

**EUROPE'S SINGLE CAPITAL MARKET**  
**“TIME TO TACKLE THE TOUGHEST**  
**CHALLENGES”**

Hemicycle / Plateau du Kirchberg, Luxembourg

Thursday, 10 March 2005

Conference Report



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## About the Conference

About 400 participants representing business, governments, the European Institutions, financial services suppliers and the media, attended the Eurofi conference dedicated to Europe's Single Capital market ("Time to tackle the toughest challenges"). The conference, held on March 12, 2005, in the Hemicycle building on Luxembourg's Plateau du Kirchberg.

The event was organised by Eurofi and Forum Europe in partnership with BNP Paribas, Crédit Agricole SA, Euroclear and Société Générale with the support of The Luxembourg Bankers' Association (ABBL), BNP Paribas Luxembourg, the European Fund Administration (EFA), JP Morgan and Standard & Poor's.

**Didier Cahen**, Secretary General of Eurofi, opened the conference and Jacques de Larosière and Daniel Lebègue, Co-Chairmen of Eurofi, presented introductory remarks. Keynote addresses were delivered by **Jean-Claude Juncker**, President of the European Council and Prime Minister of Luxembourg, **Charlie McCreevy**, EU Commissioner for Internal Market & Services and **Jean Claude Trichet**, President of the European Central Bank.

During the proceedings, the conference asked a number of questions, including:

- What conditions were needed to speed-up the integration process?
- How well were Europe's financial services authorities doing in tackling regulatory and supervisory matters?
- Did Europe's sheer diversity of post-trading activities make any single solution impossible?

## The Conference Programme

### First Session:

#### Creating the right conditions to speed-up the integration process

**André Villeneuve**, Chairman of Liffe/Euronext, moderated the first session. It examined three major topics:

- Further expectations from the FSAP
- The prospects for cross-border mergers
- The future of the single retail marketplace
- Towards a Single European Payments Area

*Further expectations from the FSAP:* What do investors, users and providers of financial services still expect from the Financial Services Action Plan? Do they assign different levels of priority to their expectations?

The speakers were **Philippe Maystadt**, President of the European Investment Bank and **Thomas Seale**, CEO of European Fund Administration and Chairman of the Association of the Luxembourg Fund Industry

*The prospects for cross-border mergers.* Does the financial services sector in the EU need "European champions", and is it comparable to or different from other areas of business and industry? What are the primary remaining obstacles to cross-border mergers in the sector, and what has been their impact on profitability? What challenges do American banks represent as a result of Europe's limited record in banking consolidation?

Panel speakers were **François Veverka**, Executive Managing Director, Standard & Poor's, **Sir Nigel Wicks**, Deputy Chairman of Euroclear and Michel Pébereau, Chairman of the European Banking Federation.

*The future of the single retail marketplace.* Is the creation of a single retail marketplace as vital as it is often argued, and if so how can market participants be more fully convinced of it? What are the main difficulties created by the wide spread of costs that retail clients across Europe are charged for banking services? What are the advantages to be gained from the creation of major EU-level service providers with substantial operations in Europe's national marketplaces? How feasible is the concept of a new "26th regime" of financial services rules that would complement the 25 EU countries' national rulebooks?

The lead speaker on this topic was **Daniel Schanté**, Director General, Comité Européen des Assurances.

Towards a Single European Payments Area. Can we define and assign priorities that could hasten the creation of the Single European Payments Area?

Speaking on this topic were **Gerard Hartsink**, Senior Executive Vice President, ABN Amro & President of the European Payment Council and **Dominique Monneron**, Member of the Management Board, Caisse Nationale des Caisses d'Epargne.

#### **Second Session:**

##### **Regulatory and supervisory matters**

**Antonio Borges**, Vice Chairman of Goldman Sachs, took over the reins after coffee and led the discussion on regulatory and supervisory matters.

What do investors, users and providers of financial services still expect from the Financial Services Action Plan? Do they assign different levels of priority to their expectations?

Contributing on this panel were **Kees Van Dijkhuizen**, President of the Financial Services Committee, ECOFIN Council, **Michel Pébereau**, President of the European Banking Federation, **Sir Nigel Wicks**, Deputy Chairman of Euroclear and **David Wright**, Director Financial Markets, DG Internal Market & Services, European Commission.

#### **Session Three:**

##### **Does Europe's sheer diversity of post-trading activities make any single solution impossible?**

**Sir Andrew Crockett**, President of JP Morgan Chase International, moderated the final session that was preceded by the presentation of the results of Eurofi's study on *Post-trading activities*.

**Didier Cahen**, Secretary General of Eurofi, introduced the study and the results themselves were presented by **Jean-Marie Andrès**, Partner ADS Consulting and **Marc Truchet**, Associate Partner, Financial services practice, ICME International. Eurofi's members, in partnership with Euroclear, financed this study with additional contributions from BNP Paribas and Société Générale.

Following the presentation, the panel were asked a range of questions relating to post-trading activities:

- Other than reducing cross-border clearing and settlement costs, what are the main challenges to the global competitiveness of Europe's main financial centres?

- In terms of achieving worldwide competitiveness, what are the various needs of Europe's public and private sector borrowers, and of investors?
- Is a strategy conceivable that would be common to both?
- Considering the genuine limits of markets forces, what should be the key aims of the European level regulation?
- How will potential trading platform consolidation have an impact on post-trading activities?
- Are the economic stakes (costs/benefits) of the removal of the Giovannini barriers equivalent for all players?
- Do certain post-trading activities require specific management requirements, and how can these activities be identified?
- Is freer competition the driving force that is needed to increase market efficiency?

The panel speakers were **Alain Closier**, Global Head of Securities Services for Investors, Société Générale, **Carmine Di Noia**, Legal Committee, European Association for Listed Companies, **Alberto Giovannini**, CEO of Unifortune Asset Management and principal policy advisor to the Cesame Group, **François Marion**, CEO of Credit Agricole Investor Services, **Jacques Philippe Marson**, CEO of BNP Paribas Securities Services, **Mario Nava**, Head of Unit, Financial markets infrastructure, DG Internal Market, European Commission, **Axel Nawrath**, Managing Director, Policy, Communication & Legal, Deutsche Börse and **Chris Tupker**, Chairman of Euroclear.

**Closing Remarks:**

**Jacques de Larosière** and **Daniel Lebègue**, Co-Chairmen of Eurofi, closed the conference.

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## A pragmatic approach rules the day

The revamped Lisbon Strategy featured strongly in Eurofi's conference on the single capital market. Although Prime Minister of Luxembourg **Jean-Claude Juncker** was extremely concerned about its progress, it was seen – in its renewed form – to be the driving force for European competitiveness. Juncker saw the main barrier to progress in meeting the Lisbon goals as being a “lack of national ownership”. He also wanted the Growth and Stability Pact to play its role, Juncker argued that the Commission should apply the rules that had been enshrined in the Maastricht Treaty – then it could work!

Commissioner **Charlie McCreevy** agreed that the key to economic success, for the EU, was the implementation of the expanded Lisbon objectives. To contribute towards those goals, McCreevy wanted a single integrated financial market based on “sufficient, reasonable and cost-effective rules”. In the immediate future, he wanted to concentrate on unfinished business. That meant less new legislation. Commissioner McCreevy, though, was also in tune with Prime Minister Juncker. To achieve a fully integrated financial market, McCreevy wanted a “clearer sense of joint commitment and responsibility from the member states”.

ECB President **Jean Claude Trichet** described an integrated financial system as being vital to the euzozone's economy. He saw the completion of the FSAP as a “window of opportunity”, a phrase taken up by Euroclear's **Sir Nigel Wicks**, who saw the period of dollar weakness as giving European banks a window of opportunity for cross border mergers, a window that may close when the dollar recovered and US banks started on the European merger trail.

In terms of what was expected from the FSAP, the EIB's **Philippe Maystadt** called for a new clearing & settlement infrastructure, the EFA's **Thomas Seale** wanted a tweaking of the UCITS system rather than a major overhaul and Eurofi co-chair **Daniel Lebègue** wanted, above all, a pragmatic approach.

As for cross-border mergers, Wicks stressed the need for a sound business case, before such transactions should be contemplated. However, he was positive that mergers would happen – especially if they were backed by “sound IT management”. The EBF's President **Michel Pébereau** wanted the markets to drive mergers and, in agreement, he looked to innovation to improve competition and drive down costs.

Pébereau was one of a number of speakers to support the idea of a 26<sup>th</sup> Regime, launched by Eurofi Co-Chairman **Jacques de Larosière**. Daniel Schanté and Dominique Monneron also supported the concept. In essence, it would constitute a “new regulatory approach that fostered pan-European services”. It would be a body of core optional European rules offered to market participants.

