

THE INTEGRATION OF EUROPEAN FINANCIAL MARKETS: WHAT
CHALLENGES AHEAD?

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Monetary Committee

I am pleased to intervene during this CESR meeting, as Chairwoman of the Economic and Monetary Committee of the European Parliament. Let me give you some thoughts, based on my experience as a member of the EP, on the evolution of financial legislation in Europe and the corresponding integration of financial markets. Let me recall that the European Parliament is closely involved in this evolution as part of the co-decision process.

1- The evolution of financial markets integration

1.1- First, I would like to give a brief overview of the integration of financial markets.

Important point for a MEP: the integration of financial markets is not an end in itself. What we want is to promote a better functioning of financial markets in order to improve the allocation of resources, for growth and employment: let us never forget that, beyond often very technical challenges, the place of people in the economic system should be at the center of our concerns. That's a core objective we must always keep in mind.

In that respect, the European Parliament has a specific role to play. Beyond the defence of peculiar interest, it is, like the Commission, an institution where discussions should take into account the global framework. What should be the optimal architecture of the European financial market in order to improve the financing of the European economy? That's how I conceive the role of the Committee I've the honour to chair; I mean to reach a balanced agreement, acceptable for all. Bearing that in mind we should also try to improve the quality of the ongoing discussions on the review of the Lisbon strategy. In his report, Mr Kok mentions the need to complete the harmonisation of financial markets. Looking forward I think that we should get a more integrated approach : the core issue is not the integration of financial markets in itself, but how to finance an overall strategy to improve the competitiveness and the employment situation in the European economy, taking into account globalised trends towards outsourcing.

I think that we will all agree that the Euro not only eased but also justified financial integration: it put exchange risk in European cross-border transactions to an end and helped the Monetary Union fully benefit from the effects of financial markets opening at the international level.

This integration was based on a voluntary approach from the Commission, the Council and the Parliament, which was mirrored in the Financial Services Action Plan adopted in 1999 in order to complete the internal market of financial services. In this field of regulated markets,

harmonisation is much more complex than in the field of goods. That's why the European Parliament accepted the implementation of an innovative legislative procedure in the area of securities, I mean the Lamfalussy process in which CESR plays a key role. Up to now, thirty-nine legislative or non-legislative measures were adopted out of the forty-two originally scheduled: this result shows undoubtedly the huge amount of work done in that respect. You have noticed, furthermore, that despite the turmoil of financial markets and the downside trend of the stock markets over the last four years, the parties involved remain firmly committed to maintaining an ambitious program and sticking to it.

The FSAP was assigned a demanding objective: the definition of general principles for the functioning of markets and the promotion of financial services in Europe as well as the improvement of the prudential framework. In that respect, it would be difficult to mention all adopted measures in the context of the FSAP: let me just refer to the texts which are to change significantly the financial services landscape in Europe and on which the European Parliament as legislator was directly involved.

- the directive on market abuse adopted in December 2002,
- the directive on prospectus, adopted in July 2003,
- the investment services directive now called MIFID, adopted in April 2004;
- the directive on transparency, agreed upon in April 2004 ;

Finally, I'll just add that important issues are still being discussed, such as the Capital Adequacy requirements (Basel II). This is quite a list!

1.2- What for the future of the FSAP?

1.2.1 the follow up of the Lamfalussy procedure

It is obviously too early to try to draw conclusions on the impact of all the texts I mentioned: in that respect, I would like to stress that it is up to Member States to incorporate them now into national legislation: the implementation of these measures will in any case have a considerable impact for European financial markets in a near future.

However, it seems that "prior to any other concern" the convergence of national supervisory practices, the proper enforcement and the reinforcement of cooperation between supervisory authorities in all aspects, will be the key issues to the success of the FSAP to ensure that the emerging system of EU regulation works to the satisfaction of businesses and eventually to achieve an integrated market. This is going to be one of the main challenges faced by European regulators and CESR over the coming years. Your task is huge and on some aspect we have been too ambitious when we understand that the deadline we have settled for the MIFID directive will not be respected. We will also look very carefully to the proposal you will make concerning the revision of the UCITS directive.

Nevertheless, I would like to thank CESR for its contribution to this debate by issuing at the end of October an relevant and forward looking report on "which supervisory tools for the EU securities markets", already known as the Himalaya report.

