



Financial Services

Turning the Corner

Preparing the challenge of the next phase of European
capital market integration



Brussels, 2 June 2004

Tenth Report



I Introduction

The Financial Services Action Plan (FSAP) has been delivered in full and on time – a major success for an EU programme of this scale and complexity. This was only possible because there was a clearly defined objective and timetable, a carefully planned strategy, high quality resources, systematic monitoring, and notably the goodwill of Member States, the European Parliament and market participants operating in a growing climate of trust, cooperation and mutual understanding. In parallel to the legislative roadmap, the impulse of the Lamfalussy process has played a major part in this success as well - and its recent extension to the banking and insurance areas is politically welcome.

Since the previous Progress Report of the FSAP¹, the Italian and Irish Presidencies have given a very welcome and expert final push, concluding many key legislative initiatives. The call from the Brussels European Council of 25 and 26 March 2004 for the remaining elements of the FSAP – the Investment Services and Transparency Directives – to be finalised before the end of term of the current European Parliament – has been heeded.

However, regulation alone does not deliver an integrated single market. The extent to which the FSAP will contribute to the creation of a truly European market for financial services and to increased European competitiveness now depends on the consistent and timely implementation of the FSAP measures at Member State level, convergence of national supervisory practices and rigorous enforcement.

It is still too early to make a final evaluation to what extent the FSAP has achieved its stated objectives. Many of the key FSAP measures have only just entered into force; others still need to be transposed in the Member States. Furthermore, some of the more technical implementing measures of key securities directives have yet to be adopted. With this in mind, the European Commission has begun a monitoring process to assess the state of integration of European financial markets, *inter alia* with the help of four expert groups of market participants².

What is certain, however, is that the FSAP is already acting as a powerful vector for change. Financial markets are organising themselves on a cross-border basis – particularly as regards trading risk management and other upstream business functions. The benefits of the integrated Single Capital Market should be enjoyed by all of the Member States, including the new Member States. Enlargement of the single market is expected to amplify the economic benefits to the Community, particularly during the high-growth catch-up phase, when the new Member States will have additional financing needs to fund capital investment programmes.

1 See Ninth Progress Report: http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm

2 See for more detailed information Sections III.C and III.D.



The FSAP measures with an implementation deadline before 1 May 2004 formed part of the *acquis* which all 10 new Member States should have transposed and implemented from the date of accession³. Where implementation deadlines of FSAP measures are later than May 2004, deadlines apply to all 25 Member States alike. To facilitate this process, delegates from the new Member States have been included as observers in all relevant preparatory and regulatory meetings and committees over the last year. Furthermore, the European Commission has for some time maintained an intensive dialogue with the new Member States in the field of financial services, notably by peer reviews carried out by supervisors from the EU15. This has led to recommendations and action plans drawn up by the new Member States to ensure effective implementation of the *acquis*.

II. STATE OF PLAY ON REMAINING FSAP MEASURES

Of the 42 FSAP measures, 93% have crossed the finishing line within the time limit set by Heads of State and Government⁴. Since the last Progress Report of 25 November 2003, agreement has been reached on the following:

- The Financial Instruments Markets Directive (former Investment Services Directive) was finally adopted on 21 April 2004⁵, after only 18 months negotiation. The Council agreed its Common Position by qualified majority only in December 2003. The European Parliament started its second reading in January and adopted the proposal on 30 March. The key issues were the pre-trade transparency requirements and the rules concerning price improvement. The European Commission considers the final result to be a balanced package;
- The European Parliament Plenary vote on the compromise package for the Transparency Directive took place on 30 March 2004 and thus allowed for political agreement by Council on 11 May 2004. The Directive improves financial reporting by security issuers, in particular interim financial reporting. Amongst others, share issuers will be required to publish an interim management statement unless they already provide quarterly reports. Apart from transitional provisions for existing bond issues, the compromise includes a delegation to the European Commission to decide on the equivalence between International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) vis-à-vis third country accounting standards.

