FINAL

FINAL REPORT

OF

THE COMMITTEE OF WISE MEN

ON

THE REGULATION OF EUROPEAN SECURITIES MARKETS

Brussels, 15 February 2001

THE COMMITTEE OF WISE MEN

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PREAMBLE

The Committee's final report based on ECOFIN mandate

This document constitutes the Committee of Wise Men's final report on the Regulation of European Securities Markets in accordance with the Committee's terms of reference which were defined by the European Union's Economic and Finance Ministers (ECOFIN[*]) on 17 July 2000.

ECOFIN (26/27November 2000) requested the Committee to refine regulatory proposals and produce operational recommendations for Stockholm European Council 23/24 March 2001

It is presented in the context of the ECOFIN's Conclusions of 26/27 November 2000 (see Annex 1) which requested that the Committee's final report be ready by the middle of February 2001. ECOFIN Ministers particularly emphasized that the final report should refine the regulatory proposals in the Committee's initial report, taking fully into account the institutional balance in the Treaty and the role of national regulators. Operational recommendations were requested. These Conclusions also stated that the ECOFIN Council would examine the Committee's final recommendations at the beginning of March, in order for measures to be taken at the Stockholm European Council of Heads of State and Government on 23/24 March 2001. The ECOFIN Council also requested that discussions should advance with the European Parliament.

Broad agreement on Committee's initial findings at Nice European Council

The Nice European Council in December 2000 (see Annex 1) also gave its broad agreement to the findings in the Committee's initial report and confirmed the invitation to the Council of Ministers and the European Commission to report back at the Stockholm European Council on the basis of the Committee's final report.

Acknowledgements

The Chairman of the Committee of Wise Men, Alexandre Lamfalussy, and members of the Committee would like to thank once again the French and Swedish Presidencies of the European Union; the President of the European Commission, Romano Prodi; European Commissioners Frits Bolkestein and Mario Monti; the Chairperson of the European Parliament's Economic and Monetary Affairs Committee, Christa Randzio-Plath, and the members of this Committee; the Director General of the European Commission's Internal Market Directorate General, John Mogg; the Director General of the Commission's Legal Service, Jean-Louis Dewost; the Jurisconsulte of the Council, Jean-Claude Piris; the Chairman of FESCO (the Forum of European Securities Commissions), Georg Wittich; Members of FESCO, and the Secretary General of FESCO, Fabrice Demarigny, for their invaluable assistance and cooperation.

The Committee again thanks all those who have taken part in its

[*] A list of abbreviations can be found in Annex.

hearings and those organizations and individuals who responded to its original questionnaire and more recently to the initial report. The scale of interest in the Committee's work has enriched its reflections.

Finally, the Committee would like to thank the Rapporteur, David Wright, and the Secretary of the Committee, Pierre Delsaux, and their staffs, for their constructive and efficient contribution to their work. They displayed professionalism, imagination and loyalty to the Committee's gradually evolving consensus view, whilst sparing no effort to respect the very tight timetable.

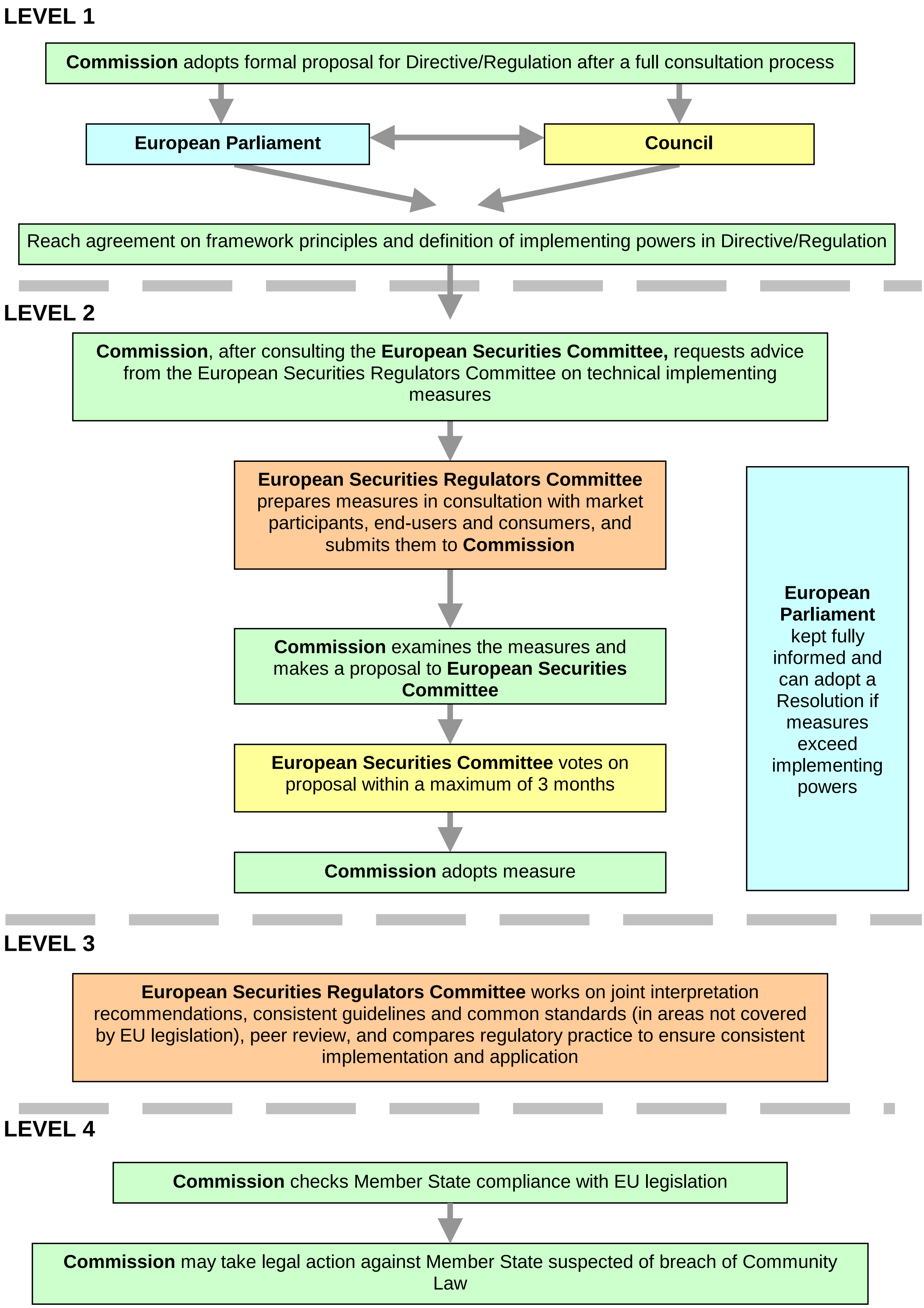
SUMMARY OF THE COMMITTEE OF WISE MEN'S RECOMMENDATIONS

CHAPTER I - *"The reasons for change"*		
Subject	**Recommendation (The precise wording of all the recommendations are in the text)**	**Action**
Economic benefits of integrated markets	Carry out research work and publish quantitative estimates as soon as possible (new *"Cecchini"* study) and continuously benchmark progress towards an integrated European Financial Market. (see p. 9)	European Commission, also with Member States and markets
Supply of equity and risk capital for SME's	Ensure appropriate environment is developed in the EU (see p. 10)	European Commission, European Parliament, Council of Ministers, Member States
Differences in legal systems and taxation; political, external trade and cultural barriers	Must not be ignored if full benefits of integrated European financial methods are to be assured. Furthermore, establish comprehensive list of external trade barriers to be removed in the next Trade Round (see p. 11)	European Commission, European Parliament, Council of Ministers, Member States, markets
Priorities of the Financial Services Action Plan	**Adopt by end 2003** • Single prospectus for issuers • Modernize admission to listing • Home country control for all wholesale members and definition of professional investor • Modernize investment rules for UCITS and pension funds • Adopt International Accounting Standards • Single passport for recognized stock markets(see p. 13)	European Commission, European Parliament, Council of Ministers, Member States
European regulatory and supervisory structures	Encourage convergence to ensure European Securities Regulators Committee works efficiently (see p. 15/16)	Member States, European regulators, European Commission
Clearing and settlement	Further restructuring necessary; pursue work in ISD review and Giovannini Group; consider whether regulatory framework needed; examine general systemic issues, in the context of monetary policy and smooth functioning of payment systems; on competition issues – careful examination is required by the European Commission (see p. 16/17)	European Commission, Council of Ministers, European Parliament, Member States, European Central Bank, markets
Managing prudential implications of integrated markets	Strengthen cooperation between financial market regulators, institutions in charge of micro and macro supervision and cross-sectoral regulators (see p. 17)	Economic and Finance Committee, European Central Bank and national central banks, European Commission, European Parliament, Member States and European regulators
Resources	Improve the allocation of resources devoted to the task of building an integrated European securities/financial market (see p. 17/18)	European Commission, European Parliament, regulators
Training	Improve the deployment of best regulation and common understanding throughout the European Union (see p. 18)	Private sector, markets, European Commission, regulators

CHAPTER II – *"Regulatory reform : the Committee's recommendations"*		
Subject	**Recommendation**	**Action**
Regulatory reform	Establish new 4 level regulatory approach at European Council in Stockholm and ensure it functions by end 2001 (see p. 20)	European Commission, European Parliament, Council of Ministers, regulators
Level 1 – Framework principles	Future securities market legislation to be based, case by case, on framework principles (Level 1) and implementing principles in Level 2, within a broad conceptual framework (see p. 22-24)	European Commission, Council, of Ministers European Parliament, regulators, markets
Level 1 consultation and transparency mechanisms	Establish new open, transparent consultation mechanisms with: - Strengthened and open dialogue with market participants and end users - Results of consultation published - Deadlines for each stage - Consult Member States/regulators early on Level 1 proposals - Inform European Parliament on an informal basis and seek, wherever possible, early non-binding understandings on scope of implementing powers in Level 2 (see p. 25)	European Commission with European Parliament, regulators, market participants
Level 2 implementing details	• Set up 2 new committees (i) **European Securities Committee** (ESC), (ii) **European Securities Regulators Committee** (ESRC) and ensure functioning by end 2001 • Agree on working methods and mandates (see p. 28-32)	Council of Ministers, European Commission, European Parliament, regulators
Level 2 consultation procedures and transparency	Strengthened consultation process (see page 32/33)	Regulators, European Commission
Institutional balance	Ensure periodic reporting and full transparency to European Parliament at all times. European Commission to take *"utmost account"* of European Parliament Resolutions…(see p. 33-35)	European Commission, European Parliament, Council of Ministers
Level 3 **Strengthened cooperation**	ESRC responsibility Objectives: - Consistent guidelines for administrative regulations - Joint interpretative recommendations, common standards - Compare and review regulatory practices - Carry out peer reviews (see p. 37/38)	Regulators, Member States, European Commission
Level 4 **Enforcement**	Strengthened enforcement of Community rules (see p. 40)	European Commission with contributions from Council of Ministers, European Parliament and market participants

OTHER GENERAL REGULATORY RECOMMENDATIONS		
Subject	**Recommendation**	**Action**
Regulations and fast track procedures	Use whenever possible to speed up interinstitutional agreements (see p. 26)	European Commission, European Parliament, Council of Ministers
Regulatory convergence	**Short term:** ESRC members acting in Level 3 must be able to deliver undertakings made **Longer term:** more fundamental convergence will be necessary (see p. 38)	Member States, regulators, European Commission
Monitoring the regulatory system	Continuous process to monitor half-yearly the effectiveness of the 4 level regulatory procedure (see p. 40/41)	New monitoring committee composed of two external nominees from Council of Ministers, European Commission and European Parliament
Full review 2004	Full and open review (cf. IGC in 2004) (see p. 41)	European Commission, European Parliament, Council of Ministers

THE FOUR-LEVEL APPROACH RECOMMENDED BY THE COMMITTEE



INTRODUCTION

The Committee of Wise Men has been very encouraged by the response to its initial report. In general, there has been widespread support for the main thrust of its initial ideas. This was confirmed by ECOFIN Ministers and the European Council at Nice.

Committee encouraged by response to initial report

There is broad agreement with the Committee's initial diagnosis of European financial markets and of the significant benefits that the European Union could gain from constructing an integrated financial market in the near future. As a result of the consultation process, the Committee believes that there is a strong consensus on the need to deliver the European Commission's Financial Services Action Plan as soon as possible, including accelerating work on some priority issues. Chapter I of this final report sums up the key findings of the first 3 chapters of the Committee's initial report.

Broad agreement on:
- *Diagnosis of the problem and benefits to be gained*
- *Need to accelerate FSAP priorities*

The Committee notes that an almost consensual view has emerged that the European Union's current regulatory framework is too slow, too rigid, complex and ill-adapted to the pace of global financial market change. Moreover, almost everyone agrees that existing rules and regulations are implemented differently and that therefore inconsistencies occur in the treatment of the same type of business, which threatens to violate the pre-requisite of the competitive neutrality of supervision.

Common view that EU's regulatory framework does not work – hence need for reform

Almost all respondents stated that they were in favour of the Committee's regulatory proposals, with none objecting to the four level structure outlined on pages 23-26 of its initial report. Whilst Member States, the European Commission, the European Central Bank, European regulators and market participants seem broadly supportive, the European Parliament, in particular, has sought assurance about the institutional implications of the 4 level regulatory structure put forward. Chapter II of this report therefore develops in greater detail the Committee's regulatory proposals, and how they would work in practice. It refines the Committee's initial ideas – including a number of new proposals and safeguards to ensure that there is a proper and fair inter-institutional balance, anchored to respect for the democratic processes at both national and European Union levels. The importance of full transparency, flanked by an open consultation process for both market participants and consumers is given substantially more prominence in the light of comments received.

Committee's initial regulatory recommendations strongly supported

European Parliament has sought assurance on institutional balance

An analysis of all the comments received on the initial report is

Analysis of

included in Annex 3.

comments on initial report in Annex 3

Change in the legislative process is of central importance. Not just to ensure the prompt delivery of the Financial Services Action Plan but so that in the future Europeans will be able to rely on a more accountable and efficient regulatory structure that will be able to match the best in the world.

Regulatory reform needed now to ensure future competitiveness of EU

Indeed, that is where the real strategic and competitive challenge lies. The European Union has no divine right to the benefits of an integrated financial market. It has to capture those benefits by building an integrated European market - in many areas starting from a very low level. If it does not succeed, economic growth, employment and prosperity will be lower, and competitive advantage will be lost to those outside the European Union. And the opportunity to complement and strengthen the role of the euro and to deepen European integration will be lost.

EU has no “divine right” to benefits of an integrated market – it has to build one.

Failure means lower growth, lower employment….

Progress will require leadership and a spirit of cooperation and partnership to work for the wider, deeper and strategic long-term interest of the European Union and its peoples. All actors: the Council of Ministers, the European Parliament, the European Commission, regulators, market participants and consumers will need to adapt their positions in order to move forward. However it is a positive-sum game.

Leadership, partnership and cooperation required from all actors to move forward

There is no serious alternative available. The status quo would entrench the continuation of European financial market fragmentation. This means lost benefits. Lost opportunities. And a weaker European economic performance - with European savings diverted to foreign market places. The Committee strongly believes that the approach recommended in this report is the only way forward. Other options are in the present circumstances impractical, including a single European regulatory authority for the reasons stated in the initial report.

There is no serious alternative available

The Committee urges European leaders to seize this opportunity to move forward at the European Council in Stockholm on March 23/24 by adopting a resolution based on the Committee’s recommendations, including an agreement with the European Parliament.

Committee urges European leaders to seize the opportunity to move forward at Stockholm European Council on March 23/24

CHAPTER I

THE REASONS FOR CHANGE

1. ECONOMIC BENEFITS

The Committee reaffirms its view that there are significant gains from building an integrated financial market in the European Union. These findings, confirmed by reactions to Chapter I of the initial report, are supported by recent academic work.

Significant gains to be expected from an integrated European capital market

An integrated European financial market will enable, subject to proper prudential safeguards and investor protection, capital and financial services to flow freely throughout the European Union. The barriers – unnecessary bureaucracy, lack of trust, and sometimes downright protectionism - will become things of the past. European businesses, large and small, will be able to tap deep, liquid, innovative European capital pools centred around the euro for the financing they require to develop their business activities. Competition and choice will drive down the cost of capital. In short, the supply of European capital from European savings will be efficiently matched with the demand for capital from European businesses. Consumers will be better able to purchase financial services and securities from the best European suppliers of investment, insurance or pension funds, with net yields increasing as investment choice widens. Cross-border clearing and settlement should become cheaper. These are some of the obvious microeconomic benefits.

Micro benefits: *more rational allocation of capital; greater liquidity will benefit all companies, especially SME's; cost of capital will be lower; net yields higher for consumers; cheaper cross border clearing/ settlement*

In macroeconomic terms, the productivity of capital and labour will increase, enhancing the potential for stronger GDP growth and job creation. **These tangible benefits must be measured as accurately as possible, and publicized as soon as possible by the European Commission because they will galvanize the political, economic and social case for reform and progress**.[*] In essence what is required is a financial market Cecchini report.[**] **The Commission should also construct a comprehensive series of macro and micro indicators to continuously benchmark progress towards an integrated European Financial market.**

Macro benefits: *increased productivity of capital and labour; stronger growth and employment; but need to quantify benefits*

Furthermore, the Committee believes that, provided European financial markets are open, competitive and innovative, the benefits

All Member States will benefit

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[*] The capitalization of European insurance, investment (UCITS) and pension funds alone is equivalent to 10 trillion Euros – or the size of European GDP – one indicator of the importance of this sector.

[**] The original Cecchini report calculated the cost of the non integration of Europe in the field of goods and services.

of integration will spread to all Member States. **The Committee urges governments and the European institutions to pay particular attention to ensuring that there is an appropriate environment for the development of the supply of risk capital for growing small and medium sized companies, given the crucial importance of this sector for job creation.** The Committee also believes that if its recommendations are followed – and effectively implemented – the primary beneficiaries will be those small and medium sized European companies.

Development of risk capital for SME's must be ensured

If recommendations acted on, SME's should be primary beneficiaries

2. EUROPEAN FINANCIAL MARKET TRENDS

The Committee observes that, in some segments of financial activity, there has been satisfactory progress towards a single market – for instance in the non-guaranteed inter-bank market. The Euro bond market is now also substantial, with the Euro government bond market already 40% larger than the US Treasury market. But the euro corporate bond market remains well behind its dollar equivalent.

Mixed signals on development of EU financial markets

On the positive side, turnover on European stock exchanges reached a record level in 2000: further evidence of an emerging European equity culture. However, the capitalization of European stock exchanges remains significantly behind those of the US equivalents. As a rough rule of thumb, taken together, European securities markets are still only about half of the size of those in the US.

EU markets still roughly ½ US size

The development of European securities markets is being held up by a plethora of interconnected factors and barriers such as:

- the absence of clear Europe-wide regulation on a large number of issues (e.g. prospectuses, cross border collateral, market abuse, investment service provision) which prevents the implementation of the mutual recognition system;
- an inefficient regulatory system;
- inconsistent implementation, in part due to lack of an agreed interpretation of the rules that do exist;
- a large number of transaction and clearing and settlement systems that fragment liquidity and increase costs, especially for cross-border clearing and settlement;
- the inadequate development of funded pension schemes in most Member States.

EU financial market development being hindered by a plethora of barriers, e.g.….

Absence of clear EU regulation, an effective decision making system, or common interpretations of rules

3. OTHER FACTORS SLOWING MARKET INTEGRATION

The Committee considers that a number of other factors are playing a significant role in slowing market integration. These are not directly,

But there are other factors

nor always susceptible to be dealt with by regulatory rules and practices. Among the most important are:

slowing down market integration….

- differences in legal systems (e.g. bankruptcy proceedings, effective judicial procedures etc);
- differences in taxation (e.g. withholding taxes, the imposition of stamp duty or different taxation rates applied to equities versus government bonds etc);
- political barriers (e.g. miscellaneous and creative techniques to protect national markets or products that favour local suppliers);
- external trade barriers (e.g. EU trading screens are not authorized in the US);
- cultural barriers of which there are two types. Firstly, those that can be dealt with by public policy – for example the different approaches to corporate governance; different emphases on the strength of the role of competition policy; different approaches to market consultation; different disclosure standards. Secondly, others which hopefully will converge as markets integrate – such as different entrepreneurial cultures which in many cases are slowing the supply of new fast growing firms for the equity markets, due in part to European venture capital still being only one third of the size of the parallel US market.

Main ones are differences in legal systems and taxation…

Political and external trade barriers and….

Cultural barriers…

These barriers must be also addressed

While putting forward proposals for the removal of these barriers is not within the remit of the Committee's work, the Committee considers that it will be necessary to deal with them if the full potential of an integrated European financial and securities market is to be captured. It is particularly important that the European Commission, working with the Member States, should establish a comprehensive list of external trade barriers. **In the next Trade Round, as a matter of priority, the EU must try to remove the most pernicious trade barriers hampering the global expansion of the EU's securities industry**.

The external trade barriers should be removed in next Trade Round

4. THE NECESSARY EUROPEAN RULES ARE MISSING

The shortcomings and lack of European regulation are responsible in a major way for preventing progress towards the cross-border integration of financial markets in a large number of areas. This was recognized, and indeed is at the heart of the reason for the European Commission's Financial Services Action Plan which was designed to fill the lacunae (the Lisbon European Council agreed it should be delivered by 2005 at the latest). Among the most important gaps are:

Lack of basic European rules is a major handicap

FSAP designed to fill the gaps

- lack of commonly agreed guiding principles covering all financial services legislation;
- failure to make the mutual recognition principle work for the wholesale market business in the context of the Investment Services Directive (ISD); for regulated markets themselves; for the retail sector; or for a single passport prospectus working for cross-border capital raising;
- outdated rules on listing requirements, no distinction between admission to listing and to trading, and lack of a definition of a public offer;
- ambiguity over the scope and application of conduct of business rules (Article 11 of the ISD) as well as on the definition of who is a professional investor;
- no appropriate rules to deal with alternative trading systems;
- potential inconsistencies between the E-commerce Directive and financial services directives;
- no comprehensive market abuse regime;
- no cross-border collateral arrangements;
- no set of common European-wide accepted international accounting standards;
- outdated investment rules for UCITS and pension funds;
- unresolved public policy issues for clearing and settlement activities;
- no agreed takeover rules;
- no high and equivalent levels of consumer protection and no efficient methods for resolving cross border consumer disputes.

The list of missing European legislation is long and significant

Some of the main ones are listed here….

But this list is not complete

And there are more.

Many of these gaps and deficiencies are being tackled by new legislation. But results will take far too long at the present rate of progress. The result is that the development of efficient securities markets in the EU is being badly hampered. Market infrastructure (exchanges and clearing and settlement systems) is not as efficient as it might be and the chances of delivering the FSAP on time are close to zero. The Committee believes that remedying this unsatisfactory situation should be among the Union's top priorities.

Result?
Cross border consolidation of markets and exchanges being hampered.
Delivery of FSAP in question

5. DETERMINING THE PRIORITIES – ONE WAY TO SPEED UP PROGRESS

The Committee believes that European policy makers must make a much stronger effort to determine, in the context of the Financial Services Action Plan, which are the near-term priorities. Politicians

European Governments must be bolder and determine the should highlight and drive forward those likely to have the biggest impact in the shortest time towards achieving the objective of an integrated European financial market. They should set an ambitious deadline for their agreement and ensure these deadlines are met.

and determine the priorities - i.e. drive forward those which will have the biggest impact in the shortest time

This is not an easy exercise. The Committee urges the European Council to give its full political agreement at Stockholm in March to a list of priorities so that these priorities are effectively operational from 2003 at the latest. The Committee's suggested priorities are as follows:

European Council should agree on a short list of priorities at Stockholm European Council for delivery in 2003

THE COMMITTEE OF WISE MEN'S PRIORITIES TO BE ADOPTED AND BROUGHT INTO EFFECT AT THE LATEST BY THE END OF 2003

- A single prospectus for issuers, with a mandatory shelf registration system.
- Modernization of admission to listing requirements and introduction of a clear distinction between admission to listing and trading.
- Generalization of the home country principle (mutual recognition) for wholesale markets, including a clear definition of the professional investor.
- Modernization and expansion of investment rules for investment funds and pension funds.
- Adoption of International Accounting Standards.
- A single passport for recognized stock markets (on the basis of the home country control principle).

