

THE FBF IN THE ERA OF EUROPE

Most of the regulation in the banking and financial services sector is, or will be, defined at a European level. In 2002, European authorities laid the legislative foundation for the future of the banking sector, the financial markets, and investor & consumer protection. French banks took this opportunity to promote their fundamental principles at this level: full harmonisation (level playing field), transparency and consultation in the decision-making process.

DRAFT OF THE NEW INVESTMENT SERVICES DIRECTIVE (ISD)

Organising the financial markets

There are two basic stock market models in Europe: the order-driven model found in France and continental Europe, and the quote-driven system used primarily in the United Kingdom. However new order execution systems have emerged alongside regulated markets over the past few years.

In order to take these developments into account, the European Commission deemed it necessary to revise the 1993 Investment Services Directive, which transposed into the French Financial Activity Modernisation Act of July 2nd 1996. On November 19th 2002, it published a draft Investment Services

Directive (ISD), with the aim of setting rules on market access while taking on board innovations in this area. The definition of this new framework represents a fundamental issue for financial intermediaries as well as investors and businesses.

Competition and transparency

French banks would like orderly competition, which genuinely guarantees the protection of investors and business finance, and thus favour free competition amongst the different trading systems in place across Europe: regulated markets, Multilateral Trading Facilities (MTF) and internal order processing by investment companies (internalisation).

However, the same rules must be applied to all participants, particularly with regard to transparency. By encouraging price transparency, only these rules can ensure investor protection and avoid the risk of competitive distortions and market fragmentation.

■ In this light, the FBF broadly agrees with the provisions put forward by the Commission concerning equity markets:

- pre-trade transparency rules;
- the client limit-order display rule where orders cannot be executed immediately by internalisation;
- the quote disclosure rule for retail transactions applicable to investment companies that stand counterparty to their clients' orders;
- the express approval of clients as to the way in which an investment company proposes to execute orders.

■ However, the FBF believes that these provisions require clarification on certain points:

- limit-order display rule: limit orders received must be matched on the market when they can be executed against equivalent orders existing on the market at the same time;
- quote disclosure rule: this should concern true market makers for volumes that are representative of trades transacted by investors;
- the presumption of best execution on the primary market for the stock in question, i.e. the market offering the best price, liquidity and security (guarantee from the clearing house).

Initiatives of French banks and the FBF

In 2002, the FBF and the AFEI (Association Française des Entreprises d'Investissement – French Association of Investment Firms) played a key role in promoting and supporting these principles both in France and throughout Europe. The FBF has notably clarified the thoughts of the Paris financial centre in this matter by responding to the two consultations organised by the European Commission. It has systematically stated its position before Euro MPs from all Member States, the European Commission, other banks and other European banking associations. These relentless efforts are now paying off as the European Commission is amending its plan to strengthen

transparency rules, in particular by proposing that limit orders should not be stored in the internalisation system.

Outlook

The debates within the Council and Parliament will continue throughout 2003. In principle, the draft European directive should be passed in early 2004 and be applied in 2005, thus explaining the FBF's ongoing efforts to further improve the Commission's proposal.

THE LAMFALUSSY PROCESS

The European system for creating directives and regulations is time-consuming: it often takes four to five years to draw up a directive and then transpose it into national legislation. This timeframe is ill-suited to the fast-changing financial sector, which is marked by continuous innovation. It was against this backdrop that the Lamfalussy Process was set in motion. Since early 2002, this process has helped accelerate the process for passing European securities legislation, while fostering closer involvement of market participants in the decision-making process.

In the autumn of 2002, the European Commission proposed to extend the Lamfalussy Process to directives relating to the banking sector in anticipation of the 2005 deadline for implementing its financial services action plan. The aim is also to avoid differences during the transposition of the laws into the legislation of Member States.

French banks are in favour of this proposal on the condition that it results in the genuine harmonisation of banking regulations. They support the creation of a European Banking Committee, which would bring together national regulators to be consulted alongside sector professionals. However, the FBF has requested that the problems encountered during the preliminary work following this process be ironed out.

IAS/IFRS STANDARDS

Towards common accounting standards in Europe

The European Union has decided to apply the accounting standards of the International Accounting Standards Board (IASB) from 2005, in order to enable the comparison of corporate financial statements from different countries and to facilitate the convergence of European and US standards. The Commission's proposal was approved in March 2002 by the European Parliament by almost unanimous vote and the corresponding regulation officially approved by the Council of Finance Ministers in June 2002.

French banks support greater transparency...