The proper functioning of level 3 is a key element of this integration and one of the prerequisites is an efficient cooperation and convergence of approach (which is not easy to

the extent that regulators might have differing competences and different views regarding the investor protection) between supervisory authorities. Beyond level 3, cooperative arrangements between supervisory authorities also need to be set up.

In addition it seems clear that all supervisory authorities must enjoy the same or equivalent powers (in all aspects including supervision but also investigation, sanction, and exchange of information), especially with regard to the concept of mutual recognition where the host and home authorities' links will be intensified. Finally, there must be a mutual trust between regulators: how can a host competent authority accept mutual recognition if it is not sure (or does not trust) that the appropriate controls have been put into place by the home authority? In this step by step process, the CESR contribution is important: should we and how should we move towards a capacity for CESR to take European decisions? It is an issue that has already been discussed within different bodies: for example some have proposed a European regulator during the discussions in the Convention on the future of Europe. It was proposed as a global and unique body supervising securities, banking and insurance. But because we are in an on-going process maybe should we favour a more pragmatic approach where CESR has the key role to play.

It seems important that the Commission, with the involvement of the Council and the European Parliament, periodically assesses the proper or improper functioning of this cooperation between regulators as well as the role of CESR in that respect and suggests some responses to the potential failures. In any case we should bear in mind that the main objective is to provide market players (investors or issuers) with regulatory and supervisory decisions that are broadly consistent irrespective of the Member State where this offer is made.

The ECON will consider this Himalaya report with great consideration when it will start its work on the post-FSAP. The next step will be the hearing of our experts on the 19th of January. The questions we already have in mind are related first to the opportunity to conduct a full and public impact study on current FSAP, second on consultation of all interested parties. We need to improve the political accountability of financial services legislation and regulation in the European Union also by instauring a dialogue with associations representing the financial but also the user and the consumer sectors.

1.2.2 Areas where an action might be necessary

Finally I would like to stress what could be the "framework" of the next FSAP.

You all know that the Commission already decided on an evaluation process to assess the situation of financial market integration in the EU in the context of the adoption of FSAP measures. We reached a point where we have to decide what to do: we can look backward with satisfaction and contemplate what we did or look ahead and decide to go further. Of course, I personally prefer the second approach: of course, we have to implement fully this impressive catalogue of measures already adopted but I am deeply convinced that there is still a long way to go. Let me just mention some points:

Obstacles remain in the field of financial markets and those obstacles, which hamper a satisfactory functioning of the market, require further legislative measures. Measures will have to concentrate on clear and precise objectives in order not to overcomplicate matters for the market. Some of them concern the environment of financial market and will not depend on the Lamfalussy procedure ; I am referring to the issues of tax barriers as well as legal, administrative and imperfect information obstacles.

You know that the link between the Union and citizens is of great concern to all members of Parliament. In that respect, much progress was achieved in the area of European markets and wholesale markets but national retail markets remain rather segmented and, finally, you will agree that consumers benefits maybe not as much as we could have thought from financial market integration. Maybe we should work toward further harmonisation in the field of payments systems or credit to the public (consumer credit, insurance products or mortgage). But there we have to think how best to deliver taking into account the failure of the first attempt to have a text on consumer credit. We may want to have a European regime in addition to national one's when it comes to cross-borders products.

There is another domain in which progress is needed: I mean post market activities. The Giovannini reports shed light on the fragmentation of markets at the European level and on all the obstacles that prevented the clearing-settlement system to function in a satisfactory way. It is a core issue indeed and after the Andria report we adopted last year we expect Commission proposals. It should not be forgotten that the current configuration leads to unequal access, excessive costs and inefficiency, but also raises concerns for risk spreading and financial stability at the European level.

In other sectors the opening of markets was based on the splitting of functions e.g. the railway sector where the infrastructure and transport functions were split leading to separated legal entities. All thing being equal, I think that the same principle should apply when thinking on the functioning of the post-market: this issue will be of high importance for my committee during the current legislature and I understand that if such a decision should be made concerning clearing and settlement it is up to the legislator to do it.

2- Enhancing the transparency and democratic accountability

Now I would like to raise some recent questions relating to the democratic accountability

In the light of recent events, a reflection should take place to consider how to improve the democratic accountability of a system in which the genesis of European Union financial services is more and more often in "external organisations" (i.e. not linked to the European Community).