When the Lamfalussy process had been added to the mix, **Antonio Borges**, Vice Chairman of Goldman Sachs, said it had brought a whiff of “fresh air” to the proceedings. Borges said that all eyes were now on the Commission, and **David Wright** gave a thorough overview of its work in the financial sector to-date. He insisted, and he was believed, that the Commission was listening. Appealing for time, Wright looked forward to implementing the financial framework across the 25 member states. Wicks returned to the fray and suggested that the Commission might want to create a new unit to oversee such implementation activities. This idea was strongly backed by de Larosière.

The (lack of) the creation of a Single European Payments Area proved to be a sticky subject and with progress being slow, both Commissioner McCreevy and Trichet hinted that regulation might be used to clear the impasse. The clock was ticking loudly.

The conference closed with a free-ranging discussion on post-trading. Eurofi's study had failed to reach a firm conclusion and the resulting panel discussion showed way. In the chair, **Sir Andrew Crockett**, President of JP Morgan Chase International, appealed to the practitioners to think of the greater European good, but it was to no avail.

Principal policy advisor to the Cesame Group, **Alberto Giovannini**, had identified the problems and argued that the decisions should be left to business, backed by legislation where necessary. The Société Générale's **Alain Closier** suggested that a pragmatic approach was called for, perhaps backed by legislation, which would take time to formulate. **Jacques Philippe Marson**, CEO of BNP Paribas Securities Services placed clearing & settlement and the efficiency of the European financial markets firmly at the centre of the EU's attempts to achieve the revamped Lisbon goals. Marson wanted a carefully planned step-by-step approach that did not favour individual companies.

**Chris Tupker**, Chairman of Euroclear, however, was happy with the current situation and suggested that everyone wait for the next version of *euronext* to solve some of the current problems. **Mario Nava** had listened carefully to all of the arguments. He declared that the European Commission would take its time and conduct an informed dialogue – when the decisions were taken, they may not all be popular ones.

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## Introductions and welcome

Opening the conference, Eurofi Secretary General **Didier Cahen** described his organisation as a “flexible and proactive” unit that was spearheading the drive towards Europe’s Single Capital Market. He saw Eurofi’s role, typified by the days’ conference, as a catalyst that would stimulate the debate swirling around Europe’s financial integration.

### *Pan-European reforms*

Eurofi co-chairman **Jacques de Larosière** thanked the co-organisers and contributors before looking back to the arrival of the euro in 1999, an event that had “spurred the creation of a vast financial market”. As an example, he commented that bonds issued by non-European international entities had amounted to 900 billion EUR as opposed to the US dollar equivalent of 580 billion EUR. However, de Larosière wanted to go beyond this “bi-polar financial debt market”. His goal was the creation of a truly integrated financial market within Europe, a prerequisite if it was to be a global economic player. If it became easier to raise the capital needed to finance investment; improved capital productivity, growth and employment would naturally follow.

To achieve this, de Larosière wanted structural reforms that brought “more flexibility, less regulation, greater competition and improved productivity”. In addition, he wanted EU member states to demonstrate financial fiscal discipline, and speaking in a personal capacity, de Larosière called for the authorities to retain the Stability Pact (with its “crucial role” for Europe) and to make it work effectively.

Fellow Eurofi co-chairman **Daniel Lebègue** reminded the audience that many of the FSAP goals had been achieved, with a resulting sturdy capital market. But he saw the need for more hard work, as Europe was lagging behind the US in certain areas. In terms of restructuring, Lebègue wanted concerted efforts to bring a genuine pan-European market for both consumers and savers.

In making recommendations to the Commission and the European Parliament, Lebègue explained that Eurofi had prioritised certain areas. These were not necessarily the easiest ones in which to make progress. For example, the creation of a consolidated supply of services (particularly in pensions and savings) at a pan-European level. Lebègue described Eurofi’s proposals as pragmatic and looked forward to a healthy discussion on the issues.

### *A 26<sup>th</sup> Regime*

Returning to the microphone, **Jacques de Larosière** introduced the day’s proceedings. Noting that the morning sessions would focus on how financial integration could be speeded-up, he referred to Commissioner McCreevey’s comments concerning a pause in the creation of the regulatory framework in order for implementation and consolidation to proceed. However, de Larosière also acknowledged that the Commissioner had stated that some new regulation might be required.

In the retail sector, de Larosière argued that it was appropriate to develop a voluntary approach. He preferred a pragmatic line of attack that favoured both consumers (a wider choice of products, adequate protection, etc.) and financial players (so Europe could become a global actor with the right economic and commercial conditions).

This could be achieved, de Larosière argued, with the creation of a 26<sup>th</sup> Regime. It would constitute a new regulatory approach that fostered pan-European services. This regime would be a body of core optional European rules offered for some financial products to market participants, “to promote creativity among financial institutions and ensure proper protection for consumers”.

To achieve the creation of the 26<sup>th</sup> Regime, de Larosière called for a collective approach that involved users of retail financial services, financial industry representatives and public decision-makers. To this end, he recommended the creation of a European consultative committee (with the addition of representatives of political bodies and the banking and financial industry) chaired by a “wise man”.

*Work to be done*

*On the subject of regulation and supervision*, de Larosière applauded the Lamfalussy framework while noting that there remained work to be done. In particular, he argued that the need for transnational supervisory tools was stronger than ever before. De Larosière questioned the current system (“regulation by autonomous national regulators”) and asked if it was suitable for an increasingly integrated financial market. He wanted divergences in national regulatory arrangements to be reduced in order to develop a more integrated framework.

Finally, de Larosière turned to the afternoon session that would look at the issue of post trading. Describing the current arrangements as “complex and fragmented”, he declared that these arrangements added an additional cost of between 1.5 billion EUR and 5 billion EUR to issuers, investors and intermediaries. De Larosière wanted cross-border clearing and settlement to be as “efficient, safe and cost effective” as it was at the national level.

Making a reference to the two Giovannini reports that had identified barriers to a harmonised post-trading situation, de Larosière declared that the Eurofi study had drawn some firm conclusions:

- More support and involvement was required from *domestic players*
- The EU-25 had to tackle the tax and legal barriers so that the Giovannini timetable could be respected
- There were deep concerns relating to the application of fair competition (although there was no consensus on this point)

De Larosière stated that the “heated debates” proved the existence of a genuine problem. At the heart of the matter was the discussion on the best way of handling both “core post-trading activities and commercial ones” and the opportunity to interlink post-trading activities to ensure effective competition between them. He concluded that the subject was putting a break on European integration and, speaking personally, he reasoned that leaving the subject to market forces might not be the right solution.

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## Keynote address: Jean-Claude Juncker,

President of the European Council and Prime Minister of Luxembourg

Opening his address, **Jean-Claude Juncker** looked ahead to the forthcoming sessions of the European Council that would have to agree on both the reform of the Growth and Stability Pact and the mid-term review of the Lisbon Strategy. Speaking candidly, Juncker described the Lisbon process as a “disaster”. Agreement was now required, as to what had to be done to make Europe a real global powerhouse. For Juncker, the main problems were, a) no detailed implementation plan existed for “Lisbon”, and b) there was a lack of national ownership. Only if the various actions were harmonised across the EU-25 could Europe become more competitive in line with the Lisbon goals. Juncker argued that the focus had to be on improving *competitiveness*, as this would drive both employment and sustainable development.

Juncker explained that he had started his remarks with “Lisbon”, as it was fundamental to Europe’s future. This drive to make Europe a global player had to be understood before the Growth and Stability Pact could be seen in its proper context. On the subject of the Pact, Juncker said there had been too much talk. He did not agree with those who wanted to kill it, but he did favour a fundamental review. The Pact had strengths, but weaknesses existed and these had to be addressed. The weaknesses (that had not been identified when the Growth and Stability Pact was originally created) included:

- a) Some of the items necessary to achieve a balanced EMU policy had been omitted
- b) It should have been designed on a more long-term basis, as the rate of growth at the time (of creation) was not sustainable

Juncker concluded that a more long-term approach was required, one that acknowledged the need to reduce public deficits so that member states had room to manoeuvre at times of economic downturn. He saw this as simple common sense. Juncker also identified the need to adopt a more proactive stance that would involve strengthening the governance of the euro. It had to be managed as a single currency, as it was plainly not 12 individual ones. Mistakes made in one part of the eurozone could impact other member states.

As for how the Pact should be handled, Juncker acknowledged that the German press were fond of saying that it had too much flexibility. He did not totally agree, arguing that it clearly allowed deficits that were slightly in excess of 3%, but that deficits over 5% (that occurred on a regular basis) were certainly not foreseen. Juncker therefore wanted to strike a balance between those two positions, i.e. how could the Pact recognise an excessive budget deficit?

Adding a note of criticism for the Commission and the Council, Juncker reasoned that the Growth and Stability Pact was flexible enough to handle the current situation, and that the problems were resulting from a lack of application of the actual rules and criteria (e.g. the mid-term and long-term budget situation, the level of public investment, etc.) that were enshrined in the Maastricht Treaty.

