

# **The Europeanization of British Financial Services**

By

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**ESRC Seminar Series / UACES Study Group on the Europeanization of British  
Politics and Policy-Making (EBPP)  
2<sup>nd</sup> May 2003**

**WORK IN PROGRESS: DRAFT**

## *Introduction*

In general this paper is concerned with issues relating to theoretical and empirical discussions regarding the conceptual nature of Europeanization and European integration. Through an analysis of British financial services in terms of banking, investment and insurance directives, the Financial Services Authority (FSA) and the Financial Services Action Plan (FSAP) the paper identifies both ‘situation’ and ‘process’ conceptualizations of Europeanization and illustrates its close links with the idea of European integration.

Initially, this paper provides a conceptualization of Europeanization and explains its relationship with European integration. Second, it provides an overview of changes to the British regulatory structure over the last 20 years. Third, the paper explains the role of interest group intermediation in the formulation of shared beliefs and preference up-loading to EU policy-making institutions. In this context, the paper identifies how the concept of a ‘competent authority’ was up-loaded to the EU and the how Britain interpreted the downloaded structure in the form of the FSA. In addition, the FSA is investigated in its role as a unitary ‘competent authority’ and its attempts at policy transfer in championing this model are explored. Indeed, this brings into question the differences between vertical and horizontal policy transfer and up-loading. Finally, an analysis of British financial services provides some insight into the affects of Europeanization and European integration on the sector, as well as the affects the sector has had on Europeanization and European integration. Through an analysis of British financial services the study is able to track elements of

European integration as well as up-loading and downloading examples of Europeanization.

### *Conceptualizing Europeanization and European Integration*

This paper understands Europeanization in the following way: Europeanization 1 (En1) entails downloading or top-down Europeanization and is based on conceptualizations forwarded by Buller and Gamble (2002), Dyson and Goetz (2002), George (2001) and Ladrech (1994). These commentators provide analysis of wider perspectives of Europeanization but emphasize En1 because of its clarity in terms of explanatory power. Europeanization 2 (En2) incorporates up-loading or bottom-up Europeanization and is based on conceptualizations indicated by Börzel (2002), Bulmer and Burch (2001), Dyson (1999) and Risse *et al* (2001). In most instances, these conceptualizations emphasize the creation of the EU policy-making structures, which border definitions of European integration, rather than the mechanism of domestic up-loading. This causes problems when it comes to identifying the differences between Europeanization and European integration.

Up-loading can either be seen on a macro level where governments formulate grand transformations in terms of the Single European Act (SEA), the Single European Market (SEM), Economic and Monetary Union (EMU) and Financial Services Action Plan (FSAP). Or it can be seen on a micro/meso level where other interests involve themselves in the process through interest groupings and networks. This paper accepts that governments outline their intention to compromise their positions in formulating macro decisions but argues that (especially in relation to the SEM) other actors work out the detail of compromise in the realization of regulatory structures. As this paper deals with financial services it concentrates on the latter form of up-loading and explains this in relation to European integration. Consequently, this conceptualization of Europeanization perceives institutional linkages in terms of governmental activity, interest group intermediation and network interaction and identifies these as the means by which preferences are up-loaded to the EU and impact on the development of political structures and EU legislation; whereas, examples of European integration incorporate the actual transformation of both the

EU political structure (changing political space) and legislation (evolving directives, regulations etc).

This approach was partly identified by Featherstone and Kazamias (2001) when they considered that domestic structures were not the passive recipients of EU impacts. “Domestic and EU institutional settings are intermeshed, with actors engaged in both vertical and horizontal networks and institutional linkages” (p 1). They emphasised changes brought about on domestic policy in terms of fit or misfit and how the member states deal with these. “Europeanization is assumed to be a two way process, between the domestic and the EU levels, involving both top-down and bottom-up pressures” (ibid, p 6). The success in negotiations between domestic actors at the EU level will determine the level of fit or misfit when it comes to policy implementation. The level of success regarding up-loading (En2) will determine the level of change in relation to downloading (En1). It could be argued that if there has been no misfit at the domestic level if change has failed to occur, Europeanization has not taken place. This is when it is important to investigate bottom-up processes of Europeanization and identify the levels of success in member state up-loading. If member states have lobbied effectively and had much of their perspective included in EU policy, misfit will be limited and consequent domestic change will be minimal. This does not mean that Europeanization has not taken place but that bottom-up Europeanization was effective and top-down Europeanization minimized.

