

## **Accelerating the creation of a single market in retail financial services through a 26<sup>th</sup> regime for pan-European products**

Introducing pan-European retail financial services will help individual investors to grasp the genuine benefits of the single market. The creation of a 26th regime, to be offered on an optional basis to market participants, constitutes a supplemental regulatory approach that is likely to foster these pan-European services.

This approach will make it possible to surmount many of the problems arising from the harmonisation of domestic laws, insofar as national legislation would not have to be invoked. These problems include competitive distortions due to mutual recognition, political problems caused by amending laws that required decades of preparatory work, and the lengthy schedules for drafting and then transposing EU directives.

Trying out this new approach in the field of retirement savings would help to solve the problem of pension financing in Europe. It would also alert public opinion to the economic and practical benefits of European integration while facilitating the emergence of European financial players. A strong political will is needed to bring it into being.

The only way of ensuring wide-ranging support for such a regime is to pursue a collective approach involving users of retail financial services, finance industry representatives and public decision-makers. One crucial prerequisite for establishing the necessary political momentum is to find a neutral and mutually agreed process for assessing the political and institutional difficulties encountered on the path to an integrated market in retail financial services in Europe.

This entire process should be entrusted to a European consultative committee on consumer financial services.

### **An integrated market in financial services will deliver major commercial and economic benefits both to consumers and to the finance industry.**

As the European Commission pointed out in its first report on indicators of the economic benefits of financial integration, consumers are unaware of the potential advantages of monetary and financial integration. And yet integration would ensure broader choice and keener pricing for final consumers.

To achieve this, financial service providers must be able to operate on a pan-European basis, without bearing the cost of compliance with twenty-five sets of regulations. They would thus be able to pass along to customers the savings generated by combining business volumes across several Member States – in other words, critical mass – and to introduce products and pricing practices currently available only in some Member States to the entire European Union.

At the same time, consumers must be aware of exactly what they are buying, so that they can compare products and protect themselves properly against mis-selling. Consumer confidence is key to the successful integration of the retail financial services market.

**Only the emergence of multi-local European participants within the EU can ensure broader choice and uniform pricing**

Creating an integrated European market in retail financial services is also of cardinal importance to financial intermediaries. It is true that some banks and insurers with a leading position on their home market are building up a commercial presence in other EU countries. But differences in administrative constraints, local regulations and the VAT regimes applicable to production centres are preventing these groups from fully rationalising their production systems and processes. As well as hobbling innovation, this situation raises costs for the finance industry and hence for consumers.

Consequently, although these participants are the natural channel through which to pass on the benefits of the single market, they remain in the same position as other local operators, unable to make a full contribution in terms of lowering prices and broadening choice.

**Customers want a local presence in retail financial services. For this reason, in their efforts to promote integration, European institutions should focus less on removing obstacles to cross-border trade and more on eliminating the regulatory and tax differences that stop industrial groups integrating at a pan-European level.**

Consumers of retail financial services are basically looking for reliable suppliers to provide a high-quality, low-cost, personalised service that meets their needs.

Europe's institutions have hitherto sought to develop cross-border sales of financial products and services as a means to promote lower prices and wider choice. But the retail banking market is by nature based around multi-channel, local relationships, where disputes are settled through the courts in the consumer's home country. Accordingly, EU citizens will take only a marginal interest in increased cross-border sales of financial products and services. This must no longer be the primary policy goal or a key integration indicator.

Rather, the European institutions should work to standardise and simplify production conditions in Europe, for this alone will ensure the emergence of pan-European operators, deliver uniform prices and broaden local choice. Furthermore, the institutions must make sure that all industry participants, regardless of size, are subject to national laws and regulations that will allow them to become European operators.

**Efforts to harmonise national laws reach their limits.**

The procedures for integrating retail financial services in Europe are based on harmonising national laws. This means that extremely ambitious political agreements are going to have to be struck, particularly in an enlarged Europe of 25 countries.

To avoid disrupting national legislations, the European institutions have put forward the mutual recognition principle, whereby Member States accept the laws of the service provider's home country as the basis for commercial relations with their citizens. Unfortunately, disparities in national laws, especially in terms of consumer protection, mean that this approach creates unacceptable situations of unfair competition between domestic and cross-border participants, making it hard to conclude political agreements. In addition, the Commission can only propose common rules in the shape of directives, entailing the usual problems in terms of

negotiation periods and transposition differences.

To address these problems, Eurofi is suggesting a new approach aimed at regulatory integration.

**The 26th regime: a body of European rules to foster creativity among financial institutions and ensure proper protection for consumers is needed to allow all participants – European and domestic – to design products and services that can coexist with local offerings.**

In practice, the aim is to define simple and adequate rules to permit the emergence of optional pan-European products and services that would be accessible to multinational and local participants and that would compete with domestic products and services. The rules should be simple to leave maximum room for creativity by financial institutions. This will promote robust competition and ensure that products are appealing. The rules should be adequate to ensure that consumers are properly protected, covering issues like the cooling-off period, consumer information (invoicing, performance, product description, potential risks, procedures for changing supplier), prudential rules and dispute settlement by courts in the consumer's country of residence.