3 The Acts of Accession of some new Member States foresee transitional measures for the minimum capital requirement for co-operative credit institutions under the Banking Directive and the Deposit Guarantee and Investor Compensation Schemes. These transitional measures apply to the local market; it will not be possible to benefit from direct access to the European Internal Market while having to comply with less strict regulation. All transitional measures will end after 2007 at the latest.

4 Lisbon European Council of 23 and 24 March 2000, reconfirmed by consecutive European Councils, including the Brussels European Council of 20 and 21 March 2003.

5 Directive 2004/39/EC



- The Directive will also lead to better dissemination of information on issuers across Member States; details thereof should be laid down in implementing rules to be adopted by the European Commission;
- The Directive on Take-over Bids was formally adopted on 21 April 2004⁶. It includes harmonised rules governing the bid procedure and provisions to protect minority shareholders. Although the European Commission tried to broker a far more ambitious agreement, there was no common opinion on how to create a new balance between the power of management and shareholders. The result is a disappointing *de minimis* optional outcome. The compromise does not underpin a level playing field and is a retrograde step in terms of economic reform. The Commission considers that the final compromise does not contain a meaningful harmonisation of the key provisions and published a Declaration expressing its disappointment;
 - After the European Parliament's Plenary vote on 30 March 2004, the Council agreed on a proposal for a Directive⁷ to restructure the financial services committees in the banking, insurance and UCITS⁸ sectors on 11 May 2004, thus allowing for a more streamlined, flexible and faster legislative approach for the whole financial services sector. See for more details Section III.B;
 - The European Securities Committee (ESC) agreed on 19 April 2004 to adopt the second set of implementing measures in the area of Market Abuse using the Lamfalussy process⁹. Furthermore, ESC members voted unanimously in favour of the Commission's proposal for a Regulation on implementing measures for the Prospectus Directive. This Regulation was adopted by the Commission on 29 April 2004¹⁰;
 - From 1 January 2005 onwards¹¹, all EU companies listed in the EU will have to prepare their consolidated accounts in accordance with IAS¹² and IFRS¹³ adopted at Community level. The implementation of IAS/IFRS for listed companies by 2005 will bring about greater transparency and comparability in the field of financial reporting through high quality standards.

6 Directive 2004/25/EC

7 COM(2003) 659 final

8 Harmonised collective investment undertakings that can operate throughout the EU.

9 See Doc ESC/48/2003 – rev 4: http://europa.eu.int/comm/internal_market/en/finances/mobil/cesr_en.htm

10 Regulation 809/2004 of 29 April 2004, OJ L 149, 30.4.2004, p.1

11 In conformity with Regulation EC/1606/2002 as agreed unanimously by the Member States and by the European Parliament.

12 The IAS were issued by the International Accounting Standards Committee (IASC), the predecessor of the IASB.

13 The IFRS are issued by the International Accounting Standards Board (IASB), the successor of the IASC.



On 29 September 2003, the European Commission adopted all existing IAS into Community law, with the exception of IAS 32 and IAS 39 which were still being reviewed by the International Accounting Standards Board (IASB)¹⁴. By 31 March 2004, the IASB delivered the complete set of standards that companies should apply from 1 January 2005 onwards, notably IFRS 2 on share-based payments, IFRS 3 on business combinations, IFRS 4 on insurance contracts, and IFRS 5 on disposal of assets. The European Financial Reporting Advisory Group (EFRAG) is currently preparing endorsement opinions in this respect. IFRS 1, a standard designed to facilitate the first time application of IAS/IFRS, was adopted by the Commission on 6 April 2004.

On IAS 39, discussions continue between the IASB and interested parties. On 21 April, the IASB re-exposed the fair value option in IAS 39. Further discussions relate to the presentation of cash flow hedges and the possible application of a third type of hedge. On IAS 32, the Interpretation Committee of the IASB, IFRIC, is working on a draft interpretation regarding the treatment of cooperative shares that will be exposed for further comments in the near future. It is the Commission's intention to take stock of the ongoing discussions between the IASB and the European banking industry on IAS 39 at a next meeting of the Accounting Regulatory Committee, planned on 14 June;

- On 30 March 2004, the European Commission published its Communication on the regulation of UCITS¹⁵ depositaries in the Member States setting out a step-by-step approach to reduce differences in national rules on the depositaries used to safeguard assets in UCITS¹⁶. The four main areas for action are: prevention of conflicts of interests; clarifying depositaries' liability; convergence of national prudential requirements; and enhancing transparency and investor information.

