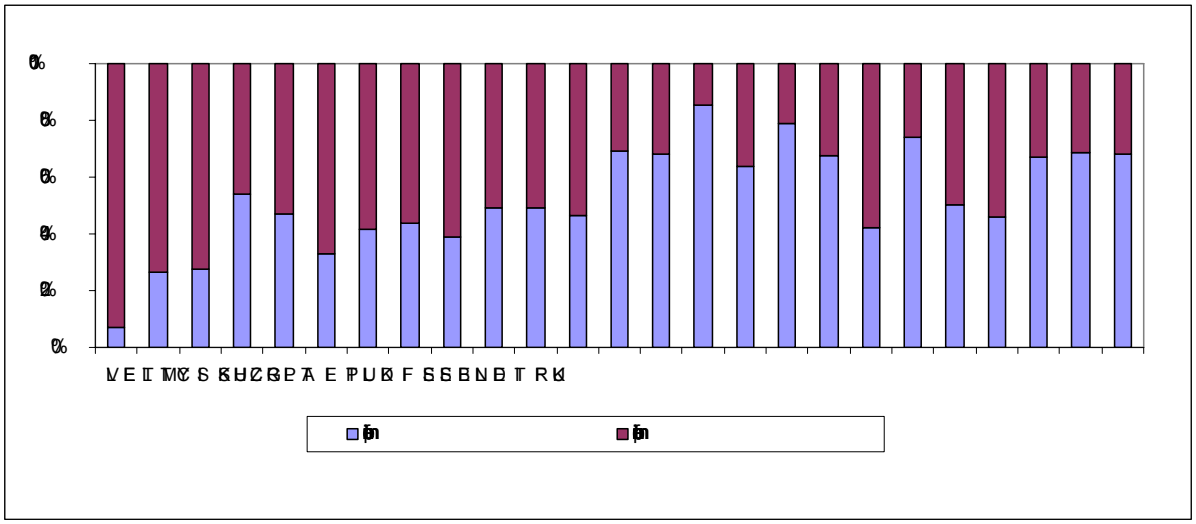
	2002	2003	2004
Banking companies	na	3	1
Trading companies	na	95	35
Non-trading companies	na	208	116
Total	465	306	152

Source: Ministry of Finance

Turnover, employment and profitability

3.4 Profitability is high: the sector is growing very fast. In 2005, this was due to cost containment, as premium income remained stable. As the Bank of Malta has reported, testing exercises indicate a strong shock-absorption capacity.

Figure 3.2: Percentage of life premium income and non-life premium income, 2005



Source: CEA, European insurance market in figures 2005

3.5 The number of jobs in the insurance sector has increased.

Table 3.2: Employment in insurance market, 1998-2002

	1998	1999	2000	2001	2002
Total Insurance	787	835	816	843	840
Private	*777*	*831*	*811*	*836*	*833*
Public	*10*	*4*	*5*	*7*	*7*

Source: Ministry of Finance, 2002

Market shares and concentration

3.6 The insurance sector is relatively highly concentrated.

Table 3.3: Market shares of the largest insurance groups, 2004

	Non-life premium on national market	first 5	first 10	first 15
Non-life insurance groups	**114**	**72%**	**89%**	**94%**
Life insurance groups	**135**	**100%**		

Source: CEA, European insurance market in figures 2005

Switching behaviour and role of technology

3.7 Respondents to our survey indicate an increasing level of switching behaviours with possibilities of further increase in the future.

Consumer protection

3.8 Table 3.4 shows the pattern of complaints since 2002. Respondents to our survey declared an increasing level of understanding of insurance products the education of which is a function independent of FSAP measures.

Table 3.4: Insurance complaints received from MFSA

	2002		2003		2004		2005	
	Reviewed	Pending	Reviewed	Pending	Reviewed	Pending	Reviewed	Pending
Insurance	27	4	85	15	212	10	78	29

Source: Malta Financial Service Authority

Trade and international penetration

3.9 The extensive work in terms of insurance regulation in recent years has made the Maltese insurance industry very well placed in the cross-border market.

3.10 During the first full year of EU membership, the MFSA issued eight licenses to new insurance companies.

Table 3.5: Number of Authorised Insurance Licence Holders

	2003	2004	2005
Locally-domiciled Insurers	7	8	12
Foreign domiciled Insurers	14	12	10
Recognized Insurance Body	1	1	1
Affiliated insurance Companies	1	0	4
Insurance Managers	2	2	6
Agents of: Local Insurers	11	11	10
Foreign insurers	14	14	12
Insurance Brokers - Companies	24	24	24
Insurance Brokers - Individuals	41	39	39
Insurance Sub-Agents	559	564	548

Source: MFSA

Table 3.6: Number of EU Insurance undertakings that have exercised their right to provide insurance services in Malta, 2005

	Number of Notifications		Number of Notifications
Austria	9	Latvia	1
Belgium	6	Liechtenstein	1
Czech Republic	4	Lithuania	1
Denmark	2	Luxembourg	13
Estonia	2	Netherlands	8
Finland	3	Poland	1
France	9	Spain	1
Germany	13	Slovak Republic	1
Gibraltar	1	Slovenia	1
Hungary	4	Sweden	6
Ireland	18	United Kingdom	51
Italy	15		

Source: MFSA

Competitiveness

3.11 Integration into the European Union so far seems to have offered Malta an opportunity to take advantage of its relatively light-touch regulatory regime with respect to insurance. For example, the recent Open Europe report[1] notes:

> "Aside from migration of business to non-EU jurisdictions, we may also see firms capitalising on regulatory arbitrage within the EU, taking advantage of "lighter touch" regulatory regimes. In the insurance sector, Malta is a good example. To date around a dozen captives have been established in this new accession state, not least because Malta offers a relatively straightforward and attractive regulatory regime."

3.12 On the other hand, labour costs are not as attractive as they used to be. If labour costs continue to increase above a competitive level, Malta might lose its competitive advantage over other countries.

Impact of the FSAP and FSAP Legislative Measures on the Maltese Insurance Sector

Market entry, cross-border business and takeovers

3.13 EU membership has enabled the Maltese insurance industry to move into the international scene. An advantageous corporate tax regime has increased the significance of this business.

[1] [redacted]

3.14 Many of the world's insurance and reinsurance companies have set up in Bermuda, where a lighter regulation and tax regime make it attractive to set up business. Furthermore, insurers are setting up captives offshore, more particularly in less tightly regulated member states of the EU, notably Malta, where an off-shore regulation was set-up a decade ago (1994).

3.15 Aside from migration of business to non-EU jurisdictions, we may also see firms capitalizing on regulatory arbitrage within the EU, taking advantage of "lighter touch" regulatory regimes.

3.16 So far, the FSAP does not appear to have had any significant impact on the openness of the Maltese insurance sector to foreign firms. Indeed, our view is that the Maltese would have been keen to attract foreign entrants with or without the FSAP.

Competition

3.17 Although effects of the FSAP on competitive pressure from abroad may have been limited, greater requirements of regulatory transparency and other measures may increase the confidence of entrants and make the Maltese insurance market more contestable.

Competitiveness

3.18 It appears that while insurance market operational costs have considerably increased, prices have remained the same. Both phenomena are independent of the FSAP. However, the FSAP might allow for an increase in prices. E-commerce and product variety would have improved in any case.

3.19 Maltese competitiveness seems to have increased with Accession to the European Union, as the opportunity to locate under relatively light-touch regulation in Malta seems to have been attractive to certain firms. However, thus far it is difficult to discern an impact of the FSAP, as distinct from EU membership.

3.20 Looking to the future, the path for competitiveness appears very sensitive to the form that EU measures take. Harmonizing directives that remove Malta's regulatory advantage are likely to damage Maltese competitiveness. In contrast, measures that develop the Single Market through removing barriers to trade without destroying regulatory competition may be to Malta's advantage. Our assessment is that the net effect will be to reduce Maltese competitiveness — partly by reducing its scope for regulatory competition and partly by improving the regulatory regime elsewhere in the EU and hence reducing the potential regulatory advantage of a light-touch regime.

Employment

3.21 Since competitiveness will be undermined, our belief is that over time the impact on Maltese insurance sector employment will be negative.

Consumer protection

3.22 The role of the FSAP in reducing the scope for regulatory competition by Malta may have provided additional consumer protection, because there was some risk that "light-touch" regulation in Malta would drift into inadequate regulation, if the temptation to compete for business location on the basis of low regulation oversight had been too great.

4 SECURITIES MARKETS

Malta Securities Markets

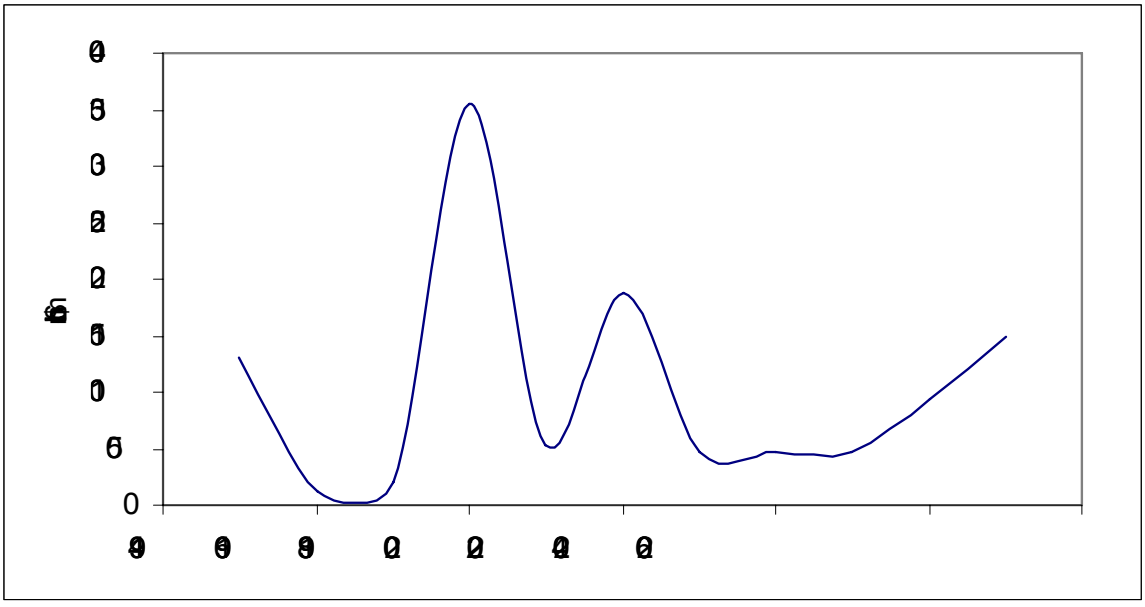
4.1 This is a very small market. The Malta Stock Exchange was formed in 1992. The exchange is managed by a council, the leader of which is the Chairman. The Council is responsible for approval of applications for listing and for supervising performance of the ongoing obligations of listed companies. Prospectus and listing requirements are in line with EU standards.

4.2 Because of an excess of liquidity in the banking system and the small number of banks, the trading activity is very low.

4.3 As of the end of 2004, there were fourteen equity listings and twenty-seven corporate bonds listed on the Exchange, along with some Maltese Government stocks. The exchange had listings for about 40 mutual funds such as Fidelity and HSBC. Total market capitalisation at the end of July, 2005 stood at MTL 2.5 billion, up from MTL 2.1 billion in the previous year.

4.4 2005 saw improved levels of trading, and a rise of 63 per cent in the market index. Market capitalization at the end of 2005 was MTL 2.9 billion.

Figure 4.1: Total value of share trading



Source: World Federation of Exchange

Factors Specific to Maltese Securities Markets

4.5 We have identified the following factors as being important unusual features of the Maltese securities sector. These are:

(a) Tax regime: Licensed funds are exempt from taxation, although they can choose to pay tax at 25 per cent, in which case generous deductions can be claimed against income and the fund has access to Malta's network of double taxation treaties.

(b) The trading activity is very low.

Impact of the FSAP and FSAP Legislative Measures on the Maltese Securities Markets

Cross-border activities

4.6 In January, 2004, the Stock Exchange said that it could soon form part of a wider regional stock exchange to be called BorzaMed, which will consist of bourses located around the Mediterranean rim. They will share a common trading platform.

4.7 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 BorzaMed 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 BorzaMed into a large system, the BorzaMed would lose most of its disadvantages as a small exchange.

4.8 Since we believe that the FSAP will stimulate precisely these kinds of development, our assessment is that the impact of the FSAP will have been positive.

Other objectives of the FSAP in the securities sector

4.9 The Prevention of Financial Markets Abuse Act, which came into effect in April 2005, repealed the Insider Dealing and Market Abuse Offences Act and updated rules regarding inside information and disclosure.

4.10 The new laws put in place more detailed provisions against market manipulation, and lay down rules concerning the dissemination of information by journalists and researchers pertaining to financial instruments. They also stated that all interests and conflicts of interests must be fully declared. The Act covers issuers and their managers, ordinary investors, national statistics bodies, competent authorities in Malta and abroad, operators of recognised investment exchanges and other insiders.

4.11 Moreover, during 2006, the MFSA signed a Memorandum of Understanding with International Organizations of Securities Commissions (IOSCO) to facilitate the exchange of information and provide for clearer channels of co-operation. This is a cross-border network seen as an essential tool to strengthen the capital markets against financial fraud.

Financial Conglomerates

4.12 According to the MFSA there are no companies in Malta that meet the accepted definition of financial conglomerates. Therefore, we may not make any assessments regarding the impact of the FSAP on financial conglomerates.

5 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Competitiveness**	**Employment**	**Consumer Protection**
Banking	Limited	Positive	Unclear so far, positive in future	Unclear so far, net positive in future	Positive
Insurance	Limited	Possibly positive	Negative in future	Negative in future	Positive
Securities	Positive	Slightly positive	Limited	Limited	Positive

THE NETHERLANDS

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in the Netherlands

Division of responsibility

1.1 Responsibility for regulating and supervising financial services is spread over two authorities:

(a) **De Nederlandsche Bank (DNB),** which carries out supervision of financial soundness, administrative organisation and internal control of institutions; and

(b) **The Netherlands Authority for the Financial Markets (AFM),** which was created in 2002. It is an integral, cross-sector authority responsible for supervising the financial market as a whole. It supervises institutions' business conduct with respect to both consumers and markets, such as the stock market. It became operational as a unified regulator in March 2002. AFM is the successor to the STE (Securities Board of the Netherlands), which supervised all participants in the securities trade. Sector-based supervision has been replaced by function-based supervision, which is divided into prudential supervision and supervision of market conduct.

1.2 The principal activities of AFM are:

(a) the granting and withdrawal of licences;

(b) keeping a register of licensed institutions; and

(c) the assessment of reports by licensed institutions.

Key features of financial services regulation

1.3 The main legislation includes:

(a) **Act on the Supervision of the Securities Trade 1995** (Wte)**:** this is the principal act governing the supervision carried out by AFM. The Wte 1995 provides that the AFM can exercise supervision by means of statutory powers, can carry out investigations and inspections, can monitor compliance and can obtain information laid down in the Act. The Wte 1995 created a licensing system for various types of securities services.

(b) **NR'99**: an evaluation of the statutory supervision code NR'99 resulted in revision of the regulations. The NR'99 Revision has been in force since 1 January 2002. The supervision of the prudential regulations set out in NR'99 has been transferred to the DNB.

(c) **Listed Companies Act 1996**: the AFM is charged with implementing the Disclosure of Major Holdings in Listed Companies Act 1996 (Wmz), which refers to the Wmz 1991 and, following amendment, the Wmz 1996. The Wmz implemented the directive of the European Communities of 12 December 1988 by publishing major investors in companies.

(d) **Consumer Credit Act**: the purpose of the Consumer Credit Act is to protect consumers against over-consuming. Consumers must be given, or must be able to obtain, sufficient information to make well-considered decisions about whether or not to enter into credit agreements. Moreover, lenders may only extend credit in cases where, based on the information available to them, they may reasonably assume that the party receiving the credit can fulfil the financial obligations stemming from the credit transaction.

Key features of banking regulation

1.4 In carrying out its supervision of the conduct of banks, the AFM distinguishes between the various categories of banks. This distinction is based on the scope of the laws on which the AFM's supervision is founded.

1.5 The AFM distinguishes between the following categories:

(a) banks that act as institutions for securities, collective investment schemes and/or consumer credit institutions; and

(b) banks that do not act as such institutions, but do carry out activities on the securities markets.

1.6 The AFM supervises compliance with the Financial Services Act by banks and other providers of financial services. The Financial Services Act lays down rules for providing, mediating in and advising on financial products for consumers and — in the case of insurance — for businesses. Under the Financial Services Act, financial services may only be provided by parties that have been granted either a licence or dispensation.

Key features of insurance regulation

1.7 In September 2002, the AFM replaced the former Pensions and Insurance Supervisory Authority of the Netherlands (PVK), currently incorporated into the Dutch Central Bank, as the supervisor for the conduct of insurance companies.

1.8 The AFM supervises compliance with the Financial Services Act by insurance companies and other providers of financial services. The latter Act lays down rules for providing, mediating in and advising on financial products for consumers and — in the case of insurance — for businesses. Under the Financial Services Act, financial services may only be provided by parties that have been granted either a licence or dispensation.

1.9 Since 1 December 2003, insurance companies have also been subject to securities-related market conduct supervision.

Key features of securities regulation

1.10 AFM is the licensing body for securities institutions. The rationale behind the supervision of market conduct is to create an integrated approach for the entire financial sector, such that all parties engaged in the securities markets are subject to the same rules of conduct. These latter rules aim to contribute to the proper functioning of the market and to ensure confidence in the financial sector.

1.11 The purpose of supervision is not to protect investors against high-risk financial products or products with limited prospects of high returns. Rather, AFM aims to ensure that investors are capable of understanding the risks attached to the investments on offer. Securities institutions are responsible for fulfilling whatever promises they make to their investors.

1.12 In order for AFM to achieve this objective, only banks and securities institutions that have been granted a licence by AFM or DNB may offer securities services to the public.

1.13 At present, AFM supervises brokers by requiring the registration of client brokers. Client brokers are securities brokers that only introduce clients to licensed securities institutions and/or CIS's. AFM also supervises brokers and advisers (financial service providers) that provide advice and mediation services for financial products.

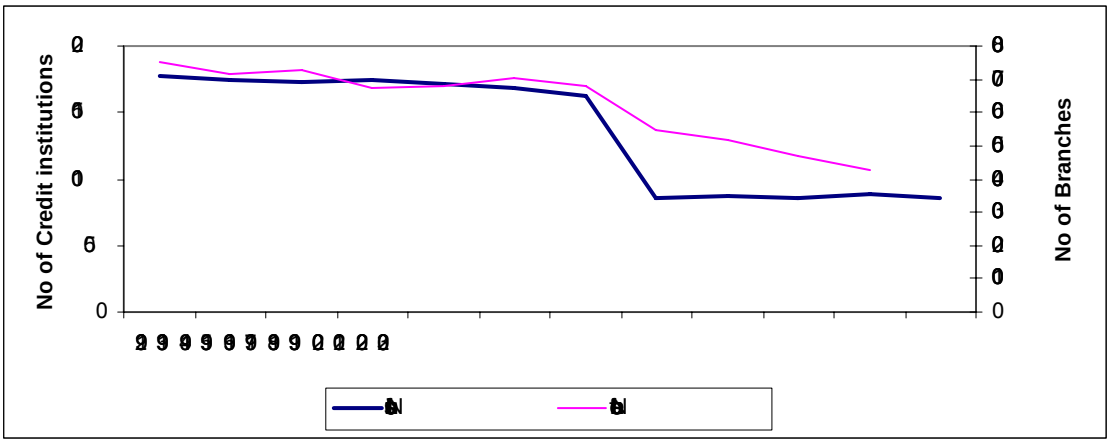
2 BANKING

Headline Overview

Number of players

2.1 Between 1992 and 1998, the number of credit institutions (CI's) followed a slow but steadily decreasing trend (see Figure 2.1). However, between 1998 and 1999, the population of CI's fell significantly, resulting in a form of "step change". Since 1999, the number of CI's has stabilised at approximately 90. The number of branches has followed a more gradual decreasing trend.

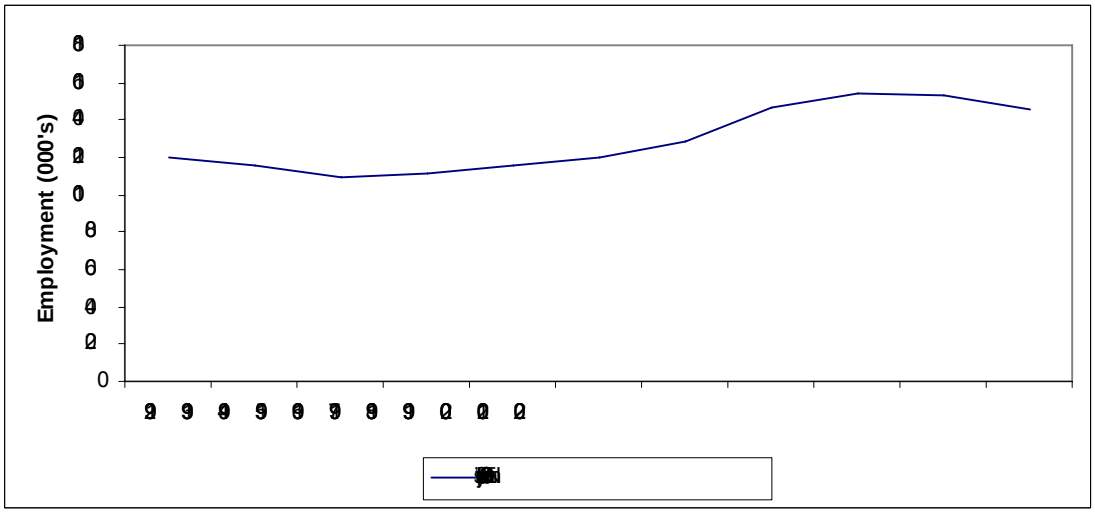
Figure 2.1: Institutions and branches in the Dutch banking sector



Source: OECD

Employment

Figure 2.2: Employment in credit institutions

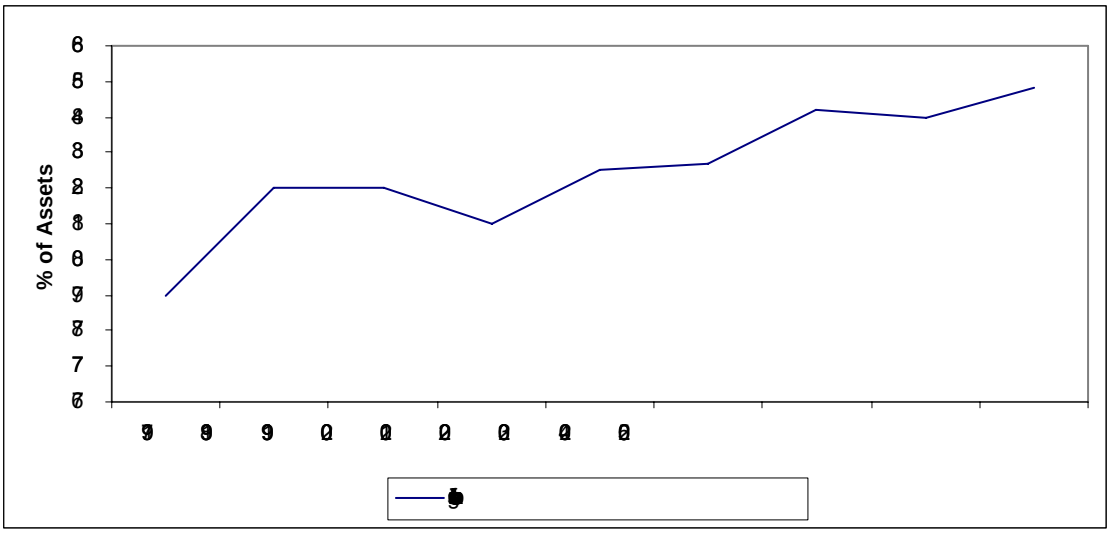


Source: ECB

Market shares and concentration

2.2 There are four major banks in the Netherlands, ABN AMRO, Rabobank, ING (that unites very different institutions including the former Postal Savingsbank) and Fortis. Many of these banks have recently expanded into foreign markets.

Figure 2.3: CR5, Share of the 5 largest Dutch credit institutions in total assets



Source: ECB

2.3 The Dutch banking sector is one of the most concentrated in the EU15. Only Finland has a comparable level of concentration. As Figure 2.3 illustrates, the trend in concentration has been upward since the introduction of the FSAP.

2.4 In specific markets the degree of concentration is extremely high. In 2004 the Financial Sector Monitor (FSM) of the Netherlands Competition Authority estimated the actual market shares of the largest Dutch banks on various markets for products for private individuals and small and medium sized enterprises (SMEs). The results are reported in Table 2.1.

Table 2.1: Concentration Ratios for different segments of the market (%)

C4	Private individuals	SMEs
Current accounts	95	95
Consumer credit	80	n/a
Mortgage loans	70	70
Savings accounts	85	85
Investment management	75	75

Source: Dutch Competition Authority

2.5 Concentration is especially high in the payment market. This may be due to the fact that this market appears to still have remaining barriers to entry. To enter the Dutch payments market, banks must at least have a banking licence and access to the inter-bank circuit in order to make payments. For a bank, it is very difficult to enter the payments market with only one or indeed only a few banking products linked to a current account. The margins that can be obtained from an individual activity are very small. The need for potential entrants to have access to the inter-bank circuit, in order to be able to offer an integrated range of products, remains a barrier to entry. A bank may instead enter the savings or credit market and then extend its activities to the payments market. Competition in the payments market relates mainly to acquiring new account holders, such as young people, students and start-up companies. In this regard, reputation and brand recognition are important assets for a bank. The necessary investments in time and funds may also be regarded as a barrier to entry. Since the reputation and brand recognition of a bank is of considerable importance, it is not easy for foreign entrants to establish relationships with business customers.

2.6 The H-H index shown in Table 2.2 below suggests that the level of concentration in the banking sector has slightly risen since 1999. It would not be unreasonable to suggest that an increase in the level of concentration in the Dutch banking market may have reduced the intensity of competition between incumbent banks.

Table 2.2: Herfindahl- Hirschman Index[1]

1997	1998	1999	2000	2001	2002	2003	2004	2005
1654	1802	1700	1694	1762	1788	1744	1726	1796

Source: ECB

2.7 Nevertheless, the view of respondents to our survey was that individual banks did not possess dominance.

2.8 Since 2000, the number of credit institutions from the Eurozone has significantly dropped. In 2005, the number of CI's was lower than in 1997. There was a 72 per cent drop in the number of branches between 2000 and 2005.

[redacted]

Table 2.3: Number of non- Netherlands branches and subsidiaries

	1997	1998	2000	2001	2002	2003	2004	2005
Number of branches of CI's from EU area	9	10	18	5	7	7	7	7
Number of subsidiaries of CI's from EU area	9	9	12	2	2	0	0	0
Number of branches of CI's from third countries	11	11	10	9	9	8	7	6
Number of subsidiaries from third countries	20	19	16	17	17	16	16	16

Source: ECB

Trade and international penetration

2.9 Our econometric study suggests that the impact of the FSAP on trade has been a rise of 1.3 per cent in imports of financial services other than insurance and pensions, and a rise of 1.6 per cent in exports. Full implementation of the FSAP is projected to lead to a further 1.0 per cent rise in imports and 2.0 per cent in exports.[1]

2.10 Between 2000 and 2004, there have been a number of EU mergers and acquisitions (M&A's). There have also been a number of domestic M&A's between 2001 and 2004.

2.11 ABN-AMRO has recently acquired Banca Antonveneta in Italy. Such a merger could suggest that Dutch banks may be more interested in expanding their activities in countries other than those to which they have been historically linked (Belgium, Luxembourg and France). However, in the last two years, there has been no sign of further international expansion.

Table 2.4: Number of Mergers and Acquisitions

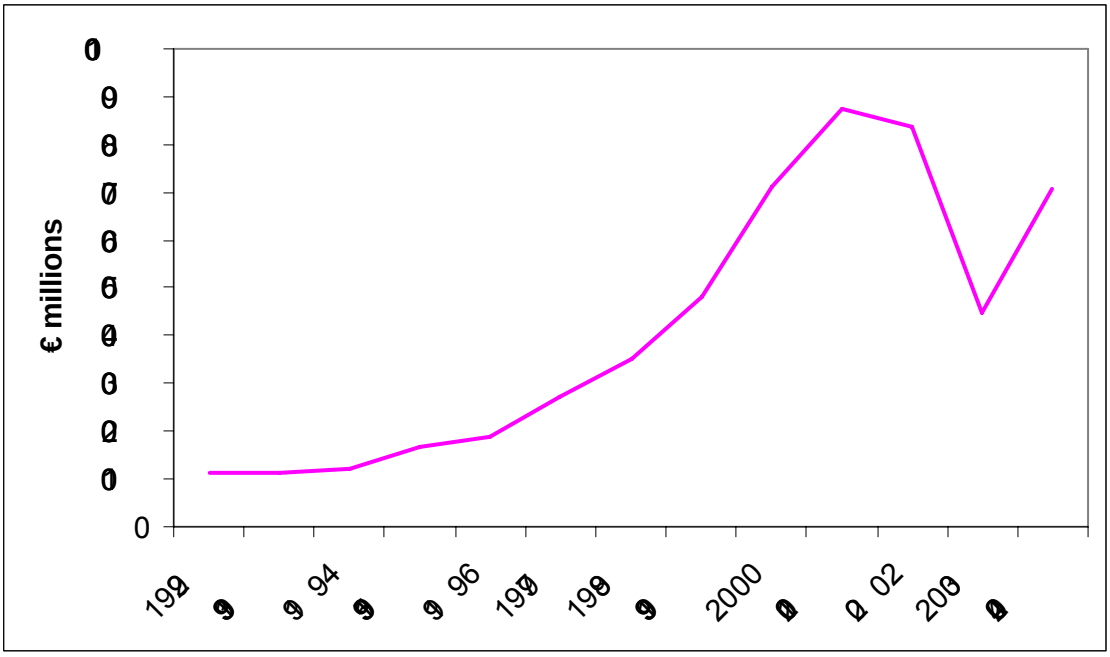
	2000	2001	2002	2003	2004	2005	2006*
Number of domestic M&A's	0	2	1	2	1	0	0
Number of EU M&A's	4	1	0	2	1	0	0
Number of third country M&A's	0	1	0	1	0	0	0

*Source: ECB * first half*

[1]

2.12 The level of trade in non-insurance financial services in 2004 was 25 per cent higher than in 1997.

Figure 2.4: Dutch trade in non-insurance financial services including banking and financial auxiliary activities (in € millions)



Source: Eurostat

Prices

2.13 Figure 2.4 gives total non-insurance financial services trade for 1992-2004. Trade in 2004 was some 25 per cent higher than that in 1997, after a period linked to the financial boom of the last years of the twentieth century.

2.14 According to the Dutch Competition Authority the banking sector is characterized by a high risk that market forces will not operate effectively enough. There remain a number of barriers to entry; and prices do not respond to changes in supply and demand which are sometimes caused by excessive regulation. It appears that households and companies in the Netherlands are charged higher banking rates than in Belgium, France, Germany, Spain and the United Kingdom. The Authority's study also shows that changes in relevant costs are translated only to a limited degree into changes in the rates charged to customers.

Consumer protection

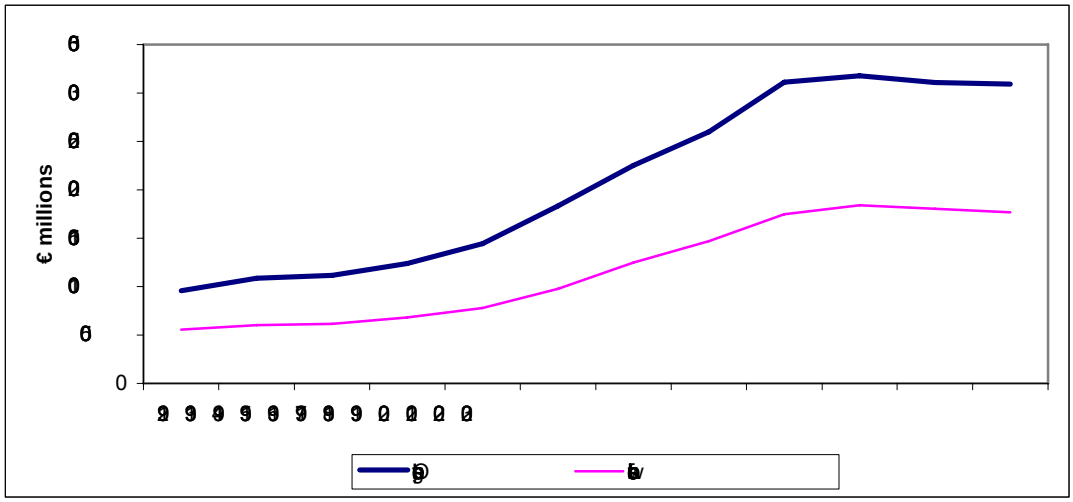
2.15 The Dutch Competition Authority claims that there are product linkages in the Dutch banking market, which may result in barriers to switching. This may have a negative effect on competition within the sector, and thus on consumer protection. These linkages may be present even for individual accounts and give rise to switching barriers.[1]

[1]

Competitiveness

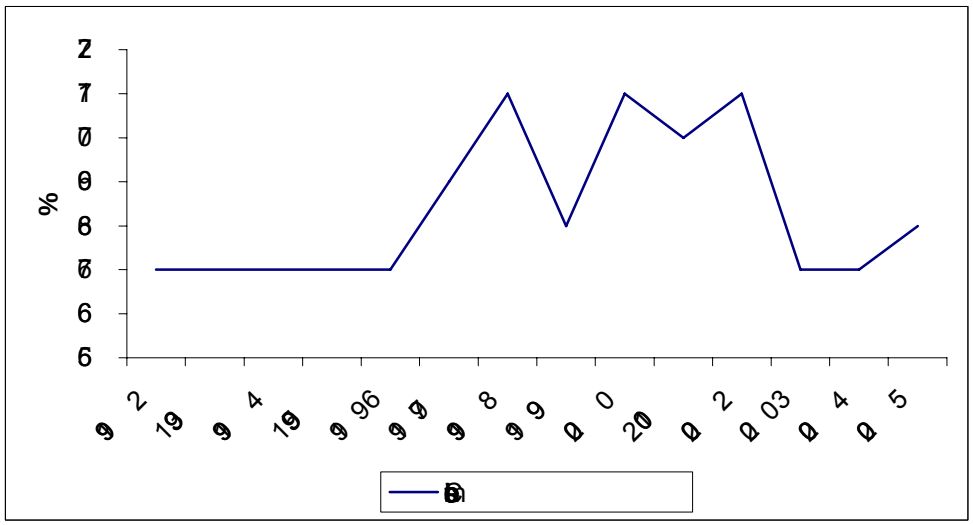
2.16 Over the last 25 years, the level of competitiveness of Dutch banks has not significantly changed compared to other European countries. Since 1990 the ratio of operating expenses to income has varied between 0.67 and 0.71. This range of variation 0.04 has been much smaller than the EU average of 0.28.

Figure 2.5: Operating and labour expenses



Source: OECD

Figure 2.6: Cost-to-income ratio (expressed as a %)



Source: OECD; Europe Economics

Table 2.5: Key performance indicators of the banking sector (%)

	Net interest margin[a]	ROA[b]	ROE[c]
1993	1.8	0.7	15.9
1994	1.9	0.7	15.2
1995	1.9	0.8	15.8
1996	1.9	0.8	16.0
1997	1.8	0.7	15.6
1998	1.7	0.6	14.3
1999	1.7	0.8	17.9
2000	1.6	0.7	17.2
2001	1.5	0.6	15.2
2002	1.5	0.4	11.5
2003	1.5	0.6	16.0

a: Net interest income to average total assets.

b: Net income before tax to average total assets.

c: Net income before tax to average capital and reserves.

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

Factors specific to the Netherlands:

2.17 The following factors appear to be unusual features of the Dutch banking sector:

(a) The banking sector suffered (and still suffers) from a lack of competition due to the presence of significant barriers to entry that have led to the Netherlands having the highest degree of concentration among the EU15.

(b) There seems to be a large number of financial conglomerates in the Netherlands[1] relative to the size of the country.

2.18 Nevertheless, the Netherlands is one of the founding members of the EU and has traditionally been involved in setting the policy agenda of the Union.

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

Assessment by category

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

2.19 The Dutch Competition Authority has reported that between January 2000 and May 2005, a total of 29 Dutch commercial banks with a legal entity in the Netherlands successfully applied for a licence. Some 195 non-Dutch EU banks made official notification to the Dutch Central Bank, but only 11 opened a branch office in the Netherlands. Of the remaining 184 commercial EU banks, only three were registered with the Chamber of Commerce or had a website in the Dutch ".nl" domain. In other words, out of the 195 non-Dutch EU banks that could have entered the Dutch banking market, only 14 did so. Incidentally, also in this period not a single bank from outside the EU was issued with a licence to set up a branch office in the Netherlands. Such factors suggest that the Dutch banking market still has some way to go to become integrated with those of other EU member states.

2.20 In 2004 the FSM interviewed various parties who had entered or exited Dutch financial markets in recent years. Entries and exits occur on a relatively limited scale in many market segments in the Dutch financial sector, and new entrants are able to acquire a substantial market share only in occasional cases. Market positions appear to be stable, in that the same players dominate the market year to year. The competitive pressure exerted by new entrants is therefore limited by the remaining barriers to entry and expansion. There are further barriers to entry, including access to sales channels, the limited switching behaviour of customers and image. These may make it more difficult for foreign entrants to enter the Dutch banking sector.

2.21 From the lack of foreign entry arising from remaining barriers, it appears that the FSAP has only had a limited impact, if any, on the degree of openness of the Dutch banking market to foreign firms.

Competition

2.22 Consolidation was expected to be a natural concomitant of the early period following the introduction of the euro. As discussed in the main report, our econometric modelling suggests that the FSAP may possibly have reduced the extent to which the euro drove consolidation. However, in the case of the Netherlands such tendency appears to have been relatively limited.

2.23 Figure 2.3 and Table 2.1, which illustrate the CR5 and the concentration ratios in the Dutch banking sector, suggest that since 1998 the relatively high level of concentration in the Dutch banking market has increased.

2.24 Table 2.2 illustrates the level of concentration given by the Herfindahl-Hirschman index. Since 1999, the Herfindahl-Hirschman index has very slightly increased from 1700 (in 1999) to 1796 (in 2005). In other words, the level of concentration in the Dutch banking sector is bordering on “high”. Unless there is considerable price rivalry between large firms in a highly concentrated market, there must be concern that competitive pressures might be limited.

2.25 As we discuss below, in recent years Dutch banks have become more efficient (perhaps partly reflecting the consolidation illustrated above). In theory, in the case of a competitive market, one might expect efficiency gains to be passed on to consumers in the form of lower prices if, prior to such efficiency improvements, banks were not making profits commensurate with risk. However, once profits recover to reflect proper risk, additional efficiency gains should be passed on to customers through lower prices. According to the Dutch Competition Authority this has not happened. If so, that would appear to be an indicator that competition is not fully effective.

2.26 Given that concentration has increased and that cost reductions seem not to have been passed on to consumers, our conclusion is that, so far, the FSAP measures do not appear to have materially enhanced competition in the Dutch banking sector.

Employment

2.27 As discussed earlier, there has been a slightly rising trend in employment in the banking sector since the mid 1990s. It is too early to state whether the FSAP contributed to this rising trend.

Competitiveness

2.28 As discussed above, costs appear to have fallen without corresponding falls in income. Thus competitiveness may have risen.

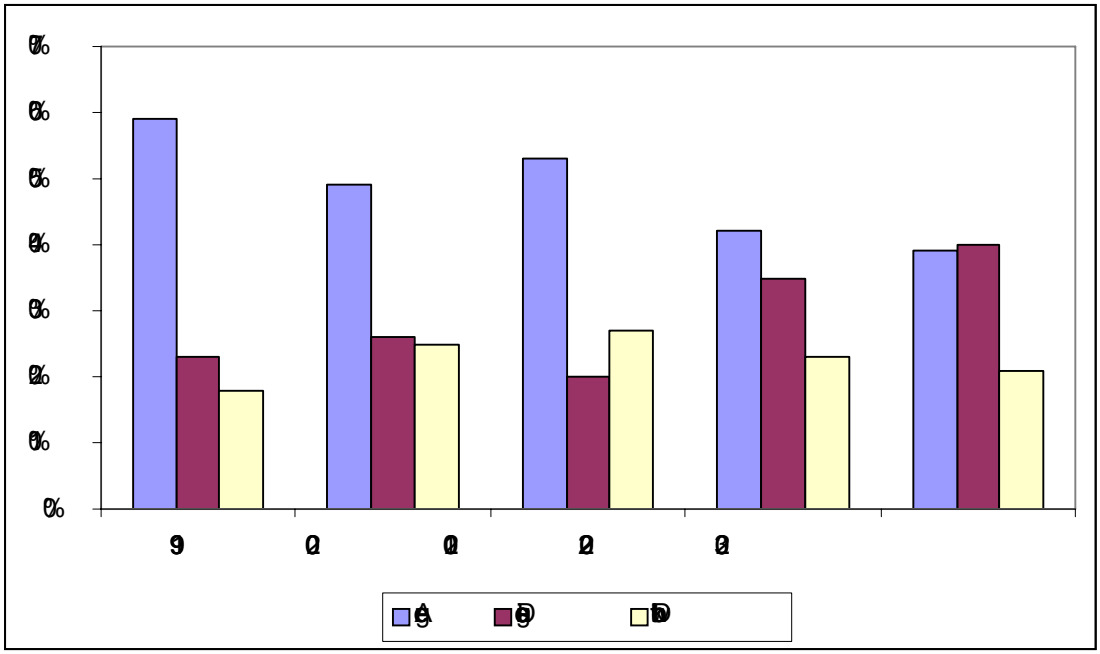
2.29 As illustrated in Figure 2.6, there has been a fall in cost-to-income ratios during the period of the FSAP (though also some volatility). It seems reasonable to attribute this to cost-reducing consolidation, as evidenced by increasing concentration in the industry. Since we do not attribute increased concentration to the FSAP, we likewise do not credit the FSAP with the associated efficiency improvements.

2.30 In short, we find limited, if any, effect of FSAP on competitiveness.

Consumer protection

2.31 Figure 2.7 shows that the share of consumers who feel adequately protected in the financial services markets has continuously and considerably declined since 1999 (from 60 per cent to 40 per cent), with the exception of 2001 where the percentage of consumers who felt protected rose from 48.9 per cent to 54 per cent. So far, the implementation of the FSAP has not improved the perceptions of consumer protection.

Figure 2.7: Percentage of agreement and disagreement with the statement "Consumer rights are adequately protected in relation to financial services"



Source: Eurobarometer

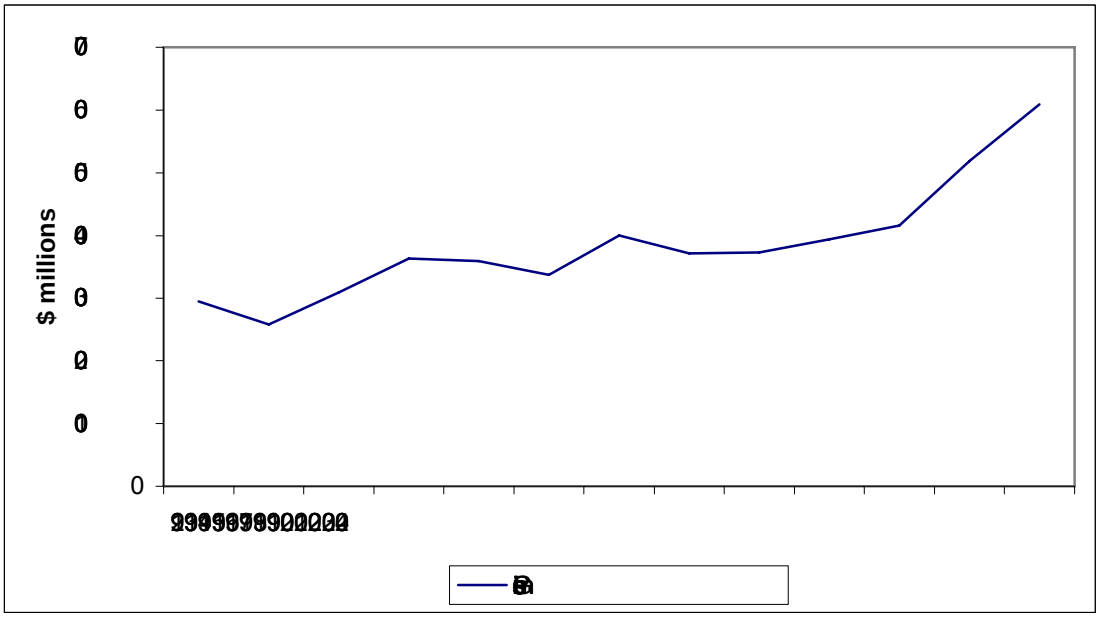
3 INSURANCE

The Dutch Insurance Sector

Turnover

3.1 Figure 3.1 illustrates that the level of gross premiums in 2004 was nearly double the level in 1997.

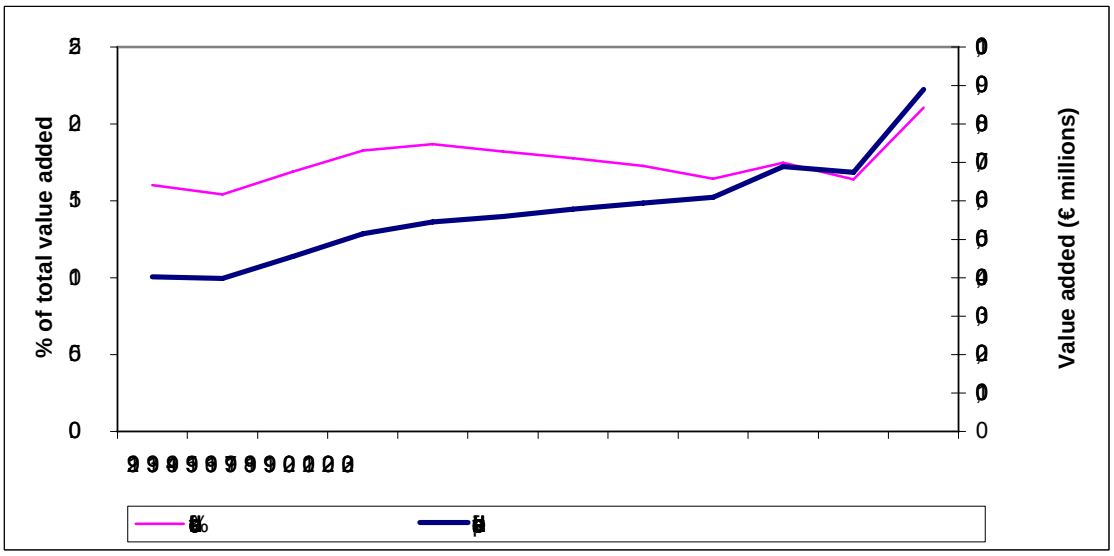
Figure 3.1: Gross premium income in the insurance and pensions sector



Source: University of Groningen

3.2 Figure 3.2 below sets out value added in absolute and relative terms. Both values have followed an increasing trend, with the insurance sector growing to account for 2.1 per cent of GDP in 2003.

Figure 3.2: Value added of Dutch insurance



Source: University of Groningen

Concentration

3.3 Table 3.1 reports concentration ratios for life and non-life insurance markets. The rates in the two markets are different and cover different time periods. But it is clear that the non-life insurance market is less concentrated than the life insurance market[1].

Table 3.1: Concentration rates in the life and non-life insurance markets

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Non Life (C4)	na	na	na	na	35	35	35	35	37	42
Life (C5)	64	63	63	61	60	59	58	66	na	na

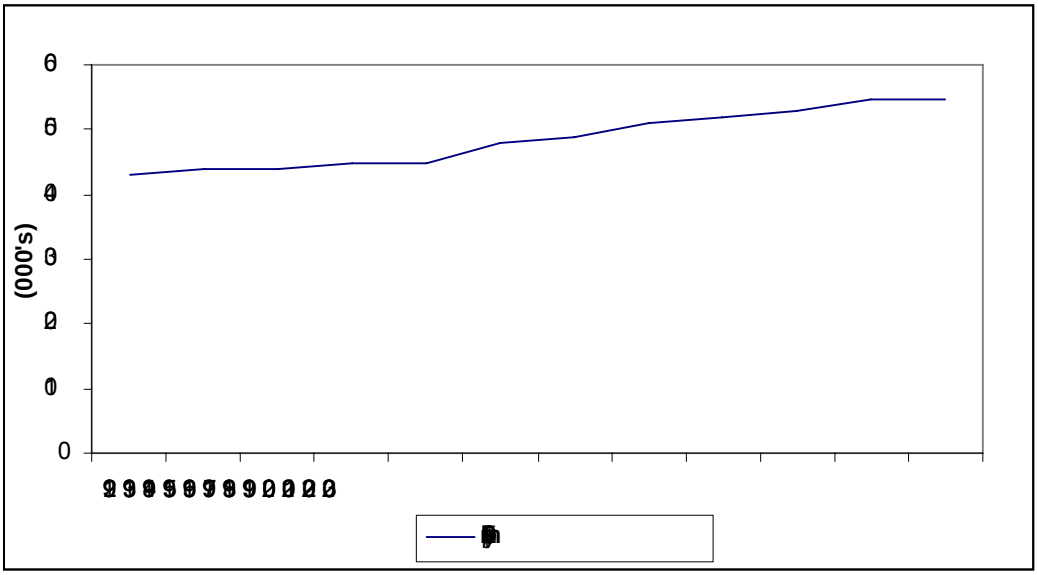
Sources: Assurantiemagazine jaarboek 2003 and RNB. Na represents missing data from time series.