The Committee's priorities

6. THE MAJOR PROBLEM: THE CURRENT REGULATORY SYSTEM IS NOT WORKING

Whilst part of the problem concerns the incomplete regulatory coverage at European level, the greater part of the responsibility lies in the way in which European Union legislation has been decided (or left undecided) and "implemented" (or not "implemented"). The problem is the system itself.

The major part of the problem – the EU legislative process does not work

The current system requires the European Commission to make a proposal to the Council of Ministers and the European Parliament, who decide, by a co-decision procedure specified in Article 251 of the Treaty. The average time taken for a co-decision procedure from the Commission's proposal to final agreement in co-decision across all

Current procedures

domains is over two years – and in the financial services area, the average time is longer.*

The Commission, in the preparation of its proposals, has improved its efforts to consult the regulators and markets on forthcoming proposals, but to date there is no agreed procedure, nor obligation, nor deadlines imposed for the consultation mechanism.

Insufficient consultation and transparency noticeable

Moreover, under *"subsidiarity"* pressure from the Member States, the Commission has generally put forward Directives rather than Regulations. This leaves more latitude for Member States to implement Community Law but too often leads to uneven transposition and different interpretations. Furthermore it puts further pressure on the Commission to check and enforce proper implementation. Directives also require at least 18 months for transposition.

Plus uneven transposition and erratic implementation by Member States of agreed Community rules

Blockages can occur in the system at four levels:

(i) in the **Commission** itself – over-stretched, sometimes slow off the mark;

(ii) most notably in the **Council of Ministers** where there is far too often a tendency to add unnecessary levels of complexity to straightforward Commission proposals (often in an attempt to try to fit 15 sets of national legislation into one Community framework);

The multiple possibilities of blockage

(iii) in the **European Parliament**, although much less than in the past;

(iv) and finally in the **Member States** where transposition and implementation are often late and frequently incomplete.

Therefore, taken together, the current system has a number of major shortcomings:

The current regulatory system is:

- **it is too slow** (e.g. the Takeovers Directive proposal (12 years so far and not yet adopted); the European Company Statute (more than 30 years); Basel I (over 4 years);

too slow….

- **it is too rigid** and cannot react speedily enough to changing market

too rigid….

* Between 1 May 1999 and 31 October 2000, **in all legislative domains**, 19% of dossiers were agreed at first reading, 53% in second reading, 28% required conciliation. First readings took an average of 8 months, second readings more than 2 years, conciliation an additional 2-3 months.

conditions. Every change, however small or technical, requires a full blown Commission proposal to be negotiated by co-decision;

- **it produces too much ambiguity** (e.g. Article 11 of the Investment Services Directive concerning conduct of business rules; public versus private offers in the 1980 Directive). Worse still, Directives are often ambiguously implemented – partly due to the texts themselves, but also due to the lack of coordination by an effective network of European regulators;

producing too much ambiguity….

- **it fails to distinguish between core, enduring, essential framework principles and practical, day to day, implementing rules**. The result is that Directives are too detailed and are unable to be adjusted expeditiously.

and failing to distinguish between core principles and detail….

7. YET THE PACE OF MARKET CHANGE IS ACCELERATING

The pace of change in financial markets, global and Europe-wide, is accelerating – another reason why the European regulatory system must be able to keep pace. Globalization, instantaneous, interconnected electronic markets, deregulation and information technology developments are all increasing the rate of market change.

But market change is accelerating – and European regulation is not up to speed….

The euro itself is making markets more transparent, liquid and interconnected and is an additional stimulus, indeed another reason why the European Union must aspire to faster and more flexible regulatory procedures to remain competitive in the global financial market.

Damaging competitiveness of EU financial markets

8. THREE FURTHER IMPORTANT PARAMETERS

3 other parameters need attention

(i) Convergence of regulatory and supervisory structures

Today, there are about 40 public bodies in the European Union dealing with securities markets regulation and supervision. Competences are mixed. Responsibilities are different. The result at European level is fragmentation and often confusion.

(i) EU regulatory convergence is required

More convergent regulatory and supervisory structures are vital to ensure that the future European Securities Regulators Committee, a key part of the Committee's regulatory proposal, can function effectively. This is further explained in the second part of this report.

(ii) Clearing and settlement

(ii) Clearing and settlement

The Committee is convinced that further restructuring of clearing and settlement is necessary in the European Union. **The process of consolidation should largely be in the hands of the private sector**. Market forces should mainly determine the contours of European clearing and settlement such as the extent of linkages between post-trading bodies, (clearing, settlement, CSD's etc), and the possible emergence of a single European central counterparty.

Restructuring required – led by the private sector to remove obstacles to consolidation

This does not mean that there are no public policy issues at stake. In particular, public policy should focus on competition issues and removing the kinds of obstacles and impediments that make consolidation difficult. Among the most important public policy issues are the excessive costs of cross-border clearing and settlement in the EU compared to the US, due to fragmentation; competition issues such as open and non-discriminatory access, exclusivity agreements etc; the soundness of the technical linkages between CSD's; the prudential implications of one central counterparty; and whether clearing and settlement organizations should be authorized and supervised according to common European standards (e.g. conditions for access to payment systems, information sharing and cooperation). There may also be a need, perhaps, to separate clearing system issues from settlement (an efficient clearing system being a public good).

Key issues:

Excessive European costs of cross border clearing and settlement compared to US; competition matters; prudential implications

The Committee is of the opinion that if in due course it emerged that the private sector was unable to deliver an efficient pan-European clearing and settlement system for the European Union, a clear public policy orientation would be needed to move forward.

If private sector fails to deliver an efficient c/s system, public policy lead will be needed

In the light of the consultations underway in the context of the **updating of the Investment Services Directive** (due in the second half of 2001) and **the forthcoming work of the Giovannini Group,*** **the Committee urges that serious consideration be given as to whether the EU needs to establish a regulatory framework for clearing and settlement activities**.

Is a c/s regulatory framework needed at EU level?

* The Giovannini Group is a group of market participants that advises the Commission on economic and financial matters. It has recently begun to work on clearing and settlement issues.

Such a framework would have to take into account the vital importance of ensuring the smooth functioning of European clearing and settlement mechanisms as a prerequisite for the efficient functioning of securities markets. In addition they would also have to take into account the general systemic issues raised and the way in which such systems are vital for the infrastructure for monetary policy operations and the smooth functioning of payment systems. Consideration might also need to be given to the European Central Bank being involved in this work. **The ECOFIN Council could ask the Economic and Finance Committee to launch discussions on the above areas.**

Smooth functioning of c/s essential for efficient securities markets and for the infrastructure for monetary policy

EFC could launch work

Finally, on competition questions, **the Committee suggests that the European Commission's Directorate General for Competition should examine the situation in order to ensure that the Community's competition policy is being properly respected in this crucial sector**.

Competition issues:
DG Competition should carefully examine the situation

(iii) Managing the prudential implications

While the Committee strongly believes that large, deep, liquid and innovative financial markets will result in substantial efficiency gains and will therefore bring individual benefits to European citizens, it also believes that greater efficiency does not necessarily go hand in hand with enhanced stability.

Whilst benefits of integration are clear – enhanced stability not necessarily the result….

Increased integration of securities markets entails more interconnection between financial intermediaries on a cross-border basis, increasing their exposure to common shocks. It is not within the remit of this Committee to evaluate such risks, and even less to make recommendations on how to deal with them. However, given the growing interlinkages between all segments of the securities markets and the full range of financial intermediaries, **the Committee believes that there is an urgent need to strengthen cooperation at the European level between financial market regulators and the institutions in charge of micro and macro prudential supervision. The ECOFIN Council should ask the Economic and Finance Committee to report on the development of this cooperation**.

Committee believes urgent need to strengthen cooperation at EU level notably from regulators and institutions responsible for micro/macro supervision

9. RESOURCES AND TRAINING

Building an integrated European financial market, in the tight timeframe that the European Union's Heads of State and Government have defined, **requires a proper allocation of resources to the task**. This applies in particular to the European

Resources must be properly allocated to the task of building an EU integrated

Commission, the European Parliament and to national regulators as well. In general there are too few experts around with the detailed knowledge necessary to undertake this difficult work.

EU integrated financial market

In general, there are too few

The Committee is firmly of the view that insufficient staff are being allocated to tackle the complex task of building an integrated European financial market. Barely a handful, for example, in the European Commission are working on infringement work, which is time consuming, often exceedingly complex but nevertheless essential work. The shift from conceptualization to the hard negotiation of the many legislative proposals in the Financial Services Action Plan also requires further staff. **In summary the Commission has very few staff working on financial services – which is not logical given its economic importance for the European Unio**n.

Commission is very understaffed in this key economic area….

The European Parliament's Secretariat dealing with these matters is also too lightly staffed and ought to be reinforced.

The EP as well

Finally the Committee recommends **that the private sector along with European regulators should lead a new training drive** to improve the deployment of best practice and common understanding among regulators and market participants throughout the European Union.

New private led training system necessary

To summarize, the challenges facing the creation of an integrated securities market in Europe are that the basic legislation is not in place; that there is still insufficient prioritization; and that the present system cannot produce quickly or flexibly enough the type of legislation that modern financial markets require; and that inconsistent implementation is severely handicapping the emergence of a pan-European market.

Summary: *Basic legislation is not in place; there is insufficient prioritization; the current regulatory system does not work; implementation is erratic*

The Committee of Wise Men is therefore convinced that regulatory reform is required if the European Union's objectives are to be fulfilled, and if the Financial Services Action Plan is to be delivered on time. Sufficient resources must be available. Part Two contains recommendations on how these challenges could be met.

Therefore regulatory reform is required

CHAPTER II

REGULATORY REFORM

THE COMMITTEE'S RECOMMENDATIONS

1. INTRODUCTION

The Committee's proposal in its initial report centred around a four level approach.

Level 1: Framework principles to be decided by normal EU legislative procedures (i.e. proposal by the Commission to the Council of Ministers/European Parliament for co-decision).

Level 2: Establishment of two new committees – an EU Securities Committee and an EU Securities Regulators Committee (in a format similar to that of FESCO) to assist the European Commission in determining how to implement the details of the Level 1 framework.

The Committee's four level initial proposal

Level 3: Enhanced cooperation and networking among EU securities regulators to ensure consistent and equivalent transposition of Level 1 and 2 legislation (common implementing standards).

Level 4: Strengthened enforcement, notably with more vigorous action by the European Commission to enforce Community law, underpinned by enhanced cooperation between the Member States, their regulators, and the private sector.

This approach recognized two layers in the legislation related to financial markets : **basic political choices** that can be translated into broad but sufficiently precise framework norms (Level 1); and the **more detailed technical measures**, in full conformity with this framework, needed to implement the objectives pursued by the legislation (Level 2).

Level 1 *= principles*
Level 2 *= detailed technical measures*

The two layers should be efficient, in the sense of achieving the stated objectives with the lowest cost in terms of regulatory burden; they should aim at establishing a level playing field, by removing any opportunity to erect regulatory barriers to competition; they should help speedy implementation and be flexible, so that they can be quickly adapted to the rapid pace of technical changes and product innovation in the financial markets. As experience shows, and as the Committee documented in Chapter III of its initial report, there is a trade-off between these requirements and the extent to which basic legislation (Directives and Regulations) is specific and covers the details of technical implementation.*

Importance of principles of efficiency, lowest regulatory cost, flexibility and competition

In the case of financial markets, the distinction between framework legislation on the one hand, and implementing measures to be adopted on a faster track on the other, helps to remove that trade-off, at least in part. **The Committee believes that this distinction should be adopted at the EU level, subject to the following constraints: the process must be transparent; it must respect the institutional balance; and be in conformity with the structure of the Treaties.**

***It is necessary** to adopt at EU level a distinction between Level 1 and Level 2 subject to proper institutional balance and transparency*

This Chapter sets out in detail how the Committee believes each of the four levels of the regulatory approach should work in practice. It defines the key roles and requirements of the different institutions and actors. Diagrams illustrate the decision-making process. Lastly it responds to certain comments made about its possible workings.

This chapter sets out details of the Committee's regulatory proposal….

* To give one example, even the limited possibility of mutual recognition allowed by directive 80/390EEC for share prospectuses cannot be used for the issues of covered warrants or similar financial instruments.

THE MAIN ISSUES BROUGHT TO THE ATTENTION OF THE COMMITTEE OVER ITS 4 LEVEL REGULATORY APPROACH

Main issues raised on the Committee's 4 level regulatory approach, derived from the responses to the initial report

1. Members of the European Parliament have raised concerns that the 4 level approach would represent a dilution of its right of co-decision under the Treaties. They have also suggested more use of Regulations rather than Directives, the use of fast track procedures and far more transparency.[*]

2. Market participants and some regulators commented that they would like also to see greatly reinforced transparency, openness, and accountability at all levels. Early and institutionalized involvement of market practitioners and consumers in the legislative process is strongly recommended. Deadlines at every stage of the procedures are widely supported.

3. Respondents wanted a clearer definition concerning the *"substance"* of Level 1 framework principles and of Level 2 implementing measures.

4. Respondents felt that the links between the various levels should be made clearer. In particular, the role of the Securities Regulators Committee needed attention. How would it be established? Who would participate in it? How would it link with the Commission? Under what conditions?

5. Questions were raised about the differences between the competences and powers of the national regulators. These differences could harm the effectiveness of the European Securities Regulators Committee and cooperation in Level 3. Some respondents called for more convergence in the national regulatory structures.

6. Some have called for overarching principles for all European financial services legislation.

[*] Fast Track procedure involves early adoption of an act after first reading in the European Parliament – by ensuring prior consultation and agreement with the Council of Ministers and the Commission.

2. A CONCEPTUAL FRAMEWORK FOR EUROPEAN SECURITIES LEGISLATION

The Committee believes that all European financial services and securities legislation should be based around a conceptual framework of overarching principles. These principles should be consistently applied, and in the future could be either enacted in a framework Regulation jointly agreed by the Council of Ministers and the European Parliament or possibly in a future amendment to the Treaty at the next Intergovernmental Conference. Among the most important could be:

- to maintain confidence in European securities markets;
- to maintain high levels of prudential supervision;
- to contribute to the efforts of macro and micro prudential supervisors to ensure systemic stability;
- to ensure appropriate levels of consumer protection proportionate to the different degrees of risk involved;
- to respect the subsidiarity and proportionality principles of the Treaty;
- to promote competition and ensure that the Community's competition rules are fully respected;
- to ensure that regulation is efficient as well as encouraging, not discouraging, innovation;
- to take account of the European, as well as the wider international dimension of, securities markets.

The Committee believes there is a need for all financial services and securities legislation to be based around a conceptual framework of overarching principles

3. THE DETAILS OF THE COMMITTEE'S PROPOSAL

LEVEL 1 – FRAMEWORK PRINCIPLES

The Committee considers that, without amending the Treaty, new types of Directives or Regulations should be developed in the securities field. They should contain framework principles, with implementing powers being delegated to a second level.

- **What are Level 1 framework principles?**

The framework principles are the core political principles, the essential elements of each proposal. They reflect the key political choices to be taken by the European Parliament and the Council of Ministers on the basis of a proposal by the European Commission. They determine the political direction and orientation, the

What are Level 1 framework principles?

fundamentals of each decision. They should be specific to each Directive or Regulation.

Level 1 principles should clearly specify the nature and the extent of the technical implementing measures that should be taken at the second level and the limits within which the resulting provisions can be adapted and updated at that level without requiring a change of framework legislation. This is in order for the Council of Ministers and the European Parliament to be fully and precisely informed on the nature of the delegations they are being requested to grant. The European Commission, whenever possible, should indicate the type of implementing details that could be covered in Level 2.

*Need for precision of what are key principles (**Level 1**) and implementing measures (**Level 2**) so EU institutions know exactly where they are…..*

Consider two examples:

- the forthcoming Prospectus Directive. The Level 1 framework principles would include all the relevant Articles concerning the type of single passport (e.g. compulsory shelf registration, with a securities note and a summary prospectus, definition of a public offer, the role and powers of the competent authorities; the language regime etc). However, all the technical details and definitions of what constitutes the detailed implementing contents of the prospectus (such as the contents of a prospectus for each specific type of financial instrument) would be delegated to the Level 2 procedure.

Some examples…. *the forthcoming Prospectus Directive….*

- conduct of business rules under Article 11 of the ISD. A new text would include the basic elements of these rules (due diligence, acting honestly, adequate disclosure, home country conduct, the necessity to differentiate between professionals and retail investors). The implementing measures would contain the detailed rules that investment firms should apply in their relations with clients (specific type of information to ask from the client, what should be disclosed to the client etc).

Or Article 11 of the ISD

Two specific examples of a prototype Community Directive in the new structural format are attached to understand the form of the Committee's ideas (see Annex 4….).

The substantive content of what should be delegated to the Level 2 procedure would **in every case** be agreed by the Council of Ministers and the European Parliament on the basis of the European Commission's Level 1 proposal. **This is a crucial point and a key democratic safeguard.**

Delegated powers to Level 2 would be determined always on a case by case basis…

- **Are there legal guidelines or rules for determining what should be included as Level 1 framework principles?**

Legal context – Article 202 of the Treaty

The EC Treaty (Article 202), the jurisprudence of the European Court of Justice and some recent interinstitutional agreements give some broad guidance. Article 202 of the EC Treaty refers only to *"…powers for the implementation of the rules…"* as being able to be delegated from the normal Level 1 co-decision procedure (Article 251 of the EC Treaty).

ECJ case law

In a number of judgements,[*] the European Court of Justice has referred to the requirement for all *"essential elements"* to be included in the basic legislation. This would mean them being included in the Commission's co-decision Level 1 proposal.

Level 1 *= "Essential elements";* ***Level 2*** *= Applying the essential elements of basic instruments…*

What does essential (or by implication, non-essential) mean? This has never been defined, but the recent June 1999 Interinstitutional Agreement on comitology agreed by the European Parliament/Council/Commission has stated that the use of the comitology process refers to *"…applying the essential provisions of basic instruments…. as well as measures designed to adapt or update certain non-essential provisions of a basic instrument…"*.

Committee believes technical implementing powers should be delegated to a new Level 2 procedure

The Committee considers that technical implementing powers for securities legislation should be delegated to the Level 2 procedure through a Level 1 framework Directive/Regulation. The extent of the technical implementing powers should be decided on a case by case basis for each Directive/Regulation by co-decision on the basis of a Commission proposal.

Advantages of new approach

- **What are the advantages of the new approach?**

Speeding up, legislation

(i) The legislative **process would speed up** – because the key Level 1 political co-decision negotiations between the Commission, the Council of Ministers and the European Parliament would focus solely on the essential issues and not on technical implementing details. As the section on Level 2 shows, the process of updating technical details would also be speeded up.

Maintaining democratic and institutional balance

(ii) **The process would be democratic and flexible** – with the range and scope of implementing powers being defined by the Council of Ministers and the European Parliament by co-decision on a case by case basis for each Level 1 proposal.

(iii) **The EU institutions** would be able to benefit from the technical and regulatory expertise of European regulators, with the European

[*] For example see ECJ, 17 December 1970, Köster, 25/70, ECR 1161, paragraph 6.

regulatory expertise of European regulators, with the European Commission fully retaining its right of initiative.

Ability to benefit from expertise of EU regulators

- **Level 1 Consultation and Transparency mechanisms**

The European Commission alone has the right of initiative under the Treaty. However the Committee recommends that in the future, before the Commission draws up a proposal in these areas, it should take the following steps:[*]

1. Consult, beforehand, in an open, transparent and systematic way with market participants and end-users (issuers and consumers). Deadlines should be set and made clear. Where necessary, open hearings should be held. There should be a strengthened and open dialogue with market participants and end-users so as to advise the Commission on a continuous basis on Level 1 work. Use of the Internet should be used to encourage more participation. A summary of the consultation process undertaken should be made available when the final proposal is made. The Committee recognizes that this will take a little time to set up and that there are resource implications for the Commission services.

The Commission must put in place a more rigorous consultation and transparency mechanism for Level 1 work

Strengthened and open dialogue with market participants and end-users is essential

2. Continue to consult Member States and their regulators on an informal basis as early as possible on any impending Level 1 proposals.

Ex-ante consultation with Member States and regulators.

3. Inform the European Parliament on an informal basis of forthcoming proposals (including more systematic use of the *"2005"* group)[**] and seek, wherever possible, early, non-binding, understandings on the scope of any implementing powers that might be delegated to Level 2. This will help guide the European Commission, the Regulators and Securities Committees on the scope of the work that they should undertake, preparing them, where possible, in advance of any formal co-decision agreement in order to gain time.

Commission should seek early informal understandings with European Parliament, if possible, on scope of Level 2 implementing powers

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[*] See, inter alia, paragraph 9 of the Protocol on the application of the principles of subsidiarity and proportionality annexed to the Treaty of Amsterdam (O.J C340, 10/11/1997 p. 0105).

[**] The *"2005 Group"* is an informal high level group composed of the chairperson of European and Monetary Affairs Committee of the European Parliament, the Presidency of the Council of Ministers, the incoming Presidency and the European Commission.

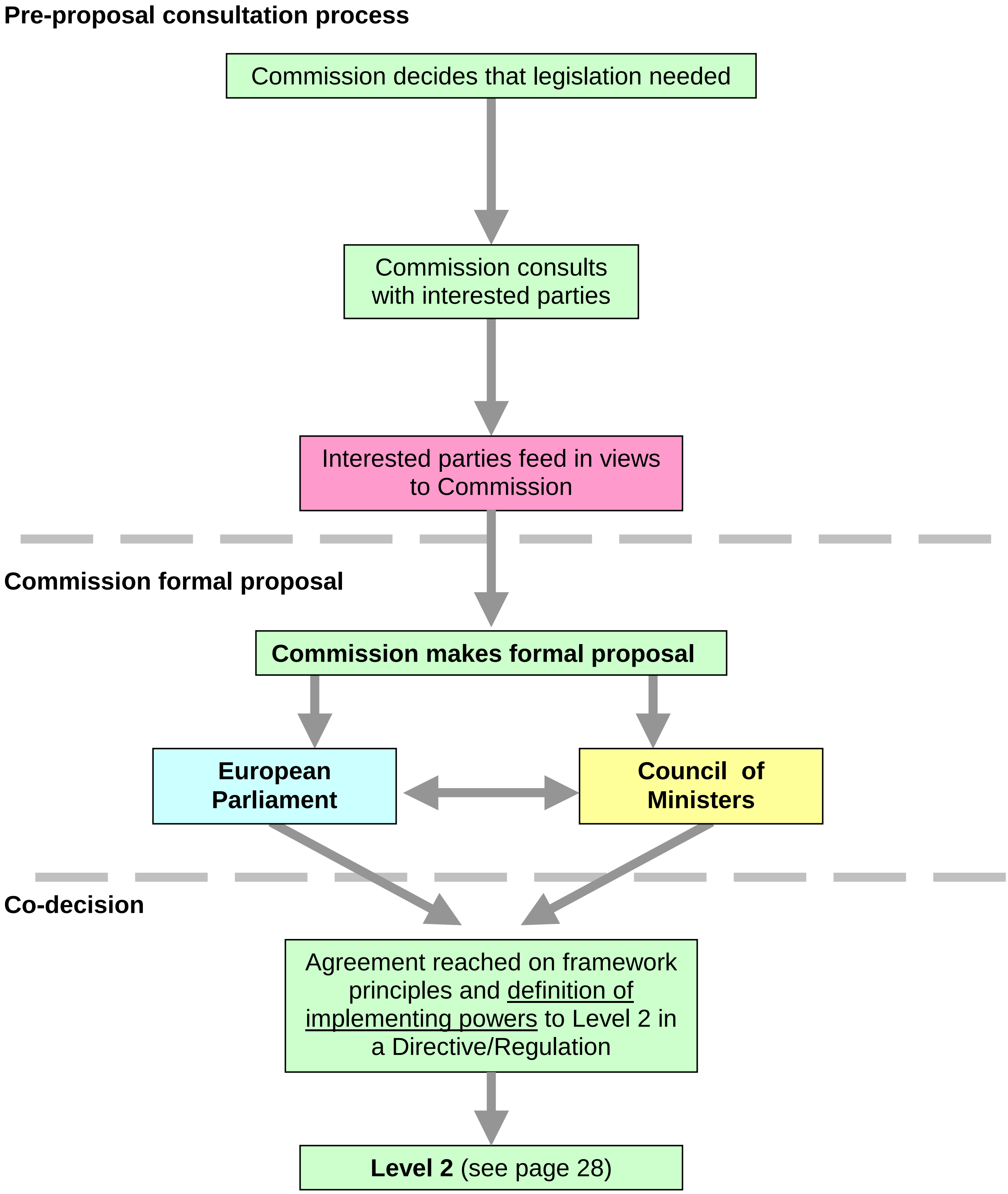
- **More use of Regulations and fast track procedures**

Committee supports use of Regulations and fast track procedures whenever possible….