On 27 April 2004, the Commission issued two Recommendations¹⁷ in order to facilitate the implementation and interpretation of some provisions of the amended UCITS Directives¹⁸. The first concerns the UCITS simplified prospectus, clarifying the contents and presentation of some of the elements of information which have to be included in this document. The second was issued on the use of derivatives by UCITS. The aim of this Recommendation is to reconcile expanded investment opportunities by UCITS, particularly with respect to derivatives with the need to adapt risk management standards, and hence investor protection accordingly;

14 IAS 32 deals with the disclosure of financial instruments and their classification as debt or equity. IAS 39 deals with recognition, derecognition, measurement and hedge accounting.

15 Harmonised collective investment undertakings that can operate throughout the EU.

16 COM(2004) 207 final: http://europa.eu.int/comm/internal_market/en/finances/mobil/ucits/index.htm

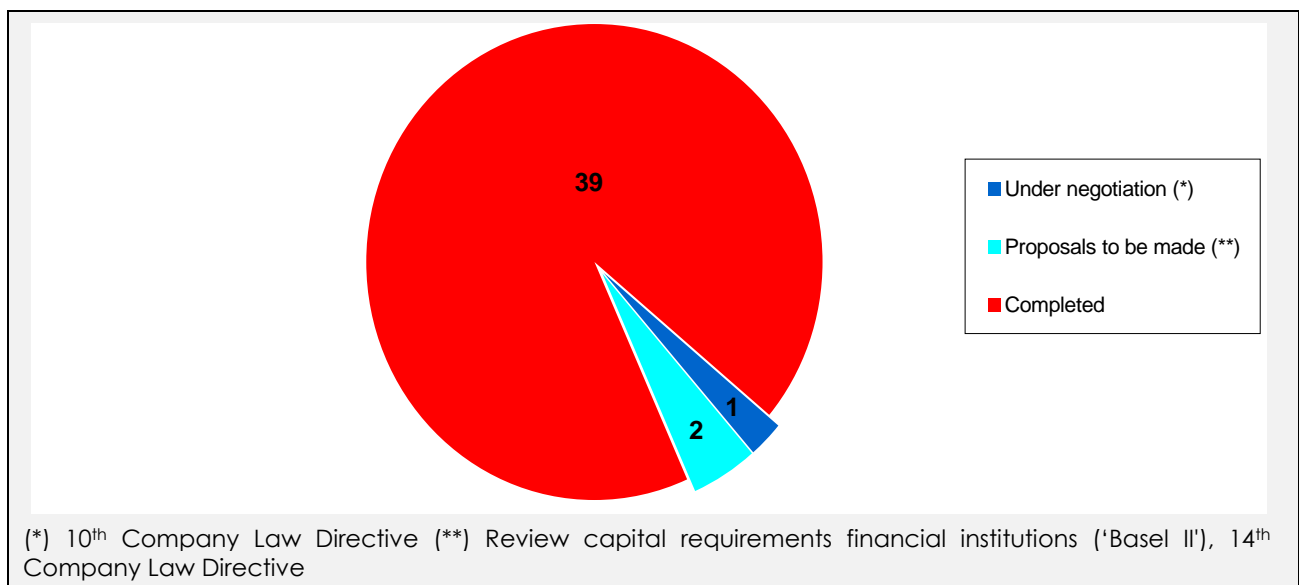
17 C(2004) 1541: http://europa.eu.int/comm/internal_market/en/finances/mobil/ucits/#recommendation

18 Directive 85/611/EEC as amended by Directive 2001/107/EC and Directive 2001/108/EC



- On Clearing and Settlement, the European Commission came forward with a consultative Communication on 28 April 2004¹⁹. This Communication outlines the direction for future work to increase efficiency and safety of cross-border clearing and settlement, while at the same time ensuring a level playing field among the different providers of clearing and settlement services.