3.4 Both the number of insurance companies and the share of insurance premium as a percentage of GDP appear to have remained fairly stable in the past decade.

Employment

3.5 Figure 3.3 illustrates a steady increasing trend in employment in the insurance sector since early 1992.

Figure 3.3: Employment in the insurance and pensions sector 1992–2003



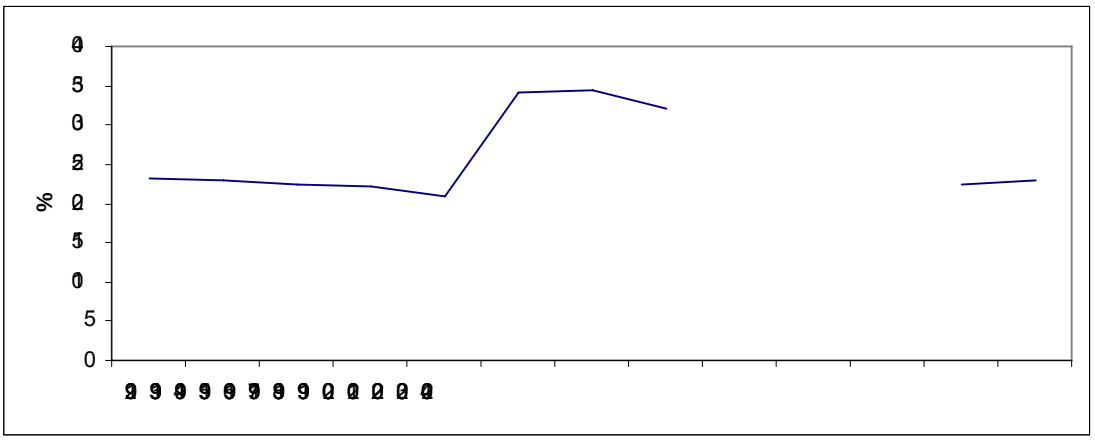
Source: University of Groningen

International entry

3.6 Following a decade of low-to-medium foreign participation, the Dutch insurance market is now characterised by a strong presence of foreign undertakings. As illustrated in Figure 3.4, in 2004 15 per cent of the Dutch insurance market was controlled by foreign undertakings.

3.7 The sharp increase in gross premiums of branches or agencies of foreign undertakings in 2004 may have been caused by a number of mergers and acquisitions that involved foreign players.

Figure 3.4: % of domestic market share of branches/agencies of foreign undertakings

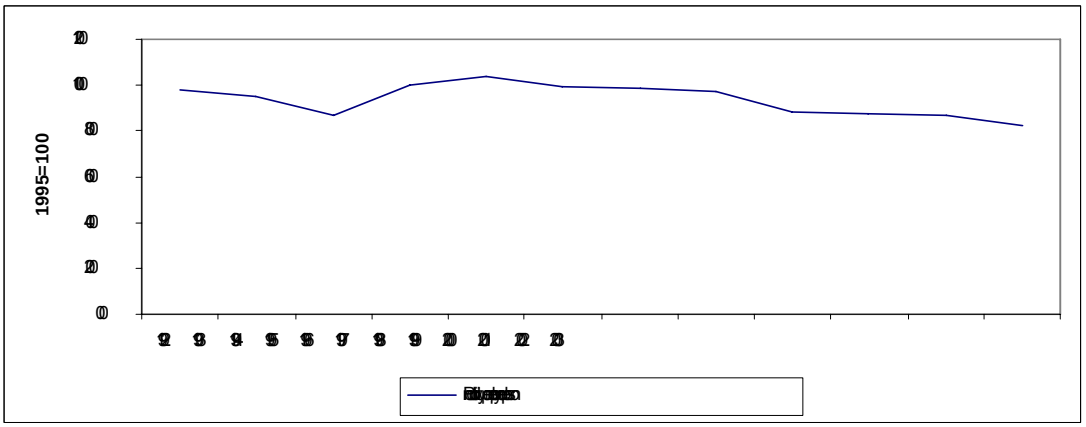


Source: OECD[1]

3.8 It is worth noting that the introduction of FSAP coincides with the reversal of a declining trend. Figure 3.4 shows that since 1998 foreign participation in the Dutch insurance market has increased constantly from 4 per cent to more than 15 per cent. The introduction of the FSAP may have been a factor in this steep rise.

Competitiveness

Figure 3.5: Labour productivity (per worker) in the Dutch insurance sector (1995 = 100)



Source: University of Groningen

3.9 Since 1998, productivity has been slowly and constantly decreasing.

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

Assessment of impact by category

Market entry, cross-border business, and takeovers

3.10 Figure 3.4 suggests that since the implementation of FSAP, there has been a marked increase in the number of foreign undertakings in the Dutch insurance market.

3.11 Since the Netherlands is one of the founding members of the EU, it is likely that the insurance sector was already integrated at a regional level, prior to the implementation of the FSAP. The increasing trend in foreign penetration may be attributable to a greater EU-wide tendency to engage in cross-border business, which in turn may well be related to the implementation of the FSAP.

Competition

3.12 In theory, the increase in market openness resulting from a rise in cross-border activity should have a spill-over effect on competition, whether in the form of active competition or (foreign) contestability. In the case of the Dutch insurance sector, the theoretical mechanism appears to work in practice. Indeed, the rise in the degree of openness in the Dutch Insurance market triggered by the implementation of the FSAP has increased the level of competition in the sector. Therefore we may conclude that the FSAP has had a slightly positive impact on competition in the Dutch Insurance sector.

Competitiveness

3.13 The slight acceleration in the decrease in productivity highlighted earlier may well be related to the burden of compliance costs that insurance companies have had to cover in order to apply the FSAP directives. In the short term, the implementation of the FSAP has had a negative impact on competitiveness. However, in future, as compliance costs are absorbed, efficiency scores may rise. Thus FSAP may yet have a positive impact on the level of competitiveness.

Employment

3.14 Since the level of employment in the Dutch Insurance sector has been following a constantly increasing trend, since the early 1990's (well before the FSAP), it may not be attributable to implementation of FSAP.

Product variety, e-commerce, and prices

3.15 According to MKB Nederland, the umbrella organisation of SME's, companies have been confronted in past years with considerable increases in premiums.

3.16 Research was carried out by Statistics Netherlands into the innovativeness of the entire financial sector relative to other sectors. The research was carried out in 1998, to provide a starting point for the evaluation of the FSAP. Results show that there is fairly little innovation in the financial sector. The number of companies that launched new products on the market is fairly small: 17 per cent as opposed to 48 per cent in industry as a whole and 21 per cent in the all-companies sector. Turnover obtained from these new financial products is fairly small. The companies with new products obtained 17 per cent of their turnover from the new products, as opposed to 30 per cent in industry and 27 per cent in the all-companies sector. Companies in the financial sector referred to long lead times for the development of products as a bottleneck.

3.17 Starting from this low benchmark, it is likely that through introducing more foreign competition, FSAP will have a positive effect on the innovation process in the insurance sector.

Consumer protection

3.18 Using linkages similar to those applied in the banking sector the Dutch Competition Authority studied the choices of individuals who bought a lump-sum policy in the period between 1980 and 2003.

3.19 It concluded that the advice of insurance brokers was suboptimal in the sense that it led to consumers choosing policies with lower returns. This happened because it appeared that brokers were more inclined to sell products with the highest commissions rather than those most suited the needs of the customer.

3.20 Practices of this sort might be a factor in the decline in the perception of Dutch consumers who feel adequately protected in the financial market according to Eurobarometer data.

3.21 The FSAP measures implemented in the area of Insurance Mediation may have an effect on this behaviour.

3.22 However, according to the same authority, the majority of complaints received by the Dutch Ombudsman relate more to the refusal by insurers to pay out claims than to the presence of switching costs.

3.23 We may perhaps tentatively conclude that the impact of the FSAP on consumer protection may have been slightly negative, since with the changes that the FSAP has brought about, consumers now feel less confident about their rules and their rights as purchasers of insurance products. This loss of confidence may leave them more open to exploitation.

4 SECURITIES MARKETS

Dutch Securities Market

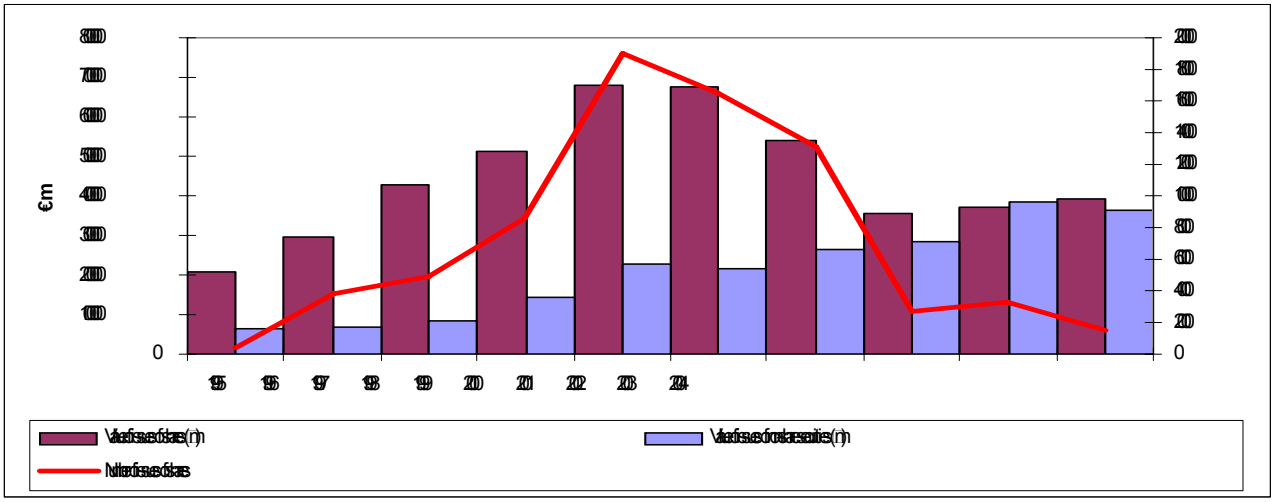
4.1 The Netherlands has a long tradition in financial markets. Amsterdam emerged as the most important financial centre of the 16th century and was the first exchange where stocks rather than securities were traded.

4.2 The modern Amsterdam Stock Exchange Association was founded in 1851 to regulate stock trading. It required membership to trade on its floor. In 1997, the Association abandoned its membership model and merged with the European Options Exchange, launched in 1978, to emulate the Chicago Board Options Exchange.

4.3 On 22 September 2000 the new company (Amsterdam Exchanges) became part of what is now the fifth biggest exchange in the world, i.e. Euronext.

4.4 With specific regard to the Amsterdam Exchange, the number and value of stock issues have increased significantly since 1995 and peaked, as in other European countries, around the time of the millennium (see Figure 4.1). The issuance activities decreased in the subsequent years before recovering slightly more recently. On the contrary, the value of non-stock securities issued has increased steadily and substantially over the past decade.

Figure 4.1: Number and value of security issues

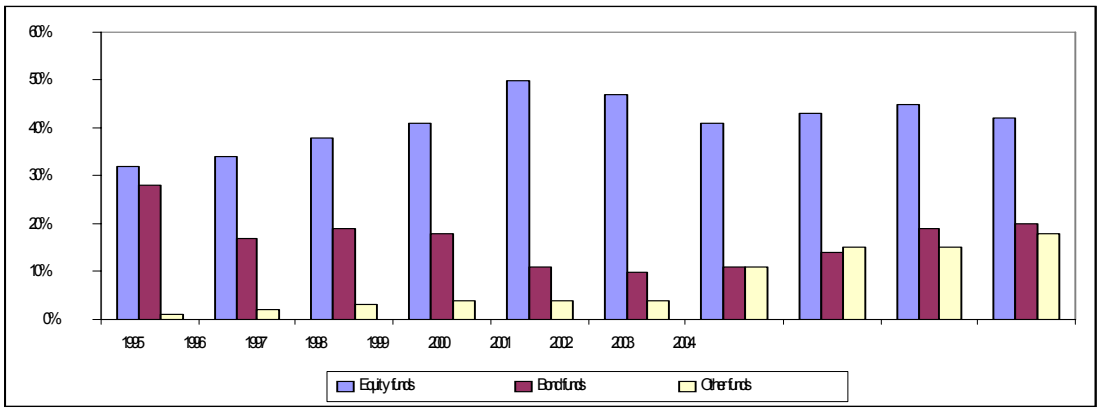


Source: DNB

4.5 Figure 4.2 shows the structure of investment institutions by type of institution. It reveals that equity funds have become less important since 2000 while real estate and other funds have increased their share. Money market funds have almost disappeared.

4.6 The primary role of money market funds is that of coping with exchange rate risk. Thus it is likely that this effect is due to the introduction of the euro rather than to FSAP measures.

Figure 4.2: Structure of investment institutions by type



Source: DNB

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

Cross-border activities

4.7 As we described above the Dutch securities market experienced a period of increased integration during the early 2000's.

4.8 Respondents to our own survey took the view that what really made integration possible was the ISD directive that kick-started the process allowing investors in different parts of the European Union to operate more easily in other countries. We can conclude that, so far, the FSAP has had no impact on the openness of the securities market to foreign firms. However, our view is that since there remain many EU countries that are not involved with the Euronext exchange, further implementation of the FSAP measures should have a positive effect, if only small, on cross-border activities, by facilitating Dutch penetration in those countries.

4.9 Our econometric study suggests that the impact of the FSAP on trade has been a rise of 1.3 per cent in imports of financial services other than insurance and pensions, and a rise of 1.6 per cent in exports. Full implementation of the FSAP is projected to lead to a further 1.0 per cent rise in imports and 2.0 per cent in exports.[1]

Competition

4.10 An increase in cross-border activity and trade should of itself enhance the level of competition in the Dutch 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 Dutch securities 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 Dutch securities sector.

4.11 As illustrated in Figure 4.3, the level of employment in the Dutch securities market continuously increased between 1992 and 2000. Since 2001 it has remained relatively stagnant. This may simply be a bear-market effect.

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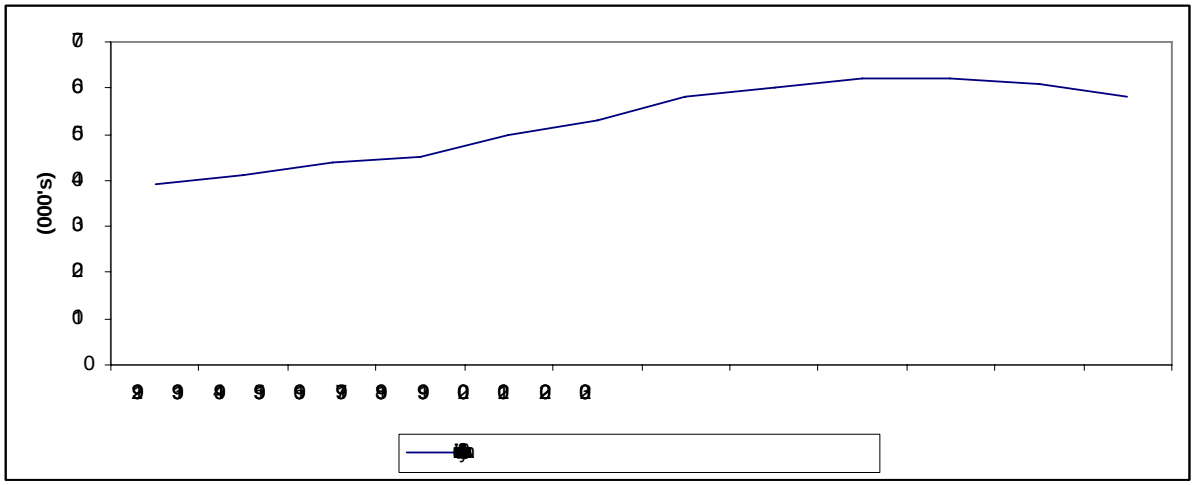
[1]

Employment

Figure 4.3: Employment in the activities auxiliary to financial intermediation (000's)



Source: University of Groningen

4.12 So far, it is difficult to draw a definitive conclusion about the impact of the FSAP on the level of employment in the Dutch securities sector. However, one might suggest that in the medium 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

4.13 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 Dutch securities market.

Consumer protection

4.14 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Dutch 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 Dutch securities market; but if more inexperience market users were to use that market, the FSAP might have a positive impact.

Other objectives of the FSAP in the securities sector

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

4.16 As regards increases in the volume of trade, both in the past and in the future, the most likely scenario is that it will increase. However, it is widely considered that that this would have happened even without the implementation of FSAP.

4.17 A very similar picture emerges of the patterns followed by the exchange of stock and derivatives across national borders: in other words, the increase achieved in recent years and the further increase envisaged for the future cannot be attributed to FSAP. Indeed, a merger of Euronext with the NYSE seems likely to increase the ease of international transactions.

5 FINANCIAL CONGLOMERATES

5.1 In the current Dutch regulatory regime for financial conglomerates, the separate requirements that apply to banks, securities firms, and insurance firms apply to financial conglomerates as if they were independent, undiversified institutions. However, there are various rules about organizational structure that apply to financial conglomerates as whole entities.

5.2 Historically, as in most countries, supervision in the Netherlands has been organized along sectoral lines. As we have recorded, banking supervision resided at the central bank, de Nederlandsche Bank (DNB), the Pensions and Insurance board (PVK) was responsible for the pension and insurance industry, and the Securities Board (STE) was responsible for the securities firms and the exchanges. As early as 1990, however, supervisors realized that the changing financial landscape necessitated closer cooperation. To this end PVK and DNB signed a so-called Protocol in which the two supervisors agreed to coordinate the supervision of banks or insurance companies in conglomerates. The Protocol contains, *inter alia,* a requirement for financial conglomerates to report on group solvency, risk concentration and intra-group transactions.

5.3 It recently became evident that even closer coordination was needed. Thus, since September 2002 a new structure of financial supervision (the Authority for the Financial Markets, AFM) has been in place. It is no longer primarily organized along sectoral lines but along functional lines. This function-based model closely mirrors developments in some other countries, where there are also moves towards a more cross-sectoral supervisory model.

5.4 However, it might be argued that the AFM, as a unified financial regulator, is itself a response to the complexities of financial conglomerate regulation. A single financial services sector authority is better placed to regulate conglomerates whose business may cover a wide domain of services. The alternative of single sub-sector regulators may find it increasingly difficult to disentangle the practices of financial conglomerates.

5.5 The definition of financial conglomerates used previously in the Netherlands was stricter than currently: any combination of banking and insurance would qualify as a financial conglomerate.

5.6 The new Dutch model of regulation distinguishes between prudential and market-conduct supervision. The former focuses on the financial soundness of an institution, and the latter aims to promote proper relations between market participants, consumer protection and the transparency of processes in the financial market.

5.7 Financial conglomerates operating in the Netherlands are listed in Tables 5.1 and 5.2 below.

Table 5.1: Financial conglomerates headquartered in the Netherlands

Name	Countries in which they operate	Characterization
ABN AMRO	France, Austria, Belgium, Denmark, Czech Republic, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland Portugal, Slovakia, Spain, Sweden, UK	Banking
Eureko	Netherlands, Belgium, France, Spain, Greece, Germany, Austria, Italy, UK, Poland, Luxembourg, Romania	Banking, insurance and asset management
ING	Netherlands	Banking and insurance
Rabo-Interpolis	Netherlands	Insurance
Robein	Netherlands	Banking and Insurance
SNS-Reaal	Netherlands	Financial advice, insurance for people in health care profession

Table 5.2: Other financial conglomerates operating in the Netherlands

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Allianz	Germany	Insurance group doing asset management and banking	Insurance
Barclays	UK	Banking	Banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Banking
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
Svenska	Sweden	Universal banking and Insurance	Banking

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

5.8 At the time of writing, the EU Directive on Financial Conglomerates has not yet been transposed in the Netherlands.

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

Assessment by category

5.9 Dutch financial conglomerates have experienced steady growth over the past few years. However, this trend was already present before FSAP. Consolidation will help Dutch conglomerates to compete with their European counterparts by levelling the playing field and providing a shared set of rules.

5.10 A negative effect of the FSAP on operational costs — the cost of compliance with the new regulations over the period 1999–2005 is clearly present.

5.11 It is difficult to say what will be the effects of the FSAP on the level of cross-border transactions and on the formation of new conglomerates. It is, however, likely that the trend would have continued upwards even in the absence of the FSAP.

5.12 Respondents to our survey believe that FSAP is having an effect on the make-up of financial conglomerates. In the absence of the FSAP the number of financial conglomerates involved in the banking sector would be considerably higher. However, we caution that it is difficult to interpret this result in the absence of detailed comments from the stakeholders.

Consumer Protection

5.13 On the basis of our previous conclusions regarding the impact of the FSAP on the banking and insurance sectors, one may conclude that the FSAP may have had a slightly negative effect on consumer protection.

Competition

5.14 Based on our previous assessment of the impact of the on the banking and insurance sectors, one may establish that the FSAP has had negligible impact on the level of competition for conglomerates.

Employment

5.15 Although we do not have specific data regarding only financial conglomerates it is likely that the number of jobs have increased given that in both banking and insurance the number of employees has risen and we have seen an increase in the number of conglomerates. The FSAP may have had a small but positive effect.

6 CONCLUSION

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitive-ness**	**Employment**
Banking	Limited	Almost none	Negative in short term (perhaps less negative in longer-term)	Limited	Unclear (perhaps positive)
Insurance	Positive	Slightly positive	Unclear. Perhaps negative	Negative (perhaps positive in the future)	Limited
Securities	Perhaps small but positive in the future	Probably slightly positive in the future	Negligible	Limited	Unclear. Perhaps negative
Financial Conglomerates	Limited	Negligible	Slightly negative	Slightly negative	Limited

POLAND

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Poland

Division of responsibility

1.1 Responsibility for financial regulation and supervision of the banking, securities and insurance markets was consolidated into a single body in July 2006: The Financial Supervision Authority, KNF.[1]

Key features of banking regulation

1.2 Polish banking supervision is still regarded as too passive and there have been calls for there to be more pressure to conclude agreements with bank supervisory bodies of countries where strategic investors come from to allow stronger monitoring of capital groups where Polish banks are dependent companies.

1.3 The main pieces of legislation affecting the banking sector include the Banking Act, the Bankruptcy and Rehabilitation Act, and the Bank Guarantee Fund Law.

1.4 The most recent comprehensive amendments to Poland's Banking Act were adopted by the Polish Sejm (the lower house of parliament) on April 1, 2004. In terms of the effectiveness of banking supervision, the most significant changes relate to the capital base (regulatory capital, or "own funds"), capital adequacy and large exposures; the amendments on these questions were the only ones that did not take effect until January 1, 2005.

Key features of insurance regulation

1.5 The main legislation affecting the Polish insurance sector is the Insurance Law (1990) and (1995). In 2003, the EU sponsored a major overhaul of the Insurance Law including acts on Compulsory Insurance, Insurance Guarantee Fund, Insurance Mediation and Insurance and Pension Fund Supervision.

1.6 According to the Insurance and Pension Funds Supervisory Commission, the insurance acts were adapted in connection to Poland's accession to the EU — in particular, the Polish Act on Insurance Intermediation was adapted in December 2004 to be in accordance with the European Union Directive on Insurance Intermediation. Moreover, comprehensive works on amending the insurance law commenced in 2005.[2]

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[1] [redacted]

[2] [redacted]

Key features of securities regulation

1.7 The National Depository for Securities (KDPW) was founded in 1991 as an integral part of the Warsaw Stock Exchange. Since 1994, it has operated as an independent joint stock company. The main responsibilities of the KDPW are:

(a) registration and custody of securities in public trading;

(b) assigning identification numbers to securities admitted to public trading;

(c) keeping depository accounts for entities entitled to hold securities in KDPW;

(d) providing services for issuers and managing corporate actions;

(e) performing clearing and settlement functions for securities and cash following transaction execution; and

(f) providing a guarantee for settlement by creating and managing special funds in order to eliminate risk in transactions between market participants.[1]

1.8 The main legislation affecting the Polish securities sectors includes:[2]

(a) Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies (2005);[3]

(b) Act on Trading in Financial Instruments (2005);[4]

(c) Act on Capital Market Supervision (2005);[5]

(d) The Law on the Public Trading of Securities (last amended 2004);

(e) Act on Investment Funds (2004);

(f) Act on Bonds (last amended 2000); and

(g) Act on Commodity Exchanges (last amended 2004).

1.9 The three acts passed by the Parliament on 29 July 2005, which came into force on 24 October 2005, are a new constitution of the Polish capital market. The changes, according to the Polish SEC, aimed mainly at increasing the role of the Polish capital market in the economy.

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1 [redacted]
2 [redacted]
3 [redacted] e
4 [redacted]
5 [redacted] ,

1.10 Changes are based on three basic assumptions:

(a) stimulation of competition and liberalisation (allowing trading off the regulated market, wider forms of trading);

(b) full harmonisation with EU regulations (implementation of prospectus directive); and

(c) three acts regulating the whole capital market (primary market, secondary market and supervision are regulated separately, breakout complies better with EU rules on law-making and will facilitate further harmonisation with new EU regulations).

1.11 The financial regulatory framework in Poland has been influenced greatly by Poland's accession into the EU in 2004, and the process of bringing Polish financial regulations in line with EU standards started many years earlier.

Survey respondent views on the regulatory process of the FSAP

1.12 Key issues identified by stakeholders include:

(a) Very late availability of the official Polish language version of the CRD due to translation difficulties made implementation of that measure difficult.

(b) Despite changes taking place in legal aspects (deregulation), market practices, past institutions and pre-existing structures meant that many new possibilities were/are not exploited.

(c) Overall, the FSAP is felt to have increased credibility, improved investor confidence and enhanced co-operation with EU institutions.

(d) 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 — i.e. there is a sense of regulatory fatigue.

Factors specific to Poland

1.13 There are a number of general features of the Polish financial services industries which might be of non-trivial importance when conducting evaluation of FSAP. These include:

(a) Transition from communism since 1989. Industry, which had been state controlled, began to be privatised in the early 1990s. Prices were freed, subsidies were reduced, and Poland's currency (the zloty) was made convertible as the country began the difficult transition to a free-market economy. Reforms initially resulted in high unemployment, hyperinflation, shortages of consumer goods, a large external debt, and a general drop in the standard of living. The situation later stabilised, however, and during the 1990s Poland's economy was the fastest growing in east Europe.[1] Poland currently has the highest unemployment rate in the EU.

[1] [redacted]

(b) Accession to the EU in 2004. Poland joined the EU in May 2004, and surging exports to the EU contributed to Poland's strong growth in 2004, though its competitiveness could be threatened by the zloty's appreciation.[1] Therefore assessing the FSAP on its own would be of extreme difficulty given that Poland embodied the community Acquis in a relatively short time-span.

(c) Similar to other new Member States, the Polish banking sector is dominated by foreign investors, mostly from other EU Member States, who in combination account for around 70 per cent of total assets in the sector in 2005.[2]

(d) A relatively large agriculture sector. Agriculture is mostly privately run and was so even during the Communist years, accounting for 15 per cent of the gross national product and occupies more than 25 per cent of the workforce.[3]

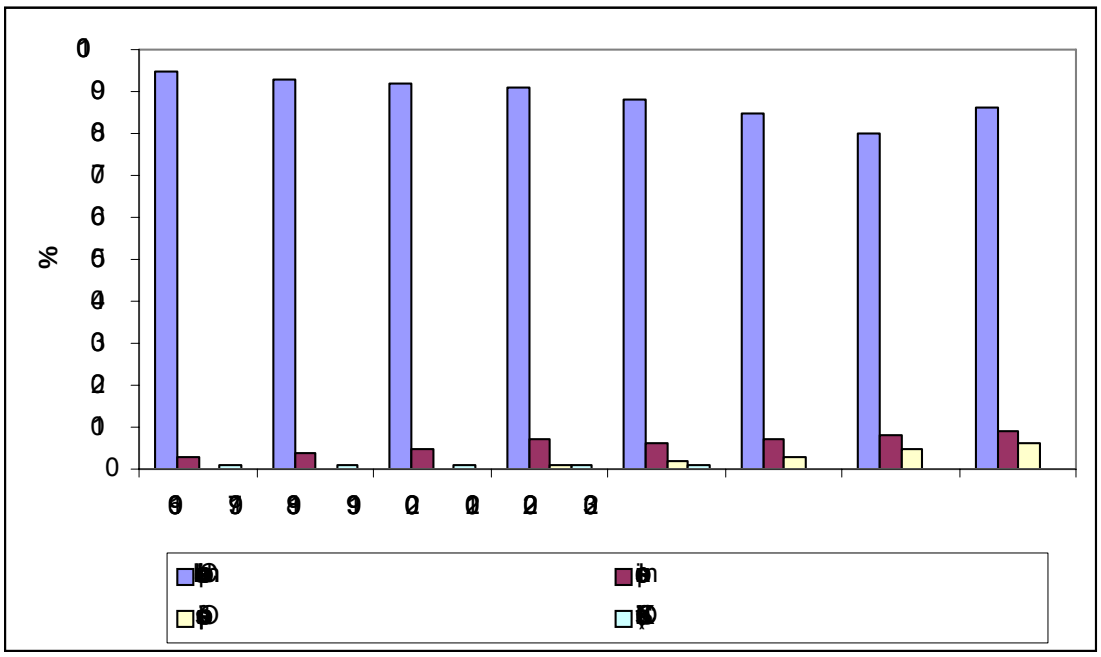
1.14 These specific factors (as well as specific industry factors) will be taken into consideration when evaluating the effects on FSAP.

[1] [redacted]
[2] [redacted]
[3] [redacted]

2 THE POLISH BANKING SECTOR

Headline Overview

Figure 2.1: The structure of assets of the Polish financial system



Source: National Bank of Poland (2004) "Financial system development in Poland 2002-2003"

Features of the banking industry

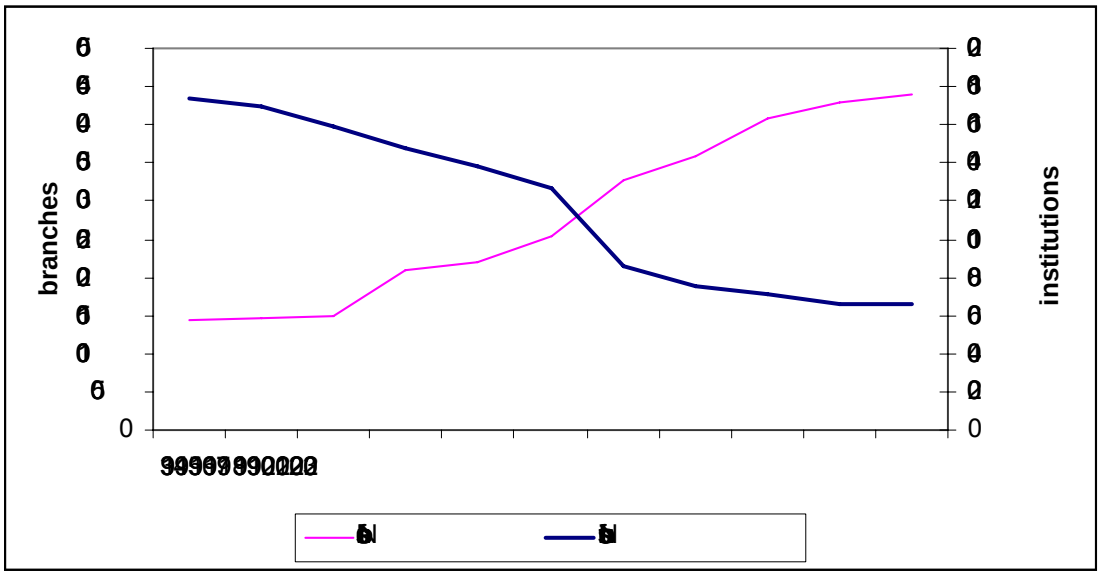
Number of players

2.1 The banking sector developed very quickly in Poland after the end of the communist regime. However specific data are only available since 1993. The reform of the banking sector was one of the key components in the reform of the Polish economy beginning in 1989. By the end of 2004, only 13.4 per cent of the Polish banking sector was state-owned.[1]

2.2 Currently there are mainly two types of banks in Poland: domestic commercial banks and cooperative banks. Although the latter constitutes the majority of banks in Poland, commercial banks dominate the sector in terms of assets (commercial banks account for more than 90 per cent of total assets, total loans to non-financial customers, total deposits taken from non-financial customers, and total capital funds). The total number of banks declined significantly from early 1990s, and most of this decrease is due to the reduction in the number of cooperative banks.

2.3 Figure 2.2 illustrates the number of branches and institutions in Poland.

Figure 2.2: Banks in Poland 1993 - 2003



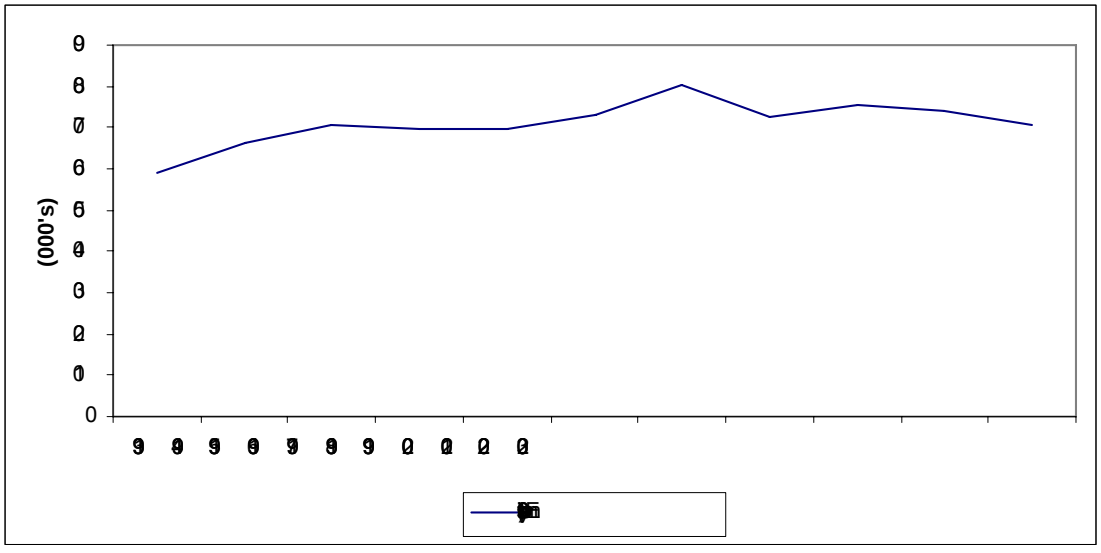
Source: OECD

2.4 However, while the number of institutions decreased sharply the number of branches followed an opposite path. This indicates consolidation in the sector with the smaller players exiting and a number of larger institutions entering the market.

Turnover, employment and profitability

2.5 Figure 2.3 illustrates employment in Polish credit institutions.

Figure 2.3: Number of employees in credit institutions 1993-2003

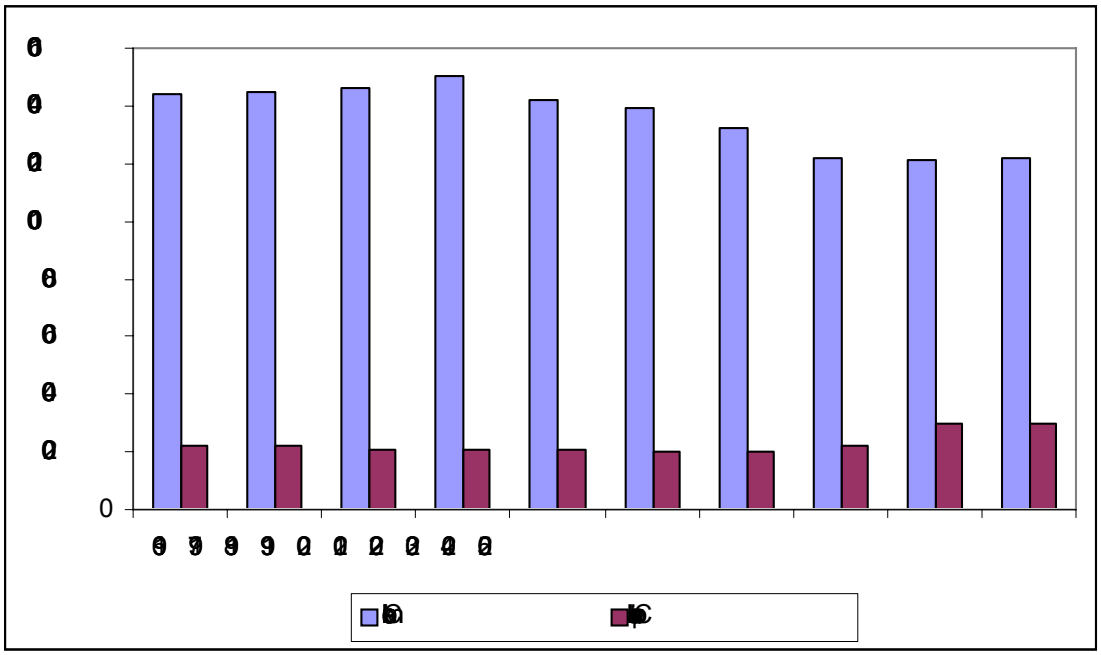


Source: OECD

2.6 Net income has grown substantially. In 1993 net income was slightly more than 5,000 millions of zloty, but had increased fivefold by 2000. In the following two years, probably because of the bear market, growth was slower.

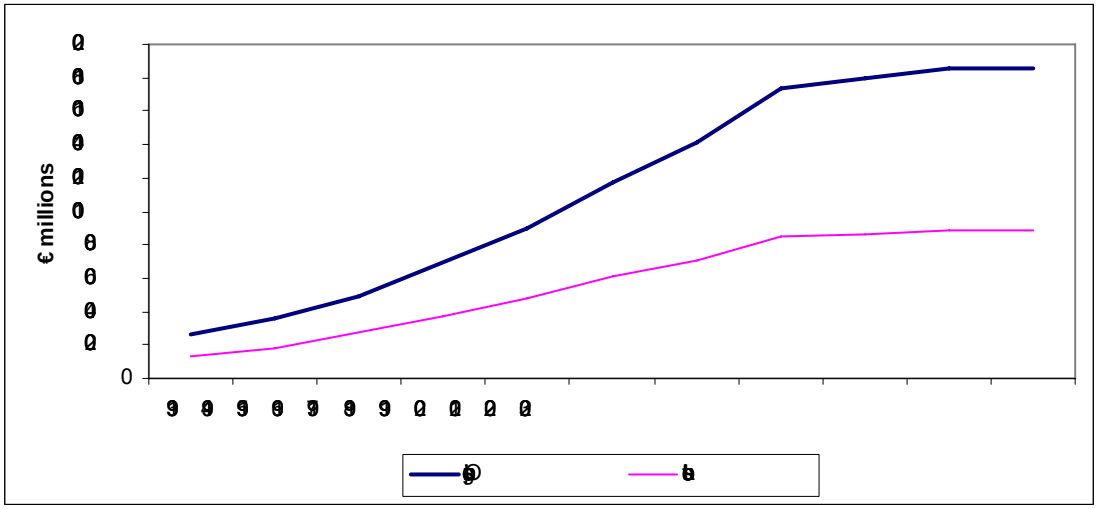
2.7 Employment in the sector rose during the 1990s, but in the early 2000s declined, somewhat. Bearing in mind the significant foreign involvement in the sector, it is perhaps of interest to note that employment in Polish banks by 2005 was lower than in 1996 (see Figure 2.4).

Figure 2.4: Staffing at Polish banks (excluding foreign offices)



Source: National Bank of Poland (2006) "Summary evaluation of the financial situation of Polish banks first half 2005"

Figure 2.5: Operating and labour costs for Polish banks 1993-2003



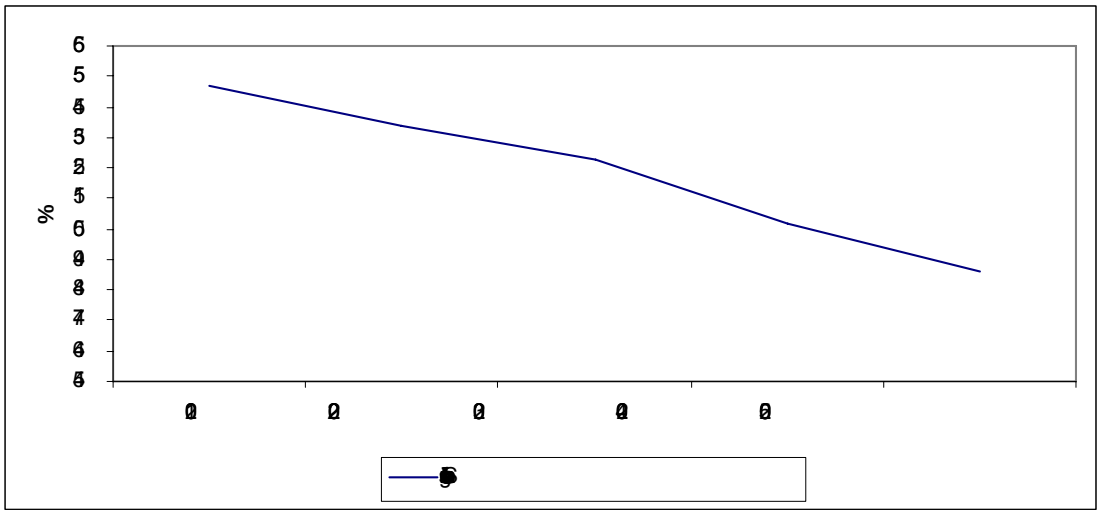
Source OECD

Market shares and concentration

2.8 According to the National Bank of Poland (NBP), the level of competition in the Polish banking sector was rather low as compared with Western European countries, given the high margins and stringent regulations.

2.9 Figure 2.6 reports the CR5 in the banking sector according to assets, loans and deposits.

Figure 2.6: Share of the largest five banks' assets (CR5) (%)



Source: ECB

Table 2.1: Herfindahl -Hirschman Index[1]

2001	2002	2003	2004	2005
821	792	754	692	650

Source: ECB

2.10 The level of concentration, in terms of the share of the largest five banks (CR5), has decreased from its peak in 2001.[2]

2.11 According to the NBP, despite the fact that the number of banks decreased in 1994–2000, the level of competition did not diminish. Moreover, empirical analysis carried out by NBP suggested that the Polish market is characterised by monopolistic competition, i.e. many market players offering heterogeneous products, but with a reasonably high level of competition.[3]

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. Some respondents to that survey took the view that the effects on the switching behaviour of bank customers have so far been negligible. However, it appears that the increased switching behaviour is more attributable to EU accession rather than to the FSAP itself.

Dimensions of price and quality competition

2.13 The survey also queried views of price and quality competition. Respondents took the view that the FSAP has had a positive effect on process — i.e. prices remained stable, rather than rising, as they would have done in the absence of the FSAP measures. It appears that efficiency improved slightly, but not because of the FSAP.

2.14 Banks in Poland offer all types of payment cards, the majority of which (95 per cent) have both payment and ATM withdrawal functions. Debit cards still dominate the market, although their share of that market is steadily declining, coming down in 2004 to 85 per cent. The share of credit cards rose from 8 per cent to 12 per cent, whereas the share of charge cards decreased to 4 per cent.[1]

2.15 While the number of payment cards keeps growing, more and more Polish banks have also started offering internet-based services, and the number of domestic offices of both commercial and cooperative banks also grew from 1,436 in 1993 to 3,705 in the middle of 2005.[2]

2.16 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

2.17 Survey respondents regard the tax regime as an advantage that Polish banks have over their foreign counterparts.

Consumer protection

2.18 The results of our survey suggest that consumer protection in Poland is widely regarded as having improved over the past five years and respondents envisage it improving further in the future.

Trade and international penetration

2.19 The path followed by the number of total and Polish-owned banks suggests that foreign players dominate the Polish banking sector.

Table 2.2: Number of non-Polish branches and subsidiaries

	2001	2002	2003	2004	2005
Number of branches of CI's from EU area	0	0	0	3	7
Number of subsidiaries of CI's from EU area	34	35	35	32	33
Number of branches of CI's from third countries	0	0	0	0	0
Number of subsidiaries from third countries	12	11	10	8	9

Source: ECB

Table 2.3: Number of Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005	2006*
Number of domestic M&A's	4	6	2	1	4	1	0
Number of EU M&A's	11	3	6	1	3	1	0
Number of third country M&A's	1	0	0	0	0	1	0

**First half only*

Source: ECB

Competitiveness

2.20 Table 2.4 reports a number of competitiveness indicators for Polish banks.

2.21 The profitability and performance indicators of the banking sector were highly sensitive to changes in the economic climate, according to the NBP. In 2002, they decreased considerably due to "the deterioration in the quality of the banks' loan portfolio", while a year later, "an improvement in the economic climate and the banks' actions resulted in the improvement of most profitability and performance indicators".[1]

[1] [redacted]

Table 2.4: Key performance indicators of the Polish banking sector

	Net interest margin[a] %	Cost/income ratio[b]	ROA[c] %	ROE[d] %
1997	5.6	55.0	2.1	34.1
1998	4.8	62.2	0.7	9.1
1999	4.2	63.2	1.0	12.9
2000	4.2	62.3	1.0	14.2
2001	3.7	61.6	1.0	13.1
2002	3.4	63.9	0.5	5.8
2003	3.2	68.2	0.5	5.8
2004	3.3	65.1	1.4	17.2
2005[e]	3.3	59.6	1.7	21.5

a: Net interest income to average total assets less interest due and outstanding on irregular assets.

b: Ratio of operating expense (general expense and depreciation) to net income from banking activity, adjusted by net income / expense on other operating activity.

c: Net earnings to average total assets less interest due and outstanding on irregular assets.

d: Net earnings to average core capital.

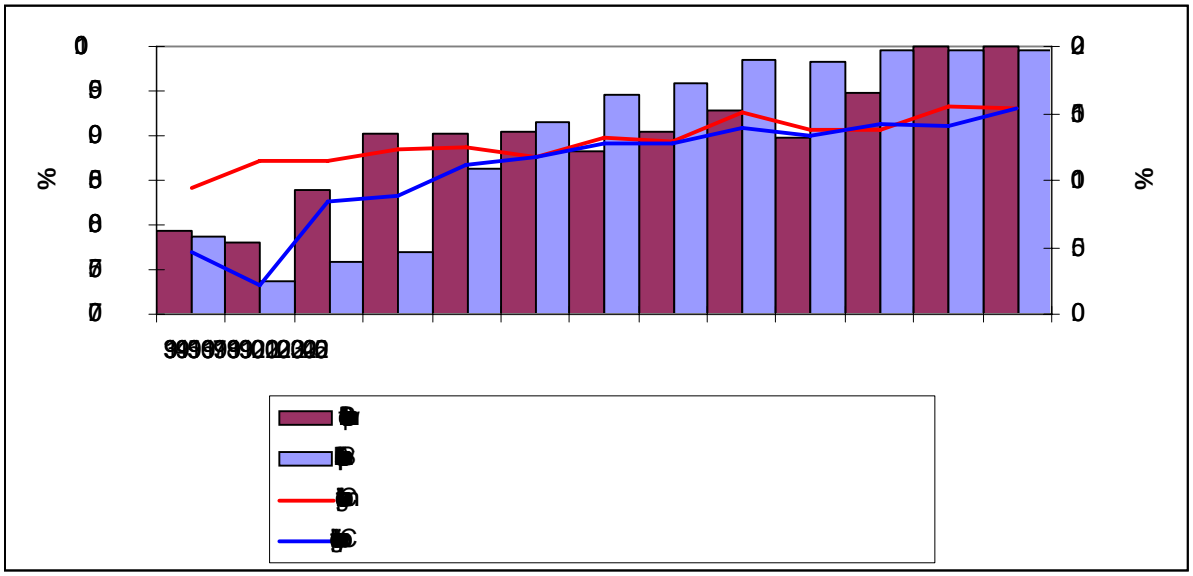
Source: National Bank of Poland (2006) "Summary evaluation of the financial situation of Polish banks first half 2005"

2.22 It is difficult to say whether the Polish banking sector has become more efficient or competitive since 1999, as the performance of banks heavily relies on macro-economic conditions. However what is clear is the presence of a negative trend for the majority of indicators with a recovery in the year 2005.

CRD

2.23 The capital adequacy in the Polish banking sector has improved greatly since the early 1990s, which has been evidenced by the significant increase of both the share of banks with adequate risk-based capital ratio (above 8 per cent) and the average risk-based capital ratio in the banking sector. In particular, now all domestic commercial banks and more than 99 per cent of cooperative banks have capital ratios above 8 per cent, as required by both Basel I and Basel II.

Figure 2.7: Risk-based capital ratio (%)



Source: National Bank of Poland (2006) "Summary evaluation of the financial situation of Polish banks first half 2005"

2.24 There have been some accounting principle amendments in 2005, which had, "in principle, the neutral impact on the size of commercial banks' funds", according to NBP.[1]

Impacts of the FSAP and FSWP Legislative Measures on the Polish Banking Sector

Assessment by category

Cross-border activities

2.25 While Poland has been relatively open from the early 1990's there appears to have been an increase in the level of cross-border activity since the inception of the FSAP. While the number of subsidiaries from other EU state undertakings has not increased significantly the number of branches of CI's has. This is likely to have been the case for a number of reasons including:

(a) Poland is one of the more successful transitional Member states and this in itself would have tended to increase the level of cross-border activity independent of the provisions of the FSAP. These factors would have included, price liberalization, trade liberalization, privatisation, the removal of state subsidies, and the enhancement of property rights, to name but a few.

(b) The 'single passport' granted by EU accession has removed the remaining obstacles to foreigners operating in the Polish banking sector through the setting up of branches.

(c) The removal of technical and regulatory barriers to trade facilitated by the transposition of the FSAP directives into national legislation should also have served as an impetus to increasing the level of cross-border activities. The FSAP is also likely to have contributed to more cross-border activity through improving the strength and credibility of the institutional framework of the banking sector.

2.26 Overall, while the growth in the level of cross-border activity has partly been driven by factors other than those to do with the FSAP, it appears that the positive effects of the FSAP cannot be totally divorced from this.

