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The regulatory regime governing the world's financial markets is rightly the subject of fundamental review in response to the financial crisis. The changes have been far-reaching and profound. Led by the G20, policymakers have shown a desire and willingness to co-ordinate their actions to reflect the fact that global markets are now more seamless than ever before.

Five years on from the recognition of the need for a co-ordinated response to the financial crisis, this study uses three case studies to examine if the ambition of a coherent global regulatory framework has been achieved. It identifies the drivers which influence policymaking and the implementation of regulation and considers the desirability of different approaches to regulation. The impact and consequences of differences in regulation for banks and their customers are identified.

A series of wide-ranging new recommendations are made to enhance the global, transatlantic and European policy making and regulatory implementation processes.

How do the reforms differ?

1. Structural reforms
   Regulators in the US, the UK and several European countries have proposed separating investment banking operations from deposit-taking arms. However, there was little co-ordination of the reforms between national authorities and the proposals work in different ways.

2. Basel III
   Developed by the Basel Committee on Banking Supervision (BCBS) to strengthen the supervision and risk management of banks, this framework is being introduced through the European Union's Capital Requirements Directive IV. The G20 has committed to the implementation of Basel III but material differences are emerging in how it is introduced across the G20 and within the EU.

3. EU Consumer Credit Directive
   Introduced in April 2008, this directive aimed to increase harmonisation of the laws and regulations surrounding personal loans and other credit products across the Single Market. However, strong national divergence remains – driven by significant differences in market structures – and there is little evidence of consumer appetite for a Single Market in credit.

What are the consequences of differences in regulation?

1. Impact on financial services
   The ‘Balkanisation’ of financial markets may create entry barriers, increase complexity, reduce competition and incentivise arbitrage. That being said, local regulation permits regulators to tailor rules to their markets and can reduce interconnection and the risk of contagion.

2. Impact on customers
   Higher compliance costs could be passed on to business clients and consumers. If businesses withdraw from markets there is a risk customers are denied access to some products and services. Alternatively, barriers to entry for banks could lead to the emergence of new service providers, a more stable banking system and local differences in rules which give corporates in one market an advantage over their competitors.

What previous efforts have been made to co-ordinate regulation?

1. Financial Stability Board
   When the G20 agreed to a fundamental reform of the financial system in 2008, the world’s leaders committed to do so on a co-ordinated basis. The Financial Stability Board (FSB) was charged with ensuring that the national financial authorities worked closely with their international counterparts on effective regulation, supervision and measures to promote financial stability.
2. Basel Committee
This organisation aims to ensure the Basel regulatory framework is fully implemented, within agreed timelines and watches out for inconsistencies.

3. Europe and the European Financial Stability Facility (EFSF)
A new supervision framework consisting of the European Systemic Risk Board and three European Supervisory Authorities (ESAs) has been introduced to enhance the consistency of rules and their implementation across the Single Market.

Study Recommendations

1. Global
• David Cameron, Barack Obama and other G20 leaders should set priorities to achieve greater regulatory consistency.
• The FSB should be strengthened to become a truly global standalone resource.
• The board must continue to monitor implementation and identify divergence at an early stage.
• Supervisory colleges, forums where officials from different authorities supervising a global institution can co-ordinate their thinking, should identify inconsistent regulation.

2. Transatlantic
The Transatlantic Trade and Investment Partnership (TTIP) should be used to establish a mechanism to incentivise regulators to enhance the coherence of the implementation of regulation in the EU and US.

When assessing differences in transatlantic regulation, the focus should be on outcomes – particularly for end-users – rather than the strict equivalence of regimes.

3. EU – International Engagement
• The European Commission should be given a mandate to push for global convergence of financial services regulation.
European policymaking needs to be more flexible to respond to international negotiations before hard-coding rules for the Single Market.

4. EU – Single Market
• Convergence is vital for wholesale markets, but the same is not true for retail banking services, where action should only be taken at EU level if there is clear justification.
• The European Commission, EU Council and the Parliament should work together to improve the quality, clarity and consistency of regulation.
• Enhance the role of ESAs, which are currently being held back by a lack of clear mandates, inappropriate timetables and limited resources.
• Establish a single supervisory culture between Member States to ease regulatory congruence.
**Recommendations**

**Global**

1. The G20 should set priorities to achieve greater regulatory coherence and to avoid losing momentum.

2. The FSB should be strengthened to become a truly global standalone resource.

3. The FSB should proactively monitor implementation and identify possible divergence at an early stage.

4. The peer review process is critical. It should be enhanced to assess the consistency of national implementation.

5. Supervisory colleges should actively seek to identify inconsistent regulatory approaches and build trust.

**Transatlantic**

6. The Transatlantic Trade and Investment Partnership should be extended to provide a mechanism for enhancing regulatory consistency.

7. The EU and US should prioritise mutual recognition of regulation rather than equivalence of regimes.

**EU – International Engagement**

8. The European Commission should be tasked to pursue global convergence of financial services regulation.

9. European policy making and legislative processes need to be flexible to allow alignment with global standards.

**EU – Single Market**

10. Convergence is necessary for wholesale markets and consumer protection but retail markets are different.

11. Level 1 – Legislative process. Improve the quality, clarity and consistency of legislation.

12. Level 2 – Technical standards. Enhance the role of the ESAs to empower them to deliver congruence.

13. Level 3 & 4 – Interpretation & implementation. Establish a single supervisory culture between Member States to facilitate regulatory congruence.
1. Introduction

In the aftermath of the financial crisis, policymakers worldwide have been working to renew the rules which govern financial markets. The changes proposed are rightly far-reaching, and represent a necessary fundamental redesign of global regulation to improve the robustness of the financial system. The banking industry fully supports this objective.

Many of the regulatory reforms have been pursued through the G20 and international standard-setters; others have been undertaken on a national basis. Although the objectives underlying reforms have, for the most part been aligned, there have been varying levels of coordination between jurisdictions as they design and implement new rules.

This study seeks to explore differences in regulation and highlight areas of convergence by analysing recent regulatory reforms. It is structured around the following three case studies:

- Structural reforms (Volcker, Vickers, Liikanen and Trennbankengesetz)
- Basel III / CRD IV
- EU Consumer Credit Directive

The case studies are chosen to examine a broad range of topics: the wholesale and retail sides of banking and the international, transatlantic and intra-EU policy making processes.

Through the case studies, drivers for regulatory divergences are identified. The consequences for the financial services industry and the important impact on end-users are considered. Previous efforts to drive regulatory consistency and lessons learned are reviewed.

Based on this analysis, recommendations are suggested to enhance the policy making processes to facilitate coherence and overcome differences. The recommendations are strictly forward-looking and are not aimed at reopening agreed regulatory reforms. The study is intended to support the delivery and implementation of measures designed to strengthen the banking system.
2. Key Regulatory Differences and Drivers

**2.1. Structural Reform**

Several countries have recently proposed structural changes as part of the reform of their banking sectors. While the high-level objectives of these reforms are similar, the proposals vary significantly in coverage and scope:

- **The US was first to present their structural reform proposal, which was proposed by President Obama in January 2010. The Volcker rule, subsequently signed into law as part of the Dodd-Frank Act, constitutes a separation approach, where proprietary trading is separated from other banking activities. These activities are prohibited from co-existing within a group which contains a deposit-taking bank.**

- **In the UK, the Independent Commission on Banking (Vickers Commission) presented their report in September 2011. It proposes a ring-fencing approach, under which the domestic retail/SME deposit business is segregated away from global wholesale and investment-banking activities. The latter may be carried out by entities in the same corporate group, provided that the ring-fenced services are provided from a separate entity that is clearly independent.**

- **The report of the European Commission’s High-Level Expert Group on Bank Structural Reform (Liikanen Group) was published in October 2012. It suggests a separation approach, by carving out proprietary trading, market making and alternative investment funding from the insured deposit part of banks. These activities are allowed to co-exist within the same banking group as long as they are carried out in separate subsidiaries.**

- **Several EU countries have drafted reform proposals based on Liikanen. In Germany, the Trennbankengesetz was passed in May 2013. It builds on the Liikanen subsidarisation approach, requiring certain investment banking activities to be carried out in a separate subsidiary. However, it differentiates between client-driven risk-taking and proprietary trading. The former is permitted in the deposit bank, whereas the latter is not. In this respect, the German proposal resembles the US Volcker rule, which is trying to distinguish between client business and proprietary trading.**

A number of drivers contribute to the divergences in the regulatory reform proposals. On one hand, there are specific socio-economic drivers linked to the individual situation in each country. On the other hand, there are overall drivers influencing regulation-making processes.

