



EUROPEAN CENTRAL BANK

The integration of the single market for financial services: the Eurosystem perspective

Keynote speech by
Jean-Claude Trichet
President of the European Central Bank

at the
CESR Conference

“Europe’s Single Market in Financial Services: under construction or fully
integrated”

Paris
6 December 2004

European Central Bank
Press and Information Division
Kaiserstrasse 29, D-60311 Frankfurt am Main
Tel.: 0049 69 1344 7455, Fax: 0049 69 1344 7404
Internet: <http://www.ecb.int>

Reproduction is permitted provided that the source is acknowledged.

Ladies and gentlemen,

It is a great pleasure to be here at the first Committee of European Securities Regulators' (CESR) conference with such a distinguished audience. This is certainly the right place to address our common objective of fully developing a "European single market".

The process of financial integration is a very challenging and complex endeavour which results from the effective interplay between public and private action. Public authorities, both national and European, do play an important role in ensuring that basic conditions are in place for market participants to expand their cross-border activities. These conditions include an adequate framework of regulation, supervision and financial stability. Whereas public action is necessary, the concrete realisation of financial integration rests eventually on the initiatives of market participants to exploit the opportunities offered by the institutional framework.

In this context, we can assert that significant progress has been achieved in the pursuit of financial integration in Europe so far but the final goal of a single financial market has not been fully achieved yet: On the side of market participants a fully fledged pan-European dimension of market activities remains to be achieved. On the side of public authorities the basic components of the institutional framework are already in place, but they need time before fully producing the desirable results.

I would like to focus my contribution on the integration of the European securities markets, emphasising the priorities for further public action from a Eurosystem perspective.

The interest of the Eurosystem in the integration of securities markets

The Eurosystem has a clear interest in the integration of securities markets. First of all, an efficient and well-integrated financial system is crucial for the smooth transmission of monetary policy in the euro area. Securities market is a particularly relevant area, since the Eurosystem's monetary policy operations need to be fully collateralised. The harmonisation of national laws and practices in the field of securities – which is one important element to further integration in the securities markets - enhances the effectiveness of the Eurosystem's collateral policy.

Second, the Eurosystem's monetary policy operations also rely heavily on the smooth delivery of securities. Securities settlement systems should ensure that such a smooth delivery both at a national level and on a cross-border basis. At the same time, safety and soundness of securities clearing and settlement systems is equally important from a central banking perspective. In this regard, I want to mention the recently published standards on securities clearing and settlement systems, which have been jointly developed by the ESCB and the CESR. These standards provide a benchmark for regulators, supervisors

and overseers to adapt their practices to a commonly accepted approach in the field of securities settlement. I would recall that such standards are based on the current market situation and legal framework, which is not harmonised at the EU level. Should a Directive on clearing and settlement be finally adopted at the EU level, it is clear that the standards would have to be assessed for their conformity with the provisions of the Directive and, if necessary, amended accordingly.

Third, the Eurosystem's interest also stems from the relationship between integration of securities markets with financial stability. Central banks have a natural role in this area, confirmed by the Treaty, which states that the Eurosystem should contribute to the smooth conduct of policies relating to the stability of the financial system. **An important task of the Eurosystem in this respect is the systematic monitoring of sources of vulnerabilities for the euro area financial system and the assessment of its degree of resilience to potential shocks.** In this context, I would like to announce that the ECB will start publishing the output of this activity in the form of a financial stability review, with the first issue already scheduled to be published on 15 December. Another task of the ECB in this area is the provision of advice on draft Community and national legislation in the financial field either through formal opinions or through its participation in the relevant regulatory (level 2) and supervisory (level 3) committees. In particular, the ECB

follows closely the work of the European Securities Committee (ESC) and the CESR which play an important role in assisting the Commission in shaping the regulatory framework in the securities field.

Priorities in the areas of financial regulation and supervision

The level of integration of securities markets, including market infrastructures in both the trading and post-trading areas, has increased significantly since the introduction of the euro. Given this substantive progress, it is important that integrated markets develop on the basis of a sound framework for financial regulation and supervision. The CESR has a crucial role to play in this regard.