Competition

2.27 To the extent that the increase in the level of cross-border activity has increased the level of contestability in the market, and therefore the intensity of competition, it would appear that the FSAP has played a positive role in this.

2.28 Figure 2.6 illustrates that the concentration of Polish banking has decreased a little in recent years. We have also provided data that suggest there may have been some consolidation in the sector with a number of foreign players expanding their position. Concentration is not high by EU15 standards. It may well be the case that the FSAP, coupled with market players' expectations on Poland accession to the EU, has had an effect in bringing foreign players in the Polish market.

2.29 Additionally, It appears that Polish 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 to consumers in the form of lower prices if, prior to such efficiency improvements being made, banks were not making profits commensurate with risk (which, given the risks connected with the transition from a planned to a market economy, seems potentially relevant). However, once profits have recovered to properly reflect risk, 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 yet.

2.30 It may be interesting to note however, that 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).

Employment

2.31 Figure 2.3 illustrates a decrease of around 10 per cent in employment in the banking sector over the period of the FSAP. However, the trend seems to have started before the FSAP and followed a period in which employment had risen by 50 per cent in less than five years (from 120,000 to nearly 180,000 people employed). It seems natural to suppose that external factors were driving the trend and the FSAP might have had a secondary effect: Accession to the EU in 2004 (incorporation of the Community Acquis and adaptation to the Internal Market) is clearly another important factor.

2.32 Respondents to the survey carried out by Europe Economics have the view that the FSAP had no effect in the past on the level of employment but that a sizeable positive effect is likely to take place in the future.

2.33 However, in moving towards the establishment of a EU regional market in banking, the level of intra-industry trade is likely to increase and thus so too should the level of employment in this sector. To the extent that the transposition of the FSAP directives have helped to facilitate this increase in intra-industry trade, it would appear that that FSAP should have a positive effect on employment.

2.34 Overall, however, it would appear that the effects of the FSAP on employment are unclear.

Consumer protection

2.35 Respondents to our survey took the view that although consumer protection is perceived to have improved over recent years, the FSAP is not considered a factor in this. It is perhaps no surprise that an economy that experienced a communist regime up to less than twenty years ago has seen improvements in consumer protection and that the perceived effect of measures such as the FSAP appear small compared to transition effects.

2.36 Our view is that, notwithstanding this caveat, the FSAP is likely to have had some positive effect on consumer protection in Poland over the last few years.

2.37 As noted earlier, the Polish authorities have been criticised for being too passive with respect to banking supervision. Thus, it would appear that there is some scope for fostering greater credibility in the supervisory regime through the effects of the FSAP, and thus further enhancing consumer protection.

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

2.38 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.

2.39 The FSAP appears to have had a direct effect on this already, especially in favouring relationships with foreign players.

2.40 As discussed above it appears that the main form this has taken in practice is for foreign entrants to have come in, rather than Polish institutions to form alliances or developing their network abroad.

2.41 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 participation of Polish banks in the EU market, also.

2.42 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.[1]

[1] [redacted]

3 INSURANCE

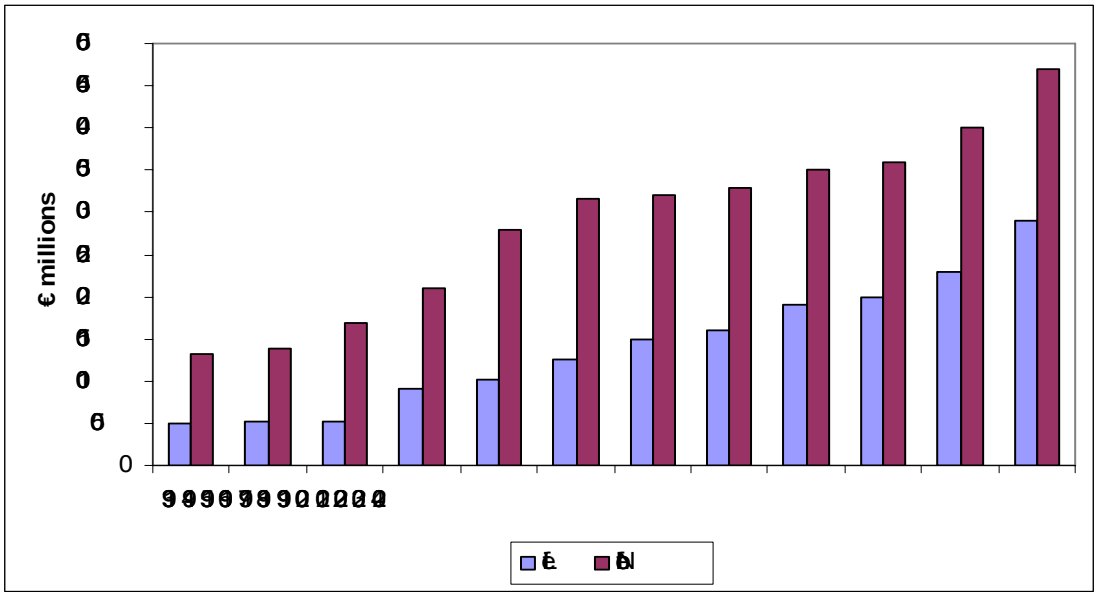
The Polish Insurance Sector

3.1 Poland boasts one of the most developed insurance markets in Central and Eastern Europe. The insurance market is open to foreign investment, but remains dominated by state-owned companies. However, the Polish insurance sector still has significant scope for expansion. This becomes evident when one compares the 3.1 per cent share of gross written premium in Poland's GDP with the 7.2 per cent average in the EU.

Turnover

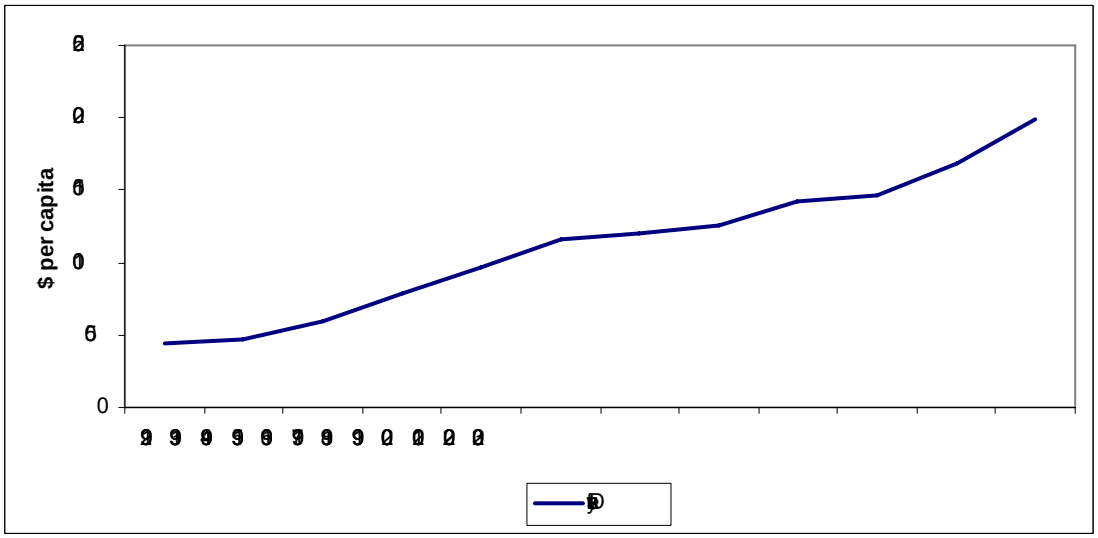
3.2 The Polish insurance sector has experienced substantial growth in the past decade. Prior to the 1990s, there were only two insurance companies in existence in Poland, both of which were state owned. Growth in a segment of the Polish insurance sector is shown in Figure 3.1.

Figure 3.1: Life insurance gross premiums in Poland, 1993-2004



Source: OECD

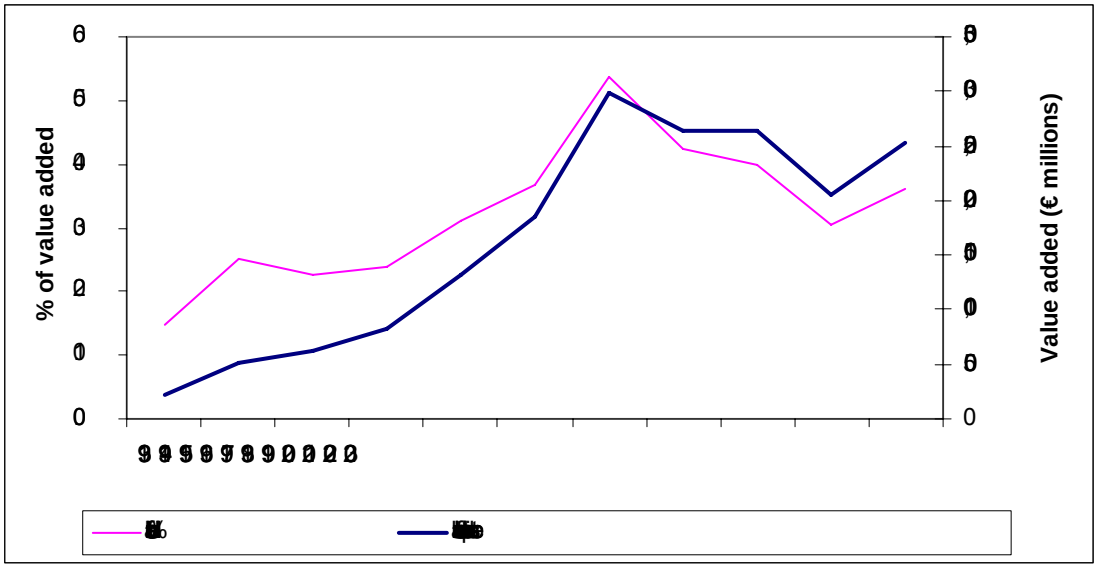
Figure 3.2: Premium Density (gross direct premiums/population)



Source: OECD

3.3 Figure 3.3 sets out value added. As can be seen, value added followed an upward trend up to the bear market of the early 1990s.

Figure 3.3 : Value added of Polish insurance



Source: University of Groningen

Market shares

3.4 The Polish insurance sector is highly concentrated but has become much less so over the past decade. In the life insurance sector, the market share of the biggest player, PZU Zycie, has decreased to just a bit over 40 per cent in 2004 from nearly 90 per cent in 1995. In the non-life insurance sector, the combined market share of the top two players, PZU and Warta, has decreased to just over 60 per cent from nearly 80 per cent over the same period.[1]

Products variety, e-commerce, and efficiency

3.5 Respondents to our survey took the view that the variety of relevant products available on the insurance markets in Poland has increased in recent years and they predict it will increase more in the future. The typical view is that provisions of the FSAP did not play a primary role in the determination of the historical trend, but instead attribute it to general market developments. However it seems likely that the FSAP will have an effect in the future.

3.6 Through the three years to the end of 2004, the use of channels of distributing insurance products in Poland had changed, since the relative prominence of direct sales had been largely replaced by the use of other distribution channels. The increased use of alternative distribution channels means consumers might have more ways of purchasing insurance products. Trends are shown in Figure 3.8 and Figure 3.8.

[1]

Switching and consumer protection

3.7 The effects on switching behaviour of the FSAP are regarded as positive.

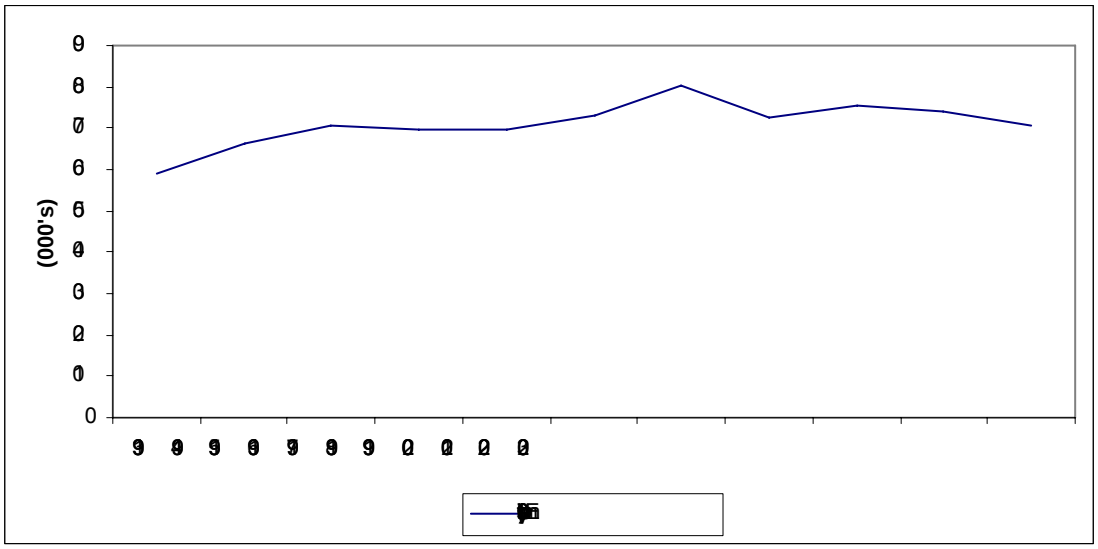
3.8 The level of consumer protection in insurance markets appears to have increased noticeably over the past few years. Further enhancements in consumer protection are anticipated in the future, and there may be some evidence of a direct effect of the FSAP.

The degree of understanding of insurance products appears to have increased, and is expected to increase further in the future. However, the FSAP seems to be working against this, since it is regarded as increasing the challenge for consumers to understand products.

Employment

3.9 Figure 3.4 illustrates an upward trend in employment in insurance going back to the early 1990s. The path is similar to that followed by income. However, employment is down from its 1999 peak.

Figure 3.4: Employment in insurance, 1993-2003

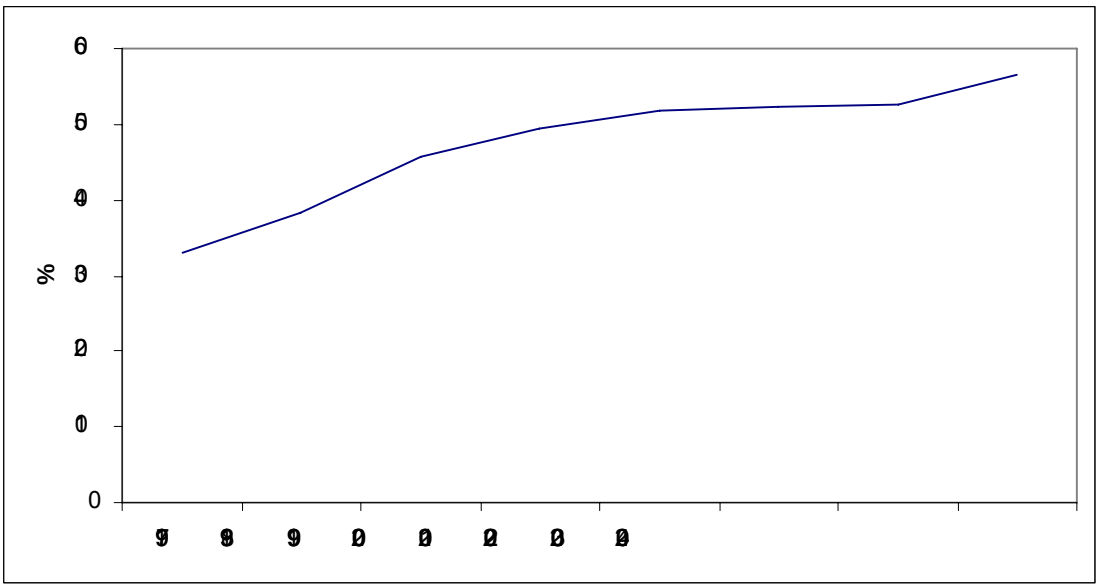


Source: University of Groningen

International entry

3.10 The degree of international penetration has increased during the period of the FSAP, as exhibited in Figure 3.5.

Figure 3.5: Market share of (foreign controlled undertakings) and (branches/agencies of foreign undertakings) in total domestic business

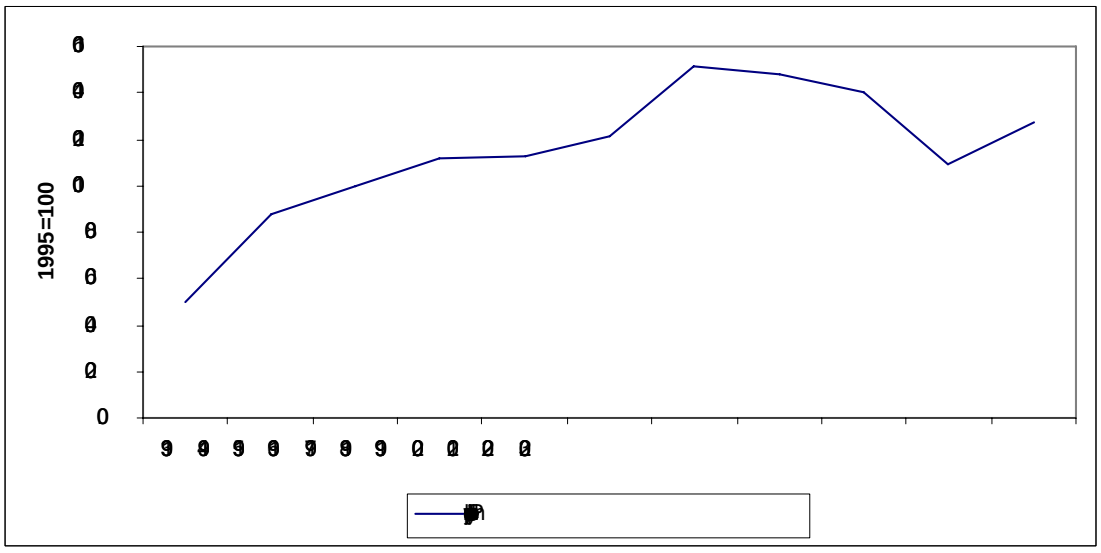


Source: OECD

Competitiveness

3.11 Figure 3.6 gives labour productivity in insurance and pensions.

Figure 3.6: Labour productivity in Polish insurance and pensions sector (1995 = 100)



Source: University of Groningen

3.12 As can be seen, productivity rose rapidly from the early 1990s, but fell back during the period of the early 2000s bear market.

3.13 However, the profitability of the Polish insurance sector has increased considerably in the past several years, as shown in Table 3.1. However, it is difficult to say whether the Polish insurance sector has become more efficient or competitive over the same period, as the performance heavily relies on macro-economic conditions. Nevertheless the impact of FSAP on the profitability of insurance companies might be limited, as accession to the EU might be a much bigger driver.

Table 3.1: Key profitability indicators of the insurance sector (%)

	Sales profitability[a]			Equity profitability[b]			Assets profitability[c]		
	Total	Life	Non-life	Total	Life	Non-life	Total	Life	Non-life
2001	4.59	3.67	5.25	12.19	9.77	13.89	2.18	1.29	3.30
2002	6.21	5.58	6.68	13.28	12.18	14.07	2.50	1.67	3.63
2003	7.85	9.73	6.32	15.62	20.00	12.23	2.96	2.79	3.22
2004	10.77	11.49	10.16	16.77	22.49	13.46	3.84	3.20	4.77

*a: calculated as (Net financial result / gross written premiums) * 100%*

*b: calculated as (Net financial result / capital and reserves) * 100%*

*c: calculated as (Net financial result / assets) * 100%*

Source: Insurance and Pension Funds Supervisory Commission, Poland

Impacts of the FSAP and FSWP Legislative Measures on the Polish Insurance Sector

Assessment of impact by category

Market entry, cross-border business and takeovers

3.14 It appears that the Polish insurance market still has considerable scope for increasing its openness. However the combined effect of EU accession and implementation of FSAP measures in the future is likely to have a positive effect in the future.

3.15 A very similar argument can be applied to mergers and acquisitions as well as takeovers. As the integration process will develop Polish insures will enlarge their relationships with their European counterparts. FSAP measures would probably have an effect but it would be almost impossible to disentangle the specificity of the FSAP from the overall accession process.

3.16 Even in the present of entry barriers in this sector, to the extent that the FSAP has increased the openness of other European insurance markets there should be scope for Polish insurance firms to penetrate other EU markets and thus develop the sector though these means.

Competitiveness

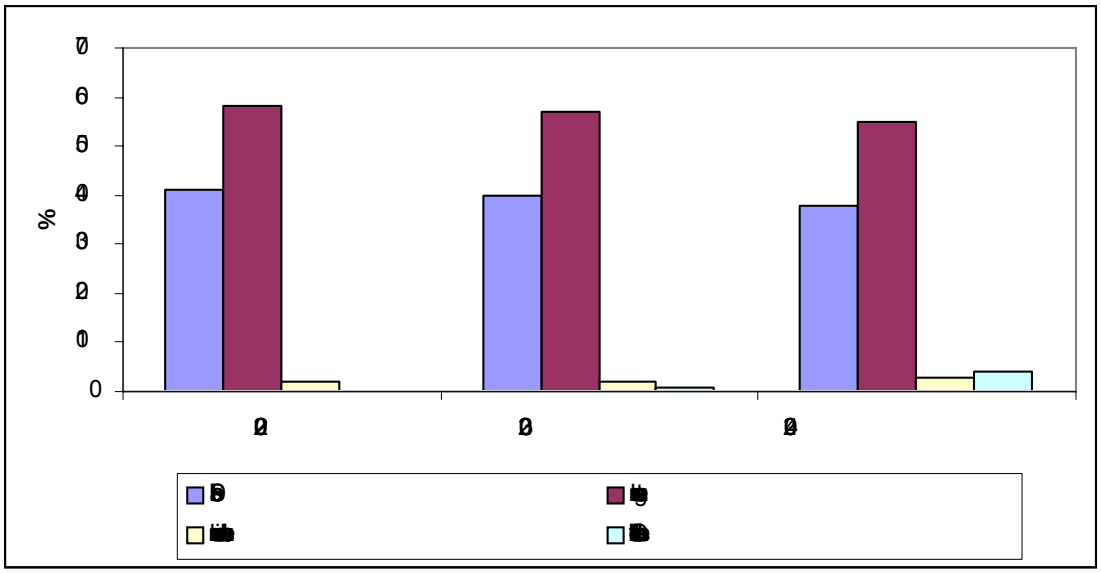
3.17 As can be seen in Figure 3.6, labour productivity rose rapidly from the mid 1990s, but it is difficult to disentangle FSAP effects from EU Accession, the aftermath disruption of the communist regime, and the financial markets boom-and-bust of the late 1990s and early 2000s.

3.18 Respondents to our survey took the view that little, if any, of this increased operational efficiency is attributable to the FSAP. However they see it as a major driver of efficiency in the future. The poor regulatory environment of Poland would benefit significantly from the introduction of FSAP-related measures.

3.19 Respondents to our survey did not perceive increased vulnerability of Polish firms to foreign takeovers, however we believe that a more pronounced presence of foreign players in the market would be beneficial for Polish firms as knowledge spill-overs would be able to boost even more the productivity of insurance companies.

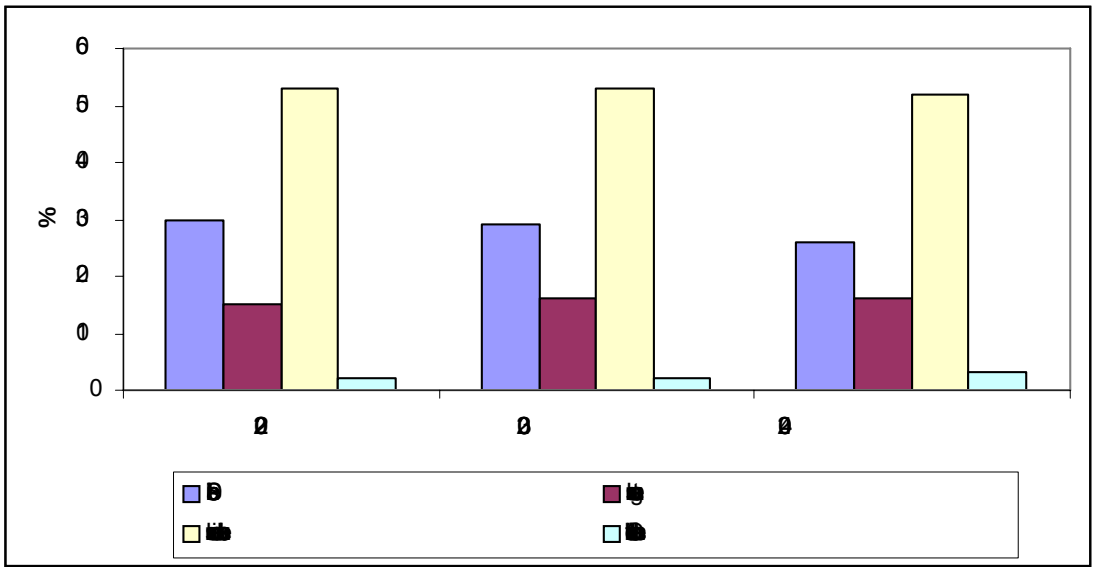
3.20 Unsurprisingly, factors that are regarded as the main drivers of competitiveness of Polish insurers are the low level of regulation and operational costs.

Figure 3.7: Life insurance distribution channels



Source: Insurance and Pension Funds Supervisory Commission, Poland

Figure 3.8: Non-life insurance distribution channels



Source: Insurance and Pension Funds Supervisory Commission, Poland

3.21 Efficiency has improved and will continue to do so in the future. The effects of the FSAP would be visible only in future trends though.

4 SECURITIES

Industry features

History and responsibility of the regulator

4.1 In 1989, the new post-communist government began creating a capital markets structure. The new legal framework, the Act on Public Trading in Securities and Trust Fund was adopted in March 1991, and the Warsaw Stock Exchange (WSE) joint-stock company was established by the State Treasury in April 1991 (it is perhaps worth noting that the WSE remains majority owned by the state). At the same time, the Polish Securities Commission, with its chairman appointed by the Prime Minister, was created.

4.2 The responsibilities of the Polish SEC are:

(a) taking actions intended to ensure proper operation of the capital market;

(b) exercising supervision over the activities of the regulated entities and performance by such entities of the obligations related to their participation in trading on the capital market, to the extent defined in legal regulations; and

(c) performing activities related to education and information on the operation of the capital market.

4.3 The Commission also drafts legal acts related to the operation of the capital market.

4.4 The Warsaw Stock Exchange share capital stands at 42 million zloty, divided into 60,000 registered shares. The shares of the WSE may be purchased by banks, brokerage houses, the State Treasury, trust fund companies, insurance companies and the issuers of securities approved for public trading and listed on the WSE.

Trends and developments

4.5 Table 4.1 and 4.2 report a number of indicators that describe the trends of the Polish securities market since 1994.

Table 4.1: Number of participants and activities in the Polish capital market

	Number of:							
	Entities in public trading	**IPOs**	**Stock issues**	**Bond issues**	**Banks conducting brokerage activities**	**Brokerage houses**	**Investment corp-orations**	**Investment funds**
1994	59	10	44	0	22	32	1	1
1995	81	6	26	0	22	32	2	4
1996	107	1	47	0	21	29	5	11
1997	200	16	74	0	16	31	10	30
1998	253	14	59	0	11	35	15	46
1999	261	5	49	0	8	40	17	66
2000	265	4	58	0	6	43	21	85
2001	269	1	26	0	6	36	19	108
2002	264	1	15	11	5	33	19	124
2003	263	0	28	57	6	30	17	137
2004	294	16	63	27	8	33	20	254

Source: Poland Securities and Exchange Commission

Table 4.2: Value of activities in the Polish capital market

	Value of (€m)					
	IPOs	**Stock issues**	**Bond issues**	**Net assets of investment funds**	**Capitalisation of the Warsaw Stock Exchange (€ m)**	**Turnover on the Warsaw Stock Exchange (€ m)**
1994	283	420	0	560	3801	8986
1995	186	93	0	256	5167	10418
1996	9	392	0	447	10259	13877
1997	1187	851	0	572	14524	18954
1998	1032	928	0	510	24189	17999
1999	576	592	0	613	34947	25197
2000	58	958	0	1798	36747	63114
2001	1	795	0	3318	29817	51790
2002	2	149	510	5831	33698	38665
2003	0	335	1224	7556	50445	49053
2004	2210	874	207	9068	71087	62899

Source: Poland Securities and Exchange Commission

4.6 Table 4.1 and Table 4.2 show that the Polish securities market expanded considerably from 1994 to 2004. The number of entities listed rose from 59 to 294; investment corporations and funds rose respectively from 1 to 254.

4.7 Although such a rapid growth is clearly the result of a start from a null basis the increase is nonetheless very large.

Concentration rule

4.8 The implementation of the MiFID will lead to the abolition of a rule that forces trades of securities to be conducted on an official stock market. The rule was implemented in order to achieve maximum liquidity and transparency, and to achieve efficient price revelation by forcing all trades to occur together. With the abolition of this rule investment banks will be able to consolidate trades by themselves without using a stock market. To ensure transparency MiFID has detailed rules for pre- and post-trade transparency, together with rules on the reporting of transactions.

Impact

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. Participants to our survey suggest that integration of Polish markets caused a very steep increase in cross-border business that has taken place, and will continue to take place over the next years. However, respondents are of the view that the FSAP may have slowed the pace of EU integration rather than promoted it.

4.10 It may be argued that, had the EU accession taken place without the FSAP then the Polish market would have had an even deeper relationship with the rest of the EU. However this might be due to the fact that other European firms would have exploited a badly regulated and weak market that had been developing for only some ten to fifteen years.

4.11 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.

4.12 With regards to the FSAP objective of increasing the volume of trade in the future (as well as in the past), the most likely scenario seems to be that it will increase. However, it is widely considered that that this will happen even without the implementation of the FSAP measures. Similarly, past increases in volumes are not regarded as having been driven by the FSAP.

4.13 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 increased envisaged for the future are not attributed by survey respondents to the implementation of the FSAP.

4.14 Where the respondents to our survey think that the FSAP did have an effect in the past (and will have one also in the future) is in 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.

4.15 One concern of small EU countries such as Poland, with regards to the securities, is the likelihood of being consumed by bigger players.

4.16 It appears likely that the effects of MiFID will tend to increase the existence of Multilateral Trading Facilities (MTF) and this may serve as a source of job migration to locations such as Germany and the UK, where the use and development of MTF is relatively greater. Thus, it may be expected that with full implementation of the FSAP, employment in the Polish securities market may be expected to fall in the short term.

4.17 Overall, however, it would appear that the net effect is unclear as the FSAP may also serve in contributing to sufficient growth in total volumes that the migration of a portion of jobs to London will not offset the wider gains - i.e. securities jobs will increase in the future, even though the effect up to now will have been limited.

Consumer protection

4.18 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Polish 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 Polish securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.

5 FINANCIAL CONGLOMERATES

5.1 The EU Mixed Technical Group on the Supervision of Financial Conglomerates has identified no financial conglomerates headquartered in Poland.

5.2 Table 5.1 exhibits those firms identified as financial conglomerates headquartered in another Member State that we have found to be operating in Poland.

Table 5.1: Other financial conglomerates operating in Poland

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Allianz	Germany	Insurance group doing asset management and banking	Insurance and some banking
BNP Paribas	France	Equal focus on retail, corporate and investment banking, asset management	Banking
Danske Bank	Denmark	Insurance, mortgage finance, asset management, brokerage, real estate and leasing services - mostly banking	Banking
DZ Bank Gruppe	Germany	Investment Banking	Investment Banking
Eureko	Netherlands	Banking, insurance and asset management	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%	Life, non-life and pension fund sales channels: Agents, brokers, direct, banking channel
HSBC	UK	Personal, commercial, corporate, institutional and investment, and private banking	Consumer Finance, Corporate Banking & Treasury and Investment Banking
ING	Netherlands	Banking, insurance and asset management	Corporate and Investment Banking
Munich Re	Germany	Reinsurance	Reinsurance

Continued overleaf

Table 5.1: Other financial conglomerates operating in Poland (cont.)

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Nordea	Sweden	Banking, Asset Management, Insurance. Contribution to net profit: Retail Banking 66%, corporate and institutional banking 25%, asset management 5%, life insurance 3%	Banking
Provident Financial	UK	Lending company whose speciality is home credit	Home credit
San Paolo-IMI	Italy	Retail and Commercial banking group doing insurance	Banking
SEB	Sweden	Banking firm doing insurance and asset management	Asset management, Cash Management, Foreign Exchange, Trade Finance, Financing and Leasing
Societe General	France	Corporate and Investment Banking	Banking
Svenska	Sweden	Insurance, Banking, Asset Management	Banking

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

Impact of the FSAP and FSWP Legislative Measures in the Polish Financial Conglomerates Sector

Openness to foreign firms

5.1 Our assessments for other sectors have suggested that the effects of the FSAP on openness were positive for banking and insurance, and maybe negative for securities. As Polish conglomerates mainly incorporate banking activity, we conclude that the influence of the FSAP is likely to be positive.

Competition

5.2 Among the other sectors, in securities and insurance the effect of the FSAP was assessed as being positive and in banking the effect is negative. For financial conglomerates we would see the overall impact as limited.

Consumer protection

5.3 The effects of the FSAP on consumer protection in the banking and securities sector was assessed as slightly positive and positive and in the insurance sector in some cases negative and in other positive. For conglomerates we conclude that the overall impact is likely to be slightly positive.

Employment

5.4 Earlier sections assessed that the main change in employment was negative in the short term and perhaps positive in the long term in the banking sector. It was perhaps negative in the insurance sector and unclear in the securities. Since conglomerates mainly incorporate elements of banking, we assess the net effect as slightly negative in the short term and perhaps positive in the long term.

Competitiveness

5.5 For banking we have assessed the competitiveness impact as positive, whilst for insurance limited in the short term and positive in the long term and negative for securities. 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 ASSESSMENT

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Positive	Limited	Slightly positive	Positive	Perhaps negative in the short-term; perhaps positive in the long-term
Insurance	Positive	Positive	Positive in some respects, but negative in others	Limited in short-term; Probably positive in longer-term	Perhaps negative
Securities	Perhaps positive	Perhaps positive	Perhaps positive	Perhaps positive	Unclear. Perhaps positive in the long term
Financial Conglomerates	Positive	Limited	Slightly Positive	Slightly Positive	Perhaps negative in the short-term; perhaps positive in the long-term

PORTUGAL

1 INTRODUCTORY OVERVIEW

1.1 In this section we provide an overview of financial services regulation in Portugal.

Regulatory Institutions

1.2 Responsibility for financial regulation and supervision of the banking, securities and insurance markets in Portugal is spread across four authorities.

(a) **Bank of Portugal:** responsible for the prudential supervision of credit institutions, investment firms and other firms operating in the financial sector;

(b) **Insurance Institute of Portugal (Instituto de Seguros de Portugal, ISP):** responsible for the prudential supervision in the sectors of insurance and pension funds, and related intermediation;

(c) **National Securities Market Commission (Comissão do Mercado de Valores Mobiliários, CMVM):** agency in charge of supervising the Portuguese securities markets, along with the Bank of Portugal;

(d) **National Council of Financial Supervision (Conselho Nacional de Supervisor Financeiros (CNSF):** responsible for the coordination of the activity of the institutions in charge of financial regulation and supervision.

Key Features of Financial Services Regulation

1.3 The main legislation includes:

(a) Bank of Portugal's **Organic Law** (Law 5/98, January 1998, amended by Decree Laws 118/2001 of April 2001 and 50/2004 of March 2004) reinforces the independence of the Bank of Portugal, part of the European Systems of Central Banks (ESCB), by establishing its administrative and financial autonomy and the framework under which it exerts its regulatory and supervisory duties.

(b) **Securities Code:** Approved by Decree-Law No. 486/99 in 13 November 1999, the Securities code determines the regulations and general provisions of the CMVM.

(c) **Decree Law 289/2001**, of November 2001, reinforcing the autonomy in ISP's decision-making with respect to the Ministry of Finance, and establishing the scope of its regulatory and supervision powers.

(d) **Decree-Law No. 473/99** of November 1999**:** Approves the Statute of the Portuguese Securities Market Commission established by the Decree-Law No. 142-A/91, as of 10 April.

Banking regulation

1.4 The principal activities of the Bank of Portugal in reference to financial services regulation are:

(a) Supervising credit institutions, investment companies, leasing companies, factoring companies and credit-purchase financing companies;

(b) Overseeing processes of payment systems;

(c) Managing the foreign assets of the country;

(d) Incorporating financial companies, including dealers, foreign exchange or money-market mediating companies, investment fund management companies, wealth management companies, credit card issuing or managing companies, regional development companies, group-purchase managing companies, and exchange agencies;

(e) Monitoring the activities executed by credit institutions and financial companies through strict supervisory practices (such as on-site inspections); and

(f) Ensuring "the collection and compilation of the monetary, financial, foreign exchange and balance of payments statistics, particularly, within the scope of its co-operation with the European Central Bank".[32]

Insurance, reinsurance and pension fund regulation

1.5 The Portuguese Insurance Institute (Instituto de Seguros de Portugal, ISP), the authoritative Portuguese organization that directs and supervises the insurance and reinsurance, pension fund and brokerage industry, follows the guidelines laid out in Decree-Law no. 289/2001, which was passed on 13 November 2001.

1.6 Though the ISP maintains administrative and financial autonomy, it is officially a state-owned corporate organization. Its primary source of revenue is the fee it charges those under its control. The ISP Board members govern the organization and are backed by a Consultative Committee and audited by an Audit Committee.

1.7 The ISP works with several national and European Community authorities, for example the Bank of Portugal, the Portuguese Consumer Institute and the Securities Market Commission in all matters that fall within its authority, in order to guarantee the successful management and regulation of the Portuguese financial system and to protect the rights and interests of consumers.

[2] [redacted]

Securities regulation

1.8 Established in April 1991, The Portuguese Securities Market Commission was created to supervise and regulate securities and other financial instruments markets. The CMVM, an independent public institution, maintains administrative and financial autonomy. Therefore, rather than relying on funding from the General State Budget, the CMVM obtains its revenue from the fees that it charges for its services.

1.9 Regulation by the CMVM includes:

(a) Continuous supervision of the actions of companies of organizations doing business in capital markets, in order to identify illegal acts (principally within stock market trading);

(b) Monitoring compliance with rules and regulations;

(c) Exposure of criminal offences;

(d) Punishment of those who break the rules through the imposition of fines;

(e) Granting registrations of individuals and companies; and

(f) Information disclosure through the Internet.

1.10 The CMVM is, in turn, regulated by internal and external individuals and organizations. The internal regulators include the Supervisory Board of the CMVM, which is comprised of three members, one being an Accredited Chartered Accountant appointed by the Finance Minister, and the Advisory Board of the CMVM, which is comprised of representatives from nearly all the entities operating in the securities market. The CMVM is regulated externally by the Minister of Finance, who is officially responsible for the CMVM, the Council of Ministers, the Assembly of the Republic, the Budget Directorate-General, an external auditor, and several commercial and tax courts.

Consumer Protection

1.11 The Competition Authority of Portugal was created as an independent and financially autonomous institution by Decree-Law 10-2003 of January 18, 2003. Before its establishment, the Competition Council and the Directorate General of Competition and Trade were the primary regulators that served to protect the rights of consumers through the maintaining of competition laws.

1.12 The Authority states that its mission is the following:

> To ensure compliance in Portugal with national and Community competition laws, which are the foundation of a market economy, with the following aims:
>
> – Efficient working of the markets for all products and services;
>
> – A high level of technical progress; and, above all,
>
> – Pursuit of the greatest benefit for consumers.

1.13 The goals of the Authority include the following:

(a) Ensure full enforcement of and compliance with competition laws;

(b) Identify markets where competition has been restricted and promote the best solutions to improve efficiency and benefit consumers;

(c) Provide an effective service for the government, other regulatory agencies and society at large, at the highest standards, taking account of internationally recognised best practice;

(d) Free and healthy competition benefits for enterprises as well as consumers by establishing a level playing field and discouraging predatory practices.

2 BANKING

2.1 In this section we review key developments in the banking sector and identify impacts of the FSAP.

Headline Overview

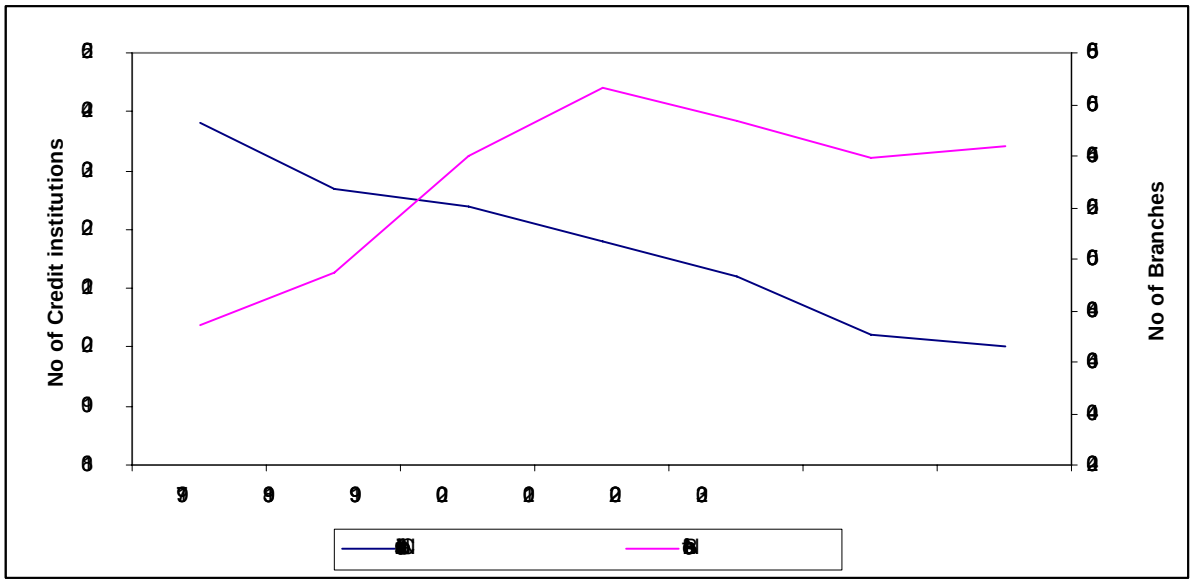
2.2 According to the IMF impact document, published in 2006[33], Portugal's banking system generally compares well with other European Union countries in terms of efficiency, profitability, and the quality of assets, with solvency levels close to the average in the EU, despite the sector being relatively small and concentrated.

2.3 Foreign participation in the market is quite high, although there is still extensive state ownership of the sector. The recent Financial Sector Assessment Program found that banks have diversified their sources of income, rationalized operating costs, and enhanced risk management procedures.

Number of players

2.4 Figure 2.1 illustrates the trend in the number of credit institutions (CI's) and branches from 1992 to 2003. Between 1992 and 2001, the number of branches increases steadily, and then levels out, and declines slightly until 2003. We can also see from this figure that the number of CI's almost doubled from 27 to 46 from 1992 to 2003.

Figure 2.1: Institutions and branches in the Portuguese banking sector



Source: ECB

2.5 In its 2005 Annual Report, the Bank of Portugal highlighted a continued decline in the number of registered credit institutions and financial companies.

---

3 [redacted]

2.6 This is linked to two factors:

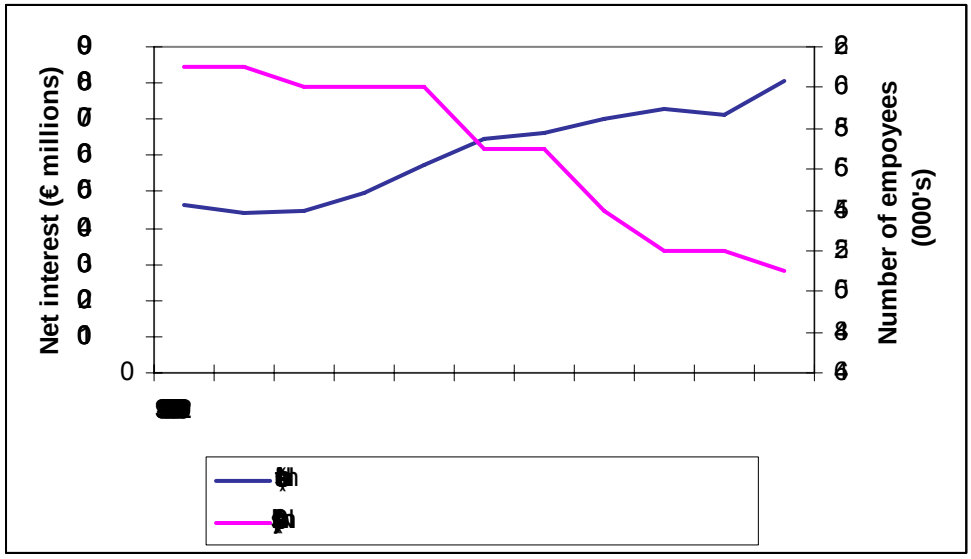
(a) The legislation (Decree Law 186/2002) which created a new type of institution, called "credit financial institution", whose purpose is to carry out operations authorised to banks, except for the taking of deposits; and,

(b) The rationalisation of the banking sector for example where groups incorporated new entities.

Turnover, employment and profitability

2.7 Figure 2.2 below shows trends in income and employment in the Portuguese banking sector. Income has followed a sustained upward trend, reflecting both the soundness of the banking system and a growth in household borrowing which has been strengthened by favourable monetary conditions and low interest rates. From 1982 to 2003 we can also see that there has been a gradual decline in employment, with the steepest fall occurring between 1998 and 2002 with a levelling off in the number of employees after this date. Again, the IMF and the Bank of Portugal relate this trend to the rationalisation of the sector in the quest of higher efficiency in a difficult macroeconomic environment.

Figure 2.2: Income and Employment in Portuguese banks, 1992-2003



Source: OECD

2.8 Although the Portuguese banking system features relatively high levels of expenses compared to its assets, in terms of profitability it still compares well with the EU15 average.

Market shares and concentration

2.9 Significant levels of foreign investment and consolidation led to a structural change in Portugal's banking industry during the late 1990s. In 1996, Banco Comercial Portugeuês (BCP), Banco Pinto and Sotto Mayor, and Banco Portugeuês de Investimento were the three largest private banks. In 2006, after several years more of consolidation, there were six major banking companies in Portugal: Banif, BES, BPI, the Credito Agricola Group, CDG, and Millennium BCP.

2.10 This greater concentration is also shown in Table 2.1 overleaf:

Table 2.1: Credit Ratio 5 of assets of CI's, 1999-2004 (%)

	1999	2000	2001	2002	2003	2004
CR5[34]	44	59	60	60	63	66

Source: ECB

Table 2.2: Herfindahl-Hirschman index for CI's total assets, 1999-2004

1999	2000	2001	2002	2003	2004
566	986	991	963	1,044	1,093

Source: ECB

2.11 This shows that the trend in concentration (as measured by the Herfindahl index) has been increasing since the introduction of the FSAP.

2.12 Several empirical studies have also shown that the Portuguese banking sector has remained competitive.[35]

2.13 Table 2.3 below shows, there were twenty-two domestic mergers and acquisitions between 1997 and the first half of 2006.

Table 2.3: Number of Mergers and Acquisitions

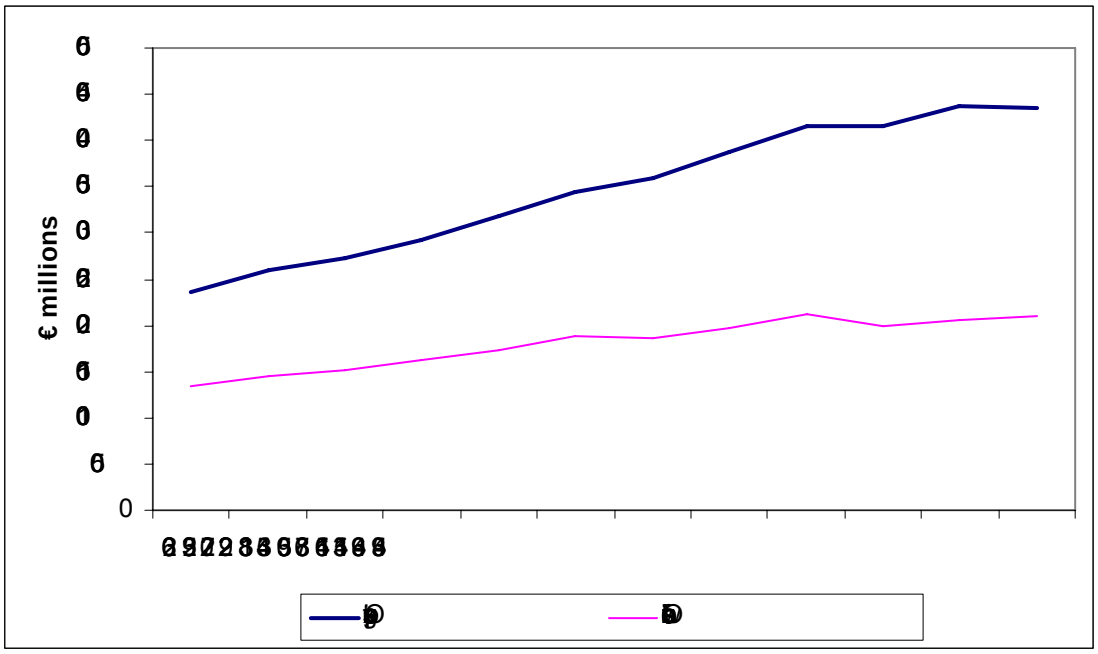
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006*
Domestic M&A's	2	3	1	5	2	1	5	1	1	1
Internal EU M&A's	0	0	2	5	0	1	4	2	1	2
Third country M&A's	0	1	1	3	0	1	0	0	2	0

*Source: ECB, * first half*

Competitiveness

2.14 Figure 2.3 overleaf shows that, from 1992 to 2003, operating expenses (including labour costs) have been increasing steadily. The ratio of operating expenses to income varied between a minimum of 1.59 and a maximum of 2.99, a range that is somewhat smaller than that of other countries.