In the first category, economic drivers, such as market structure, banking sector size and regulatory objectives, as well as political and legal drivers can be identified:

- **In the US, the Volcker proposal was drafted in the direct aftermath of the bank failures of 2008/09, aiming to deliver regulatory changes quickly. Given the proximity of the financial crisis, the goal of the legislators was to reduce the level of systemic risk inherent in the financial industry. The result is a complex proposal subject to a much delayed rule-making process. It requires a stringent separation of proprietary trading and client-driven activities. Another driver worth noticing is legal. Other than the separation of proprietary trading, the Volcker rule does not impose many additional restrictions on the transactions of banks with other financial firms. This is due to the fact that, unlike in European countries, the US has historical regulation restricting banks’ dealings with affiliates.**

- **In the UK, the financial sector is the largest industry. Compared internationally, the market is large relative to the economy due to the role of London as a global financial centre. The domestic**

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1 The precise detailed approach to ring-fencing is set out in the Financial Services (Banking Reform) Bill currently before the UK Parliament
The EU banking sector is of significant size with total assets at ~350% of nominal GDP. After the publication of the Vickers report, the European Commission became concerned that Member States would take individual divergent approaches to structural reforms, potentially undermining the Single Market. The Liikanen Group was faced with the challenge of creating a structural reform that would suit all Member States despite the differences in their markets and the different reforms being pursued. The Liikanen Group concluded no specific banking market or model featured particularly well or badly during the financial crisis, and that the main drivers for the crisis was excessive risk-taking. It therefore established a reform proposal to carve out high-risk trading from insured deposits.

Germany has a tradition of state-backed banks designed to finance industrial companies. Pre-crisis, these banks increased their involvement in riskier investment banking activities beyond their original banking scope. This development motivated policymakers to stress the segregation of client business and proprietary trading in addition to following the Liikanen approach.

In addition to the factors discussed above, minimal co-ordination between national regulators was a crucial driving force for the divergences in structural reforms.

The timing of the various proposals was not coordinated, with proposals being published between early 2010 and mid-2013. As a result, the expert groups which produced their proposals at a later point in time had the opportunity to consider previous proposals, the public response and hence the lessons learned which led to divergences in the reform proposals. This was inter alia relevant for the definition of activities to be explicitly segregated away from deposit-taking banks.

In addition to the different timetables there was a lack of coordination regarding the content of the reform proposals. The proposals were drafted independently with limited dialogue or interaction, resulting in very different outcomes.

It is especially noticeable that the structural reform proposals were not a specific part of the G20 reform programme and did not appear to be a priority for the Transatlantic Financial Markets Regulatory Dialogue (FMRD), established with the purpose of furthering the integration of global financial markets. Participants in the study, whilst welcoming the work undertaken via the FMRD, expressed concern over its effectiveness, and questioned whether the FMRD remained sufficient to respond to the challenges posed by the post-financial crisis regulatory reform landscape.
### Structural reform approaches

<table>
<thead>
<tr>
<th>Regulation</th>
<th>UK</th>
<th>Europe</th>
<th>Germany</th>
<th>US</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indep. Comm. on Banking (Vickers)</td>
<td></td>
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<tr>
<td>White Paper “Banking reform: delivering stability and supporting a sustainable economy”</td>
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<tr>
<td>Final report, High-Level Expert Group on reforming the structure of the EU banking sector chaired by Erkki Liikanen</td>
<td></td>
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<tr>
<td>German draft legislation “Trennungsgesetz” in close cooperation with the French regulation</td>
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<tr>
<td>Dodd-Frank Act</td>
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<td>Swaps spin-off (Section 716)</td>
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<tr>
<td>Volcker Rule (Section 619)</td>
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</table>

### Applicability
- **UK**: banks with >£25 BN mandated deposits
- **EU**: banks >15–25% or €100BN of HFT & AFS assets
- **US**: banks registered as foreign banking organisations

### Ring fence type
- **Retail ring fence**: Full legal ring-fence around current accounts and overdrafts for retail and SME clients
- **Trading entity**: Legally separate deposit bank and trading entity allowed in same holding company; individual capital, funding and regulatory requirements
- **Trading entity separation**: Legal separation of deposit bank and risky trading
- **Swaps entity**: Certain swaps required to be in separate legal entity

#### Required in the deposit bank
- **EEA retail/SME deposits and overdrafts**
- **Insured deposits**
- **Retail payments services**

#### Permitted in the deposit bank
- **Small amount of hedging for non-financial clients** (to be defined)
- **Trade finance**
- **Project finance**
- **Corporate lending**
- **Interbank lending**
- **Corporate lending & loan syndication**
- **Hedging for non-bank clients (rates & FX within narrow risk limits)**
- **Securities underwriting**
- **Trade finance, project finance**
- **Vanilla securitisation** (for funding purposes)
- **Most core bank activities**
- **Market making (incl. limited prop. trading)** for direct client servicing activities
- **Vanilla securitisation** (for funding purposes)
- **Secured HF & PE business** (e.g. some lending & project finance, excl. high-leverage)
- **Most core banking activities**
- **Certain derivatives: FX, customer loan-related interest rate swaps, inter-affiliate, bona fide hedging**

#### Explicitly segregated away from deposit bank
- **Most wholesale/investment banking activities including market-making and underwriting**
- **Non-EAA activity**
- **Transactions with other financial institutions other than for activities explicitly permitted**
- **Prop trading**
- **Market making**
- **Alternative investment funding (HFs, PE, GVs)**
- **Prop trading (without direct client context)**
- **Market making without direct client context**
- **(Unsecured) lending & guarantee business with HF & PE**
- **Certain types of swaps: commodities, equity, energy, non-gold/silver metals, agri, non-cleared CDS, CDS on ABS**
- **Prop trading banned**

