Jean-Claude Trichet: Financial services policy 2005-2010 - the ECB's view

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at an exchange of views on Financial Services Policy 2005-2010, European Commission, Brussels, 18 July 2005.

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Introduction

I would like to thank the European Commission for the invitation to participate in this important event. I am sure that all discussions today on the Commission's Green Paper on Financial Services Policy in 2005-2010 will be highly beneficial for finalizing its thoughts on the matter, which will be reflected in the White Paper to be issued by the end of this year.

The definition of the main priorities for financial services policy in the years to come is an important milestone in the pursuit of further financial integration. Although it should be recognized that financial integration in the EU has proceeded apace in recent years, in particular as a consequence of the introduction of the euro, further progress still needs to be made.

While the objective of financial integration is inherent in the achievement of the Single Market, it is currently also extremely important in the context of the Lisbon reforms. Financial integration is a key factor in the development and modernisation of the financial system which, in turn, can lead to greater productivity and competitiveness, a more efficient allocation of capital and the potential for greater and more sustainable non-inflationary growth. For example, an empirical study by London Economics[1] estimated additional growth resulting from financial integration of the European bond and equity markets to be 1.1% over a decade or so.

Let me give you the views of the ECB on the proposals put forward by the Commission, noting that the Eurosystem is preparing a contribution on this subject, which will be issued shortly. I should underline that the interest of the Eurosystem in the pursuit of financial integration is closely related to the tasks which have been given to it by the Treaty, including the conduct of the single monetary policy, the promotion of smooth payment and settlement systems and the contribution to financial stability.

I will start with some general considerations and then turn to some specific areas, notably financial regulation, financial supervision, and financial stability.

General considerations

Speaking generally, let me express broad support for the key policy orientations set out in the Green Paper. Over the next five years, financial services policy should aim primarily at consolidating and simplifying existing Community legislation, while ensuring that the measures adopted thus far under the Financial Services Action Plan (FSAP) are effectively and consistently implemented and enforced at the national level. Behind this broad orientation lies the shared notion that the main efforts to remove residual legal and regulatory obstacles to the free provision of financial services in the EU have been achieved with the FSAP. Therefore the adoption of new Community legislative initiatives should be evidence-based.

The role of public intervention in regulating the EU financial sector remains important. First, developments in financial markets will always pose challenges to the existing regulatory framework that have to be considered. Second, the consistent and correct implementation of FSAP measures at the national level remains a challenging task for all authorities involved, notably the Commission, national governments and supervisory authorities. Third, the importance of the work of consolidating and simplifying the existing EU regulatory framework proposed by the Commission should not be underestimated. Indeed, this work represents a window of opportunity for rationalizing the existing

[1] London Economics (2002), "Quantification of the macro-economic impact of integration of EU financial markets", Report to the European Commission.

rules applicable to financial institutions, especially those operating on a cross-border basis. It also involves the pursuit of synergies among the several EU public policies applicable to the financial sector, notably financial services, consumer and competition policies.

If this process is successful, responsibility for promoting financial integration will then chiefly lie with financial institutions themselves, which should exploit the framework promoted by public authorities to expand their activity across borders. In this context, I would emphasise that this is also dependent on the ability of the financial industry to coordinate its members effectively whenever common initiatives are needed. This applies for instance in the areas of payment and securities clearing and settlement systems, where common infrastructures benefit cross-border transactions. In this field there is also a specific role for public authorities, notably to serve as catalysts for coordination among market participants, thus facilitating the emergence of market-led initiatives. One example is the role played by the Eurosystem in the promotion of the Single Euro Payments Area – SEPA – project, where the ECB, together with the European Commission, strongly supports the integration of retail payments.

Financial regulation

Turning to the area of financial regulation, let me highlight three aspects.

First, there is a need to proceed with the adoption of the remaining measures envisaged in the FSAP in order to complete the regulatory framework. In this respect, from the ECB's perspective, the planned legislative work in the field of securities clearing and settlement is very important. An efficient securities clearing and settlement infrastructure is of fundamental importance for the integration and efficiency of financial markets. Therefore, the ECB supports the Commission's intention to put forward a proposal for a directive on securities clearing and settlement for two reasons: a directive will help remove residual barriers – as identified by the "Giovannini Group" – to efficient EU clearing and settlement arrangements and will also provide a legal basis for securities clearing and settlement systems. In this context, the work which has been conducted jointly by the ESCB and the Committee of European Securities Regulators (CESR) in setting standards on clearing and settlement systems can assist the competent authorities in their oversight and supervisory activities in this field.