Europeanization is conceptualized in the context of ‘situation’ in terms of downloading (En1) or up-loading (En2). Each of these conceptualizations allows situations where empirical reliability can be made explicit from a particular perspective. However, if the study is to ensure greater depth of understanding of the effects of Europeanization on the EU and member states an analysis needs to include both En1 and En2 and a move away from Europeanization as ‘situation’ toward ‘process’. Understanding is further developed when the ‘content’ of Europeanization is taken into consider. ‘Content’ includes issues like policy transfer, shared beliefs, institutional norms (accountability), informal rules (democracy), discourse (language used when discussing issues relating to the EU e.g. EMU) and identities (e.g. does the euro provide an EU identity?). (For further see Howell, 2002; 2003; Olsen, 2002 and Radaelli, 2000).

In addition to difficulties with Europeanization we also encounter conceptual problems regarding European integration. For instance, as noted above some conceptualizations of Europeanization and European integration seem to be identical and in most instances it is extremely difficult to distinguish between them. This paper argues that difference exists between Europeanization and European integration however, they do continuously interact with each other; for instance the development of the supranational level in the context of evolving institutions can be seen as European integration. Up-loading or En2 indicates the use of governments or sub-national interests in the development of European integration and the switch toward a new centre of policy-making.

Overall, the EU environment (or political space at the EU level) encompasses European integration; up-loading and downloading incorporate Europeanization. On the one hand, Europeanization can be seen as the source of change in relation to the EU level in terms of European integration and the development of supranationality. On the other hand, European integration can be seen as the source of change and Europeanization the outcome of change on member state governmental, legal and regulatory structures. Fundamentally, we have interactions between Europeanization and European integration in the construction and perpetuation of supranational institutions and development of EU and domestic policies and systems. Europeanization incorporates up-loading from the member states, which can be undertaken by government, interest groups, sectors or companies. At some point Europeanization becomes European integration (this is difficult to pinpoint because of the continual interaction between the two areas) this is where EU institutions develop legislation, which is eventually downloaded to member states. Indeed change is indicated through European directives and regulations which on the one hand are directly downloaded by the EU and on the other downloaded through domestic legislatures. In the latter case En1 provides the opportunity for greater interpretation and diversity throughout the EU. Through a study of financial services this paper illustrates these intricacies (for further on this conceptualization of Europeanization and European integration see Howell, 2002 and 2003).

*The Structure of the British Financial Services Sector*

Prior to the SEM British financial service regulatory structures were relatively liberal in relation to other EU member states with supervision based on self-regulation. Other member states had different regulatory structures that ranged from state-controlled sectors like Greece, Portugal and Italy; highly regulated sectors like Germany and France and more liberal sectors such as the Netherlands and Luxembourg (the British regulatory structure was in this category). Overall there were different regulatory structures throughout the EU in the 1980s. However, through the formulation of the SEM in financial services there was a general perception regarding levels of regulation in the EU. In the 1980s member states had different beliefs regarding supervision however, by the end of the 1990s there had been some convergence of these beliefs. Agreed legislation moved the regulatory structures away from self-regulation and state-control and identified a means by which shared beliefs could be concretized in the market structure (for further see Howell, 1999; 2000).

In the early 1980s the British industry was primarily supervised through the Department of Trade and Industry (DTI) with regulation revolving around solvency control, which relied on the principle of 'freedom with disclosure'. Following the Financial Services Act (1986), overall control moved to the Treasury but their involvement was limited and regulation was implemented through the Securities and Investment Board (SIB) and Self-Regulatory Organizations (SROs). There were four main SROs, which were answerable to SIB: the Securities and Futures Authority (SFA), the Investment Management Regulatory Organization (IMRO), the Life Assurance and Unit Trust Regulatory Organization (LAUTRO) and the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA). On top of this some functions of banks and building societies were regulated by SROs and others by the Bank of England and the Building Societies Commission respectively. Furthermore, Recognised Investment Exchanges (RIEs) were regulated by SIB and the Bank of England, Recognised Clearing Houses (RCHs) by SIB and professional firms by both Recognised Professional Bodies (RPBs) and SROs both of which were answerable to the SIB. In a practical context, this meant that independent advisers, for instance were regulated by the SFA, IMRO and FIMBRA; or unit trust management companies by the SFA, IMRO and LAUTRO, which caused confusion for the

consumer, company and regulator. The complicated structure and limited co-operation between regulators led to issues of under-regulation in terms of mis-selling and bad advice. Indeed for the sector itself the situation was problematic, for the consumer it was a minefield. There were attempts to clarify the process 1995 when LAUTRO and FIMBRA were merged into the Personal Investment Authority (PIA), however this did little to deal with the overlapping of competences regarding the supervision of the sector. The regulatory structure was supposed to ensure efficient expert regulation however, the problem was that although these bodies were independent in name they were closely tied to the financial services sector and may have been 'captured'? Indeed in an attempt to move away from self-regulation and the problems of capture a statutory independent authority was initiated in 1997; the Financial Services Authority (FSA).

