



Financial Services

Political challenges

Fourth Report

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Financial Services

POLITICAL CHALLENGES

INTRODUCTION: THE BALANCE OF DECISION-MAKING WILL MOVE TO THE COUNCIL AND EP

The political and economic case for a seamless, integrated European financial services market is as strong as ever. The internal benefits of a fully integrated pan-European financial sector, anchored on the Euro, remain huge, notably a significant increase of the EU's financial markets. The stronger, internally, Europe's financial sector is, the stronger Europe will stand externally on global markets and in global trade negotiations. However, moves to achieve this – in a shorter term – will be played out against a less propitious global economic outlook. This will strengthen the cost-pressures for consolidation of Europe's fragmented markets.

By the summer, in terms of decision making the locus of work in relation to the Financial Services Action Plan (FSAP) will gravitate from the Commission to the Council and the European Parliament although the Commission will, of course, continue to play an active role throughout this new phase. Since the endorsement of the FSAP by the Cologne European Council in June 1999, 18 measures are now on the table for adoption in the Council and the European Parliament. Although early agreements are emerging, there are already some challenging issues which will demonstrate whether there is a real political will to complete the FSAP on time and in accordance with the European Council's 2003/2005 mandates. A key issue is whether the Stockholm European Council Resolution (23.3.2001) to secure more efficient securities market regulation can be made to work expeditiously.

A PERIOD OF CONTINUOUS CHANGE IN EUROPE'S FINANCIAL SECTOR¹

The consolidation of the European financial services industry is continuing as financial institutions engage in mergers and acquisitions on a cross-border and cross-sector basis. The privatisation of the banking sector is continuing in a number of Member States. Recent developments (notably including the Allianz/Dresdner and Nordea/Unibank deals) show the emergence of some of the largest financial groups in the marketplace. Several Member States are examining the adequacy of their regulatory structures in response to these developments. There are some signs of convergence and closer cross-border and cross-sector cooperation. On an international scale recent turmoil in the banking markets in Turkey and the continued need for a bank balance sheet restructuring in Japan reinforce the Union's need to be rigorous in its own regulatory and supervisory systems to withstand any spill-over effects.

The first example of a cross-border European stock Exchange – Euronext – is now in place and may lead to further consolidation if it proves to be successful. The Austrian stock exchange has formed an alliance with Deutsche Börse and created NEWEX, in co-operation with the relevant exchanges for the trading of Central and East European securities. The global dimension of the rationalisation of trading infrastructures was recently heightened by the acquisition by NASDAQ of a majority shareholding in EASDAQ ('NASDAQ Europe'). The corresponding central counterparty and settlement

¹ As indicated in the third progress report the Commission will define, by the end of the year, indicators of key trends and the economic benefits of an integrated financial services sector. These will provide a more detailed statistical analysis. First indicators will be available by the end of this year



systems are also in the process of consolidation. A growing number of exchanges are developing links with central counterparties/clearing houses in other Member States. Competition between these facilities is increasing. In equity markets, new trading systems have made limited progress in attracting liquidity from traditional exchanges. Despite the dampening of volume growth and the slow pace of consolidation of infrastructures, European financial markets continue to mature and become more sophisticated. This is evidenced by the continued deepening of European markets of corporate bonds of all investment grades and of venture capital markets.

THE POLITICAL RESPONSES: THE STOCKHOLM EUROPEAN COUNCIL AND THE FSAP

The European institutions have responded to this continuing change in Europe's financial landscape and developments in the global marketplace. The measures in the FSAP are more targeted and address the issues arising from these market trends.

First, the Stockholm European Council has added impetus to securities market integration

The Stockholm European Council's key message is that a prosperous EU economy over the next years depends on the rapid and successful integration of the Union's financial markets. The deadlines set by Heads of State and Government to implement the Action Plan by 2005 and to integrate European securities markets by 2003 are now firm. In its Resolution, the Stockholm European Council endorsed the

conclusions of the Wise Men's report, the steps it proposed in the securities field, and the priorities identified in the Action Plan, including the importance of adopting the proposed directive on the distance marketing of financial services. The European Council confirmed that the regulation of securities markets should be flexible enough to respond to market developments, be transparent and be characterised by legal certainty.

As a first response to the continuing change in the Union's financial sector and the Stockholm Council, the Commission will, shortly, adopt the decisions to set up the new committee structure - a Securities Committee (in its advisory - non comitology - function) and a Regulators Committee. National regulators are also working urgently to organise the establishment of the independent Regulators committee to act as an independent advisory group to assist the Commission, in particular in its preparation of draft implementing measures.

Making this new approach work through targeted and up-to-date legislation is central to achieving the integration of Europe's financial markets. However, success will only be possible if the three institutions - the European Parliament, the Council and the Commission - work together, fully respecting the present institutional balance in the Treaty and the prerogatives of the institutions involved. The Commission has, as a result of these developments, brought the FSAP into line with the Stockholm conclusions (fig. 1).