Table 1 gives an overview of the structural reforms discussed as well as the drivers of differences in the various countries.
<table>
<thead>
<tr>
<th>Drivers of differences</th>
<th>UK</th>
<th>Europe</th>
<th>Germany</th>
<th>US</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market structure</td>
<td>3 G-SIBs</td>
<td>Commercial-banking oriented universal banks</td>
<td>15 G-SIBs</td>
<td>Universal banking model</td>
<td>1 G-SIB</td>
</tr>
<tr>
<td></td>
<td>Concentration ratio (market share top 5 banks): ~40%</td>
<td>Increased market concentration due to industry consolidation in the past two decades</td>
<td>Concentration ratio (market share top 5 banks): ~30%</td>
<td>Domestic market share ~95%</td>
<td>Historically, regional banks growing into large universal banks, resulting in comparatively smaller amount of market financing</td>
</tr>
<tr>
<td></td>
<td>Domestic market share ~70%</td>
<td>Historically significant amount of market financing due to traditionally small local banks</td>
<td>Domestic market share ~40%</td>
<td>▪</td>
<td></td>
</tr>
<tr>
<td>Size of banking sector</td>
<td>Total assets of banking sector ~500% of nominal GDP</td>
<td>▪</td>
<td>Total assets of banking sector ~350% of nominal GDP</td>
<td>Total assets of banking sector ~320% of nominal GDP</td>
<td>Total assets of banking sector ~80% of nominal GDP</td>
</tr>
<tr>
<td>Experience from current financial crisis</td>
<td>Northern Rock bank run</td>
<td>Banking crisis turning into a sovereign crisis in the Eurozone</td>
<td>Landesbanken's risky operations outside state backed mandate</td>
<td>▪</td>
<td>Subprime crisis</td>
</tr>
<tr>
<td>Regulatory reforms objectives</td>
<td>Creation of a more stable and competitive basis for UK banking</td>
<td>▪</td>
<td>Lessen connection of insured deposits from high-risk trading</td>
<td>Lessen connection of insured deposits from high-risk trading</td>
<td>▪</td>
</tr>
<tr>
<td>Relevant national law (pre-crisis)</td>
<td>Historically, no law restricting commercial and retail banking ties</td>
<td>▪</td>
<td>Historically, no law restricting commercial and retail banking ties</td>
<td>▪</td>
<td>▪</td>
</tr>
<tr>
<td>Political landscape</td>
<td>Independent Commission on Banking commissioned following the Coalition Agreement</td>
<td>▪</td>
<td>Political aim to establish European Banking Union</td>
<td>▪</td>
<td>▪</td>
</tr>
</tbody>
</table>

few gaps □ few overlaps
2.2. Basel III

The Basel III Accord was developed by the Basel Committee on Banking Supervision (BCBS) to strengthen the regulation, supervision and risk management of the banking sector.

In the European Union, the rules are being implemented through the CRD IV package. CRD IV consists of a new regulation containing detailed rules subject to ‘maximum harmonisation’ and a new directive, containing provisions to be adopted by Member States.

Table 2: CRD IV package

<table>
<thead>
<tr>
<th>DIRECTIVE 2013/36/EU</th>
<th>REGULATION EU 575/2013</th>
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</thead>
<tbody>
<tr>
<td>(Strong links with national law, less prescriptive)</td>
<td>(Detailed and highly prescriptive provisions)</td>
</tr>
<tr>
<td>Access to taking up/pursuit of business</td>
<td>Capital liquidity</td>
</tr>
<tr>
<td>Exercise of freedom of establishment and free movement of services</td>
<td>Leverage</td>
</tr>
<tr>
<td>Prudential supervision</td>
<td>Counterparty credit risk</td>
</tr>
<tr>
<td>Capital buffers</td>
<td></td>
</tr>
<tr>
<td>Corporate governance</td>
<td></td>
</tr>
<tr>
<td>Sanctions</td>
<td></td>
</tr>
</tbody>
</table>

Regulatory divergences can be observed on two levels; between the Basel III rules issued by the BCBS and the CRD IV package, and between the CRD IV package and the national implementation in the various EU Member States. It is worth noting that national implementation is currently on-going; however, it is the areas of national discretion within the CRD IV, which are most likely to result in local differences.

- **Basel III vs. CRD IV**
  CRD IV largely reflects the Basel III capital requirements; however, unlike Basel III, the definition of capital is not limited to ordinary share capital but a principles-based set of minimum criteria. Moreover, unlike Basel III, CRD IV does not automatically require banks to deduct significant investments in their subsidiaries. Also, Basel III proposes the introduction of a binding minimum leverage ratio, whereas CRD IV only requires banks to compute their leverage ratios without introducing a binding minimum requirement. Another notable difference is the definition of the Credit Valuation Adjustment (CVA). In the CRD IV, transactions with non-financial corporates are allowed to be excluded from the CVA requirement for counterparty credit risk.

- **CRD IV national discretion**
  CRD IV attempts to balance harmonisation of rules across the Single Market and flexibility for individual Member States to impose higher requirements. For example, Basel III requires banks to hold capital buffers above the regulatory minimum capital requirement. Some of these capital buffers will operate at a national and some even at a bank specific level. Moreover, CRD IV leaves room for the adoption of national measures to address local risks and potential crises.
Table 3 gives an overview of the divergences between Basel III and the CRD IV package

**Capital**
- Principal-based approach to determine the quality of capital instruments (as opposed to definition of common equity Tier 1 capital as comprising only retained earnings and common shares)
- Amendments to the rules on deductions from capital (especially for significant investments in insurance companies)
- Transactions with non-financial corporates allowed to be excluded from the CVA requirement for counterparty risk

**Credit Valuation Adjustment (CVA)**
- Transactions with non-financial corporates allowed to be excluded from the CVA requirement for counterparty risk

**Liquidity**
- Definition of liquid assets (yet to be decided)

**Leverage**
- Definition of leverage ratio (yet to be decided)

**Counter cyclical capital buffer**
- National macro prudential buffer up to 2.5%

**Systemic risk buffer**
- National systemic risk buffer up to 3%, buffer rates above 3% need prior approval from the Commission

**Systemic important institution buffer**
- National G-SII surcharge between 1 – 3.5%, national O-SII surcharge up to 2%

**Real estate risk weights**
- National authorities can set real estate risk weights up to 150% based on reported losses on real estate lending

**Definition of default on obligor**
- Default definition of 90 days may be replaced with 180 days for residential or SME commercial real estate

**RWA definition**
- Model approval at national level

**National macro flexibility**
- Adoption of temporary national measures to address macro-prudential or systemic risk

The drivers of difference are mainly of economic and political nature:

- **Protectiveness of national banking sectors.** During the policy making process, some regulators and politicians acted to protect their national banks; trying to negotiate in their favour or to mitigate the impact of requirements on their economies.

- **Different political views on the level of bank capitalisation.** Politicians in different EU Member States were aiming at different percentage levels of capital requirements for banks. By allowing constrained national discretion for various capital buffers, these discrepancies can be facilitated within a co-ordinated framework.

- **Political concern about local crises.** Local politicians and local regulators are closer to the developments in their home markets and therefore required a certain degree of freedom to deal with adverse local market developments.

- **Different local markets and banking practices.** As an example, the UK has historically had a default period of 180 days for retail mortgages. The European Commission proposed that the definition of default be harmonised to 90 days. This would have had an adverse impact on UK customers which led to agreement that there should be national discretion in this area.

- **Policy making process.** European legislation is negotiated by the co-legislators through what is known as the ‘trilogue process’. Unfortunately, these negotiations are of variable quality and the timetables are frequently set by political events. For example, the CRD IV negotiations spanned several EU presidencies, leading to many changes in the technical and political personnel responsible for drafting the regulation.

- **The status of the Basel Committee and its agreements.** The Basel Committee is a grouping of banking supervisory authorities and central banks with no founding treaty. It issues recommendations for minimum requirements rather than binding standards. It is therefore possible for politicians adopting the
recommendations into their local law to make different choices. This was the case with CRD IV and ultimately led to deviations between Basel III and CRD IV.

- The European decision to apply Basel rules to all credit institutions, not just the largest cross-border banks. This increases the complexity of drafting rules to implement Basel standards in the EU.

### 2.3. EU Consumer Credit Directive

The EU Consumer Credit Directive came into force in April 2008. It was the first directive to require maximum harmonisation in this area, its predecessor, the first Consumer Credit Directive from 1987 set minimum standards only. The aim of the directive is to facilitate cross-border consumer credit services by harmonising the relevant laws and regulations of the EU Member States. The directive sets provisions for a harmonised framework in a number of core areas, mainly regarding transparency, consumer information and protection, while allowing Member States a certain degree of flexibility in the implementation of the directive.