The Committee proposed in its initial report that in order to help speed up the legislative process, more use should be made of Regulations, rather than Directives. Regulations can speed up the implementation process because they are directly applicable in the Member States. The Committee considers that Regulations should be used whenever possible, along with fast track procedures, although these techniques will not be able to resolve all the problems.

The Committee believes that the choice of the approach (Regulation versus Directive) should be made by considering the pros and cons of each measure on a case by case basis. The guiding principles should be those set out on pages 20 and 22-24.

LEVEL 1 – FRAMEWORK PRINCIPLES



LEVEL 2 – IMPLEMENTING THE DETAILS

Level 2 = a functioning network of regulators, European Commission, and a Securities Committee to determine Level 2 implementing details

Level 2 is composed of an actively functioning network of national securities regulators, the European Commission and a new European Securities Committee to define, propose and decide on the implementing details of framework Directives and Regulations, determined by the co-decision procedure in Level 1.

Two new Committees needed ESC + ESRC

It is therefore proposed that two new Committees are formally established – an EU Securities Committee (**ESC**) which will have a primarily regulatory function and an EU Securities Regulators Committee (**ESRC**) with advisory functions. The roles of these Committees are described below. They should be established and be functioning before the end of 2001.

Trust must be built up…

And the European Parliament fully informed

The Committee emphasizes the crucial importance it attaches to building solid triangular relations of trust and efficiency between the European Commission and the Securities and Regulators Committees, based on a clear understanding of their respective roles. The European Parliament must be fully informed throughout the process.

- **Level 2 working methods**

Level 2 working methods

The main tasks of the European Commission and the Securities and Regulators Committees can be summed up in the following way:

Commission asks ESRC to work on a subject…..

1. Without prejudice to the Commission's right of initiative, after consultation with the Securities Committee (ESC) and in the light of the results of the Level 1 co-decision process, the Commission would ask the European Securities Regulators Committee (ESRC) to begin work on the technical details of the subject and agree a timeframe for the work to be carried out.

ESRC consults openly and widely…..

2. The ESRC, having thoroughly and openly consulted the markets and end users, according to a prescribed process, with fixed deadlines (see below) would forward its technical advice to the Commission in due time.

ESRC forwards its work to the Commission

3. The Commission, without prejudice to its right of initiative under the Treaty, would then consider this technical advice.

Commission forwards a proposal to the Securities Committee

4. The Commission would then forward a proposal to the Securities Committee, taking into account the work of the ESRC. The Commission would also ensure that the European Parliament is fully informed of all emerging proposals – the agenda/documents etc both ex-ante and ex-post, in line with the Interinstitutional Agreement. The

Securities Committee would then vote on the Commission's proposal according to the decision making rules for such committees. If the Securities Committee agreed by qualified majority voting with the Commission's proposal the Commission could decide to enact the legislation. (For further details see voting procedure below.)

THE SECURITIES COMMITTEE (ESC)

- **Role**

The ESC will be a Committee of major importance, with 3 main roles. **Firstly**, its central role would be to act as a Regulatory Committee under Article 202 of the Treaty – in which the Commission's proposal would be voted on with a fixed deadline (usually 3 months). **Secondly**, it could also act in an advisory capacity to the Commission in particular, but not only for, Level 1 legislation (in this guise, it will replace the existing High Level Securities Supervisors Committee). **Thirdly**, it could also advise the Commission on Level 2 mandates for the ESRC.

ESC has 3 roles Key one is acting as a Regulatory Committee

- **Voting procedure**

The voting procedure in the Securities Committee (in accordance with the 1999 decision laying down the procedures for the exercise of implementing powers conferred on the Commission) would be as follows :

- The Commission submits the draft measures to the Securities Committee.
- The Securities Committee votes on the draft measures according to a fixed timetable.[*]
- If approved by the Securities Committee, the draft measures are then adopted by the Commission and become binding in Community law.
- In case the Securities Committee votes against or if no opinion is delivered, the draft measures are submitted to the Council of Ministers as the Commission's proposal.
- The Council votes within a determined period[**] to adopt or oppose

[*] The Committee shall deliver its opinion on the draft within a time-limit which the chairman (the representative of the Commission) may lay down according to the urgency of the matter. The Committee votes by qualified majority in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the Committee shall be weighted in the manner set out in the Treaty for the votes in Council. The chairman shall not vote.

the proposal.

- In case of opposition by the Council, the Commission shall re-examine the proposal.
- The Commission may then choose between three options : (1) submit an amended proposal of implementing measures to the Council, (2) re-submit its initial proposal or (3) abandon the draft implementing measures and present a legislative proposal based on the EC Treaty by use of its initiative powers. In that case, the draft implementing measures are replaced by a draft legislative act, e.g. a Regulation or a Directive.
- If the Council neither approves the draft measures proposed by the Commission nor indicates any opposition to them, the Commission shall adopt the proposed implementing act.

Voting procedures in the ESC (continued)

- **Role of the European Parliament**

Key supervisory role of European Parliament.

The European Parliament must be kept informed of the Securities Committee's work and receive all related documents (agendas, draft measures, results of the votes, minutes of the meeting, list of those present).

EP must be fully informed at all times of what is going on….

If the European Parliament considers that draft measures submitted by the Commission exceed the implementing powers provided for in the basic instrument, the Commission would have to re-examine its proposal. Taking the utmost account of the Parliament's Resolution, the Commission might then submit new draft measures to the Committee, continue with the procedure, or submit a proposal under co-decision procedure.

If European Parliament considers Commission's proposal exceeds implementing powers – Commission shall re-examine its proposal and take utmost account of European Parliament's position

- **Membership of the Securities Committee**

The Member States will nominate members to the ESC, which the Commission will chair. For this reason, the ESC is not a body of the Council of Ministers. Member State nominees should be of a high level (e.g. at the rank of State Secretary), in which case no doubt the European Commissioner responsible for securities matters issues would chair. It is essential that attendance should not be downgraded. The Committee of Wise Men considers it particularly important that the Securities Committee, having such a key role, must work in a collegiate way – with members nominated for sufficiently long periods to ensure continuity and the building of a real *"…esprit de corps…"*. Members of the ESC should, whenever possible, be

Committee wants membership of ESC to be at high level (State Secretary)

Collegiality and esprit de corps are very important

** This period is laid down in the basic legislative instrument from which the Committee originates. It cannot exceed three months from the date of referral to the Council.

present when votes are taken. The ESC must also work in a transparent and open way – and should be ready to report to the EP on a regular basis.

- **Setting up the Securities Committee (transitional arrangements)**

The Securities Committee will be legally established when the first implementing powers are granted to it. However, in order to permit the ESC to begin work as soon as possible – pending any formal conferment of implementing powers – the Commission could formally set it up as an Advisory Committee by a Commission Decision. The Committee recommends this course of action.

Modalities of setting up the ESC quickly

- **The ESC acting as a Regulatory Committee:**

The Committee considers the optimal approach is to delegate, case by case, the relevant implementing powers as each Level 1 proposal is agreed by co-decision of the Council and European Parliament. This would allow all the three Institutions to precisely determine the scope of implementing powers for each piece of legislation.

Case by case delegation of scope of implementing powers

EU SECURITIES REGULATORS COMMITTEE (ESRC)

The ESRC should be a Committee with two hats. **In Level 2** it would act as an advisory committee to the European Commission. **In Level 3** (see page 37) it would act alone as a fully independent committee of national regulators to ensure more consistent implementation of Community Law.

The ESRC to have 2 roles – one in Level 2, the other in Level 3

- **Composition**

In Level 2 the ESRC should be established as an independent advisory group to the Commission. The members of the ESRC should be the heads of the competent authorities for securities regulation/supervision designated by each Member State – building on the structure already successfully established by FESCO. The Chairman should be elected by the members of the ESRC from one of their number. What is crucial however, is that those attending the ESRC, at all times, are competent to advise the Commission on any agreed subject. It is therefore important that the secretarial arrangements should reflect the need to keep close operational links with the Commission for Level 2 work

ESRC to be composed of national regulators and should be an independent advisory committee to the Commission. Close operational links will be necessary with the Commission in the organization of Level 2 work.

Furthermore the Commission would obviously play a key role in the

Commission

Committee, informing the members of the political priorities, discussing emerging ideas etc.

would have key role in the ESRC

The Committee considers the European Parliament should be able to request the ESRC to report to it periodically. The Chairman of the ESRC should also be an observer in the Securities Committee. The ESRC should also produce an annual report on its work and forward this to all the European Union's institutions.

The European Parliament should be able to request the ESRC to report to it periodically

- **Voting procedures in the ESRC**

The Committee does not think that unanimity is an appropriate voting procedure for the ESRC in Level 2, for several reasons:

(i) It could lead to lower common denominator agreements.

(ii) If the voting procedures of the ESRC were inconsistent with those of the Securities Committee, there would be the potential for incongruous, or at worst, perverse decision making in Level 2.

Voting in the ESRC should be by qualified majority

It is therefore recommended that the Regulators Committee should vote in its Level 2 role by Qualified Majority Voting. Minority opinions should be recorded and made public in the final advice sent to the European Commission.

- **Setting up the ESRC**

ESRC should be politically endorsed at the Stockholm European Council and then as an independent advisory group to the Commission

The ESRC should be politically endorsed at the Stockholm European Council and be legally established as an independent advisory group to the Commission (outside the comitology process).

- **Consultation procedures and transparency**

The Committee considers that the ESRC must consult market participants, consumers and end-users according to a fixed, preferably mandatory set of procedural rules that should be set out in its statutes and rules of procedure. The following principles should apply to the consultation process:

ESRC must also set up an open and transparent consultation process

- market practitioners must be involved…
- at every level…
- in a continuous process…

Principles of consultation process

- with particular weight given to those with knowledge and expertise on the subject in question…
- in an open process, using, *inter alia*, the Internet…
- with end-users views being considered at the same time.

The Committee considered the merit of *"practitioner forums"* at European level, but given the complexity of deciding who should be members, bearing in mind that there are 15 Member States (and soon more) as well as a wide range of interests to be covered, the Committee prefers the alternative outlined below.

Committee looked at practitioner forum idea….

Once advice on implementing measures has been requested from the European Commission, and with a specified timeframe agreed for the work, the ESRC would set up the consultation process.

but prefers the following ESRC consultation process….

Four basic procedures could be envisaged:

- In the case of complex issues, the ESRC should consult first on the basis of a *"concept release"* – outlining the problem and the options and asking for public input on what, if any, regulatory approach would be appropriate. The time for such a consultation should not exceed 3 months.

Four basic procedures must be followed for an ESRC consultation…

- Once a regulatory approach had been decided, a draft proposal would be released by the ESRC for consultation with markets and end users (3 months maximum).

- Where necessary the ESRC could use hearings, or roundtables, as this Committee has done. Use of the Internet should be compulsory for the consultation process.

With hearings, roundtables….

- A summary of the public comments should be appended to each of the ESRC's final recommendations.

Public comments should be disclosed…..

The Committee recommends the Commission to maintain a similar level of transparency and openness as these proposals move to the Securities Committee.

- **Maintaining institutional balance and involvement of the European Parliament**

The Committee is acutely aware of the importance of maintaining institutional balance between the European Commission, European

Importance of institutional balance

Parliament and the Council of Ministers.

balance

It was put to the Committee that the procedure suggested should be accompanied by a call-back mechanism for the European Parliament: in particular a new interinstitutional agreement should give European Parliament (and Council of Ministers) the possibility to oppose, within a given period, a Commission proposal for the implementing measures. The Committee considered this possibility with interest, but it was convinced by the argument that the introduction of a *"Parliamentary override"* is not envisaged in the Treaty.

"Call-back mechanism" for European Parliament considered…

but not envisaged in the Treaty

Nevertheless the Committee believes that there are ways to ensure that the European Parliament will maintain a significant degree of control and have a significant impact on the implementing legislation enacted at Level 2 and in particular on the work of the Securities Committee.

But can meet European Parliament's concerns in other ways:

First, having agreed on the scope of implementing powers in Level 1, the European Parliament (along with other interested parties) will be fully informed at all times of the content of the ESRC's emerging advice and subsequently about the Commission proposals. The Commission and the two Committees will keep in close contact with the European Parliament, sending all the necessary documentation and agendas in good time (these requirements are specified, *inter alia*, in Articles 1 and 2 of the Interinstitutional Agreement). Further assurance could be given to the Parliament if, as suggested, the Commission published, whenever possible, at least in an indicative form, drafts of the more important implementing measures when it puts forward level one legislation.

(i) By keeping the European Parliament fully informed….

Second, before the Commission makes a proposal to the Securities Committee and after the Securities Committee has voted on it, the European Parliament will have sufficient time available to check that the proposal and the decision conform with the scope of the implementing powers defined by co-decision in Level 1.

(ii) By giving the European Parliament time to check the proposal (before ESC votes)

Third, if the European Parliament were to consider that the European Commission's proposal on the intended decision does not conform with the scope of implementing powers, it would pass a resolution. Were it to do so, the Commission would be required to re-examine its proposal and should take the utmost account of the European Parliament's position. Given the importance of institutional balance, it would be inconceivable if the Commission did not. The Commission, on the other hand, would have already undertaken to take the utmost account of the position of the European Parliament in its proposals.

(iii) By ensuring that Commission takes utmost account of any European Parliament resolution against proposal

Furthermore, it is in everybody's interest that the European

In everybody's

Parliament be given an adequate role in the procedure, within the limits of the Treaty. Were Parliament not to be satisfied, the consequences would be felt the next time co-decision legislation (Level 1) conferring implementing powers on the Securities Committee is proposed. This point would no doubt not be lost on the Commission or on the Securities Committee.

interest to give an adequate role to the European Parliament

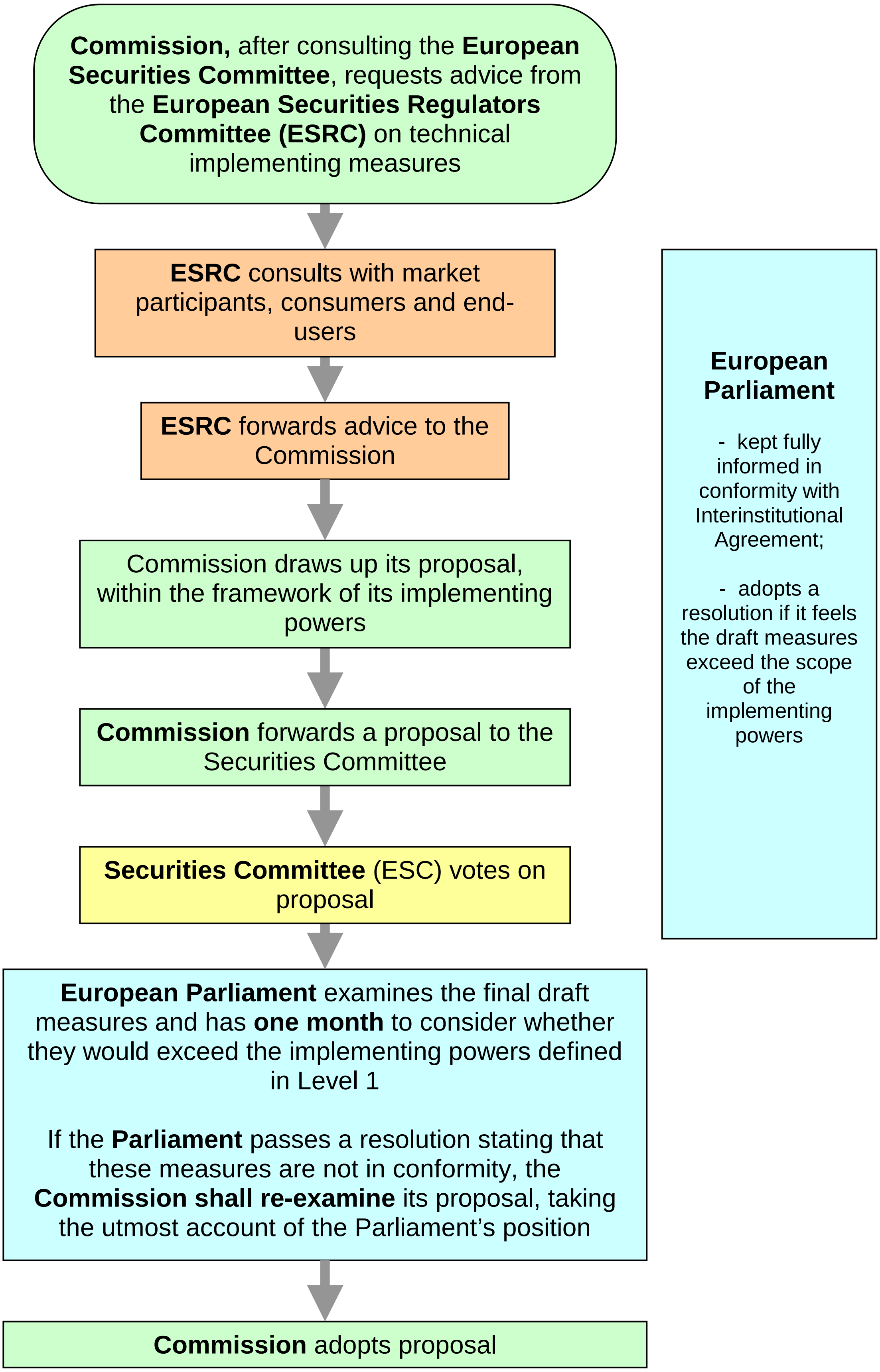
The Committee therefore concluded that these considerations properly safeguard parliamentary oversight.

So European Parliament's interests will be safeguarded

To the extent that any political problems remained, they should be dealt with by the three Institutions working together (the Commission, the European Parliament and the Council of Ministers) as soon as possible – in any case before the European Council in Stockholm or in the full review in 2004 recommended later in this report (which also coincides with the next Intergovernmental Conference).

The EU institutions should work together to sort out any residual problems

LEVEL 2 DECISION MAKING



LEVEL 3 – STRENGTHENED COOPERATION BETWEEN REGULATORS TO IMPROVE IMPLEMENTATION

The initial report stated that Level 3 should encompass a *"…framework of enhanced and strengthened cooperation and networking between (national) regulators with a view to ensuring consistent and equivalent transposition of Level 1 and Level 2 legislation…"*. National regulators were also encouraged to agree joint protocols for improving implementation and a peer review process to ensure consistent enforcement practice in the ESRC. The Committee confirms this approach.

Level 3 is strengthened cooperation among regulators to improve implementation

The essence of Level 3, therefore, is to greatly improve the consistency of the day to day transposition and implementation of Levels 1 and 2 legislation. It is the national regulators who have the prime responsibility for this work – acting in a cooperative network. It is the other main part of their responsibility.

Objective is to improve day to day transposition and implementation

- **Membership and voting**

Acting in its Level 3 role, the ESRC should be composed of a representative for each Member State designated by the national supervisory authority, or authorities. Given the crucial importance of common implementing rules and interpretations, the ESRC should decide by consensus in Level 3. The Commission could attend as an observer.

In Level 3, ESRC is more "independent". Voting by unanimity is necessary for implementation

- **Definition of Level 3 ESRC work**

The key objective is to greatly improve the common and uniform implementation of Community rules. The ESRC therefore should:

- produce consistent guidelines for the administrative regulations to be adopted at the national level;
- issue joint interpretative recommendations and set common standards regarding matters not covered by EU legislation – where necessary, these could be adopted into Community Law through a Level 2 procedure;
- compare and review regulatory practices to ensure effective enforcement throughout the Union and define best practice;
- periodically conduct peer reviews of administrative regulation and regulatory practices in Member States, reporting their results to the Commission and to the ESC.

The role of the ESRC in Level 3

The outcome of this work would be non-binding although clearly it would carry considerable authority.

Currently FESCO is carrying out only some of those tasks. So a political resolution will be needed to mandate regulators to carry out all of this essential work. Market participants should be prepared to submit examples of uneven implementation practice to the regulators, Commission and the Member States.

- **The importance of supervisory and regulatory convergence**

An important, immediate condition for the ESRC to achieve successfully the objectives stated above is that those mandated by the national regulatory authorities should have both the knowledge to carry out their work and the ability to deliver from the very outset the undertakings on which they have agreed. In the longer term, far more fundamental convergence is necessary among European regulatory structures in a number of areas. The main ones are to converge *"horizontal"* structures; the degree of autonomy of regulators; and not least the involvement of market participants in the regulatory process. The Committee urges governments to coordinate their efforts in this regard given the various initiatives underway.

The Committee believes regulatory convergence is necessary

ESRC members must be able to deliver the undertakings they make

LEVEL 3

LEVEL 1 / 2 ACTS

EU Securities Regulators Committee

Translation of Level 1 / 2 Acts and other EU securities legislation into effective and even enforcement of Community rules, using, *inter alia*:

- **Day to day administrative guidelines;**
- **Joint interpretation recommendations;**
- **Common (but not binding) standards in areas not covered by EU legislation;**
- **Comparison of regulatory practice to improve enforcement;**
- **Peer Reviews**

LEVEL 4 – ENFORCEMENT

The fourth level of the Committee's proposal concerns strengthening the enforcement of Community rules. All actors have a role to play here, but the major responsibility falls on the European Commission, which has the legal duty to act as guardian of the European Treaties.

Level 4 = greatly strengthened enforcement

The Committee however also underlines the role that Member States, regulators and the private sector have in improving enforcement of agreed Community law. The Commission, for example, needs complaints, information, and strong, well-researched cases. Yet too often the private sector is reluctant to come forward for fear of damaging its market opportunities. Regulators should inform the Commission immediately if they become aware of any potential infringements.

The primary responsibility is with the European Commission –but others must help, including….

The European Parliament as well should inform the Commission of any areas where it believes Community Law is being breached. As in the other areas, a partnership approach between the public sector and private sector is necessary for efficiency and success.

the European Parliament…..

The Commission, however, should be bolder in enforcing Community Law and checking the accurate transposition of agreed legislation. In many cases the mere opening of a case by the European Commission results in a rapid solution being agreed with the offending Member States.

The Commission should be bolder…..

4. MONITORING THE REGULATORY SYSTEM

The Committee underlines the particular importance that it attaches to an efficient, continuous process to monitor the effectiveness of the 4 level regulatory procedures that it is proposing. In the initial report the Committee suggested that *"…half yearly reports could be given to the Council on the progress, or lack of it, being made…"*.

An efficient half yearly monitoring process is essential

There are two questions: precisely what should the monitoring mechanism look at and who should the monitors be?

