FINANCIAL SERVICES POLICY

Financial services form an essential part of the EU’s efforts to complete the internal market, under the free movement of services and capital. Progress towards integration has come in phases: (1) removal of national entry barriers (1957-1973); (2) harmonisation of national laws and policies (1973-1983); (3) completion of the internal market (1983-1992); (4) creation of the single currency area and the pre-crisis period (1999-2007); and (5) the global financial crisis and post-crisis reform (from 2007 onwards). The withdrawal of the United Kingdom from the EU brings a new set of challenges with potential implications for the financial services sector within the EU and beyond.

LEGAL BASIS

The legal basis for directives and regulations dealing with financial services are provided by Articles 49 (freedom of establishment), 56 (freedom to provide services), 63 (free movement of capital) and 114 (approximation of laws for the establishment and functioning of the internal market) of the Treaty on the Functioning of the European Union (TFEU).

MILESTONES ON THE ROAD TOWARDS AN INTEGRATED EU FINANCIAL MARKET

A. Early efforts at removing barriers to entry

Early efforts to integrate the Member States’ financial systems were based on the principles of freedom of establishment and freedom to provide services, with coordination of legislation and policies where necessary.

The Treaty of Rome, signed in 1957, created the Common Market, abolishing obstacles to freedom of movement for persons, services and capital between Member States. Article 61(2) stated that ‘the liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the progressive liberalisation of movement of capital.’ Article 63 gave a mandate to the Council to draw up a programme for the abolition of existing restrictions preventing such liberalisation.

In 1962, the Council duly adopted general programmes for the abolition of restrictions on freedom to provide services and freedom of establishment. In order to implement these programmes, the Council adopted a number of directives on insurance and banking between 1964 and 1973.
B. Harmonisation of national laws and policies


C. Completion of the internal market

In June 1985, the Commission published a White Paper[4] detailing a clear programme and timetable for the completion of the internal market by the end of 1992. It included a specific section on financial services (paragraphs 101-107), which begins: ‘the liberalisation of financial services, linked to that of capital movements, will represent a major step towards Community financial integration and the widening of the internal market.’ The harmonisation proposed was based on the principles of a single banking licence, mutual recognition and home country control. The 1987 Single European Act incorporated into primary EU law the goal set in the 1985 White Paper.

D. Creation of the single currency area

In May 1999, the Commission published the Financial Services Action Plan (FSAP)[5], driven by the introduction of the euro and the impetus this gave to addressing the remaining segmentation of EU financial markets. The FSAP included 42 legislative and non-legislative measures to be completed by 2004.

In July 2000, the Economic and Financial Affairs Council (ECOFIN) set up the Committee of Wise Men on the Regulation of European Securities Markets, led by Alexandre Lamfalussy. The Committee’s final report[6], published in February 2001, gave a diagnosis of the state of the EU financial market and provided a number of recommendations. The main problem was identified as the EU’s institutional framework, which was deemed ‘too slow, too rigid, complex and ill-adapted to the pace of global financial market change’. The report proposed what later became known as the ‘Lamfalussy process’, a four-level legislative approach first used only for securities legislation, but later expanded to other areas of financial services legislation.

The FSAP was largely completed by the 2004 deadline, with 39 out of the 42 measures adopted, with some even going beyond what had initially been envisaged. Two measures followed in 2005, leaving only one pending, the 14th Company Law Directive on the cross-border transfer of company seats.

E. Global financial crisis and post-crisis reform

The period leading up to 2007 was characterised by increasing integration and interdependence of financial markets, not only within the EU but also globally. This came to an abrupt halt with the outbreak of the global financial crisis in 2007-2008, and

the ensuing European sovereign debt crisis, as cross-border financial flows dropped severely. Between October 2008 and October 2011, the Commission approved EUR 4.5 trillion of State aid measures to help financial institutions[7]. The crisis revealed the urgent need for reform of the financial services sector.

