



Eurofi, the dedicated think-tank for the integration of financial services in Europe, is organizing a conference on September 11 and 12 to discuss the proposals put forward by the financial industry at the ECOFIN, set against a global crisis with leaders facing new challenges.

This crisis shows that the supervision of cross-border financial groups must be adapted in order to factor in the rapid spillover of risks, the internationalization of their activities and the centralized organization of their financial management and strategy.

That is why Eurofi is proposing a series of pragmatic measures to improve the supervision of these groups and the prevention of crises, notably including:

- The establishment of colleges grouping the European supervisors concerned together, which would be given a similar mandate in order to ensure identical protection for all of the group's European customers;
- A specific role entrusted to the supervisor from the home European country, ensuring that decisions relating to capital requirements and the organization of supervision can be taken quickly and effectively, and that information is immediately made available to all the other supervisors;
- The mission entrusted to the European supervisor committees (CEBS and CEIOPS), to facilitate the resolution of possible differences of views between supervisors from a given college and check that the conditions for fair competition between the financial institutions are brought about.

The current unrest also illustrates the speed of changes and developments in the finance sector: securitization techniques have contributed to the development of a vast parallel banking system that lies outside the scope for control by supervisors and has played a decisive role in triggering and spreading the crisis. Furthermore, the context of low interest rates and abundant liquidity has fueled excessive appetite for complex products with poorly measured risks. Insofar as innovation will continue, by its very nature, to put prudential regulations to the test, Eurofi suggests:

- integrating the prevention of asset bubbles into the Central Banks' mission to combat inflation,
- Putting in place the conditions for genuine macro-prudential supervision at European and if possible global levels, ensuring that supervisors systematize their collective search for the more effective management of systemic risks resulting from constant changes to business models and risk assessment models for banks, insurance companies and rating agencies.

The texts on the agenda for the Ecofin Council – Solvency II and the revision of the bank capital directive - offer the opportunity to rapidly take these proposals into account.

More specifically, political decision-makers must adopt a proposed Solvency II directive that includes all of the elements required for Europeans to be able to benefit from effective risk prevention at an appropriate cost through a prudential approach based on an economic assessment of risks.

This approach must also ensure that conditions are maintained for balanced competition. To achieve this, it is necessary to define focused limits to the use of surplus funds as own funds. Similarly, the provisions underpinning Solvency II will need to be applied for pension funds at the time of the next review of the Institutions of Occupational Retirement Provision (IORP) directive. This objective also means factoring in the specific features of all the players concerned, and notably mutuals, which account for a significant part of the market.

Furthermore, economic risk assessment approaches must safeguard the key role notably played by insurers in financing the European economy by not penalizing shares.

More generally, the crisis highlights the value of finding stable financial mechanisms for promoting lasting economic growth. Long-term investors meet the dual need for structural development and financial stability in Europe. That is why Eurofi is suggesting that EU authorities look to identify and specify the prudential and accounting measures required to facilitate this type of investment in Europe.

In addition to these changes in terms of prudential and supervision regulations, the success of the current European-level reforms in terms of retail payments and securities represents a decisive issue for strengthening the competitiveness of the European financial industry and reducing prices for consumers and investors.

The first area in which stronger European integration is necessary concerns investment funds.

Eurofi's work shows that implementing a Management Company Passport is a feasible and attractive objective but should be implemented with a staged approach. It is possible, as of the revision that is currently underway for the UCITS Directive, to significantly reduce the administrative and prudential obligations set for asset management companies outside of their home country, without increasing the risks thanks to a clear framework defining the responsibilities of the market players themselves as well as those of the supervisors of the fund and of the management company. According to the analysis by Eurofi's working group, the simplifications identified would make it possible to rapidly achieve 30 to 50% – representing 250 to 300 million euros – of the total expected savings for a European passport for management companies, which require a

Nice, September 2008

greater convergence of the regulatory frameworks governing administrative activities for UCITS in Europe (e.g. methods for calculating the net asset value and sharing responsibilities between the fund's custodian and the management company, etc.). This must be undertaken within the framework of the Directive's current revision.