Table 4 shows relevant areas of consumer credit policy and gives an overview of topics covered by the EU Consumer Credit Directive, and those left to Member State discretion

<table>
<thead>
<tr>
<th>TOPIC</th>
<th>EU CONSUMER CREDIT DIRECTIVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information included in advertising</td>
<td>✓ (Article 4)</td>
</tr>
<tr>
<td>Pre-contractual information</td>
<td>✓ (Article 5)</td>
</tr>
<tr>
<td>Assessment of creditworthiness</td>
<td>✓ (Article 8)</td>
</tr>
<tr>
<td>Database access</td>
<td>✓ (Article 9)</td>
</tr>
<tr>
<td>Information included in credit agreements</td>
<td>✓ (Article 10)</td>
</tr>
<tr>
<td>Credit agreement contracts</td>
<td>✗</td>
</tr>
<tr>
<td>Right of withdrawal</td>
<td>✓ (Article 14)</td>
</tr>
<tr>
<td>Early repayment</td>
<td>✓ (Article 16)</td>
</tr>
<tr>
<td>Late repayment</td>
<td>✗</td>
</tr>
<tr>
<td>Default</td>
<td>✗</td>
</tr>
<tr>
<td>APR calculation</td>
<td>✓ (Article 19)</td>
</tr>
<tr>
<td>Interest rate level</td>
<td>✗</td>
</tr>
</tbody>
</table>

Although the directive seeks to set a single set of rules for consumer credit across the EU Member States, there remain a number of important differences.

One example is the right of withdrawal. Article 14 of the directive permits a borrower to withdraw from an agreement within 14 days following conclusion of the agreement or (if later) once the borrower has received a copy of the executed agreement. The borrower is required to give notice by means that can be proven and must repay the credit and also pay interest for each day the credit was drawn down.

Right of withdrawal legislation in the three largest consumer credit markets within the EU are as follows:

- In the UK, new section 66A of the Consumer Credit Act implements Article 14 of the EU directive virtually unchanged.
In France, the existing withdrawal period was increased from 7 to 14 days in accordance with the EU directive. However, the new law goes further than the directive since it forbids money transfers between the borrower and the lender for the first 7 days after the conclusion of the credit agreement. Only after this period may the credit be paid to the borrower.

In Germany, a new law providing for the introduction of withdrawal forms for consumer credit contracts was passed in July 2010. The use of these forms is optional, however, in order to demonstrate legal compliance, they are used extensively. Moreover, under certain circumstances, the new law introduces the ability for creditors to deliver information regarding the credit contract after its conclusion. In this case, the period for the right of withdrawal starts on the date the additional information was received by the borrower and is increased from 14 days to one month.

Another area worth exploring is the regulation of interest rates within these markets. As far as consumer credit pricing is concerned, the EU directive exclusively focuses on price disclosure, but is silent regarding pricing and the existence or level of interest rate ceilings:

- In the UK, there are no interest rate ceilings
- In France, national law sets an interest rate ceiling for consumer credit at 33% above the average rate set quarterly by the Banque de France
- In Germany, national law does not specify an interest rate ceiling. However, a court ruling defined a consumer credit interest rate ceiling of two times the average money market rate

Overall, the directive leaves substantial flexibility for implementation and in addition is silent on central topics, such as pricing (see also table 4). As a result, despite introducing full targeted harmonisation when adopted, there are still significant divergences in national law and policies regulating the consumer credit market in the EU. In fact, there is a very shallow cross border market for consumer credit in the EU. It is estimated to be just 2% of the overall credit market within the EU and interestingly, has not grown since the introduction of the EU Consumer Credit Directive.

Economic, political, legal, sociological and technological drivers all contribute to the national divergences:

- In the UK, expansion of consumer credit has historically been associated with times of economic growth. Wide availability of consumer credit has been politically encouraged and the UK has the most market-based approach to credit regulation in Europe with few restrictions on credit terms and price. This attitude has resulted in a large consumer credit market with a significant variety of consumer credit products from a wide range of providers. Sociologically, it has also driven a greater acceptance of credit, with a low household savings rate and one of the highest credit card penetration rates in Europe.

The virtually unchanged implementation of Article 14 of the EU Consumer Credit Directive, without additional rules, is a direct result of the ‘light touch’ approach to consumer credit regulation, whereas the lack of a price ceiling is consistent with the historic political encouragement of the growth in consumer credit.

- In France, the main political priority has traditionally been consumer protection. This has been enforced via price controls (e.g. interest rate ceiling), tight payment incidents control and the management of over indebtedness, over which the Banque de France has direct control. An obligatory credit assessment via the single national credit reference database FICP is required. By contrast with the UK, France has amongst the highest household savings rate and lowest credit card penetration in Europe. The additional rule on the borrower’s right of withdrawal is consistent with the strict legislative regime. The interest rate ceiling is an enforced price control.
In Germany, the main political aim has been to create a transparent credit market, engaging borrowers to gather information easily and hence make well-informed decisions. Instead of enforcing transparency by law, the federal government has looked towards self-regulation of the industry through trade associations, which have traditionally been strong in Germany. The result is a set of industry-wide recognised General Business Conditions, which are recognised in law as binding on both the creditor and the borrower. Germany has a traditional consumer credit market, with a rather narrow product mix distributed predominately by local retail banks. The country has a high household savings rate and modest credit card penetration. The withdrawal forms for consumer credit contracts developed by the industry and recognised by national law are an example of the country-typical self-regulation approach. Beyond legislation and self-regulation, the courts have had a significant influence in policy development as a consequence of interpretation of consumer legislation.

Table 5 gives an overview of the identified economic, political, legal, sociological and technological drivers

<table>
<thead>
<tr>
<th>Economic</th>
<th>Political</th>
<th>Legal</th>
<th>Sociological</th>
<th>Technological</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market structure</strong></td>
<td>UK</td>
<td>Germany</td>
<td>France</td>
<td></td>
</tr>
<tr>
<td>• Largest consumer credit market in Europe</td>
<td>• Second largest consumer credit market in Europe</td>
<td>• Total consumer credit market size – €140 BN</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Total consumer credit market size ~ €300 BN</td>
<td>• Total consumer credit market size ~ €250 BN</td>
<td>• Market segmented into consumer finance houses servicing lower income / higher risk groups and banks targeting more affluent borrowers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Alternative players, such as mobile lending providers, in addition to retail banks</td>
<td>• Consumers tend to have single core supplier relationship (Hausbank)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• High degree of competition</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Product offering</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Large variety of consumer credit products</td>
<td>• Narrow consumer credit product mix</td>
<td>• Medium degree of product innovation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• High degree of product innovation</td>
<td>• High degree of exclusion of low-income-consumers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Little credit exclusion of low-income-consumers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Political agenda</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Consumer credit associated with growth</td>
<td>• Main aim is transparency</td>
<td>• Main aim is consumer protection</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Marked-based approach to consumer credit regulation</td>
<td>• Self-regulation through trade associations: development of general business conditions (Allgemeine Geschäftsbedingungen)</td>
<td>• Price controls, resulting in historically little variation in rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Few restrictions on credit terms or price</td>
<td>• Management of overindebtedness</td>
<td>• Management of overindebtedness</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>National law/ regulation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Consumer Credit Act 1974/2006</td>
<td>• Verbraucherkreditgesetz 1990 / BGB 2002</td>
<td>• “Scrivener Law” 1978 / Loi n°2010-737</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• No interest rate ceiling legally enforced</td>
<td>• Interest rate ceiling defined by court</td>
<td>• Interest rate ceiling defined by law</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>National household saving/ borrowing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Sociologically larger acceptance of credit</td>
<td>• High households savings rate of ~10.6%</td>
<td>• High households savings rate of ~15.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Low households savings rate of ~5.4%</td>
<td>• Low credit card penetration of ~0.3 credit cards per capita</td>
<td>• Low credit card penetration of ~0.2 credit cards per capita</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• High credit card penetration of ~1.2 credit cards per capita</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Credit reference databases</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Three privately owned credit databases (Callcredit, Equifax, Experian)</td>
<td>• Single national credit reference database (SCHUFA)</td>
<td>• Single national credit reference database (FICP)</td>
<td></td>
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</tr>
</tbody>
</table>
3. Consequences

The case studies identify how the implementation of policy objectives can be inconsistent across jurisdictions, even when there is political agreement on the content and goals of measures. This section considers the consequences of those differences for the financial services industry and the users of the services it provides.