### *Interest Group Intermediation and Up-loading*

This paper argues that EU institutions interact with interest groups extensively in legislation formulation. Interest groups will be defined as non-governmental organizations that attempt to have an influence on public policy. They are entities that provide an institutional linkage between sectors and government. More precisely they are "those types of organisations whose political task it is to reflect the interests of the economic or occupational sections they represent" (Lieber, 1974; p 29). Interest groups are described as "those organisations which are occupied ... in trying to influence the policy of public bodies in their own chosen direction ... European interest group ... are centrally organised associations of interest group ... each of which represents either a number of similar groupings or both national groupings and European industry committee groupings" (Kirchner, 1980; p 96). Interest groups upload sector preferences through the European Commission and Parliament; preferences that through European integration are eventually incorporated in policy-making mechanisms e.g. directives and downloaded to member states.

The SEA created an impetus for the use of interest groups. With Qualified Majority Voting (QMV) and the SEM programme, lobbying in Brussels became imperative.

European institutions (especially the Commission and the Parliament) “have developed a comprehensive network of contacts that cut across, and are independent of, member countries. Increasingly it is necessary for lobbying to be based on broad alliances representing a more European perspective. We might think of this process as Europeanization” (Andersen and Eliassen, 1991; p 174 author’s brackets). Through the use of European-wide interest groups and networks European institutions sector preferences are up-loaded into the European integration process or European political space. In this way we observe an interaction between Europeanization and European integration in the formulation of policy.

European-wide interest groups and supranational institutions make it impossible for one Member State to be purely self-interested. Domestic self-interest has become intermeshed with other member states; “national self-interest has partly become a collective European interest ... forty years of working together has resulted in collective outputs being produced and recognised by the parties involved” (Greenwood, 1995; p 2). If common interests are to exist then they must be based on a set of shared beliefs. The European Commission and Parliament consider that speaking to European organizations allows an understanding of European-wide interests or the shared beliefs of European sectors. Indeed, to ensure effective lobbying it is necessary to build coalitions. At the same time both the European Commission and the European Parliament stress that they want to speak to European-wide institutions because this provides shared beliefs and a European rather than domestic perspective. This may be made a little clearer through a study of financial services and the Third Life Assurance Directive in particular.

### *The Third Life Assurance Directive: Up-loading, Downloading and European Integration*

Most financial services companies are members of interest groups and use these to influence British policy-making. For instance, in a survey of British life insurance companies 100% of respondents subscribed to a national interest group and most of these were members of the Association of British Insurers (ABI) (Howell, 1999; 2000). Indeed, through their membership of the ABI they were automatically part of a European wide-interest group or the Comité Européen des Assurances CEA.

Insurance interest representation at the EU level is primarily undertaken by the CEA, which has operated throughout Europe since 1953. The institution existed before the creation of the EEC and this is reflected in its membership, which it is not made up of member states alone. “Nevertheless the single most important function of the organization is to work through its ‘Common Market Committee’, which is officially recognised by the EU and through which all insurance directives pass” (Vipond, 1995; p 105). This is reflected by the Commission, which considers itself as an organization that is always open to external input; input, which can be seen as up-loading and which Commissioners always welcome. The Commission has “a reputation for being accessible to interest groups (because) it is in the Commission’s own interest to do so since interest groups can provide the services with technical information and constructive advice” (OJ/C 63/02 author’s brackets).

Directorate-Generale XV (DG XV) considered the CEA to be the main representative of the insurance industry and was reinforced in a speech by Leon Brittan in 1989 “the CEA has proved its worth ... as a standard bearer for the insurance industry at the European level. I know that DG XV has come to rely greatly on the CEA and its officials ... as an organisation which is fully representative of the insurance industry, which puts your views and concerns to us frankly and powerfully and defends them tenaciously” (Sir Leon Brittan, speech given to the CEA November 1989; cited in Camerra-Rowe, 1996; p 18).

These sentiments were supported by a number of interviews undertaken by Howell (1999; 2000) and Camerra-Rowe (1996) in which a Commission official indicated, “they (the Commission) have almost institutionalised corporatist - like relations with the CEA” (p 18 author’s brackets). National interest groups up-load domestic preferences to the European interest group; European interest groups provide an environment in which different beliefs can be explored and developed into shared beliefs of the European sector (of course differences still remain but a consistent approach is reached). Shared beliefs are eventually compromised with those pursued by the EU for instance in interviews with DG XV representatives considered that they pursued ‘the spirit of the treaties’ in their negotiations with interest groupings (Howell, 2000). Through this process a regulatory structure is eventually agreed and downloaded through the EU and domestic structures. However, the level of

convergence throughout the EU will be tempered (especially with regard to directives) through domestic cultures and identities having an impact on interpretations of downloaded legislation. Overall, through interest intermediation common discourse can evolve which paves the way or provides the basis for vertical and horizontal policy transfer. Vertical policy transfer comes through EU policy or European integration processes. Horizontal policy transfer incorporates learning from and taking on other member state policies without EU involvement. One may argue that the latter does not incorporate En1 because change does not emanate through EU structures. However, there are problems with this distinction e.g. member states may learn from other member states who have themselves made changes because of vertical policy transfer. Through an analysis of the financial services sector in relation to up-loading, downloading and European integration the rest of this paper will deal with some of these issues.