Figure 2.3: Operating and labour expenses, 1992-2003



Source: OECD

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

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

2.15 Foreign bank presence is high in Portugal, especially since consolidations started taking effect in the mid 1990's and early 2000's (see above). At the same time, Portuguese banks have used international capital markets to finance their lending activity.

2.16 Foreign presence in the market is part of a process which was already taking place prior to the implementation of the FSAP. However, the FSAP might have accelerated this trend through having reduced both the technical and regulatory barriers aimed at harmonizing the European banking market. As a result of such facilitations, international banks may have been more inclined to enter the Portuguese banking market and therefore make it more open to international business. Therefore, our view is that the FSAP may have had a slightly positive impact on openness in the Portuguese banking sector.

Competition

2.17 As previously shown, the level of concentration, which is currently relatively high in the Portuguese banking sector, has increased since the implementation of the FSAP.

2.18 As argued in the IMF report, such an increase in the level of concentration does not necessarily imply a decrease in the level of competition in the Portuguese banking sector. Indeed, an increase in cross-border activity, accelerated by the FSAP should increase the level of competition, through the exposure of the current bankers on the Portuguese market to more competitors and more contestability.

2.19 From the two points presented above, it is difficult to establish with certitude what impact the FSAP has had on the level of competition in the Portuguese banking sector. However, it may be reasonable to accept that despite the increased level of concentration, the increasing openness of the Portuguese banking sector has naturally had a positive impact on competition in that sector, through the increase in contestability and competition from international competitors. Therefore, our view is that since the FSAP has had a slightly positive impact on competition in the Portuguese banking sector.

Competitiveness

2.20 Despite economic conditions characterised by very low growth levels and little signs of improvements in the near future, the competitiveness of banks operating in Portugal has benefited from the rationalisation of the sector; a process which may have benefited from recent legislation which in turn was influenced by the FSAP.

2.21 Furthermore, an increase in competition partly facilitated by the FSAP should also increase the level of competitiveness in the Portuguese banking sector. Indeed, banks that wish to remain in an increasingly competitive banking market are forced to become more efficient and competitive. Therefore, our assessment is that the FSAP has had a slightly positive impact on the competitiveness of the Portuguese banking sector.

Employment

2.22 There has been a gradual decline in employment over the past decade. However, the number of employees seems to be levelling out in the past few years. We do not have enough available information and data to draw a conclusive assessment about whether or not the FSAP has influenced the level of employment in the Portuguese banking sector.

Consumer protection

2.23 Greater harmonization of regulatory requirements of the sector with regard to consumer protection, should contribute to the improvement of consumers' perceptions with respect to their rights and protection. Furthermore, as a result of increased competition in the Portuguese banking sector, consumers will be naturally more protected. 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 a disappointed client will easily change companies that will provide them the same service without having abusive practices. Therefore, our view is that the FSAP can be expected to have a slightly positive impact on consumer protection in the Portuguese banking sector.

Conclusions

2.24 Key conclusions include:

(a) The banking sector constitutes a key element of the Portuguese financial system.

(b) The sector has shown the ability to thrive despite an unfavourable macroeconomic environment. Consolidation and rationalisation processes brought about higher concentration and efficiency, without having had detrimental effect on competition.

(c) The FSAP may have helped in fostering a coherent legislation and a favourable environment behind the soundness of the Portuguese banking sector.

(d) Furthermore, there are indications of openness of the market to penetration from other EU countries.

3 INSURANCE

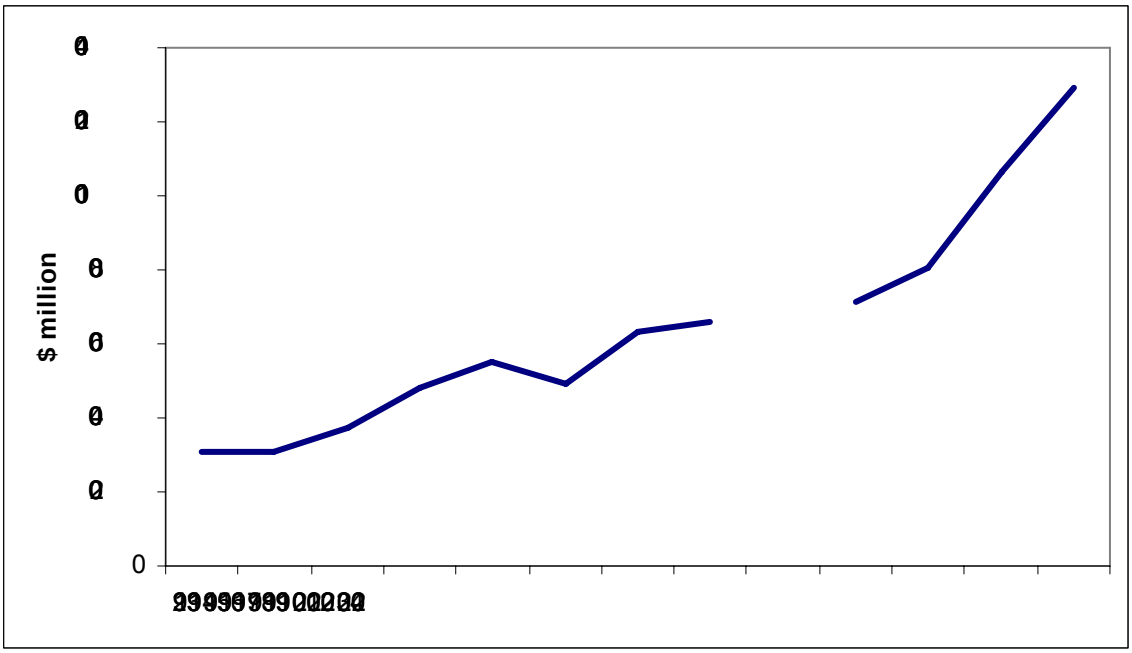
3.1 In this section we review key developments in the insurance sector and identify impacts of the FSAP.

The Portuguese Insurance Sector

Turnover

3.2 Figure 3.1 below shows the trend in gross premium income in the Portuguese insurance sector from 1992 to 2003.

Figure 3.1: Gross premium income in the insurance sector



Note: Data not available in 2000.

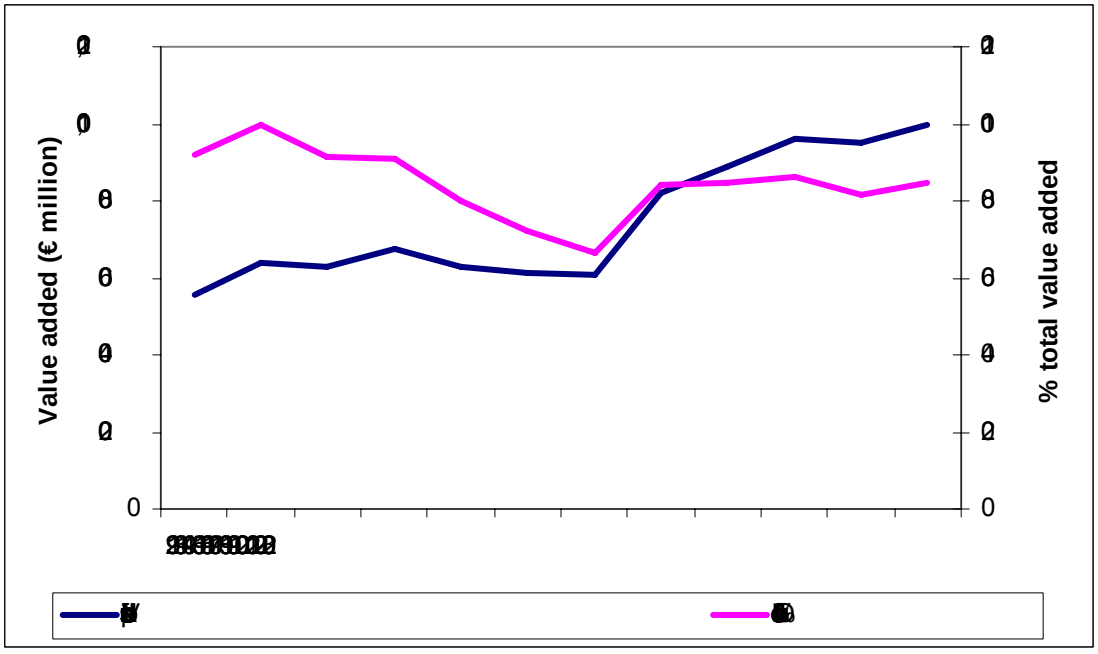
Source: OECD

3.3 Figure 3.1 illustrates that gross premium income in the insurance sector has increased since 1992, with the exception of a slight drop in 1997, which was quickly recovered in 1998. By 2003, the gross premium income was more that four times what it had been in 1992.

3.4 In its 2005 report[36], the Instituto de Seguros de Portugal (ISP) links the growth in the sector of insurance and pension funds to the "financial easiness provided both by the financial and securities markets", namely through low interest rates and loan term extensions, and to the implementation of the EU Directive on the Taxation of Savings which, along with the strong performance of stock markets, generated a greater availability of financial resources.

3.5 Figure 3.2 below sets out value added of insurance in absolute and relative terms. As shown in the figure, the value added of the insurance and pensions sector has increased since 1992, levelling out between 1995 and 1998, and then increasing more steeply from 1998 onwards.

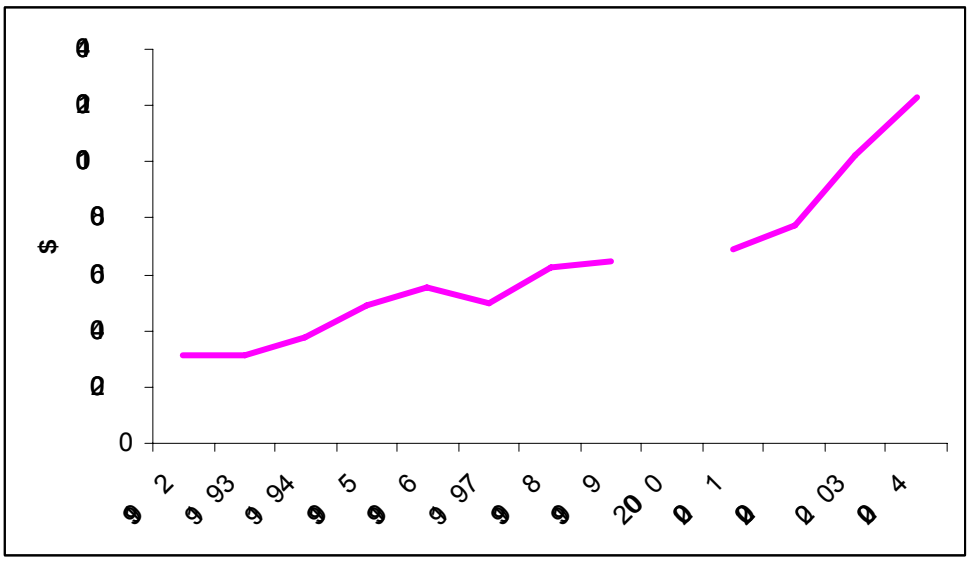
Figure 3.2: Value added of Portuguese insurance



Source: University of Groningen

3.6 Figure 3.3 overleaf shows the insurance density amongst the population. When put together with the increased value added of insurance, these figures suggest a highly growing insurance and pension funds sector in Portugal. This picture is confirmed by the IMF in its FSSA report.

Figure 3.3: Insurance density (gross direct premium/population, $ per capita)



Note: Data not available in 2000.

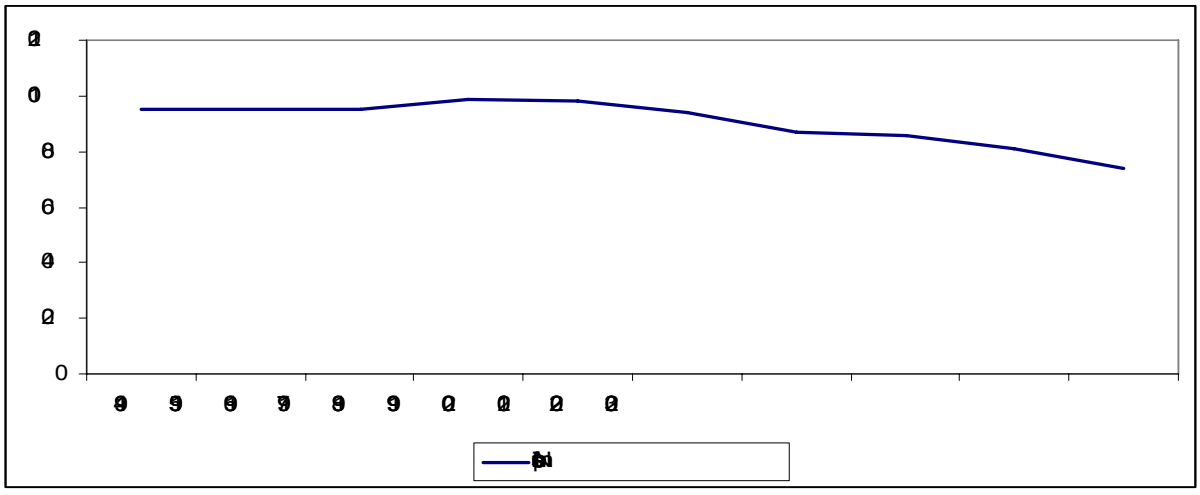
Source: OECD

Concentration

3.7 The sector has gone through a process of consolidation which has brought about a decrease in the number of companies. According to the IMF's FSSA report, the degree of concentration is relatively high, with 60 per cent represented by the top five companies and 20 per cent for the next five companies; the banking sector is involved, up to 50 per cent of the market, via ownership links.

3.8 This picture is confirmed by Figure 3.4 overleaf, which shows a continued reduction in the number of insurance companies.

Figure 3.4: Number of insurance companies

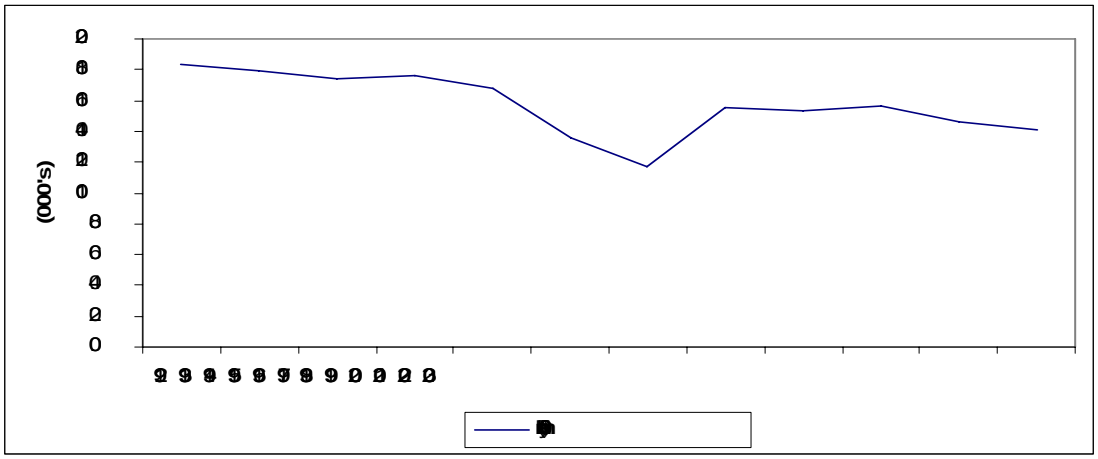


Source: OECD

Employment

3.9 Figure 3.5 below shows the trend in employment in the insurance industry.

Figure 3.5: Employment in the insurance and pensions sector, 1992–2003



Source: University of Groningen

3.10 Figure 3.5 shows the downward trend in employment in the insurance and pensions sector since 1992.

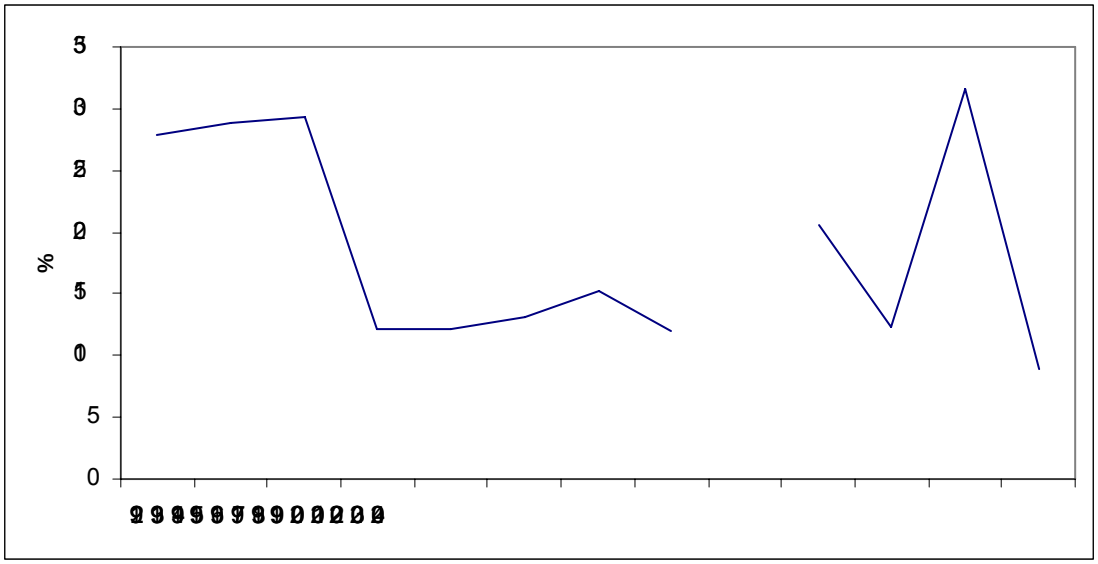
3.11 From this figure we can see that between 1996 and 1999, the level of insurance and pensions sector experienced a dramatic dip in employment. By 1999, however, the level of employment had recovered back to the steady declining trend.

3.12 These trends appear to reflect a process of rationalisation of the sector, also witnessed in the wider financial system in Portugal.

International entry

3.13 Figure 3.6 illustrates that the level of foreign penetration in the Portuguese insurance markets has not been particularly stable since the early 1990's. In fact, the 2005 ISP report mentions that in 2004 there was a decrease in the proportion of the activity of foreign branches in the Portuguese market.

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

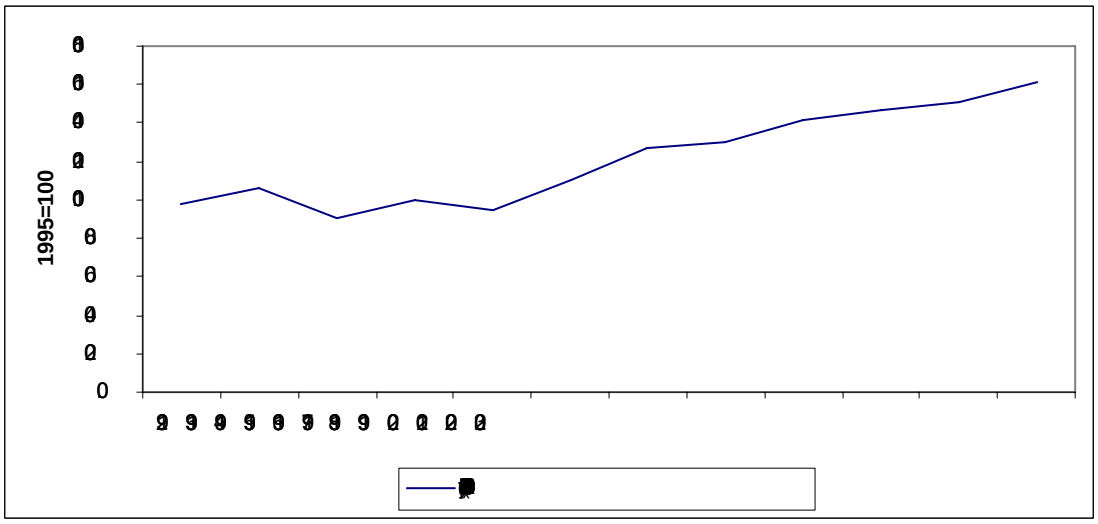


Source: OECD[37]

Competitiveness

3.14 Figure 3.7 shows the trend in labour productivity in the insurance sector.

Figure 3.7: Labour Productivity (per worker) in the Portuguese insurance sector (1995=100)



Source: University of Groningen

3.15 From this Figure we can see that labour productivity was fairly constant from 1992 to 1996. It then began to increase steadily and continued to do so through 2003.

Impact of the FSAP and FSWP Legislative Measures on the Portuguese Insurance Markets

Market-entry, cross-boarder business, and takeovers

3.16 The limited and declining market share of foreign branches appears to indicate a small impact of the FSAP in its objective to contribute to the creation of a single market.

3.17 However, the fostering of a coherent legal framework may have helped the development of the Portuguese insurance and pension funds markets.

3.18 Therefore, from the information above, so far, it is difficult for us to draw any major conclusions regarding the impact of the FSAP on the Portuguese 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.

Products variety, e-commerce, and prices

3.19 The development of the market may have been favoured by the EU legislation and the principles fostered by the FSAP; the increase in the product variety may then have been favoured.

Competition

3.20 So far, it is too early to conclusively evaluate the impact of the FSAP on the level of competition in the Portuguese 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 Portuguese insurance sector.

Competitiveness

3.21 If cross-border activity rises and as a result competition also increases, then there should naturally be an increase in the level of competitiveness as a result of increasing efficiency among the insurers that wish to remain in the market. Such results would be partly attributable to the implementation of the FSAP which would have had a positive impact on the level of openness of the Portuguese Insurance sector.

Consumer protection

3.22 Greater transparency and consumer protection are current objectives in the Portuguese legislation which have been affected by EU Directives and the principles of FSAP, although direct effects are not yet observable. If further implementation of the FSAP does harmonise the EU insurance market, then it would be logical to anticipate that consumer protection in the Portuguese Insurance sector will improve with more competitive markets and better informed consumers.

Conclusions

3.23 The Portuguese markets for insurance and pension funds have enjoyed remarkable growth rates in the past few years.

3.24 Professional and efficient supervision by the ISP has fostered the development of the market.

3.25 The relevance of the FSAP on those patterns is not completely clear, although the FSAP has probably favoured the development of a coherent legislation which in turn constitutes an important condition for past and future growth of these markets.

3.26 Full integration into a single market, and the openness to foreign companies, do not yet appear to have been fulfilled.

4 SECURITIES MARKETS

4.1 In this section we review key developments in the securities markets and identify impacts of the FSAP process.

Portuguese Securities Market

4.2 The Lisbon Exchange (historically called the Business Man's Assembly) was established on 1 January 1769, on the east side of the Praça do Comércio. The Porto Stock Exchange was created nearly a century later. In November 1986, the first Public Offer of Sale in Portugal transpired on the Porto Stock Exchange and on 27 February 1989, the Porto Stock Exchange led the first Privatisation in Portugal.

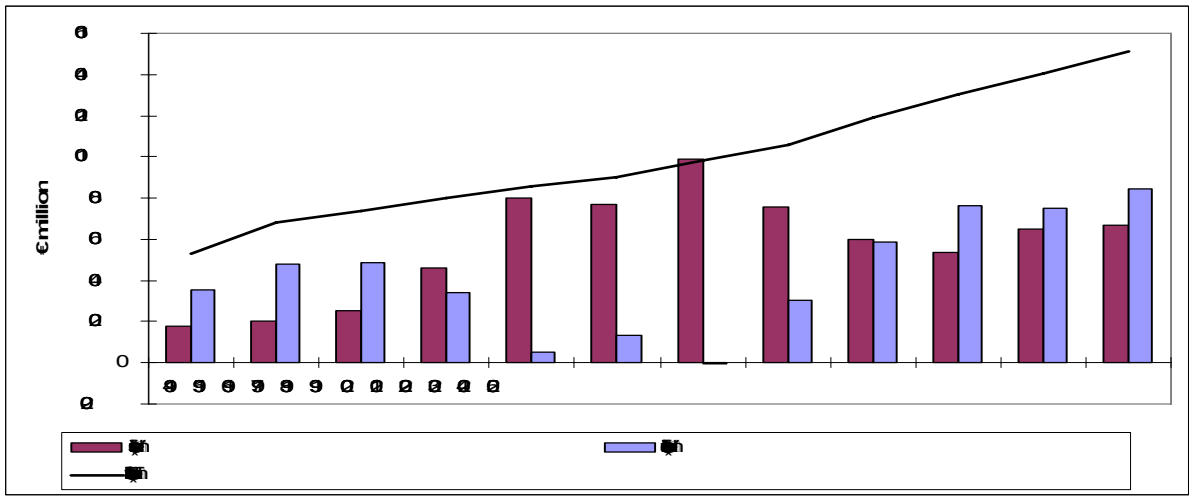
4.3 On 20th December 1999, the merger of the Lisbon Stock Exchange Association and Porto Derivatives Exchange Association was decided and their transformation into a joint stock company began. The new, single company changed its name to BVLP (Bolsa de Valores de Lisboa e Porto) — Sociedade Gestora de Mercados Regulamentados, S.A. BVLP became responsible for managing the regulated cash and derivatives market and other non-regulated markets, on the 10 February 2000. The Signature of the Memorandum of Understanding between BVLP and Euronext N.V. took place on 13 June 2001. By the end of January 2002 the shareholders accepted the conditions of the merger between Euronext N.V. and BVLP.

4.4 BVLP officially changed its business name to Euronext Lisbon on 6 February 2002. The integration of Euronext's markets was completed by November 2004. Euronext now uses a single platform (NSC) for cash products and a single platform (LIFFE CONNECT®) for derivatives products.

The value of securities issued

4.5 Figure 4.1 shows the value of securities issued from 1994 to 2005.

Figure 4.1: Value of securities issued



Source: ECB

4.6 From this figure we can see that, although the total value of all securities issued in Portugal has steadily increased since 1994, there is a large difference between the total value shares issued and the total value of non-share securities issued. In 2000, while the total value shares issued peaked, the total value of non-share securities issued dropped to its minimum value. By 2002, however, they levelled out, and by 2003 the value of the non-share securities was once again greater than that of the shares issued.

Regulatory developments

4.7 The supervision of the market for securities has been greatly enhanced by the increasing professionalism of the activity of the CMVM, which has been gained through the accumulation of experience (since 1991). The IMF, in its FSSA report, calls for further enhancement of its financial independence with respect to the Ministry of Finance.

4.8 The regulatory structure in the market for securities requires cooperation between the CMVM, responsible for market conduct, with the Bank of Portugal, responsible for the prudential regulation of market participants (see IMF's FSSA report).

4.9 In its 2005 report[38] the CMVM points out that the gains in the main indices (PSI20 and PSI General) were clearly above Portuguese GDP growth figures (which reflect the stagnation of the Portuguese economy) although they were below the performance of most EU stock markets.

4.10 At the end of 2005 there were only 51 listed companies and one company, the BSCH (a Spanish cross-listed issuer) represented about half of the overall stock market capitalisation. This reflected the fact that, in the words of the CMVM report, external financing of Portuguese firm unrelated to banking has been practically non-existent.

4.11 This report calls for the creation of a developed capital market in order to promote the funding of firms, most notably for Small and Medium Enterprises. The report also suggests that the process of the creation of such a market should focus on lowering costs and enhancing credibility and transparency.

4.12 In this respect it can be argued that the harmonization fostered by EU Directives may play a prominent role, although, according to CMVM, the "efficient transposition" shall take into account the specific characteristics of the Portuguese market.

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

Cross-border activities

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 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 Portuguese penetration into those countries.

Competition

4.15 An increase in cross-border activity and trade should of itself enhance the level of competition in the Portuguese 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 Portuguese 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 Portuguese securities sector.

4.16 As illustrated in Figure 4.2, despite some cyclical variations, the level of employment in the Portuguese securities market has increased between 1992 and 2000. Since 2001 it has slightly decreased. This may simply be a bear-market effect.

4.17 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 Portuguese securities market should rise slightly.

4.18 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 Portuguese securities market.

Competitiveness

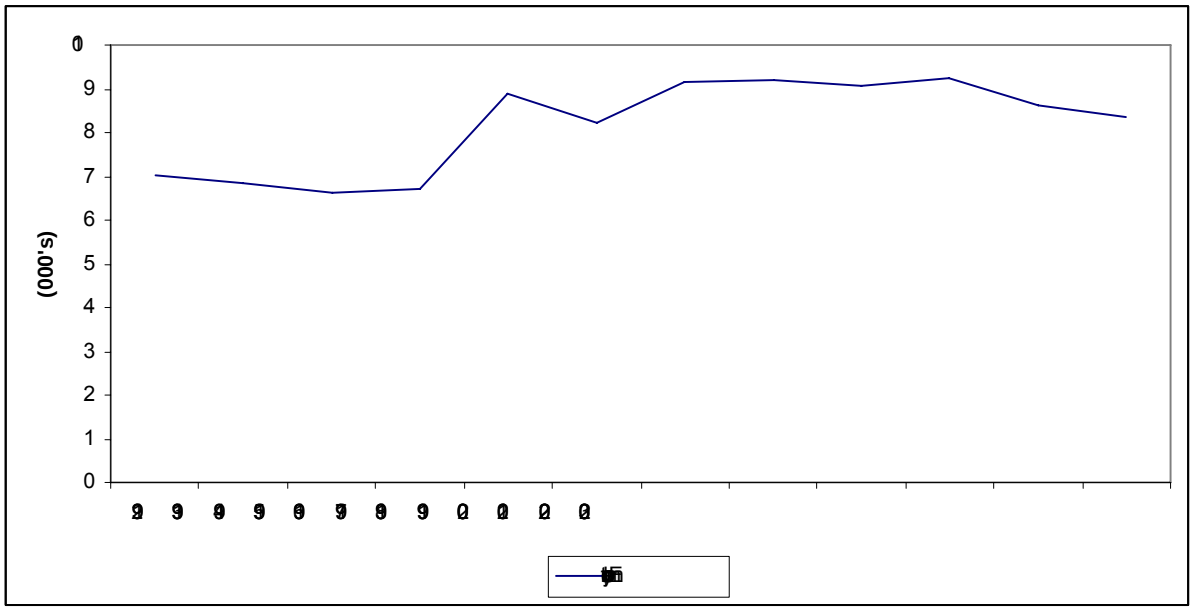
4.19 So far, the FSAP has had a limited impact on competitiveness. However, MiFID (soon to be implemented) is likely to expose Euronext to more competition, which in turn is likely, over time, to decrease transaction costs and thus enhance competitiveness in the Portuguese securities market. Therefore,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

Consumer protection

4.20 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Portuguese 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 Portuguese 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.

Employment

Figure 4.2: Employment in the activities auxiliary to financial intermediation (000's)



Source: University of Groningen

4.21 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 Portuguese securities market should rise slightly.

4.22 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 Portuguese securities market.

4.23 Therefore, our view is that so far, the impact of the FSAP on employment in the Portuguese securities sector is unclear, but perhaps positive in the future.

Conclusions

4.24 It is possible to anticipate that measures such as the MiFID may indeed be paramount to the development of the Portuguese financial market and a more prominent role of the stock exchange.

4.25 The securities market has a small role as an alternative to banks for corporate financing in Portugal. The FSAP may favour the future development of this market via greater focus on credibility and transparency, besides the creation of more opportunities for cross-border market penetration.

5 FINANCIAL CONGLOMERATES

Financial Conglomerates Operating in Portugal

5.1 According to the Bank of Portugal report, special attention is placed on the prudential supervision of conglomerates, assessing their capitalisation levels in cooperation with the ISP, within the framework of the Conselho Nacional de Supervisores Financeiros (CNSF).

5.2 Table 5.1 below shows the financial conglomerates operating in Portugal.[39]

Table 5.1: Financial conglomerates operating in Portugal

Name	Head office base	Characterization of Conglomerate	Characterization of Subsidiary
Allianz	Germany	Insurance group doing asset management and banking	Insurance with some banking
Barclays	UK	Banking and Insurance	Banking
BNP Paribas	France	Equal focus on retail, corporate and Investment banking, asset management	Corporate Banking
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%	Banking
Grupo Santander	Spain	Insurance, Banking, Asset Management	Banking
Old Mutual	UK	Asset management, Life assurance, Banking, Offshore trust and company services	Banking and insurance
RBS	UK	Banking firm doing insurance	Banking
Societe General	France	Corporate and investment bank	Investment Banking

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

5.3 The transposition of the Financial Conglomerates Directive will entail new evaluation exercises of capitalisation levels, with the view on group-wide supervision.

[9] [illegible]

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

5.4 The FSAP could boost expansion of big conglomerates across EU border, and this may result in an increased foreign penetration into the Portuguese market.

5.5 The FSAP should also reinforce the supervision of conglomerates, which however is already one of the goals related to the coordination role played by the CNSF.

Openness

5.6 We have seen that the form of entry by banks into Portugal has been affected, and that openness in the insurance sector has been positively affected by 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.

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

Competition

5.8 We have seen that competition is expected to be slightly enhanced in both banking and insurance. Therefore this can be expected to apply for financial conglomerates as well, since the activity in the Portuguese securities sector is significantly specialized in banking.

Consumer protection

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

Employment

5.10 We assess the effects on employment in both banking and insurance sectors as unclear. Therefore, our view is that the impact of the FSAP remains unclear.

Competitiveness

5.11 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 Portuguese conglomerates.

6 CONCLUSIONS

6.1 The Portuguese financial system has showed a high level of resilience in presence of a difficult macroeconomic context characterised by very low GDP growth rates in the last few years.

6.2 The banking sector is the most significant part of the financial services sector. Its efficiency has increased markedly in the last few years, which also witnessed higher levels of concentration and profitability with more vigorous competition.

6.3 It is possible that FSAP, rather than being a primary cause in these processes, has been a positive accompanying factor which reinforced transparency and coherency in legislation, conditions which certainly favour the development of the market and the operational efficiency of firms.

6.4 The same conclusions could be applied to the Portuguese insurance and pension funds sectors, which have been characterised by remarkable growth rates in the last years, starting from a situation of little development.

6.5 With regards to the insurance market, however, the very low presence of foreign firms contrasts with a more visible penetration in the banking sectors.

6.6 This indicates that there is still a long way to go before a single market in financial services can be considered to be a reality in Portugal.

6.7 However, the FSAP could be very important towards the development of the market for securities and for increasing the importance of the stock market as a source of financing for Portuguese firms. Market transparency and credibility, after the recent world-wide wave of scandals in the financial markets, are key factor for such development to occur.

6.8 Finally, a more coherent setting may also stem from the transposition of the Directives linked to FSAP with regards to the prudential supervision of conglomerates, although this is already a prominent goal of the operations of the CNSF.

Assessment

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

SLOVAKIA

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Slovakia

Division of responsibility

1.1 The Slovak Financial Market Authority (FMA) was established by Act 96 2002 to supervise and licence capital markets and insurance markets. In January 2006, the duties of the FMA were integrated into the National Bank of Slovakia (NBS) making it the supervisor of financial markets in the areas of banking, the capital market, insurance and pension savings. In order for the Bank to carry out these duties a Financial Market Supervision Unit was created. This was completed on the basis of the 2004 Financial Market Supervision (FMS) Act and other amendments to the National Bank of Slovakia Act.

1.2 The newly integrated NBS supervision system has a wide coverage of financial market activities in Slovakia. It covers, among other things, domestic banks, branches of foreign banks, cross-border banking services, securities dealers, the Bratislava Stock Exchange, domestic asset management companies, insurance and reinsurance, pension management companies, and foreign entities providing capital market and insurance services in Slovakia, whether independently on the basis of the single European licence or on the basis of a special licence. The Financial Market Supervision Unit itself is divided into two sections: Supervision of Banking and Securities Dealers and Supervision of Capital Market, Insurance and Pension Savings.

1.3 Another important player in financial markets regulation, albeit indirectly, is the Ministry of Finance. This has a Financial Market section with dedicated units for banking, capital markets and insurance. It is also responsible for legislation.

1.4 There is no specific agency dealing with financial conglomerates. The activities of such companies are typically dealt with by the NBS.

Factors Specific to Slovakia

1.5 In 2005, Slovakia was one of the new member states with the highest growth rate. In the fourth quarter of 2005, the Slovak economy achieved the highest growth in domestic product in its history: 7.5 per cent. Standard & Poor's raised its country rating for Slovakia to "A" reflecting the favourable economic prospects.

Key features of banking regulation

1.6 The main overseer of banking in Slovakia is the NBS.

1.7 The main legislation affecting the Slovak banking system includes:

(a) Act on Banks (2001). This law governs the relationships associated with establishment, organisation, management, and terminations of banks within Slovakia, as well as other relations associated with the operation of foreign banks.

(b) Act on the Supervision of the Financial Market and on amendments and supplements to certain laws (2004). This Act lays down general rules of procedure for supervision of the financial market.

1.8 Other Acts include: Protection of Bank Deposits, Home Saving, Payment System, and on Collective Investment Schemes.

Key features of insurance regulation

1.9 The main overseer of insurance in Slovakia is the NBS.

1.10 The main legislation affecting the Slovak insurance system includes:

(a) Act on the Insurance Industry (2002). This law (which has been subsequently amended) covers most areas in EC Directives with regard to market entry, organisation, management and winding up.

(b) Act on the Supervision of the Financial Market and on amendments and supplements to certain laws (2004). This Act lays down general rules of procedure for supervision of the financial market.

1.11 Other Acts include: Insurance and Reinsurance Mediation and on Civil Liability.

Key features of securities regulation

1.12 The main overseer of securities in Slovakia is the NBS.

1.13 The main legislation affecting the Slovak securities markets includes:

(a) Act on Securities and Investment Services (2001). This regulates securities, investment service and other contractual relations involving securities.

(b) Act on the Supervision of the Financial Market and on amendments and supplements to certain laws (2004). This Act lays down general rules of procedure for supervision of the financial market.

1.14 Other Acts include: Stock Exchange and Collective Investments.

Key features of financial conglomerates regulation

1.15 The main legislation affecting the Slovak conglomerates includes:

(a) A Decree by the NBS on own funds of a financial conglomerate and large exposure of a financial conglomerate (2004).

(b) Act on the Supervision of the Financial Market and on amendments and supplements to certain laws (2004). This Act lays down general rules of procedure for supervision of the financial market.

Consequences of the FSAP for the Regulatory Environment

1.16 Respondents to our survey noted that when the FSAP began to be transposed there was a direct impact on the supervisory regime. The previous emphasis on regulations based on process shifted towards ones that emphasised risk. Further, the FSAP is said to have increased the level of communication between the supervisory authority and sector representations and other Member States, e.g. through Memoranda of Understanding.

1.17 The FSAP was also identified as one of the factors contributing to the integration of supervisory authorities.

1.18 However, one should be wary in attributing changes to the regulatory environmental wholly to the FSAP, as its implementation in Slovakia coincided with preparations for EU membership.

2 BANKING

Headline Overview

2.1 In 1998, following a period of economic deterioration, Slovakia was close to an economic and financial crisis. Within the economy, the banking sector growth had been hindered by an uncertain macroeconomic climate. This led to renewed emphasis on economic reform by its policy makers. Thus, in 1999-2000 a large-scale restructuring programme was enacted. The measures consisted of recapitalisation, restructuring and the privatisation of the largest banks, as well as the resolution of small to medium sized credit institutions. Regulatory and supervisory reform accompanied this restructuring.

2.2 The recapitalisation was very large in scope. In 1999, state-owned banks were re-capitalised to the value of 2 per cent of GDP and in 2000, bad loans amounting to 12 per cent of GDP were removed from the balance sheets via substitution of government securities.

2.3 The main privatisations were of the country largest two banks. After being rehabilitated, majority shareholdings in Slovenská sporiteľňa (67 per cent to Erste Bank of Austria) and Všeobecná úverová banka (95 per cent to Banca Intesa) were sold in 2001. Since the end of the privatisation and restructuring programme, the government only retains a shareholding in two banks currently: Poštová banka (37.14 per cent) and Slovenská záručná a konsolidacna banka (100 per cent).

2.4 These changes greatly contributed to the sector's turnaround, as witnessed by an increase in the solvency ratio from 6.6 per cent in 1998 to 22.3 per cent in 2002. The sector also witnessed large-scale consolidation and the entry of foreign banks. Indeed, by the end of 2004, the Economist Intelligence Unit reported that foreign capital controlled 98 per cent of Slovak banking assets.

2.5 The legacy of the banking sector restructuring persists today. Slovak credit institutions are much more risk averse and lend cautiously. Further, non-performing loans remain relatively high (estimated at 8 per cent of total loans in September 2004). This has caused banks to rebalance their portfolios towards lower-risk investments such as government securities. While the risks are lower, so are the rewards.

Features of the industry

Number of players

2.6 At the end of September 2005, there were eighteen banks and five branches of foreign banks operating within Slovakia. In addition, there were 93 foreign entities providing some form of cross-border banking services.

2.7 Of the aforementioned eighteen banks, there were three building societies:

(a) CSOB Stavebná Sporiteľňa a.s.

(b) Prva Stavebná Sporiteľňa a.s.

(c) Wustenrot Stavebná Sporiteľňa a.s.

2.8 The table below charts an increasing number of branches and credit institutions operating in Slovakia since 2001.

Table 2.1: Slovak branches and credit institutions, 2001-2005

	2001	2002	2003	2004	2005
No of Branches	1052	1020	1057	1113	1142
No of Credit Institutions	21	20	21	21	23

Source: ECB

2.9 As noted above, foreign banks also play a significant direct and indirect role in the Slovak banking sector, especially so after the privatisation programme. Indeed, measured in terms of capital, foreign banks' market share increased between 1999 and 2004 from 37.8 per cent to 98 per cent.

Table 2.2: Foreign ownership of banking assets, 1999-2004

	1999	2000	2001	2002	2003	2004*
Share of foreign-owned banks in total banking assets (%)	37.8	40.6	90.5	95.6	96.3	98.0

** Preliminary data*

Source: ECB

2.10 This increase in asset ownership is not reflected in a significant upsurge in foreign subsidiaries and branches in Slovakia. This may suggest that the increase in banking asset ownership has come via acquisitions of Slovak banks during and following the privatisation programme at the end of 1990s and beginning of 2000's.

Table 2.3: Non-Slovak Branches and Subsidiaries, 2001-2005

	2001	2002	2003	2004	2005
Branches of Credit Institutions from EU area	2	2	3	3	5
Subsidiaries of Credit Institutions from EU area	13	14	15	15	15
Branches of Credit Institutions from third countries	0	0	0	0	0
Subsidiaries from third countries	1	1	1	1	1

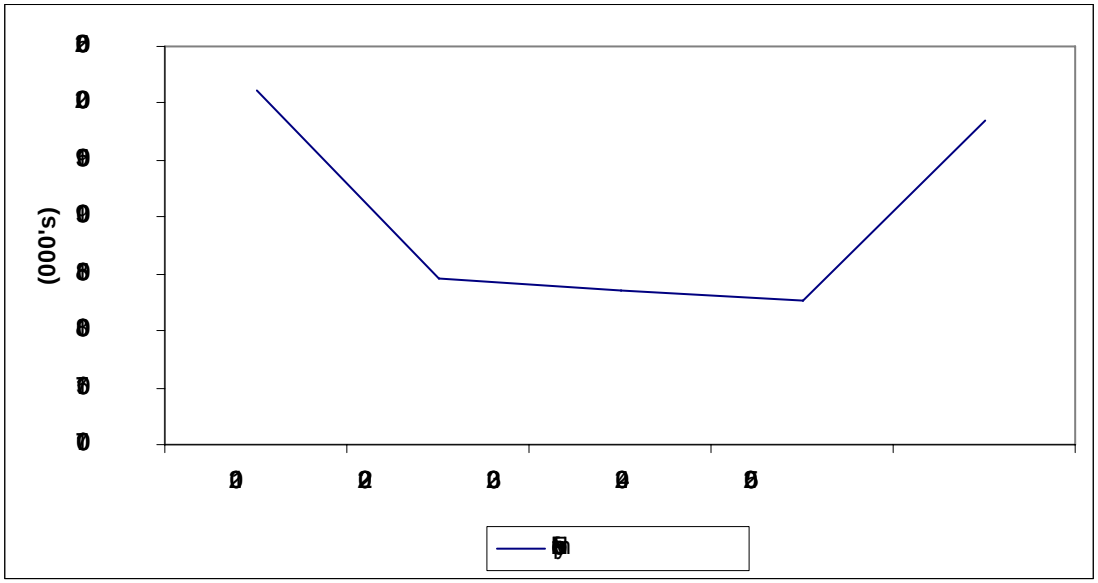
Source: ECB

Turnover, employment and profitability

2.11 Compared to other central and eastern European Member States, Slovakia has a relatively high level of monetarisation[40] (defined as total assets as a percentage of GDP): 99 per cent in 2002 compared to 72 per cent in Hungary and 67 per cent in Poland.

2.12 The figure below shows how employment in the banking sector has recovered in the past year. One might conjecture that the reason employment fell was merger and acquisitions during 2001 and 2002 which led to the restructuring of banks — see Table 2.8. Since the end of the major wave of mergers and acquisitions (and appropriate lag time) employment figures have recovered.

Figure 2.1: Employment in Slovak banks, 2001-2005



Source: ECB

Table 2.4: Trends in banking employment 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006
Banking Sector of the SR* - Total	25,049	24,096	23,232	21,639	21,133	21,282	20,745	20,981
Central Bank	1,313	1,304	1,321	1,315	1,315	1,357	1,172	1,228
Commercial Banks and Branch Offices of Foreign Banks Total	23,736	22,792	21,911	20,324	19,818	19,925	19,573	19,753
Commercial Banks - Total	22,803	21,839	20,796	19,151	18,386	18,492	18,097	18,098
of which:								
- Banks without foreign capital participation	16,258	15,435	7,469	1,000	1,020	879	787	792
- Banks with foreign capital participation	6,545	6,404	13,327	18,151	17,366	17,613	17,310	17,306
Branch Offices of Foreign Banks	933	953	1,115	1,173	1,432	1,433	1,476	1,655

Note: all figures refer to end of second quarter

**SR= Slovak Republic*

Source: National Bank of Slovakia

2.13 The decline in employee numbers between 2001 and 2004 is also reflected in profit/loss statistics for this period. The sector, in aggregate, recorded a profit again in 2005.

Table 2.5: Profit/Loss and Revenues in Slovak Banks 2000-2005 (SKK m)

	2000	2001	2002	2003	2004	2005
Profit/Loss	12,922	12,248	-12,053	-19,841	-21,977	15,212
Revenue	313,349	231,640	276,437	343,035	353,359	372,921

Source: Slov Stat Online

2.14 The National Bank of Slovakia (NBS) reports that by the end of the third quarter of 2005, total assets increased in the banking sector by SKK 187 billion to SKK 1.35 trillion. Earnings were reported at over SKK 1.5 billion. The bank also reports ROE as 16.8 per cent (weighted by volume of own funds).

2.15 According to the NBS, the average monthly wage in the financial intermediations sector in the second quarter of 2006 was SKK 42,470 compared to SKK 40,430 in 2005 second quarter and SKK 38,014 in 2004.

Market shares and concentration

2.16 In 2002, the banking sector remained dominated by the three ex-state banks: Slovenská sporiteľňa, Všeobecná úverová Banka and Tatrabanka.

2.17 The table below shows the share of total assets by the five largest banks rising (albeit marginally) between 2001 and 2005.

Table 2.6: CR5 share of total assets 2001-2005 (%)

2001	2002	2003	2004	2005
66.1	66.4	67.5	66.5	67.7

Source: ECB

2.18 However, when concentration is measured via the Herfindahl-Hirschman index, one sees concentration actually declining between 2001 and 2005.

Table 2.7: Herfindahl-Hirschman Index[41]

2001	2002	2003	2004	2005
892	856	783	798	795

Source: ECB

Switching behaviour

2.19 Switching is notoriously difficult to assess, and subjective judgment 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 take the view that switching between banking products has risen between 1999 and 2005 as market participants have become more sophisticated and the level of consumer information increased.

Dimensions of price and costs

2.20 Respondents to our survey have stated that the prices of banking products fell by more than 20 per cent between 1999 and 2005. The operational costs of banks also fell by a similar amount due to IT improvements.

Consumer protection

2.21 The results of our survey suggest that, in the banking sector, the volume of consumer complaints has remained constant in recent times. Transparency in the sector has increased.

[redacted]

The potential future role of technology

2.22 The view of respondents to our survey is that technology has facilitated the expansion of e-commerce and other new avenues of banking. The entry of new market players is expected to further expand this medium.

Trade and international penetration

2.23 The table below tracks mergers and acquisition in Slovakia since 2000. While there was a flurry of acquisitions in the early 2000's (related to sector restructuring), this has declined to no activity since 2004.

Table 2.8: Mergers and Acquisitions 2000-2006

	2000	2001	2002	2003	2004	2005	2006*
Domestic M&A's	0	1	0	1	0	0	0
Internal EU M&A's	1	4	2	2	0	0	0
Third country M&A's	0	0	0	0	0	0	0

*Source: ECB. * first half.*

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

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

2.24 Our econometric study suggests that the impact of the FSAP on trade has been a 1.3 per cent increase in imports of financial services other than insurance and pensions, and a rise of 1.6 per cent in exports. Full implementation of the FSAP is projected to lead to a further 1 per cent rise in imports and 2 per cent in exports.[42]

2.25 Respondents to the survey have identified the Accession of Slovakia to the EU as a major instrument in increased cross-border trade since 2004. The source of increased cross-border trade was identified as Austria, Germany and the UK. The form of cross-border trade has typically been parent companies and their subsidiaries and different banking services.

2.26 It is not easy, as in the case of other New Member States, to disentangle the effects of the FSAP from wider initiatives to join the EU.

Competition

2.27 While the overall number of banking institutions has risen between 1999 and 2005, respondents to our survey do not attribute this to the FSAP.

2.28 As previously mentioned, since Slovakia is a New Member State, it is difficult to disentangle the effects of the FSAP from the wider initiative to join the EU.

