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FINANCIAL SERVICES AND CAPITAL MARKETS - THE WAY AHEAD

Ladies and Gentlemen,

You have asked me to look ahead. I shall try to do this first by identifying underlying factors which are likely to exert a decisive influence on the future of financial markets and on the working conditions of financial institutions in Europe. In my subsequent remarks I intend to make a more traditional summary of present and future activities in our common area of interest, i.e. banking coordination in the Community.

EMS

I take as my starting point the European Monetary System. We can now look back upon a period of almost four and a half years during which the EMS has been operating, and operating successfully. Its primary purpose is the creation of fairly stable relationships between the participating currencies and it is in this light it should be judged. The aim of the EMS is not the reintroduction of fixed parities. There is perhaps a tendency for the press to evaluate the performance of the EMS against the ambition of fixed parities. Time and again even relatively serious newspapers have predicted that the end is nigh for the EMS because another realignment has taken place. But it is important to underline that these have been orderly realignments and orderly realignments form part of the normal functioning of the EMS. Changes in parities are now arrived at by collective decision rather than by unilateral action. The EMS has survived notwithstanding pressures developing both from outside and from within.

There have been parity adjustments, but it is fair to say that the magnitude of parity changes as between EMS currencies has been much less than the movements of EMS currencies against other currencies e.g. the U.S. Dollar and the Yen. Given the importance of trade between Member States*, this relative stability has been of great importance to industry in the Member Countries.

The coordination of economic policy and the convergence of economic performance have certainly not fulfilled all expectations, but it needs to be stressed that the EMS with the exchange rate fluctuation limits it imposes has directed the policy of weak EMS countries towards greater economic discipline. At the same time it has helped to make the policies of strong countries more expansionary. These effects have been particularly noticeable on French and German economic policies respectively, following the currency realignments in March this year. It has as a consequence brought about what might be called indirect convergence of economic policies, which again in turn tends to reinforce the system. It has also acted as a brake on protectionist tendencies. These are, in my view, highly positive achievements.

In 1981 47.6% of the external trade of the Ten Member States was with other Member States.

THE ECU

Another favourable development which I would like to stress is the emergence of the European Currency Unit (ECU) on the financial and commercial markets as a currency in its own right. The volume of ECU deposits and credits has increased sixfold in two years, and in the first quarter of 1983 the ECU was the third major issue currency in the Eurobond markets - after the US\$ and the DM - with an issue volume of ECU 600 million. A well organized ECU interbank market has helped the ECU, which previously was only a unit of account and a savings instrument, to expand into a vehicle for transactions on private markets.

We are likely to see further dynamic growth in the use of the ECU over the next few years, but there is still at least one major obstacle to its wider use, namely the continued refusal by Germany to grant it the status of a foreign currency. Specifically, Germany alone refuses to allow it to be used for transactions by residents, taking the view that the ECU is in effect an indexation clause which is prohibited by the German banking legislation. We have made repeated calls to the German Government to review this and most recently in our communication on the promotion of the international role of the ECU (COM (83) 274 final of 13 May). I hope that the German contingent at this convention will use their influence and try to prevail on the German authorities to change their attitude.

LIBERALIZATION OF CAPITAL MOVEMENTS

Let me turn now to the work being done on liberalization of capital movements, something which follows naturally from the EMS and the ECU. As you know, some Member States, notably Germany and the United Kingdom, have already completely removed all exchange controls, while others like Belgium, the Netherlands and Luxembourg, have done so for all practical purposes. Given the higher degree of stability between Community currencies, it is fair to assume that the monetary authorities of the remaining Community countries will find more scope for a gradual liberalization of capital transactions too. It can also be argued that the importance of a number of these restrictions for the purpose of balance of payments policies has been overestimated. We probably also have to admit that more efforts should have been devoted to a gradual liberalization of these transactions. But we now have a good chance to make up for this. The Commission is convinced that the austerity measures taken in countries like France, Belgium and Denmark will deliver results in terms of improved external accounts and that it is important to take this opportunity to see that the free movement of capital called for in the Treaty of Rome becomes a reality.

ABOLITION OF INSTITUTIONAL OBSTACLES : BANKING

The factors I have commented on up to now have an influence on the working conditions of financial institutions. I would therefore like to turn to a broad outline of the Commission's work aiming at the abolition of obstacles to the exchange of financial services across frontiers in the Community.