#### *Up-loading Shared Beliefs*

Howell (1999; 2000) indicated that the ABI and CEA were highly involved in the creation of the Third Life Assurance Directive. The ABI forwarded a policy of self-regulation, which was partially taken up by the CEA and DG XV but eventually led to a more specific concept of ‘competent authority’ and a less liberal regulatory structure than the British life insurance industry would have preferred. However, in its proposal for a Third Life Assurance Directive, the European Commission made clear that “the internal market in insurance represented a primary goal ... in view of the importance of this strongly expanding sector”<sup>1</sup>. Howell (2000) argued that the insurance industry considered that it needed priority treatment because it lagged behind the liberalization of the other economic sectors within the financial services sector. Directives in the banking industry had already been implemented, and as a consequence the insurance industry had been left at a competitive disadvantage in relation to these (an example of up-loading (En2) to the EU policy-making institutions).

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<sup>1</sup> Com 91 57 final SYN 329 p 2

In the Third Life Assurance Directive this took the form of a more distinct and accessible ‘competent authority’ than that which existed in Britain. For instance the directive identified that the ‘competent authority’ should introduce appropriate safeguards to prevent “irregularities and infringements of the provisions of assurance supervision” (OJ 360; 10). Furthermore, the directive indicated that member states must have an institution capable of ensuring the “orderly pursuit of business by insurance undertakings” (ibid). Through the SEM, consumers should have wider choice; however, they must be provided with enough information to enable choices best suited to their needs. Such information is all the more important when the contract is of a long-term nature. Consequently the consumer should receive clear and accurate information regarding the ‘essential character of the products proposed’ (ibid; 23) and an accurately defined complaints procedure. Furthermore, the Second Banking Directive indicated that the ‘competent authority’ for credit institutions should provide authorization in terms of capital as well as sound prudent management (Art 5). Given the problems regarding mis-selling in the British financial services sector and difficulties regarding competencies in the regulatory structure these stipulations could not have been achieved by the structure that existed in the early 1990s and some change would be necessary if the directive was to be adhered to. The level of change and type of structure was at this point open to interpretation, which illustrated the diversity still apparent in applying directives. Indeed, member states pursued different models and diversity in relation to regulatory structure still exists today. However, in general there does seem to be a shift toward a single statutory regulator even though this is not universal.

The Third Life Assurance Directive identified what a regulated market should involve. It included regulations approved by the appropriate ‘competent authorities’, which should be empowered by national authorities to supervise insurance undertakings. Furthermore, the ‘competent authorities’ may also restrict authorization of both companies and products (Art 4). So when the FSA gives authorization for classes of insurance or companies it is valid for the entire EU (except in the context of general good). ‘Competent authorities’ encompass member state authorities that are statutorily empowered to supervise insurance undertakings and are able to grant and withhold authorization. The ‘competent authority’ should ensure minimum

guarantees and that reputable individuals control and administer companies. It should also carry out verification and authorization of a company's ability to trade in other member states (this may be accomplished with the assistance of the member state authority in which the company trades) (Arts 5 and 9). However the "financial supervision of an assurance undertakings ... shall be the sole responsibility of the home member state. If the 'competent authorities' of the member state of the commitment have reason to consider that the activities of an assurance undertaking might affect its financial soundness, they should inform the competent authorities of the home member state. The latter authorities shall determine whether the undertaking is complying with the prudential principles laid down in this Directive" (Art 8, Para 1). Supervision incorporates levels of solvency, and technical provisions, both mathematical and assets covering these provisions in relation to regulations indicated by the member state based on principles outlined in the directive. Overall the "competent authorities ... shall require every assurance undertaking to have sound administrative and accounting procedures and adequate internal control mechanisms" (Art 8, Para 3).

Each member state will need to ensure that its competent authority is able to carry out the supervision of companies with head offices in their territories, which includes business in other member states. The competent authority must have the powers to ensure that council directives are implemented. In a practical context, this means the ability to investigate an undertaking in terms of all of its business on the spot and insist on documentation being made available. The competent authority also needs to ensure consumer protection in all member states and have the means of enforcement at its disposal. It may also make provision for the "competent authorities to obtain any information regarding contracts which are held by intermediaries" (Art 10, Para C).