FIGURE 1: State of play on individual original FSAP measures²⁰



The Commission's legislative Work Programme for the year 2004 is outlined in Boxes 1 and 2. These calendars envisage that in the light of the lessons learned from the Parmalat scandal (see Section III.A), the global fight against terrorist organisations, and the need to timely implement the new international capital requirements framework, high priority should be given to the adoption of three proposals by the new European Parliament and Council this year:

Box 1

Priority proposals scheduled for urgent handling by EP/Council in 2nd half 2004

- Modernisation of 8th Company Law Directive on Statutory Audit
- Third Money Laundering Directive (to be proposed in June)
- Review capital requirements for financial institutions (CAD III)

¹⁹ COM(2004) 312

²⁰ Originating from the strategic objectives of the FSAP, additional – more specific - measures have also been prepared in response to wider market developments over the past five years. These measures, which are neither included in the original Action Plan or in figure 1, are described in this Report to provide a more complete overview of the state of play in the area of financial services.



- On 16 March 2004, the European Commission published the proposal for the 8th Company Law Directive on Statutory Audit²¹. This proposal has been identified as a short term priority to reinforce audit quality and to restore the trust in the audit function²². Investors and other interested parties should be able to rely more fully on the accuracy of audited accounts and enhance Europe's protection against the type of recent scandals that have damaged financial markets. The Directive will clarify the duties of statutory auditors, their independence and ethics, and introduce the full responsibility of the group auditor for the audit of consolidated accounts of groups of companies. Furthermore, external quality assurance and robust public oversight over the audit profession based on common criteria for national public oversight authorities is considered necessary. Discussions in Council and European Parliament have already started.

By introducing these stringent requirements, Europe will have a comprehensive regulatory basis for effective and balanced international co-operation between European and third-country regulators. For example, the Directive proposal and parallel regulatory initiatives of the US Public Company Accounting Oversight Board (PCAOB) have laid the framework for mutual and reciprocal co-operation on auditor oversight between Member States and the US. This was confirmed by Commissioner Bolkestein and PCAOB chairman McDonough at a meeting on 25 March on EU-US on regulatory co-operation;

- The second proposal that has gained greater priority in the light of recent corporate scandals, the events of 11 September 2001 and 11 March 2004 as well as the revision in June 2003 of the 40 Recommendations of the Financial Action Task Force on money laundering and terrorist finance, concerns the strengthening of the legal framework for combating money laundering and terrorist finance. To that end, a Third Directive on prevention of the use of the financial system for the purpose of money laundering and terrorist finance will be proposed by the European Commission in June;
- An ambitious timetable underpins the implementation of a revised capital framework for banks and investment firms by 2006/2007. This effort is taking place in parallel with the work of the G-10 Basel Committee to develop a new international framework that should increase the risk-sensitivity of banks' and investments firms' supervisory capital requirements, increase the stability and safety of the European financial services sector and improve the efficiency of asset allocation.

21 COM(2004) 177

22 Follow-up of the Commission Communication 'Reinforcing the Statutory Audit in the EU', issued on 21 May 2003 – COM(2003) 286 Final



According to a recent study carried out for the Commission²³, the likely consequences of the new capital rules for the European economy and in particular for small- and medium-sized entities will be generally positive, not only for financial institutions and consumers, but also for the European economy as a whole. At its meeting in May 2004, the Basel Committee resolved outstanding issues so as to reach agreement on the new international framework by its mid-year target. The European Commission remains on target to present its legislative proposals within a short period after agreement in Basel so that the implementation date for the new framework can be met in the EU.

Box 2

Ongoing negotiations in EP and Council and forthcoming proposals

- Follow-up to the Action Plan on Company Law and Corporate Governance
- Company law proposal to simplify and modernise the 2nd Directive on capital maintenance
- Directive on Reinsurance Supervision (proposed on 21 April 2004)
- 10th Company Law Directive on cross-border mergers (proposed on 18 November 2003)
- 14th Company Law Directive on cross-border transfer of seat
- New Legal Framework for Payments in the Internal Market (proposed on 2 December 2003)
- Regulation implementing FATF recommendation nr. 7 into EU Law
- Proposal on Insurance Solvency II (proposal foreseen in 2005)

Apart from the proposals mentioned above which should be the focus of particular attention in the coming months, the Commission continues to press ahead with the remaining key FSAP measures and complementary actions²⁴:

- The Commission's Communication on Company Law and Corporate Governance²⁵ included an Action Plan comprising a balanced mix of legislative and non-legislative initiatives with a chronological prioritisation of the foreseen measures. Apart from the 10th Company Law Directive on cross-border mergers (already proposed, see below), also a Commission proposal to simplify and modernise the 2nd Directive on capital maintenance and alteration is expected this year.

