

**Frits Bolkestein**

Member of the European Commission in charge of the Internal Market, Taxation and Customs

**Learning the lessons of the Financial Services Action Plan**

Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

Address at Edinburgh Finance and Investment Semina

**Edinburgh, 29<sup>th</sup> January 2004**

## **Introduction**

The creation of an integrated financial market is not art for art's sake: it is a crucial part of the recipe for transforming Europe into the world's most competitive marketplace. A single, deep and liquid capital market can, by eliminating inefficiencies in the financial system, increase returns on savings while simultaneously reducing the cost of borrowing capital.

The FSAP has, however, not been without its critics. This may be because of the up-front costs of regulatory change that market participants are currently experiencing. But I do not think we have lost sight of the longer-term benefits that should trickle down to the full range of stake-holders – the issuers, investors and institutions that serve them. I want therefore to tackle some of the criticisms head-on. I would also outline some lessons that the Commission has drawn from the experience of the past five years ... let me start by recalling briefly why we went down this road in the first place.

## **FSAP – building commercial freedoms**

The FSAP is about giving effect to a range of commercial freedoms – the freedom for market participants to buy and sell financial instruments freely across borders; the freedom to raise capital in other Member States on the basis of domestic financial disclosure documents; the freedom for financial institutions to provide services to EU consumers on the same terms and conditions as they do domestically. The FSAP is about enhancing competition and choice. Delivering efficiency gains. Fuelling investment. And facilitating job-creation.

Of course, there has to be a catch. The integration of European financial markets requires far-reaching and comprehensive regulatory reform – more so than in other service sectors.

If we are to move forward, we must accept that realising single market freedoms requires some pooling of regulatory sovereignty. Borderless finance in Europe is not synonymous with regulation-free Europe. Where harmonisation is needed, it should be carefully calibrated. It should not exceed that which is “necessary and sufficient” to iron out substantive divergences between national regulation which are materially important in preventing cross-border business.

## **Where are we today?**

The FSAP is on track and on time. 37 of the 42 measures have been finalised - an unprecedented success rate for an EU legislative programme of this scale and complexity. It is testimony to the political commitment of the Council, European Parliament and the financial community to create the conditions for a single, deep and liquid financial market.

I am optimistic that the Irish Presidency will tie up loose ends on outstanding proposals such as the Directives on Investment Services and Transparency. In addition, work continues on other core building-blocks of the EU legislative framework. Let me mention four.

1. **Basel II:** We are confident that work on a new Basel Accord can be completed by mid-2004. We shall issue a proposal for a directive shortly afterwards. This will be necessary if we are to allow ourselves sufficient time to ensure implementation by end-2006.
2. Also in the prudential field, the Commission is adding the finishing touches to its proposal for a prudential framework for the **re-insurance sector**. A proposal for a Solvency II framework is scheduled for early 2005.
3. **Corporate Governance/Company Law:** The corporate Governance Action Plan is a central plank of Commission policy to restore confidence of investors and shareholders. The Parmalat scandal has served to remind us – if we had forgotten – of the potential detriment associated with unscrupulous board-room behaviour and lax oversight. The financial services industry must clean up its act – we need a return to ethical conduct and diligence. We ignore the long-term damage to investor confidence at our peril. The Commission's forthcoming proposal on statutory audit will address some of the failures which have characterised recent corporate scandals.
4. **Financial reporting:** The decision to move to a common system for financial reporting for EU listed companies has been one of the boldest and most significant steps under the FSAP. For the first time, European investors will be able to compare "like with like" when reading annual accounts. On IAS 39, we are aware of profound concern regarding the prospects for reaching a satisfactory solution. The Commission is doing everything in its power to find a viable solution. Failure could have significant consequences for our long-term objective of facilitating the emergence of a global financial reporting standard.

### **Has FSAP made a difference?**

Has this legislative investment translated into tangible improvements in the functioning of European financial markets? Given that many of the key measures have yet to enter into force, or have only just done so, it is too early to make any definitive pronouncement. But the FSAP has coincided with a profound restructuring of the European financial landscape. Business anticipation of the emergence of a coherent legal framework, alongside the introduction of the euro, has been a catalyst for change.

Markets are being reshaped by the emergence of a pan-European commercial logic. Change is particularly evident at the level of financial markets: we have witnessed the appearance of new markets and new financing techniques. There are now more options available to capital-hungry businesses – including the emergence of venture capital and private equity as important sources of funding for start-ups. All of these markets are organised on a cross-border basis: they are looking for pan-European solutions to support their trading and investment strategies. This, in turn, is driving a reorganisation and consolidation of exchanges and of clearing and settlement infrastructures.

Change is not confined to the wholesale markets: professional market players are not the only ones to pocket the benefits. Yes, direct business-to-consumer provision of financial services remains the exception. But European financial institutions are increasingly competing for the custom of investors and consumers in other Member States. A third of EU mutual funds are now marketed and distributed on a cross-border basis. Access to local distribution networks or platforms is at the heart of these cross-border business strategies. Efficiency improvements in financial markets are also feeding through to European households in the form of lower mortgage and borrowing costs.

