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### Supervision

The European representatives in the panel (regulator, supervisor and industry representative alike) referred to their belief that the motto should be: “evolution, not revolution” regarding the future of the *supervisory framework* in Europe. In this context, there was agreement that quite a lot has happened in Europe in recent years (e.g. the establishment of CEBS, the adoption of the Lamfalussy process) and that these developments have led to improvements and indeed have the potential to lead to additional positive developments in the future. The ultimate goal of the processes put in place in Europe is to create a common supervisory culture, with consistency of approaches. In addition, the EU can be seen as a “laboratory” for the world, given that the EU comprises one market, but 25 competent authorities, which have to devise coordinated solutions in the area of banking supervision.

Commenting on the supervisory structure in place in the US, which involves four main federal regulators/supervisors and fifty state regulators/supervisors, the representatives of US federal regulators underlined that communication between regulators is of key importance. They mentioned that although supervision in the US can appear fragmented, there is a willingness to maintain efficiency. European regulators pointed out in this context that although there are four agencies in the US, they all talk with one voice in Basel, and it was concluded that Europe can learn from that.

On the US supervisory framework, Ms. Marinangel referred to the importance of the comment period when new rules are being proposed. She indicated as well that it is important for banks to have the choice in terms of responsible agency, as is the case with the supervisory structure in place in the US, whereby a bank can choose to be supervised at the state or the federal level.

The US regulators then went on to highlight that they are mindful of the *regulatory burden* (there are 850 US regulations in the area of banking), and pointed out their efforts to identify areas where the burden can be reduced in the future.

EU Supervisors and industry representatives alike also expressed concern over the current regulatory burden in the EU. Another concern of the industry, that of “gold plating” (i.e. at national level, going beyond what is foreseen in an EU Directive), was also raised.

*Basel II* was then much talked about. It was agreed that it is a very complex piece of legislation, reflecting the increasing complexity of the banking business. It was pointed out that while some areas did not represent a serious risk in the past, such as the area of mortgages, now, with the arrival



of new products, such activities have become risky, and that such developments must be addressed by the supervisors, notably via Basel II.

In addition, despite its complexity, Basel II is not sufficient: it also requires a high level of communication at all levels – between the supervisors and the industry and between the supervisors at the EU level and at the global level, especially given the current trend of globalisation. In this context, the EU representatives in the panel agreed that lessons can be drawn from CEBS, notably the fact that cooperation can make progress if it focuses on practical problems. The right approach is thus a “bottom-up approach”, meaning that concrete questions should be addressed first, and cooperation should be pursued on these questions. This approach has made it possible for CEBS to respond to a significant number of practical questions.

The complexity of Basel II also explains to a large extent the difficult debates that took place recently in the US. Mr. Roldán indicated that similar debates had taken place in Europe two or three years ago. Mr. Pearson highlighted the fact that when there are talks about Basel II in the US and in the EU, the issues discussed are not the same: In Europe, the concept of “Basel II” includes the three approaches whereas in the US, it only refers to the most advanced approaches for measuring risks.

Commenting on the complexity of Basel II, the US regulators referred to the importance of having floors in the legislation during the transition phase and to the American focus on “leverage”, which is not so much a focus in Europe.

The *scope of application of Basel II and the need to guarantee a level playing field* was then discussed. Ms. Marinangel stressed the need for the capital requirements to treat similar risks equally. This explains the criticisms of small and mid-size banks in the US on Basel II. On the basis of the results of QIS 4, these banks would not be able to benefit from the same capital reductions as large banks adopting Basel II. The result of the initially proposed bifurcated approach would be an increase in the number of acquisitions, a consequence of the fact that banks applying Basel II would benefit from lower capital requirements, enabling them to compete more effectively than banks applying Basel I, especially in areas such as lending to small- and medium-sized firms and to house buyers. Against this background, Ms. Marinangel welcomed the proposed introduction of Basel Ia, as this would increase the possibility of creating a level playing field between large banks applying Basel II and all the other US banks. Specifically, she expressed the belief that Basel Ia goes in the right direction in that it goes beyond the Standardised Approach of Basel II regarding credit risk and on the other hand does not cover operational risk, which would not be appropriate.

Ms. Koller mentioned the long-standing support of the ESBG for the “universal” application of Basel II throughout the debate, notably on the question of a level playing field between large and small institutions. In this context, the possibility for smaller institutions to opt for the standardised or IRB Foundation approaches was highlighted as especially important.

In Europe, a specific issue is the possible conflict between an EU level playing field and a national level playing field. She therefore pointed out that convergence is needed first.