As for the future, Juncker wanted the Commission to be the “guardian of the Treaty” as it was originally intended. The Commission should launch appropriate measures, once an “excessive deficit” existed in a member state. He added that sanctions could be applied and it was a matter of clarifying when actions could be taken, so that the Pact could work as originally intended.

Juncker added that recommendations had been submitted to the Commission and the Council. The draft had not received universal acceptance from member states, far from it, but he felt the approach was right. Juncker wanted reform that would produce a Growth and Stability Pact that worked in the long-term. More discipline was required and the Pact had to be handled in a more transparent manner for all.

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## Session 1: Speeding up the integration process

The first session moderator **André Villeneuve**, Chairman of Liffe/Euronext, indicated that the discussion would seek to bridge the gap between the “ambition and reality” of the integrated financial services market. With work to be done, he was eager to hear what the various actors expected from the FSAP.

**Philippe Maystadt**, President of the European Investment Bank, focussed on two (major) initiatives: the FSAP and the Lamfalussy process. He was positive about the achievements of both, and gave thanks to both the Commission and Eurofi. Moving on to the expectations of the European Investment Bank (EIB), Maystadt looked for progress in three areas:

- *An improved infrastructure was required:* especially in clearing & settlement
- *The liquidity of the short-term paper market had to be enhanced:* this was too fragmented and lacked cash-flow
- *The securitisation market needed to be more integrated:* as it was developing on a national basis

His final point related to the EU's new member states. They had impressed Maystadt, as they had been extremely open-minded in relation to cross-border trading. Perhaps, he added, there was a lesson there for the EU-15.

**Thomas Seale**, CEO of European Fund Administration and Chairman of the Association of the Luxembourg Fund Industry followed Maystadt. Speaking on a personal basis, Seale looked at the need for further regulation in the investment funds markets. Noting that the mutual fund industry was showing impressive growth (11% in the last 12 months), he said that the vast majority of the transactions were guided by UCITS<sup>1</sup>. Despite this performance, UCITS' legislation was often subject to criticism, for two reasons:

- Fund sizes were smaller than in the US, leading to greater costs
- Cross-border transactions were a relatively small percentage (+/- 20%) of the business

Seale added that the industry was seen to be “fragmented and nationally-focussed”. That was the background for the creation of an Experts Group by the Commission. It had made 13 recommendations as to how a “true single market for investment funds” could be created. Other voices, however, have called for UCITS to be abandoned. Given that UCITS has been scandal-free, Seale identified the issues as cost and market access. To solve the problems, he argued for “*greater competition and transparency in fund distribution*”.

He argued that the excessive costs were due to administrative difficulties in cross-border fund distribution, tax reporting complexities and compensation to distributors. In addition, there was a lack of competition at the distribution level; Seale therefore recommended:

1. *the removal of trade barriers to cross-border fund distribution:* which would increase competition at the local level
2. *the enhancement of transparency and more customer education:* as European fund investors had difficulties comparing funds
3. *the facilitation of cross-border fund mergers:* the larger funds generated would produce economies of scale

Overall, Seale wanted these cost savings to be generated by tweaking the current system rather than by evoking new legislation – he wanted “healthy market competition”.

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<sup>1</sup> Undertakings for the Collective Investment of Transferable Securities (UCITS); A public limited company that coordinates the distribution and management of unit trusts amongst countries within the EU.

### *Mergers and the single retail marketplace*

**François Veverka**, Executive Managing Director, Standard & Poor's, took up the baton and placed the focus on cross-border mergers. He considered the term "European champions" as somewhat controversial. Certainly he saw the need for dynamic and competitive banks in Europe, so they could be a force on the global scene. Looking at the recent activity, with for example, Santander Bank's purchase of Abbey National, Veverka saw "a period of change" which would hopefully lead to future growth.

Although there had been no massive switch to European powerhouses, he did wish to point out that there were now 25% less banks in the EU-15 compared with 10 years ago. Calling this "spectacular", he said this might be the reason for the improvements in the European banking scene (more profitability, better productivity, etc.). Veverka saw obstacles to further consolidation, for example, the healthy situation in the financial market meant that mergers were now more expensive. He hoped that the reforms of the FSAP would speed-up integration and a removal of obstacles, but – so far – he had not seen sufficient enforcement of the legislative rules.

Looking further afield, he warned European banks to be aware of the situation in the rest of the world (US, Latin America, etc.), as such regions had begun to reform their banking facilities before the EU's latest enlargement. He saw increased competition from the Americas, and looked for more consolidation in the EU-25.

**Sir Nigel Wicks**, Deputy Chairman of Euroclear, was not impressed by the term "champions" in relation to the banking fraternity because it carried the flavour of mergers motivated by politics, protectionism or prestige. Conversely, but not perversely, he argued for more cross-border mergers, with the resulting organisations being headquartered in Europe. These mergers should be undertaken on the basis of "good business cases". Wicks reasoned that they were required as the market was fragmented and organised (largely) along national lines. In essence, Europe lacked "concentrated financial mass".

Why were there insufficient mergers? Culprits included in Wicks' analysis were: "a lack of enthusiasm by some regulators", fiscal and cultural issues, differences in corporate laws and "social obstacles in some countries". He argued that Europe could support more global banks, but he was waiting for strong business cases to be made. Wicks then argued that he did expect more pan-European banks to emerge, because of:

- *IT innovation*: this would bring economies of scale, however as competition authorities were reluctant to see mergers of their domestic banks, these economies could only be achieved through cross-border mergers
- *International accounting standards*: these should increase transparency and reduce risk premiums
- *Basle II*: this may provide an incentive for banks to seek economies in their capital usage (through mergers)

Wicks also saw a change in the political climate. He believed that there had been encouraging signs (that obstacles to cross-border mergers might be about to be removed) at September's informal ECOFIN meeting and from the EU Commissioners responsible for competition and financial markets. Despite this, he did not want to underestimate the challenges and risks that lay ahead. Wicks had one piece of advice above all others; the key was "skilful IT management". In his opinion, banks that achieved that objective were the ones that would succeed.

Turning to the US, he argued that Europe needed an integrated market (and hence financial mass) in order to compete. And he added a word of warning – the weak dollar was adding a price premium for US bidders, but this would not last forever. Wicks saw a "window of opportunity" in which a European financial market could be finalised; otherwise the European economy would suffer.

The next speaker to the microphone was **Michel Pébereau**, Chairman of the European Banking Federation (EBF). He agreed with Wicks that the banking sector, including the retail market, was highly fragmented. Quoting Mr. Padoa-Schioppa, he said that “financial integration would enable the EU ... to benefit from access to cheaper and higher quality financial services”, leading to an increase of 0.5% in GDP.

Pébereau argued that the retail market would benefit from further integration as consumers generally based their decisions on product availability and price, and would therefore appreciate an integrated market. With a reference to the increased number of online banking services, Pébereau argued that the challenge would be to provide a “multi-channel delivery” of services (Internet, self-service terminals, bricks & mortar, etc.), which would result in greater competition and reduced prices for consumers.

Pébereau then looked at how the European integrated market could be developed: a key factor was consumer “trust”, which implied all banks having access to the whole of the market through all channels. That, in turn, meant that banks had to comply with certain principles:

- The appropriate information had to be received before decisions were made
- Consumers had to have time to reflect on purchasing decisions
- Products should have a certain flexibility in design (in different countries)
- Advisory services should be available to all
- There should be cheap access to arbitration procedures (particularly cross-border)

Pébereau reasoned that products meeting these five principles would be “genuine European products” that would benefit from economies of scale as they would be covered by a single IT system that covered the complete market. However, he did not want “rules” to be so restrictive that a) innovation was discouraged and, b) the costs to the financial industry were increased (as all member states would have to adapt their systems to meet the highest levels of consumer protection).

He therefore argued for better services at competitive prices, introduced under a set of “simple rules” that facilitated cross-border transactions. Pébereau commented that the EBF wanted full harmonisation of the key banking elements (as described) which could be agreed, based on a principle of mutual recognition. He concluded with a comment on the “26<sup>th</sup> Regime” for financial services. He pointed out that since the “traditional” methods for reaching further integration still faces difficulties in succeeding at EU level, the potential of a 26<sup>th</sup> regime was worth further exploring.

**André Villeneuve** had heard enough to convince him that there really was a new climate in the financial sector. He hoped this could continue as the conference moved on to the insurance business.

**Daniel Schanté**, Director General, Comité Européen des Assurances, took up the cudgels and described a comprehensive (850 billion EUR) yet fragmented European insurance market. Noting the ongoing work on the various directives, the work on international accounting standards, Solvency II, he also referred to the various regulatory initiatives (distance selling regulations, unfair commercial practices, etc.). A regulatory pause was therefore welcome. Acknowledging that the FSAP had brought positive results, he called for a coherent implementation across the EU-25.