At one level, there are clear benefits to differences in approach. For example, the tailoring of international rules to local markets can work in favour of the users of financial services, although it can distort competition. On the other, differences in rules can result in barriers to entry, fragmentation and increased cost and complexity. These all impact financial services institutions but have differing impacts on end users from the adverse (such as an increase in costs for products or services) to the positive (the entry of new providers for services into the market). An assessment of the consequences of differences should therefore focus on an assessment of the outcomes of regulation rather than the form it takes.

3.1 Financial Services

Fragmentation and regionalisation

The most imminent impact of regulatory divergence is the fragmentation or ‘Balkanisation’ of global financial markets. National differences create entry barriers and make it more costly for banks to stay in foreign markets. This may ultimately result in the withdrawal of institutions from certain markets, reducing competition and limiting product offerings.

Increased cost and complexity

Differing regulatory requirements across countries result in increased operational and compliance costs and, due to differences in reporting standards, increased reporting efforts for banks. The differences in structural requirements between the Volcker, Vickers and Liikanen proposals may oblige banks to create different organisational structures in the respective countries or alternatively, three separate entities across countries, which will result in significantly increased management complexity.

Shadow banking

The increased cost and operational effort for international banks to operate across countries with different regulatory and structural requirements might incentivise regulatory arbitrage. This can come about by banks moving parts of their business to less regulated locations or outside the regulated financial sector altogether. This may have an adverse effect on financial stability as activity moves beyond the regulatory perimeter.

Competitive disadvantages

Differences in capital requirements will result from national discretion regarding capital buffers under Basel III as well as divergences in the structural reform proposals. Banks with higher capital requirements and hence higher funding expenses have a competitive disadvantage compared to their competitors. That being said, there can be benefits of being regarded as better-capitalised during times of financial stress.

Risk of arbitrage and price distortion

Different treatment of specific asset classes under different regulatory regimes will lead to price distortion and arbitrage. One example is the divergences in national rules regarding liquid assets in the computation of the liquidity coverage ratio (LCR) under Basel III (though final rules are yet to be confirmed).

Adaption to differences in national markets and behavioural patterns

Local markets vary, inter alia in size, structure,
product offering and market standards. These differences are more significant for the retail side than the wholesale/investment banking side of the financial services business. Where there are significant differences in local retail markets, it is appropriate to have a set of individually adjusted rules and it might even be ill advised to apply a one-size-fits-all approach, e.g. UK consumers would have been disadvantaged had the definition of default in CRD IV been harmonised at 90 days.

**Response to adverse local market developments**

National discretion allows for local authorities to adopt temporary measures to react to adverse developments in their respective market. Local regulators and politicians are closer to their home market and therefore have the expertise needed to analyse the national stability situation and react accordingly to adverse developments. Also, national flexibility allows for the measures that need to be taken to be adjusted to the local legal and economic circumstances.

**Crisis prevention**

National regulatory differences have a positive secondary effect which arises because of the regionalisation of global financial markets. In less intertwined markets, regional crises will spread more slowly and hence, contagion risk is decreased. That being said, the ‘Balkanisation’ of integrated banking groups can increase the complexity of responding to a crisis.

### 3.2. Non-Financial Corporates and Retail Clients

**Regionalisation**

Regionalisation of banks will have an adverse impact on end-users. For both corporate and retail customers, regulatory inconsistencies that lead to banks retreating from foreign markets will mean reduced choice in smaller markets – which may potentially lose access to certain services. Internationally operating corporate clients will also have increased operational complexity due to multiple banking relationships across countries.

**Increased costs**

Regulatory divergence is likely to result in increased banking costs for end-users. Higher operational and compliance costs incurred by banks will be passed on to their clients via higher lending charges. A reduction in competition might also result in changes to pricing and increased hedging and financial risk management fees.

**Financial product access**

Regionalisation of financial markets will ultimately result in narrower product offerings. This mainly affects corporate clients and investors, who will be confronted with reduced investment opportunities.

**Stable banking sector**

As outlined above, national flexibility in some areas of banking regulation has a number of positive effects, such as policies tailored to local markets and crisis prevention. A banking sector less prone to international crises and more stable is obviously advantageous for all end-users, corporates and retail.
New service providers

National differences in banking regulation will lead to regionalisation and hence a decreased number of players in each market. This could permit new non-financial service providers as well as creative new business models, such as peer-to-peer lending, to fill a part of the gap left in the market, especially for retail clients.

Lower charges for European corporates

One of the deviations between Basel III and the European CRD IV implementation regards the counterparty credit risk charge exemption for non-financial corporates. The charge exemption is expected to be passed on to corporate end-users, resulting in lower lending charges for European corporates.

Key:

- **Highly adverse consequences**
- **Adverse consequences**
- **Positive consequences**

4. Structures To Deliver Consistent Regulation

4.1 Financial Stability Board

The G20 committed in 2008 to a fundamental reform of the financial system and to seek to do so on a co-ordinated basis. To this end, the G20 tasked the Financial Stability Board (‘FSB’) with coordinating the work of national financial authorities and international standard setting bodies (such as the Basel Committee on Banking Supervision) and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. To enable the FSB to deliver, the G20 agreed that the then ‘Financial Stability Forum’ should be reestablished as the FSB, with its membership expanded to mirror the G20 and mandate broadened to include the promotion of financial stability.

The FSB undertakes a number of initiatives to monitor implementation of initiatives sponsored by the G20, FSB and international standard setters. Most noteworthy is the progress report provided by the Chairman of the FSB to each meeting of the G20. Table 6 provides a summary of the relevant initiatives.

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2 The most recent report was submitted on 5th September 2013: [http://www.financialstabilityboard.org/publications/r_130905.pdf](http://www.financialstabilityboard.org/publications/r_130905.pdf)
Table 6: Implementation monitoring and review initiatives

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Scope</th>
<th>Frequency</th>
<th>Outputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>G20 Progress Report</td>
<td>All G20 recommendations</td>
<td>For each G20 meeting</td>
<td>• Tabular report&lt;br&gt;• Progress report</td>
</tr>
<tr>
<td>FSB Implementation Monitoring Network</td>
<td>National implementation of all G20/FSB recommendations</td>
<td>Annually</td>
<td>• Progress report to G20&lt;br&gt;• National survey</td>
</tr>
<tr>
<td>FSB Peer Reviews</td>
<td>Country reviews</td>
<td>2–3 years following an FSAP</td>
<td>Peer review report</td>
</tr>
<tr>
<td>FSB Peer Reviews</td>
<td>Thematic reviews</td>
<td>As determined by FSB</td>
<td></td>
</tr>
<tr>
<td>FSB Progress Reports on specific issues</td>
<td>National implementation of G20/FSB recommendations in specific area</td>
<td>As determined by FSB</td>
<td>Progress report</td>
</tr>
<tr>
<td>Standard setter implementation monitoring</td>
<td>Standard setter standards&lt;br&gt;Scope varies</td>
<td>As determined by standard setter</td>
<td>Implementation surveys + Monitoring report</td>
</tr>
</tbody>
</table>

4.2 Basel Committee

The Basel Committee monitors its members' implementation of the Basel regulatory framework (including Basel II, Basel 2.5 and Basel III). The assessment programme is intended to encourage member jurisdictions to fully implement standards within agreed timelines and to identify inconsistent supervisory outcomes. The figure below illustrates the structure.