Cross-border exchanges of investment funds are also being held back by the lack of technical standards and insufficiently automated processes, which are generating additional costs, estimated at several hundred million euros per year, as well as operational risks, which are growing with the volumes exchanged. Eurofi's working group has drawn up a proposed road map enabling around 80% of cross-border exchanges to be automated within four years. It also suggests creating a European governance body for this market, grouping together all of the players concerned - asset managers, fund distributors, custodians, technical operators – notably to take the decisions required in terms of implementation lead-times and standards.

Securities infrastructures represent a second area with key issues when it comes to competitiveness. Due to a lack of sufficient integration, prices for cross-border transactions are four to 10 times higher than domestic prices, generating additional costs estimated at around two billion euros each year. In the absence of any workable consolidation options at European level, the European authorities have chosen to reduce these additional costs by putting the various infrastructures in competition with one another and consolidating settlement-delivery through Target 2 Securities (T2S).

Whereas various projects point to a development of competition on the markets (trading), rationalization efforts still need to be made on post-market, on which the vast majority of the technical obstacles and costs are concentrated.

The implementation of a harmonized European legal framework for securities and post-market activities, the rationalization of share and bond clearing operations through stricter steering of interoperability projects for clearing platforms and the review of the opportunities for the geographical and functional extension of the T2S platform represent three areas for progress to be looked at in further detail by the market and the European authorities as of now.

In addition, Europe is committed to building the Single European Payments Area (SEPA), which has two objectives:

- Enabling citizens and businesses to make and receive payments in euros, both within and outside of their national borders, under the same conditions and with the same rights and obligations, wherever they may be located.

- Creating the conditions for greater competition and improving the efficiency and effectiveness of payment systems in order to achieve a high level of recurrent savings.

Today, this process is being hindered by the lack of a European consensus on the competition law requirements relative to sharing out the value provided by payment systems between banks, retailers and consumers. At the same time, the savings linked to the reduction in inappropriate uses of cash, which Eurofi has estimated at more than 16 billion euros each year, are not on the European agenda.

That is why Eurofi is suggesting that the Commission and European System of Central Banks draw up a European user awareness program pointing the cost of inappropriate uses of this traditional means of payment, combined with incentive pricing and communication measures making it possible to ensure the development of the most innovative, efficient and effective means of payment.

The development of EU financial participation and employee shareholding schemes would favor the long term investments in Europe and better associate European workers to the benefits of an increasingly globalised economy.

Lastly, microcredit has been developing for close to 20 years now in both Western and Eastern Europe. It makes it possible to finance income-generating initiatives and employment for people in difficulty. However, its development is being hindered by social legislation and an often unfavorable perception of individual initiative, as well as restrictive banking regulations and the small size and often suboptimum management conditions for the 200 or so microfinance institutions (MFIs), most of which are currently starting up their operations.

Eurofi recommends that the ECOFIN Council:

- Approve and encourage the creation of the new tool – JASMINE – proposed and backed by the Commission, Parliament and European Investment Bank (EIB) Group for the global steering of the "Initiative for the development of microcredit in Europe in support of growth and employment", adopted last November;
- Support the EIB Group's decision to set up a cofinancing facility, with 20 million euros set aside by the European Investment Fund (EIF), with a view to supporting 50% of operations to finance the creation or development of an MFI;
- Encourage banks' involvement in this process for cooperation with MFIs.

Nice, September 2008

THE THINK TANK DEDICATED TO FINANCIAL SERVICES IN EUROPE

11 bis, rue Mansart - 75 009 Paris - FRANCE - Tel.: +33 1 40 82 96 03 - Fax: +33 1 40 82 96 03 - www.eurofi.net