The first Corporate Governance initiatives under the Action Plan are expected for the second half of 2004. These are:

1. The Recommendation on aspects of Directors' Remuneration, giving shareholders more transparency and influence (a public consultation has already taken place);

23 See: http://europa.eu.int/comm/internal_market/regcapital/index_en.htm#consequences

24 Detailed information about progress on the FSAP remains available through a regularly updated overview on the Commission's website: http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm

25 COM(2003) 284 Final - published 21 May 2003



2. The Recommendation aiming at promoting the role of (independent) non-executive or supervisory directors (nomination, remuneration and audit committees). A public consultation will end on 4 June;
3. A confirmation at EU level of the collective responsibility of directors for financial statements²⁶;
4. Full disclosure of the use of structures, like special purpose vehicles²⁶; and
5. The introduction of an Annual Corporate Governance Statement, covering the key elements of corporate governance structures and practices²⁶.

In the meantime, methods for encouraging coordination and convergence of national codes and of the way they are enforced and monitored are being considered and should lead to the creation in 2004 of the European Corporate Governance Forum announced in the Action Plan. In addition, the future Netherlands' Council Presidency may organise a Conference on corporate governance with the participation of the European Commission;

- On 21 April 2004, the European Commission presented its proposal for a Directive on Reinsurance Supervision²⁷. The proposed Directive is the first sector-specific European prudential legislation aiming to harmonise methods for reinsurance supervision in Europe. It abolishes some remaining trade barriers for intra-EU cross-border reinsurance activities and provides greater policy holder protection. The proposal also provides for the possibility to conclude agreements with third countries with the main purpose to exchange information between competent authorities and agree on mutual recognition. A prudential framework will be set up in line with the recommendations of the Financial Stability Forum and the IMF. This framework will lead to greater macro-economic stability and less systematic risk in the insurance sector;
- As a follow-up of the Communication on Company Law and Corporate Governance of 21 May 2003²⁸, the European Commission presented a new proposal for the 10th Company Law Directive on cross-border mergers on 18 November 2003²⁹. The proposal is under discussion in Council and European Parliament, where the Plenary vote is foreseen for October. The Directive aims at facilitating cross-border mergers of commercial companies. Current differences in national legislation make these kinds of operations very complex and costly.

26 via amendments to the 4th (annual accounts) and 7th (consolidated accounts) Company Law Directives

27 COM(2004) 273: http://europa.eu.int/comm/internal_market/insurance/reinsurance_en.htm

28 COM(2003) 284 Final

29 COM(2003) 703: http://europa.eu.int/eur-lex/en/com/pdf/2003/com2003_0703en01.pdf



The proposal is particularly aimed at small- and medium-sized companies. Under the proposal, the basic principle for a cross-border merger procedure is that it is governed by the same rules as the procedure for domestic mergers;

