

# The crisis and the EU's retail financial services policy

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Since Lehman Brothers' collapse in autumn of 2008, the world has seen an almost unprecedented meltdown of the financial sector. The weeks and months that followed were characterised by policymakers rushing to develop rescue packages (including *de facto* nationalisations of major financial institutions) to save banks and other financial institutions. Other trends have been the disappearance of the familiar concept of the investment bank as we knew it, a consistent drop in central banks' interest rates, major liquidity injections on the markets and more or less non-committal calls by politicians to keep markets open and avoid protectionism.

Given the seriousness of the situation and the perceived imminent risk of a complete collapse of the global financial system, the attention of policymakers has naturally focused on the systemic issues that constituted the biggest threat to the financial system. Immediate damage control was the watchword.

However, as the crisis intensified and started spilling over to the so-called "real" economy at the beginning of 2009, previous calls for a fundamental overhaul of the system and the way the markets operate were answered through concrete steps as well as long-term policy decisions in the US, the EU and at a global level.

The EU in particular saw the publication of the so-called de Larosière report on financial reform in February 2009. In its preliminary response to the report, the European Commission said that it would incorporate most of de Larosière's recommendations in its future policymaking. Again, much of the future policy work will focus on addressing macro and systemic issues, such as a more integrated supervisory system.

## THE PLACE OF THE RETAIL FINANCIAL SERVICES SECTOR IN THE EU'S POLICY REACTIONS TO THE CRISIS

The retail financial services sector has not been entirely forgotten, however. The Commission had already begun to focus on the retail sector in 2007 but in the light of recent events, this work has become less visible and less of an immediate priority. Notwithstanding this

slow down in activity, the integration of the retail financial sector remains a confirmed long-term objective.

One cannot help but note that the current crisis and its spill-over to the real economy have also affected retail investors and "ordinary" bank customers. Their protection from future financial crises therefore remains on the EU's agenda. This concern has been reflected in the Commission's response to the de Larosière report and subsequent policy measures are to be expected.

## THE EU'S EXPECTED POLICY MEASURES

A number of policy measures can be foreseen in the coming year. The Commission intends to review by the end of the year the adequacy of deposit guarantee schemes in banking, securities and insurance – legislative proposals may result. Responsible lending and borrowing with a focus on the role of credit intermediaries is also an area in which policy measures are expected for the autumn. An extensive study on the subject published by the Commission in January 2009 found a significant degree of market failure that comes at the consumers' detriment. It also found that well-designed regulatory intervention can resolve (or at least mitigate) some of these market failings.

The Commission is expected to furthermore present a policy proposal by the end of 2009 to provide direct funding "to facilitate capacity-building of investor stakeholders to represent their interests in financial services policies at EU-level through training, research and information." It will also examine ways to ensure that foreclosure procedures are avoided where possible and would like to continue promoting the strengthening of financial education, in particular in schools. On more specific policy issues, the Commission intends to come forward with proposals to ensure that the benefits of SEPA (Single Euro Payments Area) are realised.

Finally, one should mention the Commission's Communication on packaged retail investment products, which was published at the end of April 2009 having been announced in reaction to the de Larosière report. In it, the Commission announces horizontal legislation by the end of 2009 to – on one hand – increase key

disclosure requirements to allow for better comparison between products and – on the other hand – introduce consistent selling practices. Existing pieces of legislation on UCITS as well as the MiFID (Markets in Financial Instruments Directive) are likely to serve as benchmarks for these upcoming legislative proposals.