[2] [illegible]

Consumer protection, switching and product variety

2.29 Participants in our survey regard consumer protection and general transparency to have increased between 1999 and 2005, but not as a result of the FSAP, but other EC Directives and participation in the EU in general.

2.30 It is also stated that due to increasingly complexity of banking products and more competition, consumer understanding of banking products has declined since 1999. However, as the market beds down, consumer understanding is predicted to increase. Related to the increasing complexity is the increased variety of products on offer to consumers. It is expected that product variety will further increase in the presence of increased competition. These trends are said to happen independently of the FSAP.

2.31 Perhaps as a consequence of misunderstanding of banking products, switching behaviour is said to have increased between 1999 and 2005, and this phenomena is regarded as on-going.

2.32 The implementation of EC directives and a number of new primary and secondary pieces of legislation were identified by survey respondents as the drivers of improved supervision and rules in the banking sector. These improvements are expected to continue beyond 2005, but are believed to be the consequence of legislation required to become a member of the EU rather than additional measures.

Competitiveness

2.33 According to survey respondents, the main factors determining competitiveness of Slovak banks against the foreign competitors is the availability of skilled personnel, business infrastructure and a good business environment coupled with Government responsiveness.

2.34 Survey respondents also claimed that the provisions of the FSAP have disadvantaged European banks by creating an uneven playing filed vis-à-vis competition with non-EU banks.

Employment

2.35 As Table 2.4 shows, employment in the Slovak banking sector declined between 1999 and 2005. This has been mostly attributed to restructuring in the banking sector. Respondents to the survey also note that this change would have taken place regardless of the FSAP.

2.36 Respondents also stated that they expect the number of jobs in the sector to fall (thereby by inference seeing the increase in employment at the beginning of 2006 as an aberration) in the future.

2.37 Similarly, changes in wage levels in the sector were not caused by the introduction and implementation of the FSAP.

3 INSURANCE

Headline Overview

3.1 As noted in the introductory chapter, the National Bank of Slovakia is the supervisory agency for the insurance sector. Deposit insurance is provided for under the Bank Deposit Protection Act, and the amount contained therein was increased upon Slovakia's membership to the EU.

3.2 Within the financial services sector, insurance comes a distant second to banking – holding around six per cent of total assets, compared to eighty eight per cent held by banks. Nonetheless, the insurance sector is expanding with premium income rising: in 2005 total premium income rose to €1,366 million from €1,198 million in 2004.[43] Of these figures, approximately forty per cent comes from life assurance. Within the insurance sector, pension funds have seen the most rapid growth.

3.3 One of the most significant changes for the Slovak population last year was pension reform, which converted the pensions system to a three pillar system. The model consists of statutory pension insurance (1st pillar), commercial retirement savings (2nd pillar), and private pensions insurance (3rd pillar).

Turnover and employment

3.4 The table below charts the increase in revenue and changes in profitability in the sector since 2000.

Table 3.1: Insurance sector revenue, costs and profits 2000-2005 (SKK million)

	2000	2001	2002	2003	2004	2005
Revenue	50,699	56,880	88,284	147,737	140,155	146,334
Costs	49,865	55,657	88,291	146,455	137,247	143,756
Profit/Loss before taxation	804	1,223	-7	2,282	2,908	2,578

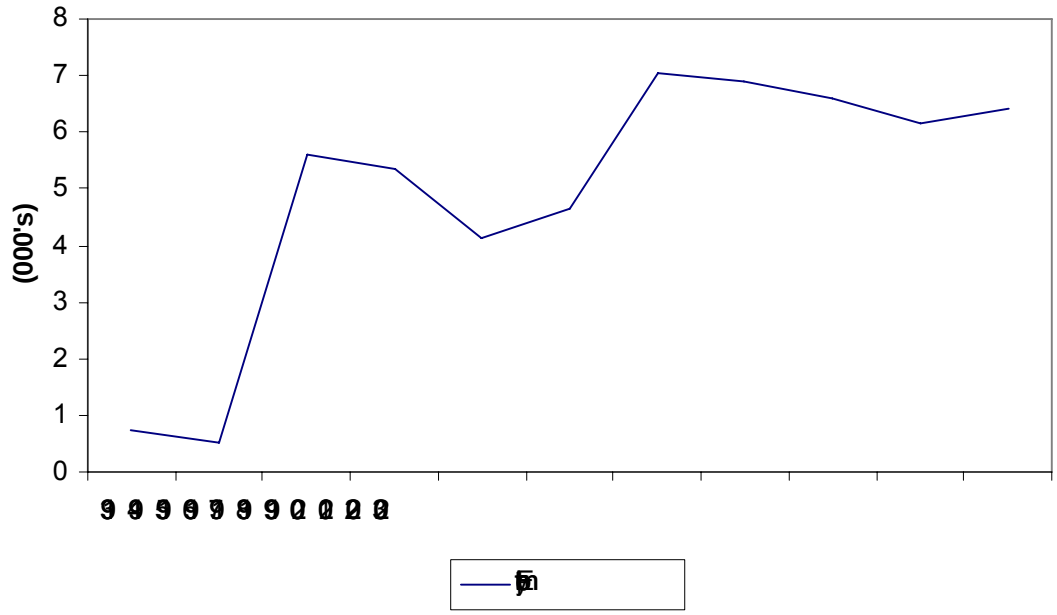
Source: Slov Stat Online

3.5 Profitability has more than tripled since 2000 due to significantly increased revenues, although the ratio of profitability to revenue has only increased marginally.

3.6 Total investments in the Slovak insurance sector reached €1,749 m in 2005, and the CEA reports that in the sector employed 6,484 staff in 26 companies.

[43] [redacted]

Figure 3.1: Employment in the Insurance and pensions sector

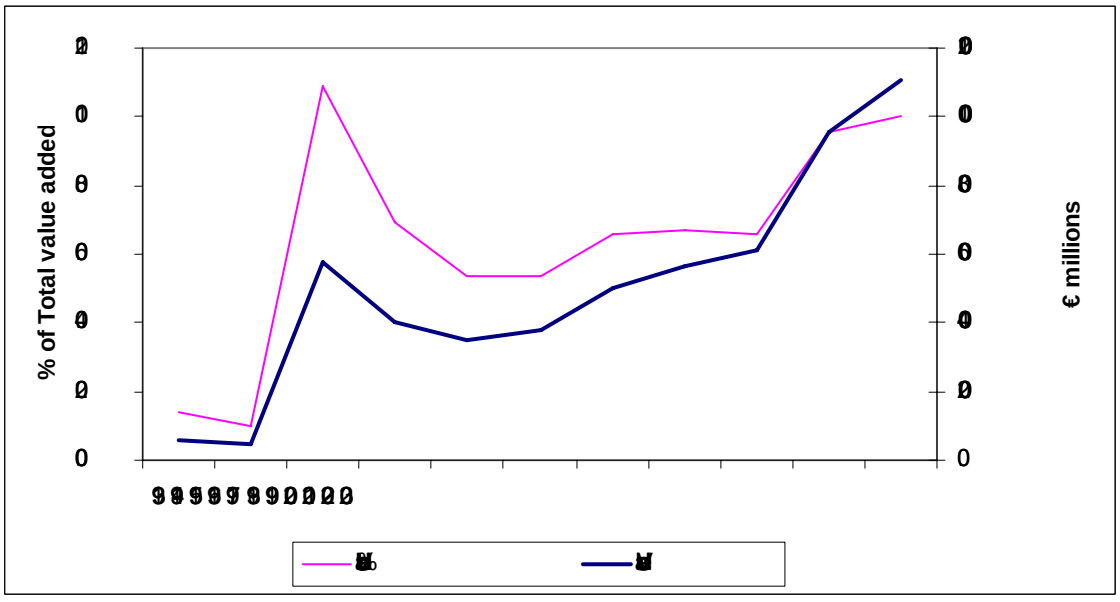


Source: University of Groningen

3.7 The level of employment in the insurance and pensions sector has been subject to volatility over the period 1993 to 1999. From the latter year, movements in the employment in this sector appear to have been somewhat less dramatic.

Value added and productivity

Figure 3.2: Value added of the Insurance and pensions sector



Source: University of Groningen

3.8 The value added of the insurance sector appears to have followed a growing trend on average over the period 1994 to 2004. The sharp increase in both the value added of the sector and its share of total value added in the economy between 1994 and 1995 seems to have coincided with an equally sharp jump in the number employed in the sector over the latter period.

Figure 3.3: Labour productivity in the Slovakian insurance and pensions sector

Source: University of Groningen

3.9 The increase in the number employed in this sector appears to have been followed by a fall in the level of productivity as measured per worker. Figure 3.3 illustrates that this decline continued up until 2000 where is appears to be on the rise again.

Market participants, shares, and competition

3.10 In the insurance industry in the Slovak Republic has passed through a successful de-monopolisation, beginning 2002, of mandatory insurance. Compulsory insurance had previously been administered by a single company. Slovenská poisťovňa which did not face any competition in this sector. According to the OECD, this de-monopolisation has had a positive impact on improving the quality of insurance services and products.

3.11 The table below shows the concentration ratios for the largest five non-life and life insurance groups in Slovakia. Since 1993, these ratios have fallen.

Table 3.2: CR5 ratios for non-life and life insurance companies 1993-2004 (%)

	1993	**2004**
Non-life	99.8%	89.7%
Life	100%	75.2%

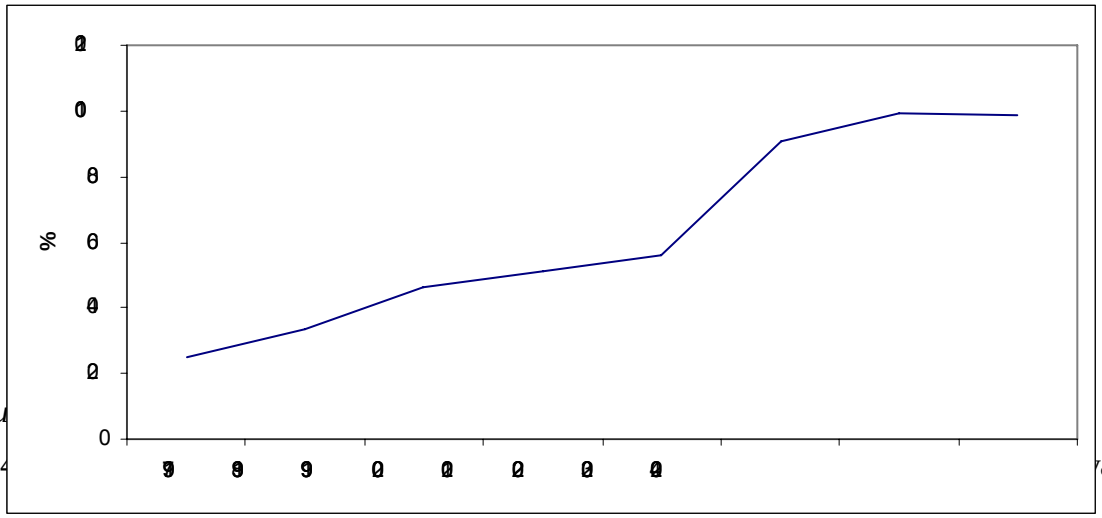
Source: CEA

3.12 There appears to be some sentiment that, for the size of the market, there are too many companies operating in Slovakia — this may indicate that there is scope for consolidation.

3.13 Table 3.3 shows the evolving channels for insurance distribution in Slovakia.

International Penetration

Figure 3.4: Market share of branches/agencies of foreign undertakings as a % of total domestic business



Sou

3.14 …akian

Table 3.3: Insurance distribution channels 1998-2004

	1998	2003	2004
Insurance company employees	42.3%	7.4%	11.6%
Agents (tied and multiple)	24.0%	51.6%	67.4%
Brokers	5.0%	19.1%	9.0%
Others	28.7%	21.9%	12%

Source: CEA

International entry

3.15 Between the years 2004 and 2004, the number of enterprises involved in selling insurance products declined from 28 companies to 26.

Table 3.4: Number of insurers in Slovakia 2003-2004

Year	National enterprises	Branches of non-EU/EEA countries	Total under national supervision	Branches of EU/EEA countries	Total activity in country	Branches of Slovak insurers in EU/EEA countries	Branches of Slovak insurers in non EU/EEA countries
2003	27	1	28	0	28	0	0
2004	25	0	25	1	26	0	0

Source: CEIOPS

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

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

3.16 Cross-border trade (as measured by use of international branches, mergers, and location of business) appears to have increased between 1999 and 2005 — although this was may be largely the result of EU membership and the accompanying Accession process. Survey respondents did not consider the FSAP as being responsible for the historic growth, nor is it seen as likely to contribute to increased cross-border trade activity in the future.

Competition

3.17 Barriers to entry may have fallen in the insurance sector, perhaps partly as a result of the FSAP. Other factors contributing to the fall may include Slovakia's entry to the EU (which allowed for the use of the Single European Passport) and full market liberalisation.

3.18 Insurance prices appear to have increased in Slovakia independent of the FSAP. Survey respondents expect this trend to continue.

3.19 Switching between banking products also increased between 1999 and 2005, the cause of which is identified by survey respondents as the FSAP. However, the impact of the FSAP is not expected to persist further, with future increases in switching not being caused by the FSAP.

Consumer protection

3.20 Preparations for Solvency II and other insurance related directives may have a positive influence on consumer protection. The directives contain a number of guarantee schemes, e.g. policyholder protection, which are expected to contribute to greater consumer protection.

3.21 Consumer complaints are expected to continue to rise regardless of FSAP related effects. The rise is attributed to the plethora of new insurance products entering the market causing consumer knowledge of all products to decline (with the associated rise in complaints). However, over the long run, consumer knowledge is expected to increase again.

Competitiveness

3.22 Survey respondents have answered that the provisions of the FSAP have enabled Slovak insurers to compete more effectively with non-European counterparts by giving them the following advantages:

(a) Reducing the regulatory burden;

(b) Creating a level playing field.

3.23 It is also reported that Slovak insurers are more vulnerable to takeovers from non-Slovak companies.

Employment and wages

3.24 During the period of the FSAP, the number of jobs in the insurance sector appears to have fallen. This does not appear to have been a result of the FSAP. The number of jobs in the sector is expected to stay constant over the next five years.

3.25 In contrast, survey respondents regard the FSAP as being responsible for an increase in monthly wages by up to 5 per cent. Subsequent pay rises are expected, but not due to EC policy.

4 SECURITIES

Headline Overview

4.1 The Bratislava Stock Exchange (BSSE) began trading in 1993. Its activities are governed by Stock Exchange Regulations, based on best practices in other European and world exchanges.

4.2 The BSSE has developed a number of cooperation mechanisms with its neighbouring exchanges, namely in Budapest, Ljubljana, Prague and Warsaw. At present cooperation relates to listing, trading, clearing and settlement rules as well as certain regulations. The BSSE is favourably disposed to an eventual merger of these exchanges.

4.3 The Table 4.1 below shows the volume of trades since the Exchange began trading.

Table 4.1: Total trading turnover 1993-2005

Year	Volume in SKK million	Volume in pcs.	Number of Transactions
1993	166.3	115 863	1 382
1994	6,283.5	8 591 864	12 967
1995	40,068.7	45 158 670	29 534
1996	114,116.3	131 235 383	180 910
1997	164,063 .9	140 220 395	157 797
1998	299,080.9	84 607 390	59 870
1999	188,441.3	53 429 940	20 659
2000	255,509.6	58 424 956	18 748
2001	393,481.0	70 512 567	20 169
2002	643,227.6	79 496 930	16 264
2003	1,096,728.7	39 278 975	62 890
2004	432,252 .2	22 377 500	17 644
2005	1,001,876.4	19 946 785	10 814

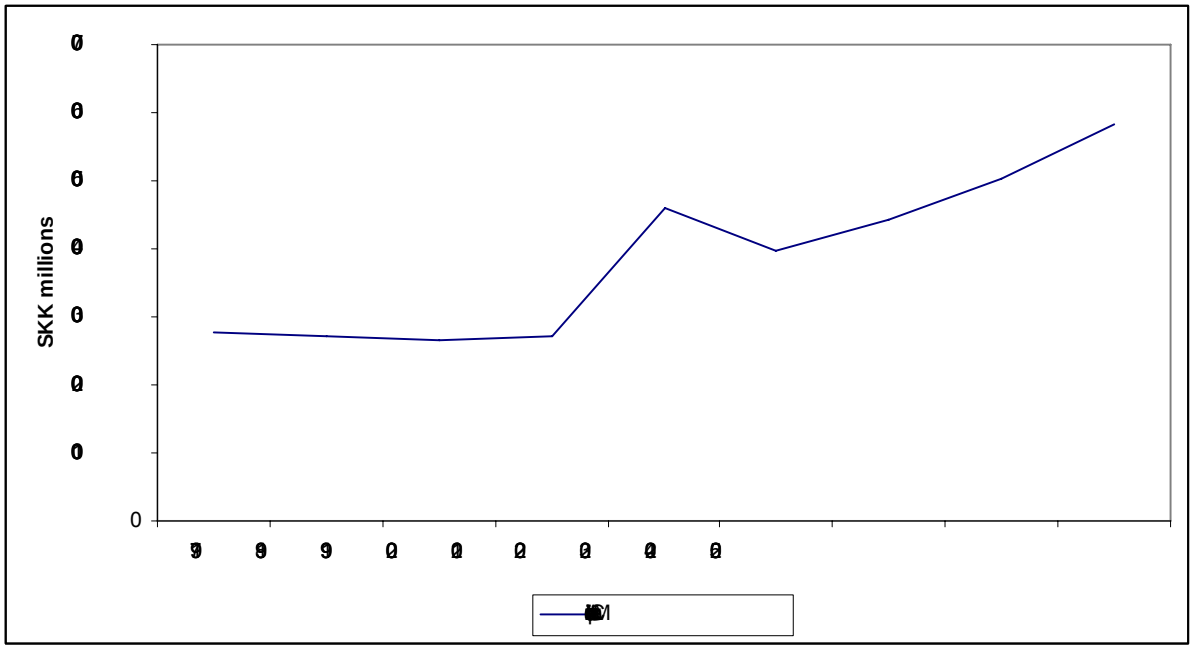
Source: Bratislava Stock Exchange

Table 4.2: Number of members and foreign investors 1993-2005

Year	No. of Members	No. of Trading Days	Foreign Investors
1993	17	84	na
1994	32	250	na
1995	48	245	na
1996	53	247	13%
1997	54	242	11%
1998	50	243	24%
1999	47	239	28%
2000	44	242	38%
2001	40	243	30%
2002	34	243	28%
2003	30	243	48.1%
2004	30	245	49.6%
2005	28	242	50.9%

Source: Bratislava Stock Exchange

Figure 4.1: Total market capitalisation (SKK million) 1997-2005



Source: Bratislava Stock Exchange

4.4 There is no screening process for foreign investment, and both 100 per cent foreign ownership and repatriation of profits are permitted. In its "Doing Business in 2005" report, the World Bank named Slovakia as the worlds top reformer in improving its investment climate over the last year, allowing it to join the top 20 economies in the world for ease of doing business.

4.5 According to the Economist Intelligence Unit, "Foreign capital already controls nearly 100 per cent of banking assets." Interest rates have been completely liberalized, and credit limits abolished.

4.6 The capital market is relatively new and small, with most trading involving government bonds.

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

Cross-border activities

4.7 It would appear that the FSAP may have had a positive impact of increasing cross-border activities in the securities market. However, given that MiFID has yet to come into force, the long run effect of the FSAP is unclear.

4.8 The growth in the number of foreign investors participating in the BSSE, as illustrated in Table 4.2, began just prior to the inception of the FSAP. This, in part, can be interpreted as at attempt by foreign investors to increase their exposure to the Slovakian securities market in the anticipation of what would eventually be the further opening up of the market.

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. The significant question is if the BSSE 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 BSSE into a large system the BSSE would lose most of its disadvantages as a small exchange. As a consequence, the effect of MiFID would be more limited.

4.10 It is interesting to note that respondents to our survey believed that access to other markets has improved (and would continue to do so) as a result of the FSAP.

Consumer protection

4.11 Given the stage in the development of Slovakia securities market relative to those of older member states, the comprehensiveness of the consumer protection regime is unlikely to be as robust. Thus, consumer protection issues are likely to be of particular relevance to the Slovakian securities market. Provisions, for example, pertaining to corporate governance rules and increasing transparency (i.e. reducing the asymmetry between firms and consumers), should have improved the degree of client protection in the Slovakian securities market, and this can largely be attributed to the implementation of the FSAP.

Competitiveness

4.12 As MiFID has not yet been implemented, the effects of the FSAP on the competitiveness are as yet unclear.

4.13 As explained above, it remains to be seen whether the BSSE will merge with other bigger players or retain its independence. Indeed, in the former scenario, the BSSE is likely to eliminate many of the pitfalls facing small exchanges and thus put it at a less competitive disadvantage.

4.14 However, if the exchange does not integrate into one of the systems the competition from other exchanges is likely to intensify. No only would it retain many of the disadvantages that face small exchanges, it may also become less competitive by virtue of the increased regulatory requirements (which tends to increase the burdens of compliance costs) stemming from the implementation of the FSAP.

Employment

4.15 Thus far, the FSAP appears not to have had a significant effect on the employment levels in this sector. 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 might also increase the aggregate level of employment in the Slovakian securities market. So far, the net effect is unclear.

Other objectives of the FSAP in the securities sector

4.16 As evidenced by Table 4.1, total trading turnover has increased significantly for the period 1999 to 2005. Respondents to our survey acknowledge this, but do regard the FSAP as having caused this. However, it is expected to contribute to higher trade volumes in the future.

4.17 In fact on the following general objectives, respondents did not see the FSAP as having an impact between 1999-2005, but in the future, having a slightly positive impact post 2005:

(a) Increasing the importance of news in one market as a driver of returns in another;

(b) The expansion of stock and derivative exchanges across national borders.

4.18 In contrast, for the following general objectives, respondents felt that the FSAP had made a slightly positive difference in 1999-2005 and would continue to do so into the future:

(a) Converging corporate bond yield spreads across different European markets;

(b) Corporate finance services becoming more integrated;

(c) The emergence of online securities trading provided by e-banks and investment firms on a cross-border basis;

(d) A common legal framework for integrated securities and derivatives markets;

(e) Removing outstanding barriers to raising capital on an EU-wide basis;

(f) Moving towards a single set of financial statements for listed companies; and

(g) Creating a coherent legal framework for supplementary pension funds.

4.19 When asked about the impact on extra-EEA competition, survey respondents saw the FSAP as important in maintaining the level of competition. In its absence, they claimed, competition would have been decreased.

5 FINANCIAL CONGLOMERATES IN SLOVAKIA

5.1 There are no financial conglomerates with their head office in Slovakia.

5.2 The table below shows the main financial conglomerates operating in Slovakia:

Table 5.1: Main financial conglomerates operating in Slovakia

Financial conglomerate	Head Office	Characterisation of Conglomerate	Primary business in Slovakia
Erste Bank	Austria	Banking and Insurance services	Banking
Allianz	Germany	Insurance group doing asset management and banking	Insurance with some banking
BNP Paribas	France	An equal focus on retail, corporate and investment banking, asset management	Equal focus on Insurance and Investment Banking
Eureko	Netherlands	Insurance group doing asset management and banking	Insurance
Gruppo Banca Intesa	Italy	Banking	Banking
Provident Financial	UK	Lending company whose speciality is home credit	Banking

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

5.3 It can clearly be noted that none of the conglomerates with a presence in Slovakia are based in the country. Nor is the co-ordinating regulator in any of these cases Slovakian.

5.4 In a monograph on Bancassurance, it is argued that the bancassurance model of provision of financial services is expected to increase in response to regulation.[44]

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

5.5 As we can see in Table 5.1, the financial conglomerates operating in Slovakia tend to engage in banking and insurance activities to relative equal levels. Thus, the conclusions for financial conglomerates in Slovakia are close to those for banking and insurance.

[4] [redacted] [redacted]

Openness

5.6 While the openness in the insurance and banking sector has probably increased, we have seen that the form of entry by banks and insurance firms into Slovakia has been negligibly affected by the FSAP. However, 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.

5.7 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.

5.8 Thus our assessment is that the FSAP has had a negligible impact.

Competition

5.9 We have seen that competition is expected to be limited in the banking sector, while it is expected to be positive in the insurance sector. As a result, we expect the effects on financial conglomerates overall, to be limited.

Consumer protection

5.10 While the effects on consumer protection are expected to be limited in banking and positive in insurance, we expect that, overall, to the extent that conglomerates engage in insurance activities, the effects will be positive.

Employment

5.11 We assess the effects on employment in both banking and insurance sectors as negligible.

Competitiveness

5.12 Given our assessments in the baking and insurance sections, we expect the overall effect on financial conglomerates will be negligible.

6 CONCLUSIONS

Assessment

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

SLOVENIA

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Slovenia

Division of responsibility

1.1 Responsibility for financial services regulation and supervision of banking, securities, and insurance markets in Slovenia is spread across three authorities.

(a) **Bank of Slovenia**: an independent Central bank established in 1991. It is responsible for the supervision of the banking sector.

(b) **Securities Market agency:** Established as an independent organisation in 1994 by the Security Market Act. It is responsible for the supervision of the securities sector. It reports annually to the National Assembly of the Republic of Slovenia.

(c) **Insurance Supervision Agency**: Established in 2000 following the Insurance Act. It is responsible for the supervision of the insurance market. It is a legally independent agency and is accountable to the National Assembly.

1.2 While these three authorities are separate legally and organisationally, they are required by law to cooperate in their activities and to exchange information. This is in accordance with the Rules on mutual cooperation between the supervisory bodies as issued by the Ministry of Finance.

Key features of banking regulation

1.3 The main overseer of banking in Slovenia is the Bank of Slovenia.

1.4 The main legislation affecting the Slovenian banking system includes:

(a) The Banking Act 1999 (amended 2004);

(b) Consumer Credit Act 2004.

Key features insurance regulation

1.5 The main overseer of insurance regulation in Slovenia is the Insurance Supervision Agency.

1.6 The main legislation affecting the Slovenian insurance system is the Insurance Act.

Key features of securities regulation

1.7 The main overseer of securities in Slovenia is the Securities Market Agency.

1.8 It engages in international cooperation with other security regulators such as the IOSCO (International Organisation of Security commissions) and the CERS (Committee of European Securities regulators). This is primarily through exchanges of information.

1.9 The main legislation affecting the Slovenian securities system is the Securities Market Act.

Factors Specific to Slovenia

1.10 During its 14 years as an independent state, Slovenia has been undertaking a process of two-fold transition. In addition to making the transition from a Socialist to a market economy, it has also been faced with having to make the transition from a regional economy, as part of the SFR Yugoslavia, to a national economy.

1.11 Despite having approximately one-thirteenth of Yugoslavia's total population, of all the Yugoslav republics it has been the most productive with a GDP per capita in 2002 estimated at just over 75 per cent of the EU average.

1.12 In comparison to other transition countries, Slovenia has been characterised by a relatively high level of economic development. According to the Global Development Network, higher volume of domestic financial resources has enabled the country to embark not only on a different transitional path than many of the other Central Eastern European Countries (CEEC's), but also employ a different sequencing of transitional activities. Its main characteristic has been a strong preference for the gradualist over the shock therapy approach.

1.13 Since 2002, the major developments in Slovenia's financial sector have been the privatisation of state owned banks and state owned insurance companies in preparation for EU accession that Slovenia achieved in May 2004.

1.14 Slovenia adopted the euro on the January 1 2007.

2 BANKING

Headline Overview

Factors Specific to Slovenia

2.1 The IMF's 2004 assessment of Slovenia's Observance of Standards and Codes, recommended that given the increasing complexity of the financial system supervisory resources are still in need of expansion.

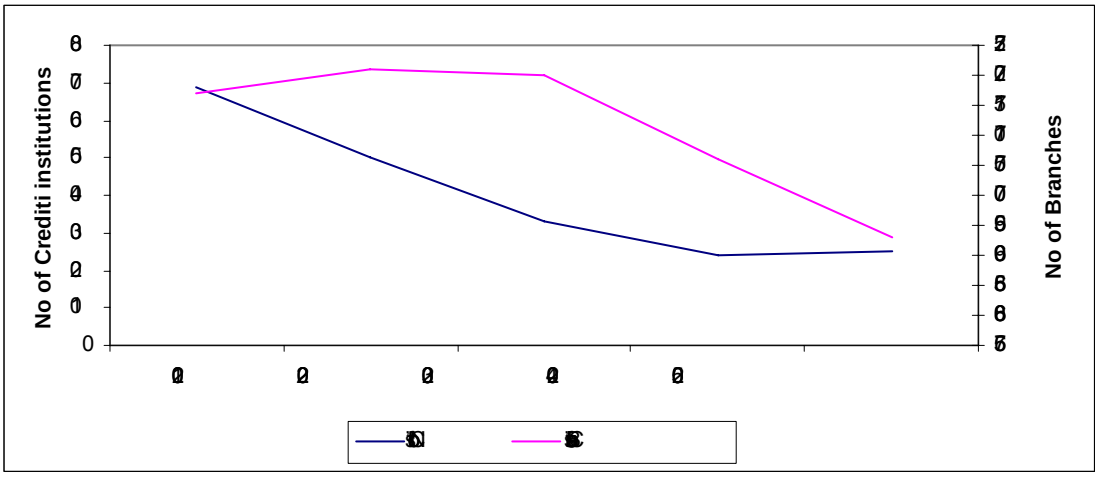
2.2 The National Bank of Slovenia, in its 2006 Annual Report, noted that all banks have now met the minimum capital requirement as of December 2005. Compared to 2004, there has been a significant shift towards the 8–10 per cent interval (from 3-5 per cent) and the 10-12 per cent interval (from 9-10 per cent).

2.3 In the same report, the IMF stated that Slovenian banking supervision showed good compliance with the Basel Core Principles and continues to improve as reflected in several upgrades from the 2001 FSAP.

Features of the industry

Players

Figure 2.1: Number of CI's and branches 2001-2005

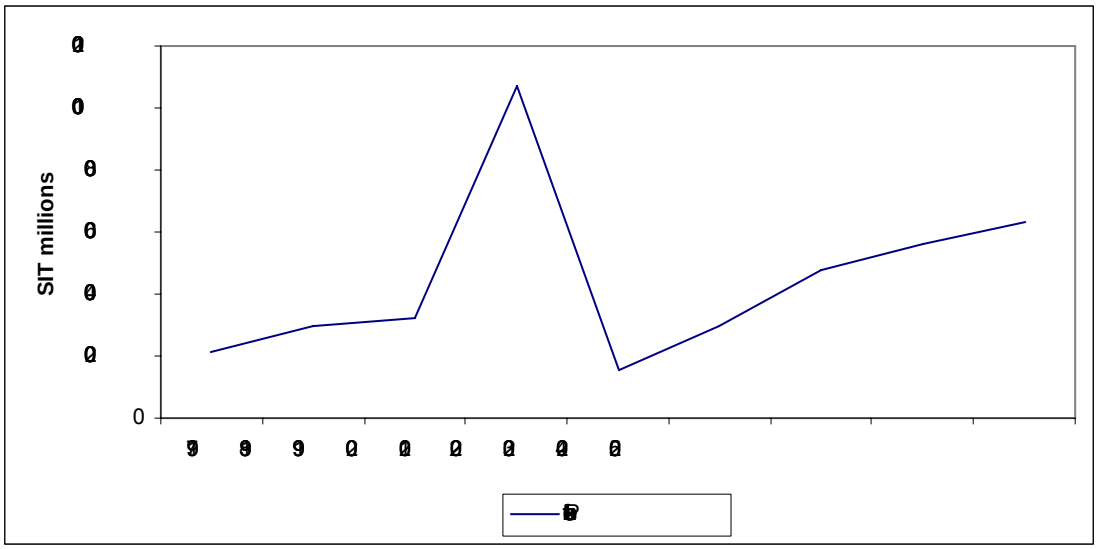


Source: ECB

2.4 As Figure 2.1 shows, the fall in the number of CI's was significant over the period 2001 and 2004 and began to creep up slightly from 2004. The number of branches also declined quite dramatically from 2003.

Income and employment

Figure 2.2: Profit before tax of the banking sector 1997-2005

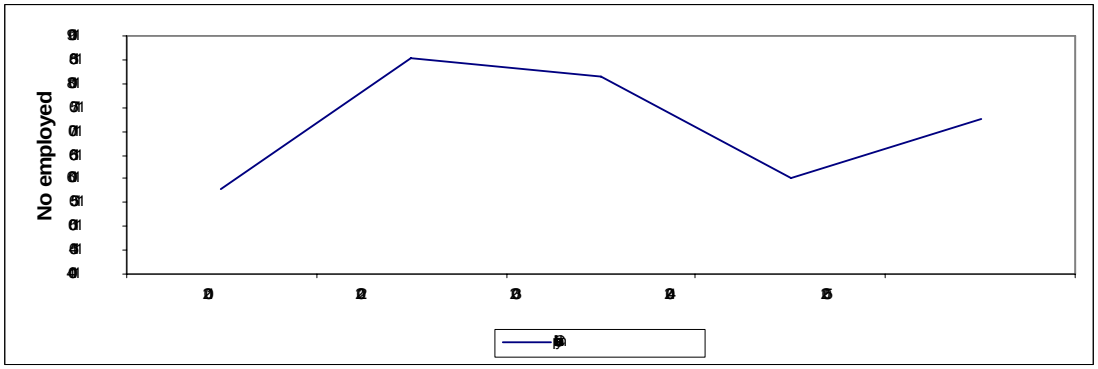


Source: OECD

2.5 Figure 2.2 shows the level of profit of the banking sector over the reported period. Profit before tax has tended to increase. Over the same period there has been a deepening of the banking sector in the Slovenian economy. The ratio of total banking sector assets to GDP has grown from 73.6 per cent in 2001 to 94 per cent in 2005.

2.6 Credit expansion in the sector has been promoted by macroeconomic stabilization and, in particular a build up of confidence in policy frameworks that ensured an environment of moderate and low inflation, which allowed interest rates to decline. CPI inflation fell from 5.7 to 2.3 per cent between 2003 and 2006 (Q1).

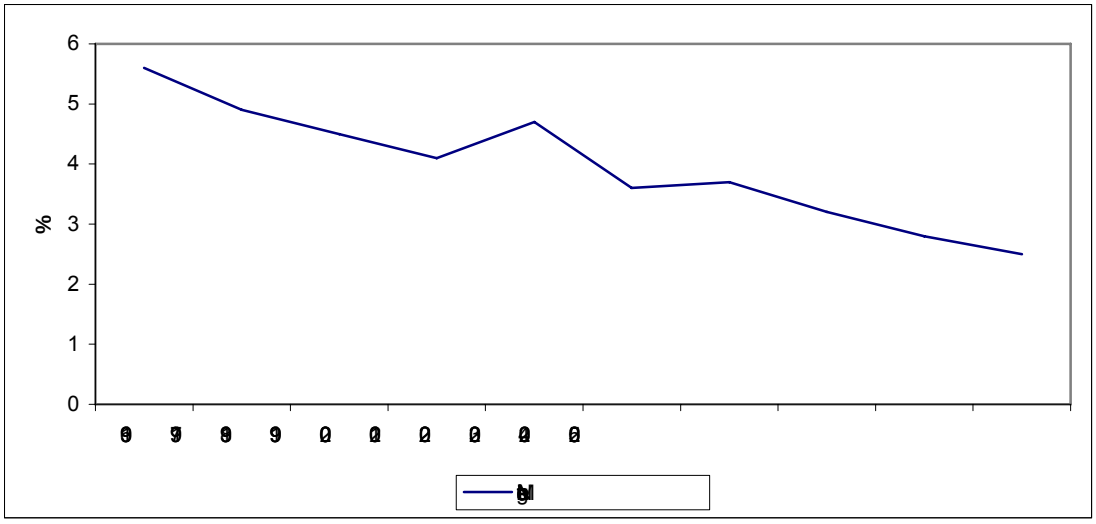
Figure 2.3: Number employees in credit institutions 2001-2005



Source: ECB

2.7 The number of those employees in the banking sector fell over the same period that the number of branches fell. While Figure 2.3 indicates that employment is rising again in this sector, once the privatization of the banking sector in Slovenia is completed, it is likely that employment will drop off again as the re-organization and rationalization that is characteristic of privatisation continues. Although, the two largest banks, NLB and NKBM, are majority owned by the state, the current government has stated that it is committed to privatising them.

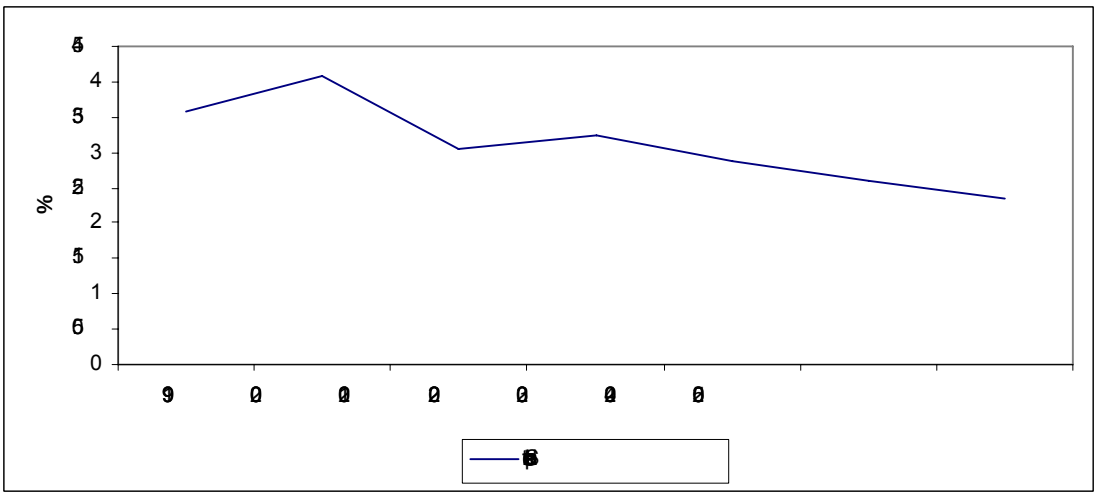
Figure 2.4: Net interest margin of the banking sector 1996-2005



Source: OECD

2.8 Figure 2.4 illustrates a declining trend in the net interest margin of the Slovenian banking sector between 1996 and 2005.

Figure 2.5: Average interest rate spread of the banking sector 1999-2005

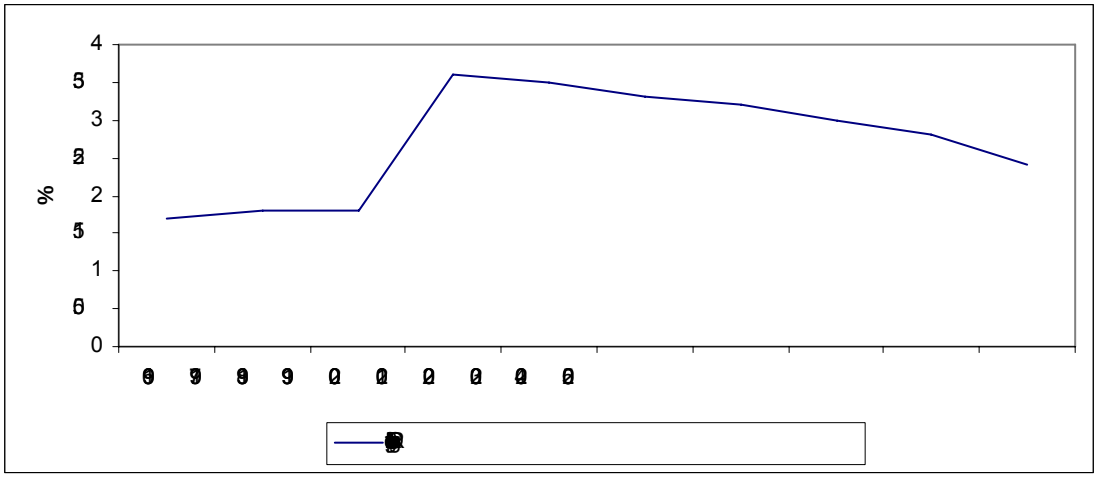


Source: National Bank of Slovenia

2.9 There has been a general decline in the average interest rate spread of the banking sector between 1999 and 2005.

Profitability and Competitiveness

Figure 2.6: Operating costs to average total assets 1996-2005



Source: OECD

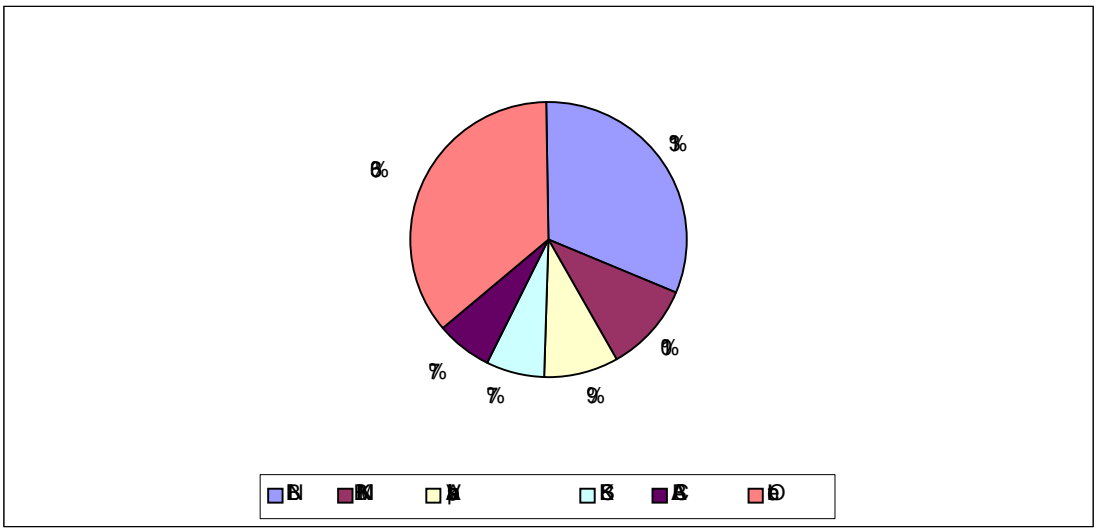
2.10 As an efficiency indicator, Figure 2.6 above suggests that there has not been a significant improvement to efficiency in the banking sector. However, according to the Bank of Slovenia, the growth in banking assets continued to outstrip that of operating costs in 2005 by 10 per cent. Efficiency will have thus improved more than this might suggest.

2.11 In 2005 there was a 4.6 per cent real growth in operating expenses but this was still 2.3 per cent lower than the growth in gross income over the same period.

2.12 In 2005, the National Bank of Slovenia identified the IFRS and the preparation and anticipation of the euro as the main sources of the increase in the operation costs of the banking sector. These have increased demand, and thus costs, of consultancy services. The real growth in the costs of the latter was 40.8 per cent in 2005. This could be regarded as 'one off' costs. Once firms understand and adopt the appropriate measures the demand for such consulting services are unlikely to be as great.

Market concentration and Competition

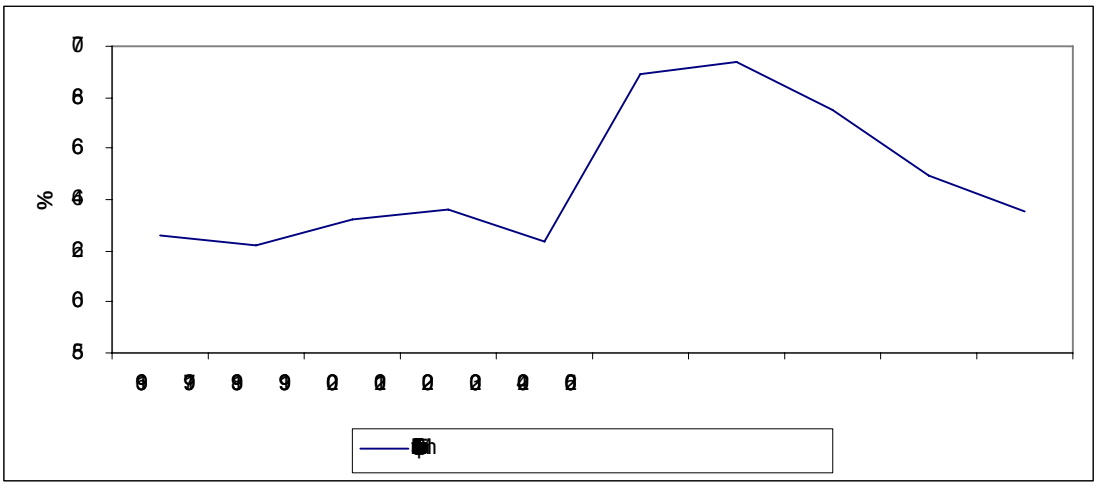
Figure 2.7: Share of total assets of the top 5 companies 2005



Source: National Bank of Slovenia

2.13 The banking sector is marked by a fairly high degree of concentration (the three largest banks account for half of total banking sector assets and the top seven hold almost 80 per cent of the market). The 2006 Investment climate report on Slovenia states that the banking sector is also marked by excess capacity and as a result, a number of the banks are unable to exploit economies of scale and have relatively low productivity levels, with the consequences being high margins and low returns on equity. With respect to Return on Equity (ROE), this was 13.42 per cent in the banking sector in Slovenian in 2005 whereas in Hungary, Poland, Czech Republic, and Slovakia it was 24.75, 20.14, 24.13, and 17.46 respectively.

Figure 2.8: Share of total assets of the 5 top companies 1996-2005



Source: ECB

2.14 As can be seen from Figure 2.8, from 2002 there has been a decline in the share of total banking assets concentrated in the top five banks. Given the contribution of Slovenia's accession to the EU in lowering the technical and regulatory barriers to cross-border activities, this trend is one that is likely to persist. The Bank of Slovenia noted in its 2005 Annual Report that the year prior to and after EU accession had been characterized by an increase in the market shares of foreign owned banks and that this has largely been at the expense of the market shares of the largest banks.

2.15 This trend is evident in the figures. The share of the largest CI's in Slovenia was 67.6 per cent in 2001 and has fallen to 63 per cent in 2004.

2.16 Despite the reduction in the concentration ratio in the banking sector, the Herfindahl–Hirschman Index illustrated in Table 2.2, suggests that the concentration level in the Slovenian banking sector is moderate as it lies above 1000, but still below 1,800. The index for Slovenia is also high relative to a number of the other new member states such Hungary, Czech Republic, Poland, and Slovakia, which have index scores of 795, 1155, 650, 1076 respectively. However, that this index has been falling over the period 2001 to 2005 also suggests that the intensity of competition in the banking sector has been increasing. Competing for greater market share on the basis of price would account for the squeeze in the interest rate spread as shown in Figure 2.5.

2.17 Banking sector reforms have also led to substantially higher competition and increased supply of new products (e.g. mortgage loans).

Table 2.1: Mergers and Acquisitions

	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006***
Domestic M&A's	0	1	0	1	0	0	0
Internal EU M&A's	1	1	3	0	1	1	1
Third country M&A's	0	0	0	0	0	0	0

*Source: ECB **first half*

Table 2.2: Herfindahl- Hirschman Index[45]

2001	**2002**	**2003**	**2004**	**2005**
1582	1602	1496	1425	1369

Source: ECB

2.18 The balance sheets of Slovenia's banks appear to be relatively strong and this is seen to largely reflect both the early and aggressive program of bank rehabilitation that was launched by the Government in 1992.

2.19 However, the disparity that characterises the balance sheets between large and small banks, suggests that the ultimate consolidation of the banking sector is inevitable. The Government has encouraged mergers as a means of dealing with the sector's excess capacity. As illustrated in Table 2.1, between 2001 and the first half of 2006, there have been two domestic and eight internal EU M&A's in the banking sector.

Cross-border activity

Table 2.3: Number of non-Slovenian branches and subsidiaries

	2001	2002	2003	2004	2005
Branches of CI's from EU area	1	1	1	2	3
Subsidiaries of CI's from EU area	4	5	5	5	6
Branches of CI's from third countries	0	0	0	0	0
Subsidiaries from third countries	0	0	0	0	0

Source: ECB

2.20 Private and Foreign ownership of the banking system has been increasing. In 2002, the sales of 39 per cent of the Government share of Slovenia's second largest bank reduced the Governments overall shareholding of the banking sector to approximately 20 per cent.

Table 2.4: Foreign ownership of Banks in 2003

	No of commercial banks	Of which foreign owned	Share of total assets that are foreign owned (%)
Czech Republic	35	27	96
Estonia	6	3	97
Cyprus	14	6	12
Latvia	22	9	47
Lithuania	13	10	96
Hungary	36	29	83
Malta	16	10	68
Poland	60	46	68
Slovenia	22	6	36
Slovakia	21	19	96

Source: Converium, OECD, CEA

2.21 The level of foreign ownership in the Slovenian banking sector has been somewhat limited relative to the other New Member states and this has largely been due to the slow pace of privatisation of the banking sector. This comparison is illustrated in Table 2.4. The limited participation of foreign ownership suggests there may be a lot of scope for this to increase in the coming years. Evidence of this is already apparent. The number of branches and subsidiaries of CI's from the EU area, as illustrated in Table 2.3, have grown from 1 to 3 and 4 to 6, respectively, between 2001 and 2005.

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

Cross-border activities and openness

2.22 While the share of foreign ownership in the banking sector is increasing, in 2003 it still remained low relative to the other Accession State.

2.23 The remaining barriers to cross-border trade, were removed upon Slovenia's accession to the EU in 2004. Coupled with the continuing process of privatization, the level of cross-border activity in the Slovenian banking sector has increased. As well as providing a 'single passport', EU accession removed the remaining barriers to foreign service providers setting up branches in Slovenia. Prior to this, the setting up of the latter had relatively more costs associated with it than setting up a subsidiary. Indeed, the number of branches, as highlighted in Table 2.3, increased from one in 2001 to three in 2005.