During the formulation of the Third Life Assurance Directive, the British life insurance industry was involved in successful up-loading and many parts of it could have been met by the Personal Investment Authority (PIA) and other existing British regulatory structures. However, considering the tasks necessary to supervise cross-border, and the model of an independent central bank, a single statutory supervisory institution best fitted the bill. These issues outlined in the directive would be better

served by a single institution and identified an element of misfit for the UK structure (McGee and Heusel, 1995; p 85). Even though up-loading was successful downloading necessitated institutional change. As noted above, along with other member states Germany has also moved toward a single regulator, a model that seems to provide best fit for EU legislation regarding financial services in general. However, following the adoption of a single statutory regulator the FSA has been outlining the benefits of this model throughout the EU, which illustrates some of the problems relating to policy transfer e.g. do German changes to their regulatory structure incorporate vertical or horizontal policy transfer? Has Germany learned from other member states or has such a convergence been brought about through EU legislation?

Of course, one may argue that national variables and globalization, rather than Europeanization, were the impetus behind the creation of the FSA as competent authority. For instance problems with the British system had already been realised following shortcomings regarding the mis-selling of pensions, the Maxwell affair, company and banking collapses e.g. Barings and Bank of Credit and Commerce International (BCCI) and endowment mortgage mis-selling. However, this paper argues that even though these variables existed, regulation needed to be brought in line with the rest of the EU and En2 or downloading provided a platform for uploading British preferences to the EU e.g. the FSA identifying models for future EU market and supervisory structures (this is discussed below in the section the FSA as Up-loader).

#### *The FSA as downloaded 'Competent Authority'*

As outlined in the directives, as a 'competent authority' the FSA aims to promote public understanding and maintain confidence in the financial system. This may be achieved through ensuring the right balance of consumer protection in terms of vetting entry to the market and helping to reduce financial crime. The FSA aims to ensure these objectives in an efficient and responsible manner with a balance between the burden to the firm and the benefits to the consumer. Protection should be balanced to ensure innovation and competition between companies. This in turn will ensure competitive UK financial services in the international environment. The PIA dealt with many of these issues, but failed to deal with some fundamental problems with

the industry in terms of poor intermediaries, commission and expertise (ibid). Indeed, through authorization (outlined in the directives) the FSA is dealing with these issues as well as consolidating financial services supervision. In this context we are locating examples of downloading through En1 and the differentiation between fit and misfit in terms of insurance regulation.

As noted in the directive, to ensure consumer confidence the FSA provides authorization of companies as having adequate resources, and fit and proper individuals in management. It also aims to ensure fair treatment at the point of sale and in the context of on-going information e.g. performance indicators. Overall, the FSA investigates unauthorized activities and where necessary fairness in marketing and advertising. It is also dealing with mortgage endowment policies and issues of redress. These could be noted as examples of En1, however; the European Bureau of Consumers Union (EBUC) argued that there is limited access to the SEM because of diverse consumer protection rules. Consumers purchasing policies through insurance companies from other member states will not know under whose jurisdiction the contract resided and will not have adequate protection (McGee and Heusel, 1995). The membership of BEUC (member state consumer groups) up-loads (En2) these concerns to the EU through the pressure group and promotes the harmonization of insurance contract law.

Through En1, the FSA has recently taken on further duties. Following the Insurance Mediation Directive responsibility is being downloaded for the regulation of sales of insurance products, including home and car policies. Additional responsibilities include the regulation of mutual societies, unfair terms in financial services contracts, Lloyd's insurance market, market abuse and applications and supervision of overseas investment exchanges. This relies on the effective supervision of investment exchanges and financial services in other states or effective downloading throughout the EU. Of course, different cultural models will identify different interpretations of the directives and this leads to diversification in the EU. As noted above, even though up-loading and European integration provide unification, the downloading procedures allow flexibility of interpretation and consequent diversity.

### *Vertical or Horizontal Policy Transfer: FSA as Up-loader?*

Since its inception FSA representatives have argued at many EU conferences and symposia for the completion of the SEM in financial services and a specific form of regulatory structure. In some instances this may be seen as an attempt at up-loading or vertical or horizontal policy transfer. In this way the FSA could be seen as attempting to transfer policy outcomes of downloading regarding a specific model of regulation and the future of financial services in the EU. As an outcome of En1, En2 and European integration the downloaded structure or FSA has become part of the process and transfers policy preferences throughout the EU (this could be seen as up-loading but this may involve ‘conceptual stretching’), which through European integration procedures become part of En1 or downloading. It is difficult to determine whether the model the FSA forwards and the means by which this is achieved incorporates vertical policy transfer, horizontal policy transfer or up-loading. As an outcome of En1 the FSA could be seen as proposing EU stipulations and actions as vertical policy transfer. However, Britain has interpreted financial services directives and the stipulations regarding a competent authority in a specific way. Indeed the FSA could be seen as attempting to convince other member states of the superiority of the British interpretation and consequent model and in this context its actions may encapsulate horizontal policy transfer.