Table 7: Basel III implementation assessment programme

- Level 1: Monitor timeliness of national transposition of standards into law
- Level 2: Assess compliance of national implementation and assess impact of gaps or divergences
- Level 3: Review regulatory outcomes

The level 3 assessments move beyond analysis of national implementation, to focus on supervisory outcomes at the level of individual banks. The initial work has focussed on the calculation of risk weighted assets – with work streams assessing the calculation of credit risk in the banking book and market risk in the trading book.
The European Union responded to the financial crisis by commissioning Jacques de Larosière to advise on the future of European financial regulation and supervision. The report identified serious shortcomings in the approach to financial supervision in Europe. Although there was a Single Market with financial institutions operating across borders, supervision remained mostly at national level, uneven and often unco-ordinated. M. de Larosière concluded that a stronger financial sector in the EU required convergence between Member States on technical rules, and a mechanism for ensuring agreement and co-ordination between national supervisors. An effective mechanism to ensure consistent application of rules would also be necessary. In response the European System of Financial Supervision was established, consisting of the European Systemic Risk Board and three sectoral Supervisory Authorities (ESAs). The ESAs are mandated to:

- draw up specific rules for national authorities and financial institutions
- develop technical standards, guidelines and recommendations
- monitor how rules are being enforced by national supervisory authorities
- mediate and settle disputes between national supervisors
- ensure the consistent application of EU law
- where necessary, settle disagreements between national authorities, in particular in areas that require cooperation, coordination or joint decision-making by supervisory authorities from more than one Member State

The figure below visualises the structure. Note that ESMA has responsibility for the oversight of Credit Rating Agencies and that the Single Supervisory Mechanism will establish the ECB as the supervisor of institutions in the Member States participating in Banking Union.

Table 8: European System of Financial Supervision (ESFS)
5. Conclusion and Recommendations

The study demonstrates the potential consequences of a lack of consistency in key areas of regulation and the benefits which can result from co-ordination. The recommendations below draw from the case studies to suggest ways in which the global, transatlantic and European policy making processes could be enhanced to minimise future regulatory divergences and to promote regulatory congruence in the interests of financial stability and customer access to banking services.

5.1. Global

1. The G20 should set priorities to achieve greater regulatory coherence and to avoid losing momentum.

The G20 has had a beneficial influence on the post crisis landscape. It gave impetus and political accountability to the work of the international standard setters and helped to forge an early consensus for the reform agenda. That being said, delivery and implementation of the agenda set by the G20 has been mixed and progress has slowed as the immediacy of the crisis has faded. This has led to a sense that the reform agenda is predominantly a matter for the North Atlantic countries, with solutions designed to meet the needs of these markets.

The G20 leaders must continue to commit to implementing reforms and seek to do so in a comparable manner. The G20 – through the FSB – has established robust procedures for monitoring implementation in priority areas. The G20 should focus on issues where progress is identified by the FSB as having slowed or where differences in regimes could have adverse consequences for financial stability and the users of the financial system.

2. The FSB should be strengthened to become a truly global standalone resource.

The Financial Stability Board (FSB) has acted as an important fulcrum for the reform programme. The G20’s decision to broaden the membership and mandate of the FSB was an important response to the crisis which has been reinforced by the decision to establish the FSB as an association. The G20 should accelerate the establishment of the FSB on a robust standalone basis, with adequate resources in terms of both funding and personnel, and a distinct personality. The establishment of an industry advisory committee is recommended to enhance the FSB’s engagement with the market.

3. The FSB should proactively monitor implementation and identify possible divergences at an early stage.

The FSB works well. It should be encouraged to:

- proactively identify areas where more consistent regulation is needed. The peer review process, engagement with the market and academic research all have a role to play in finding an appropriate and realistic balance between coordination and local flexibility
- identify and resolve critical factors which could result in unintentional differences across jurisdictions
- identify any areas in national implementation where there is the potential for unwelcome extraterritorial impact
- establish common timelines for the implementation of new standards and clear milestones against which progress can be monitored
- act as a centre of excellence and information sharing resource for supervisors
The peer review process is critical. It should be enhanced to assess the consistency of national implementation.

The commitment of the FSB members to lead by example in the implementation of standards is vital to ensuring the credibility of the FSB’s work and for promoting the goal of consistency. The process of peer and thematic reviews are central to this. To enhance their effectiveness it is recommended that:

- the G20 ensures the FSB has sufficient resource for this work
- industry and end-users are engaged in assessing the outcomes of implementation. To this end, the FSB should establish an industry and user consultative committee
- firm timetables are set in which actions identified should be taken – with a responsibility placed on the relevant parties to comply or explain why these steps have not been taken. Non-compliance should be subject to review by the FSB and the impact on global financial stability or market operation assessed and reported to the G20

Supervisory colleges should actively seek to identify inconsistent regulatory approaches and build trust.

Supervisory colleges have the potential to play a unique role in driving the consistency of the global regulatory structure. They are forums through which the supervisors of an individual institution come together to discuss – and ideally agree – the approach to the supervision of that group. As such, they are an important vehicle for building trust and understanding between supervisors. They also provide a unique lens on the real world impact of different interpretations of agreed standards. It is recommended that the college for each G-SIB be tasked with actively seeking to identify inconsistent approaches to regulation and report on these to the FSB.

5.2. Transatlantic

The case studies highlight the extent to which the financial crisis and the regulatory response have been North Atlantic rather than global. The EU-US axis has been the critical relationship, reflecting the status of these markets and the stature of their regulatory authorities.

The importance of this relationship is recognised in the close cooperation between EU and US authorities and is formalised through the Financial Markets Regulatory Dialogue (FMRD) established in 2002. Nevertheless, the structural reform case study demonstrates that a failure of regulatory cooperation and coordination between EU and US authorities is one of the key drivers of regulatory inconsistency. A trend which has been exacerbated as the implementation of the G20 agenda has progressed.

Whilst it is unrealistic – and undesirable – to seek absolute harmonisation between the EU and US, greater political engagement and commitment to regulatory dialogues would incentivise higher quality outcomes.

The Transatlantic Trade and Investment Partnership should be extended to provide a mechanism for enhancing regulatory consistency.

The critical nature of strong and sound regulation to the stability of the integrated EU and US financial systems provides a strong incentive for the transatlantic authorities to pursue closer coordination and greater regulatory coherence. The EU and US are currently at the early stages of negotiating a Transatlantic Trade and Investment Partnership (TTIP), which will include, amongst other issues, a dialogue to consider barriers to market access in financial services as well as other non-tariff barriers. This was welcomed by study participants but many
suggested the dialogue could go further to establish a framework for engagement on future regulatory coordination over and above the FMRD with an objective of enhancing financial stability. The following recommendations are made in the context of financial services but the principles may be equally applicable to technical dialogues in other policy areas.