First, banking coordination, by which I mean not only coordination of banking legislation and supervision, but also the facilitation of working conditions of credit institutions of the Community. We want our efforts here to make their own contribution to financial integration, and certainly we must ensure that progress in other areas is not slowed down by lack of movement on these structural aspects.

I take note with some satisfaction that the pace of work has quickened since the first coordination directive was adopted by Council in late 1977. We owe much to the close cooperation between the Commission and the Banking Advisory Committee on one side and between the Commission and the Committee of Credit Associations on the other side, and I take this opportunity to express my appreciation of the active and constructive participation by representatives of the savings banks who have taken part in our work in the CCA.

You will recall that the first coordination directive lays down a set of common conditions for the establishment of new credit institutions. These rules are by no means exhaustive and it is our intention to supplement the first directive with a 2nd coordination directive in due course.

The first coordination directive was also important because it defined our longer term objectives. In particular it specifies that the result of the harmonization process should be to provide for overall supervision of a credit institution operating in several Member States by the competent authorities of the Member State where it has its head office (i.e. home country control). We make a point of stressing that our objective covers prudential supervision as opposed to the controls imposed for purposes of monetary policy. It is worth noting that the ultimate aim of consolidated supervision is in full keeping with the globally accepted approach to banking supervision, as witnessed for instance by the successive "Concordats" worked out by the Basle Committee on banking supervision.

The directive on consolidated supervision which was adopted by the Council in June of this year represents a first step in this direction. It is a relatively simple instrument requiring the supervisory authorities in each Member State to exercise regular supervision on a consolidated basis over the activities of institutions in their country, and over subsidiaries and branches in other Member States. For the time being it will be necessary to maintain prudential supervision by the authorities of the country in which the subsidiaries and branches are situated as well. But we hope that in due course that can be phased out.

Before we can contemplate further steps towards exclusive home country supervision, we must ensure a degree of coordination in the requirements with respect to solvency and large exposures which presently differ widely from one Member State to the other. As you will be aware we are presently working towards the establishment of common observation ratios.

I think we can expect our work in the area of ratios to be assisted by the proposal for a directive on annual accounts of banks which has now finally been dealt with by Parliament and will reach the Council early in the autumn. This proposal of course also has a more direct role of its own as a supplement to the Fourth Company Law Directive on annual accounts of companies which provided for an optional exception in favour of financial institutions.

One of the interesting problems which arises in connection with the annual accounts of banks is whether financial institutions should be allowed to trade against undisclosed reserves; on this controversial issue the Commission has taken a middle-of -the-road position proposing that credit institutions should be allowed to maintain undisclosed reserves amounting to a maximum of 5 per cent of loans and advances to enable them to avoid dramatic fluctuations in the published results.

The subject of consolidated accounts for banking groups is not dealt with by the directive on annual accounts of banks. We therefore intend to introduce a separate directive now that the Council has adopted the Seventh Company Law Directive on annual accounts of groups of companies.

The requirements for annual accounts for branches from third countries are influenced by opposing factors: on one side the impossibility of allowing these branches to operate in the Community on what could be seen as more favourable conditions than branches from other Member States, and on the other side the wish to avoid unnecessary duplication of work, especially in cases where the head office is obliged to present accounts of similar informative standards to those of the Community. A special directive dealing with those problems will be presented by the Commission towards the end of the year.

Among our highest priorities in our ongoing work is the search for a common definition of own funds. The solution to this problem is a necessary pre-condition both for our work on establishment conditions and on ratios. While there is a wide if not total consensus on what we now call the internal elements of own funds, there are some problems with the external elements. For instance can the external elements be counted in, and if so, should they be limited, and should they count for all purposes, i.e. both for the ongoing concern and in case of liquidation.

I have confined myself here to our major activities and as I indicated a moment ago the overall picture is not at all bad. Indeed in my view the results obtained are better than might have been expected back in 1977 before the First Coordination Directive was adopted. But what of future prospects.

