Finance Norway

POSITION PAPER ON

CHALLENGES FACING THE FINANCIAL INDUSTRY IN THE INTERNAL MARKET PENDING THE INCLUSION OF THE ESA-REGULATION IN THE EEA AGREEMENT

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FNH FINANSNÆRINGENS HOVEDORGANISASJON

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- The internal market for financial services is a place where companies meet for interaction irrespective of their country of origin being EU or EEA/EFTA. If the legal standing of a part of the internal market changes, this will affect all participants in this part of the market irrespective of their country of origin. Thus, a failure to include the ESA regulations in the EEA agreement will impact companies of EU member states and thereby the EU as a whole.

- The need to include the ESA regulations in the EEA agreement is urgent. Due to the large changes in the EU regulatory environment for financial services, a delay increases the risk of imminent transformation of EFTA countries into third countries.

- Companies established in the EEA countries through branches will face new regulatory and organisational requirements if EEA countries are perceived as third countries. The inherent benefits of the internal market on transaction costs and efficiency will disappear with increased costs as a result.

- The longer the current situation exists, the more it creates a fragmentation within the European single market. The EU and the EEA/EFTA countries therefore have a common responsibility in finding a solution that will safeguard a level playing field and foster a coherent and well functioning single market for financial services.

BACKGROUND

Following the financial crisis of 2007-2008 a comprehensive legal structure guiding the production of financial services has been put in place in all parts of the global marketplace. The European Union and the EEA agreement has been the vehicle for implementation of these standards in the internal market for financial services in Europe. Indeed, the regulatory initiatives within the internal market have gone further, strengthening the internal market and reinforcing confidence in the European financial industry.

One central part of the legal infrastructure supporting the internal market in financial services is the enhanced EU Supervisory Framework that established the three European supervisory authorities (ESAs) on banking (EBA), insurance and pensions (EIOPA) and securities and markets (ESMA) in 2010. These authorities have the right to enforce sanctions directed at individual (legal) persons in EU member states.

The three EFTA states Iceland, Liechtenstein and Norway are a part of the internal market through the EEA-agreement. Only when EU legislation is included in the EEA-agreement and subsequently implemented in national legislation in the three counties do the automatic mechanisms of inclusion in the internal market enter into force. These include the right of establishment and passporting rights included in the different directives.