Schanté highlighted the importance of the strategic projects, i.e. the implementation of international accounting standards and Solvency II (with its focus on prudential supervision), where the insurance industry was fully behind the Commission. However, Schanté was concerned about slipping schedules and delays. He also wanted any further initiatives to be the subject of exacting cost-benefit analyses.

Moving to the retail market, Schanté commented that insurance products could (in theory) be sold cross-border, but in reality this was not the case – for a host of reasons. The result was that insurance operations were varying widely from one member state to another. In order for progress to be made, Schanté had three recommendations:

1. *The potential synergies within groups active in several EU countries should be better used: e.g. peer pressure was required to ensure that supervisory practices were converging.*
2. *Cross-border user requirements had to be confirmed: It was thought that candidate groups included ex-pats, the border regions, pilot pension products, etc. but further analysis was required.*
3. *Think-tank initiatives such as Eurofi's proposed 26<sup>th</sup> Regime should be encouraged – perhaps via pilot projects.*

Schanté wanted focussed actions that aimed to improve the competitiveness of the financial services industry that was a fundamental player in the overall Lisbon plan.

#### *Single payments*

**Gerard Hartsink**, Senior Executive Vice President, ABN Amro & President of the European Payment Council (EPC), reviewed, on behalf of the EPC, the actions necessary to create a single Euro payments area (SEPA). In line with previous speakers, Hartsink wanted a competitive Europe and that meant the existence of effective payments systems. In that respect, the creation of SEPA was essential and Hartsink identified the necessary actions:

1. *From the EPC: the approved roadmap had identified deliverables (two new payment schemes – credit transfers and direct debits – to be available from all banks by January 2008; a SEPA debit card scheme frame work to be introduced; the “cost of cash in society” to be reduced; etc.)*
2. *From public authorities: “Eurosystem” should deliver its TARGET II platform (a building block for SEPA) by 2007, European and national government organisations in the EU 12 should be early adopters of the new payment instruments and national SEPA planning should start in 2005; there should also be a three-way dialogue with “Eurosystem”, the Commission and the EPC to resolve open issues on the New Legal Framework.*
3. *From other stakeholders: all users had to make a contribution, all their systems and procedures to be upgraded, corporates, merchants and SMEs could not be ignored and consumers had to be convinced of SEPA's benefit.*

**Dominique Monneron**, Member of the Management Board, Caisse Nationale des Caisses d'Epargne, was happy with progress on the pan-European market. His feeling was that user requirements were similar across the EU-25 but further analysis was needed to confirm this, as over-zealous standardisation would be a mistake. In line with several other speakers, Monneron gave his support to Eurofi's 26<sup>th</sup> Regime proposal. He saw it as a pragmatic form of standardisation, which had qualities to recommend it during this “window of opportunity”. Describing the advantages of the 26<sup>th</sup> Regime, Monneron noted that it:

- speeded-up the integration process
- was optional and enabled different choices
- simplified the issue of co-existing legal environments
- brought European products across those participating member states

Monneron added that it allowed cost-benefit analyses to be performed and it fostered competition between European and national products. Finally, he emphasised that it allowed progress to take place while thorny subjects, such as tax harmonisation, could be reviewed in parallel. He saw the 26<sup>th</sup> Regime as being similar to SEPA, in that dialogue (between all stakeholders) was vital before permanent changes were made to financial and legal environments. To this end, Monneron called for a one-day conference (which might lead to the creation of a steering group) that would ensure that all stakeholders understood the aims of the regime and that all participants were speaking the same language.

#### **Q &A – session 1**

The FT's **Peter Norman** posed a question to the panel. He wanted to know if the problems in Italy (an irresistible force meeting an immovable object") in the banking arena were symptomatic of cross-border problems to be faced in the future.

**Michel Pébereau** commented that significant obstacles to cross-border mergers still had to be removed, as had been recommended by the EBF. **Antonio Borges** also saw barriers to cross-border mergers across all financial sectors. He reasoned that more trust was required as consumers were not yet ready to hold assets in a different country from their own, e.g. Vodafone/Mannesman and Santander/Abbey National.

Moving to Norman's question, Borges said that protectionism was rife throughout Europe, and not just in Italy. He added that this "focus on national interests" was causing significant problems in the progress towards cross-border integration.

**Sir Nigel Wicks** did not agree that it was mainly a matter of trust, as many shareholders in major companies were not registered in the country of origin of the company in question. On the Santander-Abbey National question, Wicks thought it was a more an issue of double taxation that had troubled shareholders. Making a direct comment to Norman, he insisted that there had been many examples of cross-border mergers in Europe (e.g. in the Benelux, Scandinavia and in the new EU member states). Wicks simply wanted the implementation of a level playing field across the EU-25.

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## Session 2: Regulatory and supervisory matters

The post-coffee session, focussing on regulatory and supervisory matters, was moderated by **Antonio Borges**, Vice Chairman of Goldman Sachs. In his opening remarks, he commented that the Lamfalussy process had brought a “wave of fresh air” to the financial sector, accompanied by high-quality regulation. It had allowed healthy dialogue, which was essential given the challenges to be faced in the future.

Adding a note of warning, Borges said that there was a feeling that the FSAP implementation process (although it was one of the most successful Commission initiatives of recent years) was going too slow and the enforcement process was causing concerns. Given the massive workload on everyone’s plates, Borges looked forward to the FSAP’s promises being turned to reality.

**David Wright**, Director, Financial Markets, DG Internal Market & Services, European Commission, agreed that the Lamfalussy process was working “quite well” due to market buy-in and political support. Making a general comment, he argued that the Commission had learnt a lot through being open and observed that this was “the way of the future”. Despite Lamfalussy’s success, Wright saw challenges ahead:

1. *Could it be sustained?* The approval of the Constitution was important and the European Parliament was (rightly) asking for increased accountability of the regulators. In addition, the sunset clauses in the directives would start to kick-in in 2007.
2. *A broader consultation process was required:* Some refinements were necessary, but the current consultation did not have sufficient input from the consumer lobbies and the SMEs (as mentioned in the Lamfalussy paper submitted to the conference)
3. *The huge 2005 workload:* This included Mifid (the former financial services directive), which was a complex operation (the dialogue would be an extremely open one), and the equivalence determinations under the Transparency and Prospectus directives (2007 deadline on the equivalence of third country accounting systems)
4. *The necessity to guarantee coherence (of terms):* this applied across the security, banking and insurance areas
5. *The danger of compromise:* by shifting difficult areas from level 1 to level 2, or (conversely) by putting too much detail in to level 1

Moving to the future of supervision in the European context, Wright declared that CESR’s Himalaya Report represented the Commission’s view, i.e. decisions should be based on facts and evidence from the field. It had to be an intense step-by-step approach that first focused on supervisory convergence. He also believed the monitoring should continue, and commented that an agreement had been reached on this between the European Parliament, the Commission and the Council.

Wright also wanted to emphasise that the Commission had to have “the time to do the job”, and Commissioner McCreevey had indicated as much with his desire to extend the date of application for the Mifid directive. In conclusion, he highlighted the challenge to implement and transpose the directives across the EU-25. This would involve many players (the Commission, member states, market participants – more input needed here - and regulators).

Returning to the podium, **Michel Pébureau** turned the discussion to banking supervision at the European level – a vital aspect of a future cross-border infrastructure. He did not feel the current framework was adequate, and a consolidated approach was essential. Pébureau also saw a “window of opportunity”, as the Commission had submitted a directive that aimed to transpose *Basel II* in to the EU.

He was not happy, however, with the Basel Committee’s notion that the rules had to be applied nationally. Obviously this would not be suitable for multinational banking groups and it was not the way to build a single market. Furthermore, he said that Basel II would increase the amount of regulations unless efforts were made to stop further fragmentation.

Pébereau then turned to the steps needed to develop a future consolidated supervisory system. Describing the Capital Requirement Directive (CRD) as a major achievement that would simplify the validation process for cross-border groups. However, a similar approach had to be applied to the other pillars (of Basel II) – prudential supervision and market information.

Pébereau's answer was for the Commission to identify the obstacles to consolidated supervision. In this work, they would receive the full support of the EBF. Other obstacles mentioned included: deposits systems, cash settlement management, and Pébereau felt that CRD should handle all these obstacles.