Assuming the Committee's 4 level regulatory structure is endorsed, there needs to be a strong system to report on the functioning of the legislative and regulatory process. It should identify the bottlenecks, and who is responsible. It should also report on whether there is real progress towards an integrated financial market. The Committee would expect all the institutions to pay considerable attention to its findings. The monitoring system however should not propose

Monitoring system should be blunt: where are the bottlenecks and who is responsible?

The results must

findings. The monitoring system, however, should not propose remedial measures.

be acted on

Given the fact that the Council of Ministers, European Commission and the European Parliament have equivalent stakes in the process, the Committee suggests that the Monitoring Group should be composed of two external nominees (i.e. not drawn from the membership of the Institutions) of the Council, European Parliament, and the European Commission.

Committee suggests 2 external nominees per Institution for the monitoring group

The Monitoring Group should produce half-yearly reports.

Half yearly monitoring reports are required

5. FULL REVIEW – 2004

Assuming that the new regulatory structure is functioning from the beginning of 2002 onwards, the Committee considers that there is a strong case for a full and open review of the 4 level process in 2004. This is in part due to the convergence of a number of significant political factors – a new Intergovernmental Conference (agreed upon at Nice), a period when the first wave of enlargement should be underway, and also a period when the main priorities of the Financial Services Action Plan should have been successfully negotiated.

Full review should take place in 2004 – coinciding with the next IGC

But another benefit of a full review in 2004 would be to dissipate any misplaced fears of institutional rigidity or permanence.

“No finality”

If in the light of the Monitoring Group’s half-yearly reports, it was manifestly clear well before 2004 that progress was not being made and that there did not appear to be any hope of progress, a full review would need to take place earlier. As already mentioned in the initial report, if the full review were to confirm in 2004 (or earlier as the case may be) that the approach did not have any prospect of success, it might be appropriate to consider a Treaty change, including the creation of a single EU regulatory authority for financial services generally in the Community.

If no progress, full review should take place earlier

FINAL COMMENTS

The outcome will hinge on the ability and willingness of the principal actors, the Commission, Council of Ministers, European Parliament, and national regulators to play *“a cooperative game”,* since all these actors carry part of the responsibility for the identified shortcomings in the current regulatory system.

What is the likelihood that the proposed framework could work? It is of crucial importance that there are:

- Clear mandates given to the two key Level 2 Committees.
- Full transparency throughout the system, coupled with deadlines in the decision making process.
- Strong monitoring and reporting to Council, Commission and Parliament and to the public at large.
- Active, well defined involvement of market participants and consumers.
- National regulatory structures reformed in a way that brings them closer to one another over time. Without such convergence there is serious risk that neither the ESRC nor the ESC, nor indeed their interaction, will yield results.

It will also be important that each institution can identify the benefits, both for itself, but also for the European Union in its entirety. **What are they?**

A more rational use of scarce resources. Faster decision making, more in tune with the needs of modern financial markets. A concentration of political efforts and energy on the key political principles. Bringing European regulators with their experts into a much more important *“formal”* European role: advising the European Commission on the necessary implementing details of each subject. For the Commission, the pivot of the whole system, there will be a much better chance to deliver the ambitious FSAP on time. For the European Parliament, far greater transparency and open consultation, no finality due to a 2004 review, participation in the monitoring system and the ability to determine what the scope of implementing powers are (in Level 1). Finally for the Council of Ministers: streamlined decision making and greater efficiency.

The Committee of Wise Men urges all concerned to give this fair and balanced approach their full hearted and active support. The benefits of success are simply too large to be ignored.

The present system, the status quo, simply will not do.

Brussels, 15 February 2000

ANNEX 1

ECOFIN COUNCIL MEETING ON 27 NOVEMBER 2000

CONCLUSIONS

1. The Council welcomes the initial report of the Committee of Wise Men, chaired by Alexandre Lamfalussy, on the Regulation of European Securities Markets and the methods the Committee has used to gather the views of interested parties.

2. ECOFIN shares the diagnosis of the report, namely:

- The economic benefits on economic growth, employment, productivity and for consumers, SMEs, large companies, as well as sovereign borrowers of integrating the EU's financial markets are considerable, which confirms the importance of the Lisbon Economic Reform Agenda. The Financial Services and Risk Capital Action Plans contains the right measures to be implemented as a response towards improving the single market in financial services, but these measures require more prioritisation.
- Financial markets are changing at a very fast pace, requiring regulators to keep up with market developments, a view strongly supported by market participants. In this context, the present regulatory system is too slow and complex, and is producing unnecessary levels of ambiguity and uneven implementation. Therefore urgent action is needed to make the current European regulatory system become more efficient, so that the goal of an integrated European financial market be delivered in the near future.

3. ECOFIN requests the Committee to present a final report in mid-February 2001. This report should focus on refining the regulatory approach proposed in its initial version, taking into account the institutional balance resulting of existing Treaty arrangements and the role of national regulators. This report shall propose operational recommendations.

4. ECOFIN shall examine these recommendations at the beginning of March in order to take appropriate measures at the Stockholm European Council in March. In this perspective ECOFIN recommends that discussions should be advanced with the European Parliament……

EUROPEAN COUNCIL – NICE

7-10 DECEMBER 2000

CONCLUSIONS OF THE PRESIDENCY

Regulation of financial markets

30. The European Council broadly agrees with the initial findings in the interim report by the Committee chaired by Mr Lamfalussy on the regulation of European securities markets and the third Commission report on the action plan for financial services. It invites the Council and the Commission to report back to it on this subject at Stockholm in March 2001 on the basis of the Committee's final report.

ANNEX 2

RECOMMENDED TIMETABLE
2000 – 2004

2001	
15 February	Publication of Final Report by Wise Men
15 February – 23/24 March	Consideration of report by Council of Ministers, European Parliament, Commission
23/24 March	Agreement at European Council, Stockholm on regulatory reform and FSAP priorities
April/May	(i) Commission brings forward some first FSAP directives in new format (ii) Commission decision on setting up European Securities Committee as an advisory group pending formal delegation of powers via adoption of a Level 1 directive/regulation.) (iii) Commission decision to set up European Securities Regulators Committee as an independent advisory group (outside comitology)
April – September	(i) New consultation procedures set up (Commission and ESRC) (ii) Interinstitutional Monitoring Committee agreed and set up
June/July	Giovannini report on clearing/settlement
November	First interinstitutional monitoring report presented to all Institutions
By December 2001	First provisional results from research on economic benefits of integrated European financial markets
By end December 2001	• Review of Commission, European Parliament and regulators staffing requirements • New private sector training initiative launched
By end December 2001	New Level 2 committee structure must be operational

2002	
March	Second monitoring report on functioning of regulatory system
September	Third monitoring report on functioning of regulatory system

2003	
March	Fourth monitoring report
September	Fifth monitoring report
By December	Interinstitutional agreement (and delivery) of key priorities (single prospectus; listing requirements; home country principle for wholesale markets, including definition of professional investor; new investment rules for investment and pension funds; adoption of international accounting standards; a single passport for recognized stock markets).

2004	
	• Intergovernmental Conference • Full review of *“new”* system • FSAP review
March	Sixth monitoring report

ANNEX 3

ANALYSIS OF THE COMMENTS ON THE INITIAL REPORT OF THE COMMITTEE OF WISE MEN ON THE REGULATION OF EUROPEAN SECURITIES MARKETS

SUMMARY

Forty one replies have been received, most of them from the private sector.

41 replies

All the respondents welcome the general thrust of the Committee's initial report. They consider it as a valuable contribution to the policy debate. They all share the analysis of the current situation contained in Chapters I, II and III of the initial report. They also share the view that urgent steps must be adopted in order to remove barriers to the integration of the European financial market.

Full support for the Wise Men's initial report

Most of the replies focus on the possible approach for European Regulation described in Chapter IV of the initial report.

Replies focus on regulatory approach

There is a general agreement that a more efficient, flexible and faster legislative process is needed. Responses nevertheless insist that faster legislation should not be at the expense of the quality of the regulatory system.

Accelerate the legislative process but maintain quality

Respondents also support the main lines of the proposed institutional and regulatory framework. However the objectives have to be defined. The distinction between primary and secondary technical legislation needs to be delineated clearly. Political willingness will be necessary to achieve this objective.

Full support for the four-level approach

Most of the respondents called for a more detailed analysis of the regulatory approach with practical examples in the final report.

Respondents want more details

The main issues raised by the respondents:

1. Guiding principles for the new regulatory framework

Most of the respondents consider that the following principles need to be applied:

Guiding principles

- **Transparency** of the whole legislative process is seen as fundamental. This implies early publication of preliminary thinking about policy, open consultation methods, the publication of agendas, the publication of minutes and documents of meetings, the establishment of forum/technical groups, organisation of conferences, roundtables, etc. The European Institutions and the new regulatory model should therefore adopt these working methods. Respondents also called for the Securities and Regulators Committees to set out these principles as a rule.

Transparent legislative process

- **Openness**. Market practitioners and consumers should be involved in the legislative process through early and continuous consultation.

Involvement of market practitioners

- **Accountability**. The democratic accountability of the Securities and Regulators Committees is seen as of vital importance. Respondents stated there must be adequate accountability mechanisms to fully inform the European Parliament. Different variants were suggested, such as hearings in front of the Parliament, regular reporting and the granting of observer status to the European Parliament in the Securities Committee.

Strong democratic safeguards necessary

TABLE 1 : COMMENTS ON THE NEW APPROACH SET OUT IN THE INITIAL REPORT

General opinion on the initial report	Full support of all respondents
Role of regulation/level of regulation	Need for a balance; avoid over-regulation
Guiding principles	Transparency, openness, accountability and flexibility
New approach of the legislative system **→ Level 1** **→ Level 2** **→ Level 3** **→ Level 4**	Widespread support for the concept of a four-level system Need for a clear definition of basic objectives Need for a clear distinction between primary and secondary legislation
Regulations/Directives	No clear positions expressed
Role of national regulators	Need for harmonization of competences General support for increased cooperation
Transparency	Needs to be set out as a guiding principle
Role of market participants / consumers	Early and institutionalised involvement in the legislative process
Enforcement	Need for increased resources for the Commission

2. Possible four-level approach

A small number of respondents argued that the adoption of a set of principles and objectives applying to all securities legislation would be useful for assessing future legislation.

(a) Level 1

Distinction necessary between primary and secondary legislation

The adoption of Level 1 legislation is considered to be crucial to the success of the new approach. A clear distinction must therefore be drawn between primary and secondary legislation (principles in Level 1, implementing details in Level 2). This may vary depending on the subject. Level 1 should contain "essential elements": fundamental principles which are unlikely to require amendment in the short or the medium term.

On the type of legislation, the suggestion to move from Directives to Regulations was also mentioned. Nevertheless, respondents did not set out clear preferences for either.

(b) Level 2

The final report should expand on some of the key points, such as:

Key point - define Level 2 more clearly

- <u>The role, the objectives and the working procedures of both Committees</u>

There is a general consensus that a set of objectives should be drafted to define the competence of both Committees. The need for transparency and co-operation with market-practitioners should guide their work and deliberations. Several respondents expressed concerns about transposing FESCO's working methods to the EU institutional framework. They therefore called for more details on the working procedures of the Regulators Committee.

Role, objectives and working procedures of both Committees

- <u>The composition of the Regulators Committee</u>

As there is not a common template for supervision, the composition of the Regulators Committee raises major issues, and some concerns. For example, the Competent Authorities that should advise the Commission in Level 2 might be current FESCO members. The missions and competence of national regulators vary considerably among the Member States. Prior harmonization of the national regulatory functions would therefore be desirable.

Composition of the Regulators Committee – need for convergence

- <u>The links between the Securities and the Regulators Committees and the European Parliament (EMAC)</u>

The respondents called for the role of the European Parliament to be respected in order to keep the legislative process open, accountable and democratic. Different models are proposed, such as the full accountability to Parliament of the Securities Committee, and the obligation to regularly report the activities of the Committees.

Strong links with the European Parliament essential

TABLE 2 : COMMENTS ON THE NEW INSTITUTIONAL FRAMEWORK

Securities Committee	General support for its establishment It needs to be accessible and transparent
Regulators Committee	Demand for more details on its role and composition
Role of European Parliament	Its rights should be preserved Accountability of the Securities Committee to it is recommended
Links between both Committees	More details are requested
Comments on FESCO	Criticism on the lack of transparency
Single European Supervisor	General agreement that it would be premature to create it for the time being

(c) Level 3

Convergence between national regulators

Most respondents consider that differences in the competences and powers of national supervisory authorities hinder the consistent application of EU legislation and effective international cooperation. A great majority of replies indicate that prior harmonization of the national regulators competences is seen as necessary, as well as a thorough revision of the division of responsibilities between supervisory authorities and exchanges.

(d) Level 4

More enforcement resources for the Commission

The lack of enforcement by the Commission is seen as having been a serious obstacle to the completion of a single market for financial services. Proposals for an increase in the enforcement resources and instruments for the Commission should be considered in the final report.

3. Other comments

Respondents have also submitted comments on the other preliminary conclusions of the initial report.

These are summarized in the following table:

TABLE 3: OTHER COMMENTS ON THE PRELIMINARY CONCLUSIONS

Economic benefits	Agreement on the proposal to carry out a proper study of the benefits
Trade issues	Endorsement of the Wise Men's analysis and suggestion to address these issues more prominently in the final report
Market volatility	Suggestions to exclude any assessment of volatility from the final report
The FSAP	General agreement to accelerate the completion of the FSAP to 2004 The EU needs to ensure that faster legislation does not mean lower quality legislation

Other comments

Some additional comments deal with the main technical issues contained in the initial report.

These are summarized in the table below:

TABLE 4 : ADDITIONAL COMMENTS

Clearing and Settlement	Suggestions to remove the obstacles necessary for the completion of a European market. Others express some doubts concerning the initial report's assessment of the savings that could be generated by an integrated clearing and settlement system. Some raise competition questions. Most of the respondents consider that market forces should drive the consolidation process.
Country of origin and mutual recognition	Some replies insist on the immediate and widespread implementation of these principles, notably for wholesale markets
Alternative trading systems	Request for the establishment of a level playing field between the exchanges
OTC market	Further regulation of the OTC markets considered unnecessary and undesirable
Categorization of investors	Differentiation between investors generally considered useful and necessary

Additional technical issues

ANNEX 4

Hypothetical examples of the possible role of the Securities Committee

These examples aim to describe how Level 1 proposals could be structured but are without prejudice to future work in the areas by the Commission and FESCO.

(a) Harmonization of regular reporting obligations

Note : the changes that could be made to the text in this hypothetical example are indicated in bold characters in italics.

COUNCIL DIRECTIVE
of 15 February 1982
on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing
(82/121/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 54 (3) (g) and 100 thereof,

Having regard to the proposal from the Commission (1),

Having regard to the opinion of the European Parliament (2),

Having regard to the opinion of the Economic and Social Committee (3),

Whereas Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock-exchange listing (4) seeks to ensure improved protection of investors and a greater degree of equivalence in the protection provided, by coordinating requirements as to the information to be published at the time of admission;

Whereas, in the case of securities admitted to official stock-exchange listing, the protection of investors requires that the latter be supplied with appropriate regular information throughout the entire period during which the securities are listed; whereas coordination of requirements for this

[1] In implementing the following principles, the competent authorities shall make an appropriate distinction between the requirements applying to the professional investors and those applying to retail investors (retail investors are to be understood as investors acting outside their professional activities).

regular information has similar objectives to those envisaged for the listing particulars, namely to improve such protection and to make it more equivalent, to facilitate the listing of these securities on more than one stock exchange in the Community, and in so doing to contribute towards the establishment of a genuine Community capital market by permitting a fuller interpenetration of securities markets;

Whereas, under Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock-exchange listing (5), listed companies must as soon as possible make available to investors their annual accounts and report giving information on the company for the whole of the financial year; whereas the fourth Directive 78/660/EEC (6) has coordinated the laws, regulations and administrative provisions of the Member States concerning the annual accounts of certain types of companies;

Whereas companies should also, at least once during each financial year, make available to investors reports on their activities;

Whereas this Directive can, consequently, be confined to coordinating the content and distribution of a single report covering the first six months of the financial year;

Whereas, however, in the case of ordinary debentures, because of the rights they confer on their holders, the protection of investors by means of the publication of a report is not essential;

Whereas, by virtue of Directive 79/279/EEC, convertible or exchangeable debentures and debentures with warrants may be admitted to official listing only if the related shares are already listed on the same stock exchange or on another regulated, regularly operating, recognized open market or are so admitted simultaneously;

Whereas the Member States may derogate from this principle only if their competent authorities are satisfied that holders have at their disposal all the information necessary to form an opinion concerning the value of the shares to which these debentures relate;

Whereas, consequently, regular information needs to be coordinated only for companies whose shares are admitted to official stock-exchange listing;

Whereas the report must enable investors to make an informed appraisal of the general development of the company's activities during the period covered by the report;

Whereas, however, this report need contain only the essential details on the financial position and general progress of the business of the company in question;

Whereas, in order to take account of difficulties resulting from the current state of laws in certain Member States, companies may be allowed a longer period to implement the provisions of this Directive than that laid down for the adaptation of national laws;

Whereas, so as to ensure the effective protection of investors and the proper operation of stock exchanges, the rules relating to regular information to be published by companies, the shares of which are admitted to official stock-exchange listing within the Community, should apply not only to companies from Member States, but also to companies from non-member countries

HAS ADOPTED THIS DIRECTIVE:

SECTION I

General provisions and scope

Article 1

1. This Directive shall apply to companies the shares of which are admitted to official listing on a stock exchange situated or operating in a Member State, whether the admission is of the shares themselves or of certificates representing them and whether such admission precedes or follows the date on which this Directive enters into force.

2. This Directive shall not, however, apply to investment companies other than those of the closed-end type. For the purposes of this Directive 'investment companies other than those of the closed-end type' shall mean investment companies:

- the object of which is the collective investment of capital provided by the public, and which operate on the principle of risk spreading, and

- the shares of which are, at the holders' request, repurchased or redeemed, directly or indirectly, out of those companies' assets. Action taken by such companies to ensure that the stock-exchange value of their shares does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption.

3. The Member States may exclude central banks from the scope of this Directive.

Article 2

The Member States shall ensure that the companies publish a report on their activities and profits and losses on a regular basis.

The report shall be published within a fixed time limit.

The report shall be sent to the competent authorities of each Member State in which its shares are admitted to official listing, and shall be made available to the public.

It shall contain comparative figures as well as an explanatory statement relating to the company's activities and profits and losses, so as to enable investors to assess the current state and the likely future developments of the company.

The report must be drawn up in the official language or languages or in one of the official languages or in another language, provided that, in the Member State concerned, such official language or languages

or such other language are customary in the sphere of finance and are accepted by the competent authorities.

Where the accounting information has been audited by the official auditor of the company's accounts, that auditor's report and any qualifications he may have shall be reproduced in full.

Article 3

The Member States may subject companies to obligations more stringent than those provided for by this Directive or to additional obligations, provided that they apply generally to all companies or to all companies of a given class.

SECTION ***II***

Powers of the competent authorities

Article ***4***

1. Member States shall appoint one or more competent authorities and shall notify the Commission of the appointment of such authorities, giving details of any division of powers among them. Member States shall also ensure that this Directive is applied.

2. The Member States shall ensure that the competent authorities have the necessary powers to carry out their task.

3. If a company governed by the law of a non-member country publishes a report in a non-member country, the competent authorities may authorize it to publish that report instead of the report provided for in this Directive, provided that the information given is equivalent to that which would result from the application of this Directive.

4. This Directive shall not affect the competent authorities' liability, which shall continue to be governed solely by national law.

SECTION ***III***

Cooperation between Member States

Article 5

1. The competent authorities shall cooperate whenever necessary for the purpose of carrying out their duties and shall exchange any information

required for that purpose.

2. Where a report has to be published in more than one Member State, the competent authorities of these Member States shall, by way of derogation from Article 3, use their best endeavours to accept as a single text the text which meets the requirements of the Member State in which the company's shares were admitted to official listing for the first time or the text which most closely approximates to that text. In cases of simultaneous admission to official listing on two or more stock exchanges situated or operating in different Member States, the competent authorities of the Member States concerned shall use their best endeavours to accept as a single text the text of the report which meets the requirements of the Member State in which the company's head office is situated; if the company's head office is situated in a non-member country, the competent authorities of the Member States concerned shall use their best endeavours to accept a single version of the report.

SECTION ***IV***

Securities Committee

Article ***6***

1. ***The Commission shall be assisted by a Committee, composed of representatives of the Member States and chaired by the representative of the Commission (The Securities Committee)***

2. The regulatory procedure laid down in Article 5 of Decision 1999/468/EC shall apply in compliance with Article 7 and Article 8 thereof.

3. The Securities Committee shall have as its functions :

(a) to set out, for the application of Article 2 of the Directive, the following elements :

- the period within which the report shall be published;

- the circumstances in which the competent authorities will be permitted to extend the time limit for publication;

- where a company publishes consolidated accounts, the circumstances in which Member States may allow the competent authorities to require the company to publish additional information;

- the modes of publication of the report;

- the date of communication of the report by the company to the Member States competent authorities;

- the circumstances in which the competent authorities will be permitted to provide for adaptations to the particular requirements of this Directive ;

- the conditions under which the competent authorities may authorise

the omission from the report of certain information provided for in this Directive.

(***b***) without prejudice to Articles 169 and 170 of the Treaty to facilitate the harmonized implementation of this Directive through regular consultations on any practical problems arising from its application on which exchanges of views are deemed useful;

(***c***) to facilitate consultation between the Member States on the more stringent or additional obligations which they may impose pursuant to Article 3 with a view to the ultimate convergence of obligations imposed in all Member States, in accordance with Article 54 (3) (g) of the Treaty;

(***d***) to advise the Commission, if necessary, on any additions or amendments to be made to this Directive; in particular, the Committee shall consider the possible modification of ***Articles 2 and 3*** in the light of progress towards the convergence of obligations referred to in (b) above.

2. Within five years of notification of this Directive, the Commission shall, after consulting the ***Securities*** Committee, submit to the Council a report on the application of ***Articles 2 and 3*** and on such modifications as it would be possible to make thereto.

SECTION ***V***

Final provisions

Article ***7***

1. Member States shall bring into force the measures necessary to comply with this Directive not later than 30 June 1983. They shall forthwith inform the Commission thereof.

2. Member States may postpone application of the measures referred to in paragraph 1 until 36 months from the date on which they bring such measures into force.

3. As from the notification of this Directive, Member States shall communicate to the Commission the main provisions of the laws, regulations and administrative provisions which they adopt in the field governed by this Directive.

Article ***8***

This Directive is addressed to the Member States.

Done at Brussels, 15 February 1982.

(1) OJ No C 29, 1. 2. 1979, p. 5 and OJ No C 210, 16. 8. 1980, p. 5.

(2) OJ No C 85, 8. 4. 1980, p. 69.

(3) OJ No C 53, 3. 3. 1980, p. 54.

(4) OJ No L 100, 17. 4. 1980, p. 1.

(5) OJ No L 66, 16. 3. 1979, p. 21.

(b) Harmonization of core conduct of business rules for investor protection

The FESCO Expert Group on Investor Protection has drafted a proposal for the harmonisation of core conduct of business rules for investor protection (article 11 of the Investment Service Directive (93/22/EEC)).

This note sets out a model of a possible EU approach inspired by FESCO's work as it relates to information to be provided to customers.

Annex A contains an hypothetical example of a directive providing for basic principles and conferring implementing powers on the Securities Committee.

Annex B contains implementing rules which could be adopted by the expert committee process after the adoption of the basic directive described in annex A.

ANNEX A

I. Basic principles to be set out by the legislator in an EU directive[1]

Information to be provided to the customers

1. Prior to the provision of investment services, an investment firm must provide to customers information relating to

- *itself and the services it provides;*
- *the key features of investments services and financial instruments envisaged;*
- *the charges relating to the services or instruments envisaged;*
- *the risks associated with the financial instruments and transactions*

envisaged.