2.24 While this has not been a direct impact of the FSAP, it is difficult to divorce the effects of accession and the FSAP on having increased cross-border activity. Indeed, the FSAP should have served in removing technical and regulatory barriers to engaging in cross-border activities enhancing both the possibilities and incentives for foreigners to set up banking operations in Slovenia.

2.25 It may be interesting to note that respondents to our survey believe that cross-border trade in the future, with the use of international branches, is likely to increase and that in the absence of the FSAP such an increase is unlikely to transpire. Rather, the future level of cross-border trade would be relatively unchanged from the current level.

2.26 In our opinion, overall, it would appear that the FSAP has had only a slightly positive effect on the level of cross-border activity in the Slovenian banking sector. This is because despite the significant increase in openness that there has undoubtedly been, accession and the anticipation of it would have brought about a significant part of this increase in activity even in the absence of the FSAP.

Competition

2.27 Given the small positive impact we believe the FSAP has had on the openness of the Slovenian banking sector, it would also appear that the FSAP has had a slightly positive impact on the level of competition in the sector.

2.28 The greater the level of openness of the sector, the greater will be the level of contestability. A highly contestable market is one where firms tend to behave more competitively than they would were there no significant threat of entry. Thus contestability should improve the intensity of competition in the sector, increase consumer choice and drive prices towards the competitive level (i.e. where price is equal to marginal cost).

Consumer protection

2.29 We are of the view that the FSAP has and will have had a positive impact on the degree of consumer protection in the banking sector. The contribution that the FSAP should have had in instilling a more robust and credible institutional and regulatory structure in the banking sector should have increased the overall comprehensiveness of the consumer protection regime.

2.30 In addition, increased competition should provide greater protection for consumers.

Competitiveness

2.31 We believe that the FSAP appears to have had a limited impact on the competitiveness of the banking sector. Although greater competition in the sector should improve competitiveness, we have assessed that the FSAP has not played the predominant role in this. Indeed, there are a number of reasons to suggest that the impacts of the FSAP may in the medium to long run in fact reduce the level of competitiveness of the banking sector. This may be for the following reasons:

(a) The greater level of regulation stemming from the FSAP is likely to increase the burdens faced by firms in the banking sector in terms of compliance costs and regulatory fatigue.

(b) The increase in the compliance costs may to some extent mute the improvements in the efficiency saving costs arsing as a consequence of intensified competition.

(c) Increased compliance costs may also serve in acting as entry barriers and thus impinging on the degree of contestability in the sector.

Employment

2.32 Despite some cyclical variations illustrated in Figure 2.3, since 2001 the level of employment in the Slovenian banking sector has remained at approximately the same level. With the information we have, it is difficult for us to draw firm conclusions about the impact of the FSAP on the level of employment in the Slovenian banking sector, especially since Slovenia is a New Member State. Indeed, in this case it is difficult to distinguish the differences between the impact of the FSAP and the initiatives taken in view of the Accession to the EU.

3 THE SLOVENIAN INSURANCE SECTOR

Headline Overview

Factors specific to Slovenia

3.1 Composite insurance companies are insurance companies that are authorised to perform operations in both life and non life insurance. Nine of these companies are mainly domestically owned (approximately 90 per cent).

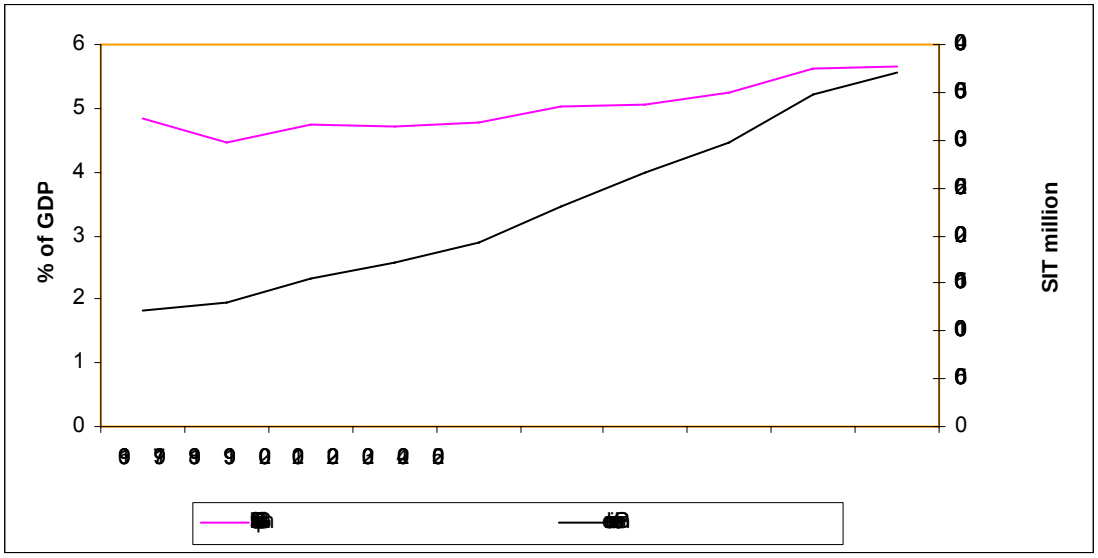
3.2 According to the IMF's 2004 assessment on Slovenia's Observance of Standards and Codes, the insurance sector was lacking in transparency and needs to develop greater capacity in setting prices and provisioning.

3.3 With regards to the effects of the Solvency II regime, although the current solvency requirements in force at the national level are in line with the requirements prescribed by the EU, given its relative infancy, it is certainly challenging to gauge the market effect of the new regime.

Features of the industry

Income and Employment

Figure 3.1: Gross premium of the insurance sector 1996-2005



Source: Association of Slovenian Insurers

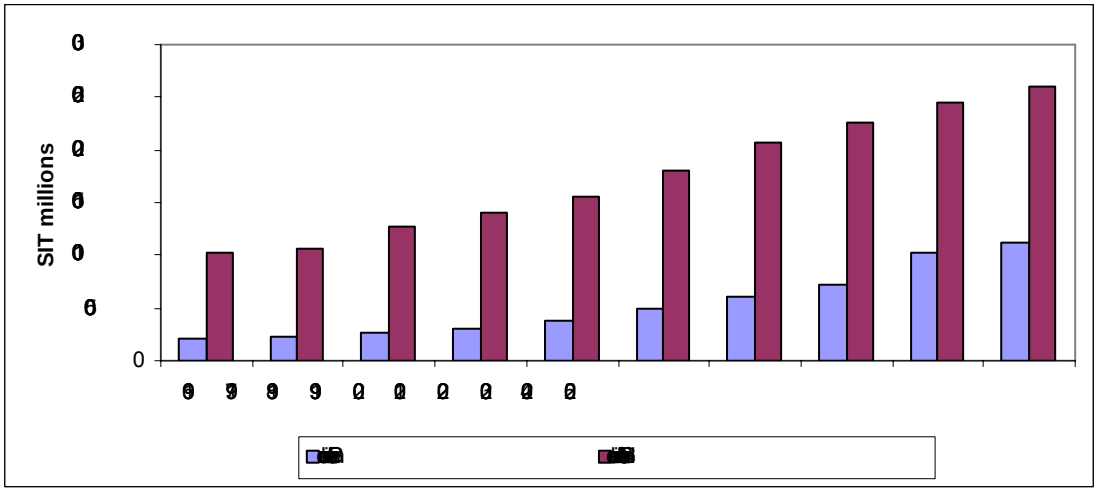
3.4 Figure 3.1 shows significant growth in both gross premium income and the amount it accounts for of GDP.

3.5 Insurers form the largest group among the non-money financial institutions, accounting for 8.5 per cent of total assets in the financial services industry.

3.6 The State still owns 60 per cent of the entire insurance market. This suggests there is greater scope for growth in this market through rationalisation and improvements in efficiency. This may be accompanied by a reduction in the level of employment in this sector as capital replaces labour.

3.7 According to the ASA, the insurance sector, in 2005, was marked by intense preparations for joining the EMU in 2007, the adoption of IFRS, reform of Health insurance, and Solvency II.

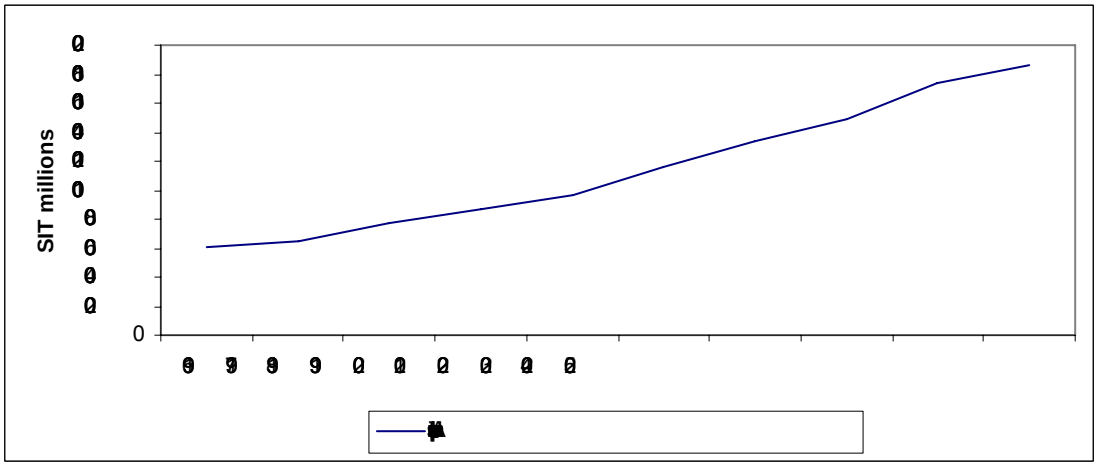
Figure 3.2: Gross life and non-life premium income 1996-2005



Source: Association of Slovenian Insurers

3.8 Figure 3.2 above, illustrates that the non life insurance sector has increased much more than the life insurance sector. Much of this increase is attributable to the rise in the level of credit insurance written premiums. The expansion of consumer credit (e.g. for mortgages etc) and thus the increase in the associated type of insurance policies, goes some way in accounting for this increase in the expansion of non-life insurance premiums in the Slovenian insurance sector.

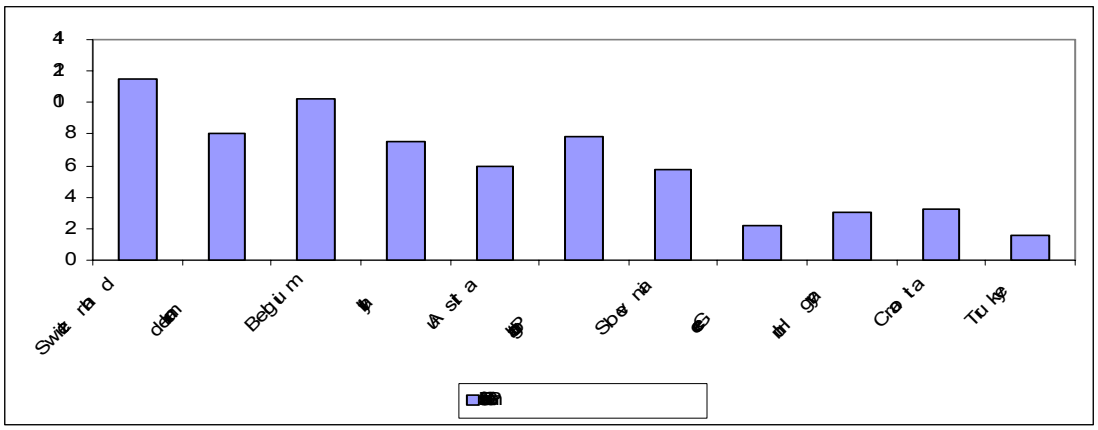
Figure 3.3: Annual expenditure per capita on insurance 1996-2005



Source: Association of Slovenian Insurers

3.9 As is illustrated in Figure 3.3, average expenditure per capita on insurance has followed a solid non-interrupted growth trend over the reported period. Premium income as a share of GDP in Slovenia was just under six per cent in 2005 and is relatively in line with many of the other Member States as illustrated in Figure 3.4.

Figure 3.4: International comparisons of Premium as a share of GDP 2005



Source: Association of Slovenian Insurers

Employment and Productivity

3.10 Respondents to our survey predicted that employment in this sector is likely to increase by at least 15 per cent between 2005 and 2010. However, consensus over what this anticipated change would be in the absence of FSAP, is lacking.

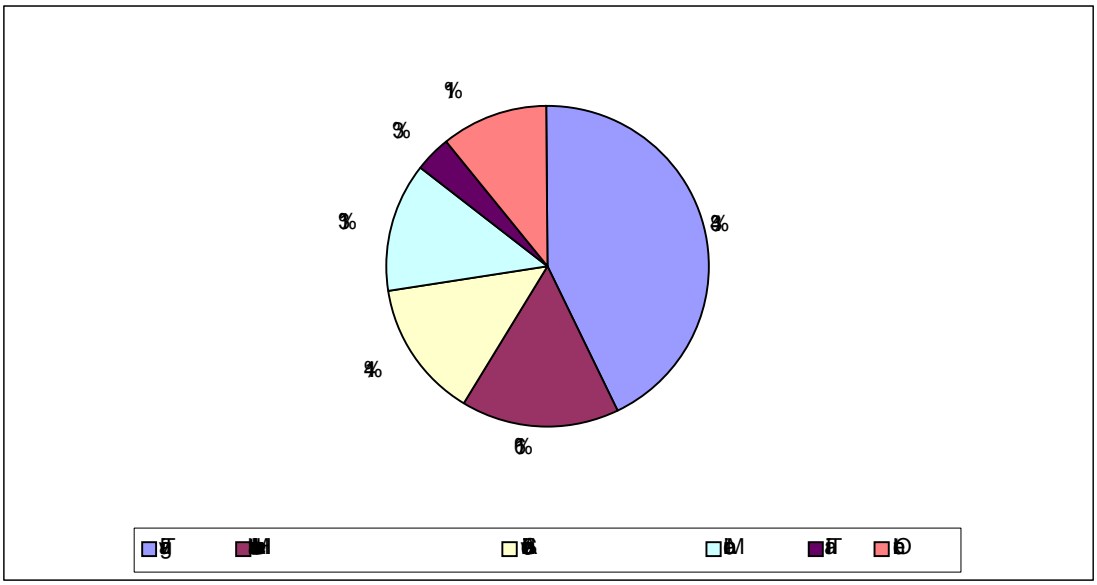
3.11 A rise in the real growth of wages in this sector of up to five per cent is expected to occur between 2005 and 2010 and all respondents to our survey believed that the FSAP will play a direct role in this. In the absence of FSAP the consensus was that real wage growth in the sector would not rise above the current rate.

Switching behaviour

3.12 According to the respondents of our survey, consumers now tend to have a greater understanding of insurance products and there has been an increase in the switching behaviour of consumers. Increases between 2005 and 2010 were predicted for both the former and the latter although the view is that the FSAP has played and will only play a negligible role in this.

Market share and concentration

Figure 3.5: Market share of top five insurance companies 2005



Source: Association of Slovenian Insurers

3.13 In 2005 there were 20 insurance and reinsurance companies in Slovenia. Of these, 15 were insurance companies and two were reinsurance companies. Out of these 15, five had a majority or dominant foreign interest in their equity.

3.14 Like the banking sector, a high level of concentration characterises the Slovenian insurance sector. The largest company holds 43 per cent of the total market in terms of gross premiums and the top five largest companies account for 91 per cent of market.

3.15 Since 2000, there have been a number of significant changes in the legislation affecting the insurance sector. The Ownership Transformation of Insurance Companies Act, designed to accomplish the privatisation of insurance companies, was postponed several times primarily as a consequence of the ambiguity concerning the estimated share of state-controlled capital.

Cross-border activity

Table 3.1: Premium and foreign ownership in eight transition countries 2003

	Share of accession countries' premium (%)	Foreign ownership share (%)	Foreign insurers' share of premium (%)
Czech Republic	18.9	55	10
Estonia	0.9	93	1
Hungary	14	88	12
Latvia	1.1	47	1
Lithuania	1.4	75	1
Poland	45.2	48	22
Slovenia	5.8	95	6
Slovakia	8.3	2	0
Total	**95.6**		**52**

Source: Converium, OECD, CEA

3.16 Table 3.1 suggests that not only is the share of foreign participation in the Slovenian insurance sector low in absolute terms, it is particularly low in comparison with most of the other new member states.

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

Cross-border activities

3.17 The FSAP does not appear to have had any significant impact on the degree of cross-border activity in the Slovenian insurance sector. Foreign involvement in the insurance market still appears to be relatively low. This is despite both the reduction in technical and regulatory barriers facilitated by the implementation of most of the FSAP directives into national law, and the reduction in the remaining barriers to entry afforded by EU accession in 2004.

3.18 The fact that 60 per cent of the entire insurance market remains in state hands may go someway in accounting for why the above assessment is likely to hold. Firms that are state owned generally prove to be problematic competitors in the sense that they tend to face relatively soft budget constraints (i.e. in the event of losses the state (i.e. the tax payer) is likely to bail out the loss making insurer). As a result, the incentives of more efficient foreign firms to enter the market and compete against insurance firms who do not face the same competitive pressures (due to state subsidies), are likely to be muted.

3.19 In this sense then, we may see more positive effects of the FSAP in action once further privatization has taken place in the insurance market.

Competition

3.20 The Slovenian insurance market is highly concentrated and given the ownership structure of the sector (majority state owned), the FSAP does not appear to have had a particularly significant impact on both the degree of openness of the sector and thus the degree of contestability that should increase the intensity with which firms compete.

3.21 In the longer term however, to the extent that the FSAP may have a positive effect on the degree of openness of the sector so might it have on competition in the sector.

Consumer protection

3.22 There was a consensus among the respondents to our survey over the view that consumer protection has increased between the period 1999 to 2005 and that the number of received complaints over the same period has grown by at least 25 per cent. One respondent noted that consumers in Slovenia have become more conscious about their rights and more aware about the possibility of complaint. The influence of the implementation of FSAP on any of this, however, is believed to have been negligible.

3.23 Our view however, is that respondents are perhaps unable to disentangle the effects that the FSAP should have had on improving the soundness of the regulatory and institutional framework and the positive impacts this is appears to have had in improving client protection.

Competitiveness

3.24 Given the limited impact that the FSAP has appeared to have had on increasing cross-border activity and competition in the sector, we do not believe that the FSAP has yet proved to have had anything but a limited effect on the competitiveness of the sector either.

3.25 The long term overall impact of the FSAP, on the other had, seems to be unclear. The greater level of regulatory requirements that has stemmed from the implementation of the FSAP means that compliance costs (both one off costs and continuing ones) are likely to increase the burdens that firms have traditionally faced in meeting their regulatory obligations. Indeed, the trade off that we can expect to arise from increasing the strength of consumer protection (i.e. more regulations) may tend to compound these costs. The costs incurred by greater regulation may militate against future improvements in costs/income efficiency ratios and may also serve in raising barriers to entry in the sector. To this extent the FSAP might prove to adversely affect the competitiveness of the Slovenian insurance sector.

Employment

3.26 It appears that employment in the insurance sector has fallen over the period of the FSAP. However, we believe that this has come about due to factors that are independent of the FSAP.

3.27 Consolidation in the sector has been rising and this tends to be associated with reorganisation and rationalisation (i.e. cost cutting and shedding excess labour) and that this trend would have transpired independent of the FSAP.

3.28 Furthermore, it would appear that as privatization in this sector continues one might expect further reductions in employment for the reasons explained above.

3.29 However, it may be interesting to note that respondents to our survey believe that employment in the insurance sector is likely to increase in the future and that would be driven by the development of new innovative products, partly assisted by the FSAP.

4 SECURITIES

Headline Overview

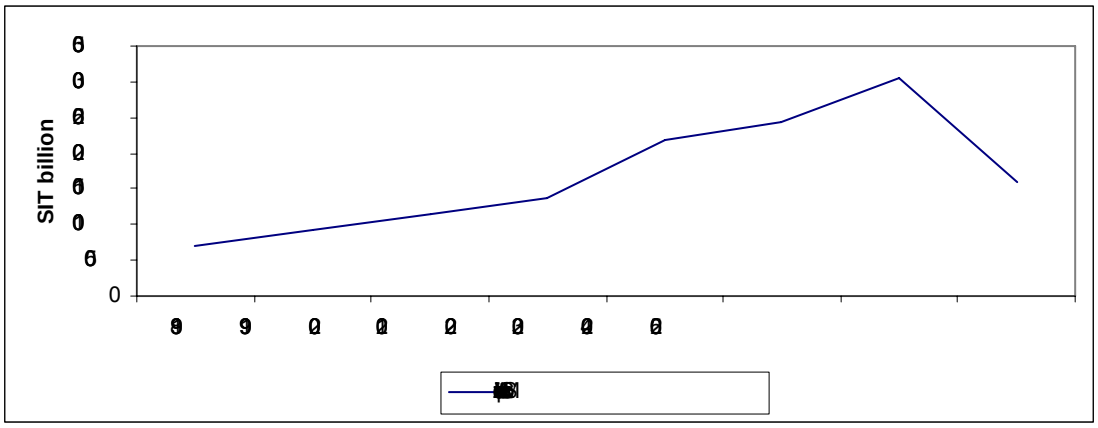
Factors Specific to Slovenia

4.1 According to the 2006 Investment climate report by the US Department of State, Slovenia's financial sector remains relatively underdeveloped for a country with its level of prosperity. The stock market is rarely used by enterprises as a means of raising capital. The shallowness of the sector militates against economies of scale and, despite the shortcomings in the banking sector, it is generally cheaper to acquire capital through banks than it is through more direct equity or debt sales.

4.2 There are a number of factors identified by the IMF regarding weakness in the area of regulation of this sector that may be contributing to what appears to be the limited attractiveness of Slovenian's investment climate. For example, the Securities Market Agency does not adequately enforce accounting standards, rather, it relies on statutory auditors to ensure compliance with them. This proves problematic in achieving the intended transparency and consistency improvements of having IFRS. This, in turn may impact investor confidence in investing in firms listed on the Ljubljana Stock Exchange (LJSE), due to uncertainty as to how rigorously regulations and standards are enforced.

Features of the market

Figure 4.1: Stock market capitalisation 1998-2005



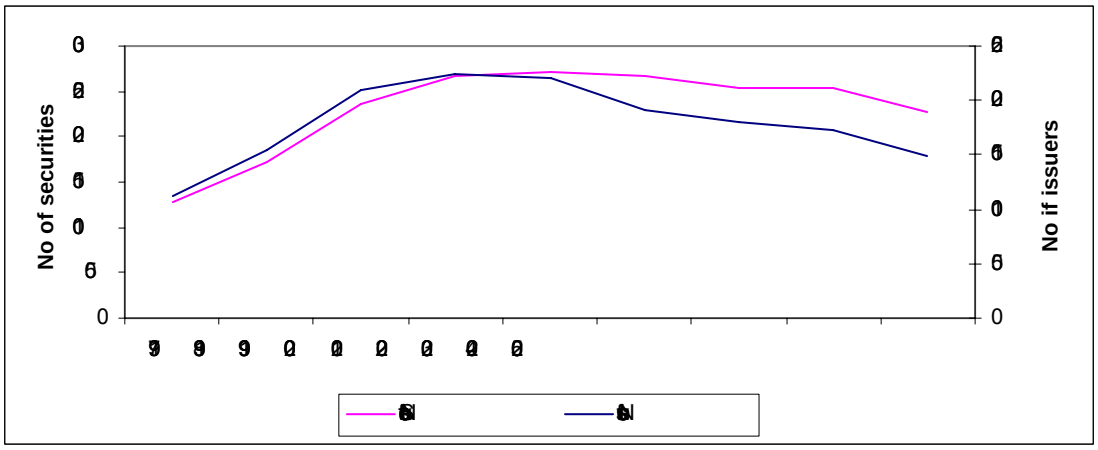
Source: LJSE

4.3 The Slovenian securities market is centred on the LJSE. The total stock market capitalization of the LJSE in 2005 was SIT 1,604.3 billion. This represented 24.5 per cent of GDP. While the degree of penetration by the LJSE into the overall financial sector is relatively small, the Slovenian Bourse Index (SBI) still gained almost 18 per cent in 2003 and 25 per cent in 2004.

4.4 As can be seen from Figure 4.1, there was a significant growth in the number of issuers and securities listed on the LJSE from the late 1990's up till 2005. Nearly all restrictions on capital and money markets were removed in 2003. Most remaining barriers were removed by May 2004. For example, marketing of foreign mutual investments funds was allowed as of May 2004.

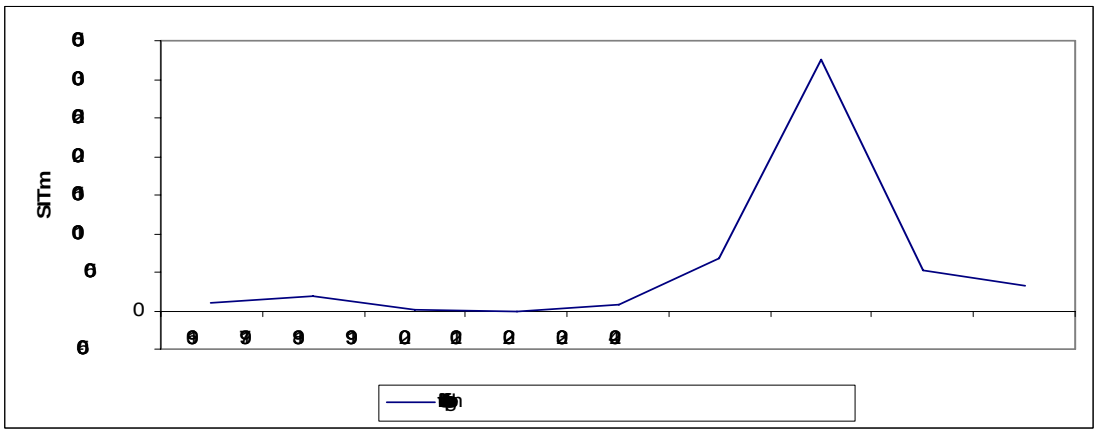
4.5 The LJSE became a full member of the International Association of Stock Exchanges (FIVV) in 1997. In spite of the market boom in 2002, Slovenia's securities markets remain relatively underdeveloped. While there has certainly been an appreciation of the market capitalisation of the LSE in recent years, as discussed above, it remains a somewhat illiquid market, with annual turnover similar to a single day's trading on the NYSE.

Figure 4.2: Number of issuers and securities 1997-2005



Source: LJSE

Figure 4.3: Net inflow of portfolio investments 1996-2004



Source: LJSE

4.6 Residents held SIT 726 billion in investments securities issued abroad by non-residents. This figure was SIT 412 billion greater than in 2004.

4.7 According to the Bank of Slovenia, this growth in the level of financial investments made abroad by residents is symptomatic of the financial deepening that Slovenia has been experiencing in recent years.

4.8 Opportunities for households and companies to increase their financial investments have arisen largely due to falling interest rates. A rise in the demand for financial investments is usually accompanied by the need to diversify financial investment portfolios. The Bank of Slovenia argues that it is the limited absorption capacity of the domestic market that has "inevitably led to outflows of this investment abroad".

4.9 From an economic stance, mitigating risks to financial investments by having exposure to the vagaries of more than one economy is a good thing. It also bodes well for Slovenia's eventual join into the EMU, by eradicating the currency exposure that is inherent in such foreign investments.

Cross-border activity

4.10 The overall volume of foreign direct investment (FDI) in Slovenia is one of the lowest in the EU. However, the Government of Slovenia has been addressing this issue. In 2001 it started a new FDI programme called FDI Promotion Programme with the objective of raising the level of net FDI in Slovenia.

4.11 The US State Department of Commerce, however, in 2006 noted that despite the governments stated commitment to improving the foreign investment climate, "practical impediments to increased FDI flow" include an incomplete legal framework regulating corporate activities, administrative barriers to business, impediments to securing land and business premises, an "ambivalent attitude toward FDI" that creates uncertainty, and a rigid labour force.

Impact of the FSAP and FSWP Legislative Measures on the Slovenian Securities Sector

Cross-border activities

4.12 While the FSAP should have made the sector more open to foreign investors by reducing the regulatory and legal disparities in participating in the Slovenian securities sector, it does not appear to have had any significant impact on the frequency of cross-border activity in this sector. Despite increasing the openness of the sector, the sector itself accounts for a relatively small proportion of the financial services market (a likely result of the banking sector still being a cheaper source of capital for firms) and is still relatively illiquid. It this context then, is seems unlikely that the FSAP has made a significant impact in the face of these barriers.

Consumer protection

4.13 Given the relatively underdeveloped nature of the Slovenian securities market, consumer protection provisions are likely to be of particular relevance. The FSAP appears to have improved the protection levels of consumers participating on in the securities sector. Not only will this have been the case due to specific legislation pertaining, for example, to corporate governance rules, but also by instilling greater degrees of credibility of, and confidence in, the institutional and regulatory foundations of the Slovenian financial system.

Competitiveness

4.14 Given the underdeveloped nature of the Slovenian securities market, the additional regulations stemming from the implementation of the FSAP, may serve in undermining the competitiveness of the sector. Additional regulatory requirements will tend to increase the compliance costs previously associated with listing on the LJSE, and it may be possible that any confidence the participating in the sector that FSAP may have inspired, may be negated or even outweighed by the additional burdens imposed by the FSAP directives.

Employment

4.15 Thus far, the FSAP appears not to have had a significant effect on the employment levels in this sector. 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 might also increase the aggregate level of employment in the Slovenian securities market. So far, the net effect is unclear.

5 FINANCIAL CONGLOMERATES

Headline Overview

5.1 Slovenia is one of the member states identified in 2006 by the Mixed Technical group that has not yet completed the process of notifying them of groups that are considered to as financial conglomerates.

5.2 Europe Economics were not able to identify any financial conglomerates operating in Slovenia[46].

6 CONCLUSIONS

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Slightly positive	Slightly positive	Positive	Limited. Perhaps negative in the future	Unclear
Insurance	Limited, perhaps positive in the future	Limited	Positive	Unclear	Limited
Securities	Positive	Slightly positive	Positive	Limited so far. Positive in the future	Slightly positive
Financial Conglomerates	No presence	No presence	No presence	No presence	No presence

SPAIN

1 INTRODUCTORY OVERVIEW

Financial Services Regulation in Spain

Division of responsibility

1.1 Responsibility for financial regulation and supervision of the banking, securities and insurance markets in Spain is spread across four authorities.

(a) **Ministry of Economy and Finance[47]:** proposes and executes the Governments' general directives on economic policy and, especially, policies related to inland revenues, budget and expenditures of State-owned companies; it is responsible for overall financial policy and delegates authority to the other regulators; responsible for formal sanctioning of major violations.

(b) **Directorate General of Insurance and Pension Funds, under the Ministry of Economy and Finance[48]:** responsible for the supervision of the control of Spain's insurance and pension fund sectors.

(c) **National Securities Market Commission (Comisión Nacional del Mercado de Valores, CNMV):** agency in charge of supervising and inspecting the Spanish Stock Markets and the activities of all the participants in those markets, ensuring transparency, correct price formation and the protection of investors.

(d) **Bank of Spain:** responsible within the European System of Central Banks for monetary policy and its execution; and responsible for the supervision of the solvency, activity and compliance with regulations of credit institutions, safeguarding the stability of the financial system.

1.2 The 17 Comunidades Autónomas (Regional Governments) also have supervisory powers over the Cajas (savings banks), though at a lower level than the Bank of Spain.

Key features of banking regulation

1.3 All credit institutions are supervised by the Bank of Spain. However, the Council of Ministers and the Ministry of Economy and Finance retains the ultimate power regarding the delegation of authority and the sanctioning of major violations. The IMF Country Report No. 06/212 (June 2006) calls for the delegation of ultimate regulatory and sanctioning powers from the Ministry of Economy and Finance and the Government to the Bank of Spain.

1.4 The main legislation affecting Spanish banking regulation includes:

(a) Law on the Autonomy of the Bank of Spain (Law 13/94, 1 June 1994), which provides the mandate to the Bank of Spain to supervise the solvency and regulatory compliance of credit institutions. This law also sets out rules regarding banks' ownership and capital;

(b) Royal Decree Law 3/1994, which establishes a single banking licence in accordance with EU Directive 89/646/EEC, allowing banks in the European Economic Area to set up branches in Spain and operate under the regulatory authorities of their own countries;

(c) Law of discipline and intervention of credit institutions (LDI) (Law 26/1988): establishes sanctioning power for the Bank of Spain for all violations, although it must have the support of the Ministry of Economy and Finance to invoke major punishments; establishes that Spanish banks must obtain permission from the Bank of Spain to open subsidiaries or representative offices abroad or to acquire significant stakes or increase existing stakes in credit institutions, or to acquire or create foreign credit institutions;

(d) 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 Directorate General of Insurance and Pension Funds, established under the Ministry of Economy and Finance.

1.6 The main legislation affecting the Spanish insurance sector includes:

(a) Royal Decree 1552/2004 which develops the structure of the Ministry of Economy and Finance, including the role of the Directorate General of Insurance and Pension Funds, under the Ministry of Economy and Finance, which is assigned supervision and control of Insurance and Pension Funds sectors;

(b) The Royal Decree 2486/1998 on the ordering and supervision of private insurance established solvency criteria and technical provisions related to civil liability and allocation of risk.

Key features of securities regulation

1.7 Law 24/1998 on the Securities Markets (Ley del Mercado de Valores) establishes that securities markets are supervised by the Comisión Nacional del Mercado de Valores (CNMV) and unifies the legal structure affecting financial market institutions.

1.8 Law 35/2003 defines the range of activities of the Collective Investment Institutions.

1.9 Royal Decree Law 5/2005 defines the prospectus to be published when securities are offered to the public or admitted to trading.

1.10 Spain's four stock exchanges (Madrid, Barcelona, Bilbao and Valencia) are encompassed in a group under the holding company Bolsas y Mercados Españoles (BME), whose group also includes the Mercados Financieros (official market for Futures and Options, Private and Public Fixed-Income), the Iberclear (Spanish Central Security Depository, in charge of the Register of Securities and Clearing and Settlement activity) and BME Consulting.

Key features of financial conglomerates regulation

1.11 Law 13/1992, which establishes a system of joint prudential supervision of the activities of groups related to banking, securities and insurance.

1.12 Law 5/2005, on the supervision of financial conglomerates, which establishes a new definition and design additional supervision for financial conglomerates.

The Implementation Process and General Effects of FSAP in Spain

Stakeholder views about implementation

1.13 It appears that the implementation was made easier by the ongoing development of the regulatory structure, which has helped the development of the Spanish financial system. This can be seen as part of the more general convergence of Spain's economy with other advanced countries in the EU.

Consequences of the FSAP for the Regulatory Environment

1.14 Communication among regulatory bodies appears to have been positively affected by FSAP; however, it also appears that on most criteria examined, the actual impact of FSAP has been minor.

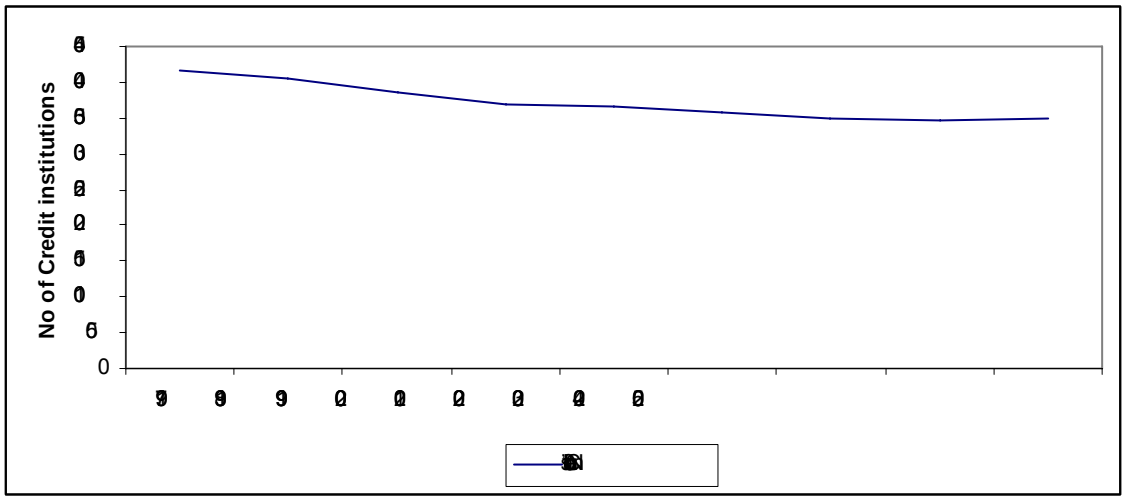
2 THE SPANISH BANKING SECTOR

Headline Overview

Number of players

2.1 The Bank of Spain reports that at the end of 2004, in total there were 348 credit institutions, of which 269 were deposit institutions, 184 were banks, and 47 were savings banks.

Figure 2.1: Number of Credit Institutions in Spain



Source: ECB

2.2 Figure 2.1 sets out trends in the number of institutions. As can be seen, there was a steady decrease in the numbers of institutions. This is in contrast to the increase in the number of branches that took place between 1999 and 2005, growing from 39,373 to 41,979 respectively.

2.3 This trend reflects a restructuring process of the sector, which included significant mergers and acquisitions and, during 2004, the absorption by parents of subsidiaries as part of internal efficiency-driven processes. In contrast, the expansion of branches reflected a strategy aimed at increasing customer proximity as well as, more recently, the consequence of branch openings by foreign EU Credit Institutions (CI's).

Turnover, employment and profitability

2.4 As illustrated in Figure 2.2, employment in banking has remained fairly stable since the 1990's. Real wages and salaries have tended to increase slightly above inflation in recent years and participants in our survey expect this trend to continue in the future. The table also shows a steady rise in net income.

Figure 2.2: Income and Employment in Spanish banks, 1981-2003

Source: OECD

2.5 According to the Bank of Spain, the growth of CI's profits before tax decreased to 9.1 per cent in 2004 from 19.5 per cent in 2003; in combination with the expansion in average total assets (ATA), this resulted in a slight decline in terms of return on ATA; however, it is pointed out that these results also depend on the charging to income, instead of reserves as in previous years, of the costs related to early retirement processes.

2.6 Profit figures in 2004 reflect a combination of a mild growth in net interest income (4.9 per cent) and a substantial increase in non-interest income (37.1 per cent). There was also a moderation in the growth of operating expenses (especially with regard to personnel), a flattening pattern in provisions and write-downs and a decline in corporate income tax.

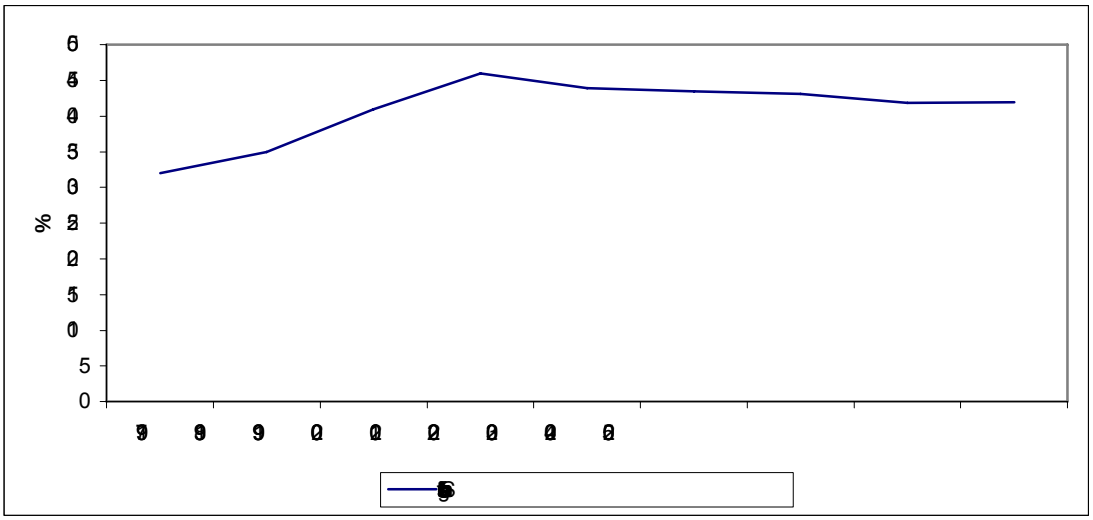
2.7 The Main Report illustrates that in 2004, the Spanish banking sector was among the best-performing within the EU in terms of return on assets and net income.

2.8 According to the Bank of Spain, high levels of income and profits reflect the performance of Spanish economy, which in recent years has experienced a sustained period of higher growth than the Euro area as a whole and this was partly a result of a decline in the level bad bank loans and the strong expansion in lending.

Market shares and concentration

2.9 According to the IMF report "Spain: Financial System Stability Assessment (2006)", savings banks have a relatively high weighting in the overall structure of the banking system.

Figure 2.3: Share of total banking sector assets held by the largest five banks



Source: ECB

2.10 Figure 2.3 indicates there has not been much change in the concentration of the banking sector from 2000 onwards and that the latter process has not resulted in a particularly high concentration level in Spain compared with some other Member States.

2.11 The biggest five credit institutions had a market share of 42 per cent in 2004, slightly lower than in 2003, which brought the share almost back to the 1999 level and broadly in line with the typical figure for the EU.

Table 2.1: Herfindahl-Hirschman index [49]

1997	1998	1999	2000	2001	2002	2003	2004	2005
285	329	441	581	532	513	506	482	487

Source: ECB

2.12 Table 2.1 illustrate that overall concentration as measured by the Herfindahl index shows a declining trend over the 2000-2004 period, leaving the figure for Spain below those typical of the EU25.

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

Switching behaviour

2.13 Switching behaviour appears to have increased in recent years, reflecting the greater dynamism of an increasingly competitive market. Respondents to our survey expect this trend to continue but do not link it to the FSAP.

2.14 The expansion of branches, both by domestic and foreign banks, has increased in the past few years, as highlighted in the Bank of Spain's "Report on Banking Supervision in Spain", 2005. The same source states that network business activity has been strengthened by the provision of internet banking services and by the most extensive ATM network in Europe. Those factors contribute to establishing a general competitive environment where customers enjoy greater switching opportunities than in previous periods.

Dimensions of price and quality competition

2.15 There appears to have been an increase in prices in recent years but respondents to our survey expect these to remain stable in the future. However, we have not been able to assess to what extent this reflects an increase in the quality of service.

2.16 The results of our survey suggest that there has been a significant increase in the variety of products in recent years and the consensus is that this trend will continue, particularly with the further development of e-commerce.

Other factors affecting competition

2.17 Respondents to the survey highlighted consumer power and the expansion of branches as important factors strengthening competition.

Consumer protection

2.18 The level of consumer protection in banking markets seems to have increased over the past few years. This is expected to continue, but respondents to the survey made no direct link between this and the FSAP.

2.19 As discussed in the Main Report, according to "Eurobarometer", in 2003, 37 per cent of Spanish consumers believed that their rights were adequately protected in relation to financial services, down from 46 per cent in 1999. This was fairly typical for the EU where the proportion of consumers taking this view dropped from 43 to 34 per cent. Thus, even if perhaps the period of the FSAP has been associated with an increase in the level of consumer protection, this has not been perceived by consumers.

The potential future role of technology

2.20 According to the Bank of Spain's "Report on Banking Supervision in Spain", 2005, Spanish banks are viewed as being among the best technologically equipped in Europe.

2.21 There appears to be further opportunities in technology-driven development as internet usage is rapidly expanding with respect to population coverage.

Trade and international penetration

2.22 In the period between 1997 and 2004 penetration of the Spanish banking sector by foreign EU banks was primarily through the setting up of new branches as opposed to subsidiaries. Branches increased from 35 to 54, while the number of subsidiaries declined slightly. This pattern is more striking when asset values are taken into account — in terms of branches, they tripled in Spain over this period.

Table 2.2: Number of Mergers and Acquisitions

	2000	2001	2002	2003	2004	2005	2006*
Domestic M&A's	4	1	7	4	4	4	2
EU M&A's	4	1	1	3	2	1	0
Third country M&A's	0	0	0	1	0	2	0

*Source: ECB. * first half.*

2.23 The Bank of Spain's "Report on Banking Supervision in Spain", 2005, relates foreign branch penetration to a model of European integration focused on proximity to the customer based on brand differentiation.

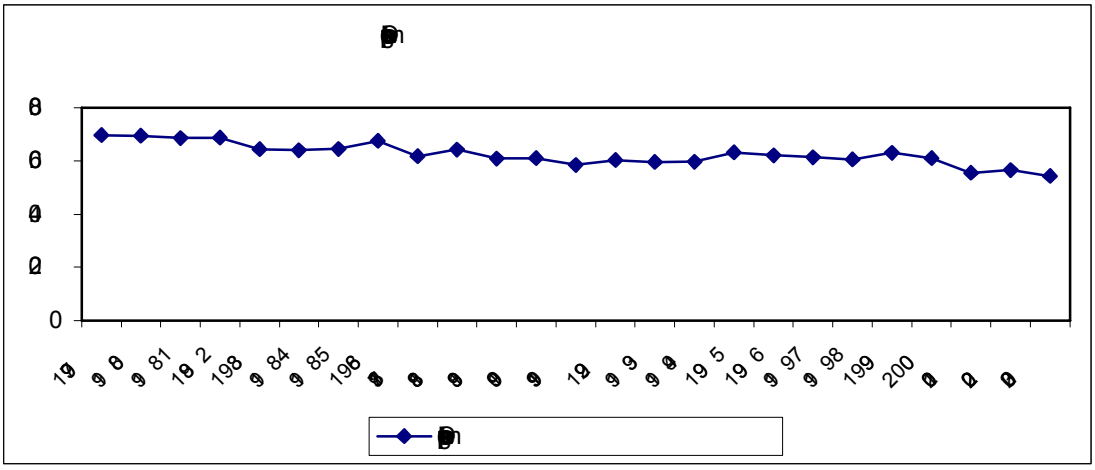
2.24 In terms of penetration of foreign markets by Spanish credit institutions, traditionally Latin American markets were the main targets; however, there has been a tendency towards increasing the presence in other EU Member States, epitomised by the acquisition of Abbey Bank by the Santander Group in 2004.

2.25 Respondents to our survey were of the view that increasing internationalisation was not attributable to the FSAP since it was a market trend that had developed earlier.

Competitiveness

2.26 Figure 2.4 gives the cost to income ratio of Spanish banks.

Figure 2.4: Operating expenses to income (expressed as ratio)



Source: OECD, Europe Economics

2.27 Figure 2.4 above, illustrates that there has been a very gradual downward trend in the ratio between operating expenses and income. This possibly reflects efficiency improvements in the system. This is consistent with the Bank of Spain's assessment as well as that of IMF's Country Report No. 06/212, June 2006, "Spain: Financial System Stability Assessment". Again, however, survey respondents tended not to relate efficiency gains specifically to the FSAP.

Factors specific to Spain

2.28 We have identified the following factors as being important unusual features of the Spanish banking sector:

(a) Spain's banking system has one of the widest branch networks in the EU (12 offices per 10,000 inhabitants aged over 15) and it is still expanding, mainly in the form of small and flexible offices, selling a wide variety of products (90 per cent of mutual funds and 80 per cent of pension schemes are sold through bank offices[50]).

(b) Savings banks (Cajas) increased their share of customer deposit from one third in 1980 to more than 50 per cent in 2005, concentrating their activity in lending to individuals and small and medium firms[51]. This upward trend in savings bank market share is still going on.

(c) A major factor behind strong domestic demand has been the boom in the housing market[52], which drove a big increase in mortgage credit.

The Effects of the FSAP and FSWP Legislative Measures on the Spanish Banking Sector

Assessment by category

Competition

2.29 Figure 2.3 illustrates that the concentration of Spanish banking has fallen a little since 2000, after having increased in the previous year, so that the overall picture does not reflect any fundamental change in concentration levels.

2.30 Most reports on the Spanish banking system[53] describes it as modern, highly efficient, and characterised by vibrant competition. As we have seen, a main feature of the competitive environment consists in the diffusion of branches throughout the country, in particular with the recent attempt to reach previously less served areas. Now, the typical Spanish resident has a greater variety of choices in his nearby vicinity.

2.31 The increasing penetration by branches of foreign banks and the diffusion of Internet banking are further intensifying competition in this sector, to the benefit of customers.

2.32 However, as we have seen, the respondents to our survey see a limited impact on competition of the FSAP, as these processes were already under way when FSAP was launched.

2.33 As mentioned above, respondents to our survey also 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).

2.34 As was discussed above, the ratio of operational costs to income has followed a downward trend in recent years; in fact, this was mainly a result of increases in income. Nevertheless, as the former was also a consequence, besides exogenous demand factors, of increased variety of product offering and greater proximity to the customer, we can deduce that efficiency has indeed improved in the last few years. Benefits for the customers were therefore achieved mostly on dimensions other than price. It may be the case, although it was not clearly found in our analysis nor in our survey, that FSAP has provided a contribution in making markets more contestable as it further facilitates entry by foreign competitors. Furthermore, once product variety becomes standard, downward pressure on prices arise as the main effect from competition. Again, the spreading of internet usage and familiarity may also foster this process.

2.35 Overall, it appears that if there are any effects of the FSAP on competition in the sector, they are small compared with other trends and factors — including in particular technological developments.[54]

The effect of FSAP on employment

2.36 Figure 2.2 suggests that employment remained substantially stable in the recent period, with remarkable stability in the period following FSAP.

2.37 While stability does not per se mean there has been no effect of the FSAP, as other effects may counterbalance it, the respondents to our survey have not perceived any effect of the FSAP on employment. We ourselves can identify no evidence of a material effect of the FSAP on banking employment.

Consumer protection

2.38 There is no clear-cut evidence of any particular effect of FSAP on consumer protection as yet.

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

2.39 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.

2.40 The FSAP appears to have had relatively little direct effect on this so far, as the banking sector was being opened up to foreign firms, most notably following the establishment of a single banking licence in 1994.

2.41 Nonetheless, there appears to be further scope for enhancing the presence of foreign banks into the Spanish market, which would plausibly be enhanced to an important degree by the FSAP.