**Objective**

- TTIP should establish a mechanism for reducing regulatory conflicts, inconsistencies and unnecessary duplication between the EU and US financial regulatory regimes and, consequently, regulatory arbitrage. As noted above, full harmonisation of the EU and US regimes is neither desirable nor realistic. TTIP should not be used to impinge on regulatory prerogatives related to financial stability or investor protection. However, ‘prudential carve-outs’ should be limited to areas of insurmountable differences related to constitutional or legal provisions which are unlikely to be resolved in the foreseeable future by common standards, mutual recognition or other such frameworks.

**Structure**

- TTIP should be used to establish a framework through which the regulatory authorities in the EU and US work more cooperatively in their rule-making and implementation activities. This should be within a framework which allows the political authorities in the EU and US to periodically take stock of progress. To provide momentum, TTIP could set timeframes in which discussions should be completed. This would assist political monitoring and provide a process for intractable differences to be escalated to the political authorities for review and consideration.

A number of study participants highlighted the importance of consistency of representatives in the discussions. The Commission currently leads for Europe in such negotiations with the ESAs acting as observers. This could be reversed to ensure the European representation is equivalent to that in the US (i.e. technical rather than political).

In addition to ensuring the correct participants, it is important to ensure they have mutually reinforcing incentives. TTIP should be used to discuss whether regulatory authorities should be given statutory objectives to pursue EU-US regulatory coherence. This could be enhanced with an objective to agree minimum acceptable regulatory practices and identify examples of good regulatory practice.

**Process**

The structure should be used to:

- provide a forum for confidential early discussion of proposed rules to assess potential cross-border issues – including extraterritoriality – and a mechanism to ensure regulatory implementation does not result in a barrier to trade. This point is a clear lesson from the structural reform case study and may address the concern that regulators find it difficult to move away from proposals once made public;

- prepare and share impact assessments;

- develop and co-ordinate timetables with firm deadlines for policy development and regulatory implementation;

- undertake technical work to facilitate mutual recognition;

- share best supervisory and regulatory practice; and

- co-ordinate engagement with the international standard setters.
Table 9: The suggested framework for TTIP

Mechanism for enhancing regulatory consistency

<table>
<thead>
<tr>
<th>Structure</th>
<th>Process</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participants</td>
<td>Facilitate confidential discussion</td>
</tr>
<tr>
<td></td>
<td>Coordinate engagements</td>
</tr>
<tr>
<td></td>
<td>Share best practice</td>
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<tr>
<td>Progress Reporting / Monitoring</td>
<td>Undertake technical work</td>
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<td></td>
<td>Coordinate timetables</td>
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<td></td>
<td>Share impact assessment</td>
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<tr>
<td>Timetables</td>
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</table>

7 The EU and US should prioritise mutual recognition of regulation rather than equivalence of regimes.

Study participants supported the use of mutual recognition and substituted compliance as a means of delivering better outcomes – notably for end users. Users and representatives of institutions argued that the focus of regulation should be on outcomes. The strive for equivalence results in delays which exacerbate the impact of differences in regulation. The transatlantic authorities should use the dialogue proposed above to develop a framework for agreeing mutual recognition.

5.3. EU – International Engagement

The case studies illustrate the dual role played by the EU and the challenges it faces in responding to the international regulatory dialogue and in building a Single Market. Recommendations in this area focus on how the EU engages in international discussion before considering the EU’s own internal process for implementing rules and regulations.

8 The European Commission should be tasked to pursue global convergence in financial services regulation.

The Internal Market and Services Directorate General (DG MARKT) at the European Commission is responsible for coordination of the Commission’s policy on the European Single Market and the removal of unjustified obstacles to trade. Financial services policy is one of the responsibilities of DG MARKT, which rightly has a number of objectives intended to promote convergence within the Single Market. The 2013 Management Plan for DG MARKT recognises the importance of coordinating financial services policy globally but does not mandate DG MARKT to pursue international convergence. Rather than seeking global convergence and equivalence with
Single Market rules, DG MARKT should be mandated to pursue global convergence of financial services policy. This would be an important attitudinal change as it would motivate the Commission to engage more fully in the international standard setting process and set a higher hurdle before the EU could depart from such standards at the implementation stage.

**European policy making and legislative processes need to be flexible to allow alignment with global standards.**

If the Commission has an objective to pursue international coherence, then it is necessary to ensure it is empowered to deliver. The key need is to ensure that the European policy making and regulatory implementation processes are sufficiently flexible to respond to the challenges of global regulation for global markets. The following steps would assist:

- when assessing the need for action at the start of the policy making process, the Commission should routinely assess whether steps could be taken at the global level to deliver the desired policy outcome. This assessment should include a cost benefit analysis to be consulted upon alongside the assessment of the steps proposed before the Commission decides to act. This process should include outreach to the international bodies and key international partners and markets

- the EU legislative process should follow a timetable which permits the international standard setting process to conclude before initiating European implementation

- should it not prove feasible to await the conclusion of the international process, the Commission should have an explicit power to review Level 2 decisions and recommend legislative fixes to bring European rules into line with international standards and address areas of incompatibility

- if differences in regulation emerge during the transposition process, the Commission should have a duty to assess the impact on markets and the power to grant temporary relief if necessary. This will require a more flexible approach than is currently the case with assessments of equivalence required by directives. The Commission should start from the presumption that constrained temporary relief should be available for G20 countries or participants in relevant international standard setters

**5.4. EU – Single Market**

The interviews held to prepare the case studies highlighted strong support for the single market and identified the importance of clear, consistent and effective rules in key areas to achieve this. The cases studies, also, however, highlight the practical, institutional and procedural challenges Europe faces in delivering consistent rules across the single market. There are interesting differences of view between the banking industry and users of financial services on the consequences of failing to achieve consistent rules. Overall, however, the balance was clearly that there are certain areas where it is vital for rules to be aligned in order to deliver a truly single market.

**Convergence is necessary for wholesale markets and customer protection but retail markets are different.**

The case studies demonstrate the difference between the European markets for wholesale and retail banking services. The financial crisis shows the importance of obtaining minimum standards for prudential regulation and market access.

Retail is different. The Consumer Credit Directive illustrates the significant national impediments to true integration and the difficulty of overcoming these barriers via European legislation. When taken with an
apparent low customer appetite for cross-border products or services, it is logical to question the need for further harmonisation in this area, beyond measures to guarantee consumer protection. A greater emphasis should be given to the principle of subsidiarity to ensure that action is only taken at Union level if justified, appropriate and necessary. This should be tested against the principles of:

- protecting consumers
- removing obstacles to the effective operation of the single market
- promoting competition
- ensuring proportionality
- addressing systemic risk

The following practical steps should support this assessment:

- the Commission should set out a clear analysis of the policy approach and discussion of the regulatory failing identified. This should include an analysis of how the proposal furthers the above objectives
- the Commission should subject its policy proposals to the widest possible consultations and impact assessment in advance of making proposals for legislation, and publish the results of this exercise
- the Commission is usually active in consulting prior to making a formal proposal. This good practice should be standard, except in cases of emergency

11 **Level 1 – Legislative process: Improve the quality, clarity and consistency of legislation.**

The European legislative process is necessarily complex but the case studies identified factors which unduly increase the complexity of the implementation process, and therefore chances of inconsistency. As found in the Basel case study, the Trilogue process often spans several EU presidencies, sometimes resulting in delays, different approaches and inconsistencies. This may reduce the quality of the Level 1 text and can result in the hardcoding of errors which are difficult to resolve at a later date. The Commission, Council and Parliament should work together to update the 2003 Inter-institutional Agreement on better law-making. In particular, consideration should be given to agreeing the adoption of formal guidelines to govern the Trilogue process with a view to increasing the consistency and the quality of the outputs. These guidelines should:

- set appropriate timeframes for negotiations
- ensure that the co-legislators have sufficient access to technical advice before and during the negotiation process – in particular the European Parliament should have the power to commission advice from the ESAs on technical matters
- permit the Jurists-Linguists to provide technical legal drafting advice at an earlier stage of the legislative process to mitigate the need for substantive changes to text post adoption which can reduce the clarity of the co-legislators’ intent
- provide for the publication of documents to increase the transparency of the discussions and permit interested parties to provide advice and evidence for consideration. Furthermore, it would be helpful if the Council text highlighted changes made
- set standards for issues to be delegated to Level 2 to bring consistency to the areas addressed by the ESAs. This will also ensure that political disagreements are not devolved to the technical level where the ESAs do
not have the mandate to find solutions. Furthermore, standardisation will reduce the prospect of overly prescriptive Level 1 text which complicates implementation and results in inconsistency.