First, the completion of the Financial Services Action Plan (FSAP) will provide the “Single European Securities Market” with a strong impetus. It is however important to note that most of the FSAP directives in the securities field are designed in line with the Lamfalussy framework. Let me mention in that context the Market Abuse Directive, the Prospectuses Directive, the Transparency Directive and the Directive on Markets for Financial Instruments. These directives warrant the adoption of a number of Level 2 implementing measures by the Commission for their full implementation. The preparation of technical advice of good quality on the content of Level 2 rules is one of the CESR’s main achievements to date, also under tight deadlines.

In this respect, the message I would like to convey to the CESR is to strive to continue the good practice of providing timely and good quality technical advice with extensive consultation practices. The recommendations of the Inter-Institutional Monitoring Group in this context are to be supported. For instance, as recently requested by the Commission, instead of a more general contribution, CESR could formulate its advice as close as possible to the content of a Level 2 measure. This will both facilitate and increase the transparency of the Lamfalussy regulatory process.

As regards the Level 2, I would consider further efforts for optimising the content of this component of the Lamfalussy framework as of critical importance. In particular, the distinction between Level 1 and Level 2 legislation, with due consideration of the applicable legislative procedures, could be better refined. The aim would be to achieve a flexible and consistent set of securities regulations among Member States, which can further enhance cross-border transactions. The good experience gained so far with the implementation of the Lamfalussy approach should allow a wider scope for Level 2 than it has been the case.

Second, the fact that integration has progressed more in the securities field than in other segments of the financial sector, makes the issue of effectiveness of supervisory convergence particularly relevant. This

implies that Level 3 needs to be further developed with regard to the supervision of securities markets.

The CESR is providing a contribution in this field by promoting strategic reflections on the key challenges surrounding supervisory convergence. I am referring to the recently published report by CESR, commonly called the "Himalaya Report". I understand that these reflections mirror the fact that, in comparison with other level 3 committees, the CESR has already gained some experience and is a position to start developing strategic considerations about its future role.

On this issue, I would like to emphasise my conviction of the soundness and potential of the Lamfalussy framework. This framework provides an appropriate institutional set-up to achieve both a more flexible regulatory process and consistent supervision for integrated financial markets. This conviction has been substantially reinforced by the good experience gained so far in the securities field. Therefore, I have confidence that the extension of the Lamfalussy framework to the banking and insurance sectors will reveal the same positive experience.

Looking ahead, I believe that one of the main objectives in the context of what is commonly referred to as "the post-FSAP strategy" is to attempt to exploit to the maximum possible extent the potential which is inherent in the Lamfalussy framework to improve the regulatory and

supervisory process. This is one of the main challenges for the Level 3 committees but it is also one of the main factors on which the success of these committees will be measured. I am aware that all the Level 3 committees are already working hard to meet the challenges posed by the Lamfalussy process.

Therefore, I am in full agreement with the conclusion of CESR in the Himalaya report that the experience so far is a success and is in the right path. The priority is indeed to implement the existing and potential supervisory tools within the FSAP and Lamfalussy frameworks. And the objective is and should be to achieve a good co-ordination among authorities in the implementation and enforcement of securities regulation across the EU.

In this respect, while acknowledging the limitations of the voluntary nature of Level 3, I would tend to think that certain "soft" tools, some of those already used by the CESR, may enhance the prospects for such co-ordination among authorities. First of all, increased transparency of CESR's activities, including consultation and reporting practices, may also enhance in my view CESR's accountability. Second, tools such as peer pressure and supervisory disclosure may provide appropriate incentives to co-ordinated efforts among authorities without changing the nature of the Level 3 Committees. In this respect, I would be happy to hear more concrete details of the CESR's proposal for a mediation mechanism of an advisory nature among national regulators. This has

the potential to enhance the dialogue among CESR members on specific supervisory issues, therefore also enhancing their co-ordination and mutual understanding. This is a good example of instruments to exploit to the maximum extent the opportunities offered by the Lamfalussy framework.

Priorities in the area of financial stability

After addressing regulation and supervision, let me now turn to the third component of the public policy framework for financial markets: financial stability.