For example, Howard Davies (the head of the FSA) (2000a) argued that formal and informal barriers to cross-border trade still existed and further changes were still needed. He considered that to deal with the situation, a couple of issues were paramount: that the process of legislation needed to be speeded up; and the network of EU regulators needed to be strengthened and the regulators themselves given more teeth to become more effective. Davies (2000) also argues that regulatory structures needed to be developed in response to changing markets at the national, European and international levels. Financial markets are not confined by national boundaries, especially in the context of the EU. In fact he argued that the EU needed to interact with the international community and be attractive to external capital and that regulation was not the only barrier to cross-border trade because cultural differences also existed. However, primarily Davies argued that regulatory complexity should be simplified because even though co-operation between regulators existed the

complexity exacerbated these relationships. Fundamentally he thought that considering the change in the industry, regulators should work toward greater convergence.

Furthermore Davies (2000a) did not propose a single regulator for securities or banking because he thought this would be premature given the diversity regarding regulation and cultural interpretation in separate member states. He thought that, “without harmonized regulation, or the ability to enforce its regulations, a pan-European securities regulator would be ineffective” (ibid, p 3). This does suggest that if regulation was harmonized, and a pan-European regulator was able to enforce its regulations, then such a construct would be effective. However, there would also be accountability problems concerning the European Parliament, European Commission and member state governments, as well as a contradiction with the principle of subsidiarity.

Howard Davies thought similar arguments applied to banking, and that as with most sectors in the EU, supervision should be enforced through regulatory networks under a common legislative framework (ibid). For instance the Brouwer report (1999) considered that EU banking supervision was adequate and would remain so as long as regulatory networks were enhanced (see Davies, 2000 and 2000a). These are further examples of the FSA not only acting as a regulator in terms of downloading but because of a concern for the regulatory structure emerging in the EU, it transfers its own perception of acceptable future scenarios and developments. In part the FSA is an example of downloading from the EU. Of course, (as identified by other member states) it did not need to take this form but the structure does allow it to deal with stipulations outlined by directives in an efficient and effective manner. If cross-border trade in financial services was to be realized through home country control member states were obliged to ensure clear lines of demarcation when it came to regulatory structures and the FSA provides this in Britain. However, the FSA also provides an example of policy transfer whereby it is involved in discussions regarding inputs to EU legislation and activities relating to European integration (which could border on up-loading).

*The Financial Services Action Plan (FSAP): Up-loading, European Integration and Downloading*

The FSA considered that if an SEM in financial services was to be brought into existence, a number of trade-offs needed to be realized; for instance what should be the balance between competition, innovation and consumer protection? If regulation drives business offshore it may negate consumer benefit. To what extent should market integrity be promoted even though it has costs for borrowers and lenders? Of course, the answers to these questions would be different for individual member states and depend on the sophistication of individual financial systems and emphasises that member states will implement different interpretations of EU policy. However, implementation should be in line with the parameters of EU policy. Some member states have been failing to implement or approve laws in financial services and such considerations motivated the British government to support claims by the European Commission that it needed more powers to force rogue member states to implement EU policy. Without these powers, the Commission argued that the SEM would miss its target and fail to become the most competitive economy in the world by 2010 (Financial Times, 2003; p 8). Indeed, if Brussels were provided with more powers to enforce EU policy implementation, downloading and up-loading would intensify and diversity would be limited.

Many of the concerns outlined by the FSA were, through European integration procedures, eventually outlined in the FSAP. In such a way attempts at policy transfer regarding the structure of the SEM have been taken up in areas of macro up-loading. Indeed, it may be argued that the FSA has become a form of up-loader, however the mechanisms of this have not yet been investigated in enough detail. The FSAP identified five main areas where action was necessary to further facilitate the construction of a single market in financial services. These were: an improved legislative apparatus, elimination of capital market fragmentation, consumer protection within a single market, supervisory co-ordination, and an integrated infrastructure to underpin financial transactions. At the European Council meeting in Cardiff (1998) the European Commission was invited to prepare a framework for

action for financial services. The European Commission (1998) concentrated on a number of main concerns regarding the European financial services market. These included, deep and liquid capital markets, which improve services to both issuers and investors, and the removal of continuing barriers to retail financial services. This would ensure more consumer choice, while at the same time cultivating consumer confidence and protection. Further concerns revolved around the need for co-operation amongst supervisors and an integrated EU infrastructure. Finally, it argued for the streamlining and clarification of the EU legislative apparatus and process. This provides an example of macro up-loading with member states sharing a set of beliefs concerning efficiency, choice and effective regulation in the formulation of the SEM. As the FSA is a new institution whether it has extended its role in terms of policy transfer to that of macro or micro up-loading is unclear. Such will necessitate further investigation.