Stockholm European Council Priorities	
FSAP measure	State of Play
Adoption before the end of year of the Distance marketing of financial services directive	Amended Commission proposal 26 July 1999
Modernisation or investment rules for supplementary Pension funds	Commission proposal 11 October 2000
Adoption of international accounting standards	Commission proposal 13 February 2001
Single prospectus for issuers	Commission proposal scheduled for end May
Modernisation of admission to listing	Commission proposal scheduled for end 2001
Single passport for recognised stock markets	Commission proposal scheduled for end 2001
Home country control for all wholesale markets and Definition of professional investors	Commission proposal scheduled for end 2001

Figure 1

Second, progress is being made on the implementation of the FSAP

Since the last progress report, the Commission has delivered 12 actions under the FSAP, including seven legislative proposals:

- ☐ the prudential supervision of **financial conglomerates** (April);
- ☐ a **streamlined prospectus** aiming to establish a single passport for European issuers (end May)²;
- ☐ preventing **market abuse** (end May)²;
- ☐ two Commission decisions to create a committee structure in the **securities** area (imminent);
- ☐ common standards on **collateral arrangements** (March); and
- ☐ a draft regulation to **apply international accounting standards** for EU listed companies (February).

In the retail financial sector the Commission has issued a recommendation on the marketing of home loans together with two communications (on e-commerce and financial services, and the prevention of fraud in non-cash payment systems). A EU-wide complaints network has been established to facilitate consumers' access to out-of-court settlement of cross-border

disputes on financial services ('Fin-Net'). In the securities sector, the two Commission communications issued last year are laying the ground for the revision of the investment services directive later this year. The modernisation of admission to listing, a single passport for stock markets and home country control for all wholesale markets (all identified as Stockholm priorities), will be considered as part the review of the ISD. However, the late transposition of the Settlement Finality Directive remains a concern. For the remainder of 2001 an ambitious timetable underpins the implementation of the revised capital framework for banks and for investment firms by 2004, following discussions in the G-10 Basel Committee. A number of significant developments in the Council and the European Parliament have occurred:

- ☐ after 30 years there is political agreement on the **European Company Statute**;
- ☐ the **winding-up directives** for banks' and for insurance companies have finally been adopted;
- ☐ a common position has been adopted on the two **UCITS** proposals; and
- ☐ the **take-over bids** directive is in conciliation.

² Depending on a Commission decision (30 May)

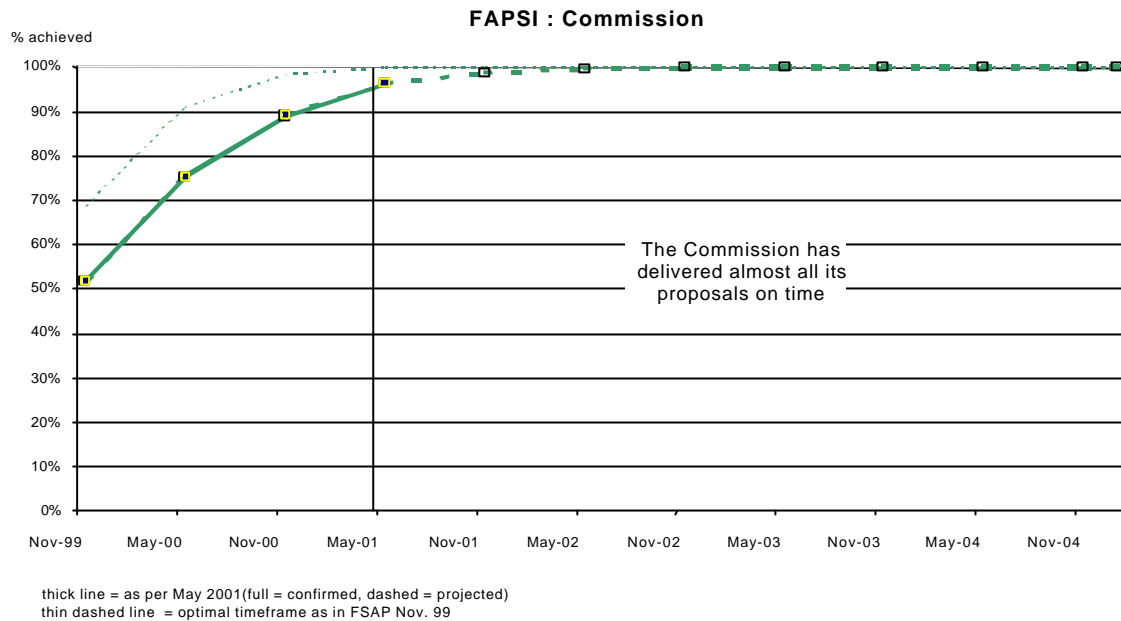


Figure 2

Progress on individual FSAP measures was tracked in the annex to earlier progress reports. This detailed exercise will continue on the internet and will be constantly updated (http://europa.eu.int/comm/internal_market/en/finances/actionplan/annex.htm).