**Sir Nigel Wicks** was another speaker to return to the podium. He reacted immediately to Wright's comment about consultation, saying that the Commission and the European Parliament were now conducting excellent open dialogues. While being positive about the Lamfalussy process itself, Wicks was still moved to ask if it was going to produce a single integrated financial market. To take this further, he examined the process in some detail:

- *Level 1*: the FSAP could not have been enacted without Lamfalussy, but some of the level 1 regulation was too detailed – perhaps due to the market participants persuading European Parliamentarians to include points of relative detail in Level 1 texts
- *Level 2*: “the jury is still out”; some participants were wilting under the weight of consultation but he was uneasy about taking detail from level 2 and leaving too much discretion to “national rule book drafters” (that road led to protectionism)
- *Level 3 (CESR)*: it was looking for coherent implementation methods, and, to this end, Wicks had heard that CESR might become the “supervisor of supervisors” – a phrase he was not totally at ease with
- *Level 4*: he wanted the Commission to develop its foreseen level 4 (enforcement) procedures, perhaps with a new combined unit (within the Commission), reporting to the Internal Market and Competition Commissioners; it could talk to market practitioners, proactively check how national authorities were implementing the legislation and look for harmonised enforcement processes
  - He wanted intensified activities (more resources, more visibility) even if that would probably not improve the European Commission's popularity

Turning to the concept of “lead supervisor”, he argued, “the devil was in the detail”. He was not sure how it would work in practice, and he therefore wanted national supervisory authorities to delegate (to other EU supervisory authorities) tasks and responsibilities. Wicks acknowledged that much study was required and that such changes would probably require legislative changes at a national level. Terms would have to be clear and public, and necessary powers would have to be delivered. Above all, Wicks emphasised the need for “trust between regulators”.

Wicks concluded with two comments. He agreed with Pébereau that *Basel II* could give too much discretion to national supervisors, and he saw his recommended (new) Commission unit being in the right place to solve that particular problem. Secondly, Wicks argued against the ECB having an added role in banking supervisory matters. He was cautious, because:

- There could be a conflict with the ECB's prime role in regard to price stability
- The ECB's credibility could be weakened if there were banking controversies
- It would complicate the ECB's accountability (central bank vs. supervisory authority)

**Kees Van Dijkhuizen**, President of the Financial Services Committee (FSC), ECOFIN Council, was the final speaker. He noted that the FSC worked behind the scenes advising ministers and assessing progress and implementation – on external and internal issues. Identifying current priorities, Van Dijkhuizen listed the financial integration green paper (post FSAP plans) and cross-border mergers and acquisitions. On the latter, he mentioned that ministers were now well aware of the importance of an integrated financial market in Europe. However, it remained complex and, he agreed, that was one reason for the existence of the FSC. It included Treasury staff, European Commission personnel, ECB representatives and

the chairs of the level 3 committees. Van Dijkhuizen added the FSC was also looking at supervisory issues (the "lead supervisor" concept, CESR's Himalaya Report, etc.) and this process included "active consultation". Other issues on the FSC's plate included financial stability and crisis management.

Referring to the topics and comments of the previous speakers, he agreed that the Commission had done a good job in the realm of the FSAP. Now, he saw implementation, enforcement and supervisory convergence as the immediate priorities. Van Dijkhuizen wanted the implementation of coherent regulations with as little national discretion as possible.

On the subject of consolidated supervision, he had heard Pébureau call for the CRD to include the second and third pillars (prudential services and market information). He wanted a step-by-step approach as this idea (lead supervisor) could reduce costs across Europe. In conclusion, Van Dijkhuizen emphasised the need for consultation, as any time taken in this way would be gained in the future if market wishes were fully understood.

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## Keynote address – Charlie McCreevy

EU Commissioner for Internal Market & Services

**Antonio Borges**, Vice Chairman of Goldman Sachs, noted that the previous session had shown that while market practitioners wanted to make progress, it was an extremely technical area where high risks were at stake. He felt that all eyes were now on the Commission, with the hope that it would show effective leadership – “it should not try to be popular”. Following some words of introduction from Eurofi Co-Chairman **Jacques de Larosière**, the floor was handed to **Commissioner McCreevy**.

### *The reasons for an integrated financial market in Europe*

Following the EU's latest enlargement and the accompanying export of democracy and peace eastwards, the Commissioner placed the focus firmly on the revamped Lisbon objectives. These aimed to deliver growth and jobs to Europe's 20 million businesses and over 450,000 citizens. He therefore wanted “carefully crafted” directives to facilitate the free movement of people, goods, services and capital in Europe. The Commissioner saw the need for basic pan-European rules that would avoid fragmented and under-performing financial markets. These rules (of the best possible quality) would help businesses to develop European strategies and consumers would benefit from enhanced integration. However, he warned against excessively detailed regulation as it might create barriers rather than remove them.

Overall, the Commissioner wanted “*sufficient rules, reasonable rules and cost-effective rules*”.

He argued that the FSAP was on the right track, in the wholesale markets, stock exchanges and in infrastructure areas such as clearing & settlement. Companies were developing pan-European strategies and profits were at record high levels. Benefits of integration were starting to be reaped and consumers were seeing prices dropping due to increased competition. The Commissioner argued that Europe was now driving the search for global convergence of regulatory standards. The EU-US financial dialogue was healthy and there were now stronger relations with Japan and China.

### *The future agenda for financial services*

The Commissioner's view of the agenda (for 2005 – 2010) was based on the recent 18-month consultation process. With the job far from finished, he emphasised that the next phase would be one of consolidation with few new initiatives. There would be a phase that ensured the transposition of European legislation into national laws and the rigorous enforcement by supervisory authorities. Monitoring would be ongoing and a first priority for the next 12 months would be “the completion of unfinished business” (reform of company law, capital requirements, reinsurance, corporate governance, Solvency II, the legal framework for payments). The Commissioner saw this workload as being sufficiently demanding.

Expanding on three key areas, the Commissioner commented:

- *Capital requirements*: the CRD made the existing capital requirements framework for banks and investment firms more comprehensive and more risk sensitive, it fostered enhanced risk management among financial institutions
- *International accounting standards (IAS)*: provided clearer, consistent and more comprehensive information for investors
  - the Commissioner emphasised that the time and effort required (from the major players) to implement both the CRD and the IAS would be repaid via the enhanced long-term health and stability of the financial services industry
- *Payments*: having expressed his confidence in self-regulation when he started as a Commissioner, he noted that the banking industry had been promising a Europe-wide payments infrastructure for four years; he insisted that this was too slow – the banking

industry had to speed-up the implementation of a single European payments area (SEPA)!

- He had seen some progress (the creation of the European Payments Council, the existence of the roadmap leading to SEPA) but the project was behind schedule.
- A political sign was necessary, and he saw the Commission's role as being to remove obstacles to progress. The Commissioner stated that the Commission could not "sit on its hands for ever" - industry must be assisted to deliver a SEPA by 2010. If necessary, the Commission would make some agreed industry standards mandatory and include a roadmap for SEPA in its draft legal text; "the time had come to press the accelerator".

In order to produce an effectively functioning internal market, the Commissioner called for a clearer sense of joint commitment and responsibility from member states. He added that the European supervisory system had to have the necessary instruments at its disposal – this challenge would also be taken forward in the Commission's new strategy. To this end, there would be a bottom-up approach, built on the success of the Lamfalussy model.

#### *The retail sector*

In an integrated financial market, cross-border services should become more prevalent. With increased consumer mobility, there will be scope for new initiatives in the retail sector. The Commissioner said that in principle, everyone should be able to buy financial products from whomever and from wherever they want, while knowing that they were properly protected.

Commissioner McCreevy added that he was interested in exploring the possibility of a 26<sup>th</sup> regime as a supplementary way of developing the spread of pan-European financial services. This could remove some of the problems arising from the harmonisation of domestic laws. He wanted consumers to be protected in the retail area, but he wanted education of consumers in parallel – as there was "widespread financial illiteracy".

Wrapping up his remarks, the Commissioner summed up the progress to-date:

- goals had been set
- a climate of trust and stability has been built
- European integration was on track
- The FSAP had delivered the rules
- The Lamfalussy process was starting to deliver results
- There was potential for improvement (if everyone worked as a team)
- Consolidation was required ahead of new initiatives – promises must be delivered
- The Commission's financial services strategy would be the subject of consultation process and delivered in November 2005 (green paper)

Following on from the Commissioner's address, **Lucien Thiel**, Advisor to the Board of the Luxembourg Bankers' Association and Member of the Luxembourg Parliament, gave a "virtual" tour of the Luxembourg financial centres. Thiel explained that Luxembourg ranked 8<sup>th</sup> in the world with a financial services market share of almost 4%. Remarkably, the financial sector accounted for 24% of the country's GDP, with 10% of the population working in the financial industry. 160 banks resided in Luxembourg, from 26 different countries and with a total balance sheet of 700 billion EUR. Thiel concluded that Luxembourg owed its success to its "open and liberal environment".