The EU therefore undertook an unprecedented overhaul of its existing financial services legislation on the basis of the international agenda, in the development of which the EU played an important role. It also adopted its own reforms to advance certain longstanding goals such as the completion of the single market. The Commission proposed more than 50 legislative and non-legislative measures after the outbreak of the financial crisis. The most important proposals came under flagship EU initiatives such as the Banking Union and the Capital Markets Union. The post-crisis reforms have brought a certain degree of centralisation, and transferred responsibility for many aspects of financial services regulation and supervision from national to EU level.

The role of international forums in setting rules and standards has increased significantly in the post-crisis financial services regulatory architecture. This is due to the globalisation and interdependence of financial markets, which increased substantially in the decades preceding the crisis, and which became clear in the global ‘contagion effect’ following the initial outbreak of the crisis in the United States. There was widespread agreement that regulatory challenges needed to be tackled at international level. Forums and bodies such as the G20, the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS) and the International Organisation of Securities Commissions (IOSCO) therefore acquired increasing importance.

KEY EU FINANCIAL SERVICES LEGISLATION IN PLACE

A. Banking

The reform of the regulatory framework for banking was at the centre of the post-crisis legislative overhaul of the financial sector. It laid the foundations for the Banking Union that was gradually established in the euro area[8]. The regulatory reform of the banking sector included wide-ranging measures establishing: (1) stronger prudential requirements for banks; (2) enhanced architecture for bank supervision and resolution; (3) rules for managing failing banks; and (4) improved protection for depositors. These initiatives are collectively referred to as the ‘single rulebook’.

1. Prudential requirements for banks: Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR).

The CRD (2013/36/EU)[9] sets rules on access to the activity of credit institutions and investment firms, prudential supervision and governance of banks. The CRR (EU No 575/2013)[10] establishes the minimum standards to ensure the financial soundness of banks (i.e. capital requirements, liquidity buffers and leverage ratios). The CRD/CRR framework is continually updated, mainly in order to reflect the latest outcomes of the

[8]See factsheet 2.6.5. for more details on the Banking Union.
work of the Basel Committee and the FSB, with the most recent being the package of banking reforms adopted in May 2019. In November 2019, the co-legislators also updated the prudential rules applicable for investment firms, which are currently subject to the same rules as banks. A review of the CRD/CRR framework is planned in 2020.

2. Enhanced architecture for bank supervision and resolution: Single Supervisory Mechanism Regulation (SSMR) and Single Resolution Mechanism Regulation (SRMR)

Since 2014, under the SSMR (1024/2013) the ECB is the central prudential supervisor for all banks in the euro area and in non-euro Member States that choose to join the SSM. The SSM is complemented by the SRMR (806/2014)\(^{[11]}\), also adopted in 2014, which aims to ensure efficient management of potential future failures of banks that are part of the SSM. The Single Resolution Board is the central authority in charge of the decision to initiate the resolution of a bank.


Also adopted in 2014, the BRRD (2014/59/EU)\(^{[12]}\) seeks to prevent bailouts of failing banks using taxpayers’ money by introducing a ‘bail-in’ mechanism, which ensures that the bank’s shareholders and creditors are first in line to cover its losses. It also requires Member States to establish national resolution funds financed upfront by credit institutions and investment firms to cover outstanding losses. The BRRD also establishes rules for prevention (i.e. recovery and resolution plans) and early intervention by national competent authorities.

4. Improved protection for depositors: Deposit Guarantee Schemes Directive (DGSD)

Amid the turmoil of the financial crisis, an essential priority was to ensure adequate protection of citizen’s bank deposits. As a first response, the minimum amount up to which bank deposits are guaranteed in case of a bank failure was increased twice. This was followed by a more comprehensive reform of the then very fragmented system of national deposit guarantee systems. With the adoption of the DGSD (2014/49/EU)\(^{[13]}\) in 2014, Member States are obliged to ensure that there is a harmonised level of protection for depositors, and at least one DGS in their territory, which all banks in that Member State are required to join. Subsequently, as part of the Banking Union project, the European Deposit Insurance Scheme (EDIS) was proposed to supplement the current EU system of national DGSs. It aims to provide a stronger and more uniform degree of deposit insurance cover in the euro area.