2.42 Our econometric study suggests that the impact of the FSAP on trade has been a rise of 1.2 per cent in imports of financial services other than insurance and pensions, and a rise of 1.5 per cent in exports. Full implementation of the FSAP and FSWP legislative measures is projected to lead to a further 1.0 per cent rise in imports and 2.1 per cent in exports.

Competitiveness

2.43 As illustrated in Figure 2.4, the operating expenses-to-income ratios of Spanish banks featured a slight downward trend which was resumed in the last few years, which suggest some success in fostering efficiency.

Conclusions

2.44 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 Spanish banking sector may not have been particularly significant.

2.45 In general, this derives from the fact that a trend already existed in favour of turning the Spanish market into a truly modern, and hence internationally oriented one. Such changes are also likely to have also been enhanced by the relatively strong performance of the Spanish economy in recent years.

2.46 This may mean that the specific effects of FSAP on the achievement of its goals, such as the establishment of the Single Market for financial services, and the promotion of a regulatory environment that may foster best practice in the sector and improved financial development, may be hard to disentangle.

2.47 Barriers to cross-border activity, for example, had already largely been removed, and financial development and broader efficiency in the sector had already been improving prior to the definition of the FSAP.

2.48 Such a conclusion is also supported by our analysis of mechanisms in the Main Report, although a number of the mechanisms we might have expected to operate could have had a material impact on Spain. For example, greater efficiency and cross-border activity.

2.49 Deeper effects might however be observed in the long term. This is especially so via enhanced regulatory certainty on the operations in the banking sector, with positive impact in terms of reduction of risk connected with expansion into new markets.

2.50 The provision of a level playing field and greater inter-operability within the EU may foster the future creation and the perception of business opportunities for Spanish companies and further cross-border activity in the Spanish banking sector. Concentration may increase if large firms take the lead in these processes.

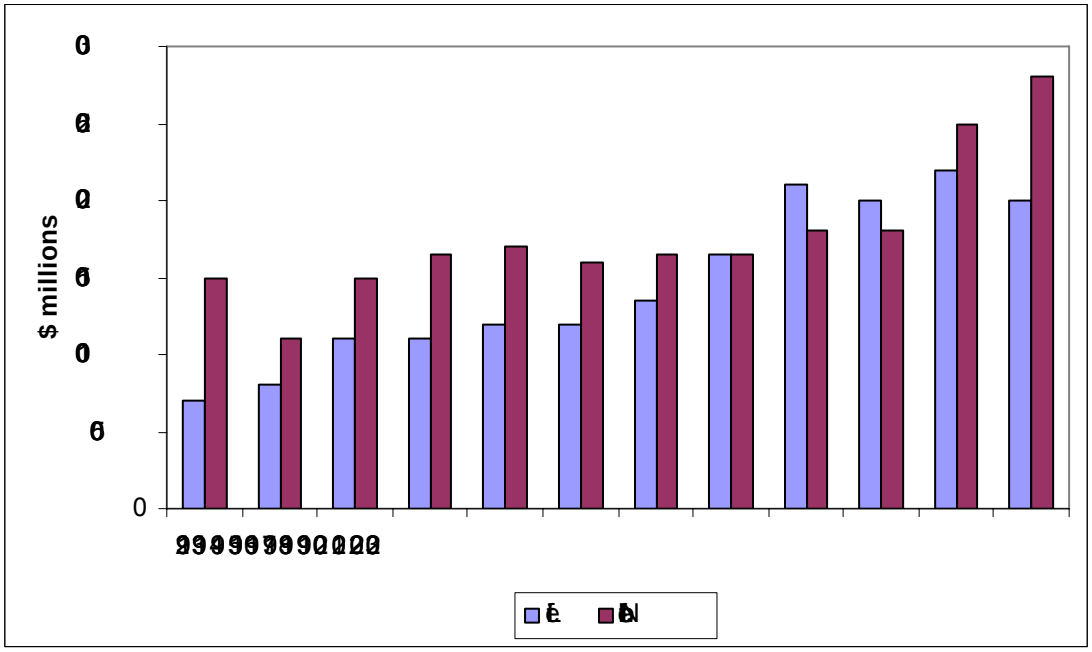
3 INSURANCE

The Spanish Insurance Sector

Turnover

3.1 Figure 3.1 gives the development of life and non-life insurance gross premiums in Spain from the1990's to 2003.

Figure 3.1: Life and non-life insurance gross premiums in Spain, 1992-2003

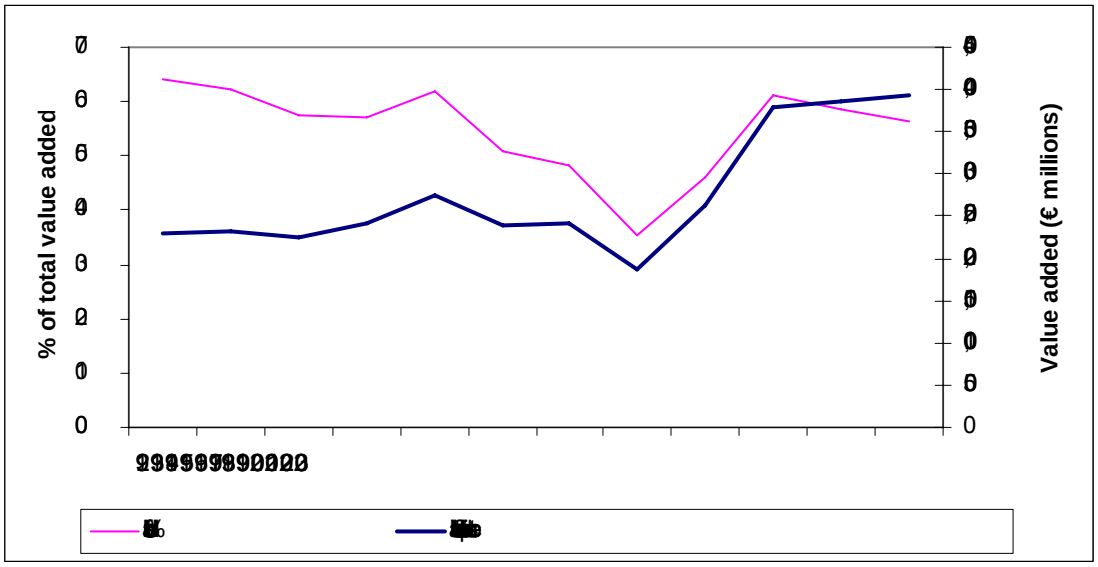


Source: OECD

3.2 It can be seen that there has been a clear upward trend in premiums written, albeit with some significant oscillations within the period considered. After 2000, life insurance premiums, following a period of steady growth, began to fluctuate and the number of premiums in 2003 was slightly lower than in 2000; however, this was combined with a remarkable growth in the non-life sector after 2000, so that the overall premium levels increased.

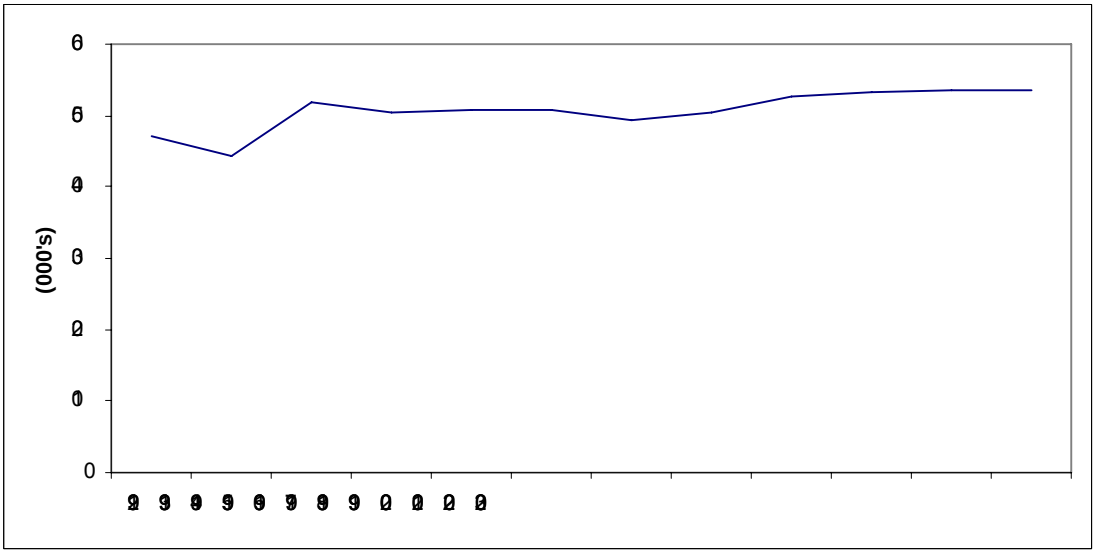
3.3 Figure 3.2 sets out value added. As can be seen, value added followed a mildly upward trend until 1996, followed by a significant drop in subsequent years. After In 2000, growth accelerated.

Figure 3.2: Value added of the insurance and pensions sector



Source: University of Groningen

Figure 3.3: Employment in the Insurance and Pensions sector



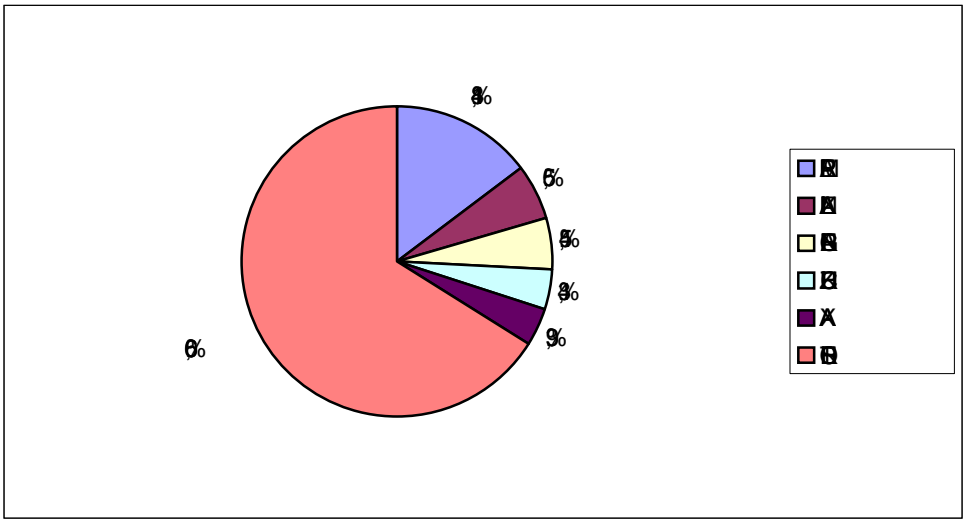
Source: University of Groningen

3.4 Employment has remained relatively stable in this sector, increasing somewhat from 1998.

Market shares

3.5 Figure 3.4 sets out market shares of life insurance companies in Spain.

Figure 3.4: Market shares of insurance groups in direct insurance premiums, 2006, second quarter



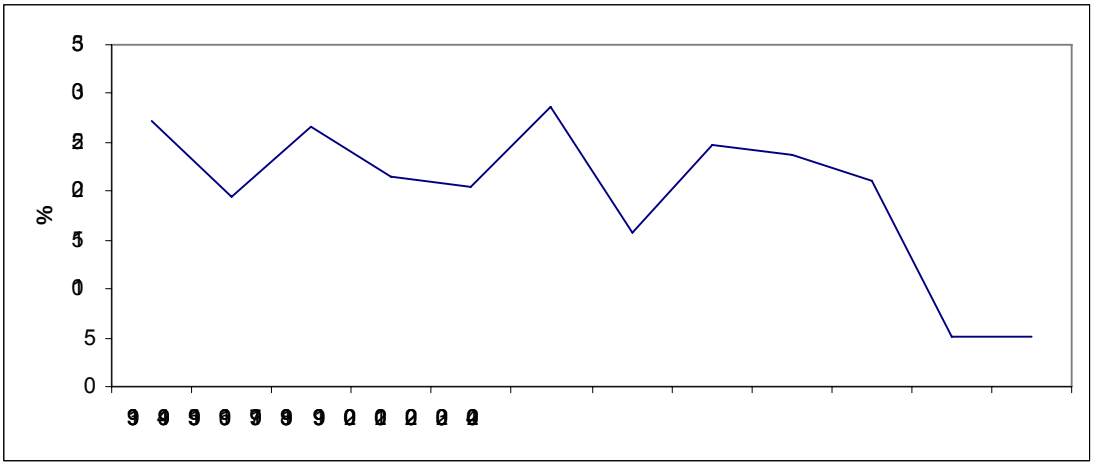
Source: ICEA

3.6 Levels of concentration seem relatively low with respect to typical EU standards.

International entry

3.7 As one can see from Figure 3.5, the presence of foreign undertakings has declined in recent years, mainly as foreign firms have tended to set up Spanish subsidiaries as a means to enter the Spanish market.

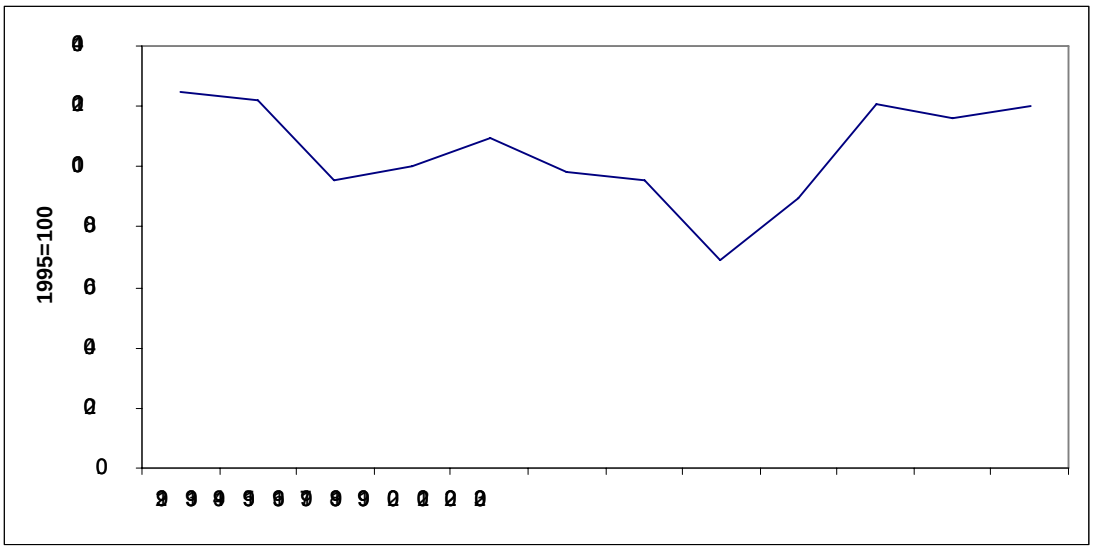
Figure 3.5: Gross premiums of branches/agencies of foreign undertakings as % of total domestic business



Source: OECD

Competitiveness

Figure 3.6: Productivity per employee in the insurance and pensions sector



Source: University of Groningen

3.8 As can be seen in Figure 3.6, a downward trend in productivity was reversed in 2000, but seems to have stabilised in the last couple of years.

The Effects of the FSAP and FSWP Legislative Measures on the Spanish Insurance Sector

Level of implementation

3.9 The Spanish insurance sector has become the tenth largest in the world and the sixth largest in Europe by net premium income[55].

3.10 The thrust of EU legislation has been geared towards removing barriers to the provision of insurance between Member States, and in Spain this has resulted in the establishment of subsidiaries. Furthermore, the single licence principle has also been adopted in the Spanish legislation.

3.11 Legislation concerning solvency requirements does not appear to provide binding constraints, as the industry features assets covering technical provisions some 15 per cent above statutory levels and a surplus of 158 per cent in its solvency margins[56].

3.12 Overall it seems that FSAP directives have contributed to processes of market reforms that however, were already taking place in Spanish insurance markets.

Assessment of impact by category

Market entry, cross-border business and takeovers

3.13 As seen above, the foreign presence in the industry has mainly occurred as a result of setting-up Spanish subsidiaries.

3.14 The market is highly competitive with low concentration levels. Overall, it seems that FSAP has not, so far, had a significant impact on these developments.

Competitiveness

3.15 As can be seen in Figure 3.6, labour productivity rose rapidly from 2000, reversing the previous downward trend, but it has subsequently levelled out.

3.16 It appears difficult, however, to single out the impact of FSAP on productivity from the effect of the improvements to operational efficiency in the market.

3.17 In particular, it does not seem that solvency requirements established by FSAP have played a major role towards increasing operational efficiency.

Product variety, e-commerce, and prices

3.18 The variety of relevant products available on the insurance market in Spain has increased in recent years and is likely increase more in the future, as competition is becoming more and more intense. The typical view of respondents in our survey was that provisions of the FSAP have not played the primary role in the determination of these trends. However, FSAP is in general seen as mechanism that will foster further competitive pressure in terms of e-commerce of insurance products.

Consumer protection

3.19 According to GESIS' Eurobarometer, the percentage of Spanish consumers who believe that "knowing in advance how good the insurance cover is" appears to be "fairly easy" or "very easy" increased, between 2002 and 2003, from 21 per cent to 31 per cent. However, in EU15 it grew from 34 per cent to 39 per cent. This remarkable increase narrowed the gap with the EU15 but did not close it, suggesting that there may still be a problem of transparency, at least in the perception of consumers[57].

3.20 A similar trend, albeit with a higher absolute level, is present in consumers' belief that confidential information given to banks and insurance companies is adequately protected. In this case, in Spain there was an increase from 41 per cent to 51 per cent in taking that view in 2003, the same as for EU15 (from 50 per cent in 2002), so the "confidence gap" was closed[58].

3.21 The level of consumer protection in insurance markets seems to have slightly increased over the last few years. We would expect enhanced consumer protection in the future, but there is no evidence of a direct effect of the FSAP yet.

Conclusions

3.22 The insurance sector shares the features of the overall financial system in Spain, which has evolved into a truly modern one, highly competitive and well supervised and regulated.

3.23 Greater efficiency and enhanced labour productivity might have benefited from FSAP, although they are also a likely outcome of the process of modernisation and increase in the intensity of competition that was already taking place in Spain.

3.24 It is therefore hard to pinpoint specific effects of FSAP, especially as we do not observe increases in direct international competition as might have been expected: large foreign companies had already entered the market via set-up of Spanish subsidiaries.

4 SECURITIES MARKETS

Spanish Securities Markets

4.1 The Ley del Mercado de Valores (Law 24/1998) establishes that the main responsibility for the supervision of securities markets lies under the responsibility of the Comisión del Mercado de Valores (CNMV), a public independent agency.

4.2 The authority of CNMV, however, is limited by the exclusive prudential oversight of the Bank of Spain regarding credit institutions involved in the securities market and by the licensing and sanctioning powers (for very serious infringement) assigned to the Ministry of Economy and Finance.

4.3 The setting up in 2001 of a unified group under the holding company Bolsas y Mercados Españoles of the four Spanish stock exchanges (Madrid, Barcelona, Bilbao and Valencia) facilitated increased efficiency in securities markets. In particular, it greatly enhanced corporate financing opportunities and eased the consolidation processes that took place in the last few years.

4.4 The growing importance of the markets for securities in Spain is reflected in the evolution of domestic market capitalisation when compared with other important markets.

4.5 Spain has enjoyed a remarkable evolution of capitalisation when compared with US, German, Italian, UK, and Euronext markets.

4.6 This evolution is derived by, and at the same time same time reinforces, the tendency of Spain's economy towards convergence with the most advanced economies in the EU, as characterised, inter alia, by steadily superior GDP growth rate with respect to the EU averages.

Factors Specific to Spanish Securities Markets

4.7 As we have seen above, capitalisation of the Spanish stock market has featured a remarkable increase.

4.8 In fact, the IMF report Spain: Financial System Stability Assessment (2006) points out that BME has become the fourth largest stock market in Europe, in terms of capitalisation, and the seventh in the world in terms of total share value traded. According to the same IMF report, over the 1996-2005 period the Spanish stock market yielded a 241 per cent return, the highest among the world's main stock markets.

4.9 The market has also witnessed a consolidation trend that, according to the BME Fact Book 2005, continued during 2005 with important takeover bid activity, as well as mergers and acquisitions.

4.10 BME also points out that the SIBE electronic system has been acquiring more and more relevance, to the point that in 2005 the volume traded by SIBE grew more than 30 per cent with respect to 2004 and reached 173 per cent of market capitalisation at the end of 2004.

4.11 Just as with the other parts of its financial system, there is a general consensus that the Spanish market for securities is soundly regulated; law 35/2003 enhanced investor protection with reference to the activity of Collective Investment Institutions, which stand among the main vehicles of investment.

4.12 There are however calls, e.g. from the IMF, to enhance the regulatory power of CNMV with respect to interference from the Ministry of Economy and Finance and the Bank of Spain.

4.13 New fiscal reforms are under way, which include taxation on capital gains of 18 per cent, versus a previous environment where investors typically had to pay higher taxes, depending on the marginal rate on their personal income. These reforms are likely to reinforce, *ceteris paribus*, the profitability of the Spanish stock market, as investors tend to exhibit "home bias", i.e. tend to purchase shares in higher proportion in the stock market of their own countries.

Impacts of the FSAP and FSWP Legislative Measures on Spanish Securities Markets

Level of implementation

4.14 The Markets in Financial Instruments Directive, MiFID, will be implemented into the national legislation in 2007.

4.15 It will enter a regulatory context that has already been geared towards transparency and protection of the investors, in an increasingly large market for securities.

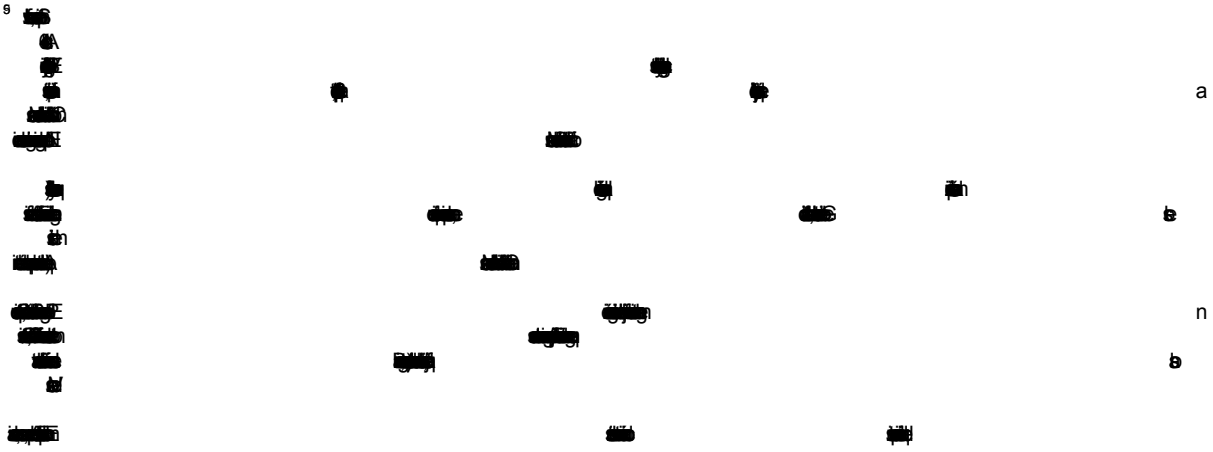
4.16 It is perceived that the rapid development of the market does call for improvement of those features, so that MiFID may well represent a further step towards higher efficiency and transparency.

4.17 A specific impact of MiFID for Spain (as for Italy, France and Poland) consists in the removal of the concentration rule[59], by which trade in shares of public companies with given characteristics and according to the determination of the CNMV can only be negotiated in the national Stock Exchanges. (Since MiFID replaces the Investment Services Directive, the provisions under the ISD allowing national regulators to require certain trades to pass through "regulated markets", as defined under Article 16 of the ISD, fall away.)

4.18 As a consequence, for instance, banks will be in a position to transfer shares among clients wishing to modify their portfolio, without necessarily going through the stock exchange.

4.19 The new rules will enhance the possibility for financial institutions to develop truly trans-national activities and offer their services throughout the EU.

4.20 MiFID will then be a key factor in the overall effort of the FSAP to develop more inter-linkages between EU markets.



Impact

4.21 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.

4.22 Although internationalisation processes are already taking place, for instance as Spanish firms are increasingly listed in foreign stock exchanges and the presence of foreign firms into the Spanish ones is also increasing, MiFID is perceived as a vehicle of new opportunities to develop EU-wide activity in the market for securities.

Competition

4.23 An increase in cross-border activity and trade should of itself enhance the level of competition in the Spanish 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 Spanish 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 Spanish securities sector.

Employment

4.24 If the aim of the FSAP of de-segmenting the EU market is achieved, and if (as a result), the Spanish securities sector expands, and/ or joins Euronext, then in the short term, the level of employment in the Spanish securities market should rise slightly.

4.25 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 Spanish securities market.

Competitiveness

4.26 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 Spanish securities market. Therefore, the FSAP is likely to have a positive impact in the future.

Consumer protection

4.27 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Spanish 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 Spanish 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

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

4.29 With regards to the volume of trade in the future the most likely scenario seems to be that it will increase. However it appears that this is a process that has been strongly affected by the Spanish economic and financial background, although FSAP's measures may have facilitated those.

4.30 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 increases widely envisaged for the future are not attributed solely to the implementation of the FSAP.

4.31 FSAP effects may be stronger in terms of the ability of 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

4.32 The modernisation of the Spanish market for securities might have been facilitated by FSAP, although it is likely to be mainly related to the Spanish economic and financial background.

4.33 MiFID may provide greater opportunities in the future for EU-wide activity in the securities markets.

5 FINANCIAL CONGLOMERATES

Financial Conglomerates in Spain

5.1 In the Spanish case, the regulator for insurance and pension funds, DGFSP, is the relevant competent authority for the supervision of the operations of the conglomerate banks, Banco Santander Central Hispano and Caja Madrid, although the main regulatory role lies with the Bank of Spain (see Table 5.1).

5.2 Due to the well developed international nature of its business, (most notably via the acquisition of Abbey Bank in 2004), Banco Santander Central Hispano is also subject to supervision by the Portuguese and UK authorities.

5.3 Banco Bilbao Vizcaya Argentaria, the other big bank in Spain, is also listed as a financial conglomerate; so are the other savings banks, Caja Tarrassa and La Caixa, which reflects the importance and the diversification of this type of institution in the Spanish context.

5.4 Conversely, The Agrupación Mutua/Bankpyme, is a group led by Agrupación Mutua, whose core business lies in the insurance sector although it has expanded in financial investment activities; supervision is placed in the hands of DGFSP.

5.5 Finally, Dutch ING has established a foothold into the Spanish market via internet banking, and also offers a variety of financial services (among which pension funds). It is also supervised by DGSFP.

Table 5.1: Main financial conglomerates operating in Spain

Financial Conglomerate	Base country	Co-ordinator	Relevant Competent Authorities (where different from the coordinator)
Agrupación Mutua/Bankpyme	Spain	DGSFP[60]	
Banco Bilbao Vizcaya Argentaria	Spain	Bank of Spain	
Banco Santander Central Hispano	Spain	Bank of Spain	Bank of Portugal Instituto de Seguros (Insurance Institute, Portugal) DGFSP FSA (UK)
Caja Madrid	Spain	Bank of Spain	DGFSP
Caja Tarrassa	Spain	Bank of Spain	
La Caixa	Spain	Bank of Spain	
ING	Netherlands	DNB (Netherlands)	DGSFP CBFA (Belgium) BaFin (Germany) HFSA (Hungary) FSA (UK)

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

5.6 The increasingly strong links in the Spanish financial system between the banking sector and insurance and pension funds is in line with an international trend for big institutions to seek benefits from diversification and related economies of scope.

5.7 The authorities operating in the system have established formal mechanisms to collaborate in the supervision of financial conglomerates, in compliance with Law 5/2005 which followed Directive 2002/87/EC on Financial Conglomerates.

5.8 According to the IMF, however, an effective group-wide supervision of financial conglomerates is still missing and collaboration remains limited to exchange of information on a case-by-case basis.[61]

5.9 As mentioned above, the Bank of Spain highlights that internationalisation via acquisition and via opening of offices abroad constitute one of the main features of the strategy followed by Spain's financial conglomerates in recent years.

5.10 At the same time, the spreading of new offices in Spain to increase proximity to clients, remains a peculiar feature of the strategy of Spanish credit institutions, most notably by those which have evolved into financial conglomerates offering insurance and pension funds.

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

Assessment by category

Competition and Competitiveness

5.11 The system of supervision of financial conglomerates was already in place before the implementation of FSAP, and at the same time there is still scope for improvement of the collaboration among authorities that might render this supervision more effective.

5.12 If the effects of FSAP eventually turn out to be significant in terms of EU-wide effective supervision, this could enhance the level of competition within the EU.

5.13 Large conglomerates such as Banco Santander Central Hispano and Banco Bilbao Vizcaya Argentaria, could experience a further boost to their international expansion in their different sectors of activity but, at the same time, an increased threat to their position in the domestic market. In view of the already intensely competitive nature of the large Spanish banks, the latter effect may dominate the former.

Major financial conglomerates and their behaviour in Spain

5.14 The recent strategy of conglomerates, which in Spain are mainly credit institutions, has consisted of a mix of international expansion and further spread of domestic offices.

5.15 As to employment, in conglomerates, it appears relatively stable so that it would be difficult to argue that the FSAP had so far had any impact.

[redacted]

Conclusions

5.16 The FSAP may be reinforcing an established trend towards internationalisation of the operation of EU conglomerates.

5.17 This could be reflected both in the international expansion of Spanish conglomerates (mainly banks with a foothold in insurance markets) and in the increasing presence of foreign firms in the Spanish market.

5.18 However, in terms of direct impact of the regulatory framework for supervision of conglomerates, in the Spanish case the impact of the FSAP is likely to have been relatively minor, since a framework was already in place.

5.19 Overall, it seems that FSAP effects are likely to be reinforce competition and strengthen regulation among conglomerates, but there is no clear-cut evidence at this stage that the impact has been significant in the Spanish context.

6 CONCLUSION

6.1 Impacts for Spain appear to have been generally positive. Also, if the FSAP can be used as an opportunity to advance Spain's financial development as well as to integrate it into a Single European financial services market, the potential rewards are significant. Our models (exhibited in the Main Report) of the scope for enhanced financial development in Spain, suggest that full and vigorous integration into a Single European financial market could raise the Spanish GDP growth rate by 0.1 per cent.

Assessment

	Impact of FSAP on…				
	Openness to foreign firms	**Competition**	**Consumer Protection**	**Competitiveness**	**Employment**
Banking	Positive	Perhaps positive	Negligible	Perhaps positive	Negligible
Insurance	Affected form of entry	Positive	Limited	Negligible	Perhaps slightly positive
Securities	Possibly positive in the future	Possibly positive in the future	Perhaps positive in the future	Possibly positive in the future	Unclear. Perhaps positive in the future
Financial Conglomerates	Limited	Limited	Positive	Limited	Negligible

SWEDEN

1 INTRODUCTION

Financial Services Regulation in Sweden

1.1 The Riksbank is Sweden's central bank and an authority under the Riksdag, the Swedish Parliament. According to the Sveriges Riksbank Act, the Riksbank's main tasks are to maintain price stability and to promote a safe and efficient payment system. The Riksbank is also responsible for supplying banknotes and coins in Swedish kronor. The Riksdag decided at the end of the 1990's to give the Riksbank an independent status.

1.2 Finansinspektionen (FI) is the Swedish Financial Supervisory Authority. This is a public authority which role is to promote stability and efficiency in the financial system as well to ensure an effective consumer protection. The FI authorize, supervise and monitor all companies operating in Swedish financial markets. The FI is accountable to the Ministry of Finance.

1.3 The FI is the sole responsible regulator for the banking, insurance and securities sectors. It is given authority, including the licensing authority, over banks, credit institutions, insurance companies, insurance brokers, market intermediaries, mutual funds, exchange and issuers.

1.4 The Swedish system makes extensive use of self-regulatory organizations — formal and informal. Regulatory responsibilities are delegated to the Stockholm Stock Exchange and VPC, the securities clearing and settlement system and central depository.

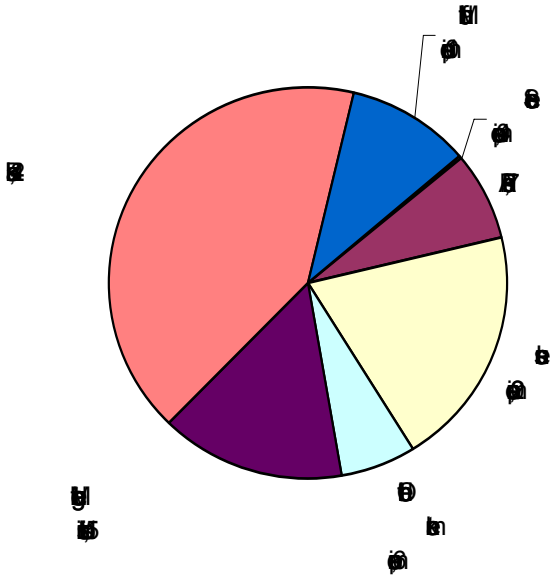
1.5 To make self-regulation effective, the FI relies on informal relationships with industry associations such as the Bankers' associations, the Swedish insurance Federation, the Industry and Commerce Stock Exchange Committee etc.

Structure of the Swedish Financial System

1.6 The financial services sector in Sweden accounts for almost four per cent of the country's total output, defined as its Gross Domestic Product (GDP). About two per cent of the country's total working population work in the Swedish financial industry.

1.7 Figure 1.1 identifies the number of key players in each segment of the financial services sector in Sweden.

Figure 1.1: Players in the financial sector, December 2004 (%)

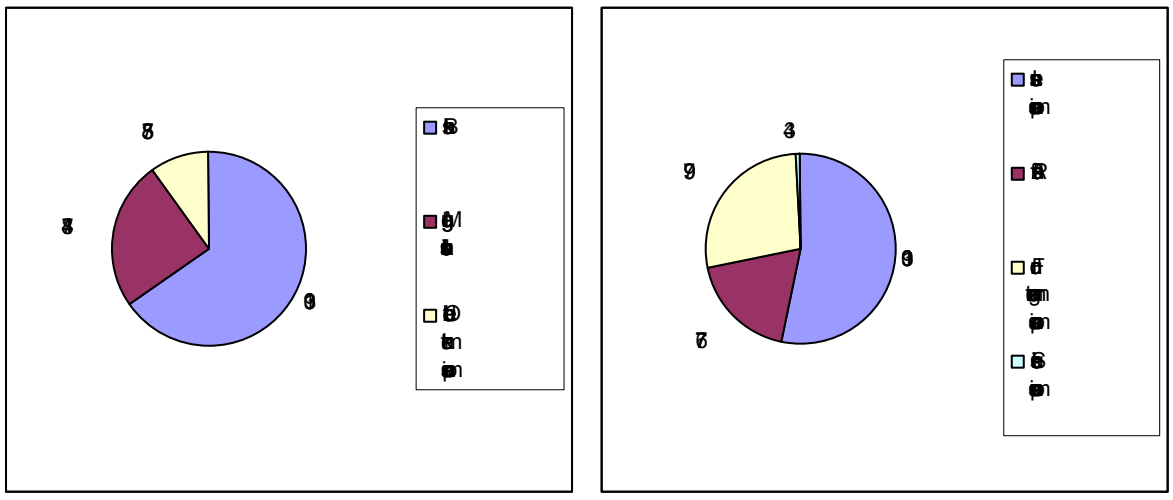


Source: Sveriges Riksbank

1.8 Figure 1.2 shows the total assets and investment assets of the financial intermediaries in Sweden in 2004. The key institutions are banks, mortgage credit institutions, insurance companies, pensions and mutual funds. There is also a significant market for fund management companies.

Figure 1.2: Total assets and investment assets of the financial intermediaries at the end of 2004 (SEK billions)

Credit Institutions **Investors and securities companies**



Source: Sveriges Riksbank

Table 1.1: Wages and total employment in the financial sector 1998-2003

Banking, insurance, and securities	1998	1999	2000	2001	2002	2003
Wages and salaries *(SEK million)*	25,199	26,290	29,339	30,454	32,593	32,594
Total Employment, Number Engaged *(000's)*	89.7	90.0	94.1	93.6	95.9	95.0
Wage per employee *(SEK 000's)*	281	292	312	325	340	343

Source: Sveriges Riksbank

1.9 The securities market is well developed — even if securities companies' total balance is small in relation to other financial companies, they play an important role in the financial market. The Swedish securities exchange is a member of an alliance of stock exchanges that include Stockholm, Copenhagen, Oslo, Helsinki, Riga, Tallin and Vilnius.

1.10 As we shall see later the Swedish financial system is highly concentrated, with key conglomerates operating across different sectors. The main conglomerates operating in Sweden are all from the Scandinavian region (e.g. Handelsbanken, SEB) suggesting the development of regional financial services.

1.11 Private ownership of financial institutions is predominant. However, the State still maintains shares in some institutions.

Consumer protection and complaints handling

1.12 A recent study of 196 companies in the banking, fund management, securities and insurance sectors showed that in general smaller companies were more likely to avoid consumer protection and to process complaints.[62] Smaller companies are found primarily among fund managers and insurance companies, as well as insurance brokers. The study also identified remaining conflicts of interest in complaints handling.

Swedish specific factors

1.13 There are a number of general features of the Swedish financial services industry which might be important when conducting an evaluation of the effects of FSAP. These include:

(a) Sweden is a member of the EU but has not adopted the Euro;

(b) The NOREX alliance (see the Nordic case study or the securities market section for more details) and the growth of a regional market;

(c) The 1992 systemic banking crisis. On 19 November 1992 Sweden was forced to abandon the fixed exchange regime due to speculative attacks to the krone (SEK). Confidence of Swedish banks declined dramatically and the collapse of the property market made the situation even worse;

(d) Pension reforms;

(e) Universal banking system. Banks provide a number of different services to customers.

Conclusion

1.14 From the overview it appears that the Swedish financial market is well established and operating in a largely competitive and non-protectionist manner. From the sector composition it appears that Sweden is highly financially developed, enjoying the consequent wider economic benefits. Consequently, it seems rational to expect that the effects of the FSAP in Sweden will be felt more in integration rather than modernisation.

1.15 The effects of the FSAP in this context are unlikely to be those of a deregulatory process per se. In practice Swedish financial services regulation does not appear to have imposed a particular pattern of financial services provision. Neither does it seem to have been so over-burdensome as to be restrictive of product innovation.

1.16 Whilst consumer protection and the legacy of the early 1990's banking problems may well have made Sweden cautious about adoption of the euro, the FSAP appears to have been introduced without too many problems.

1.17 An interesting theme to explore in the analysis is the extent to which the Swedish financial services market is becoming part of a wider Nordic financial services market and the possible effects of this regionalisation.

1.18 In some respects it may be possible to gain some insight into the future impacts of the FSAP process elsewhere from looking at Sweden.

2 BANKING

Headline Overview

Key of players and structure

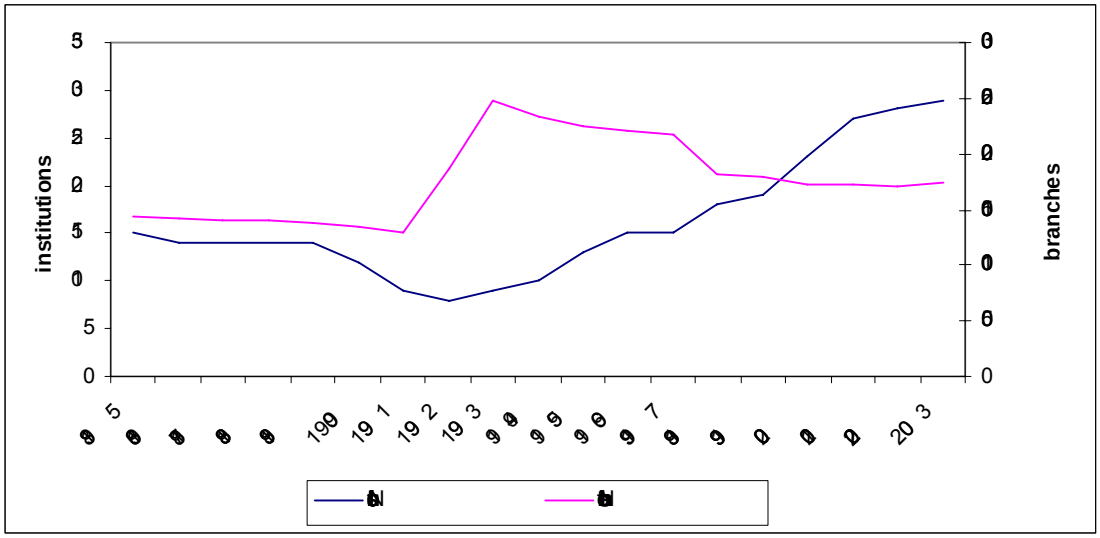
2.1 At the end of 2004, banks accounted for over 40 per cent of the total capital employed on the financial market. Banks are the largest group of lenders among credit institutions.

2.2 In Sweden the banks have traditionally had a monopoly on accepting deposits which made the banks contribute to the supply of liquidity in the economy. Only on the 1 July 2004 was this monopoly abolished enabling credit market companies to accept deposits from the public also.

2.3 In 2004 Sweden had a total of 126 banks. The number of joint stock banks and foreign banks has risen sharply since the early nineties from around 15 to almost 50. Contributing to this rise in numbers of banks have been the entering of niche banks, the conversion of savings banks into joint stock banks and foreign banks.

2.4 Figure 2.1 shows the development in the number of commercial banks and the number of branches to 2003. From this we can see the effects of the banking crisis of the early 1990s and that after this period whilst there are now more banks the number of branches is declining.

Figure 2.1: Commercial Banks in Sweden, 1985-2003



Source: OECD, Data for commercial banks only

2.5 Table 2.2 shows the trend in the number of banks for 1997 to 2003. This appears to show a decline for foreign owned banks. However this may be the result of consolidation rather than decline in market share as a whole.

Table 2.1: Non-Swedish Credit Institutions

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Branches of CI's from EU area	14	17	16	19	17	16	15	17	18
Subsidiaries of CI's from EU area	11	11	12	12	7	7	9	9	11
Branches of CI's from third countries	0	0	0	0	0	0	0	0	0
Subsidiaries from third countries	5	6	7	7	3	3	3	3	3

Source: ECB

Rise in cross-sector activity

2.6 Another important change into the Swedish banking system has been that banks and insurance companies have moved into each other's areas, and as a consequence, all of Sweden's major banks are now involved in the life insurance business and some insurance companies own their own banks. Cross-sector activity of banks into insurance activity (and vice versa) was clear already in 1980's. [63]

Concentration

2.7 The Swedish banking market is highly concentrated. The total assets of the largest banks are set out in Table 2.2. The top five banks account for over ninety per cent of total assets.

Table 2.2: The ten largest banks and bank branches, total assets at the end of 2004

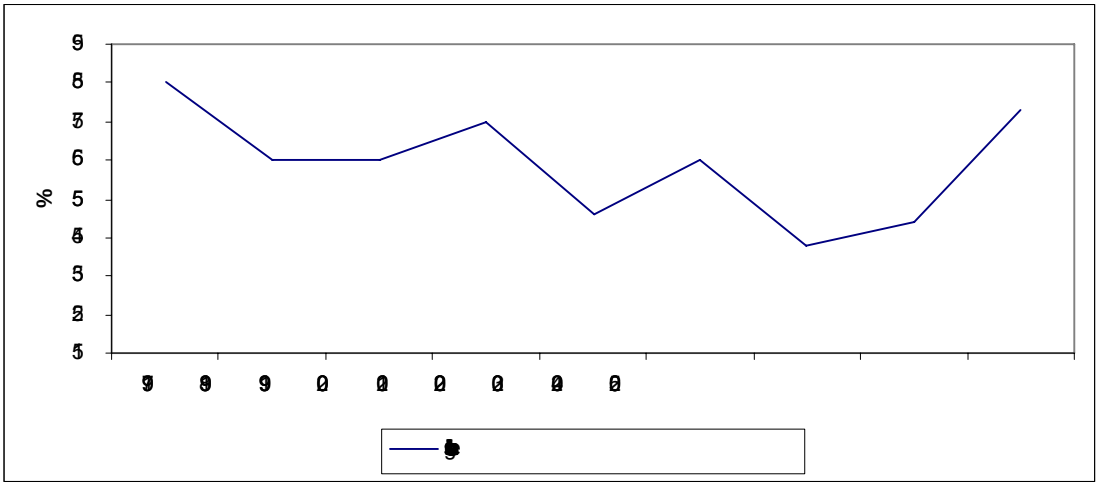
	SEK billion
Handelsbanken (Sweden)	1039
SEB (Sweden)	948
Nordea Bank Sverige (Sweden)	618
Foreningssparbanken (Sweden)	578
Danske Bank (Denmark)	328
Skandiabanken (Sweden)	45
Lanforsakringar Bank	41
GE Monet Bank	29
Carnegie Investment Bank	24
Dexia	23
Total 10 largest	**3676**
All banks	**3901**

Source: The Riksbank

2.8 A Nordic group has developed with the largest banks having operations in other Member States in the region. Swedish banking groups are also expanding into other Member States such as Germany.

2.9 The share of the five largest credit institutions fell from 1997-2005.

Figure 2.2: Share of the 5 largest Swedish credit institutions in total assets



Source: ECB

Wholesale and retail markets

2.10 Bank assets consist largely of loans to the public (SEK 1.426 billion). Almost half of these are granted to non-financial companies, and just over 20 per cent to consumers.

Table 2.3: Main performance indicators of Swedish Banks (%)

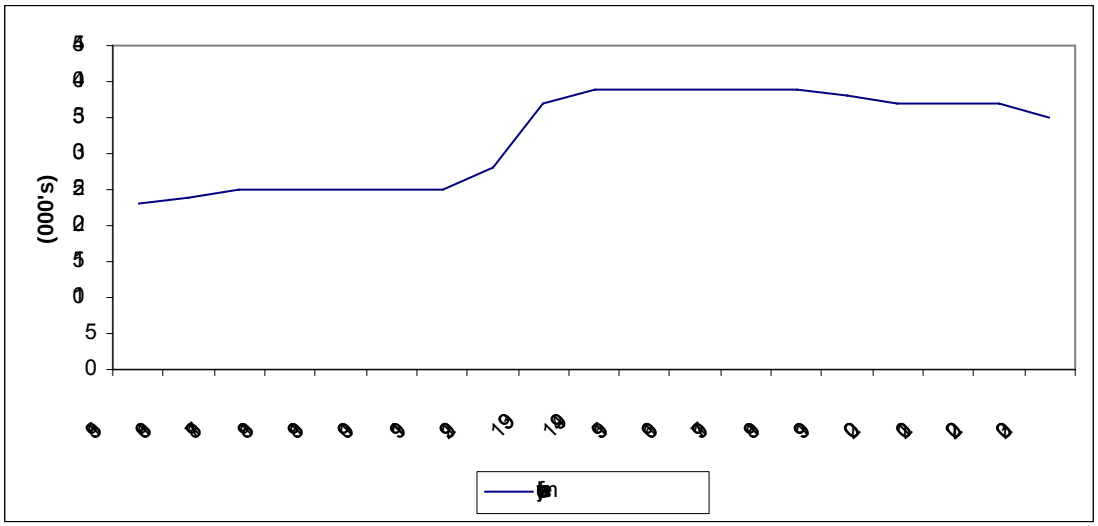
Year	Net interest margin[a]	ROA[b]	ROE[c]
1985	2	0.3	5.6
1986	2.6	1	14.9
1987	2.5	0.7	10.2
1988	2.4	0.6	8.2
1989	2.2	0.5	7.1
1990	2.1	0.2	3.6
1991	2.1	2.8	54.6
1992	2.2	0.3	5.7
1993	2.7	0.1	2.8
1994	2.6	1	18.7
1995	2.7	1.3	22.1
1996	2.1	1.3	25.6
1997	1.6	0.6	11.1
1998	1.2	0.9	17.3
1999	1.2	0.9	16
2000	1.1	1.1	19.5
2001	1.1	1.1	19.5
2002	1.2	0.5	10.3
2003	1.2	0.7	13.1

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

Turnover, employment and profitability

2.11 Figure 2.3 shows the development of employment in Swedish commercial banks to 2003.

Figure 2.3: Employment in Swedish banks, 1985-2003



Source: OECD , data for commercial banks only

2.12 Income has risen in general over time (apart from during the crisis of the early 1990s). Employment peaked in the early 1990s falling after this time.

Mergers and acquisitions

2.13 We can see from Table 2.4 that the total number of mergers and acquisitions from 2000 to 2006 in Sweden has not been as important as in other European countries.

Table 2.4: Mergers and acquisitions number

Year	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006***
Domestic	0	1	1	0	1	0	0
Inter EEA	0	0	0	0	0	0	1
from third countries	0	0	0	1	0	0	0

*Source: ECB. * first half.*

Factors affecting competition

2.14 The impression of respondents to the survey was that switching is now more common than before and that the trend is likely to continue also in the future.

2.15 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.