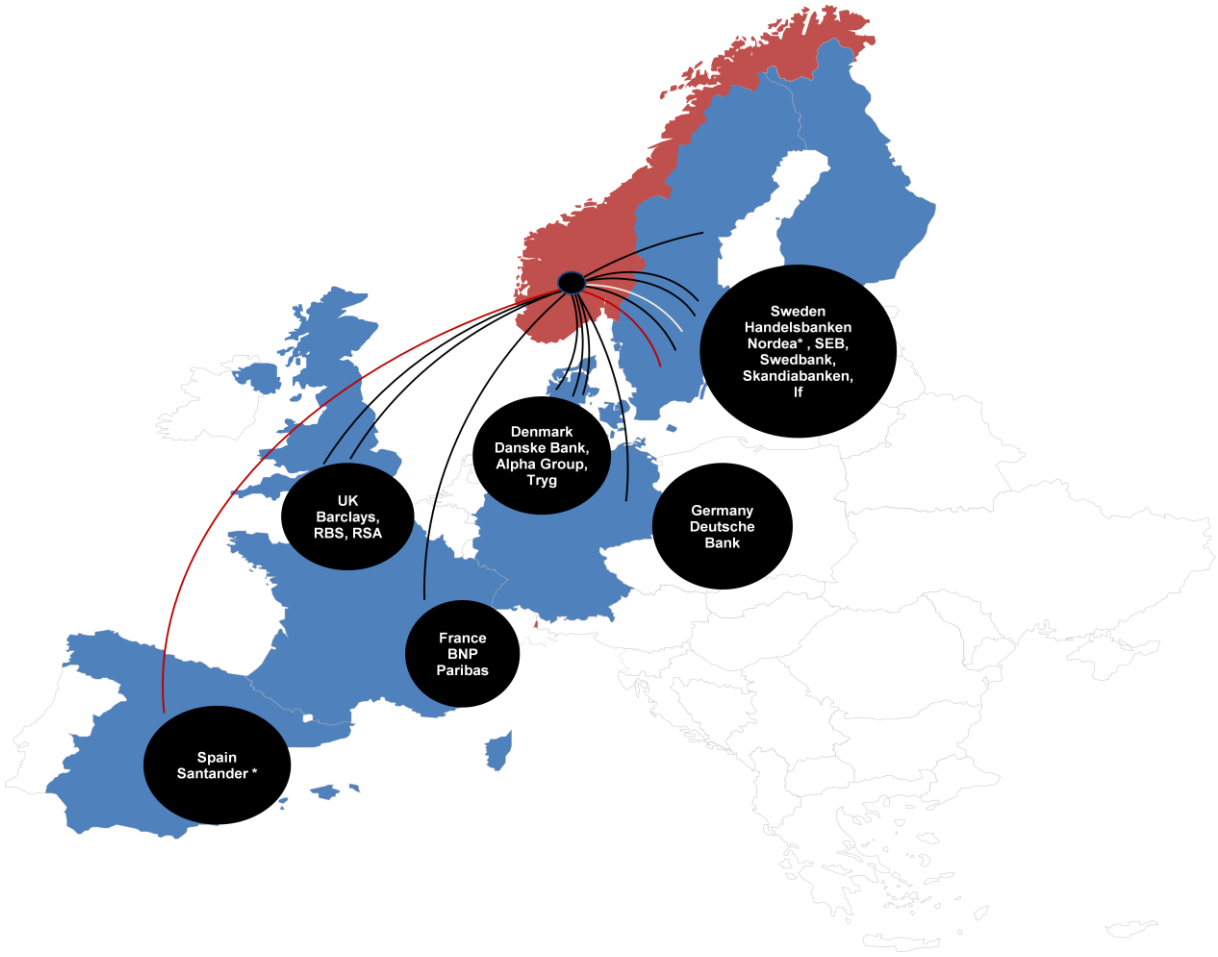
As the EFTA states are not members of the EU, allowing the ESAs to enforce sanctions directed at individual (legal) persons in these states is not compatible with the constitutions of some of the EFTA states. The EEA/EFTA states have developed a model of enforcement that will cater to these issues. This model is currently about to be negotiated with the EU Commission and scrutinised by Commission Legal Services.

It is imperative and urgent that a solution to these obstacles is found. Further delays in solving this will imminently result in financial regulation in the EEA states not being perceived as fully harmonized with the EU legislation. EEA jurisdictions risk being perceived as jurisdictions outside the internal market. This will have implications not least when it comes to cross border activity in relation to the internal market.

Market participants meet for interaction in the market. Changing the prerequisites for some parts of the market will change the rules of interaction for all market participants that are somehow connected to that part of the market. This paper sets out the possible implications of a delay in inclusion of the ESA-regulations in the EEA agreement. The paper focuses on implications for market participants that have their home state in the EU, but have engaged in activity in the EEA-states based on the principle of single licence (EU passport). We have used Norway as an example. Today, this is engagement within the internal market – but tomorrow this might be cross border activity.

THE NORWEGIAN EXAMPLE

The European financial industry is intimately integrated within the internal market. The Nordic market for financial services is in turn heavily integrated. Danske Bank, DNB, Gjensidige forsikring, Handelsbanken, If, Nordea, SEB, Skandia, Storebrand, Swedbank and Tryg are all Nordic companies active in two or more Nordic countries. All of them are active in the Norwegian (EEA-part) of the market. Companies operating cross border through establishment in the Norwegian market are illustrated in the map below. Nordea have a permanent establishment in the form of a subsidiary. The Spanish bank Santander also has a subsidiary in Norway. The other companies have established themselves in the Norwegian jurisdiction through branches.