Indeed, the process of pursuing further financial integration also needs to be accompanied by the strengthening of the framework for maintaining financial stability. The emergence of pan-European banking groups and the growing integration of financial markets and market infrastructures increase the potential scope for systemic risk in the EU. Systemic disturbances are likely not to be confined to one Member State, thus cross-border contagion may spread more easily.

Many initiatives have been or are being taken at the EU and national level to reinforce the set-up for maintaining financial stability and managing financial crisis. First, the monitoring of the stability of the financial system is being further developed. More and more central banks are developing a more systematic monitoring of the stability of

their domestic financial systems. This is reflected also in the tasks of the Eurosystem which, as I already mentioned, has established a systematic monitoring of the stability of the euro area financial system. This analysis includes all the relevant components of the financial system, notably banks, non-bank financial institutions, financial markets and financial infrastructure and reviews all possible sources of vulnerability for the system. This activity of the Eurosystem benefits from the monitoring of banking stability in the EU conducted since long by the Banking Supervision Committee, one of the ESCB committees where central banks and supervisory agencies are represented. In this connection, I acknowledge that the Level 3 committee in the insurance field, the CEIOPS, has recently activated a systematic monitoring of the stability of the insurance sector in the EU very much along the lines of the BSC work. I would thus see merit in the involvement of CESR in this area by developing a systematic monitoring of developments in financial markets from a financial stability angle.

Second, additional measures are being considered to strengthen the effectiveness of supervisory action in a more integrated financial market. For the banking sector let me mention the revised EU capital requirements framework for banks and investment firms where enhanced responsibilities are attributed to the consolidating supervisor. Indeed, along with the responsibility of being held accountable for the approval of sophisticated approaches to calculate capital requirements for the group as a whole, the consolidated supervisor is

also responsible for coordinating activities and exchanging relevant information in crisis situations. Hence, in my view, the role of the consolidating supervisor does not undermine but rather underpins the crucial need to reinforce supervisory cooperation and strengthen the interplay between the home and the host supervisor for the supervision of groups operating on a cross-border basis. Strengthening of co-operation is critical for effective prudential supervision of all financial institutions. **As to securities supervision – which is the main domain of CESR – I recognise that the main challenges are related to the fact that the principle of home country control finds a narrower application and that securities commissions have very different powers across countries.**

Third, in the area of financial crisis management, the main initiatives are in the form of promoting multilateral or bilateral agreements among the relevant authorities so that they are prepared in case of a financial crisis with cross-border dimension. The main idea behind these agreements rely on the assumption that the management of a financial crisis having a cross-border dimension is a complex endeavour which requires a clear ex-ante understanding of the role and procedural steps for all authorities involved. Such agreements are expected to be a useful tool helping to a certain extent the management of a crisis, if it were to happen, though it should be recognised that each crisis has its own unique features and therefore it is impossible to foresee its dynamics. **In this context, I should mention**

the MoU agreed in 2003 by the EU central banks and banking supervisors for the co-operation and exchange of information between them in crisis situations. The MoU - prepared by the BSC - defines general principles for co-operation and can be used as a basis for more specific agreements amongst the authorities. More recently, the ECOFIN has agreed that another agreement should be reached at the EU level between central banks, banking supervisors and Finance Ministries for the interplay among the three authorities in crisis situations. At a certain stage, I think, the issue that will have to be addressed would be to also involve other categories of supervisors, in particular securities and insurance supervisors, given that a crisis of a cross-border dimension may well cover also financial institutions falling within their competence.

Conclusion

Ladies and gentlemen,

Let me finish by reiterating that the “European single market” is still **under construction**. Notwithstanding the significant progress achieved so far, the attainment of an optimal level of integration requires an effective interplay between market forces, and both collective actions and public action. Nevertheless, **an exclusive and essential responsibility of public authorities remains the establishment of an appropriate legislative and regulatory framework. Regulatory and**

supervisory convergence represent the main elements in this process. Indeed, convergence will only be effective and produce its intended benefits if both CESR members and market participants can fully rely on a consistent set of practices across the EU. This constitutes the precondition – which has not been present so far – for workable mutual recognition among authorities and expansion of cross-border activities by market players.

Thank you very much for your attention.