On the *Basel II timetable issue*, all regulators agreed that the different timetables in the EU and the US will raise a number of practical questions. They also agreed that these questions would be best solved by appropriate communication and a robust dialogue and by the firm commitment by all to make Basel II work.



## Payments

In his key-note speech, Mr. Olson stressed the parallels but also the important differences between the US and the EU, making references to some of the main episodes in the history of the US payments market from the late 18<sup>th</sup> C until today. Giving the European perspective, Ms. Tumpel-Gugerell took the opportunity to make some hard-hitting comments about the progress of banks on the path towards a Single Euro Payments Area (SEPA), prompting some reactions from the audience. Mr. Norman then opened the panel debate by raising a number of issues and questions, notably:

- *Characteristics of a single payments area*: looking at it from the inside, can one conclude that the US now represents a full single payments area, from all dimensions?
- *Process to build a single payments area*: what were the determinants in the US to move towards a single payments area? What were/are the respective roles played by market forces on one side, and by regulators on the other?
- *Regulators and supervisors*: what are the various tools that are/can be used by a regulator in his role as “catalyst”? Are there differences in this respect between the EU and the US?
- *Customer benefits*: what are the demonstrated vs. expected benefits of a single payments area to customers? How can they be quantified in terms of economic impact?
- *Comparing US and EU*: to what extent are the two payment systems really comparable? Or are there elements that today make such a comparison irrelevant?
- *New technology, innovation*: what are the objective factors that could lead to the conclusion that a single payments area is more conducive to prompting innovation in payments products and services?

From the discussion between panelists, it became quickly apparent that the USA is indeed a single payments area (the “SAPA”, Single American Payments Area), while Europe is still on its road towards SEPA. This constitutes an important difference between the two markets, and suggests that Europeans could learn from the US experience. Ms. Holland remarked in this respect that federal payment systems (ACH, FedWire, Credit cards, etc.) have to adhere to transparent standards, driven by user requirements.

Ms. Holland invited European banks to look at what already exists on the other side of the Atlantic when building SEPA, arguing that SEPA is a “*tremendous opportunity*” to achieve global interoperability. Following Mr. Olson’s lead in making historical comparisons of payment markets, Mr. Deacon then likened the situation in the USA in the early 19<sup>th</sup> century to that of the EU in the late 20<sup>th</sup> century, before underlining the substantial cost savings expected from SEPA through enhanced competition, innovation (e.g. e-invoicing) and economies of scale. The EU/US comparison however also served to highlight the differences in time-scale between the creation of the US and the EU single payments area, with the former having occurred gradually over more than one century (from the first steps i.e.: federal banknotes, RTGS system, etc., until the most recent developments such as the consolidation of card processing infrastructures), whereas European banks are asked to realize SEPA by 2008, which is only 25 months ahead.

The main determinants in the move towards a single payments area were also much debated, with panelists suggesting that the construction of SEPA is mainly politically-driven whereas the construction of the US payments area was primarily market-driven. This raises challenges when it comes for banks to “sell” their new SEPA products: will they be sufficiently attractive? Will all customers (not only corporations and government authorities, but also SMEs and individual consumers) adopt them?



Mr. Deacon invited banks to take into account customer requirements and reminded them that the European Commission has the right to intervene through regulation in case of market failure.

Mr. Beau listed a number of requirements which he believes need to be met for the SEPA project to be successful: clarity about the objectives and timeline, a convincing strategy on the supply side, a supportive regulatory framework and a coordinated/timely delivery of SEPA payment instruments in 2008. Mr. Beau added that a lot has already been achieved by the EPC but that there is still progress to be made as regards the ambition at the service level of SEPA payment instruments.

Mr. Bielefeld differentiated between ‘destination’ and ‘journey’ aspects, explaining that the destination is clear: SEPA banks have committed through the European Payments Council (EPC) to deliver three payment instruments by 1<sup>st</sup> January 2008 (SEPA credits transfers, direct debits and card transactions), and these instruments must be attractive enough so that a critical mass of payment transactions migrates to SEPA instruments by 2010. However, from a journey perspective, he added, if one wants SEPA to be a success, the industry does not only need appropriate incentives, such as early adoption of the new schemes by government authorities, but also a supportive regulatory environment, ensuring a level playing field between market participants and also between payment instruments (including cash).

Mr. Deacon concurred that the pricing of payment transactions (including cash) should reflect their underlying costs in order to favour the most innovative/competitive payment instruments. Panelists nevertheless agreed that the “*bashing*” of cash is not on the agenda: payment instruments are not all perfect substitutes (cash is e.g. a useful contingency payment instrument in case of electronic network breakdown), not to forget its societal role from a social inclusion perspective. What is needed is a *repositioning* of cash vis-à-vis other payment instruments and the possibility for payment service providers to price for cash transactions.