Second, with regard to possible new legislative initiatives at the Community level, we agree with the principle – put forward by the Commission – that stronger efforts should be made ex-ante to better evaluate their possible costs and benefits. As to the areas where such efforts could potentially be made, those identified by the Commission, notably retail financial services and asset management, certainly warrant reflection and attention. In the area of retail financial services, the suggested combination of targeted regulatory action and more active application of competition policy could be the way forward. As regards asset management, one of the main issues seems to be whether regulatory treatment at the EU level targeted specifically at the category of hedge funds is needed. Whereas I think it is legitimate to reflect on the pros and cons of possible regulation, I strongly believe that any regulatory response, if it proves necessary, should be taken in a coordinated manner at the international level (with particular attention to the transatlantic level), given the global nature of the hedge fund industry.

Third, the envisaged process of consolidation of existing legislation represents an opportunity not only for rationalization but also to promote a truly common set of rules for financial institutions, especially those operating on a cross-border basis. This principle seems to be contained in the Commission's proposal to launch a feasibility study on whether the relevant rules at the national and the European levels could be structured as a "financial services rulebook". I support this concept: a financial services rulebook may constitute a significant contribution to reducing complexity and possible inconsistencies in the overall regulatory framework for the single financial market as well as possible legal uncertainties.

More generally, I believe that the Lamfalussy framework contains all the elements needed to effectively pursue the objectives set out by the Commission in the area of financial regulation.

Financial supervision

Turning to the area of financial supervision, the ECB shares the "evolutionary" approach proposed by the Commission which is based on: (i) the definition of and agreement on policy objectives; (ii) the full exploitation of the current institutional framework; and (iii) the notion that the creation of new structures should only be considered if the current set-up is deemed unable to fulfil such objectives.

Concerning policy objectives, there is broad agreement that financial supervision should have two main aims. The first is to facilitate the development of cross-border finance, both in terms of financial institutions (cross-border consolidation) and products and services. There is clearly potential for this development. Let me mention a few figures with regard to the banking sector. The number of credit institutions in the euro area declined from around 12,000 in 1985 to 9,500 in 1995 and to 6,400 in 2004, which is mainly attributable to mergers and acquisitions (M&As). These operations have mainly taken place between institutions based in the same country: between 1985 and 2005, cross-border transactions accounted for less than 20% in terms of number and value of all M&A deals in the euro area and in the EU. Cross-border transactions are however increasing: since the setting up of the euro, between1999 and the start of 2005, cross-border M&A operations accounted for about 30% of all deals in terms of numbers and 24% in terms of value.

The second objective is to maintain the effectiveness of supervisory standards and action as the financial markets become more and more integrated.

The current institutional set-up, and in particular the Lamfalussy framework, provide the appropriate infrastructure for achieving these broad policy objectives, if it is used to the maximum extent possible. This entails pursuing two operational goals. The first is the achievement of *supervisory convergence* by the Level 3 committees which should deliver consistent supervisory action on a cross-border basis. Eventually, the success of the Committee of Banking Supervisors (CEBS), CESR and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS) will be measured mainly on the basis of their ability to deliver effectively on the issue of supervisory convergence. Looking at CEBS – the committee most involved so far in the area of supervisory convergence, whereas CESR and CEIOPS have focussed more on their advisory role for draft Community legislation – the experience thus far is encouraging. Based on the number of consultation papers released by CEBS reflecting agreement among banking supervisors on a number of issues (e.g. validation of banks' internal approaches, Pillar II principles and supervisory reporting), one cannot fail to note that substantive progress is being made. Of course, a major challenge in this field remains compliance by individual supervisors with the non-binding deliberations of the Level 3 committees. Transparency of implementation measures by supervisory authorities is expected to play an important role in this respect.