The supervisory authorities have for the last 10 years found themselves engaged in ever increasing international cooperation, forced upon them not least by the emergence of the Eurocurrency markets; I am afraid one must add that the occasional banking crises have served to accentuate the need for this sort of close cooperation. With further financial integration the supervisory authorities of Member States are likely to require common procedures for assessing the performance of banks operating across frontiers in what will increasingly be a common banking market rather than traditional domestic markets. The authorities will also need new procedures for securing an efficient exchange of information. The common ratios for prudential purposes which we are working on are likely to become essential tools here. And in order to establish common ratios it will be necessary to work out a common definition of own funds as soon as possible. Let me add that I think that projects like a Community-wide credit information exchange and understandings on the relationships between national deposit insurance schemes will assume a much greater importance in a few years time, a good reason for starting to consider them seriously now.

To avoid any misunderstanding, let me state explicitly that although we are laying the groundwork for close integration the Commission always bases its policies on cooperation between the existing national prudential authorities. It has no intention of introducing a Community supervisory authority and with it another tier of bureaucracy. But it is important to bear in mind that the swift changes we can expect in European banking markets in the years to come do require similarly rapid adjustments on the part of the prudential authorities if the same quality of supervision is to be maintained with a bigger element of international business, and these rearrangements can only be realized at Community level.

How then do the prospects present themselves as viewed from the vantage point of the banks. First, closer financial integration in the Community is likely to mean that services business, as opposed to business transacted through a local establishment will assume a growing importance for banks. There will be ever more situations where a bank will carry out a given transaction from its head-office, although it is situated in another Member State, rather than from its local branch or subsidiary, or situations where a specialized subsidiary in another Member State is called in to handle an operation directly.

We can also expect that the range of available banking services will continue to expand, partly as a result of the rapid technical developments taking place especially in areas like communications and data processing. Market forces, inside and outside Europe, may also call into being new types or combinations of financial institutions. In the United States, for example, conglomerates with strong retailing operations are moving vigorously into insurance and also into banking.

These practical changes are likely to lead to a demand from the industry concerned for streamlined procedures of supervision throughout the Community. Put differently, all Member States will have the same interest in securing access for their credit institutions to the common market in banking, if the national banking industry is to remain competitive.

From the point of view of the banks further work at Community level is obviously needed to round off Community procedures on establishment, followed by coordinated measures on ongoing supervision.

INSURANCE

Before coming to my closing remarks let me say something about our experience in a parallel field to banking, that of insurance. Those of you who feel progress has been slow on banking should take heart - in insurance there has been virtually no progress at all over the last four years.

Community legislation has been adopted on right of establishment, both for life and non-life insurance and we have scored successes with the abolition of the green card for motor cars and with common provisions for the activities of insurance brokers. Freedom of services in the insurance sector of course denotes that an insurer in one Member State can offer cover for a risk in another Member State.

A Commission proposal aiming at facilitating provision of services has been under discussion in Council since 1975. We have recently drawn the conclusion from these discussions that there are decisive differences between some Member States on one side, and another group of Member States and the Commission on the other side, with respect to the interpretation of the Treaty Articles which define the right to provide services throughout the Community. While the Commission has a strong preference for solving the Community problems through political decisions in Council, we have been forced to put this fundamental issue to the European Court because of the impasse reached in the Council. It will not surprise you to hear that on the Commission's interpretation, which we find supported by a series of Court rulings, Articles 59 and 60 of the Treaty give a directly applicable right to exercise freedom of services in the insurance field. We expect our interpretation to be upheld by the Court and are therefore optimistic that if the political process fails to create a Common Market in insurance the legal one will. We hope sincerely that all those concerned in the industry and in the supervisory authorities of the Member States will bear this in mind and contribute to a last round of efforts to enable the Council to agree on the Second Non-life Insurance Directive.

CONCLUSION

May I conclude this speech by trying to put what I have said into a wider context. The Community has achieved great success in establishing free movement of industrial and agricultural products. Financial services have lagged behind. But that is contrary to the Treaty. Our aim is to establish a Common Market that applies equally to services as well as to goods.

In the field of banking we hope that you, the representatives of the industry concerned will give us your support. I believe we are now moving into a period when financial integration will develop at a faster pace than hitherto. We in the Commission will try to measure our present and future activities not against the relatively slow developments of the past but instead against our expectations for the future. I trust you will join us in this dynamic approach. I believe that if we succeed this will be good for your industry both within Europe and elsewhere in the world, and good for consumers as well.