Commission progress reports will, in future, present only general indications of the implementation of the Action Plan, whilst the 'FAPSI' index (*Financial Services Action Plan Implementation*) will plot actual against required progress cumulatively, of all FSAP measures. The percentage of progress reflects actions that have been achieved and the time required to process

and finalise remaining measures as at the end of May 2001 (figure 2).

The FAPSI index shows that the Commission has delivered most of its proposals in time and will, by the end of 2001, have made almost all of its proposals under the FSAP. This is reflected in figure 3 where the ten priorities set in the Commission's last progress report have been, or are likely to be achieved. However, the FAPSI index for the European Parliament and Council shows a number of cumulative delays representing slippages in the decision-making process of the Council and/or the Parliament (figure 4). More specifically the major delays are identified in figure 5.



The Commission priorities according to the third progress report

Upgrading the two Directives on Prospectuses	✓ expected May '01
Legislative follow-up to the EU Accounting Strategy Communication	✓
Directive on Cross-Border Use of Collateral	✓
Commission Communication on Upgrading the Investment Services Directive	✓
Commission Communication on Article 11 of the ISD	✓
Directive on Market Abuse	✓ expected May '01
Commission Communication on an e-commerce policy for financial services	✓
Commission Decisions establishing a Securities Committee and a Regulators Committee	✓ expected May '01
Directive on Prudential Rules for Financial Conglomerates	✓
Directive Governing the Capital Framework for Banks and Investment Firms	End 2001

Figure 3

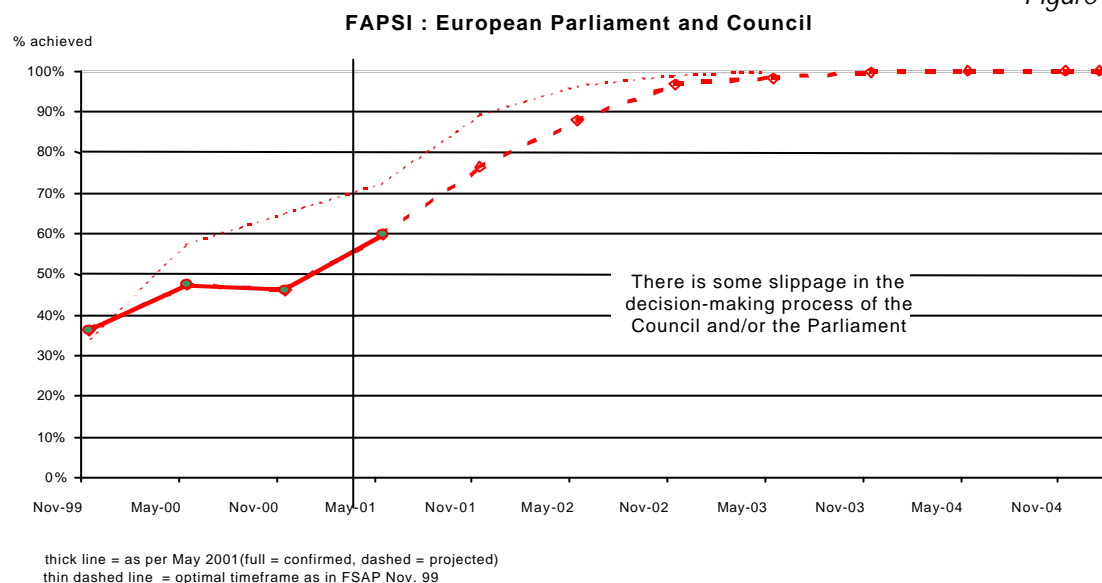


Figure 4

The Council and European Parliament priorities according to the third progress report

Directive on the Prudential Supervision of Supplementary Pension Funds	Discussion ongoing
The two UCITS Directives	2 nd reading in EP
European Company Statute	Political agreement
Directive on Take Over Bids	Conciliation
Directive on Distance Marketing of Financial Services	Discussion ongoing
Directive on the Re-organisation and liquidation of Insurance Undertakings	✓
Directive on the Winding-up and reorganisation of Banks	✓
Amendments to the Money Laundering Directive	Conciliation
Directive on Savings Tax	Political agreement
Implementing the December 1997 Code of Conduct on business taxation	Discussion ongoing

Figure 5



FINDING THE POLITICAL WILL TO MOVE FORWARD ON THE DIFFICULT ISSUES

Overall progress is at present reasonably satisfactory although care must be taken to avoid any complacency to emerge. Even today there are three areas of concern: pension funds, e-commerce and money laundering. The Stockholm European Council has identified the first two as absolute priorities. The Tampere Council concluded that measures to combat money laundering are similarly top priorities. In the coming months, other policy issues could cause delays and the Commission will in the next report highlight such issues.