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## Keynote address – Jean Claude Trichet

President of the European Central Bank

Jean Claude Trichet devoted the opening part of his remarks to the ECB's views on European financial integration, to be achieved through market forces and the coordinated efforts of the private sector and public authorities. Describing these activities as essential, Trichet gave the ECB's full support to the creation of a *well-integrated financial system*, as it was:

- *pivotal* to the smooth and effective implementation of the eurozone's monetary policy
- helping to make the eurozone economy *more efficient* through the reduction of financing costs and an improved allocation of financial resources (leading to non-inflationary sustainable growth)
- a *priority* in accordance with Article 105 of the Treaty ("support for the general economic policies of the Community")
- linked to *financial stability*

### *The institutions*

With the FSAP nearing completion, Trichet saw the post-FSAP period as a "window of opportunity" to further enhance financial integration. This implied improving the supervisory and regulatory framework (with the ensuing greater cross-border co-operation) and the financial stability arrangements. He underlined the aim to achieve a high degree of regulatory and supervisory convergence as a means of reducing the compliance burden on financial institutions. As for financial stability, monitoring and crisis management procedures had to be tailored to the possible problems (liquidity and solvency) affecting more than one country.

Noting that impressive progress had already been made in the realm of cross-border banking, Trichet gave examples, such as the extension of the Lamfalussy process to the banking sector and the establishment of the Committee of European Banking Supervisors (CEBS). The latter was developing benchmarks and best practices for implementation of directives (and the principles for co-operation between home and host supervisors) and this was where the focus should now be placed.

Emphasising this point, Trichet insisted that the ECB wanted as "close a co-operation as possible between supervisors". He argued that the interface between private banks and supervisors should be identical throughout Europe, especially in regard to the eurozone. Trichet also acknowledged the role of FSC in monitoring the implementation of the Economic and Financial Committee (EFC) recommendations on financial stability and crisis management. In regard to the latter, Trichet said that the Memorandum of Understanding between all supervisory authorities and central banks was a great accomplishment – as for the first time, principles for managing financial crises had been agreed at the EU level. However, he did note that it might not be sufficiently detailed for large cross-border banking groups, where "group specific agreements" might be necessary.

### *The markets*

Here, Trichet observed that the markets had undergone significant change following the introduction of the euro. However, the ECB had continued to observe varying degrees of integration (with only the unsecured euro money market reaching a satisfactory level). In the short-term securities markets, Trichet welcomed the Short-term European Paper initiative (set up by the ACI) and called for further such efforts to be promoted. Continuing his review of the wholesale markets, Trichet saw increasing evidence of integration, although it was still probably one of the least integrated. His final words on wholesale concerned the new credit markets, that were created in a pan-European context from the start. Even these markets faced hurdles in order to be fully integrated.

Making a general comment, Trichet declared that he heard criticism along the lines of “nothing has been done” to foster financial integration. He did not like such comments, he saw a “half-full glass” – a lot had been achieved, but there was much work to be done.

### *Infrastructure*

Following that call to arms, Trichet looked at the need for an integrated payment, clearing and settlement infrastructure. He made his remarks from the standpoint of TARGET, an example of a successful infrastructure at the pan-European level (described as one of the two largest wholesale payments systems in the world). Trichet explained that TARGET2 was due to go live in 2007, and its new functionalities would make it (perhaps) the most sophisticated payments system in the world. Describing these functionalities (introduction of a harmonised service level, a single price structure for domestic and cross-border payments, more integrated euro liquidity management, etc.) Trichet argued that TARGET2 would further improve financial integration in several respects.

Looking more generally at the securities infrastructure in the eurozone, Trichet saw a significant number of national exchanges, clearing houses and central securities depositories – “further consolidation of some of the European infrastructure” was advisable and fully supported by the ECB. Acknowledging the numerous private and public-sector initiatives (ESCB, CESR, the Commission, etc.) that aimed to promote further integration of the European securities infrastructure, Trichet highlighted the need to eliminate the barriers identified by the “Giovannini Group”. In addition, he stressed the ECB’s (and Eurosystem’s) wish to see the adoption of a framework directive on clearing & settlement, as:

- it would complement the market-led removal of the “Giovannini barriers”
- adoption of the CESR standards may require changes to the national legal framework

Trichet emphasised that any directive could usefully take stock of the ESCB/CESR findings and stipulate high-level principles to be developed at implementation time. He wanted the various groups involved (the Commission, the groups involved in the Lamfalussy framework, the private sector, etc.) to respect the Lamfalussy spirit within the framework followed by an “appropriate division of labour”. Trichet also felt the need to ask the Commission to recognise the responsibilities of the ESCB and the Eurosystem in overseeing the securities clearing & settlement infrastructure.

### *Retail markets*

Stressing the importance of retail markets, Trichet acknowledged that a pan-European mortgage market could not be created if there were restrictions when payments were made between banks within the eurozone. The SEPA, he added, was a pre-requisite for the creation of European retail markets and the Eurosystem wanted it to be in place (for citizens and enterprises) from January 1, 2008. Trichet said this was extremely important, as the actions to-date had not been sufficient. A real SEPA had to be achieved, so that payments could be made (as easily and as safely as in a national context today) throughout the whole eurozone area from a single bank account, using a single set of payment instructions.

In addition, the ECB wanted a SEPA for the infrastructure to be created by 2010. This implied that decisions taken now that related to the future generations of national systems should be made from a pan-European perspective to ensure SEPA compliance. Trichet confirmed that the ECB, with the EPC’s assistance, would monitor progress towards a SEPA infrastructure.

### *In conclusion*

Trichet emphasised that the creation of a unified structure for payments was an essential building block in the overall programme and he placed the ECB at the disposal of the private sector in its initiatives and pan-European projects. Trichet wanted the ECB to act as a catalyst, as in the STEP process. He applauded the work of Eurofi and reminded his audience

that the speed of change in recent years (EU-15, EU-25, EU-28, etc.) had been remarkable and had taken place in parallel with many technological breakthroughs.

Referring to Juncker's comments on the Growth and Stability Pact, Trichet said the ECB regarded the 3% threshold as important and the current procedures in that area should be enforced. He wanted no change at all in that area of the Pact as it was at the heart of Europe's economic and monetary union.

Trichet argued that Europe had been bold in launching a single currency without a federal government and a single budget. Some observers – including the US – had said that Europe had been too bold. He did not concur, there might be no single federal government, but there was the Growth and Stability Pact. It was a key to the effective functioning of the eurozone's monetary union. Going further, he insisted that the preventative part of the Pact had to be improved and the Commission's paper in this area represented the ECB's (and others') opinions. Trichet noted the final decision would lie with the Council and asked all players to face up to their responsibilities – whatever the decisions taken – as a mandate existed to guarantee price stability.

**Jacques de Larosière** thanked the ECB President and added that he welcomed the emphasis placed on the budget discipline needed within the eurozone.

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## Session 3: Does Europe's sheer diversity of post-trading activities make any single solution impossible?

The final session was moderated by **Sir Andrew Crockett**, President of JP Morgan Chase International. Turning immediately to the subject of post-trade settlement, which he regarded as the “plumbing” that underscored the architecture of the integrated financial system. Crockett noted that the plumbing was a vital aspect of any building, and he had heard that the estimated costs related to the current “inefficiencies” were in the region of 5 billion EUR. He said this amount as a kind of tax on transactions that was also – importantly - revenue to the financial institutions that levied the fees.

That indeed was the problem, as this was not a zero-sum game. For those who adapted to change, the efficiency improvements would lead to reduced revenues. Crockett therefore stressed the need for everyone to think of the system at large and the functioning of the European capital markets, rather than the impact on any individual firms or companies.

As was widely understood, there were divergent views on this subject, but Crockett wanted to stress the shared objectives, i.e. the need to:

- reduce fragmentation,
- consolidate the capital markets infrastructure,
- respect all user requirements
- allow market forces & competition

Crockett wanted a capital market with a European focus, one that would promote growth across the EU. In addition, the approach had to respond to market forces – perhaps backed by official intervention where necessary. With that, Crockett looked forward to hearing a healthy results-oriented discussion on the results of the Eurofi study.

**Didier Cahen**, Secretary General of Eurofi, introduced the study, saying that the current post-trading arrangements were fragmented, complex and carried additional risks and costs for investors, issuers and intermediaries. He described the scope of post-trading activities as clearing, settlement, registrar and related banking services – performed by CCPs, CSDs and banks. Cahen added that the study had aimed to produce a complete and objective review of the status of post-trading activities, to clarify the positions of the various parties and to explain the reasons for disagreements and obstacles.

**Marc Truchet**, Associate Partner, ICME International, explained that the study had been conducted using a bottom-up approach. 69 priority issues had been identified and these had been grouped into five main themes.

- How could the economic effectiveness and competitiveness of the post-trading industry be improved ?
- Were the on-going initiatives adequate or sufficient ?
- What were the expected evolutions of post-trading activities in the coming years ?
- Were there specific risk or competition issues related to post-trading activities ?
- Were specific additional governance requirements necessary ?

Truchet explained that these issues had been boiled down to three main questions:

1. How could the on-going initiatives to improve economic effectiveness and competitiveness of the post-trading industry be leveraged ?
2. What were the impacts of the likely evolutions of the post-trading market ?
3. Did certain post-trading activities require specific governance approaches ?