The second operational goal is the deepening of the *cooperation between home and host authorities* for the supervision of financial groups operating across borders. This is an essential step for reconciling within the existing framework the interests of supervisory authorities and of the industry. Cross-border cooperation among supervisors should become so smooth and effective in practice as to be perceived by the industry as unified action. In the banking sector, the work being undertaken by CEBS in this area to develop a robust model for coordination and cooperation to be used by all supervisory authorities provides an important contribution. In addition to a cooperation framework, willingness on the part of supervisors to cooperate effectively on an ongoing basis is also important. Lack of progress on this front would fuel demands for a revision of the current institutional set-up as implicit in the notion of "lead supervisor" advocated by part of the banking industry.

The review of the Lamfalussy approach due by the end of 2007 should represent the opportunity to form a comprehensive judgement about the effectiveness of progress made in the supervisory field and the possible way forward.

Let me add on the subject of supervision that the ECB fully supports the planned review by the Commission of the current regime for liquidity supervision, which represents an exception to the general principle of home country control as the host authority is responsible for the liquidity supervision of a foreign branch. Developments in financial markets, such as centralisation of liquidity management by banks and the introduction of the euro, call perhaps for reconsideration of host country responsibility for liquidity supervision. The ECB intends to contribute to this work, given the interest of central banks in liquidity matters.

Financial stability

I now turn finally to the area of financial stability. This remains one of the main objectives of financial services policy at the EU level. The interaction between financial integration and financial stability is a complex one and thus warrants close attention. Financial integration can provide the necessary conditions for a smoother absorption of shocks by financial institutions and offers them more options for managing and diversifying their risks. On the other hand, particular attention has to be given to the profound challenges to financial stability due to the structural transformation of the financial system, including intensified cross-border links. Therefore, effective arrangements for financial stability need to be maintained.

I would say that significant progress has been achieved in this field over the years, particularly as a result of the activities of the Economic and Financial Committee (EFC) as well as the work of the Eurosystem, with support from the ESCB Banking Supervision Committee (BSC). I would just mention in this respect the EFC recommendations in the area of financial stability and crisis management and the agreements, in the form of multilateral memoranda of understanding, on cooperation in crisis situations among the central banks, banking supervisors and ministries of finance. Looking ahead, I see three areas where public action could focus: financial stability assessment, management of financial stress, and deposit insurance.

First, as regards the assessment of the financial stability of the EU, the current set-up based on the EFC Financial Stability Table, mirroring the Financial Stability Forum, is certainly useful. The periodic discussions in the Table allow views to be formed at the EU level of the main areas of vulnerability for the financial system and the strength of its resilience to potential shocks. The ECB contributes to these discussions by providing the outcome of its euro area-wide financial stability monitoring, conducted with the support of the BSC and reflected in the Financial Stability Review which, since December 2004 has been made available to the public at large. Although the monitoring of economic risks is well developed in this context, there is room for enhancing the analysis of risks of a more structural nature and having a cross-sector dimension. To that end, closer collaboration between the Level 3 committees and the BSC is desirable.

Second, as regards management of financial crises, further clarification of the arrangements for effective cooperation among the relevant authorities is a major priority. For instance, the BSC and the CEBS are jointly developing proposals for further enhancing cooperation between central banks and banking supervisors, particularly in terms of identifying best practices for handling financial crises and building up operational network mechanisms. Furthermore, the Green Paper refers to emergency liquidity assistance (ELA) as an area where a review would be undertaken by all the relevant parties. I would like to note that the provision of ELA is a central bank function and an agreement exists within the Eurosystem on how this facility operates in the euro area. It is my perception that there are no specific issues relating to the provision of ELA which need to be addressed at the EU level.

Third, as regards deposit insurance, which is an important component of the financial safety net, the ECB supports the initiative of the Commission to review the existing Deposit Guarantee Directive to ascertain whether greater convergence of national schemes is desirable from the perspective of both financial integration and financial stability. The main areas of this review appear to be the reduction of national differences, which may become particularly relevant in the case of cross-border banking, and the pursuit of formal cooperation between the different national schemes.

Let me conclude by underlining once again the broad support for the key orientations put forward in the Green Paper and by thanking the Commission for its close and transparent cooperation with all interested parties during the process.