- The 14th Company Law Directive on cross-border transfer of 'seat' (their centre of activities and/or their registered office) is another priority included in the Communication of May 2003. The Directive concerns the company's right to transfer its registered office from the Member State where it is registered to another, the so-called host Member State. Such a transfer would require registration and acquiring legal personality in the host Member State and removal from its current register and loss of legal identity in that original home Member State. The European Commission has launched a consultation with the intention to present a proposal for a Directive to Council and European Parliament by autumn 2004;
- The European Commission came forward in December 2003 with a Communication on the New Legal Framework for Payments in the Internal Market³⁰, taking account of extensive consultations that have taken place³¹. One of the specific objectives of the Economic and Monetary Union was to create a Single Market for Payments in the EU. The expectation is that all European consumers will thus be able to make any payment within the EU as easily as in his or her home Member State. The European Commission proposed a set of legislative measures intended to address present legal deficiencies, and simplify and improve the implementation of EU legislation. The European Commission will come forward with its proposal for legislation in September;
- As part of the New Legal Framework for Payments in the Internal Market, a proposal for a Regulation related to payers' information on credit transfers will be handled separately and follow a fast-track regulatory procedure. The aim of the Regulation is to swiftly transpose the FATF recommendation number 7 - on financing of terrorism - into EU Law. The European Commission will come forward with its proposal this Summer;
- The intention of a future proposal on Insurance Solvency II is to create a consistent risk-based insurance solvency system that is compatible with international developments in supervision and financial reporting. Extensive work will continue over 2004; the first legislative action will be the presentation of a proposal for a framework directive in the course of 2005.

30 COM(2003) 718: http://www.europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0718en01.pdf
31 See: http://europa.eu.int/comm/internal_market/payments/framework/2004-contributions_en.htm



III. LESSONS LEARNED

Over the last 5 years, FSAP measures have been amended to keep pace with new developments in financial markets. Although the European Commission tried to keep additional measures in the area of financial services limited in amount, developments and/or incidents required adaptability and flexible political responses. This was true, for instance in the areas of company law and corporate governance, where the accounting scandals in the United States and Europe required a tailored European response (III.A). Furthermore, it became clear already at an early stage of the FSAP that an integrated market could not be achieved by regulation only: parallel work was set in hand to develop more streamlined regulatory and supervisory structures (III.B).

Financial integration is an ongoing process. In view of this, the European Commission has launched an ongoing monitoring/review of the state of financial integration to ensure that European businesses and consumers get the most out of the FSAP (III.C). The Commission will continue to monitor trends in financial services to assist in prioritising necessary action at European level (III.D). However, the objective to integrate financial services will be pursued taking full account of the views of the public and the costs and benefits of removing barriers and fragmentation: consultation and impact assessments are and will remain fundamental elements in the preparation of future regulation. An open and transparent policy approach is a strength, and will result in better regulation (III.E).

III.A Parmalat

6 months ago, a new scandal undermined investor confidence in corporate Europe. In the Parmalat affair a whole series of complex company and financial structures were apparently used to conceal fraudulent business practices over a long period of time. The Statutory Audit function is a major line of defence against fraudulent financial reporting³². An important step has been the significant modification of the existing Directive on Statutory Audit in the EU, proposed by the European Commission on 16 March this year³³. It will strengthen controls over the audit profession. With independent oversight; strengthened inspection; stronger ethical and educational principles; and high quality audit standards.

More general, the FSAP and the Company Law Action Plan contain many of the necessary legislative responses. On top of that, the European Commission believes there is a need to look at the following three priorities:

32 Although many auditors perform their job with great conviction and integrity, the recent scandals have shown that without sufficient checks and balances in place, auditors can easily become part of the offence - instead of defence - mechanism.

33 See for more information page 6 of this Report.



1. To improve corporate governance in Europe, which is the first and most important line of defence against fraud and malpractice, the Commission has announced its intention to accelerate work in particular in 3 areas: (i) role of non-executive directors; (ii) directors' responsibility for company accounts; (iii) full disclosure in company accounts of Special Purpose Vehicles, including why companies use off-shore centres³⁴;
2. Failure to properly implement and enforce legislation at Member State level is a major obstacle in the fight against fraud and malpractice. Supervisors and regulators are rightly expected to ensure that laws and regulations are being upheld. Improved cooperation between supervisors across sectors and across borders is needed (see Section III.B);
3. To enhance the transparency of financial and tax systems in order to reduce the risk of corporate malpractice, the Commission services are reflecting on ways to strengthen the main lines of defence against corporate malpractice both at EU level and at international level.

III.B Need for improved regulatory and supervisory structures

The FSAP has been successful in improving European legislation in the area of financial services. However, for the good functioning of a pan-European financial market, which implies consistent implementation of EU regulation and effective cooperation between European supervisors, and to keep pace with developments in financial markets, regulatory and supervisory structures need to adjust correspondingly.