A participant in the audience asked about the “*price of the ticket*”, i.e. cost of the journey to SEPA, to which Mr. Deacon responded by referring to the Impact Assessment realized by the European Commission in preparation for the directive on a new legal framework for payment services in the Internal Market (due by 30 November 2005). Ms. Holland suggested approaching the issue from other angles, such as asking “*what is the cost of not doing it?*” and “*what are the customer requirements?*”, referring at the same time to the success of bank competitors such as PayPal.

This led participants to compare the regulatory and self-regulatory approaches taken on both sides of the Atlantic. Mr. Bielefeld and Ms. Holland highlighted in this respect the similarity of the self-regulatory approach to the construction of the single payments area in the US and in the EU, with a clear separation between rules-making on the one hand (NACHA in the USA, inter alia the EPC in Europe) and payment operations on the other. Mr. Bielefeld went on to stress that there must be the right level of competition between clearing and settlement infrastructures, while highlighting an apparent difference of approach between the Federal Reserve and the ECB as regards their respective involvement in retail payment systems (While the Fed is very much involved operationally in retail payment systems, the ECB isn’t at this stage, although it issued a policy statement saying it does not exclude becoming involved if market conditions so required. This is in contrast to high-value payment systems, where both the ECB and the Fed are active both at policy and operational level). There was also a common understanding among panelists that the payments industry is a network industry, thus requiring an appropriate balance between cooperation and competition, interoperability being here a key word.



## Capital markets

Mr. Horn spoke of the diversity of US capital markets, pointing out that they accommodate different types of trading markets, trading platforms and traded products. To ensure their proper functioning, he added, some basic principles have to be encouraged through regulatory efforts: transparency, depth, liquidity and competition. He explained how in 1975, National Market System (NMS) was created to respond to a number of challenges, such as the dual nature of trading markets (auction vs. dealer markets), changes in market behaviour and the impact of technology. The SEC began to promote more integrated trading markets and provide investors with consolidated information. He expressed the view that New Regulation NMS of 2004 is a highly technical and complex piece of legislation, the full impact of which will be known only once it comes into effect, adding that the Regulation was adopted by a tight majority vote and that it still raises a lot of controversy as market participants have diverging views on the future functioning of the US capital markets.

In his speech, Mr. Schaub highlighted that the priority for the EU is to focus on existing regulatory framework, amend it where necessary and implement existing rules timely and consistently across the Member States. He pointed out that MiFID will introduce changes to the market structure and trading rules, end the concentration rule in many Member States, allow internalisation, extend the use of the passport, contribute to creating a level playing field in the EU and provide further safeguards for investor protection. Mr Schaub also advised that future work should concentrate on cross-border consolidation, creating internationally compatible rules and creating a coherent framework that would eventually ensure a trans-Atlantic level playing field.

Both the EU and US panellists emphasized the fact that capital markets are becoming increasingly complex. Important regulatory changes took place recently: the US is preparing to modernize its National Market System, while the EU is preparing to implement the MIFID. They warned that competition between different types of markets and between different types of orders is something that regulators must deal with on both sides of the Atlantic, in their efforts to create a deep, liquid market and to provide for an adequate consumer protection.

All panellists agreed that the burden of implementation and compliance will most probably impose serious implications on all market participants. Panellists from both sides of the Atlantic expressed hopes of a flexible regulatory approach and avoidance of over-regulation. The EU side called for obligatory cost-benefit analyses prior to adopting legal texts, whereas US participants pointed out that while such analyses had been performed there, it was as yet unclear whether or not they were correct in their predictions.

Despite the predictions that the Regulation NMS and the MiFID will become the two keystones of the capital markets, all panellists expressed the belief that the change might not be as drastic as is currently expected. They said that pure existence of regulatory infrastructure will not necessarily rapidly increase cross-border movement and allocation of capital, especially in the short term (that however depends on the specific products). They added that the two pieces of legislation are not expected to be revolutionary for clients either, as investor protection is already at a high level. Principles of best execution are already incorporated in national legislation of most countries, spreads have already narrowed, competition has increased and prices are at stable levels.

The role of transparency was acknowledged by both sides as a means to further enhance competition, both between different markets and between different products. Transparency is costly, but the lack of it could potentially be even more expensive. Finally, panellists felt that it is



still too early to discuss the need for consolidated data, as markets have not yet fully reached their potential (e.g. there are not that many MTFs for equity trading). Panellists expressed the view that once such markets emerge, it should be left up to market forces and the private sector to decide on the need for consolidated data, allowing no governmental interference.

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