2. *During the performance of investment services, an investment firm must ensure that customers are provided promptly with the essential information concerning the progress of execution of any transaction they undertake.*

3. *If an investment firm issues a marketing communication, the promotional purpose of marketing communications must not be disguised.*

4. *The information provided to the customers shall be fair, clear, and not misleading, so as to enable them to make informed investment decisions.*

Customer agreements

1. *Prior to the provision of any investment service, the investment firm must enter into a written agreement with the customer setting out the rights and obligations of the parties, a description of the services to be provided, and all other items of information necessary for the proper understanding and performance of the agreement.*

2. *The customer agreement must be clear and easily understandable by the customer.*

II. Implementing measures to be adopted by the Securities Committee

1. *The Commission shall be assisted by the Committee established by the Directive on information to be published on a regular basis by companies the share of which have been admitted to official stock-exchange listing (82/121/EEC) (The Securities Committee)*

2. *The regulatory procedure laid down in Article 5 of Decision 1999/468/EC shall apply in compliance with Article 7 and Article 8 thereof.*

3. *The Securities Committee shall have as its functions to set out the following elements :*

- *guidance as to the appropriate way to present and communicate* *information to the customer;*

- *where appropriate, the time-limit in which any requested information shall be provided to the customer ;*
- *the content of any information to be provided to the customer;*
- *the content of any marketing communication;*
- *the content of the customers agreements.*

ANNEX B

Selection of rules set out in FESCO's consultative paper on the harmonization of core conduct of business rules for investor protection

A. INFORMATION TO BE PROVIDED TO CUSTOMERS

(1) BASIC REQUIREMENTS

- ***RULES***

1. The firm must ensure that information provided to customers is clear and comprehensible. The content and purpose of the information should be easily understood and key items should be given due prominence. The impact of the message should not be diminished or obscured by the use of inappropriate content or presentation.

2. The investment firm must take into consideration the time necessary for a customer to absorb and react to the information provided and must supply its customers with information on a prompt basis according to the urgency of the situation.

3. If information provided contains comparisons, the requirement of being fair, clear and not misleading means that the comparisons must:

a) be based either on facts verified by the investment firm, or on assumptions stated within the information;

b) be presented in a fair and balanced way;

c) not omit any fact that is material to the comparison.

(2) INFORMATION TO BE PROVIDED TO CUSTOMERS BEFORE THE PROVISION OF INVESTMENT SERVICES

(2.1) MARKETING COMMUNICATIONS

- ***RULES***

4. An investment firm must be able <u>to demonstrate</u> that the information provided in a marketing communication is consistent with the information it provides to its customers before and during the provision of the investment services.

5. Any marketing communication must contain at least the information about the investment firm defined in points a) and d) of paragraph 35. In case of a cross border marketing communication, the information provided must in addition state that information about the firm can also be obtained from or through the competent authority of the Member State where the customer resides.

6. An investment firm must not use the name of the competent authority to endorse its marketing communication or services.

7. Where a marketing communication refers to a financial instrument or an investment service it must provide at least the information referred to in points a) and d) of paragraph 39.

(2.2) INFORMATION ABOUT THE INVESTMENT FIRM

- ***RULE***

8. An investment firm must provide customers with the following information prior to the provision of investment services:

a) the identity of the investment firm, its postal address and telephone number;

b) the financial group to which the investment firm belongs;

c) the identity and status within the investment firm of employees and other relevant agents with whom the customer has or is to have contact;

d) the fact that the investment firm is authorised and/or registered and the name of the competent authority that has authorised and/or registered it;

e) the legal capacity in which the investment firm acts and the functions that it performs so that that the customer is able to assess the scope of the firm’s responsibilities;

f) details of the relevant compensation scheme;

g) details of any relevant out-of-court complaint and redress mechanism and how the customer can access it;

h) any existing or potential conflicts of interest between the investment firm and its customer and an outline of the firm's policies in relation to conflicts of interest;

i) the languages in which the customer can communicate with the investment firm.

(2.3) INFORMATION ON FINANCIAL INSTRUMENTS AND INVESTMENT SERVICES

- ***RULES***

9. An investment firm must inform potential customers of the key features of financial instruments and investment services. This information must consist of a description of the type of instruments and services that must be in line with the firm’s assessment of the customer's knowledge and experience and having regard to any relevant facts disclosed by the customer.

10. The information provided to customers must include the following:

a) a description of the main characteristics of the instrument/service, including the nature of the financial commitment, whether they are traded on a regulated market or not and the risks involved;

b) price, including commissions, fees and other charges, of the instrument/service;

c) arrangements for payment and performance;

d) details on any cancellation rights or rights of reflection that may apply.

11. In order to give a fair and adequate description of the investment service or financial instrument being promoted, an investment firm must avoid accentuating the potential benefits of an investment service or financial instrument without also giving a fair indication of the risks.

12. The fair and adequate description of a compound product must contain all the relevant characteristics of the composing instruments. The ‘relevant characteristics’ of a compound product means all the different characteristics of the product, for example the different services involved, the duration of the product, the fact whether you borrow money, the interest due, etc.

13. The information on financial instruments and investment services must not state or imply that the performance of services or of the investment is guaranteed unless there is a legally enforceable arrangement with a third party who undertakes to meet in full an investor's claim under the guarantee. Sufficient detail about the guarantor and the guarantee must be provided to enable the investor to make a fair assessment of the guarantee.

14. When information provided refers to a particular tax treatment the investment firm must remind the customer that the taxation depends on his or her personal situation and that the tax treatment is subject to change. In any event the investment firm must recommend to the customer to seek independent tax advice.

15. If a reference to historical performance of investment services or financial instruments is made, it must be clearly expressed that the figures refer to the past, and that they do not constitute reliable guidance as to the performance of these services and instruments in the future.

16. Any estimate, forecast or promise contained in the information on financial instruments and investment services must be clearly expressed, must state the assumptions on which it is based, must be relevant and must not mislead the customer.

17. If the information refers to actual returns based on past performance:

a) the reference period must be stated and must not be less than one year, provided that the relevant data are available;

b) where returns relate to more than one year, they must either be reduced to an average annual rate or stated separately as annual returns;

c) where an average annual return is presented for more than one year, a reference period of at least five years must be used provided the relevant data are available. If the relevant data are not available over a reference period of at least five years (e.g. because the financial instrument or the investment portfolio has not existed for such a period), the returns may be measured from the issue date or the date on which the portfolio was established;

d) where a benchmark is used to compare returns, it must be identified and its reference period must be equal to that of the investment service or financial instrument being promoted;

e) the information provided must, if simulated returns are used, state that a simulation has been used;

f) if the return figures are not denominated in local currency, the currency used must be stated and reference shall be made to the currency risk for the return in local currency.

18. The relevant provisions on actual returns shall apply mutatis mutandis to the method of calculating and presenting the future returns. Information on estimated future returns must state that the estimated future returns are forecasts and that the forecasts are supported by figures and have been subject to verification by an independent third party.

19. A direct offer marketing which promotes a specific financial instrument or investment service must contain a fair and adequate description of the instrument or service, including the risks involved, so as to enable potential customers to make an informed assessment of such instrument or service.

20. A direct offer marketing must contain a prominent statement that, if a customer has any doubt about the product or service which is the subject of the marketing communication, he should contact the investment firm for advice or contact an independent intermediary if the investment firm does not offer advice.

Derivatives and leveraged transactions

21. If the customer envisages undertaking transactions in derivatives, the information provided must relate to the types of instruments concerned (e.g. futures/options/swaps), include an explanation of their characteristics (especially the leverage effect, the duration of the premium, the liquidity and volatility of the market) and a description of their underlying parameter (e.g. equities/interest rates/currencies), and indicate the method to be used to execute the customer's transactions (in particular, on a regulated market or not).

2.4 COMMISSIONS, CHARGES AND FEES

- ***RULES***

22. The information to be disclosed on commissions, charges and fees must contain:

a) the charges for each transaction, product or service, specifying clearly the reason for the charge and detailing, where appropriate, the percentage or rate applicable, the frequency with which it is applied, any maximum or fixed minimum fees and, where the commission or fee must be paid in foreign currency, the currency involved;

b) if various investment firms are to be involved in a transaction or service, an indication to this effect. An investment firm may elect to establish the full cost to the customer of the transaction or service or the cost solely of its own intervention, stating in this case the items involved plus an indication of the fees relating to the participation of the other firms.

2.5 RISK WARNINGS

- ***RULES***

55. In addition to the information to be included in marketing communications and product literature the investment firm must provide its customers with specific risk warnings as appropriate. Instances where the type of instrument or transaction envisaged makes specific risk warnings necessary include:

- financial instruments not traded on a regulated market;
- financial instruments not authorised to be marketed to the public in the country of residence of the customer;
- transactions in illiquid financial instruments ;
- derivatives;
- financial instruments subject to high volatility;
- short sales of financial instruments;
- securities repurchase agreements or securities lending agreements;
- foreign markets where appropriate;
- transactions which involve credit or margin payments;
- deposit of collateral;
- foreign currency transactions.

As a minimum the investment firm must explain to the customer that contracts in these instruments and transactions should not be entered into unless the customer fully understands the nature and scope of the risk and appreciates the extent of the exposure to that risk.

56. Risk warnings about derivatives must disclose that the instrument can be subject to sudden and sharp falls in value. Where the investor may not only lose his entire investment but may also be required to pay more later, he must also be warned about this fact and the possible obligation to provide extra funding. In addition the risk warning must, where appropriate, carry information on a) clearing house protections (e.g. that although the performance of a transaction is sometimes ‘guaranteed’ by the exchange or clearing house this guarantee will not necessarily protect the customer in the

event of default by the investment firm or another counterparty); b) suspension of trading (e.g. that under certain trading conditions it may be impossible to liquidate a position); c) insolvency (e.g. that in the event of default of an investment firm involved with the customer's transaction, positions may be liquidated automatically and actual assets lodged as collateral may be irrecoverable.

ANNEX 5

FINAL

7 November 2000

INITIAL REPORT

OF

THE COMMITTEE OF WISE MEN

ON

THE REGULATION OF EUROPEAN SECURITIES MARKETS

Brussels, 9 November, 2000

THE COMMITTEE OF WISE MEN

Chairman : Alexandre LAMFALUSSY

Cornelius HERKSTRÖTER

Luis Angel ROJO

Bengt RYDEN

Luigi SPAVENTA

Norbert WALTER

Nigel WICKS

Rapporteur : David WRIGHT

Secretariat : Pierre DELSAUX

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PREAMBLE

This document constitutes the Committee of Wise Men's initial report on the Regulation of European Securities Markets in conformity with the Committee's terms of reference which were defined by the European Union's Economic and Finance Ministers on 17 July 2000 (see Annex 1). The Committee has been requested to "…present an initial report to the ECOFIN Council early in November 2000. This report will present the state of play and initial approaches to solutions…". The three main elements of the terms of reference are :

Initial report

- **to assess the current conditions for implementation of the regulation of the securities markets in the European Union;**
- **to assess how the mechanism for regulating the securities markets in the European Union can best respond to developments underway on securities markets……; and**
- **in order to eliminate barriers and obstacles, to propose as a result scenarios for adapting current practices in order to ensure greater convergence and cooperation in day to day implementation, taking into account new developments in the market.**

The 3 main elements of the mandate

The Committee decided that the main focus of its work should be on securities markets, primary and secondary, dealing with equities, derivatives (including the over the counter (OTC) market), corporate bonds, government bonds etc. As to the type of securities markets, both regulated markets and alternative trading systems (ATS) were taken into account.

Focus is on European securities markets

The Chairman, Alexandre Lamfalussy, and Members of the Committee would like to thank the French Presidency of the European Union, Members of the European Parliament's Economic and Monetary Affairs Committee, representatives of the Member States and the European Commission, notably the rapporteur, the secretariat and their staffs, for their cooperation and contributions to the Committee's work. The Committee would also like to thank all those who have taken part in the Committee's hearings, often making themselves available at very short notice, and those organizations and individuals who have responded to the Committee's on-line questionnaire.

Remerciements

The Committee would welcome a wide debate on its initial conclusions in the short period that remains before its final report which will be released in mid-February 2001 in advance of the Stockholm European Council on 23/24 March. Comments may be made to the Committee via the following e-mail address : pierre.delsaux@cec.eu.int or by fax 00.32.2.2955606.

Wide debate on initial report findings encouraged

INTRODUCTION

Profound market change : driven by globalization, improvements in communications and IT, and the euro…

The speed of change in European and global financial markets today is breathtaking and accelerating. The velocity and complexity of the changes underway are among the most profound in the history of financial markets. There are many forces at work : globalization, which has created a highly competitive environment; rapid progress in communication and information technologies, which are reducing the costs of trading, spurring financial product innovation, with the introduction of new products almost a daily occurrence; and the euro, which, by removing exchange rate risk in the euro area, is helping push European financial markets towards more integration. This process is reshaping European securities markets, including stock exchanges and market participants.

Means new challenges for securities regulators and regulation

Changes of this magnitude are posing significant challenges for European financial regulators, and regulation in general in the context of building an integrated European financial market. First, the obstacles to integration arising from unnecessary differences in the various jurisdictions of the EU, which are a persistent cause of market segmentation should be removed. Second, European regulation needs to keep up with the rapid pace of technological and market change, whilst continually ensuring proper investor protection and stability throughout the whole financial system. One of the major challenges is to make sure that the European regulatory system can adjust continuously, flexibly and rapidly to future developments which are unpredictable today. Yet it needs to do this in a way which does not inhibit legitimate market development and is neutral as regards competition between different financial service providers.

An efficient regulatory process is crucial

An efficient European regulatory process for financial services and capital markets is crucial for the whole of the European Union and all its citizens. Crucial for successful economic reform, for boosting European economic growth. Crucial for helping channel the high rate of European savings towards the corporate sector. Crucial for strengthening both the international competitiveness of the European Union in the global economy and for releasing its entrepreneurial potential. Crucial also for job creation and consumer protection. There are major strategic, economic and social benefits to reap from an integrated European capital market.

Reforms needed to create an integrated European financial market parallel the "1992" internal market process

The Committee is aware of the close historical parallels between the reforms now needed at European level to create a fully integrated financial services and capital market and those used to build the *"1992"* internal market. The parallelism between the European Commission's 1992 programme and the Financial Services Action Plan is clear. The aim in both cases is to create a single economic space. Both require effective and timely regulation at European level which is a *sine qua non* to ensure that European markets work better and achieve high levels of integration. A key part of this objective is to make sure that agreed European legislation is properly implemented and make sure that agreed European legislation is properly implemented and enforced.

For the European Union, financial services integration is the major economic challenge along with building the information economy

Building an open European financial services and capital market in the next few years - the logical and necessary complement of the euro - is the major missing piece of the European Union’s internal market. In tandem with building the information economy, to which there are strong links, this is the major near-term economic challenge for the European Union – two judgements that the Lisbon European Council confirmed in March this year.

The initial report’s scope

This initial report evaluates the current situation, and the challenges ahead, from both a market and regulatory perspective. It contains the Committee’s preliminary views on some possible solutions.

Time is short to capture the benefits

There is a need for action now. Delay means delaying the benefits, or perhaps risking no benefits at all. Delay means the continuation of European financial market fragmentation, unnecessary costs and a sub-optimal European economic performance.

CHAPTER I – THE BENEFITS OF EUROPEAN FINANCIAL INTEGRATION

The Committee believes that there will be significant long term benefits if the European Union can integrate its financial and capital markets quickly. The box below summarizes the main factors.

Summary of expected benefits from an integrated European financial services and capital market

Expected Benefits from an Integrated European Financial Services and Capital Market

I. Improving the allocation of capital in the European economy :

- More efficient, deeper, and broader securities markets enabling savings to flow more efficiently to investment.
- Reduced transaction costs and increased market liquidity.
- More diversified and innovative financial system.
- More opportunities to pool risk.

II. More efficient intermediation of European savings to investment :

- Intensified competition between financial markets and intermediaries.
- Economies of scale, scope and a reduction in inefficiency.
- More economic cohesion.

III. A strengthening of the EU economy, resulting in it becoming a more attractive location for inward investment

These benefits, if taken together, should be widely shared by European citizens, small and medium sized businesses, and large companies. Below are examples of the type of benefits that could be captured :

(i) For European citizens

Higher investment returns for European citizens

The real return on ordinary investors' savings in securities (directly or through funds) should be higher. European investment funds, pension funds, and citizens themselves would be able to invest more freely across the EU. Funds will be better able to use modern investment management techniques. They would also have a more diversified investment choice of the whole European market. European funds could grow in size – reducing administrative costs and improving net returns for investors. On average a US investment fund is 6 times larger than its European equivalent and overall, the capitalization of all US investment funds is twice as large as those in the EU.

Bigger EU investment funds

And improved performance

Over the period 1984-1998 the average real return on pension funds was 10.5% in the US and 6.3% in those EU countries where funds faced severe investment restrictions. Integrated European markets with more flexible investment rules, therefore, should improve the risk-return frontier. Higher returns could also lower the cost of pension schemes, resulting in a reduction of labour costs and an improvement in competitiveness.

The Committee believes that it is of the utmost importance to underline that an integrated European capital market, by raising the real return on capital, will deliver significant direct benefits for citizens. The following indicative figures show why.

Why this matters so much for European citizens – a pensions example

If a person wants to have benefits that represent 35% of their final salary by investing in a pension scheme over a 40 year career, pension contributions need to be :

- 5% of salary if the real rate of return of the pension plan is 6%.
- 10% of salary if the return is 4%.
- 20% of salary if the return is 2%.

Macroeconomic performance could improve – impacting positively on employment creation

As the EU's demographic trends will lead to far more reliance on privately funded pension schemes in the future, these benefits are particularly important. In addition, efficient European capital markets should improve the overall macroeconomic performance of the economy, producing higher economic growth with positive impacts on employment creation and productivity.

To capture all these benefits a number of conditions will have to be fulfilled. Among the most important are :

- an efficient, competitive, innovative and properly regulated EU financial services market;
- intermediaries should exercise good professional judgement, taking into account the different needs of professional and retail investors. They should provide full explanations of the risk profiles attached to different financial products along with accurate, relevant, and timely information on savings products (including information on companies) in order to ensure proper protection of the consumer;
- rigorous monitoring and control of selling techniques, particularly in the growing internet/e-commerce distance–selling segments of the market.

But a number of conditions need to be fulfilled

The fulfilment of these conditions will contribute greatly to the attainment of broad public confidence in European financial markets.

Building public confidence is essential

(ii) For small and medium sized companies (SMEs)

Integration should benefit the financing of small and medium sized companies – the essential employment creator and backbone of the European economy. Today there is still an inadequate supply of risk capital in the EU with venture capital only 1/5 of US per capita levels. However if the European Union's financial markets can integrate (and develop deeper pools of interconnected liquidity, a common prospectus for cross-border capital raising, common listing requirements together with one set of international accounting standards etc), European venture capital financing will be encouraged from the bottom up. This correlated venture capital-entrepreneurial axis is absolutely vital for creating a dynamic European economy – and developing new companies to invest in. This means the whole financing chain - from start up capital to Initial Public Offer to wholesale debt raising - has to work efficiently. The overall strength of European capital market will be as strong as its weakest link.

An integrated EU capital market can offer a wider choice of instruments for SMEs – and will encourage venture capital growth

During the Committee's deliberations a number of differing views were put forward concerning the impact of an integrated European capital market on small/medium cap liquidity. Some argued that there will be a *"herd"* tendency, (e.g. towards index-tracking instruments) concentrating liquidity on the blue chip stocks to the detriment of the smaller stocks and peripheral and local stock exchanges. Others said that as European markets integrate, investors will seek a broader range of companies to invest in – including SMEs. Indeed as interconnected liquidity pools deepen, liquidity for SMEs could improve leading to benefits for all companies *"rising on the integration tide"*. Investors, it is argued, will always be on the lookout for highly profitable, even if riskier investments. This is what happened in the US (e.g. the NASDAQ market) where capital for new growing companies was found because many institutional and retail investors saw opportunities in

Could financial integration damage small/medium cap liquidity?

Views differ

balancing the extra marginal risk against the higher returns that small and start up companies can generate. Obviously these two conflicting trends could be at work simultaneously. In any event SMEs themselves clearly have the responsibility to demonstrate they represent good value.

SMEs themselves must demonstrate that they are a good investment

(iii) For large companies

For large European companies the cost of raising capital in the EU is higher than in the US - even for top blue chip customers. This cost is caused by the complexity of cross-border capital raising in the EU; different rules in each Member State impairing liquidity and efficient pricing; unnecessary costs of establishment plus a higher cost of capital *per se*. The relative cost may well be higher the smaller the company. At best these are unnecessary, expensive *"non-integration"* costs – at worst they drive the business out of Europe, usually to the US, with potentially damaging long term consequences for the European economy. Firms with long term, innovative investment projects may be the most affected.

Fragmented EU capital markets means a higher cost of capital for large companies

For large companies, an integrated market will offer many more possibilities to raise equity capital and to gain access to a growing euro corporate bond market to securitize their debt.

Integration benefits – securitizing debts/growth of corporate bonds and easier to raise equity capital

(iv) Stimulating competition and innovation

One of the most important elements for building an integrated securities market is to encourage competition and to ensure there is open entry and access to *"contestable"* markets on non-discriminatory terms. In an integrated and open European market, competition and innovation would stimulate new financial products and financial services. They would also reduce the costs of standard products (e.g. commercial loans, credit card, and mortgage or private equity transactions) which can be expected to converge over time to lower levels. In an integrated European market, total transaction costs would also fall and the price mechanism would work more efficiently. The experience of applying the principles of open access to telecommunications networks and to many other sectors of the European economy is an indication of the positive gains to be seized for the users of financial services from the construction of a competitive, integrated single market.

Integration will strengthen competition and innovation – driving down the cost of standard financial products

It has been suggested to the Committee that more rational and integrated clearing and settlement systems for cross-border European securities trading could save around 1 billion euros annually. It is apparent that clearing and settlement systems in the EU are not cost-efficient at present and so progress towards cost reduction in Europe could have a significant beneficial effect in promoting EU cross-border investment and market integration. This is primarily a question for the markets to determine. However there is a public interest in ensuring that access to clearing and settlement systems is open and fair, and that prudential safety is ensured.

Big clearing and settlement savings are possible

As markets integrate and competition strengthens, there will be an inevitable *"creative destruction process"*. Rationalization and restructuring can be expected particularly among intermediaries and in the banking sector, as the combination of the effects of disintermediation, concentration and conglomeration multiply. As has proven to be the case in the opening up of telecommunications markets in the EU, new financial markets, products, companies, and indeed job creation should be able to offset any downside effects, with systemic stability ensured.

However there will be some "creative destruction" that should be offset by more innovation

(v) The size of the benefits

It is not simple to quantify the net sum of these benefits, but potentially they are large. Recent evidence from cross-country data suggests that there is a close link between the size and growth of financial markets and the growth of output. Furthermore, most of this increase appears not to be driven by faster capital accumulation but by higher productivity. The evidence from some recent academic studies can be found in Annex 4.

Magnitude of benefits not precisely known – but potentially large

CHAPTER II – FINANCIAL MARKET DEVELOPMENTS IN THE EUROPEAN UNION

The Committee has identified five overarching trends in the financial markets.

Trend 1 : Significant growth in securities business and demand for equity

The European corporate sector has traditionally been more dependent on bank loans as a source of external finance than its US counterpart. At the start of the 1980s, over 80% of external financing of continental European firms was provided by banks and the European commercial paper market was non-existent. The raising of finance through the issuance of equity and corporate bonds has now overtaken bank loans as a source of corporate finance (see Table 1). Nevertheless, these sources of finance are still less developed than in the US.