The main objective of the FSAP was to emphasise mutual recognition over harmonization, supervisory institutions needed to collaborate further in the pursuit of general conditions for an efficient EU financial market. The plan was endorsed at the Cologne European Council in 1999 and was followed by a more detailed strategy in March 2002 at the Lisbon European Council. The Lisbon Council indicated a completion date of 2005 and a number of short/medium term priorities: these included access to investment capital and a review of the Investment Services Directive (ISD), a single passport for issuers, co-operations between regulators and cross-border comparatives of financial statements.

In a speech Romano Prodi, the President of the European Commission, argued that, “implementation of the FSAP must not be allowed to falter or fail”. He considered that such failure would impact on the EU strategy for “sustainable growth, competitiveness, stability, employment and innovation” (cited in European Commission, 2002; p 1). In this context, the FSAP is a means by which EU policy preferences (brought about through European integration) can be formulated into directives and downloaded to member states. It is doing this by working with other member states to implement the FSAP by creating a single EU capital market through a modernized EU legislative framework, e.g. prospectus and accounting legislation, the development of open retail markets and a re-assessment of prudential supervision.

Overall, each part of the ‘process’ may be broken down into ‘situations’, but is best understood as a ‘process’ because each constituent part overlaps so full understanding necessitates comprehension of each situation in relation to the process as a whole. The FSAP is made up of elements relating to macro up-loading, European integration and (following involvement from the financial services sector in the form of micro up-loading) downloading.

### *Downloading Directives: Constructing a SEM in Financial Services*

George (2001) argued that downloading or En1 was the clearest example of Europeanization. This may be observed in the financial services sector in the context of two co-ordination directives that have primarily affected the European banking industry. The First Banking Directive (77/780/EEC) cleared many obstacles to the freedom of establishment for banks and other credit institutions, introduced home country supervision (supervision by domestic regulators) and a common position for the granting of banking licences. However, problems were still apparent and certain obstacles needed to be removed before a genuine single market in banking could be achieved. Indeed, member states lobbied for further integration through up-loading or En2 and established further directives in the quest for a single market in financial services. The Second Banking Directive (89/646/EEC) aimed for the removal of authorization problems e.g. differentials in supervisory rules and structures and definitions of banking activities and cross-border trade. It enabled a single banking licence; a list of banking activities and minimum capital levels (5m ECU, now euros, laid down for new banks). The directive also provided supervisory rules in terms of internal management, audit systems and control levels of major shareholders. Furthermore, once banks could trade cross-border other credit institutions lobbied for a level playing field in financial services. This illustrates a loop back in the process with downloading in one industry bringing about up-loading in another.

For instance following the banking directives the directive on Investment Firms and Credit Institutions (CAD) provided the framework for the Investment Services Directive (ISD) (93/22/EEC) both directives attempted to create an internal market in

investment services and give all institutions, whether credit or investment firms, the ability to offer investment services throughout the EU.

In the UK the First Non-Life Insurance Directive (1973) was downloaded through the Consolidated Insurance Companies Act (1974) and the First Life Assurance Directive (1979) through the Insurance Companies Act (1982). The Second and Third generations of insurance/assurance directives were downloaded through the Insurance Companies Act (1994) and along with aspects of the Second Banking Directive (1989) through the Financial Services and Marketing Act (FSMA) (2000). However, problems still exist in terms of insurance, banking and securities and capital markets and further up-loading (En2), downloading (En1) and European integration is still apparent and ongoing in the financial services sector.

In other parts of the sector the interaction between En1, En2 and European integration took place regarding the formulation and implementation of the Co-Insurance Directive (78/473/EEC), the Credit and Surety ship Assurance Directive amending Directive (87/343/EEC), and the Legal Expenses Directive (87/344/EEC). Later, more specific, directives include the Council Directive on the Annual Accounts and Consolidated Accounts of Insurance Undertakings (AACAIU) (91/674/EEC) and the Council Directive setting up an Insurance Committee (IC) (91/675/EEC). The IC (the membership is made up of experts regarding insurance from the private and public sectors throughout the EU) examines questions relating to the application of existing directives and the preparation of new legislation proposals in the insurance sector. Indeed, the IC provides a forum for up-loaded preferences to be discussed on a technical level and like the BAC, indicates the close proximity and blurred edges between En2 and European integration.