The rules should be designed such that these products are eligible for the tax incentives given to competing local products.

These European products would thus be optional and would compete with national products. Local and cross-border participants alike would be able to offer them. Cross-border participants would select them on the basis of their competitive advantages in terms of customer pricing and functionalities.

In contrast to the situation created by the enforcement of the mutual recognition principle, local participants would compete on an equal footing with "new entrants" because they will have access to the 26th regime. They will benefit from the creativity and opportunities for innovation that the European legislature must seek to foster when drafting its rules. And this body of European rules would coexist with national laws.

This approach will make it possible to generate strong marketplace momentum by lessening the difficulties involved in reaching political agreements. It focuses on the rules for creating European products, without impinging on domestic legislation for similar products. In other words, the approach will allow new products to emerge, while bypassing the awkward process of adapting 25 sets of national legislation, which will continue to apply at the local level.

**Buoyed by the results of a legal feasibility study, Eurofi is focusing on the development of Europe-wide retirement savings products.**

Eurofi's members have verified the legal feasibility of the 26th regime. To develop a clearer picture of the conditions for implementing the new approach, Eurofi concentrated its analysis, as a first example, on the conditions required for the emergence of pan-European retirement savings products and services. This choice of the third pillar of pension provision took advantage of efforts underway across Europe to tackle demographic challenges and to offer workers a tax system that includes incentives in terms of retirement income.

Our work has showed that, at a time when retirement savings in Europe are subject

to a wide variety of regulations and different policy approaches, financial institutions are expressing interest in straightforward products (EET regime<sup>1</sup>, discretionary performance, option to replace fund managers) that allow them to demonstrate their skills at differentiation. The institutions also stress the industrial advantages in terms of IT and back office resources. But they recognise that the commercial appeal of these products is premised on the tax incentives generally available in different Member States.

Consumer associations and national and European national policymakers will have to give their support before the Community regulations needed to establish products of this kind can be introduced. Policymakers must agree to include European products and services in their national tax arrangements.

**Formation of a European consultative committee to involve all participants in the debate about the implementation of the 26th regime for retirement savings, to address the issues in greater detail, and to build a consensus on this supplemental legal approach.**

Several official organisations have expressed interest in the research undertaken by Eurofi in 2002 and the articles we published last year. Those bodies include the European Commission (report of the Insurance working group for the FSAP assessment), the European Parliament (draft report submitted by Ieke van den Burg<sup>2</sup>), the European Round Table for Financial Services (September 2004 publication), The European Federation of National Insurance Associations, and the Conseil de Coopération Economique (report published in February 2005<sup>3</sup>).

There is a vital need for a collective effort that is organised. Now is the time to work methodically to promote common understanding of this approach and its benefits and to initiate practical analyses of the acceptability of the provisions included in the Eurofi blueprint, as well as the various ways of incorporating the 26th regime into national tax systems. At a more general level, the aim is to foster acceptance of this new approach. Accordingly, during this phase of exploration and fine-tuning, participants in the approach must be given the greatest possible degree of freedom. But as mentioned earlier, a crucial prerequisite for establishing the necessary political momentum is a neutral and mutually agreed process for assessing the political and institutional difficulties encountered on the path to an integrated market in retail financial services in Europe.

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<sup>1</sup> The Exemption – Exemption – Taxation (ETT) regime most often used in EU countries operates as follows: income contributed to savings is tax exempt; investment income is tax exempt; while tax is levied on capital gains and annuities.

<sup>2</sup> "[...] despite low demand for cross-border financial services, there is substantial demand from certain groups of internationally mobile consumers, such as cross-border commuters and expatriates, for financial service products with which they are familiar; considers that, for such groups and such a purpose, special "pan-European" financial products, such as mortgage or insurance products, under a uniform 26th European regime (similar to e.g. the European Company Statute) may offer a voluntary option; asks the Commission to assess the feasibility of such a regime for specific financial services".

<sup>3</sup> "The integration of retail financial services and markets is a strategic priority for the next five years. [...] Advances in legal integration at Community level would encourage the resumption of capital market integration and the emergence of more efficient banking networks. Obtained through maximum harmonisation, i.e. based on a 26th legal regime, the introduction of pan-European mortgage and pension products would finally enable individuals to benefit from the products and services offered by the most competitive financial services providers."

To this end, Eurofi is proposing that the European Commission establish a small group of advisers, which could be called the European Consultative and Monitoring Group on Consumer Financial Services. This would comprise representatives of:

- users of retail financial services
- political bodies
- banking and finance industry
- a "wise man"

Analysis and debate concerning the introduction of the 26th regime for European retail financial services must be stepped up as quickly as possible. The European Consultative Committee could unveil its proposals at the European Conference on the 26th Regime at the end of this year. Among other things, this event will demonstrate that financial integration in Europe can be a shared ambition if it is based on mutually agreed and eminently practical solutions.