*1. How can the ongoing initiatives to improve economic effectiveness and competitiveness of the post-trading industry be leveraged ?*

Truchet commented that there are a number of very significant initiatives dealing with the improvement of competitiveness and with the creation of a really competitive environment in the EU post-trading market, in particular the EU initiatives following the work done by the Giovannini Group. He mentioned there had been general agreement among the market players interviewed that these initiatives were beneficial and essential for the marketplace.

In addition, the study participants had made suggestions as to how the on-going initiatives could be best employed:

- Actions are needed to further involve all market players, in particular the domestic retail banks that do not always see the full benefit of these initiatives, because a majority of their business is domestic
- A greater mobilization of political representatives is necessary through a clear and accessible presentation of the stakes involved in post-trading activities and of the on-going actions, to make sure the actions to remove the legal and fiscal barriers, in particular, are transformed into a binding timeframe
- The needs of individual investors, who are more concerned by investment funds should not be overlooked. (Note: this third point arose during the study itself and did not result from the 69 identified issues).

*2. What are the impacts of the likely evolutions of the post-trading market ?*

Truchet explained that one had to take into account the existing organization of post-trading activities when thinking of the likely evolutions.

He mentioned that although the post-trading market was still very fragmented, there had already been a certain number of significant consolidation movements in the post-trading field:

- Euroclear is a federation of settlement facilities on the Euronext zone
- LCH Clearnet is the equivalent for the clearing activities
- The Nordic CSDs have also gone through a consolidation movement
- Clearstream is in the process of building within Deutsche Börse an integrated service offer including all post-trading activities (usually referred to as a vertical silo)

These consolidation movements suggest that the natural evolution is to move towards regional hubs, corresponding probably to the main trading areas, these hubs remaining in a dominant position on each of their regional markets.

He added that two factors could impact this scenario:

- 1- The recent discussions in the trading field have triggered questions or concerns in the post-trading field. In particular, if the trading merges, what impact will this have on post-trading and will users have a choice of the post-trading facilities they use ? The increase in competition necessary to make sure users get full benefit from EU consolidation should lead to opening links between different post-trading institutions to favour free access.

This could lead to an extreme scenario with systematic interconnection at all levels (the so-called « spaghetti model »), but this option was rejected by market players as being too expensive and long to implement with no real business case backing it.

Therefore, most participants thought that the most likely outcome would be a move towards regional hubs interconnected with one another through a certain number of key links supported by a reasonable business model.

Truchet concluded by adding that if this scenario seems the most likely, an economic assessment should still be performed in order to test its real relevance.

*3. Do certain post-trading activities require specific governance approaches ?*

The final topic looked at the possible need for additional management requirements on top of the existing regulations and requirements that apply to post-trading activities.

Truchet commented that this part of the study had brought the most heated debates. He explained that some major players had already invested heavily in creating consolidated CSDs and / or started to integrate the various post-trading activities in a vertical manner and that these evolutions brought a variety of questions highlighted in the issues collected at the beginning of the study:

- do these initiatives create extra risk or competition concerns and are these concerns correctly addressed by the existing regulations ?
- how do these potential risks or competition issues measure against the benefits that such consolidated business models can possibly bring to the marketplace. In essence, what is the trade-off?

Truchet added that underlying these questions was a debate on the characteristics of post-trading activities and consequences of such characteristics: were post-trading activities ordinary commercial activities or should they require specific attention because without them the market players had no substitute to operate in the market ?

He explained there was no consensus at present on this point:

- some participants believed that post-trading activities such as settlement or the registrar function were “core” (ie the market players had no substitute to these activities for operating in the market) and therefore specific regulatory and governance requirements should apply to ensure fair competition and risk mitigation
- other participants considered this distinction as irrelevant, because these activities were open to competition in their view, adding that the focus should rather be on defining “where and how we want to go in the post-trading market” and evaluating whether risk, competition and governance issues were correctly addressed in the potential future evolution scenarios.

The latter group was also in favour of leaving the various players to construct their own business model within the existing regulatory framework, whereas the majority of the former group called for EU level intervention in the form of a regulation.

In conclusion, Truchet did not underestimate the divergence of opinions at this stage but called for a collective market-driven solution to be found for the overall benefit of an integrated European system.

**Jean-Marie Andrès**, Partner ADS Consulting, completed the study review by noting that the participants had been strongly challenged to defend their interests, but that no consensus had emerged. The four varying positions taken by the participants could be described as:

1. Simply remove the “Giovannini barriers”, as other actions would be too risky
2. As number 1, but involve more users in the infrastructure’s revamping
3. Specific regulations were required in the areas of risk and competition
4. As number 3, but there needed to be a politically-agreed target for post-trading that avoided the creation of monopolies

**Sir Andrew Crockett** returned to the microphone and immediately brought **Alberto Giovannini**, CEO of Unifortune Asset Management and principal policy advisor to the Cesame Group, to the debate.

Giovannini said he had had two objectives in his involvement in the project – the growth of the European financial market and logical consistency. He therefore explained his logical thought processes.

First, he argued that post-trading arrangements defined the securities market; and he added that no single European securities market existed (as the existing standards, regulations and laws sanctioned national monopolies in the post-trading sector). That could not be efficient now as the markets were no longer isolated. As an aside, Giovannini said that there was no need to despair, as “the train may have already left the station”.

Giovannini argued that the stage had to be re-laid (to suit the many actors in geographical and functional spaces). Advancing his arguments, he added that Brussels was the obvious place to coordinate the actors who were located in all cities and organisations across Europe. This led him to his solution – *increased co-ordination between the private sector and the various authorities*.

Giovannini noted that the Commission’s communication had called for barriers to be eliminated, so that (in parallel) cross-border transactions could be increased and service providers could be consolidated. The resulting environment would forbid artificial barriers to entry, although natural barriers might exist. That meant that there should be no abuse of dominant positions. For Giovannini, it was therefore clear that the post-trading environment would have to follow those same rules; the environment would not allow interventionism (no blue-print drafting) as decisions were best left to business people.

His final comment was that national laws would have to be changed to be in line with: a) the way in which securities were traded in the 21<sup>st</sup> century, and b) in a way that was consistent with neighbouring countries. This would promote cross-border risk sharing and investment. So directives would probably be required, e.g. to remove restrictions of locational securities and to allow generalised remote access, etc etc. His philosophy was “just do it”.

**Alain Closier**, Global Head of Securities Services for Investors, Société Générale, spoke on behalf of a European bank active in all sectors. He argued that European consolidation was vital, but he did not want to go too fast as the landscape was somewhat fragmented (different regulators & legal systems, various entities, differing taxation systems, etc.). The problem for Closier was that change had been too slow in the period leading up to 2005. Global custodians still had to work with domestic custodians, even within the *euronext* area, so that competition between US (with a single platform) and European players was unfair.

Closier saw areas of agreement (the need to reduce costs, remove barriers, etc.) and he supported the rapid removal of the Giovannini barriers. However, he thought that the evolution of the post-trading process would take a significant amount of time and he saw no advantage in looking for target business models. He favoured a pragmatic and gradual approach. However, there was no need to wait for total agreement. As an example, he took the ISIS project (clearing & settlement led by Euroclear), which would be in place by 2007, with a fully integrated settlement and delivery platform within the *euronext* area. This could be done with or without full tax and legal legislation being agreed across Europe.

As for standardisation and market forces, Closier argued for a directive that would provide a general European legislative framework that would have clear operational principles for settlements in a safe and secure environment – with no models being imposed. That would take time, he added, and during this period, progress could continue.

**Carmine Di Noia**, Legal Committee, European Association for Listed all, he called for a regulatory system that was safe, secure and

reliable for all investors: governance of post-trading facilities should Companies (EALIC), spoke on behalf of the issuers that are the object of transactions and post trading activities, in particular the corporate actions. He wanted a harmonised cost-effective service in corporate actions. EALIC would like an EU-wide legislative framework and recommended that it could be best achieved through a combination of bottom-up and top-down dialogue. In this sense, Di Noia argued, Cesame had shown the way to make progress.

Above reflect all interest at stake, including those of issuers; at the same time, issuers should have easy access to their ultimate investors. Di Noia warned that the worst outcome would be an uncoordinated and un-regulated market. As a final comment, he thought that consolidated trading may lead to consolidated post-trading. Transparency, competition and cost-competitiveness of exchanges' integration had to be evaluated ahead of the game, and Di Noia wanted the regulatory framework to be defined and understood before any implementation of mergers.

**François Marion**, CEO of Credit Agricole Investor Services, brought the discussion back to core and non-core activities. He suggested that they should be differentiated for two reasons:

1. there was a systemic risk at stake (if they were not differentiated)
2. competitive bias had to be avoided (which would not be the case if there was no differentiation)

However, Marion argued that the volume of core services had to be kept small. These core services would include:

- the *notary function*: i.e., the registration of ownership of securities on a legal record
- *access to central currency*, as an assurance of payment
- *the simultaneous control mechanisms of the security reserves* and a link to the settlement systems

Marion strongly believed that a directive, if implemented, should focus on the definition of core and non-core activities.