European equity and fixed income business growing strongly – but sizewise, still way behind the US

The most notable growth has to date been achieved in equity, where recent annual growth rates of volumes traded have exceeded 30% per annum over the period 1995-1999. Similar progress has been observed in fixed income securities particularly the issuance of asset-backed (mortgage) bonds and securitization of loans by financial institutions. The European corporate bond segment is also starting to increase (with 18% growth in 1998 and 58% in 1999). The size of the average corporate bond issuance also doubled in 1999, reflecting the better absorption capacity of the markets.

New European securities and listings beginning to expand

New securities and new listings have been a significant component in the growth of European stock market capitalization. In 1999, stock market capitalization of EU-15 markets reached 109% of GDP (85% for Euro-11 countries). This compares with cumulative total of 181% of US GDP. The number of companies listed on EU-15 exchanges has grown steadily from 6401 in 1995 to 8111 in 1999 (with the bulk of this growth occurring in the Euro-11 markets – from 3475 to 4416).

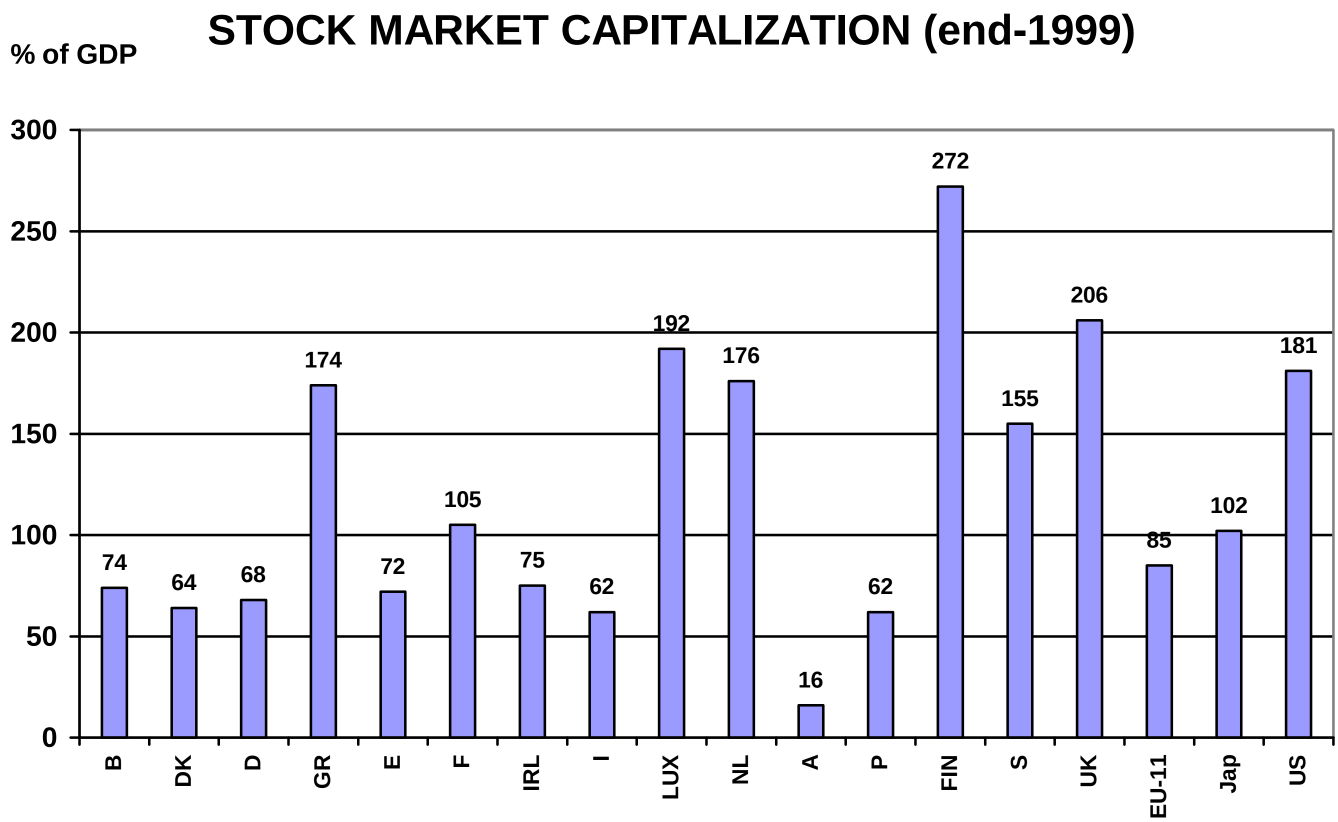
EUR-15 FIGURES

Table 1 : Comparative data on financial systems (euro-zone, US) (% of GDP, 1999):

	Euro-zone	*US*
Bank loans to corporate sector	45.2	12.4
Fixed income securities:	98.8	166.2
- corporates:	7.4	29.0
- financial institutions:	36.4	46.8
- public sector	54.9	48.4
Stock market capitalization	90.2	179.8

Source: ECB monthly bulletin, July 2000.

Figure 1



Source: BIS, FIBV (2000).

The supply of new equity is matched by a greater appetite on the part of European investors and households for securities-based investment. Whereas this demand in some countries was traditionally mediated through the banks, it is now being expressed through two additional channels :

- **Retail investors.** There are emerging signs that an equity culture is beginning to develop in the EU. In Germany, the number of shareholders directly owning shares climbed by 25% in 1999 to over 6 million. In the UK, one out of every three adults owns shares. At present, the participation of retail investors in securities markets is still routed through intermediaries. However increasingly, exchanges and new trading systems seem interested in serving the customer directly. Electronic brokerage has also driven down transactions costs, prompting a rapid increase in the number of on-line brokerage accounts in some Member States.

Evidence of an equity culture developing in the EU?

- **Institutional investors.** European institutional investors have yet to assume the dominant role played by institutional investors in the US in equity trading. However, steps to relax regulatory constraints on the investment strategies of occupational retirement schemes should sustain a greater presence by European funds in equity and investment funds business. In the investment funds market, there is a major portfolio switch underway towards the equity segments – a 20% increase in proportion compared to 1994. However, in 1999 the average proportion of equities in European investment funds was 40%, still well below the 60% figure in the US.

Institutional investors also swinging more towards the equity markets

Trend 2 : Europeanization/internationalization of securities markets

The investment horizons of funds and private investors are slowly becoming more European. The relative share of domestic equity in portfolios of unit trusts is in decline. The volume and number of cross-border transactions is increasing. The same investment firms constitute the membership of different exchanges and serve multiple national client bases. Finally, exchanges and new types of trading platforms are competing across borders for order flow and are increasingly dependent on consolidated clearing houses/central counterparty facilities.

New pan-European investment strategies are being defined

Despite these growing linkages, a strong home bias persists in primary and secondary market activity in the EU markets. In part, this situation reflects inertia in investment patterns. However, it is also the case that cross-border issuance, trading and settlement are beset by numerous outstanding legal and technical obstacles.

But there is still a strong home country bias

Globalization is also impinging directly on European securities markets in many different ways. There are now far more linkages, cross-border and between markets and participants. While investment services have long been marked by strong international competition, the elimination of obstacles to international competition in trading and execution is a more recent phenomenon. Provision of trading infrastructure services is now a business like any other. Such services are exposed to international competition through a number of powerful financial marketplaces in an increasingly globally integrated 24 hour trading environment. The competition from, and incursion of, third country trading systems on the European market is likely to develop. The European securities industry will need to respond to remain competitive.

International competition intensifying as global dimension of securities markets strengthens

The European market is, rightly, open to non-EU firms. European firms, service providers and markets should also have the opportunity to compete on an equal footing in third country markets. This means that those entry barriers or regulatory impediments to European financial service providers should be removed. There are still far too many, with some of the most important ones being in the United States.

International trade barriers to EU companies must be removed

Trend 3 : Competition and cooperation between exchanges and trading systems

Exchanges, organized and managed traditionally as national monopolies, are now competing for order flow between themselves and with new competitors. Technology has lowered entry costs and allows virtual marketplaces to serve wide geographical zones. Competition between trading platforms holds out the prospect of efficiency benefits in the processing and execution of trades.

Major changes in European stock markets underway

Some exchanges and new entrants are seeking to achieve European reach through organic growth. However, other exchanges are looking to far-reaching alliances or fully-fledged mergers.

Mergers and alliances are accelerating

Technology has also facilitated the emergence of more efficient trading systems and a new tier of trading systems functioning without a need for physical trading floors.

Many European exchanges are at the technological frontier

In the US, Alternative Trading Systems (ATSs) compete head-on with the large exchanges and have now captured some 30% of NASDAQ trading volumes, and 5% of NYSE. In Europe, ATSs provide specialized intermediary services for professional participants which complement rather than substitute for exchange – based trading arrangements. There are now more than 20 ATSs operating in Europe – largely based in the UK and Germany. ATSs have the potential to become a potent force in the European securities landscape.

New competition in the form of over 20 alternative trading systems in the EU

These new platforms are also paving the way for organized trading of fixed income securities and some derivatives business which were previously conducted on a bilateral/OTC basis. To the extent that these new trading arrangements are publicly accessible to a wide population of investors, they may give rise to some regulatory and supervisory challenges comparable to those that arise in equity markets.

Now spilling over to the fixed income and derivatives markets

Trend 4 : Growing pressures for consolidation of clearing and settlement

The pressures for a more efficient securities trading infrastructure are being brought to bear on clearing and settlement - an area where European significantly underperforms when compared to US markets, and which constitutes a major hindrance to efficient cross-border transactions. According to some industry sources, settlement charges in Europe for cross-border transactions are ten times those levied in the centralized US Depository Trust & Clearing Corporation (DTCC) system. When inefficiencies at the level of clearing/central counterparty are added in, the gap is higher. The Committee has been told that annually a maximum of up to 1 billion euros of the current annual cross-border settlement outlay could be saved through the creation of a single European settlement infrastructure.

European clearing & settlement – major progress required to cut costs

Submissions to the Committee have highlighted the widespread differences as regards the optimal configuration of European clearing and settlement facilities.

Some market participants and some clearing and settlement leaders expressed a strong preference for consolidation along functional lines (the horizontal model). According to this view, the organization of multilateral *"netting"* through a European central clearing counterparty could minimise counterparty risk and would provide the conditions for maximizing the efficient use of capital and exploiting cost efficiencies.

Horizontal or vertical integration?

The jury is still out as to whether full integration of Central Securities Depositories (CSDs) is required or whether technical linkages between existing entities will be sufficient. Technology also provides the key to the technical inter-linkage/integration of heavily fragmented securities settlement systems. Managing the full web of bilateral linkages (which could amount to up to 650 bilateral links between the 26 existing settlement systems in the EU) is generally regarded as extremely cumbersome and a source of operational, some have said even systemic risk in itself. This is sometimes coupled with calls for a dominant structure in the clearing or settlement area to be organized on a *"public utility"* basis (as in the US where the DTCC is owned by the market participants themselves). The integration of trading, clearing and settlement in vertical *"silos"* is dominant in several Member States.

One European central counterparty, like the US, or interlinkages?

A "public utility" to help reduce cost (and systemic risk)?

The importance of open and fair access to clearing and settlement systems to stimulate competition and market integration was frequently raised in the Committee's work. The alternative will be financial marketplace competition based on bundled services – with the risk of less competition at each stage of the transaction cycle.

Trend 5 : Increased volatility of financial asset prices

Recently, noticeable increase in volatility of financial assets

The Committee has noted that, more recently, there has been a sharp increase in the volatility of stock prices. This has been the case worldwide, and has been especially noticeable for prices relating to the *"new economy"* segment. Increased volatility can be observed in the behaviour of indices, but even more so in that of individual prices.

Unclear whether this volatility is a long or short term phenomenon

These developments may turn out to be a passing phenomenon to the extent that volatility reflects uncertainties regarding current business perspectives or the difficulty in assessing the working of, and the prospects for, the *"new economy"*. But they may well relate to longer lasting forces operating in our globalized economy. While a number of firms will enter the market, others are bound to disappear. Worldwide financial integration, combined with the efficiency of communication and information technology, mean that asset price changes are transmitted instantaneously across borders; and, via the OTC derivatives markets (which may themselves be a source of instability as a recent IMF paper has indicated[*]) price movements originating in one particular market may be transmitted across the border to the whole range of financial assets.

Summary

All these five trends are having, and will continue to have in the future, a major impact on European securities markets because these dynamics have not yet run their course. This is of considerable importance for European regulators and the process of European regulation.

[*] **International capital markets :** Developments, prospects and key policy issues by an IMF staff team led by Donald J. Mathieson and Gary J. Schinasi – September 2000.

CHAPTER III – THE MAIN SHORTCOMINGS OF EUROPEAN REGULATION TODAY

THE EU REGULATORY FRAMEWORK…..

The current EU legislative framework for securities markets covers mutual recognition of listing particulars, public offer prospectus, investment firms, investor compensation schemes, regulated markets, insider dealing, harmonized investment rules for UCITS (investment funds), and some company law provisions. It is based on minimum harmonization and mutual recognition. There is no single template for supervision. Cooperation between securities regulators for dealing with cross-border practices and trading is only lightly covered. The investigative powers of national authorities and sanctions are not defined at EU level.

The EU's regulatory framework for securities today is limited – it is based on minimum harmonization and mutual recognition

The current approach has begun to open previously closed national markets. For instance, figures show that a large number of investment firms have benefited from the single passport given by the Investment Services Directive (ISD) and the ability to provide services on a cross-border basis. (No data are however available on the market share of these companies.) On the other hand, a limited number of firms have so far used the freedom to establish branches in another Member State.

…..IS NOT SUFFICIENT

The results of the hearings conducted by this Committee, as well as the answers to the questionnaire, show that **far more needs to be done to achieve a real single market for financial services**. A large majority of interested participants share the feeling that transposition and implementation of EU directives is unsatisfactory, inhibiting the development of cross-border securities business. In the Committee's work and in the hearings some issues have repeatedly emerged as being particularly damaging to the construction of a integrated market. They are :

Far more needs to be done to achieve a real single market in financial services

(i) **Issuers** are still confronted with numerous practical difficulties. For instance:

- The **EU passport for issuers** is still not a reality. Firms wishing to raise capital in other jurisdictions are obliged to comply with different or additional requirements in order to gain the approval of local Regulatory Authorities. There is not even an agreed definition of a public offer of securities, with the result that the same operation is analyzed as a private placement in some Member States and not in others. The current system discourages firms from raising capital on a European basis and therefore from real access to a large, liquid and integrated financial market.

EU passport for issuers is not a reality

- **Rules on disclosure of price-sensitive and relevant market and company information** differ greatly between Member States. **Accounting rules are not yet harmonized.** More information on EU companies is often available in the US than in Europe.

Disclosure rules and other information requirements vary considerably

(ii) **For investors** several deficiencies remain, for instance:

- **Professional investors** are often subjected to multiple sets of conduct of business rules. There is still no legally agreed definition of what constitutes a professional investor, despite some recent progress.

There are still multiple rules for investors…

- **Retail investors** are faced with **different sets of consumer rules** with varying levels of consumer protection.

Different consumer rules

- There is no agreed definition of **market manipulation**.
- Effective functioning of cross-border clearing and settlement is still impeded by legal differences in the **treatment of collateral**.

And no cross-border collateral rules

(iii) **Markets and trading systems**

- There is **no single passport for organized markets and trading systems** (i.e. they do not have the right to provide services directly on a cross-border basis).

No single passport for organized markets

- **The over the counter (OTC) market** is mostly outside the scope of the EU directives – with, for example, OTC transactions having to be declared in some jurisdictions but not in others.

The OTC market is outside EU Directives

(iv) **Investment firms** now have a European passport but are often faced with different obligations in each Member State because the firms providing core services, i.e. e-brokers, broker/dealers, portfolio managers and underwriters, are subject to substantially different supervisory regimes in different Member States.

Different obligations are placed on investment firms

(v) The **large number of Regulatory Authorities** for securities in the Member States creates unnecessary cost and confusion among market players. In the EU there are approximately 40 regulatory organisations – far too many for an efficient system.

On top of a multiplication of regulatory authorities

A FIRST INITIATIVE : THE CREATION OF THE FORUM OF EUROPEAN SECURITIES COMMISSIONS (FESCO)

FESCO was founded in 1997 by the Statutory Securities Commission of the European Economic Area (EEA). It is seeking to develop standards complementing the legal framework created by the EU Directives. Specialized papers prepared by FESCO on specific issues constitute a helpful analysis of the difficulties encountered by the national regulators and can provide some solutions.

FESCO is helping develop standards

FESCO members have also agreed on multilateral Memoranda of Understanding to establish a general framework for cooperation and communication between each other. It provides for mutual assistance between the parties.

And MOU's are being exchanged

However useful this work is, FESCO is confronted with several drawbacks: it has no official status, it works by consensus, and its recommendations are not binding. Furthermore, the actual implementation of decisions in the different Member States is dependent upon the regulatory powers granted internally to each respective regulator – and these differ widely.

But FESCO has drawbacks…

A SECOND INITIATIVE : THE EUROPEAN COMMISSION'S FINANCIAL SERVICES ACTION PLAN ("*FSAP*")

The FSAP is the Commission's response towards improving the single market in financial services. Adopted in 1999 following a Commission Communication and a consultation with all interested parties, the FSAP contains a list of 42 measures to be implemented, grouped around 4 strategic objectives (retail markets; wholesale; prudential rules and supervision; and wider conditions for an optimal single financial market). Its purpose is to serve as an inspirational programme for rapid progress towards a single financial market. Most of the points mentioned above are covered by the FSAP, but prioritization of the different measures is needed.

The European Commission's Financial Services Action Plan is a blueprint for an integrated financial services and capital market

Some of the points mentioned in the FSAP are also part of the Risk Capital Action Plan which the Lisbon European Council stated should be delivered by 2003 (e.g. prospectuses, accounting rules etc).

The FSAP was endorsed by the Lisbon European Council in March 2000 which set a deadline for its implementation of 2005 at the latest. Some of the measures have already been adopted. New proposals made by the Commission are following the legislative process while others will be submitted in the next few months. The Commission is continually monitoring the implementation of the FSAP with half-yearly progress reports to the ECOFIN Council.

…And it was endorsed at the Lisbon European Council – with a 2005 deadline set for delivery

THE MAIN DIFFICULTY : THE FUNCTIONING OF THE INSTITUTIONAL FRAMEWORK

Markets participants share the view that the FSAP is the right answer to the problems outlined above. However, most fear that it will not be implemented with the required urgency. If the EU is to capture the benefits of an integrated European capital market, it must have a regulatory system that works more efficiently and flexibly, and one which is more comprehensive in scope.

But the regulatory system is not working efficiently enough

The present system as it now functions is not meeting these objectives :

- **The process to adopt legislation is often too slow**. Even when political problems do not arise, it takes three years on average to agree a Regulation or a Directive. Such a timescale is unacceptable when legislation is meant to bring an appropriate response to a fast changing world. For instance, the UCITS proposals are still pending more than two years after being proposed by the Commission. In worst cases, delays are much longer : more than eleven years for the Take-over Directive which has still not been enacted. However, examples (outside the financial services domain) show that some proposals can be adopted and implemented quickly at European level (in some extreme cases, adoption in less than eight months), when the political will is there.

The EU's regulatory system is too slow

- Seeking a political consensus leads sometimes to the adoption of **ambiguous texts** or texts with a level of harmonization so minimal that no real integration is achieved. An example is Article 11 of the Investment Services Directive. It has not given sufficient clarity about whose conduct of business rules should apply to wholesale business. The same provisions are often interpreted and applied by the Member States in a very different manner. Without legal clarity, no efficient delivery mechanisms can subsequently guarantee equivalent implementation.

Community texts are sometimes ambiguous

- Too many **delays also occur in the transposition process** by Member States. However, few infringement cases have been brought against the Member States given ambiguities in certain Community texts, a lack of Commission resources and a low number of complaints.

Few infringements have been brought against the Member States

- **Some important issues are still not appropriately covered at EU level** (e.g. pension funds, international accounting standards, the European company statute…) ,whilst some texts are clearly obsolete but remain untouched. As an illustration, more than twenty years have elapsed since the adoption of texts on prospectuses and listing requirements. This is explained, in part, by the acute political sensitivities of some issues.

Some sensitive areas are not covered at all

- There is **no rapid mechanism in place to update Community Directives** to new market developments.

No rapid regulatory updating system exists

- Existing **obligations to cooperate, procedures for notification and information sharing are not sufficient** and do not deliver enough predictability in enforcement mechanisms (a key issue for all financial actors).

Insufficient obligations to cooperate

In short, the current system, as it is now functioning, is :

- Too slow
- Too rigid
- Containing too much ambiguity and is therefore resulting in inconsistent implementation
- Over-reliant on primary legislation for determining detailed rules

Conclusions on the current regulatory system

Urgent action is needed. The Committee is therefore persuaded that in the short term any solution has to be found within the confines of existing Treaty arrangements.

A short term solution has to be found within existing Treaty arrangements

OTHER SIGNIFICANT OBSTACLES

Even if the EU Regulatory Framework in the field of securities were a complete success, there are a range of other obstacles that would still need to be tackled to achieve a completely integrated European financial services market. Such obstacles are not within the remit of the Committee's terms of reference, but the Committee wishes to underline in particular the importance of :

But there are a range of other important obstacles

- **Differences in the Member States' legal systems** which have important consequences in the field of securities (e.g. bankruptcy regimes, sanctions regimes or jurisdictional regimes which are all potential obstacles to cross-border trading).

Such as different Member State legal systems

- **The patchwork of applicable legislation** in the field of securities is creating uncertainty and increasing dramatically the costs of cross-border services. In particular it is complicating the tasks of smaller firms which have insufficient resources to cope with such complexity.

Patchwork of legislation causes uncertainty and extra costs

- **Taxation differences** which are a major impediment leading to distortions of trading flows for non-economic reasons.

Tax differences

- **Cultural differences** (such as attitudes towards corporate governance and investor protection) are additional complicating factors hindering the development of an integrated EU financial market.

Cultural barriers as well play a role

CHAPTER IV – PRELIMINARY CONCLUSIONS

The Committee considers that the pace of accelerated change in financial markets, the benefits of channelling the high level of European savings efficiently towards the corporate sector, and the requirement for the European regulatory system to reshape to meet this new challenge recognized in the European Commission's Financial Services Action Plan, needs a programme of comprehensive and coordinated reform. The Committee's preliminary views on a number of the main issues are set out below :

Initial report shows change required

ECONOMIC BENEFITS

If the European Union can integrate its capital and financial markets in the near-term, the European economy will strengthen – improving both long-term economic growth and job creation. To highlight this, **the Commission might undertake to construct a comprehensive series of macro and micro indicators to continuously benchmark progress towards an integrated European financial market, including more precise measurements of the overall macro and micro benefits**. The results should be widely publicized. If possible, preliminary results should be made available by summer 2001.

Economic benefits

TRADE ISSUES

As European financial markets integrate, reciprocal and open access to the financial markets of the EU's major trade partners is essential to ensure a level international playing field for EU financial services/companies. However, barriers to entry are prominent in many non-EU countries including several important ones in the United States. **The European Commission, working with the Member States, should consider establishing a comprehensive list of these external trade barriers which should be removed in the forthcoming WTO trade round, if not before.**

Removing trade barriers in next Trade Round

MARKET VOLATILITY

In an environment in which volatility may be increasing, regulators should pay enhanced attention to the need for intermediaries and others promoting investment products to provide investors – and, in particular, retail investors – with reliable and clear information so that they can make informed investment decisions in full knowledge of the risks.

Increased asset price volatility may also entail risks to systemic stability. It is not within the remit of this Committee to evaluate such risks, and even less to make recommendations on how to deal with them. However, given the growing interlinkages between all segments of the securities markets and the full range of financial intermediaries, the Committee believes that there is an urgent need for structured cooperation at the European level between financial market regulators and those in charge of micro and macro prudential supervision. The proper functioning of securities clearing and settlement systems as well as that of the OTC derivatives markets should be a shared concern. **The Council might wish to ask the Economic and Finance Committee to look at some of these prudential issues.**

Particular attention needed to deal with market volatility and possible risks to systemic stability

THE FINANCIAL SERVICES ACTION PLAN (FSAP)

The European Commission's Financial Services Action Plan is widely seen as containing the key elements for constructing an integrated European financial services market. This Plan was fully endorsed by Heads of State and Government at the Lisbon European Council in March 2000 and is widely supported by Member States, market participants and national regulators. Furthermore, at the Lisbon European Council a date was set for its completion – namely 2005. This Plan must be delivered. But in the view of the Committee, delivery by 2005 is too late.