Pension funds

There are diverging views on three critical contentious points: (i) the scope of the directive, (ii) the possibility for Member States to apply more detailed, quantitative investment rules, and (iii) the technical provisions. Broadly, the debate is split between those countries that already have 'second pillar' funded pension schemes and which want to avoid imposing rules that would reduce their efficiency and success, and other countries that are considering the introduction of such schemes but lack experience with the use of qualitative rules and are concerned that a qualitative approach does not provide an appropriate level of security.

The Parliament wants to cover certain risks and is seeking for a legislative proposal to eliminate tax obstacles to the cross-border provision of occupational pensions. The Commission is of the view at this stage that such a legislative measure is not required. In a recent Communication³ the Commission concludes that discriminatory tax treatment of pensions taken out with pension institutions in other Member States is contrary to the freedoms of the EC

Treaty and announces that infringements may lead to legal action.

E-commerce and distance marketing

The Commission's Communication on e-commerce and financial services was designed to set out the broad policy framework for future work on electronic commerce and financial services. The E-Commerce Directive, which enters into force mid January next year, is at the heart of that framework. It stipulates that each Member State ensure that financial services offered on the internet (with some exemptions) by a service provider established on its territory comply with the national provisions in that Member State within the coordinated field. Member States must not (in principle) restrict the freedom to provide financial services via internet on a cross-border basis. A large majority of Member States consider that this approach is the cornerstone for future policy developments in retail financial services. However, some Member States are concerned that this approach would leave gaps in consumer protection and argue that further harmonisation of consumer protection rules should precede an internal market in e-commerce and financial services.

On 7 May 2001 the ECOFIN Council endorsed the strategic approach proposed by the Commission and agreed that a programme of further convergence in consumer and retail investor protection rules aiming at a higher level of harmonisation should be complemented by additional flanking measures to build consumer confidence. According to the conclusions of the ECOFIN Council, "the Council supports the Commission's intention to propose guidance to Member States on the application of Article 3(4)-(6) of the E-commerce Directive in order to promote understanding of the regulatory framework". The Internal Market Council will consider the proposed directive on distance marketing of financial services late May. That proposal is a vital step

³ Communication on 19 April 2001 on the elimination of tax obstacles to the cross-border provision of occupational pensions (COM(2001)214).



toward further convergence in national consumer and investor protection rules and is thus an essential component of the Union's future policy framework for financial services.

Money laundering

Efficient and targeted measures to combat money laundering operations are at the heart of protecting the integrity of Europe's financial system. The proposal to broaden the range of criminal activities covered by the Money Laundering Directive and to extend the reporting requirements to certain non-financial activities and professions – in particular the legal profession – is central to achieving that objective. Parliament has a number of concerns, particularly regarding the advisory role of the legal profession, and a conciliation procedure is likely. It is hoped that a workable compromise between the position of the Council and the European Parliament will be achieved.

CONCLUSION

There are three key political messages enshrined in this report.

The overall balance sheet at the end of May 2001 is broadly positive. Of the initial 41 measures of the FSAP 16 have now been finalised. Only 6 legislative proposals are to be made by the Commission in line with the FSAP timetable (regular reporting; investment services directive; capital adequacy proposals; 10th Company Law Directive on mergers; 14th Company Law Directive on the transfer of corporate seats; and amendments to the 4th and 7th Company Law Directives on fair value

accounting). However, by this summer, the centre of decision taking on the Financial Services Action Plan (FSAP) will gravitate from the Commission to the Council and the European Parliament. The Council and the Parliament currently have 18 measures under discussion. This already represents a major challenge to ensure that the FSAP deadlines are respected.

Second, three cases will, more immediately, demonstrate how committed the Union is to achieving the deadlines set by successive European Councils. They are on pension funds, distance marketing of financial services and money laundering. The Recommendations made by the Committee of Wise Men and endorsed at the Stockholm European Council will shortly be translated into the formal establishment of a Securities Committee and a Regulators Committee. But that structure must be seen to work quickly and efficiently, and this demands the full cooperation of all the institutions and parties concerned.

Third, the FSAP is a comprehensive framework of inter-linked measures which will allow the EU to benefit from the single currency and an integrated financial sector. The full benefits will not be realised without agreement on all the elements. Future reports will identify where blockages are occurring. Moreover, there are other issues that will require political attention in a slightly longer term. The state of preparedness of the financial sector of Accession Countries, and a new trade round are but two examples. The Commission will report on these longer term challenges in future reports.