**Jacques Philippe Marson**, CEO of BNP Paribas Securities Services, placed clearing & settlement and the efficiency of the European financial markets firmly at the centre of the EU's attempts to achieve the revamped Lisbon goals. Marson saw three actions to be executed: harmonisation of the EU markets, creation of a consolidated infrastructure and the definition & implementation of a European framework.

1. *Harmonisation*: Marson supported the results of the Giovannini report, as it would reduce costs. In fact, he claimed that BNP Paribas was "walking the talk" as it was implementing XML standards (ISO2022) and talking with CSDs to improve efficiencies. He added that the private sector was pushing for harmonisation and he called for assistance from the public sector (legal and fiscal changes)
2. *Consolidation of market infrastructure*: This had to guarantee cost efficiency, risk avoidance and fairness (in competition, access and pricing)
  - a. While applauding the consolidation (Scandinavia, euronext, etc.), Marson was concerned about the Euroclear bank assuming a competitive advantage. He added that prices were increasing in the Belgian and French markets (euronext), which was the opposite from the results expected.
3. *Framework*: Healthy competition had to exist between users and not between market infrastructures themselves. The essential "public utility" type of activities had to be segregated from the banking and risk-taking activities. Marson argued that the latter had to remain competitive as risks were spread across many organisations.

In conclusion, Marson said he was most interested in:

- Long-term cost reduction and efficiency improvements
- Market safety through the division of market risk (the protection of CCPs and CSDs)
- Coordinated and well-planned changes (which avoided a drift away from best practices, e.g. the use of central bank money in clearing & settlement)

**Mario Nava**, Head of Unit, Financial markets infrastructure, DG Internal Market, European Commission, described the Commission's thinking in the area of clearing & settlement:

1. *Was the single market failing?* Nava agreed that it was clear that there were excessive costs related to cross-border transactions – in both the wholesale and retail markets (so it impacted citizens).
2. *Did it impact the European economy?* As for the costs involved, Nava had heard estimates running up to 5 billion EUR per year. However, he asked how agents and operators would operate in a harmonised market and reasoned that the post-harmonisation position (on costs) was unclear
3. *How to solve the problem?* There were three options: a) leave it to market forces (an option boosted by the Giovannini report), b) define a framework directive (right of access, supervisory arrangements, etc.), c) a structured intervention
4. *What direction should be taken?* Nava wanted to keep in mind how the chosen route would help the European economy. He also wanted a solution that was stable and sustainable, and he wanted to know what the choice would cost and how that cost would be shared.
5. *The Commission was not the only game in town!* Nava reminded the audience that there was also the ECB, the European Parliament, ECOFIN, etc.

Nava gave the following schedule: the Commission would make its initial recommendations (carefully drafted and explained) and then it would listen to the reactions of the other players – this would take up the majority of 2005. Then the Commission would look forward to actions being taken in 2006, and it would not try to be popular.

**Axel Nawrath**, Managing Director, Policy, Communication & Legal, Deutsche Börse, mentioned that there were many versions of the Eurofi study circulated in the last days before the conference. This has led to confusion. But compared to the first version circulated the current one is more moderate. However there are clearly still definitions on the scope of the post trade functions in which Deutsche Börse cannot agree. Like the inclusion of the CCP: This comes from the fact that this service is not necessary to transfer ownership of securities, but rather to facilitate the post trade processes (risk taking function). Overall Deutsche Börse were not convinced that progress can be made in trying to define the "core" and "non-core" functions as some panellists and the study have suggested. The contributions of previous panellists have shown that the target of regulation of the post trade industry remains unclear: consolidation or competition.

Deutsche Börse believes that competition between all players readily exists in post-trade, and competition in the end will drive also consolidation. Therefore the need for functional approach to ensure competition. So why distinguish through regulation, functions such as finality or settlement when also banks provide such services. Despite that, there is a need to progress on the EU legal harmonisation as a single market requires changes in corporate and tax law.

On the governance issues raised, the banks have been the first ones to change these rules. Three years ago 90 banks, among them Société Générale and BNP Paribas well represented on this panel today had no problem to sell Clearstream to DBAG, and now they claim that for-profit governance is not acceptable for such post trade services due to the lack of user participation. The same is true for the sale of Sicovam to Euroclear in 2004.

What is needed is not user-governance but customer participation, which is widely in place. Sometimes when you attempt to increase even customer governance in certain legal constituencies in the EU the regulation doesn't allow it.

Customer participation is highly regarded at Deutsche Börse Group. Since Clearstream is no longer so called “user-governed” it has won in 2004 the major customer service industry awards.

Chris Tupker, Chairman of Euroclear, concluded the panel discussion by noting that Euroclear had had misgivings about the Eurofi paper on clearing and settlement but felt it was important to deliver a balanced report even if it lacks a conclusion. He did not think that that was necessarily a bad thing as it was really a “work-in-progress” reflecting widely-differing ideas across the marketplace.

Taking Juncker’s theme of “more talking than acting”, Tupker argued that Euroclear was certainly not guilty of that failing as it was in the second year of a five-year investment programme (100 million EUR per year) that had been based on constant consultation with market practitioners. In addition, Tupker explained that Euroclear was actually taking actions (85 action points had been identified) within their five active markets to remove the so-called Giovannini barriers.

Explaining some history of the Euroclear organisation, Tupker stressed that a constant belief had been that (at all layers of the trading architecture) competition would ultimately lead to consolidation... and hence lower costs. This had led Euroclear into the cross-border equity business. Tupker added that Euroclear’s future platform would lead to reduced costs across the board.

In conclusion, Tupker said that he agreed with 80% of Marson’s comments. However, he could not agree that further anti-competition law was necessary. Tupker noted that the current discussions between the Deutsche Börse and the LSE might prove that the existing competition laws were sufficiently powerful.

## **Q&A and the panel speaks**

The London Investment Banking Association’s **John Serocold** commented that, structurally, competition should be allowed, with user governance only coming in to play where that was not possible. For Serocold, European competition law allowed dominant positions to be held but not abused.

**Jacques Philippe Marson** initially responded to Nawrath’s remark that the rules should not be changed (regarding CLEARSTREAM operating in a competitive market). However, Marson saw that as part of a philosophical debate about privatisation, he believed that certain “core” activities had to be protected (separately governed) in a monopolistic environment. Marson also argued that that this was a decision to be taken by the market itself.

Regarding Tupker’s comments, Marson reasoned that *euronext’s* harmonisation could have gone much faster and that three years had been lost due to a lack of decision-making. Costs savings would have resulted (if an existing platform had been utilised) and it would have been a basis for future integration. Now, Marson had doubts about Euroclear’s ability to meet its future deadlines for the implementation of a new platform. He wanted, like his French colleagues, a step-by-step evolutionary approach, perhaps based on the RGV real-time system – that worked well (separately governed, separately regulated and risk-protected).

**Sir Andrew Crockett** wound down the panel at that stage and commented that positions had been clarified in a way that would help Eurofi in future discussions. It was not the end of deliberations, but perhaps a corner had been turned.

## Summing up

**Daniel Lebègue**, Eurofi Co-Chairman, came to the podium to offer some closing remarks. From what he had heard, he was sure that a new (and healthy) wind was blowing across the European financial sector. This breath of fresh air was necessary to invigorate the next steps to be taken towards the creation of an integrated financial market that would encompass companies, markets, SMEs and citizens. That was the consensus – a new phase was required that would allow Europe to face “the toughest challenges” (those involving changes to the regulatory framework) and find solutions that met the collective interests of all players. Referring to Trichet’s keynote speech, Lebègue felt that a pragmatic and consistent approach would be the one most likely to succeed.

Lebègue’s Eurofi Co-Chairman **Jacques de Larosière** brought the conference to a close with three observations that he had taken from the day’s proceedings:

1. *Retail banking*: he had heard words of encouragement for the 26<sup>th</sup> regime (including support from the Commission) and there was much work to be done on that project
2. *Regulation and supervision*: he had also heard strong voices supporting the call for a consolidated mechanism that involved a “lead supervisor”; and he did not want fragmentation due to the implementation of *Basel II*,
  - a. *The Commission’s special unit*: this idea, launched by Wicks, had de Larosière’s support as it would allow implementation problems (post-Lamfalussy) to be monitored;
  - b. In addition, that unit could also look at the “*lead operator*” concept
3. *SEPA*: He was glad to hear that Commissioner McCreevy and Trichet were waiting expectantly for industry to resolve the SEPA problem; he took this as a warning – as further payments regulation may be on the horizon

With that, de Larosière closed the Eurofi 2005 conference.

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