Competition, consolidation, integration and conglomeration will continue to reshape European financial markets over the coming years. These forces will intensify the extent of cross-border and cross-sectoral financial risk. The European legislative framework must continue to find practical solutions which enable market-driven forces to generate efficiency gains – without compromising financial stability, market integrity and investor protection.

## **Lessons learned**

I would now turn to four broad lessons that the Commission takes from the experience of the past five years.

### **1) *Quality of political outcomes***

Ambiguity, optionality or incompleteness have been far too common in EU financial legislation. The political horse-trading that accompanies much EU legislative work has meant that the effectiveness of Single Market freedoms is frequently diluted. In some instances – such as the Prospectus Directive – the co-decision procedure has contributed to more operational legislation. More frequently, however, political arbitrage has resulted in the watering-down of provisions designed to give effect to important single market freedoms. By far the most regrettable example of the emasculation of an FSAP measure has been the unfortunate Take-Over Bids Directive.

The objective now must be to raise awareness of the opportunity costs of failing to agree rules which provide legal certainty and full market access rights on the basis of home country control. Member States and Parliament must be conscious of the costs associated with optionality, vague compromises and third-best solutions.

### **2) *Implementation and enforcement***

Regulatory and administrative impediments to pan-European financial business no longer arise from fundamental differences in regulatory philosophy or practice. Increasingly concerns centre on the fine-print of detailed regulation or the way in which national enforcement agencies exercise the discretion allowed to them under common framework rules. As the legislative phase of FSAP draws to a close, attention turns to limiting divergences in implementation and enforcement which may unnecessarily or arbitrarily restrict market access. Supervisory convergence is the new buzz-word.

We must do everything in our power to ensure that - after the significant investment of political and private sector effort in the FSAP - the legitimate expectations of improved market access are not thwarted by differences in behaviour by local supervisory agencies.

### **3) Consultation and involvement of market practitioners and national authorities**

We recognise that proposals for financial legislation cannot be drafted in an ivory tower. They must be subjected to rigorous scrutiny by the firms required to comply with them and by the authorities charged with implementing them. Financial legislation is too important, and the costs of bad financial law are too great, to proceed in any other way. Over the course of the FSAP, both the Commission and CESR have made great strides in this respect. We are now firmly wedded to a culture of open law-making in the financial sector. Openness is a strength.

### **4) The need for prioritisation and justification**

As the FSAP winds down, thoughts inevitably turn to the future. The key question facing us is “what next”? Are there any other integration failures that we think need fixing? Do these need EU level policy intervention?

Regulators need to be humble. It is not within their gift to force financial market integration by adopting EU legislation. EU regulators also have to appreciate that because something is technically feasible, it does not mean that it is commercially viable. A key issue for the Commission is to develop a coherent and dynamic approach to prioritising any future work at European level.

The first steps in this reflection are now underway. Four working groups of high-calibre specialists (in the fields of banking, insurance, asset management, and securities trading) are reflecting on the state of financial integration following five years of FSAP activity. The expert groups have been asked to identify products and markets where integration has yet to manifest itself and to consider the reasons which might explain these “integration failures”. Their conclusions will be made public in April. This will serve as the raw material for an open debate on future priorities.

The FSAP “stock-taking” is not the prelude to an ambitious new legislative programme. Beyond already programmed commitments, there are no preconceived notions whether or not any EU-level action is necessary. Looking ahead: where there is no demonstrable and duly motivated case for further action none will be proposed. Nevertheless, legislative harmonisation has played an important role in the past and may serve us well in the future: where a solid case can be made for targeted legislative action to overcome clearly identified legal or regulatory barriers, it should remain an option for the architects of the single financial market.

## **Conclusions**

The Commission's Financial Services Action Plan is a working example of how – with a clearly defined objective, a carefully considered strategy, limited resources and the goodwill of Member States, Parliament and market participants - a key component of the "Lisbon agenda" can be delivered.

A single financial market remains a goal worth striving for. Along the way, there may be second-best outcomes – reflecting the complex and multi-dimensional rule-making at EU level. But, the question that we need repeatedly to ask ourselves is whether there is any alternative to working together. Faced with the continued internationalisation of financial markets, is regulatory and supervisory autarky a realistic option?

Yes, we need to raise our game. We need to do better in coming forward with well-motivated, technically sound initiatives that deliver tangible improvements in market access. We are making fundamental changes to the way in which we legislate. With a constructive engagement of national authorities and market practitioners we can do better.

Market practitioners must make a positive contribution to shaping the measures taken to achieve this goal. Meshing together regulatory and supervisory systems will entail transitional costs and changes to “business as usual”. Market participants cannot expect the collective rule-making process to result in the replication of their national regime at EU level. We have to take the best from national regimes and build from them a European model which will benefit all. It is a tall order but one which I believe it is worth striving towards and with regard to which we can say that some modest progress has already been made.