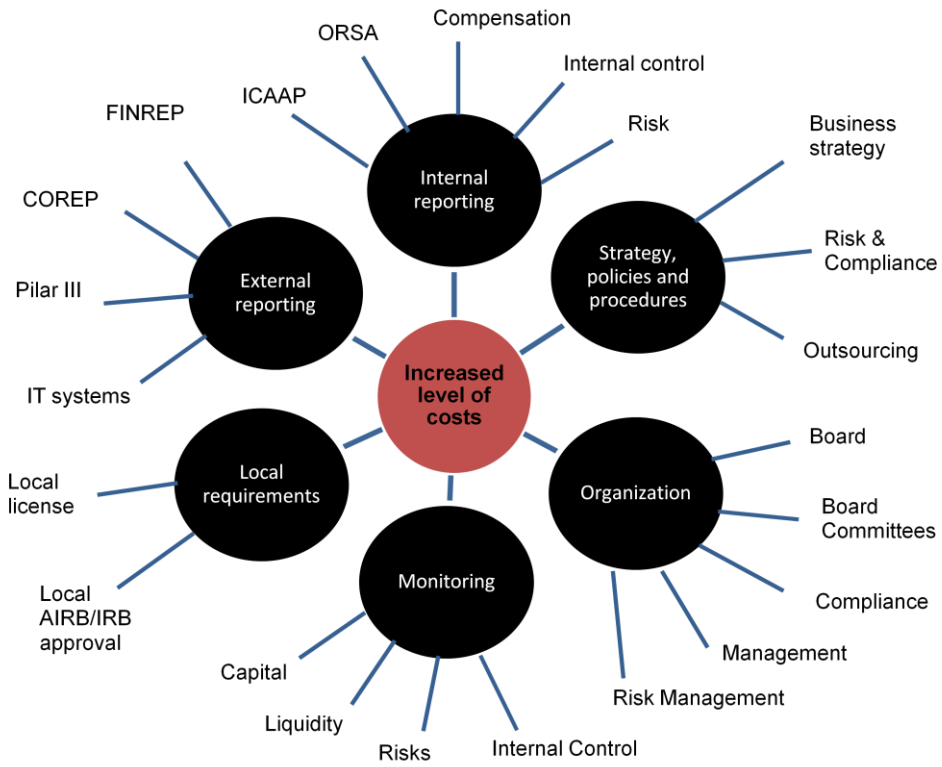
If the EFTA countries gradually turn into “third countries” it will lead to negative consequences for the companies depicted in the map above. Our perception is that it will lead to increased costs for companies that operate through branches in the EEA countries. It will lead to increased need for liquidity and capital; and above all has already led to and will continue to lead to increased uncertainty. The legal uncertainty involved is especially detrimental to financial services, an industry based on contractual legal rights.

CONSEQUENCES FOR BRANCHES

In case of the EU passport seizing to operate automatically, a branch will probably meet requirements similar to those of a legal person in the EFTA country.

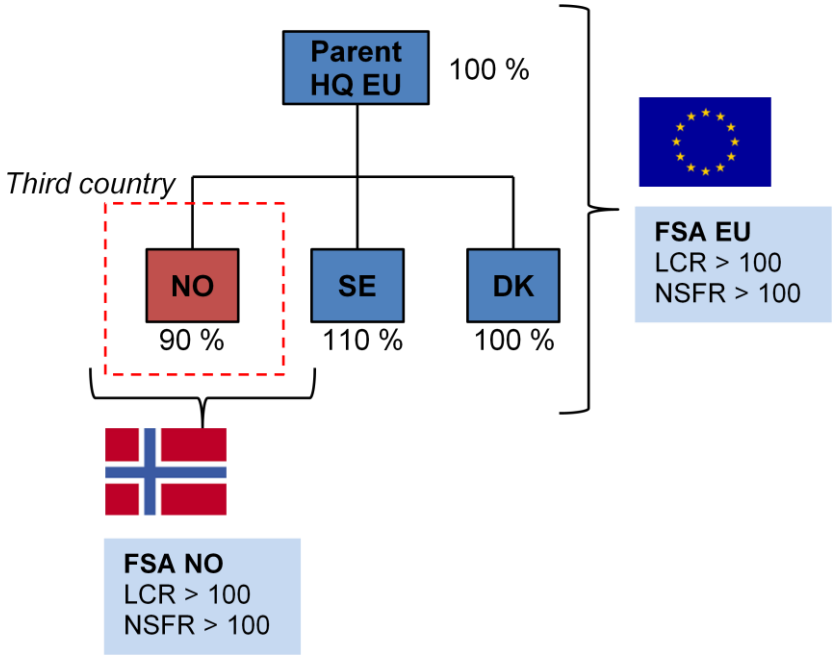
This goes to the heart of the idea behind the internal market. The passporting rights of the rules governing the internal market are the drivers for so many companies choosing to establish themselves cross border through branches. One possible effect of this no longer being possible is that companies will withdraw from the market. Alternatively, companies will need to establish subsidiary-like structures.