Taken together, these steps would enhance the quality of Level 1 text and therefore increase the likelihood of consistent implementation and the delivery of the desired outcome. To be effective, they will require collaboration by the co-legislators.

**Level 2 – Technical standards: Enhance the role of the ESAs to empower them to deliver congruence.**

The cases studies identified the importance of the ESAs and Level 2 Delegated Acts to delivering equivalent supervisory outcomes. That being said, there was a strongly held concern that the ESAs were being held back by 1) unclear guidance at Level 1; 2) inappropriate timetables for delivering technical standards; 3) insufficient independence from the Commission; 4) inadequate resources; and 5) a lack of transparency and engagement with stakeholders – particularly corporates, and the retail investor representatives who need better financing.

The following recommendations are made:

**Clear mandates**

- Clear Level 1 text is essential to ensuring the ESAs have a clear mandate for their work. At a minimum, the co-legislators must provide more guidance about their intent and the specific objectives of provisions at Level 1. As an additional step, consideration could be given to empowering the ESAs to identify technical errors in Level 1 text which have the potential to hinder the consistency of implementation within Europe or diverge from international standards.

**Appropriate timetables**

- The ESAs have been held back by unrealistic timetables set for the delivery of Level 2 standards in Level 1 text. To address this, the timetable for Level 2 implementation should not be set in absolute dates. Rather, a drafting period should be specified which begins from the date at which the Level 1 text is adopted. The ESAs should be given no less than 12 months post-adoption with the precise period set after consideration of the workload faced by the ESA.

In addition, (as noted above) there should be a procedure to review the implementation deadline and to extend it if implementation challenges become apparent – or international negotiations necessitate amendment to the intended cause of action.

**Accountability & independence**

- There is a lack of clarity regarding the respective remits and roles of the ESAs, the Commission and the co-legislators. An exercise should be undertaken to map the remits and roles of the different European institutions, with a particular emphasis on identifying the appropriate level of engagement of the Commission and the accountability mechanisms which are appropriate as a result. There must be a robust and transparent process for reviewing outputs at Level 2. In addition, when the Commission departs from ESA advice the reasons for doing so should be published.

**Resources**

- To be effective the ESAs require appropriate resources. Many of those interviewed for this study were concerned at the inadequacy of the resources provided to the EBA and feared they had been set up to fail. To counter this a full review of the resources available should be conducted. This review should cover the level of funding and staffing arrangements, including consideration of the seniority of staff the ESAs are permitted to recruit.
Engagement with stakeholders. The case studies identify a number of areas where Level 2 standards would have benefited from greater engagement with stakeholders. The following steps are recommended:

- a reconstitution of the ESA consultative committees. Whilst interests must be balanced, thought should be given to purely technical industry consultative committees which could review draft proposals and provide technical advice at an early stage. Consideration should also be given to a standalone user committee which includes greater representation of corporates than is currently the case with the ESMA stakeholder committee;

- consultations on technical standards should be subject to standard timetables to permit industry review (this will be facilitated if more realistic implementation timetables are set at Level 1); and

- a greater focus on high-quality impact assessments.

Level 3 & 4 – Interpretation & implementation: Establish a single supervisory culture between Member States to facilitate regulatory congruence.

A Single Market requires transparent and coherent implementation of standards. The study found strong support for the concept of a Single Rulebook (SRB) to bring greater consistency to the implementation of the core standards governing prudential regulation, financial stability, wholesale conduct and consumer protection. There was an expectation that this would help correct past inconsistencies which had been driven by differing national interpretations and levels of implementation. It was hoped that the move to establish Banking Union would provide impetus to deliver more uniform standards and complete the SRB. Further steps could be taken:

A single supervisory culture

- To be effective, there are areas where the SRB must be accompanied by a Single Supervisory Handbook to promote a single supervisory culture. This will mitigate the risk that national interests will result in unwarranted inconsistency which hinders the operation of the Single Market to the detriment of the users of financial services.

Participants in the study welcomed the Single Rulebook Q&A tool adopted by the EBA to allow institutions, supervisors and other interested parties to submit questions requiring clarification to the EBA, with answers published following agreement between the EBA and Commission. This was regarded as an important tool for delivering meaningful consistency and it is therefore recommend this be replicated and considered a routine part of the implementation process. To provide institutions with legal certainty the status of such guidance issued by the ESAs must be clarified.

Monitoring implementation

- The monitoring of implementation by Member States will be key to ensuring more consistent regulatory outcomes and realising the benefits of the Single Market for the users of financial services. Participants in the study considered that the peer review processes established by the ESAs were of high quality and encourage their more frequent use. This process could be enhanced by:

- ensuring reviews take place in a timely manner

- requiring the Review Panel conducting the exercise to formally engage with industry and other market participants both by pre-consulting on the areas to be examined and in seeking input to the review.
• linking the recommendations made following the review to timelines to enable the Supervisory Board to monitor progress

• publishing the full report and not just the main outcomes as is currently the case. Transparency will provide a further incentive for implementation

• mandating the ESAs to publish an annual status report identifying implementation issues requiring resolution within the next 12 months

**Thematic ex post assessments**

• Participants in the study identified a concern that policy reviews are insufficiently narrow and do not assess the impact of legislation in a broad or thematic context. It is recommended that the effectiveness and coherence of legislation should be routinely tested via ex post assessments. These should review the degree to which legislation has addressed the failings identified at the origination stage and identify unintended consequences.

**Table 10: Summary of the recommendations for the Single Market**

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<tr>
<th>Level 1</th>
<th>Legislative process</th>
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<tbody>
<tr>
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<td>Set appropriate timeframes for negotiations</td>
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<td>Ensure that legislators have sufficient access to technical advice</td>
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<td>Facilitate legal drafting advice at an early stage</td>
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<td>Provide document publication to enhance transparency</td>
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<td>Set standards for issues to be delegated to level 2</td>
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<thead>
<tr>
<th>Level 2</th>
<th>Technical Standards</th>
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<tr>
<td></td>
<td>Empower the ESAs to deliver congruence</td>
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<td></td>
<td>Set appropriate and realistic timetables</td>
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<td></td>
<td>Map the roles of the European institutions to ensure accountability</td>
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<td>Facilitate greater engagement with the industry</td>
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<th>Level 3</th>
<th>Interpretation &amp; Implementation</th>
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<td>Create a single supervisory culture across Member States</td>
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<td>Enhance the peer review process to monitor implementation by Member States</td>
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<td></td>
<td>Use thematic ex post assessments to test the effectiveness of legislation</td>
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6. Methodology

The study was prepared by the BBA. It has been discussed with a representative range of BBA member banks and so is informed by their views but has not been subject of formal due process and does not therefore represent a formal statement of the views of the BBA or its members.

The case studies, conclusions and recommendations were informed by interviews conducted with a wide range of stakeholders in the European and international policy making processes, including authorities in Europe, the US and UK.