The FBF supports the principle of international accounting standards that are geared towards improving transparency. However, the process for defining and approving standards as it currently stands is not transparent: first, because the IASB operates without any external control (see inset), and second, because the advisory group set up by

the European Commission to assist in the application of IASB standards (EFRAG) is inadequate.

... and are strongly opposed to IAS 39 drawn up by the IASB

The "fair value"* principle, which underpins IAS 39 on financial instruments, is wholly unsuited to commercial banking activities. The adoption of IAS 39 would be reflected in increased earnings volatility that is disconnected from the economic reality.

In 2002, the FBF continued its efforts in Brussels and Paris to demonstrate how IAS 39 was incompatible with the reality of banking activities. In September, the eight members of FBF's executive committee signed a letter addressed to the European authorities (members of the European Commission, Euro MPs, permanent representatives) and to the major European banks. The result: in November, the European Parliament passed a motion requesting "an in-depth, transparent re-examination of this issue" and the European Commission formally requested that the IASB take into account the comments from the European banking profession.

Outlook for 2003

The timetable is tight, because in order to be applicable in 2005, all IAS standards must be adopted in 2003. Hearings were scheduled by the IASB in March 2003 at the request of the European Commission, and the Accounting Regulation Committee (ARC) should state its position in July.

*Fair value" consists in valuing assets at the market price or based on models in the absence of market references.

THE FBF IN BRUSSELS

In 2002, the FBF set up a team in Brussels, marking the growing importance for the FBF of European issues and the position it intends to take in Europe.

Today, regulation in the banking and financial services sector is increasingly European. The majority of the legislation that will determine the structure of its activities are drawn up in Brussels, and half of the cases presented to the FBF's executive committee every month concern Europe. Opening an office in Brussels enables the Federation to follow European projects more closely from the outset, explain the reality of the banking industry to those responsible for drawing up the legislation and contribute to the creation of a European banking model.

Only a permanent presence on site, along with the support of FBF experts in Paris who participate in working groups in Brussels on virtually a daily basis, can maintain the contacts necessary for effective action. It is indispensable for a full understanding of the procedures and behaviour of participants to define common positions by establishing alliances with the aim of defending the industry's interests within a European Economic Area comprising 25 countries as of 2004.

BANKING INDUSTRY REPRESENTATION AT THE COMMUNITY LEVEL

In Brussels, the European banking industry is principally represented by ECSAs (European Credit Sector Associations), whose members have a combined total of over 2 million employees:

- the European Banking Federation (FBE) groups the professional organisations of the 15 Member states plus Norway, Switzerland and Iceland, representing over 4,000 banks;
 - the European Association of Co-operative Banks (GEBC) comprises nearly 4,000 regional or local banks in the European Union;
 - the European Association of Savings Banks (GECE) groups organisations from 25 countries, representing 1,250 banks;
 - the European Federation of Finance House Associations (Eurofinas) has 25 members drawn from 25 countries;
 - the European Mortgage Federation represents the interests of finance houses at the European level.
- These associations have seen their workload grow over the past few years with the considerable increase in the number of banking and financial services initiatives taken at the community level. The financial services action plan defined by the European Commission includes 32 proposals.

HOW DOES THE IASB WORK?

The IAS standards (recently renamed IFRS) are drawn up by the International Accounting Standards Board, which works in collaboration with a foundation primarily responsible for raising funds.

The Board, chaired Sir David Tweedie, has fourteen members (including one French member) appointed for five-year terms. The Board alone prepares its programme and passes standards by a simple majority vote without being subject to any external control or consulting openly with users.

This private body has tremendous responsibility as it has essentially been delegated a public-interest task, namely setting the accounting standards by which European companies prepare the financial statements used to inform investors of their performance. In the European Union, the authorities theoretically have the last word, as they must endorse each standard.

DRAFT OF THE CONSUMER CREDIT DIRECTIVE

Legislation contested by banking and finance professionals

With over EUR 500 billion, or 7% of Europe's GDP, in outstanding loans, consumer credit is a major economic driver. The current regulations (1987) are applied differently across the European Union, resul-

ting in competitive distortions and making it difficult for consumers looking to obtain credit in a Member State other than their own.

The European Commission adopted a draft consumer credit directive on September 11th 2002. This directive, drawn up without any real prior consultation with professionals, aroused strong opposition from the banking and financial services sector, business and industry.

If it is passed in its current form, it could seriously hinder the development of consumer credit or even prevent some consumers from having access to credit, without improving overall consumer protection.