In July 2000, the ECOFIN Council established a Group of Wise Men, chaired by Baron Alexandre Lamfalussy, to investigate the issue and to come up with options. In February 2001, their Final Report³⁵ recommended reform of the European regulatory structure in the securities area, calling for a four-level approach in the law making process:

1. Framework legislation adopted in co-decision at 'level-1', concentrating on the core political principles;
2. 'level-2' implementing measures to fill in the details of 'level-1' legislation subject to precise constraints fixed in that legislation³⁶;
3. Greater day-to-day cooperation by national supervisors and regulators to ensure consistent implementation and enforcement; and
4. More effective enforcement of Community law.

³⁴ See: http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=SPEECH/04/70|0|RAPID&lg=EN

³⁵ Final Report of the Committee of Wise Men on the Regulation of European Securities markets

³⁶ Under certain circumstances the implementing rules can be amended by a committee (so-called 'comitology') rather than by going through the longwinded and heavy procedure involving the European Parliament and Council again.



This was to be assisted by the creation of 2 new high-level groups, a Regulatory Committee (level-2) and a Supervisory Committee (level-3) in the securities field.

Although the process is still relatively new, there is broad consensus among industry and regulators that so far it has worked well in the securities sector³⁷. It has also become clear that the absence of a parallel approach in the banking, insurance and UCITS sectors was hampering the full integration of the EU financial services industry.

In November 2003, the European Commission therefore proposed the necessary steps to extend the regulatory and supervisory approach to these sectors³⁸. For this purpose, the former Banking Advisory Committee (BAC), Insurance Committee (IC) and UCITS Contact Committee have been reformed and replaced. Furthermore, the responsibilities from the UCITS Contact Committee have been transferred to the existing European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). Agreement on the extension has been reached between Council and European Parliament on 11 May 2004. The following table outlines the present state of play³⁹:

Table 1

	Securities (including UCITS)	Banking	Insurance & Occupational Pensions
Level 2	European Securities Committee (ESC)	European Banking Committee (EBC)	European Insurance & Occupational Pensions Committee (EIOPC)
	Chair: Commission	Chair: Commission	Chair: Commission
	Location: Brussels	Location: Brussels	Location: Brussels
Level 3	Committee of European Securities Regulators (CESR)	Committee of European Banking Supervisors (CEBS) ⁴⁰	Committee of European Insurance & Occupational Pensions Supervisors (CEIOPS) ⁴¹
	Chair: Arthur Docters van Leeuwen	Chair: Jose-Maria Roldán	Chair: Henrik Bjerre-Nielsen
	Location: Paris	Location: London	Location: Frankfurt

37 See Second Report of the Inter-institutional Monitoring Group for securities markets: http://europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm

38 COM(2003) 659 Final

39 In addition, the Commission will be assisted by a Financial Conglomerates Committee as soon as Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (...) enters into force (11 August 2004).

40 Commission Decision taking effect on 1 January 2004

41 Commission Decision taking effect on 24 November 2003



III.C. Priority areas for the Post-FSAP era

In the last Progress Report, the European Commission announced its intention to launch a wide-ranging, transparent and bottom-up consultation in order to map out the state of integration of financial services and to assess the effectiveness of FSAP measures. The overall objective of this stock-taking is to arrive at a broad understanding of the extent of any remaining gaps in the regulatory, supervisory, administrative, and public policy framework.

Four groups of top-calibre market practitioners have assisted the European Commission in assessing the strengths and weaknesses of the European legislative framework in the banking, insurance, securities and asset management sectors. The reports of these groups have been made public on 6 May 2004 and will be open for public comment over the period to 10 September this year⁴².

The reports reflect the consensus opinion within the expert groups, not of the European Commission or its services. The Commission will not take any definitive or formal position on the issues raised until after the public consultation process. The reports and the input deriving from the public consultation will of course be important elements for future policy decisions.