Delivery of FSAP essential

The Committee suggests that further political efforts should be made to complete the Plan by 2004. There could also be political commitments to accelerate work on a small number of priorities, some by the end of 2003, given that some of the measures form part of the EU's Risk Capital Action Plan – whose deadline was set at the Lisbon European Council to be 2003. These new dates and key priorities could be endorsed, as soon as possible, by political commitments at the highest levels. These commitments should filter down to all parts of the decision making process – particularly to the negotiator level. Swift and accurate transposition and implementation into national legislation is equally necessary.

But efforts should be made to accelerate to 2004, and some priorities even to 2003

The Committee's priorities, all of which are contained in the FSAP, are :

- **Modernizing the Investment Services Directive**

  [Required : Sorting out country of origin/country of destination rules for wholesale financial transactions; defining who are professional and retail investors and appropriate conduct of business rules; drawing up appropriate rules for regulated/non-regulated markets (ATSs)]

- **Making cross-border capital raising as easy as domestic capital raising**

  [Required : a single passport for issuers; a common definition of public offer; modernizing listing requirements and introducing a distinction between admission to listing and to trading]

The Committee's priorities

- **Creating open, transparent European markets**

  [Required : Harmonizing transparency and disclosure requirements; encouraging use of international accounting standards for all listed companies; defining more clearly European market abuse and finally agreeing take-over rules]

- **Creating European financial products**

  [Required : Updating investment rules for pension and investment funds and providing for cross-border collateral]

- **Establishing proper levels of consumer protection**

  [Required : Establishing high and equivalent levels of consumer protection and efficient methods for resolving cross-border consumers disputes]

EUROPEAN REGULATION

The present functioning of the European legislative system cannot meet the challenge of regulating modern financial markets. For reasons that have been developed in the previous chapter, the Committee is indeed concerned that the present system will not be able to deliver the Financial Services Action Plan on time.

Present regulatory system requires some urgent change – otherwise FSAP will not be delivered on time

The Committee believes that at this present stage of development of the European Union's market for securities, this regulatory challenge can best be met by building on the methods and political determination which underlie the successful creation of the single market for goods and services, while adapting those methods to particular needs of securities.

The Committee has noted during its deliberations how national securities markets regulation is often organized. In general, framework laws are passed by national Parliaments that outline the basic principles that regulators must follow. Legal implementing powers are then delegated to them to turn these principles into workable day to day rules for the market. This model is used by a number of Member States and by the United States.

Some national securities market regulators are organized rather differently

Any legislative approach must provide an efficient, timely and adaptable way of delivering the necessary European legislation to move towards the accomplishment of a single securities market in Europe. Within the present EU institutional arrangements, the approach should be constructed in a way which would :

- Respect democratic processes at both national and Union levels;
- maintain the present institutional balance in the European Union and be in conformity with the present structure of the Treaties;
- take full account of the established agreements regarding proportionality and subsidiarity.

Basic legal and institutional criteria to be fulfilled

The details of one way which might work are set out below and are presented here as a basis for further discussion and analysis. This approach could be introduced quickly. Ideally it would require political endorsement at the highest political level, namely by the European Council, by the Commission and by the Member States as well as the support of the European Parliament.

A possible approach

A POSSIBLE APPROACH

- **The broad framework principles** of securities legislation could be enacted at EU level in accordance with normal EU legislative procedures. At this political level, legislative texts should not be detailed, but concentrate on the key principles of each issue (**LEVEL 1**). In other words, the European Commission, having consulted widely, could make the necessary proposals to the Council of Ministers and the European Parliament for adoption by them using co-decision procedures. Wherever possible, these proposals could be agreed using *"fast track"* procedures that already exist, even if they are rarely used. Furthermore, Regulations[*] could also be used rather than Directives to improve the transparency, speed and accuracy of transposition and implementation.

***Level 1 :** Broad principles agreed by normal EU procedures*

[*] Regulations are legislative acts that once agreed by the Council and the European Parliament do not need Member State transposition. Directives require Member State transposition which can take up to 18 months or more.

- **The modalities of how to implement the principles set out in the Level 1 framework would be laid down also at EU level using comitology procedures (LEVEL 2)** [for details see Annex 5]. This would require the setting up of an EU Securities Committee. It would be made up of the European Commission and representatives of the Member States and would have powers to decide on the technical implementing details of Level 1 legislation and the responsibility to update them when required. The technical rules decided through this mechanism would, *inter alia*, provide the basis for the practical implementation of the single market principle of mutual recognition. They would form part of Community law and be binding on all Member States.

__Level 2 :__ A new Securities Committee is needed…

  Most importantly, the EU Securities Committee should be supported by a **committee composed of EU regulators**, in a format similar to that of FESCO, but with a precisely defined role and status. The Regulators could advise the Commission on the technical implementing details of Level 1 framework principles. Furthermore, there should be arrangements whereby market practitioners could systematically and regularly provide input to this Regulators Committee and the European Commission.

Supported by an EU Regulators Committee

- The Member States have the responsibility to implement Community law. They should do so within **a framework of enhanced and strengthened cooperation and networking between their regulators with a view to ensuring consistent and equivalent transposition of the Level 1 and 2 legislation (LEVEL 3)**. National regulators should be encouraged to agree joint protocols on certain interpretations for implementation purposes and also a peer review process to ensure consistent enforcement practice in the EU Regulators Committee. Member States should also ensure that only one National Regulatory Authority with sufficient and comparable powers is responsible for each aspect of European financial services regulation.

__Level 3 :__ Enhanced and strengthened transposition and implementation

- There would be **strengthened enforcement of Community rules through more vigorous action by the Commission and enhanced cooperation between the Member States and their regulators (LEVEL 4).** In particular, the Commission should act more vigorously to enforce Community legislation and be given sufficient resources to carry out this essential task.

__Level 4 :__ Reinforced enforcement of Community law

The overall success of this 4 level regulatory approach will depend on the political will of the Member States, the European Parliament and the Commission to make it work. **If agreed, the Committee believes that every effort should be made to ensure such an approach could be functioning by the end of 2001.** Of crucial importance also will be the readiness of national regulators to cooperate and work closely together to help deliver the framework of European legislation that is needed for an integrated market.

Success will depend on the political will of all concerned

It should start by end 2001

The Committee considers it essential that this new approach is properly accountable to the European Parliament. Annual reports on the work of Securities and Regulators Committees should be submitted to the Council and Parliament. Both Committees should report regularly to the European Parliament.

Proper accountability to the European Parliament is essential

Furthermore, the Committee believes that **a continuous monitoring process** would be necessary to evaluate how the new approach is functioning, both from a procedural stance and also by assessing how rapidly European financial services integration is taking place. Half-yearly reports could be given to the Council and the European Parliament on the progress, or lack of it, being made.

Continuous monitoring with half yearly reports to the Council and the European Parliament

The functioning of this approach should be fully reviewed around 2004, though if, in the light of the half-yearly reports, it were manifestly failing to secure sufficient progress, there would be a case for a full review earlier.

Full review around 2004

It is clearly impossible to foresee the substance of a review of developments that have yet to take place. Various scenarios are conceivable however. At one extreme, the approach sketched out above might be succeeding in developing the single market in securities. In that case, its essentials could be maintained or strengthened if that seemed necessary. At the other extreme, if the approach did not appear to have any prospect of success, it might be appropriate to consider a Treaty change, including the creation of a single EU regulatory authority for financial services generally in the Community.

Scenarios for the future

At this stage of the development of the EU's securities markets, the Committee believes that there are good reasons for not considering the establishment of a single regulatory agency. First, the basic harmonized rules necessary for the appropriate functioning of an integrated market are not yet in place. Second, speedy action is needed to correct the identified shortcomings of the present regulatory framework; and speed requires reforms carried out within the confines of the present Treaty. Third, some time will be needed to ascertain whether any such reforms deliver, or fail to deliver, results.

Case for single regulatory authority not yet made

THE ROLE OF THE PRIVATE SECTOR

Legislation and regulation provides the framework in which the private sector operates. The private sector has a major role to create the single market within that framework. In particular the private sector has an important role to reduce European financial market inefficiency, such as the excessive costs of trading securities in the EU notably clearing and settlement. Progress should be benchmarked.

Private sector has important role to play – e.g. reducing clearing and settlement costs

The private sector should also work intensively with regulators on building consumer trust to enhance the cross-border retail trade of financial services (e.g. networks of alternative disputes settlement using national financial ombudsmen; and trust marks etc). The private sector should also work with the European Commission to remove international trade barriers, and ensure constructive input to the Level 2 decision-making process described above.

…And building cross border confidence for retail trade

DELIVERING THE CHANGE

Not all of these changes can be delivered quickly. But the regulatory changes are especially urgent. The Committee suggests that the Stockholm European Council, in March 2001, might consider a **European Council Resolution** similar in structure to that used for establishing the Growth and Stability Pact in June 1997. In this Resolution, Heads of State or Government could agree with the European Commission on a series of differentiated commitments – for the Member States, the Commission and the Council to deliver the essence of the regulatory proposals so they can begin to function from 2002 onwards.

Delivering change – importance of Stockholm European Council – March 2001

AREAS FOR FURTHER REFLECTION

Impact of integrated securities markets on small and medium sized companies (SMEs)

Many of the actions outlined in this chapter can benefit SMEs, particularly those seeking to tap capital markets. However the Committee wishes to reflect further on this issue.

Committee wishes to reflect further on the issue of the impacts on SMEs

Competition

The Committee believes that encouraging competition throughout EU securities markets will benefit the integration process. Essential public policy objectives to be pursued are open access to markets and clearing and settlement systems on a non-discriminatory basis. At the same time, competition authorities should pay particular attention to any possible detrimental effects of concentration in European financial markets as integration accelerates. The Committee wishes to reflect further on this issue.

Key importance of strong competition policy

Clearing and settlement

Clearing and settlement – major progress required… and further reflection

Whilst it is certain that in Europe major progress to reduce clearing and settlement costs is required (indeed the EU must reduce cross border trading costs towards US levels as soon as possible), there are a number of important public policy issues that merit further attention – such as the role of competition policy, the need to ensure systemic stability and the future structure of clearing and settlement in the European Union.

FUTURE WORK

Future work – up to final report mid-2001

The Committee's final report will be presented in mid-February 2001. The Committee's intention is to deepen its reflections on a number of issues, notably those mentioned above, and on the legal and political analysis of the regulatory approach described above. The Committee will take into account the general political and market reactions to these proposals. It may also launch a second series of consultations.

ANNEX 1 – THE COMMITTEE OF WISE MEN'S TERMS OF REFERENCE GIVEN BY THE EUROPEAN UNION'S ECONOMIC AND FINANCE MINISTERS ON 17 JULY 2000

The introduction of the Euro and the resulting structural changes have speeded up integration of the European financial market. To deliver the full prospective benefits to European business and the EU economy, to compete in the global market for financial services and to help European business to compete in the global market for goods and services, EU capital markets need to be dynamic, competitive and innovative. They need to embrace new technology and new opportunities. To support this, regulation of capital markets needs to support the Lisbon vision of a dynamic knowledge-driven economy, with good access to capital in order for businesses to invest, grow and create jobs.

A single market in securities must be achieved rapidly to allow :

- more competitive financing on the markets of EU enterprises, including SMEs
- increased liquidity and
- greater competitiveness between intermediaries and infrastructures, in order to achieve better provision of services at lower cost.

However, growth and competitiveness will be hampered unless the administrative, regulatory or other types of obstacles which in practice impede cross-border securities transactions are eliminated.

Regulation of the markets and of financial reporting in Europe is based primarily on European directives which have established standards for regulation of a broad range of financial activities. This legislation, which was drawn up in the context of fragmented national markets, may need to be adjusted in the light of market developments. The Financial Services Action Plan is designed to make progress in these areas and remove the most significant barriers to the single market.

However, given the scope of the changes taking place on the market, it seems clear that an appropriate response is also required from national regulators.

It is therefore necessary to follow up the Action Plan with discussion on the conditions for practical implementation of the directives by the competent national authorities so as to meet the expectations of dealers and brokers, issuers and investors who wish to be able to deal with one another throughout the European Union in an effective, entirely secure and informed manner.

Taking into account the existing institutional framework, the need to respond effectively to the challenges of integrating the financial markets makes it necessary to set up a committee of independent persons, to be assisted by the Commission. The Committee will therefore focus its discussion on the practical arrangements for implementation of the Community rules concerning the areas identified by the Action Plan and will propose various approaches to adjusting the practice of regulation and cooperation between regulators in response to current developments. Without prejudice to the work being done in the framework of the Financial Services Action Plan and taking into account the measures being undertaken by securities market regulators within FESCO, the Committee will consider how to achieve a more effective approach towards transposition and implementation, in particular in the following areas of regulation : the listing of enterprises, the public offer of securities and requirements relating to reporting by issuers, the conduct of cross-border financial operations, the day-to-day operation of the regulated markets, the protection of consumers and investors in the provision of investment services, and the integrity of the market.

In this context, the Committee will have to :

1. Assess the current conditions for implementation of the regulation of the securities markets in the European Union.

   In addition, the Council invites the Commission to identify a priority-related critical path to achieving the relevant parts of the Lisbon target of Financial Services Action Plan, and the implementation, by 2003, of the Risk Capital Action Plan. The Commission will propose possible indicators of progress in realising economic benefits. The Commission will report to the Council on November 27th.

2. Assess how the mechanism for regulating the securities markets in the European Union can best respond to developments under way on the securities markets, including the creation of markets resulting from either the alliance of European (and non-European) stock exchanges or from technical innovation (ATS), while still guaranteeing the effective and dynamic operation of markets throughout the European Union to achieve a level playing field.

3. In order to eliminate barriers and obstacles, propose as a result scenarios for adapting current practices in order to ensure greater convergence and co-operation in day-to-day implementation and take into account new developments on the markets.

It will not, however, deal with the prudential supervision.

The Committee should be able to present an initial report to the ECOFIN Council early in November 2000. This report will present the state of play and initial approaches to solutions. The final report will be presented to ECOFIN during the first six months of 2001.

The Council appointed the following members of the Committee :

- Alexandre Lamfalussy
- Cornelius Herkströter
- Luis Angel Rojo
- Bengt Rydén
- Luigi Spaventa
- Norbert Walter
- Nigel Wicks

ANNEX 2 – WORKING METHODS OF THE COMMITTEE OF WISE MEN

The Committee began work on 7 August 2000, and finished the first phase on 6 November 2000 after a total of 8 meetings.

Given the broad range of issues covered by the ECOFIN Council mandate, the Committee considered it essential, even in the short time available, to canvass opinions in an open way, from the widest possible number of institutions, organizations and the public at large.

The Committee met President Prodi and Commissioners Bolkestein and Solbes on 5 September 2000 and Mr Lamfalussy appeared before the European Parliament EMAC Committee (Economic and Monetary Affairs Committee) in a closed session on 11 October 2000.

The Member States were contacted in a variety of ways. Member States' Financial attachés/counsellors were invited to make contributions. The Chairman met Member States' representatives at the HLSS (High Level Securities Supervisors Committee) on 20 September 2000, and Member States' delegates at the FSPG (Financial Services Policy Group) meeting of 12 October 2000.

As to the organizations concerned with European securities markets (the industry itself and regulatory authorities), the Committee invited them to submit written contributions. Moreover, and as a key element of the consultation process, the Committee invited leading representatives of the major constituencies of European securities markets to confidential hearings in Brussels. The Committee had a total of 25 confidential hearings, divided into separate sessions, covering markets and exchanges; ATSs (Alternative Trading Systems) and news vendors; clearing and settlement organizations; issuers ; supervisors/regulators; and institutions such as FESCO, the EU-EFC (Chairman of the Economic and Financial Committee), and the ECB (European Central Bank). In addition, a representative of the Trade Unions and several outstanding personalities from the financial world were also heard. The Committee also held a video-conference with a senior official of the US-SEC (the Securities and Exchange Commission) on 16 October 2000.

Furthermore, the Committee launched on 21 August 2000 an ad-hoc website,* with a questionnaire for anyone to express their views on a series of key questions for the Committee's work. To date 69 contributions, from a variety of sources and countries, have been received (see Annex 3 for a summary).

Finally, as part of the Committee's policy for openness and transparency, the Chairman, Mr Lamfalussy held a press conference in Brussels on 7 September 2000 in order to inform journalists about relevant aspects of the Committee's work such as organization, working method and timetables.

The initial report will be presented to the Press on 9 November in Brussels.

* Website : http://europea.eu.int/comm/internal_market (financial services, general matters section).

ANNEX 3 – SUMMARY OF RESPONSES TO THE COMMITTEE OF WISE MEN'S ON-LINE QUESTIONNAIRE

Sixty-nine responses have been received. These come from a wide range of market participants. Replies have come from all over the European Union and also from third countries (the US and Switzerland).

69 responses

THE MAIN OBSTACLES TO THE COMPLETION OF A SINGLE MARKET FOR FINANCIAL SERVICES

Main obstacles in an integrated market…

Concerning the main obstacles standing in the way of an integrated European securities market, a distinction between **general obstacles** and **specific obstacles** affecting the securities sector needs to be made. Within the general obstacles, the most mentioned are different legal traditions (i.e. solvency regulations) in 62% of the replies, tax differences (that hinder the cross border selling of financial products) in 42% of the replies, and cultural and linguistic problems. The most quoted specific obstacles are the lack of unified securities legislation (51%), the inadequate implementation of European legislation, and the differences in the powers, competencies and duties (26%) of national supervisory bodies.

Other obstacles have also been mentioned, such as accounting differences (preventing a real comparison of financial statements), the lack of a unified clearing and settlement system, institutional regulatory procedures, the imposition of host country rules and national protectionism (used by Member States not only to protect their investors but also their national industry).

Assessment of the current transposition and implementation of European securities legislation

Transposition and implementation – ¾ say is not satisfactory

Three-quarters of the respondents consider that EU securities legislation is neither transposed nor implemented consistently. The same proportion considers that current implementation is impeding the development of cross-border securities business.

The reasons why

The main reasons for these problems arise from the differing interpretations of directives (mentioned in 59% of the replies), from the ambiguity of certain provisions of some directives and from the length of the implementation periods. Some replies also mention the absence of any EU infringement proceedings for inadequate implementation. Others argue that powers granted by the Directives to the Member States in the implementation process and the unclear drafting of the Directives allow a divergent implementation of the Directives, without infringing them.

The main areas of concern are the inadequate transposition of EU legislation (36%), the need for convergence in the organization and competences of national authorities (19%) and the structure of financial markets.

Main market barriers…

Respondents particularly emphasized as barriers and major problems : the rules, differentiation of different types of investor etc), the lack of a single trading calendar and a unified policy regarding best execution of customers orders; the lack of a single market for mutual funds or private pension schemes on their investments. The obstacles to the development of the single passport for issuers are the main concerns for investment services providers. Differences in national insolvency regulation and lack of a uniform standard of regulation and supervision of central securities depositories are the main ones mentioned by clearing and settlement institutions.

And the victims = European equity, bond, pension and investment fund markets

Equity, primary and bond markets, pension and investment funds are the activities and markets which, according to the responses, are most adversely affected. There were differing opinions as to whether wholesale markets were affected or not; some responses claiming that they were, but with some others stating that they tend to be less affected. It should be noted, however, that there were relatively few responses to this question.

Self regulation and market conventions supported

There were differing views on the role of self-regulation and market conventions. Nearly 50% of respondents consider that self-regulation should play a major role in rapidly developing markets, but they disagree on what exactly that role should be. Several think that self-regulation should play a major role in some specific fields (e.g. in mutual exchanges, the adoption of internal codes of conduct or in professional markets) but that it should play a secondary role in other fields (such as retail markets). Respondents also raised some concerns as to whether self-regulatory organisations are well placed to take into account wider public interest considerations and whether competitiveness in the securities markets could raise conflicts of interest in the case of exchanges charged with certain regulatory responsibilities. They generally agreed on the need to check market conventions against the Single Market goal.

Assessment of the current arrangements for cooperation

Pan-European regulatory cooperation not sufficient

Forty-five percent of the responses state that the current arrangements for cooperation and mutual assistance between national supervisors are not sufficient. However 40% of the respondents did not explicitly answer this question and even those that consider that they are sufficient call for them to be reinforced.

The main perceived shortcomings are differences in supervisory powers and duties (23%), duplication of supervisory control (19%), deficient channels for cooperation, excessive costs and lack of expertise. Lack of transparency in the current arrangements was also mentioned.

Main developments affecting the European securities markets in the near future

Main developments affecting the EU's securities markets : consolidation and technology

The key structural developments that will affect European securities markets in the future, according to the replies, are the consolidation in the financial sector (mentioned in 62% of replies), the new profile of investors, the role of private pension schemes and the new trading platforms.

On the issue of the key technological developments, the Internet and e-business (65%) and new software for market players (49%) are by far the most frequently mentioned.

As investors become more experienced and have direct access to the markets due to the development of the on-line trading, there could be an increase in cross-border activities that will highlight these differences between Member States.

Euro is catalyzing pan-European investment strategies

Moreover, the introduction of the euro, the consequent move from national to sectoral diversification of investments in the euro zone and the role of private pension schemes are already affecting European securities markets.

Level playing field needed for stock exchanges and ATS

Many respondents highlighted the need to speed up EU legislative procedures in order to follow changes in the market; to establish a level playing field between regulated markets and new markets (ATS), to ensure competition in the markets and in the clearing and settlement procedures, avoiding monopolies, and to reduce differences between the supervisory powers and competences of the national authorities.

Prospectives on structural developments

In order to create an integrated European securities market, most respondents consider that certain regulatory and supervisory arrangements are needed.