The most recent and appropriate specific example we all have in mind is the process of adoption of the International Accounting Standards by the European Commission.

Can we, and under which conditions, delegate to an external body the elaboration of European standards?

My purpose is not to heap opprobrium on the IASB, but to use it as an example of potential democratic accountability loopholes and to elaborate some potential solutions in that respect.

Initially, the delegation of power to define these standards appeared to be logical to the extent that international accounting standards were supposed to be only technical measures, that the Commission was not (and did not want to become) an accounting standard setter and that European harmonisation appeared to be too difficult a task.

However, during this process of elaboration of IAS, some questions have been raised:

- What do technical measures mean?

(this question is also relevant for the level 1 and 2 of the Lamfalussy procedure)

In this particular situation, can we consider as strictly technical, the implementation of the fair market value, which can substantially modify the way in which financial information is produced and which potentially impacts some areas of economic activity?

It seems that the fair market value principle goes far beyond "technical measures" and should have been considered as a fundamental principle potentially involving a political choice. Therefore it should not have been "left" to an external organisation without any control. This why the ECON supported the Commission proposal to postpone the full enforcement of IAS 32 and 39.

Accordingly, the objective of narrowing the gap between the IAS and US GAAP could also be considered as a fundamental decision rather than a purely technical consideration.

The purpose is not discussed here whether the option chosen by the IASB is or not the appropriate one. But I want to emphasise the lack of democratic control regarding such a choice (especially in comparison with the Lamfalussy process where fundamental orientations are decided at level 1 under the codecision procedure).

- Is there a lack of democratic accountability?

The central question is how to implement an efficient democratic control and accountability as well as a better transparency regarding these external organisations, their decisions and objectives? Should European institutions be more involved, to what extent and how?

As an example, out of the 14 Board members of the International Accounting Standards Board, 2 are professors, 6 are (or used to be) auditors, 3 have been directly or indirectly linked to the US Financial Accounting Standards Board and only 3 work for a corporation (two Europeans, but one of them has been in charge of implementing the US GAAP for its corporation).

I do not contest the integrity of the board members, but does the composition of the board reflect fairly all market players?

The IASB is a non-profit organisation which can work thank to donors (indirectly). A more limited amount of funds is obtained from the sale of the IASB's publications and materials. As a result it might also be necessary to consider any "potential conflict of interest" resulting from this situation.

In any case it seems important to consider any tools which could lead to better organisation governance as well as to a more transparent decision procedure.

The IASB could respond that the IAS will not only apply to European corporations but also to Russian, Australian corporation and so on (actually 91 countries might apply the IAS,

including emerging countries). Therefore why should the European Community be subject to special considerations? In addition, the European community has deliberately chosen the IASB for the purpose of establishing European accounting standards.

It is true; however, it is also true that the implementation by more than 7000 European corporations of such standards will probably be a major step towards their international recognition and implementation and in that respect the European Commission representative should be subject to special considerations. In reality these standards will exist through their enforcement at the European level.

The International Accounting Standards methodology of adoption is not an isolated case: the existing framework of the 8th directive proposal, concerning the adoption of a common audit report for financial statements has been prepared on a similar basis.

As a result we could face similar questions in the near future and it seems urgent to, at least, set up an interinstitutional working group to consider this question. The European Parliament could also launch an initiative report on this subject

In conclusion, although the Lamfalussy procedure is a success, I would like to draw your attention on two points. First one is to remind you one of its main inconsistencies : the absence of the European Parliament right of call back regarding the level 2 implementing measures while the Commission granted this to the Council.

To the extent that the European Parliament is co-legislator and to allow the European Parliament to ensure its role and political responsibility properly, this unjustified situation must be solved as soon as possible and I really expect your support in that respect.

The second conclusion is about democracy. As you know there has been a great concern in the ECON after the ECB's and CESR's endorsement standards related to clearing and settlement. Many members fear that the work of the legislators would therefore be over determined. I think it is our mutual interest to avoid any misunderstanding of the role of each part and to have a great transparency around your agenda. Because of this, I believe it is vital for the future that CESR appears as an accountable body. This is why I will make sure that we meet on a regular basis. Mr Arthur Docters van Leeuwen was already in our Committee on the 6th of October. This is also why I have proposed to organise a visit of a delegation of my committee in Paris early next year and would be happy if we could held a working session with CESR on this occasion.

Thank you for your attention.