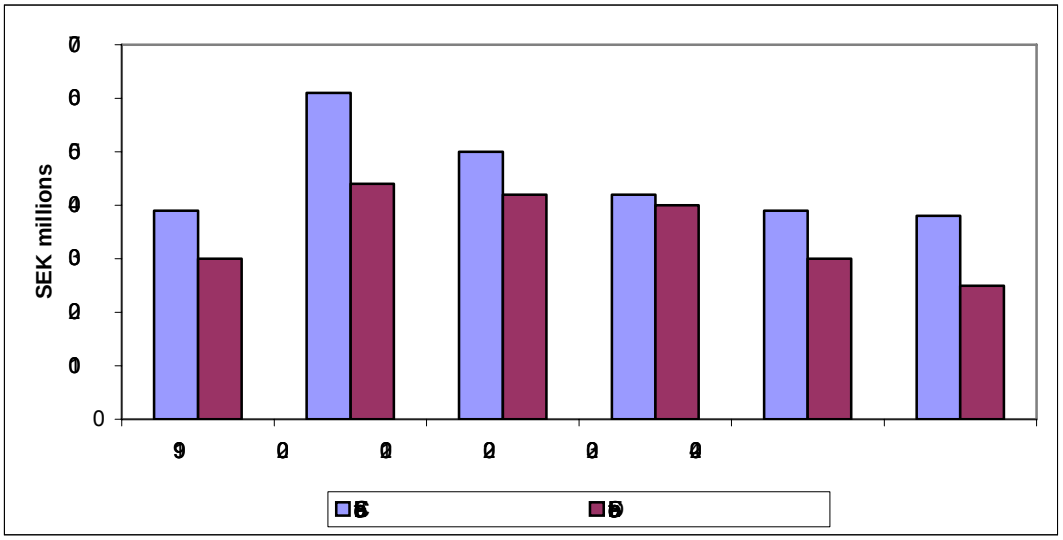
2.16 Consumer protection in Sweden is widely regarded as having improved over the past five years and respondents envisage it improving further in the future.

2.17 However a negative effect of the wider diversity of banking products is that the larger product variety makes it more difficult for the average consumer to understand the differences between similar products.

Trade and international penetration

2.18 Figure 2.4 shows total non-insurance financial services trade for 1999-2004.[64] Based on this data it appears that trade has declined since 2000.

Figure 2.4: Swedish trade in non-insurance financial services, 1999-2004



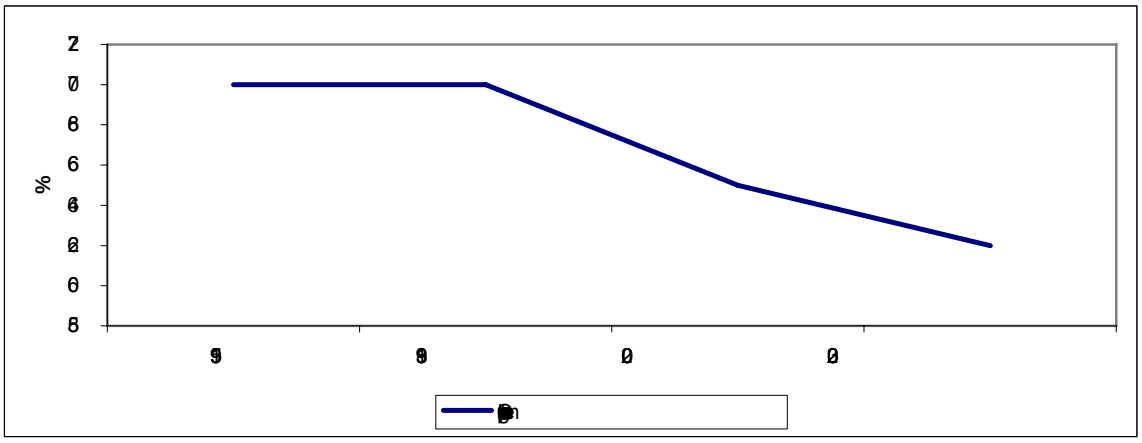
Source: Eurostat

2.19 Foreign banks have been allowed to open branches in Sweden since 1990. The number had reached 22 by the end of 2004. Most foreign banks concentrate on the corporate banking market and the securities market.

2.20 The largest foreign bank in Sweden is Danske Bank of Denmark, which became the fifth largest bank when it acquired Östgöta Enskilda Bank in 1997 and set up what it called "provincial banks".

Competitiveness

Figure 2.5: Operating expenses to income ratio, 1995-2003 (expressed as a %)



Source: OECD

2.21 Figure 2.5 gives the cost to income ratio of Swedish banks. It illustrates that, despite the crisis period of the early 1990s this ratio improved and has remained relatively steady between the mid 1990's and 2003. This indicator suggests that between the period in question, there has not been any significant improvement in this the overall degree of banking efficiency in terms of operating costs to income.

Factors Specific to Sweden

2.22 There are some specific factors that must be considered:

(a) **Universal banking model.** In addition to granting loans banks are involved in securities trading, asset management and corporate finance.

(b) **High level of cross-border activity at Regional level.** The major Swedish banks do not only operate in Sweden but also have business operations in other countries — especially in the other Nordic countries.

(c) **Use of Internet is widespread**. Customers seem to be making more use of the telephone and on-line banking facilities. More than 70 per cent of Swedish households have access to the Internet. These new channels of distribution have enabled the development of new services and intensified competition on the banking market through the establishment of new banks.

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

Assessment of effects of FSAP by category

Competition

2.23 The Swedish competition authority in an investigation on access payment system reports that the Swedish banking market is dominated by a handful of major actors who have been reporting strong profit for several years. The competition authority also claims that there is no general tendency towards lower prices for consumers.

2.24 New banks have entered the market, but they still represent only small players within it.

2.25 One problem that new entrants have encountered is customer inertia. That is to say consumers are not as a rule inclined to switch banks as they have difficulty comparing the alternatives and find it complex making the switch in practice.

2.26 Another problem experienced by small actors is the way the terms of access to the general payment systems in the banking market are designed. These concern both pricing and other requirements, particularly those of a technical nature, which are said to favour large operators.

Concentration in the market

2.27 The Swedish market is concentrated but not as much as the market of other Nordic countries (e.g. Finland). This notwithstanding, there does not seem to be a relation between market concentration and the exercise of market power.

The effect of FSAP on employment figures and industry wages

2.28 The impact (if any) of the FSAP on employment numbers and wages is difficult to establish, for example, to disentangle the changes in the banking system that are due to the FSAP, compared to those under the counterfactual, including the consequence of privatisation and globalisation policies.

2.29 Wages have increased at an average rate of 4 per cent per year, a figure that is substantially larger than the inflation rate. After a peak following the financial crisis of the early 1990s, Swedish banks have roughly employed the same number of people with a slight reduction from 1999 to 2004.

2.30 While the effects on wages is probably due mainly to an overall trend in the industry at a European level the FSAP may have prevented the growth in the number of jobs by imposing stricter requirements on banks.

Consumer protection

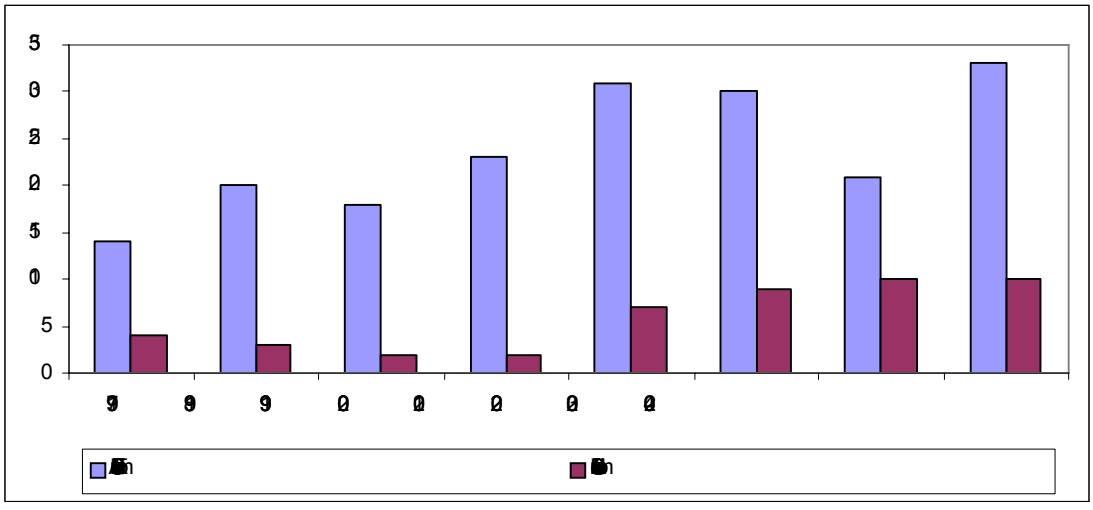
2.31 The FSAP seems to have had no effect on consumer protection and this is expected to hold in the future. However the trend has been towards a higher protection of consumers. It is likely that the regulations imposed to improve customers' welfare would have been introduced irrespective of the FSAP.

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

2.32 Nordea is one of the four largest banking groups' operating in Denmark, Finland, Norway and Sweden. Furthermore, around 30 per cent of SEB's lending is to German borrowers (developments in Germany are therefore important for Sweden though not vice versa).

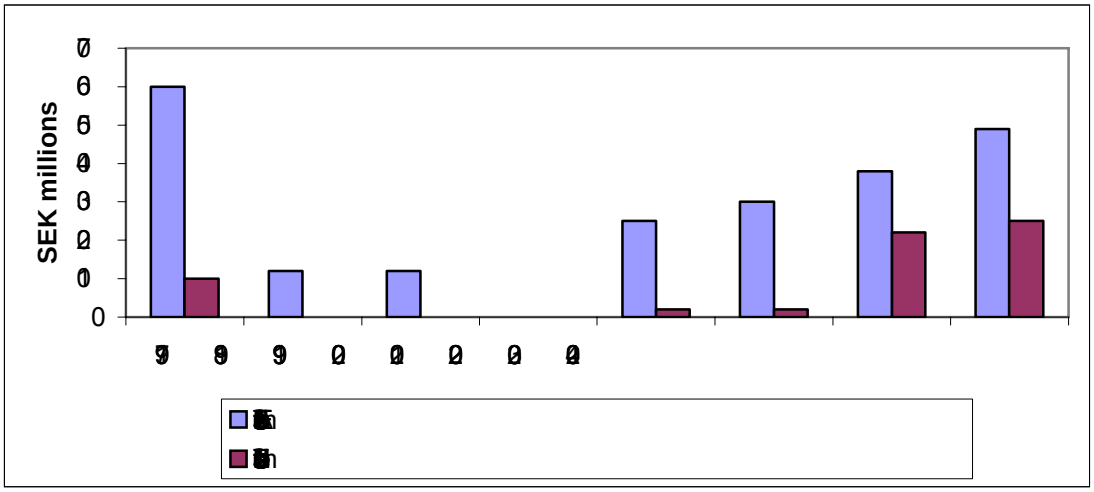
2.33 Figure 2.6 shows the branches, subsidiaries and assets from EEA and other countries in Sweden. From this we can see that whilst these have been rising they still represent a small proportion of the total.

Figure 2.6: Branches, subsidiaries and assets from EEA and other countries



Source: ECB

Figure 2.7: Assets of branches and Subsidiaries from EEA and other countries



Source: Sveriges Riksbank (both)

2.34 Table 2.5 shows the level of openness and internationalisation for Sweden for 2001, 2002 and 2003.

Table 2.5: Level of internationalization of Sweden

Number of banks			Openness			Penetration			Internationalisation		
2001	**2002**	**2003**	**2001**	**2002**	**2003**	**2001**	**2002**	**2003**	**2001**	**2002**	**2003**
149	216	222	19	19	16	25	24	32	44	43	48

Source: ECB

2.35 The degree of internationalization of Swedish banks increased from 2001 to 2003. However the effect is the sum of a slight decrease in the ease with which foreign players can enter the Swedish market and an increase in the ease of penetration into other EU markets. This suggests that the effect of the FSAP has been limited in Sweden given that the market was already open at the beginning of the 1990s.

2.36 Furthermore comparisons within EU member states help to highlight the positive performance of the Swedish Groups in terms of cross-border activities.

2.37 With regards innovation, several factors determine the degree of innovation of a financial banking system such as internet and telephone banking and credit cards transaction per capita. In the last ten years telephone and internet transactions have increased their penetration in the banking system.

2.38 Swedish banks are among the most advanced in internet banking services. All major banks in Sweden offer online status on accounts and other assets, online payments, and the possibility to buy and sell units in funds and shares. Corporate customers have been able to bank via the internet for many years. By comparison with banks in most other countries, Swedish banks have a high proportion of internet customers. In Europe Sweden has one of the highest proportions of the population using bank services through the internet. The share of Swedes paying their bills through internet has increased from 9 per cent in 1999 to 53 per cent in 2005.

2.39 One key factor behind the success of online banking is that ever since the middle of the 1990s, Swedish banks have invested heavily in developing efficient, customer-friendly online banking services. Another important reason is the large proportion, more than 70 per cent, of Swedish homes with access to the internet.

2.40 The first online banking services in Sweden were launched in 1996. Although the range of services was limited in the first few years, as more services have been added and more computers installed in Swedish homes, the number of online banking customers has soared. By the end of 2004, Sweden's banks had more than 5.3 million internet customers out of a total population of 9 million although it must be remembered that some of these customers use more than one bank. According to various surveys, the proportion of the population that uses the internet as its main channel of communication with their bank is between 40 and 45 per cent.

2.41 The growing use of the internet for banking services provides obvious advantages, not only for the banks' customers but also for the banks themselves. The internet gives the customers a better overview of their banking business and enables them to handle their everyday financial transactions without having to visit their local branch. Customers who start to bank online are also proving to be more active as they engage in more banking transactions. As for the banks, the internet enables them to make the distribution and production of their banking services more efficient. Eventually, the growing use of online banking will allow banks to replace their conventional branch offices with ones concentrating on advisory services and sales.

2.42 The implementation of the Second Banking Directive has been one of the key factors in eliminating legal barriers to cross-border banking integration. Note that it has been incorporated, together with some other Directives, into one law, the Consolidated Banking Directive 2000/12 relating to the taking up and pursuit of the business of credit institutions (OJ L126, 26.5.2000).

2.43 Our econometric study suggests that the impact of the FSAP on trade has been a rise of 1.3 per cent in imports of financial services other than insurance and pensions, and a rise of 1.6 per cent in exports. Full implementation of the FSAP and FSWP legislative measures is projected to lead to a further 1.0 per cent rise in imports and 2.0 per cent in exports.

Competitiveness

2.44 The operating expenses-to-income ratios of Swedish banks peaked during the banking crisis of the early 1990s when income was very low. However, the ratio started to fall markedly (perhaps because of cost saving programmes instituted by the banks and other structural changes) and pitted in 2001.

Conclusions

2.45 From this section we can see that the FSAP process, as part of the drive towards an internal market for financial services has had some impacts on Sweden. In particular this process has assisted the development of regional markets in the Nordic region by fostering a harmonised regulatory environment. Further the banking crisis of the early 1990s, in part due to fall-out from the lead in to the euro, had negative impacts on consumer confidence which have led to consumer protections.

2.46 However, we have noted that even prior to the FSAP there was a high level of financial development in Sweden. Legal certainty and effective corporate governance were well established. Further, the Swedish financial sector was relatively open before the FSAP and also competitive reducing other positive impacts which may have been associated with market opening.

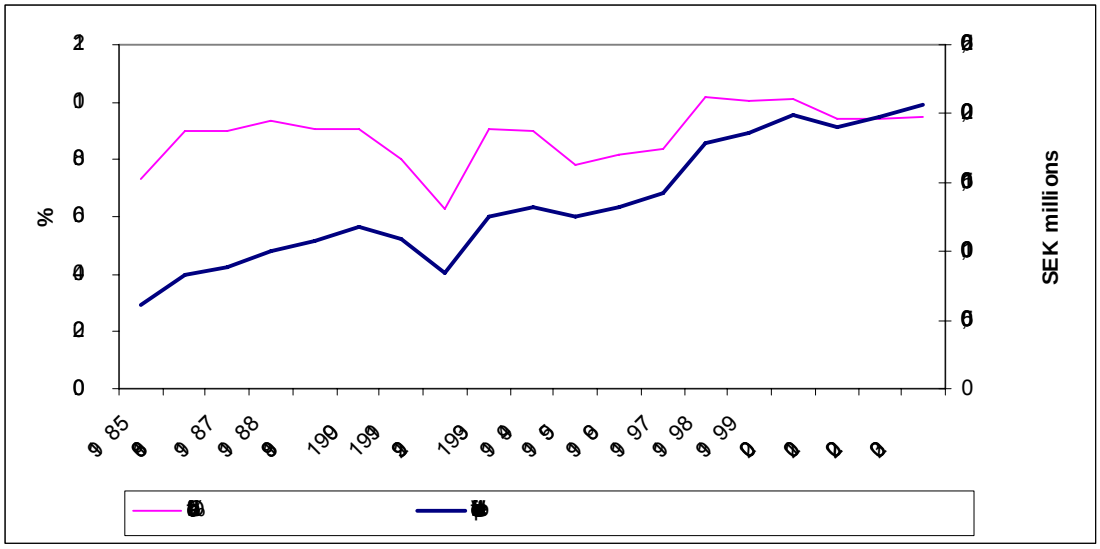
3 INSURANCE

The Swedish Insurance Sector

3.1 There are 415 insurance companies in Sweden, most of which are small local companies offering non-life insurance. However, the market is concentrated in a number of large companies. In Sweden it is not permitted to carry life and non-life business in one at the same company, although it is common to have both kind of business in the same corporate group.

3.2 Life insurance remains the most important area with over 70 per cent of total assets. Asset growth for both segments has been volatile. Figure 3.1 shows that the value added in the insurance sector increased constantly in Sweden over the last 25 years, except for the crisis of the early 1990s. The figure also shows that the share of insurance sector increased from 0.7 per cent to 1 per cent in the same period.

Figure 3.1: Value added of Swedish Insurance

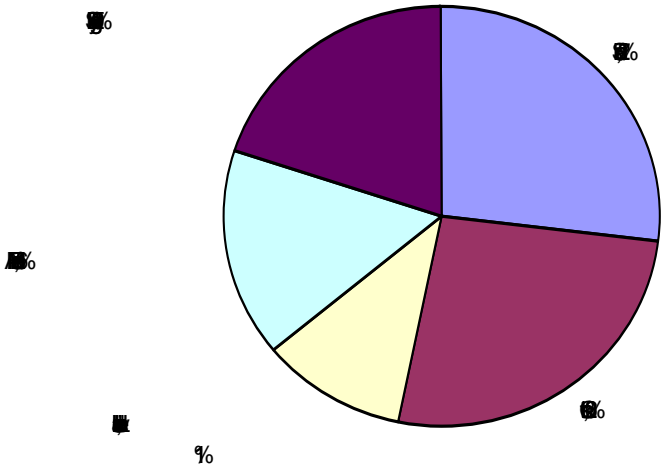


Source: University of Groningen

Concentration in the market

3.3 Figure 3.2 shows the concentration in the insurance market.

Figure 3.2: Largest insurance and unit linked insurance companies in 2003, market shares



Source: Swedish Insurance Federation

3.4 From this figure we can see that for life and non-life insurance, the four largest insurance companies/groups together account for approximately 75 per cent of the market.

3.5 Just over one quarter of the investment assets in the life insurance market belong to the four major bank groups.

Table 3.1: The ten largest insurance companies in Sweden (SEK billions)

Life insurance company	**Investment Assets**	**Non life insurance company**	**Investment Assets**
Alecta	340	AFA	150
Skandia (Liv + Link)	324	If Skadeforsakring	59
AMF Pension	223	Lansforsakringar	52
SEB Trygg Liv (Nya + Garula)	245	Trygg-Hansa	23
Handesbanken Liv + SPP	137	Folksam	20
Lansforsakringar (Liv + Fondliv)	117	FPG	13
Folksam (Liv + LO + Fond)	70	Sirius Inter	12
Robur (Foreningssparbanken)	44	SEB	2
KPA (Liv + Pension + Fond)	29	Brandkontoret	2
Nordea	17	Assuransforeningen	1
Others	21	Others	27
Total	**1567**	**Total**	**363**

Source: The Swedish Insurance Federation and Statistics

3.6 The insurance companies are either limited liability companies that distribute their profits or companies managed according to mutual principles

3.7 Life insurance companies can be divided up into traditional life insurers (who pay a guaranteed return) and unit-linked insurers (where return is determined by the performance of the individual fund). Non-life insurers manage their assets in the security market with a higher return. Labour market agreements between employed individuals also take up group insurance policies.

Table 3.2: Structure of insurance industry, no of companies

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
National companies	129	134	138	137	138	140	137
Local companies (non-life)	322	320	291	283	274	260	253
Non-Swedish companies	22	28	32	28	28	28	25
Total	473	482	461	448	440	428	415

Source: Swedish insurance federation, various years' reports

3.8 Insurance associations and pension foundations are also insurance companies, but with smaller share of the pension insurance market. The majority of the first category provide pensions insurance only. Their total assets at 2003 amounted just over SEK 88 billion. The latter are another form of pension savings, which assets approximately amounted at SEK 90 billion at 2003.

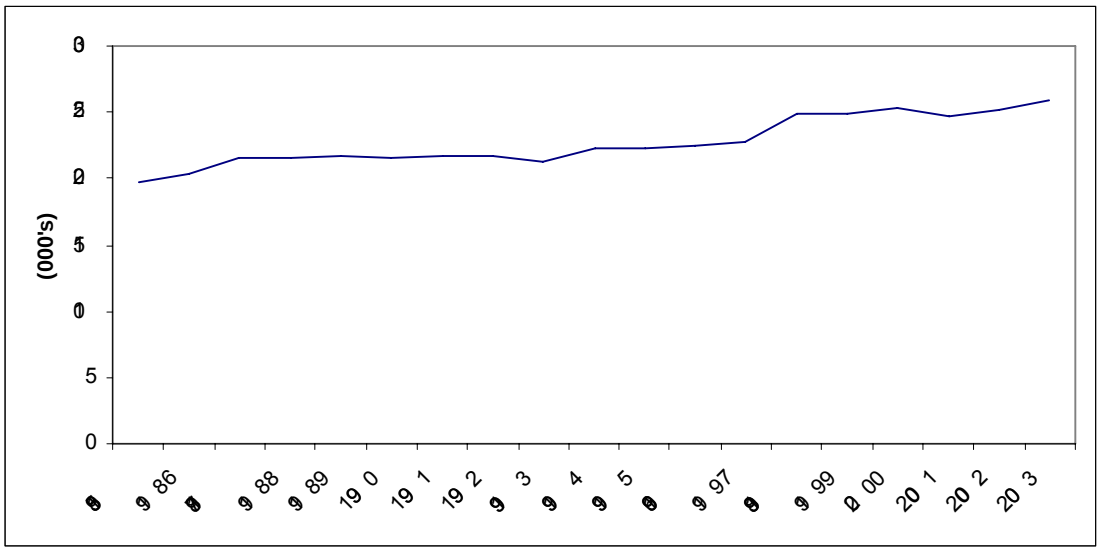
3.9 Fund management companies manage and administer different kind of funds with different investment focus. Bank-owned management companies dominate the fund management market.

3.10 Fund management companies affiliated to insurance companies have increased substantially their share of the fund market as a result of the pension reform in 2000 that introduced a premium pension system (PPM). This created competition between mutual funds and life insurance companies.

Employment

3.11 Figure 3.3 illustrates an upward trend in employment in the insurance industry going back many years.

Figure 3.3: Employment in the Insurance and Pensions sector

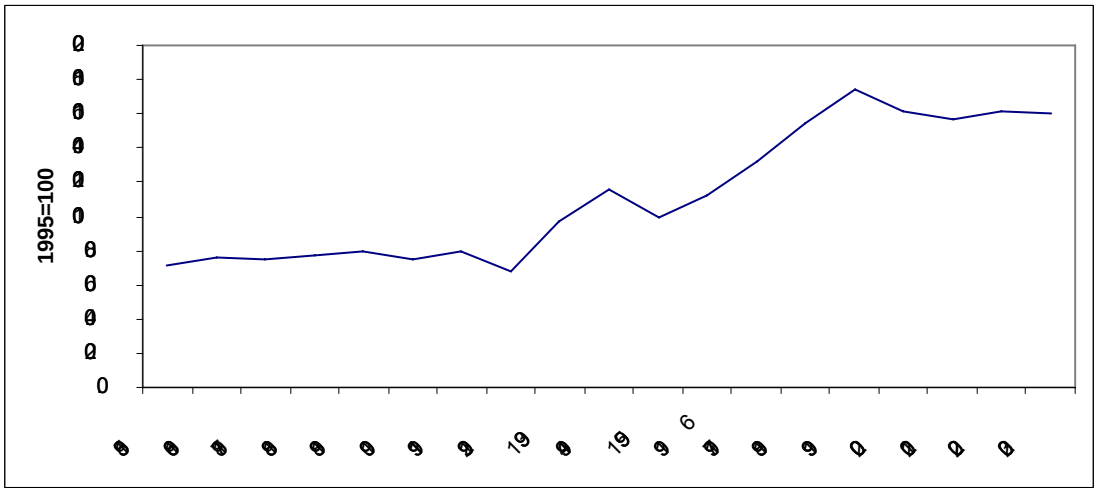


Source: University of Groningen

Competitiveness

3.12 Figure 3.4 gives labour productivity in insurance and pensions. As can be seen in the second half of the 1990s it has risen sharply and settled down since the millennium. The rise in the first half of the 1990s is probably due to the period of over-inflation that followed the crisis.

Figure 3.4: Labour productivity (per employee) in Swedish insurance and pensions sector (1995 = 100)



Source: University of Groningen

Factors Specific to Swedish Insurance Market

3.13 There are some specific factors that must be considered:

(a) **State-owned pension funds.** The Swedish pension system consists of two parts: a collective part (pay as you go) and an individual part which is a premium reserve system where pension are financed by money paid into funds during the policyholders' working life and where policyholders themselves chose the fund management company (there are different fund-based options). The major task for the national pension funds is primarily to manage the pay as you go system.

(b) **A domestic market with high presence of small and medium sized undertakings**, many of them mutual. These are shareholder owned but mutually driven companies. Returns above the guarantee level are not fully distributed.

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

3.14 The results of the survey suggest that FSAP measures in the insurance sector have been mostly implemented in Sweden. Market participants have generally adapted to the new provisions.

3.15 There are two different legislative blocks that form the foundation for all private insurance activity in Sweden.

(a) The Insurance Business Act establishes regulations for insurance operations; and

(b) The Insurance Contracts Act regulates the relationship between the insurer and the insured.

The Insurance Business Act

3.16 The Insurance Business Act contains regulations for the establishment of insurance companies, as well as rules pertaining to their operations and their overall supervision. In order to establish an insurance company or expand a company's product portfolio, a concession (authorisation) is required.

3.17 As of July 1 1995, the Swedish insurance legislation was adapted to the EU's third Non-Life and Life Insurance Directives, and since January 1 1996, the EU regulations for annual and consolidated accounts in insurance undertakings have been part of Swedish law. As from the year 2000, the possibilities for Swedish insurance companies to own shares in other companies have been adjusted to comply with EU legislation.

3.18 Supervision shall mainly be limited to stability and transparency. The distribution of profit to shareholders (joint stock companies) or guarantors (mutual companies) is permitted even in companies that conduct traditional life assurance operations. The consumers are protected through requirements for good information and a clear division between the capital of the shareholders and that of the insured and through a contracted right to surpluses.

The Insurance Contracts Act

3.19 The Insurance Contracts Act (FAL), which dates from 1927, regulates the legal relationship between the insurer and the insured and others covered by the policy. The law is applicable to life, accident and sickness insurance. FAL regulates, inter alia:

(a) the insured's obligation to inform the insurance company about risks that effect the premium;

(b) premium payment; and beneficiary; and

(c) claims settlement; and period of limitation.

The Consumer Insurance Act

3.20 The Consumer Insurance Act (KFL) is applicable to the most common non-life insurance policies. The Consumer Insurance Act contains, among other items, rules on:

(a) customer information before the policy is entered into and during the life of the policy;

(b) the right to obtain insurance coverage and premium payments; and

(c) claims settlement; and period of limitation.

3.21 The law is mandatory, which means that any insurance clauses less favourable for the consumer than those set forth in the KFL will not be applicable. A review of KFL is being considered in the Ministry of Justice.

The Motor Insurance Act

3.22 Motor third party insurance is mandatory, in accordance with the Motor Insurance Act (TFL), and covers the strict tort liability that a motor vehicle owner has for injuries to other people and damages to their property.

Assessment of impact by category

Market entry, cross-border business and takeovers

3.23 The time series of data on the number of foreign undertakings available for Sweden is not as long as it would be desirable. We only have figures (presented in Table 3.2 above) from 1999 to 2005 so that it is not possible to assess the situation before the FSAP. However after an increase from 1999 to 2001 the number of foreign undertakings declined from 32 to 25 in the following four years.

3.24 It may well be the case that these movements are caused by changes in the number of Nordic companies and not of companies from other EU countries since the Scandinavian market was already integrated before the FSAP.

3.25 This view is also confirmed by the results of the survey. They indicate that cross-border activities have indeed increased in the past and are more likely to increase in the future but that there is no specific effect of the FSAP. The majority of these activities take place within the Nordic and Baltic regions.

Competitiveness

3.26 As can be seen in Figure 3.4, 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.

3.27 Little, if any, of the increased operational efficiency can be attributable to the FSAP. However, insurance companies in other parts of Europe had a lighter regulatory burden so a "level playing field" would help Swedish insurance companies.

3.28 Swedish firms seem to be vulnerable to foreign takeovers and supplier power, the threats from substitute products, the business infrastructure and the Swedish tax regimes would be important factors in facing international competition.

Product variety, e-commerce and prices

3.29 The variety of relevant products available on the insurance markets in Sweden has increased in recent years and it should also increase in the future. Provisions of the FSAP seem not to have played a role for the current trend but will have an effect in the future.

3.30 Where the FSAP is regarded not to have had an effect (and as not having an effect in the future) is in e-commerce of insurance products: this trade has increased but not because of the FSAP provisions.

3.31 Although insurance companies are improving their efficiency and reducing their operational costs there is concern that they are not passing the improvements to consumers via a decrease in prices. In this respect there seem to be different patterns in price trends according to different products.

Consumer protection

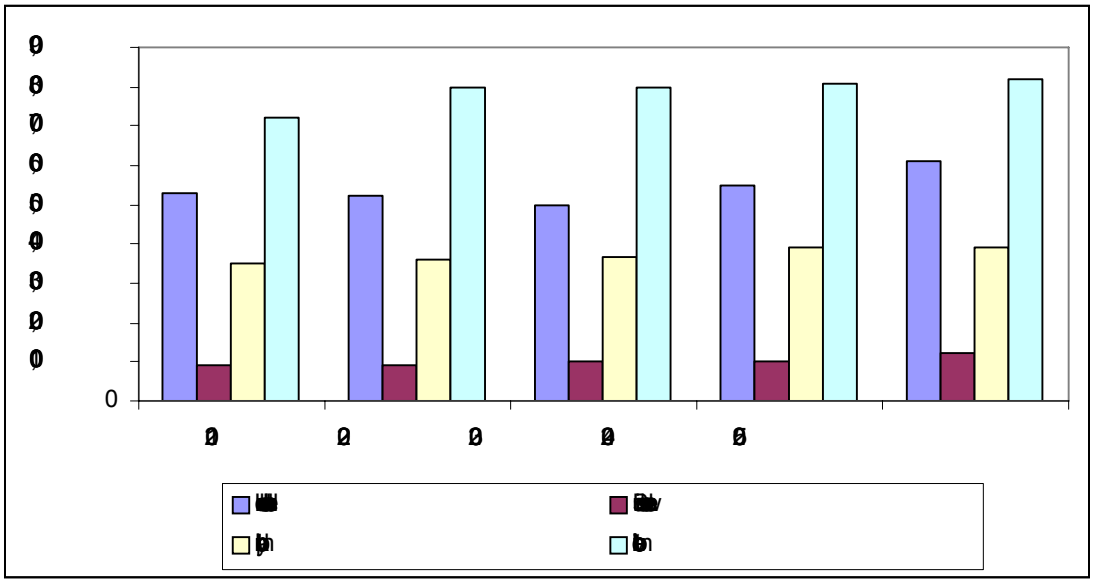
3.32 With regards consumer protection, the Insurance Business Act closely regulates the insurance industry and it is under the supervision of the Financial Supervisory Authority. The Insurance Contracts Act and the Consumer Insurance Act further safeguard the consumer's position:

(a) *Increased transparency,* more detailed information and better conditions for quick and efficient claims adjustment are some of the issues within the consumer protection area that have had attention by the Swedish insurance market. For instance, the Swedish Insurance Federation's subsidiary provide a website with an overview of an individual's future pension, with more than 250,000 registered users and close to a million visitors during its first year of existence. More pension institutions have joined during the year and now more than eight out of ten persons can get information there regarding both their public and their occupational pension based on collective agreements. The information can now also be complemented with private pension savings. Forecasts can then be made for how large the total pension will be, based on different assumptions about age and economic development. This internet service has gained international attention and received several awards for its unique service.

(b) *Increased security and decreased damages.*

(c) *Increased focus on fraud.* There are several different venues for the dissatisfied insurance customer to turn to for redress. To begin with, the insured can have the matter reviewed a second time by the insurance company. Many of the larger companies have special review committees or their own customer ombudsmen to whom the consumers can turn to have their matters reviewed.

Figure 3.5: Complaints for insurance products (number of complaints)



Source: Swedish Insurance Federation

3.33 Given the above, the FSAP is unlikely to have major effects.

The effect of FSAP on competition within insurance sector

3.34 With regards switching costs these may have decreased due to changes in national legislation (such as the 2000 Pension reform). In the case of insurance savings, lack of consumers' mobility is a competitive barrier, even if in Sweden insurance company customers are more inclined to switch than bank customers.

3.35 In 2004 insurance companies have been allowed to introduce a right (on a voluntary basis) to transfer savings from one company to another at a reasonable charge. However, a more comprehensive right could help mitigate lock-in effects on pension capital.

Conclusions

3.36 The insurance industry in Sweden has been characterised by large increases in productivity and a reduction in the number of firms operating. There have also been increases in consumer protection, an increase in the use of the e-commerce and switching costs seem to have decreased.

3.37 However, most of these trends probably started (and had most of their effect) prior to the application of the FSAP. For instance most of the increase in labour productivity occurred between 1992 and 1998 with a relatively small increase after 1998. This suggests that the dominant cause of the trend is either the banking crisis that occurred in 1992 or the entry into the EU in 1995.

3.38 Effects of the FSAP should be seen in the increase in product variety, the increase in competitive environment for Swedish firms as the regulatory playing field becomes more level, and possibly in the continuing drive to increase consumer protection.

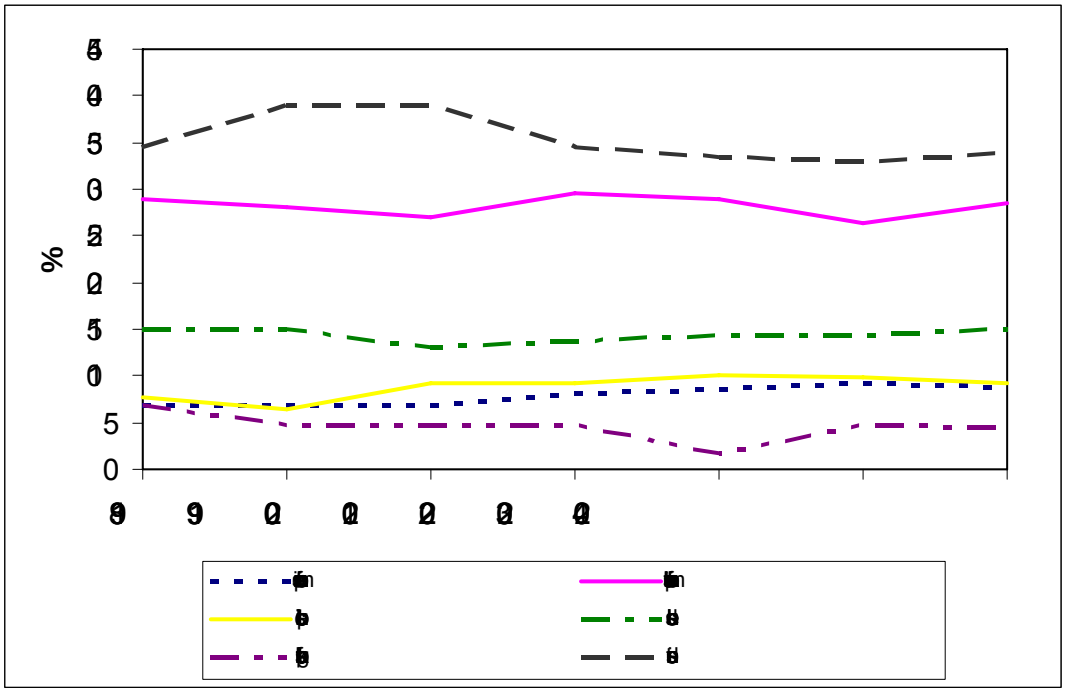
4 SECURITIES

Swedish Securities Markets

4.1 Securities companies act partly as brokers and partly as market-makers and are licensed by Finansinspektionen (FI) to engage in security trading and foreign companies

4.2 Shareholding in Sweden is widespread and extensive, and households own a non-marginal part of the shares.

Figure 4.1: Shareholding composition trends (%)



Source: Riksbank

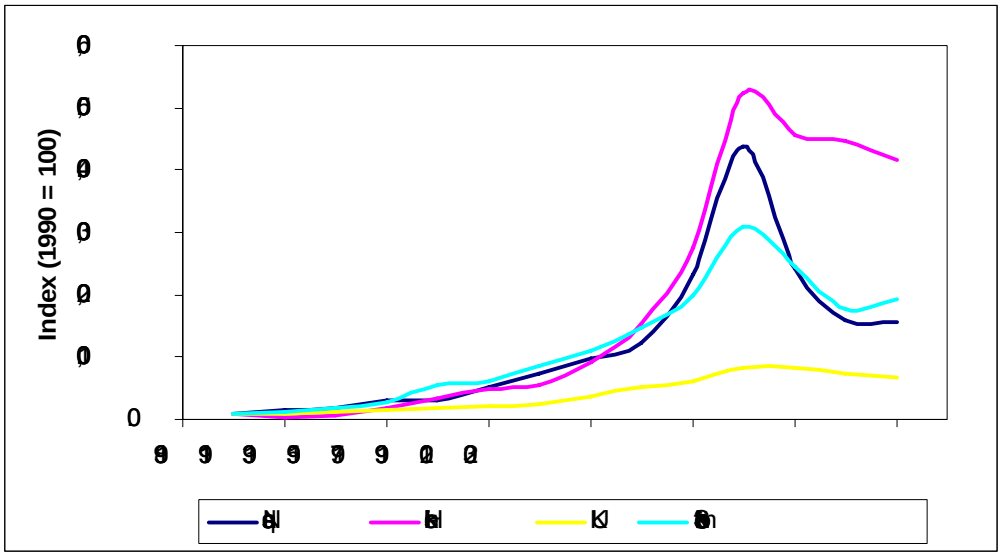
4.3 Most equity trading takes place at Stockholmsbörsen, the Stockholm Stock Exchange which is part of the OMX. All trade on Stockholmsbörsen is conducted through its members and both large and small investors have to go through one of these members in order to buy or sell shares. The members consist of companies that fulfil the exchange's requirements for membership.

4.4 Since 1990, trading in the stock market on Stockholmsbörsen has been fully automated, which means that trades are conducted directly from terminals at members' offices. Trading is carried out through the electronic trading system SAXESS (Stockholm Automated Exchange). Many of the exchange members now provide services for placing orders on the Internet, which can often entail lower direct transaction costs than trade via securities companies and banks.

4.5 At 2004 equity turnover was approximately SEK 3,390 billion, with an increase of SEK 1,000 billion compared with the previous year. The average turnover per trading day amounted to SEK 13.5 billion. Ericsson shares represent a considerable part of the market (around 27 per cent).

4.6 Figure 4.2 shows that the increase the volume of trading in the Swedish market has been less pronounced than in Finland and in the Nasdaq, but much higher than in the UK market.

Figure 4.2: Trading volumes in selected markets (1990 = 100)



Source: Elaboration on World Federation of Exchanges data

4.7 Table 4.1 reports some basic data of the Swedish securities market from 1996 to 2005.

Table 4.1: Basic data of the Swedish securities market

TOTAL	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Trading volume (SEK billion)	918	1 346	1 830	2 609	4 456	3 994	2 702	2 453	3 391	3 764
Number shares traded (000's)	8431	9021	11915	14690	27901	47044	63988	82305	83037	72064
Mean trade size (SEK 000's)	280	278	285	309	324	376	274	262	324	320
Number of transactions	3275	4836	6427	8426	13764	10628	9869	9365	10477	11757
Mean daily volume (SEK 000's)	3658	5404	7320	10353	17753	15978	10807	9852	13402	14876
Mean number of trades per day	1304 8	19430	25707	33436	54835	42512	39477	37610	41410	46470
Year-end market value (SEK bn)	1 687	2 164	2 413	3 717	3 583	2 856	1 779	2 314	2 699	3 507
Turnover rate, %	66	66	76	94	107	134	122	124	134	124
Change in index, %	38	24	10	66	-12	-17	-37	30	18	33
Number of trading days	251	249	250	252	251	250	250	249	253	253
Number of new companies, net	18	54	36	54	46	24	10	5	10	9
Number delisted firms, net	12	22	21	30	35	30	18	20	15	14
Number listed firms at year-end	229	261	276	300	311	305	297	282	277	272
of which foreign companies	12	16	18	23	19	20	19	16	20	20

Source: Riksbank

Other marketplaces

4.8 Besides Stockholmsbörsen AB, Nordic Growth Market (NGM) is also licensed by the FI to operate a stock exchange in Sweden. NGM has specialised in small growth companies and offers listing and share trading in the lists NGM Official and NGM Equity and derivatives trading in the list Nordic Derivatives Exchange (NDX).

4.9 Swedish legislation also contains the concept of an authorised market place. An authorised marketplace substantially operates as a stock exchange, although it does not have the same requirements on the organisation of the board and the establishment of a disciplinary board as a stock exchange and has less far-reaching requirements with regard to listing, information and reporting.

4.10 Unofficial trading also takes place in shares of small companies, which are not listed on a stock exchange or authorised marketplace.

Private equity

4.11 In Sweden the first private equity investment companies were established at the end of the 1980s. However, development has been swift, in particular in recent years, and, according to the Swedish Venture Capital Association, there are now over 115 private equity investment companies, which together have a capital of around SEK 220 billion. Approximately SEK115 billion of this amount has been invested in portfolio companies. This can be compared with lending by Swedish non-financial companies in the form of bonds and certificates that totals SEK 330 billion and with their loans from credit market undertakings active in Sweden of SEK 1,224 billion. Investments through private equity investment companies are accordingly a not insignificant source of financing for the corporate sector.

Derivatives

4.12 The vast majority of the equity derivatives traded via Stockholmsbörsen are options and forwards. In addition to derivative contracts for individual equities, trading on Stockholmsbörsen also includes options and forwards that are linked to the exchange's equity indexes, OMX options and OMX forwards.

Swedish Specific Factors

4.13 There are some specific factors that must be considered:

(a) Shareholding in Sweden is widespread and extensive.

(b) Sweden is a major member of the NOREX alliance that has led to increasing co-operation and integration in securities trading in the Nordic region.

(c) Sweden is not part of the Euro area. However this does not seem to have had a negative impact on its securities market.

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

Swedish legislation and regulation

Table 4.2: Swedish legislation

Capital adequacy	Swedish banks and securities companies are busy implementing new risk management methods, though the directive (CAD III) and implementing measures will not be finalised until the end of 2005. The Swedish Financial Supervisory Authority has published certain general **guidelines** for the industry, awaiting the accomplishment of the directive, implementation measures from EU and amendments to Swedish legislation. The adjustments will require considerable investments in IT systems and new risk management procedures, as well as additional expertise in risk management in the Swedish banks and investment firms.
European Prospectus Directive	In order to implement the new Prospectus Directive into Swedish legislation, a committee appointed by the government has published an **interim report (SOU 2004:95, October 2004).** The government will now process the legislation in order that it should come **into force by 1 July 2005**. In addition, the same committee in its final report will propose civil law provisions, due to take effect at a later stage and not before 2006, that relate to matters of liability for the issue of prospectuses.
Regulation of market abuse	In 2003, as a result of the Market abuse directive, the Swedish government commissioned a report concerning the potential changes to the Swedish legislation. The report **(SOU 2004:69, June 2004)** proposed measures for increasing the efficiency of handling reports about insider dealing and suggested that **investigations of insider dealing should be moved from the Swedish Financial Supervisory Authority to the Swedish National Economic Crimes Bureau**. Regarding financial research activities the commission proposed **increased transparency of conflicts of interests** in relation to financial institutions.
IOSCO principles for sell-side securities analyst conflict of interest	The Swedish Financial Supervisory Authority has, by means of general guidelines effective from November 2004, implemented the IOSCO principles for addressing sell-side securities analyst conflict of interest that were published by IOSCO in September 2003.
Financial advice and consumer protection	A new law came into force on 1 July 2004 concerning financial advice services provided to consumers. The law pertains exclusively to **financial advice provided by service providers to consumers** and only applies to advice concerning financial instruments and certain types of insurance. This law states that the service providers offering financial advice to consumers must ensure, at the latest by July 2005, that the consultants providing such advice have sufficient competence for the task and do not mis-lead clients. They must also ensure that any financial advice is documented and that the client gets a copy. The law gives consumers the **right to compensation** in the event of inappropriate advice. Various training institutes offer programs for certification of financial advisors. Licensing requirements are normally on a more qualified level than required under the new act. This licensing has been a self-regulation measure for brokers, advisors and other groups of employees within the Swedish securities market since 2001.

IAS and IFRS	The mission to adjust the Swedish system to meet the IAS international accounting standards has been underway for many years and, in fact, the Swedish Financial Accounting Standards Council, a self-regulatory body, completed this adjustment work in 2003. Pursuant to European regulation, IAS or rather International Financial Reporting Standards (IFRS) have direct effect in member states as from 1 January 2005. The regulation concerns all listed companies at group level. In Sweden, it has been proposed that the **regulation should correspondingly apply also to unlisted companies**. Certain amendments as to IFRS have been made in Swedish law, effective from 2005 with some transitional provisions for financial companies. Stockholmsbörsen (Stockholm Stock Exchange) has required listed companies to include in their annual reports for 2004 a statement of major differences that will occur due to the IFRS adjustments.

Table 4.3: Industry Self Regulation and Liaison Initiatives in Sweden

Code of corporate governance	In close collaboration with the Commission on Confidence in Business a working party proposed a **code of corporate governance.** The code is an act of self-regulation and comprises **best practises** regarding, among other issues, annual general meetings, the appointment of the board of directors and auditors, the functions of the board of directors, corporate management and issues of transparency regarding corporate governance.
Licensing	SwedSec AB, a subsidiary of SSDA, oversees the licensing requirement system for brokers, advisors and other groups of employees within the Swedish securities market. By the end of 2004 some 140 companies had signed an agreement with SwedSec, undertaking to allow only licensed personnel to provide qualified financial advice and services to their customers.
Listing requirements	**Stockholmsbörsen introduced stricter listing requirements in 2002 for companies listed on the exchange**. In order to ensure the independent, controlling function of the board, companies are now allowed to have only one member of the board who is also actively involved in the operation of the company. More than half of the members of the board must be independent of the company, and at least two of these must be fully independent of the largest shareholders of the company.

Liquidity provider	**In 2003, Stockholmsbörsen introduced a system of liquidity providers on the Swedish equity market.** The effect of this is that members of the stock exchange during the trading day undertake to quote purchase and sale prices continuously in shares with relatively poor liquidity to add strength to trading in these. **The system is intended to improve the liquidity of low-turnover shares and, as a result, to reduce risks and transaction costs.** The requirements on liquidity providers are high by international comparison. For example, liquidity providers are obliged to quote prices in at least four trading posts and to maintain a limited spread between the sale and purchase prices. The result has been a significant reduction in spreads. By the end of 2004 there were liquidity providers in the shares of 73 companies.
Bidding obligation	Regulations pertaining to bidding obligations were tightened in September 2003. The new rules mean that **major shareholders must bid for all shares in a company when their voting rights exceed 30 per cent of the total voting rights.** Previously, the limit was 40 per cent.

Table 4.4: Specific Issues

VPC (Central Securities Depository, CSD)	The consolidation of the Nordic CSDs markets is essential for the successful creation of an integrated Nordic securities market. VPC AB and the previously OMX-owned Finnish Central Securities Depository (APK) announced in November 2004 that the two companies will merge, resulting in the creation of a Finnish-Swedish CSD – NCSD – to facilitate the harmonization of rules and settlement processes and promote the development of a common technology platform, which will accelerate the horizontal integration of the post-trade part of the value chain. This will increase the efficiency and competitiveness of the Nordic financial market. NCSD will cover approximately 70 per cent of the total Nordic CSD activities. In November 2003, VPC introduced a new method of closing securities deals in Sweden. **The new system for Clearing & Settlement entitled New Clear makes possible shorter clearing times and more efficient securities links with other countries**. The new clearing system lives up to the most stringent international requirements and achieved a **timely settlement rate of 99.4 per cent in 2004**.

Central counterparty (CPP)	In recent years, projects have been run, both within VPC and OMX, with the **aim of analysing the advantages of a Central Counterparty (CCP) and creating a model for a CCP in the Swedish cash market for financial instruments.** However, settlement risks in the Swedish cash trade sector have been estimated to be so limited that the advent of a CCP must be considered more-or-less an adaptation to match the international trend. In 2003 VPC presented a prototype that should be able to function in all the Nordic countries. It is currently being evaluated by the securities industry.

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. Survey participants suggest that integration of Swedish markets indicate an increase of cross-border business over the next few years but again the role played by the FSAP is not the primary one. In addition they envisage that the most significant part of this increase will be located in other Nordic markets.

4.15 Some survey respondents believe that there is a risk that MiFID will limit investor access to the EU-market.

4.16 Given that the Stockholm Stock Exchange is part of the OMX group, which also has exchanges in Copenhagen, Helsinki, Riga, Tallinn and Vilnius, it seems unlikely that the FSAP has had significant direct impact on the integration of Swedish securities market with other EU Member States.

4.17 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 Swedish securities sector at an aggregate level, as the OMX has already had a positive impact on the level of employment.

4.18 Consumer protection issues are of relatively limited importance in the securities market. For this reason, the short-term impact of the FSAP on the Swedish 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 Swedish securities market; but if more inexperienced market users were to use that market, the FSAP might have a positive impact.