The chart below highlights some of the most important factors which local companies operating in the EFTA countries probably will need to adjust to and comply with for each local branch if EFTA countries are considered as third countries. Parts of these may to some degree already be in place as parts of a pragmatic approach to operating cross border. There will, however, be an unequivocal need for further elements of governance, supervision, control and transparency that are necessary for sound stand alone legal persons. Organisation, strategy, policies and procedures are together with internal reporting basic elements of a company. Direct host supervision will need this, together with monitoring and external reporting in order to fulfil its objectives. Further to this the company will most probably need to fulfil local requirements in order to get the required licences.



Entities operating as branches today will require more competence – both legal and factual, and resources working under these circumstances. This will have a substantial impact on costs and reduce the economies of scale on group level.

In addition to this, the capital and liquidity planning of a company will be affected by the fact that the supervisory authorities in a third country will need for the branch under supervision to fulfil the solo capital demand both regarding volume and regarding composition. I.e. the capital and liquidity requirements must also be met locally. European financial institutions operating with branches in EFTA must therefore comply with requirements at group level *and* at solo level for all EFTA branches. This will lead to more complex liquidity and capital planning including increased buffers of liquidity and capital.



In fact, those branches that are subject to home supervision today, risk being subject to host supervision in the EFTA, subject to local rules, tomorrow. The differences this entails will be enhanced by a development where the EFTA states no longer are bound in following the development of financial legislation within the EU.

CONSEQUENCES FOR PROVISION OF CROSS BORDER SERVICES

A large number of businesses have notified Norwegian authorities of provision of cross border services.[1] The extent of this provision of services is not known, but is significant. Notably, this is the method for extending business in the internal market beyond the single point of entry. As such these practices go to the core of the functioning of the internal market. If the EFTA countries gradually turn into "third countries" these market participants' entrance into the Norwegian market will no longer be automatic – by notification.

WHAT TO DO?

The delay in solving the problem of inclusion of the ESA regulations in the EEA agreement has generated a large back-log of legislation pending. The CRD IV, Solvency II and EMIR directives presupposes the functioning of the ESAs. A vast number of EU legislative acts and the technical guidelines and standards connected to these are also part of this regulatory back-log. In order to implement the regulation a solution must be found creating a workable European supervisory model also in the EEA countries.

The EFTA partners to the EEA agreement have developed a model of enforcement that will cater to the issues evoked by the incompatibility of the ESAs right to enforce sanctions directly at individual (legal) persons in the three states respectively. A delay in negotiations and quality control of the solutions put forward is costly and must be avoided.

This is an issue for all Member States in the European Union that have companies that have utilised the inherent freedom to provide services by utilising the internal market passport by going cross border by means of a branch. In the Nordic market this clearly is an issue for Sweden, Denmark and Finland.

Other member states are also affected.

Finance Norway, together with the Banking Associations of the other two EEA/EFTA countries, urge the EU institutions to engage in a constructive dialogue in order to reach a workable solution to this problem. Finance Norway also underlines the urgency of finding a solution. The regulatory backlog is in fact the regulatory tidal wave that the EU institutions have developed for a stable, safe and well functioning internal market for financial service. The Norwegian financial sector wants to remain a part of that.

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[1] Some 400 credit institutions and more than 700 insurance companies have notified Norwegian supervisory authorities in order to be able to operate cross border without permanent establishment. Some 4500 institutions have notified of MiFid article 31 cross border activities of investment advice, and more than 500 payment institutions are also notified to the authorities.