French banks are highly critical

The FBF is in favour of full harmonisation, i.e. adopting the same rules throughout Europe, thus offering greater security and simplicity to both professionals and consumers. However, it believes that, in their current form, several of the draft directive's provisions are unworkable or fall outside the scope of competence of credit institutions.

In particular, it disapproves of the provisions on joint liability of the lender and the supplier of goods, whereby the lender is liable for any flaws or defects in the goods financed, as well as the notion of responsible lending, which comes down to introducing a presumption of the lender's liability.

Similarly, the FBF does not agree with the provisions concerning the solicitation and use of data, which are allowed in all other economic sectors.

Sustained efforts on the part of the FBF

The Chairman of the AFECEI took a stand on this issue in the autumn of 2002 by proposing substantive amendments to the draft directive. The FBF lent support to his initiative through a number of meetings with Euro MPs, the Commission and consumer representatives.

Outlook for 2003

Given the amount of criticism levelled at this draft directive, the discussions could prove drawn-out. The Council and the Parliament should issue an opinion after first reading at the end of 2003. The Ministry of the Economy, Finance and Industry is keeping a close eye on the directive's ramifications for the banking sector and the French economy, while Medef is adopting a similar position to that of the FBF.

CONSUMER CREDIT: FRANCE ADOPTS THE EUROPEAN METHOD FOR CALCULATING THE ANNUAL PERCENTAGE RATE

The adoption at a European level of a standard formula for calculating the Annual Percentage Rate (APR) on consumer loans is the first step towards harmonisation. Nevertheless, French banks would like to go a step further in order to enable true comparisons. The components of the APR still vary from one country to another, but are the most complete in France. The APR applied by French banks is therefore a clearer, more accurate indicator of the cost of credit to the consumer, but can also give the false impression that it is higher than in other European countries.

What is the APR?

The Annual Percentage Rate is a formula that expresses the total cost of a loan as a single interest rate.

■ The components of the APR (interest rate + insurance + sundry fees) are regulated in France. They vary between countries across Europe, thus making comparisons difficult.

■ A mathematical formula is used to calculate the APR precisely. To date, France, Germany and Finland are the only countries that use the same formula.

The European APR directive

■ This directive, which was adopted in 1998, aims to harmonise the method of calculating the APR in all Member States of the European Union by defining a single formula.

■ As of July 1st 2002, French banks have been required to use the new European formula, which applies solely to consumer credit in the form of a loan or overdraft, regardless of the amount or duration.

■ This new directive does not apply to mortgage loans and loans to self-employed professionals and businesses.

The new calculation method does not change the cost of credit

It is merely a different presentation of the formula, i.e. the decision to use a "common language" for all countries of the European Union, without any impact on the price effectively paid.

DIRECTIVE ON THE DISTANCE MARKETING OF FINANCIAL SERVICES

With the euro making cross-border comparisons easier, the number of financial products (consumer credit, life insurance, etc.) offered to the French population by European banks by post, telephone or the Internet, is likely to increase. Against this backdrop, consumers must benefit from the highest possible level of legal security. Consequently, in May 2002, the European Council and Parliament adopted a directive concerning the relations between banking and financial institutions and their customers via remote distribution channels. The directive does not require full harmonisation, which was supported by French banks, but it does preserve the essential elements:

- the directive left in place the reference to the Rome Convention*, whereby the law of the consumer's country of residence is applied in the event of solicitation. This excludes systematic recourse to the legislation of the country of origin. Host country legislation, which is more favourable for French consumers, can be applied;
- the other key article in the directive states that any pre-contractual information is subject to the same laws as the contractual information in order to avoid the final contract harbouring any surprises for the consumer.

* The Rome Convention entitles parties to choose freely the legislation that governs the contract. Where no explicit clauses exist, the legislation generally applied is that of the country of origin, i.e. the country of the service provider, but specific consumer protection rules have been defined where clients are solicited in their country of residence.

UCITS DIRECTIVES

On February 13th 2002, the publication of two directives on UCITS created the framework for a genuine European collective investment market. The first extended the range of assets in which UCITS can invest to deposits, money market instruments and derivatives. The second harmonised the operating conditions of investment management companies and the information to be communicated to investors with the implementation of a single, simplified pro-

spectus. The FBF supports a rapid, innovative transposition of these directives into French law within the framework of the COB (French Securities and Exchange Commission) regulations and the draft law on financial security. The French investment management business, ranked number two worldwide, will benefit from the related development opportunities.