COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION

Fifth progress report on the Financial Services Action Plan

AN INTEGRATED EUROPEAN FINANCIAL MARKET EUROPE MUST DELIVER ON TIME

FIFTH PROGRESS REPORT

INTRODUCTION

In June 2001, the Commission concluded that the overall balance sheet on progress towards financial integration was broadly positive[1]. There were, nonetheless, a number of test cases which would shortly demonstrate whether there is a real political will to meet the European Council deadlines of 2005 (2003 for securities markets) set in the Financial Services Action Plan. Failure of timely delivery of individual measures could endanger the overall optimal timeframe. The economic context for making progress was already recognised as being difficult; any delays would increase the cost pressures for consolidation of the EU's still fragmented financial sector.

Against this backdrop, this fifth progress report has been drawn-up again with the assistance of personal representatives of Ecofin ministers in the Financial Services Policy Group. It delivers three central messages to the Ecofin Council:

– an integrated European financial sector remains as crucial as ever as a motor for growth and employment. Crucially it also can act as a buffer against volatility and hence a pole of stability in these turbulent economic circumstances;

– there has been important progress since the last report. But there remains a concern about the pace to deliver the Action Plan in line with the agreed timeframe and political statements of successive Ecofin and European Councils; and

– a broad and critical mid-term review is needed of what has been accomplished, what benefits of integration there are, and what still needs to be done. Political action must follow.

INTEGRATING EUROPE'S FINANCIAL SECTOR IS NEEDED MORE THAN EVER

First, as a pole of stability

After the tragic events in the USA on 11 September, the extraordinary European Council meeting in Brussels on 21 September concluded that economic slowdown would be stronger than forecast, but underlined that "*thanks to the single currency, the countries of the euro zone are sheltered from the shocks associated with monetary fluctuations*". Integrated financial services markets are a prerequisite to derive the full benefits of the euro and to ensure the continued stability and competitiveness of the EU financial sector.

Global and European financial markets have, despite volatility, reacted with maturity. This has resulted in more risk aversion, potentially less liquidity and higher spreads. Close and swift co-operation between the Federal Reserve, the European Central Bank and other central banks has ensured liquidity and the functioning of the financial markets.

Stock markets suffered initial severe losses which have been recovered. There are particular concerns about the effects of the downturn in equity markets on the insurance sector, since equities represent a substantial proportion of investments (30%). The precise effect of the downturn in equities and the final estimates of claims flowing from 11 September have not yet crystallised (estimates range from \$20 to \$80 billion).

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[1] Fourth Report : « Financial Services-Political Challenges » June 2001 COM(2001)286 final.

Collaborative efforts by regulators have sought to mitigate possible contagion effects. Nevertheless, the interaction of slower economic growth and possible financial vulnerability calls for continued vigilance to ensure that any second round effects are managed prudently and responsibly.

The Action Plan contains a number of important measures that, once implemented, will respond directly to the twin challenges of uncertainty and the less favourable economic outlook. For financial services companies, financial resilience remains paramount – strong prudential rules for banks, investment firms and insurance companies to reflect the real risks they run are needed more than ever. Adequate provisions, reserves and risk management measures are essential to meet times of strain. Political agreement on the proposed *Collateral Directive* is a priority to address a possible decrease in credit quality and increased contagion risks, and is within reach before the end of the year. Early next year the Commission will issue a *Communication on clearing and settlement*. It will examine how to improve the efficiency in the EU and related issues for the stability of the financial system. Within individual sectors the Union's supervisors and regulators are devising policy responses that may be needed at EU level. *The Roundtable of Regulators* is also ensuring co-ordination between the European supervisory and regulatory committees to ensure that cross-sectoral issues are coherently and effectively tackled[2].

Recent developments underscore that the need for European financial integration as a motor for growth and employment, a buffer against market volatility and a pole of economic stability is stronger than ever[3]. A sound and stable EU regulatory framework is also of paramount importance to cope with possible stability risks that could emerge in an enlarged Union.

Second, to combat terrorism

The attacks on the US call for concerted and intensified efforts at all levels to fight terrorism. Opportunities for terrorists to finance their activities must be eliminated. Thus, reinforcing the anti-money laundering framework, both at the EU level and globally, is a top priority. The agreement recorded on the *anti-Money Laundering Directive* at the ECOFIN and the joint ECOFIN/JAI Councils on 16 October, and adoption of the proposal in co-decision with European Parliament, was a crucial step. Extending the identification and reporting requirements is a vital element of the Union's commitment against the financing of crime and terrorism. Political agreement on the proposed *Market Abuse Directive* is within reach before the end of the year. It will ensure that the financial markets are protected against insider dealing and market manipulation. Furthermore, the joint ECOFIN/JAI Council on 16 October has called upon the Commission to present before the end of this year a final report on the *monitoring of cross-border cash flows*.