### **NEW POLICIES – OLD NEWS**

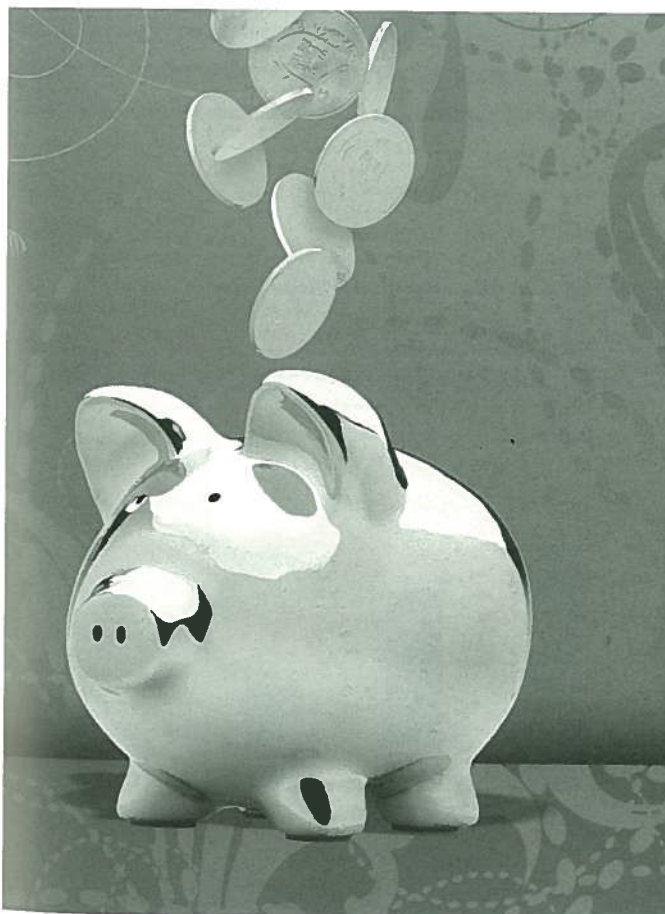
The above shows that the EU is just getting ready to tackle the retail financial services sector and one can expect a significant amount of activity in the coming weeks and months despite the remaining urgency to address broader market issues. But this interest in the retail sector is not new. The initiatives described above only complement what the Commission was already intending to do prior to the crisis. Through the financial turmoil that financial markets have gone through, these initiatives have gained a different kind of momentum and have been re-oriented to be in line with revisited broader financial market policy objectives.

For instance, financial education was already mentioned – if only

timidly – in a Commission Green Paper of 2007. At the time, the Commission admitted that the issue was primarily one which should fall within the remit of Member States. Nonetheless, this did not keep the Commission from setting up an EU expert group on the subject in the autumn of 2008 to find ways to increase financial education activities in the EU's Member States.

In other areas of retail financial services, the current crisis has called into question the institutions' planned timeframe or even forced them to reconsider the goals and direction of planned policy measures. For instance, the SEPA – a bank-driven initiative (strongly supported by the Commission) to treat cross-border payments within the EU like domestic ones – is facing a certain slowdown. Some banks have indicated that SEPA is not a priority in a financial climate in which simple economic survival is at stake. However, the Commission believes that despite these indications, the initiative remains on track and that all deadlines will be upheld and met by all market players.

In the area of mortgages, the focus has shifted to take account of lessons learnt from the crisis. While policy measures envisaged in the



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Commission's 2007 White Paper on EU mortgages aimed at driving forward the pure integration of the mortgage market, the Commission's attention seems to have shifted towards more consumer-oriented considerations, such as responsible lending and borrowing or the prevention of foreclosure.

### **IN LINE WITH THE EU'S POLITICAL AIM: ENHANCING GENERAL CONSUMER PROTECTION**

This initiative is clearly in line with the (un-)declared goal of the EU to increase consumer protection. The Commissioner in charge of consumer affairs, Meglena Kuneva, has managed to impose a strong consumer protection angle on a range of EU policies, including financial services, since she took office in January 2007. Much to the dismay of the industry, she has proven an effective counterweight to Commissioner Charlie McCreevy, in charge of financial services, who traditionally defended the Anglo-Saxon free market philosophy, in particular in financial services (even if he had to revise that approach slightly in recent times).

This trend is likely to continue for at least as long as the economic crisis continues. Also, as the current Commission is likely to stay in office until the end of the year no substantial policy shift can be expected before then. And while Commissioner Kuneva's future within the Commission is currently unclear (e.g. she was elected as a Member to the European Parliament in June 2009), it is a given that Commissioner McCreevy will not return to Brussels under the new Commission. Depending on how the crisis evolves and on the personalities who will take over the portfolios currently held by McCreevy and Kuneva, consumer policy in financial services might well continue to feature prominently on the agenda next year.

This is partly due to the fact that beyond the crisis, the retail sector continues to be largely fragmented across national markets compared to the wholesale sector, a situation that the Commission would like to remedy.

### **POLITICAL ROOM FOR MANOEUVRE IN THE FUTURE**

Overall though, the Commission has publicly admitted that the adoption of policy measures for retail financial services in the current economic crisis will be even more challenging than before. Proper cost-benefit analyses justifying such measures will have to be carried out and weighted more carefully. This is one development the industry is likely to welcome.

For as long as the EU faces a serious economic downturn, it will continue to address the big macro-economic challenges and the shortcomings in the wholesale financial markets as a priority. This is understandable and necessary. At the same time, however, the industry needs to be careful not to be caught off-guard as the Commission has made it clear that the long-term objectives for the retail financial services sector remain unaltered. It will continue to address this sector, in particular to enhance consumer protection. For the industry, constructive cooperation with the EU institutions should therefore remain the way forward in the months to come.

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