The European Commission will not rush headlong into announcing new legislative initiatives beyond those already announced. The present legislative programme on Solvency II, Reinsurance, Clearing and Settlement, the Legal Framework for Payments, Corporate Governance, and the reform of Company Law is already a demanding and continuing regulatory priority in the post-FSAP period. Nevertheless, where necessary, targeted legislative action in response to specific market failures or regulatory gaps may be an appropriate response and should not be *a priori* ruled out.

Member States, meeting in the Financial Services committee (FSC), have also been seeking to develop a collective view on progress on integration of the financial services and the remaining challenges in the area. The FSC report on financial integration has been sent to the 2 June ECOFIN Council. There is considerable synergy between the reports prepared by the expert groups and the high level policy assessment being undertaken by the FSC. The FSC Report will provide an important additional political perspective in defining the remaining challenges over the coming period.

42 See: http://europa.eu.int/comm/internal_market/en/finances/actionplan/stocktaking.htm



III.D. Financial Integration Monitor

Contrary to its obvious legislative and institutional legacy, evidence on whether the FSAP is significantly improving cross-border commercial opportunities for financial institutions and investors is difficult to determine. In line with the intentions, which have been set out in the Commission Staff Working Paper "Tracking financial integration"⁴³, the European Commission has continued work to monitor the trends in the Internal Market for financial services, based on an extensive indicator-analysis.

The Commission's first annual 'Financial Integration Monitor (FIM)' Report has been published alongside the four expert group reports and will be presented to the ECOFIN Council of 2 June 2004. It provides a first comprehensive documentation of changes in the level of cross-border integration in key financial segments over recent years.

The Report records increased integration of financial markets and of upstream value-chain functions. It also describes developments in terms of competition, market structure, efficiency and the intensity of cross-border risk transmission channels. However, it remains difficult to determine the extent to which ongoing changes in the EU legislative framework – as opposed to other significant structural developments such as the introduction of the euro, cyclical factors or technology – have contributed to these outcomes.

The analysis is also a response to the call from stakeholders for a more evidence-based policy-making process in the future. The FIM-indicator project is an ongoing process and this first Report should therefore be seen as a first attempt to compile a body of information which will be refined in further editions.

43 See: http://europa.eu.int/comm/internal_market/en/finances/cross-sector/reporting/tracking-financial-integration_en.pdf



III.E. Consultation and Regulatory Impact Assessment

The Commission is adhering to its commitment to transparency and consultation at all stages in the policy process. The goals of the FSAP could never have been achieved without applying full transparency and thorough consultation, an area in which there has been a sea-change in Commission's practice. Proper consultation takes time and is demanding for industry, consumer representatives and regulators. However, consultation is essential: it is an element of good regulatory practice and leads to better quality regulation, more suited to market needs, building on inside constituency of stakeholders in the process. With the successful open policy approach of the FSAP as a reference point, the European Commission is keen to maintain the momentum and improve further consultation policy.

The development and delivery of an integrated market for financial services remains an important objective, but it is clearly not an objective that should be pursued without regard to the balance of costs and benefits of removing barriers and fragmentation via European regulation. The FSAP stock-taking clearly calls for more evidence-based policy making and objective prioritisation of policy areas that still need remedial action. Where regulation at European level is appropriate, it must be both effective and proportionate, respecting the subsidiarity principle. It must avoid distorting legitimate competition between market players and be attentive to European competitiveness in a global market place. This should not only apply to directives and regulations, but also to implementing measures and supervisory standards agreed upon within the Lamfalussy framework.

Apart from the subsidiarity and proportionality tests already consistently applied, impact assessments⁴⁴ should prevent inappropriate regulation from reaching the statute book. In short, all the elements of Better Regulation package are important to good policy making.

The next Progress report on financial services initiatives will be sent to the ECOFIN Council by end 2004.

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⁴⁴ However, a word of caution is in order: analytical metrics are not sufficiently developed to allow regulators to quantify, with any precision, the costs and especially benefits of regulatory proposals (which may take the form of "intangibles" such as improved market integrity, transparency, investor confidence or financial stability). Furthermore, for the impact analysis to be an effective element of good regulatory governance, one should not only take the benefits for the financial services sector into account, but the broad public benefits. To prevent exaggeration of the costs of regulation, only those costs should be taken into account which are additional to those resulting from current market practice.