The AACAIU proposed the harmonization of EU insurance accounting practices, which was necessary if valuation and solvency indicators were to be uniform, again this provides an illustration of downloading. Also under discussion during the early nineties was the proposal for a Council directive on the co-ordination of laws, regulations and administrative provisions relating to insurance contracts. This was discontinued in 1993 following a tentative compromise reached through the idea of the general good. This is where member states can protect domestic consumers

through barring certain products from their territories. Initially, one might argue that in this context En2 and European integration were unsuccessful because the EU was unable to bring about convergence through agreement between member states. However, general good involves four stringent tests, which incorporate: public interest test = public interest reasons that justify restrictions, duplication test = public interest is not protected in member state where providers are established, non-discriminatory test = applies to all, and the proportionality test = the same result cannot be obtained from less restrictive regulation. General good intends to provide balance between public interest of consumers in individual member states and the creation of a SEM in insurance. Fundamentally, to ensure the judicial application of these tests clear demarcations regarding competent authorities and their responsibilities are necessary in all member states.

Insurance directives only partially regulate cross-border activity, and at the same time as we witness En2 and European integration through three generations of directives, paradoxically we also see diversity of interpretation through member state regulation or En1. As noted, general good also identified the necessity of clear demarcation regarding 'competent authorities' throughout the EU. The directives indicate that 'competent authorities' should regulate financial services products and activities and ensure consumer protection. As member states must allow financial service companies supervised by other 'competent authorities' to trade in their territories, and interpret 'general good', there needs to be a high level of clarity and confidence regarding regulatory institutions. As recognition between 'competent authorities' evolve, 'general good' becomes less necessary. As confidence between member state regulators emerges there will be little need to evoke what could be seen as a barrier to trade. Furthermore, the implementation of the EC Unfair Contract Terms Directive in 1993 reduced the extent that insurance contracts could be used as NTBs. However, member states find difficulty in reaching a compromise in these areas because of sovereignty, identity and cultural issues.

### *Conclusions*

This paper attempts to overcome a number of problems relating to conceptualizations of Europeanization and the difference between Europeanization and European

integration. Europeanization can be understood from an En1 (top-down) or an En2 (bottom-up) perspective. European integration comprises the environment on which Europeanization impacts or from which it emanates. However, it is more complicated than this, with interaction between the two areas merging into one another for different lengths of time and with differing levels of intensity. This means that at different times the emphasis on Europeanization will either be based around mechanisms of change in terms of up-loading from the domestic to the EU level, or downloading from the EU to the domestic level. The success of the member state in terms of up-loading will have implications when it comes to downloading in respect of impacts and change on the domestic environment. The success in up-loading will affect misfit and consequently have an impact on downloading in the context of fit. One may argue that this is why in most instances both En1 and En2 need to be brought into the equation.

In the context of financial services there is up-loading and downloading as well as European integration in the formulation of directives and the regulatory structure. However, when these separate parts of the process are identified it is difficult to break them down as each 'situation' overlaps the other. Furthermore, 'content' in the form of shared beliefs and policy transfer may also be observed. This may be seen clearly when we look at the Third Life Assurance Directive, 'competent authorities', the FSA, and the FSAP. The FSAP indicated that a SEM in financial services had been under construction since 1973. Following the shared belief between member states that a SEM was necessary, domestic and European interest groups up-loaded preferences to EU policy-making institutions, which through European integration processes formulated legislation that was then downloaded to member states. Furthermore, believing the drive toward a single market in financial services had faltered there was further macro uploading of shared beliefs by member state governments and through this up-loading and European integration processes the FSAP was formulated (in this way we observe an interaction between macro up-loading and European integration). The implementation of the FSAP then builds on previous attempts to provide a SEM in financial services, which involves the utilization of micro up-loading in the creation of rules and regulations for downloading (this is achieved through the realization of shared beliefs at the micro level). In this context, we can observe the formulation of directives (through micro

up-loading and European integration) in banking, insurance and capital markets. These directives and regulations are then downloaded to member states where different interpretations of policies are implemented. Unification does take place but paradoxically there is room for cultural diversity.

In terms of the 'competent authority', downloaded through the directives, Britain adopted the single regulator model of the FSA. This has since developed its role and begun to take an active part in policy transfer throughout the EU, which involved some interaction with European integration, however it remains to be seen whether the FSA will become a full time active up-loader. Europeanization is made up of En1 and En2, which incorporate the outcomes and in-puts of European integration, as well as the interaction between these 'situations' through 'content' fit/misfit and impacts.

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