B. Financial markets and market infrastructure

1. Investment services and trading venues: Markets in Financial Instruments Directive (MiFID)

From 2004, MiFID I (2004/39/EC)\(^{[14]}\) laid down uniform standards governing securities trading that made for more competition and improved investor protection. In 2014,
a revision of the directive (MiFID II) (2014/65/EU)[15] and a regulation (MiFIR) (600/2014)[16] were adopted, significantly updating the legal framework. This framework introduces a number of provisions aimed at enhancing consumer protection and market transparency. Both instruments became applicable on 3 January 2018.

2. Derivatives contracts and clearing houses: European Market Infrastructure Regulation (EMIR)

Derivatives contracts play an important economic role, but also involve certain risks, which were highlighted during the financial crisis. Adopted in 2012, EMIR (648/2012)[17] sets out rules regarding over-the-counter (OTC) derivative contracts, central counterparties (CCPs, or clearing houses) and trade repositories. It seeks to preserve financial stability, mitigate systemic risk and increase transparency in the OTC market. EMIR was subsequently updated by the co-legislators in May 2019, enhancing the supervision of EU and third-country CCPs.

3. Access to capital market funding: the Prospectus Regulation

The flagship initiative on building a Capital Markets Union included a substantial review of the EU framework for public offering of securities (i.e. initial public offerings or IPOs). The Prospectus Regulation (2017/1129)[18], adopted in June 2017 (and replacing the Prospectus Directive of 2003, 2003/71/EC), aims to facilitate the access of smaller companies to capital market funding, and to improve the quality and quantity of the information to be provided to investors, in particular retail investors.

The efforts to improve funding opportunities for smaller companies were supplemented by the proposal for a Regulation on European Crowdfunding Services for Business. Crowdfunding is an innovative and increasingly popular form of financing for start-ups and SMEs at an early stage of company growth. The new EU framework will provide legal certainty for crowdfunding platforms, enable them to operate across the Union, and boost the funding opportunities for small companies. The co-legislators reached an agreement on the proposal in December 2019.

C. Insurance: Solvency II Directive

Solvency II (2009/138/EC)[19], adopted in 2009, harmonised existing piecemeal rules for the non-life insurance, life insurance and reinsurance sectors. The directive set out rules concerning authorisation for the taking-up of business, capital requirements, risk management and supervision of direct insurance and reinsurance companies. The Solvency II framework was amended a few times, mainly to provide clarity on the treatment of insurance products with long-term guarantees, and to incentivise investments in infrastructure and long-term sustainable projects.

D. Payment services: Payment Services Directive 2 (PSD 2)

PSD 2 (2015/2366)[20] updates the EU framework on payments to adapt it to the new developments in digital payments. It entered into force on 12 January 2016, and

became applicable as of 13 January 2018. It reinforces the security requirements for electronic payments and the standards for the protection of consumers’ financial data. It also opens up the market to innovative business models offering payment services based on secure access to clients’ payment accounts (‘open banking’). PSD 2 also contains provisions concerning the authorisation and supervision of payment institutions.

**ROLE OF THE EUROPEAN PARLIAMENT**

From the 1957 Treaty of Rome to the present day, Parliament’s role in decision-making on financial services has grown from the confines of the consultation procedure to an equal footing with the Council, as the ordinary legislative procedure is now used in many policy fields.

Under the ‘Lamfalussy process’ for adopting and implementing EU financial services legislation, Parliament, together with the Council, adopts basic laws (level 1) under the ordinary legislative procedure (EU secondary legislation). Parliament also has a scrutiny role in the adoption of level 2 implementing measures.

Parliament has been actively involved in carrying forward the ambitious legislative projects for developing the EU regulatory framework for the financial sector. By virtue of its proactive approach, Parliament is prominently involved in the ongoing debate with the Commission, the Council and other international institutions about development of the supervisory and regulatory structure for financial markets, as well as in exploring ways of addressing systemic risk and the challenges emerging from fast-paced technological developments.

Within Parliament, the Committee on Economic and Monetary Affairs (ECON) is the lead committee for financial services.


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11/2020