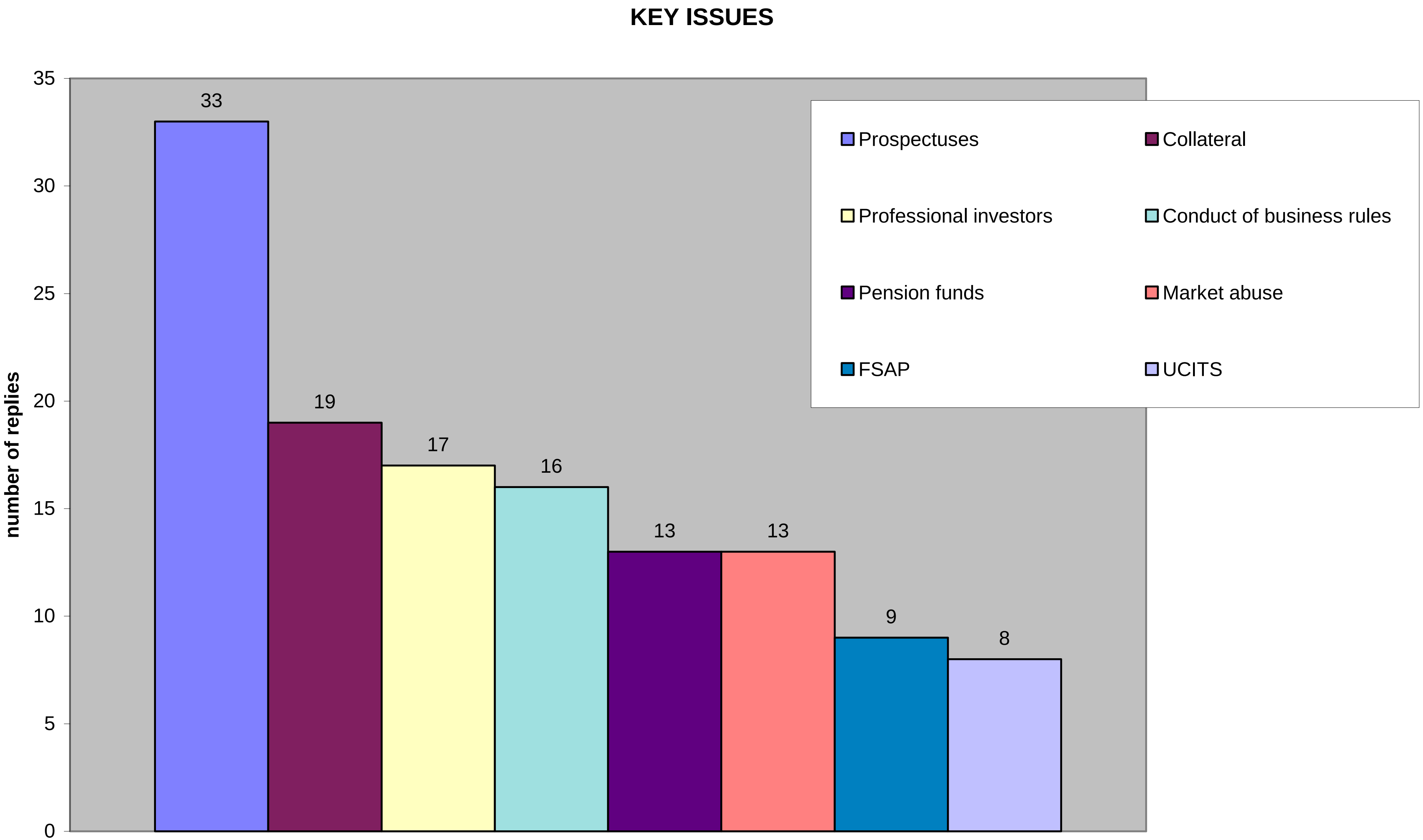
More harmonization required, but with emphasis on mutual recognition

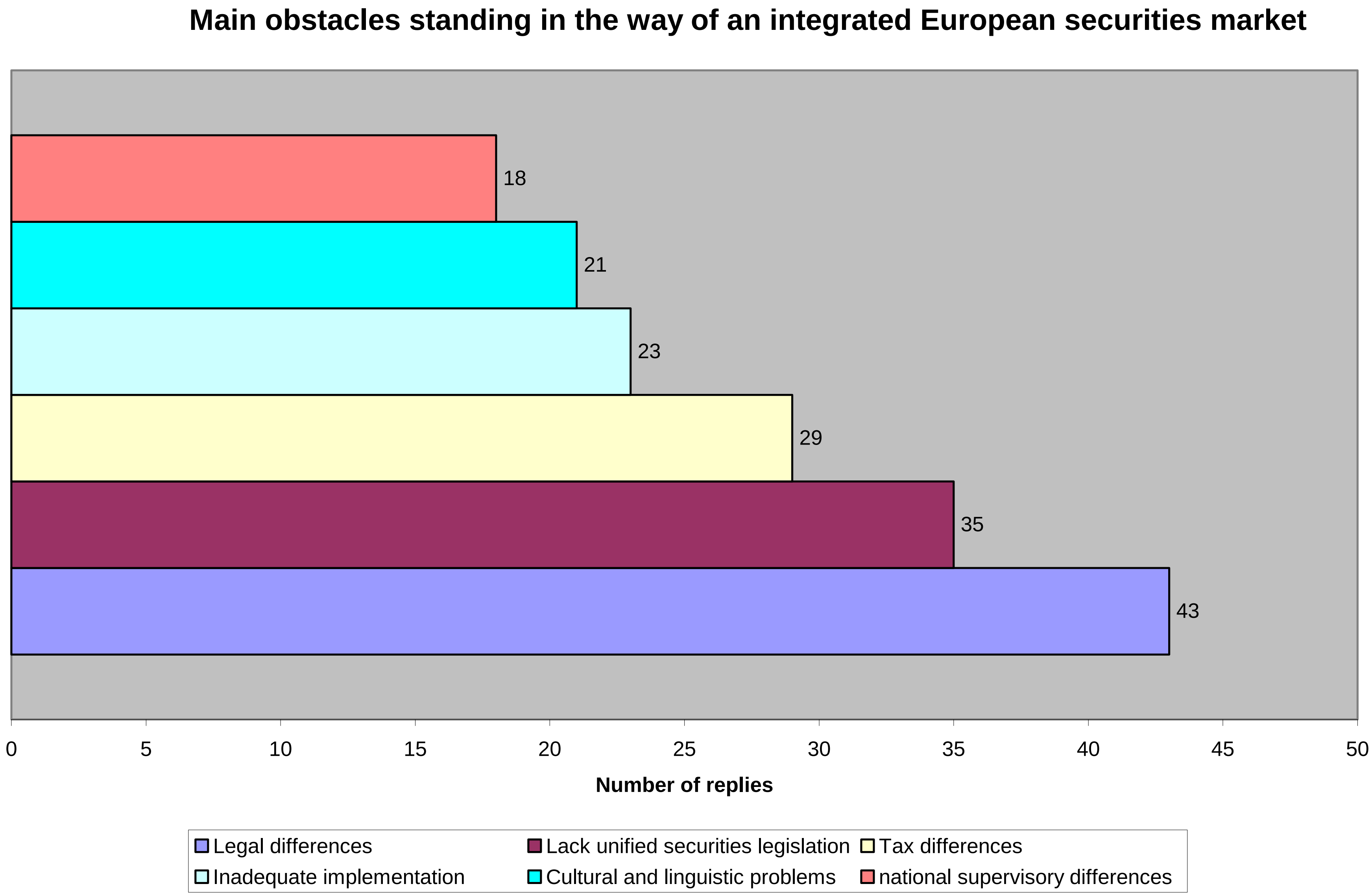
Framework principles should be set in Directives – with detailed legislation in a European Securities Committee

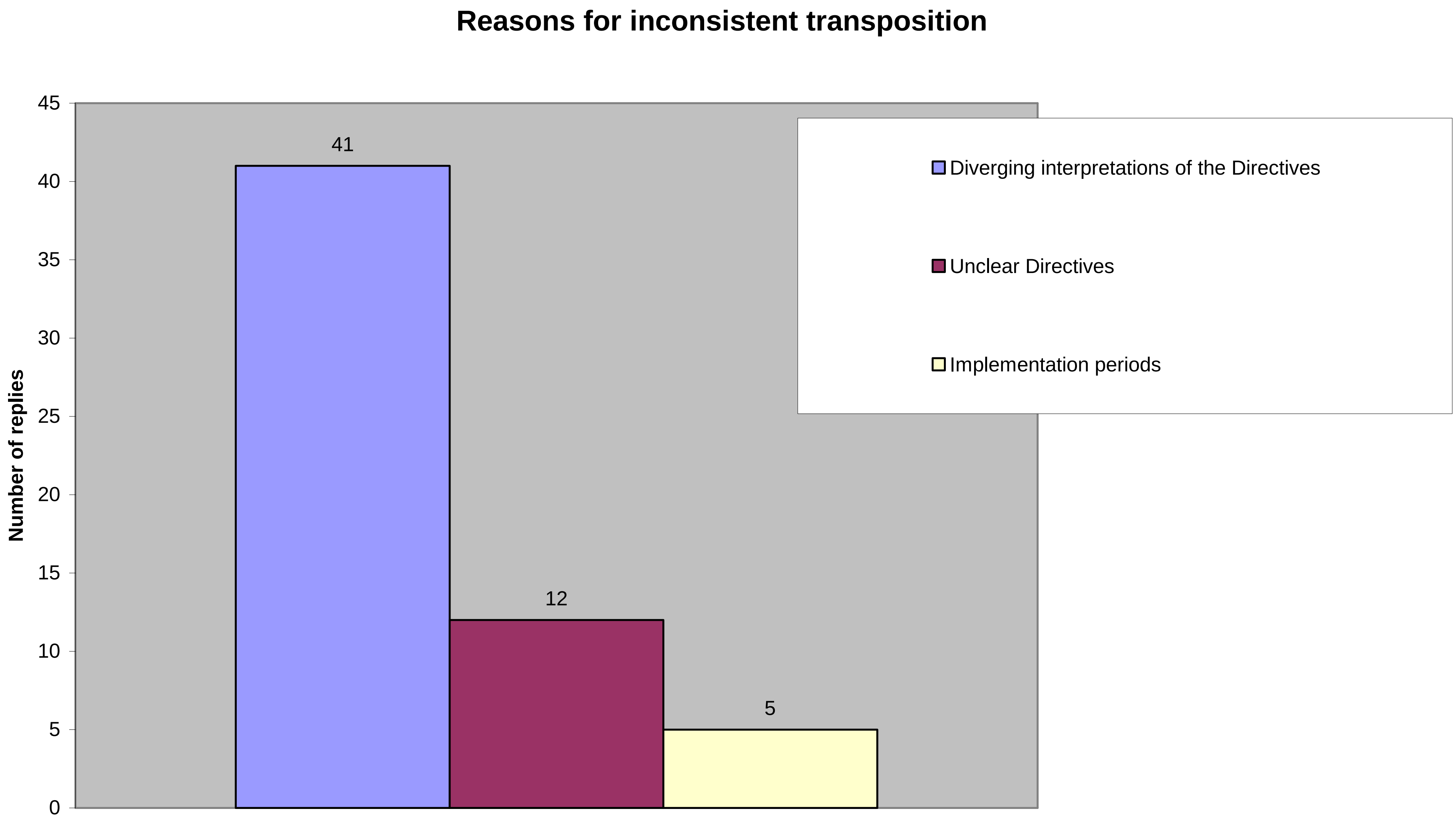
As far as regulatory arrangements are concerned, a greater level of harmonization of legislation at European level and more emphasis on mutual recognition was called for. However, a high number of respondents also call for improvements in the way that EU legislation is adopted, amended and implemented. Directives cannot establish detailed regulation without becoming rapidly outdated. Directives should set a framework of enduring principles. Secondary detailed legislation could then be determined by a European Securities Committee with enough comitology powers to revise and update EU legislation. The great majority of respondents are satisfied with the work of FESCO. Nevertheless they urge prompt clarification of its legal status and role. Greater transparency and broader consultation with the industry in the regulatory process are also called for. In any case, new EU institutions or agencies should not lead to additional unreasonable costs.

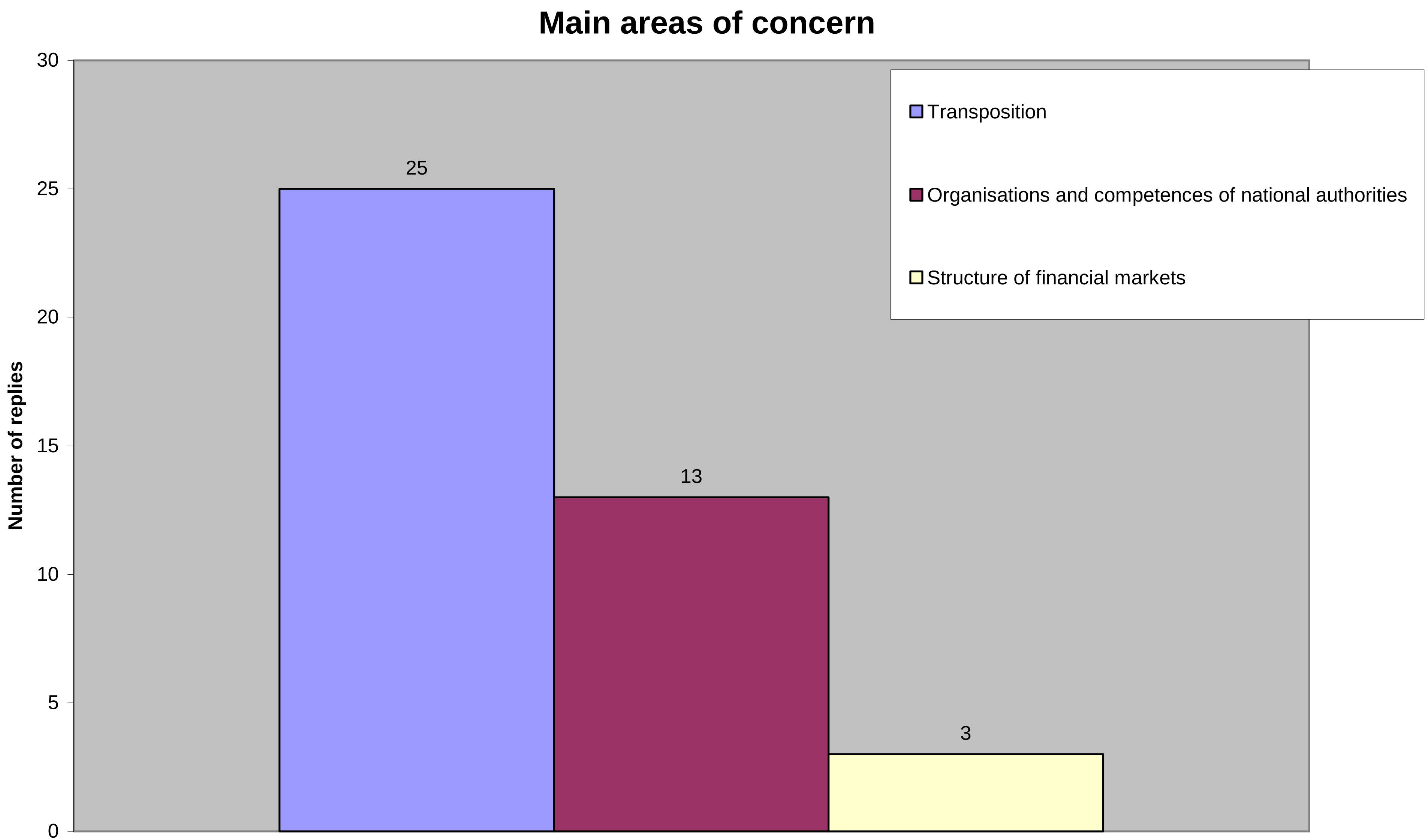
Single European Regulatory Authority not supported at this stage

Regarding supervisory arrangements, close cooperation between supervisors is also necessary. Greater convergence in supervisory powers, duties and competences would help to achieve this goal. The issue of a Single European Regulatory Authority was referred to in roughly half of the responses. Among those who did comment, there is clear opposition to the creation of such a body in current circumstances. Some respondents said that it might be an option for the medium- or long-term after further harmonization of the regulatory framework.


KEY ISSUES
number of replies
35
30
25
20
15
10
5
0
33
19
17
16
13
13
9
8
Prospectuses
Collateral
Professional investors
Conduct of business rules
Pension funds
Market abuse
FSAP
UCITS


Main obstacles standing in the way of an integrated European securities market
18
21
23
29
35
43
0
5
10
15
20
25
30
35
40
45
50
Number of replies
Legal differences
Lack unified securities legislation
Tax differences
Inadequate implementation
Cultural and linguistic problems
national supervisory differences


Reasons for inconsistent transposition
Number of replies
45
40
35
30
25
20
15
10
5
0
41
12
5
Diverging interpretations of the Directives
Unclear Directives
Implementation periods


Main areas of concern
Number of replies
30
25
20
15
10
5
0
25
13
3
Transposition
Organisations and competences of national authorities
Structure of financial markets

ANNEX 4 : RECENT ACADEMIC WORK ON THE LINKS BETWEEN SIZE AND GROWTH OF FINANCIAL MARKETS AND THE GROWTH OF OUTPUT

There has been a large body of economic literature over the last century, including renowned economists like Joseph A. Schumpeter, who have consistently underlined the positive influence of the development of a country's financial sector on the level and rate of growth of its per capita income. Some academics, however, have contested this conclusion on the grounds that the direction of the causality is not proven.

In the 1990s this question has been given increasing attention and an expanding theoretical literature has emerged. It has tended to depart from the traditional focus on bank financing by examining the possible links between stock markets and long-run growth. For instance, liquidity and risk based models have been designed which show that greater international risk sharing through internationally integrated stock markets result in accelerated productivity growth by inducing shifts from safe, low-return portfolios, into high-return alternatives.

Until recently, however, little empirical evidence was made available to sustain the theoretical predictions foreseen by these models. However, the findings of three recent papers, briefly discussed below, shed light on this issue by showing, using new methodology, the validity of the positive predictions of the theoretical models.

Rajan and Zingales (1998),[*] in order to avoid the debate about reverse causality, focus on the theoretical mechanism through which financial development affects economic growth. In particular, they argue that, according to the theoretical models, financial development should disproportionately help firms, or industries, typically dependent on external finance for their growth. To test this assumption they examine a large cross section of industries and countries to verify whether industries that are more dependent on external financing grow relatively faster in countries that, a priori, are more financially developed. Their empirical findings suggest that *ex ante* development of financial markets substantially facilitates the *ex-post* growth of sectors dependent on external finance.

The results also suggest that financial development may play a particularly beneficial role in the development of new firms. Therefore, if these firms are disproportionately the source of ideas, financial development can enhance innovation, and thus enhance growth in indirect ways. This finding is very relevant for the new economy and shows the importance of having adequately developed risk capital markets.

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[*] **Raghuram G. Rajan and Luigi Zingales.** "Financial Dependence and Growth". *American Economic Review Nr. 88, pp. 559-586, June 1998.*

Another consequence of the results is in the trade area. The existence of a well-developed financial market represents a source of comparative advantage for that country (or group of countries) in industries that are more dependent on external finance.

Levine and Zervos (1998)* ask whether well-functioning stock markets promote long-run economic growth. Their paper empirically investigates whether measures of stock market liquidity, size, volatility and integration with world capital markets are robustly correlated with current and future rates of economic growth, capital accumulation, productivity improvements and saving rates. They use data on 47 countries from 1976 to 1993.

They find no support for theories which contend that stock market liquidity, international capital market integration, or stock return volatility may reduce private savings rates or hinder long-run growth. On the contrary, they find that stock market liquidity, as measured both by the value of stock trading relative to the size of the market and by the value of trading relative to the size of the economy, is positively and significantly correlated with current and future rates of economic growth, capital accumulation and productivity growth.

Moreover, the positive link between financial development and economic growth suggest that financial factors are an integral part of the growth process.

Beck, Levine, Loayza (2000)* centre their research not only on the direct impact of financial development on economic growth but also on its impact on the sources of economic growth. In particular, they examine the impact of financial intermediary development on savings rates, physical capital accumulation and total factor productivity growth. They use data from 63 countries over the period 1960-1995.

Their findings do not show a robust relation between financial intermediary development and either physical capital accumulation or private savings rates. However, they show a robust positive link between financial intermediary development and both real per capita GDP growth and total factor productivity growth. In sum, their results are consistent with the Schumpeterian view that financial intermediaries affect economic development primarily by influencing total factor productivity growth.

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* **Levine, Ross and Sara Zervos.** "Stock Markets, Banks and Economic Growth". *American Economic Review Nr. 88 pp. 537-558, June 1998.*

* **Beck, Thorsten, Ross Levine and Norman Loayza.** "Finance and the Sources of Growth". *Journal of Financial Economics Nr. 58, pp. 261-300 (2000).*

ANNEX 5 – EUROPEAN UNION COMITOLOGY PROCEDURES

Description of the procedures for the exercise of implementing powers conferred on the Commission

WHAT IS COMITOLOGY?

"*Comitology*" refers to the delegation of implementing powers by the Council to the Commission for the execution of EU legislation. Representatives of the Member States, acting through Committees called "*comitology committees*", assist the Commission in the execution of the implementing powers conferred on it.

A first Comitology Decision was adopted in 1987. The new Comitology Decision was adopted on June 28, 1999, in execution of a Declaration adopted by the 1996 Intergovernmental Conference. It entered into force on July 18, 1999.

The objective of the new comitology decision is twofold :

- To harmonize and simplify the various existing comitology procedures.
- To provide the European Parliament with extended monitoring powers on the Commission's use of its implementing powers.

THE DIFFERENT COMITOLOGY PROCEDURES

The Council Decision lays down three different procedures – an advisory, a management and a regulatory procedure – for the exercise of implementing powers conferred on the Commission.

It provides criteria for the determination of the relevant procedure. These are based on the needs comitology intends to fulfil.

According to the text of the Council Decision, the regulatory procedure shall be used for measures of general scope designed to :

- Apply essential provisions of basic instruments, and
- Adapt or update non-essential provisions of basic instruments.

DESCRIPTION OF THE REGULATORY PROCEDURE

Legal base

The Treaty provisions do not provide any direct basis for the use of comitology. The use of comitology must be provided in a basic legislative act, whether a regulation or a directive.

This basic legislative act must stipulate the scope of the powers granted to the Commission.

The implementing powers delegated to the Commission must be strictly defined. There is no possibility for an open-ended delegation of powers. Furthermore, comitology procedures cannot be used to modify essential provisions of the basic instruments.

How the procedure works

The basic legislative act must provide for the establishment of a comitology Committee, composed of representatives of the Member States and chaired by a representative of the Commission. The Parliament does not delegate representatives or observers.

The Regulatory Committee works as follows :

- The Commission submits the draft measures to the Regulatory Committee.
- The Committee votes on the draft measures in a fixed delay.[*]
- If approved by the Committee, the draft measures are then adopted by the Commission and become binding.
- In case of disapproval by the Committee, the draft measures are submitted to the Council as the Commission's proposal.

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* The Committee shall deliver its opinion on the draft within a time-limit which the chairman (the representative of the Commission) may lay down according to the urgency of the matter. The Committee votes by qualified majority in the case of decisions which the Council is required to adopt on a proposal from the Commission. The votes of the representatives of the Member States within the Committee shall be weighted in the manner set out in the Treaty for the votes in Council. The chairman shall not vote.

- The Council votes within a determined period[*] to adopt or oppose the proposal.
- In case of rejection by the Council, the Commission shall re-examine the proposal.
- The Commission may chose between three options : (1) submit an amended proposal of implementing measures to the Council, (2) re-submit its initial proposal or (3) abandon the draft implementing measures and present a legislative proposal based on the EC Treaty by use of its initiative powers. In that case, the draft implementing measures are replaced by a draft legislative act, e.g. a regulation or a directive.
- If the Council neither adopts the draft measures proposed by the Commission nor indicates any opposition to them, the Commission shall adopt the proposed implementing act.

Role of the European Parliament

The European Parliament does not formally participate in the work of the Regulatory Committee. It nevertheless plays an external supervising role.

The European Parliament must be kept informed of the Committee's work and receive all related documents (agendas, draft measures, results of the votes, minutes of the meeting, list of presence).

If the European Parliament considers that draft measures submitted by the Commission exceed the implementing powers provided for in the basic instrument, the Commission shall re-examine its proposal.

The Council may, where appropriate in view of any such position, decide on the Commission's proposal of implementing measures. Notwithstanding the Parliament's opinion, the Council may adopt the proposed measures. It may also oppose to them. The Commission shall then re-examine the draft measures. In case the Council neither adopts the proposal nor indicates any opposition to it, the Commission shall then adopt the draft implementing measures.

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[*] This period is laid down in the basic legislative instrument from which the Committee originates. It cannot exceed three months from the date of referral to the Council.

ABBREVIATIONS

ATS - Alternative Trading Systems
Basel – Basel Capital Review
CSD - Central Securities Depository
ECOFIN – Economic and Finance Council
ECB – European Central Bank
ECJ – European Court of Justice
EFC - Economic and Finance Committee
EMAC - Economic and Monetary Affairs Committee
EP - European Parliament
ESRC – European Securities Regulators Committee
ESC – European Securities Committee
FESCO – Forum of European Securities Commissions
FSAP - Financial Services Action Plan
GDP – Gross Domestic Product
HLSS – High Level Securities Supervisors' Committee
IAS - International Accounting Standards
IGC – Intergovernmental Conference
ISD - Investment Services Directive
OTC - Over The Counter
QMV – Qualified Majority Vote
SME's – Small and Medium Sized Enterprises
UCITS – Undertakings for Collective Investment in Transferable Securities