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[2] The Roundtable of Regulators was set up informally on the Commission's initiative early in 2000 to meet the call from the Economic and Financial Committee to strengthen the cross-sector co-operation at the international level and to promote information exchange among supervisors and regulators across sectors. It comprises the Chairmen of the EU financial regulatory and supervisory groups: Banking Advisory Committee, ECB Banking Supervisory Committee, Contact Group of banking supervisors, Insurance Committee, Conference of Insurance Supervisory Authorities, European Securities Committee, Committee of European Securities Regulators

[3] To strengthen the monitoring process of the Action Plan, the Commission is developing a set of financial indicators. They will focus on quantifying trends of integration and efficiency within the EU financial market and be used to develop future policy. These economic assessments should become available over the next few months.

Supporting the *Financial Action Task Force on money laundering* at all levels is a high priority. Its mandate and the scope of its 40 recommendations have been expanded. By easing bank secrecy laws and by enhancing the transparency of legal entities, financial trails left by terrorists can be identified and followed to the end much more quickly and efficiently than at present.

Third, to take full advantage of the imminent introduction of € notes and coins

On 19 October the European Council in Gent issued a Declaration on the preparation for the introduction of euro notes and coins, based on an evaluation report by the Commission. The European Council appreciated the historical importance of the introduction of euro notes and coins and the benefits that will follow for the citizens and businesses of Europe. It noted with satisfaction that the preparations are in hand although attention still has to be paid to a number of issues. The cross-border payment systems must be improved and the costs for cross-border payments must be reduced. Today, cross-border euro payments are far more costly than national payments[4]. The European Council therefore invited the ECOFIN Council to adopt before the European Council in Laeken the Commission's proposal for a *Regulation to reduce bank charges* for cross-border payments in euro. The proposed Regulation will enable European citizens to transfer payments across the borders as easily and cheaply as is the case for national payments.

But further policy efforts are needed to establish a Single Market for all. Consumer protection must be enhanced and cross-border trade simplified. The ECOFIN Council has already endorsed the *strategy for cross-border electronic financial services*[5]. A new roadmap for a single retail financial market is being developed by the Commission in close co-operation with the Member States, covering three policy areas:

– a programme of convergence covering contractual and non-contractual rules to provide high quality and comparable information to consumers. The final adoption of the proposal for a Directive on the Distance Marketing of Financial Services will be an important element in securing that coherence. Together with the Commission's Communication on E-Commerce and Financial Services[6], the Directive will be a cornerstone of the policy for retail financial services traded on the internet;

– targeted steps to encourage consumer confidence in cross-border redress and internet payments to improve security and provide consumers with legal security when making payments on-line within the Union; and

– enhanced supervisory co-operation between host state authorities and those in the country where the provider is established.

To these ends, the Commission will in particular:

– in order to assist Member States and service providers and to ensure compliance with the E-Commerce Directive carry out the analysis foreseen in its Communication on E-Commerce and Financial Services; and

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4 Bank charges: Key findings of new Commission study MEMO/01/294, 20th September 2001, available at http://europa.eu.int/comm/internal_market/en/finances/payment/directives/index.htm.

5 Report from the FSPG to the Ecofin Council of 7th May 2001.

6 Communication from the Commission to the Council and the European Parliament - E-Commerce and Financial Services, 2001 COM(2001)0066 final.

– propose to revise and update the Consumer Credit Directive (anticipated for the end of 2001).

The *Fraud Prevention Action Plan*[7], adopted in February, will similarly help in increasing public confidence in cross-border payment systems and help the development of electronic commerce. There is a growing problem of fraud and counterfeiting of cards and other non-cash means of payment used for cross-border transactions. Fraud currently amounts to an estimated 600 million euro per year in the EU. The emphasis of the Plan is to improve the technical and legal security of payment instruments, the exchange of information, training and education of all parties concerned.

IMPORTANT PROGRESS IS BEING MADE

The political agreement in the Internal Market Council on 27 September on *the Distance Marketing Directive* was a major breakthrough in developing an integrated financial market for consumers. It will complement the E-Commerce Directive, which enters into force in January next year. The final adoption of the anti-Money Laundering Directive to reinforce the Union's anti-*Money Laundering policy* also represented important progress. The *Statute for a European Company Regulation*, formally adopted on 8 October 2001, is a further step towards integrating the EU financial market by offering an optional legal structure for companies to organise their operations on a pan-European legal basis. The formal adoption of the Directives on *UCITS* and *Insurance Solvency Margin I* is imminent. The Council Presidency is aiming for a political agreement on the proposed *Insurance Intermediaries Directive* at the Internal Market Council on 26 November. As regards the proposals in *the Wise Men's report*[8] the basic committee structure is now in place. It will play a crucial role in assisting the Commission in its task of implementing parts of the Action Plan.

On the Action Plan itself, detailed and regularly updated progress on the implementation of the 42 measures is now available on the internet[9]. More generally, figure 1 in the present report shows that 25 Action Plan measures will have been finally completed by mid December. Nine of these are legislative acts formally adopted by the Council and the European Parliament[10]. The remaining 16 are Decisions, Communications, Recommendations or Reports[11]. The Commission is preparing eight further Action Plan measures. Six of these are legislative proposals, including updating the Capital Framework for banks and investment firms, and a revision to the Investment Services Directive (both anticipated next year).

7 Communication from the Commission to the Council, the European Parliament, the European Central Bank, the Economic and Social Committee and the Europol – Preventing Fraud and Counterfeiting of non-cash means of payments, COM (2001)11 final.

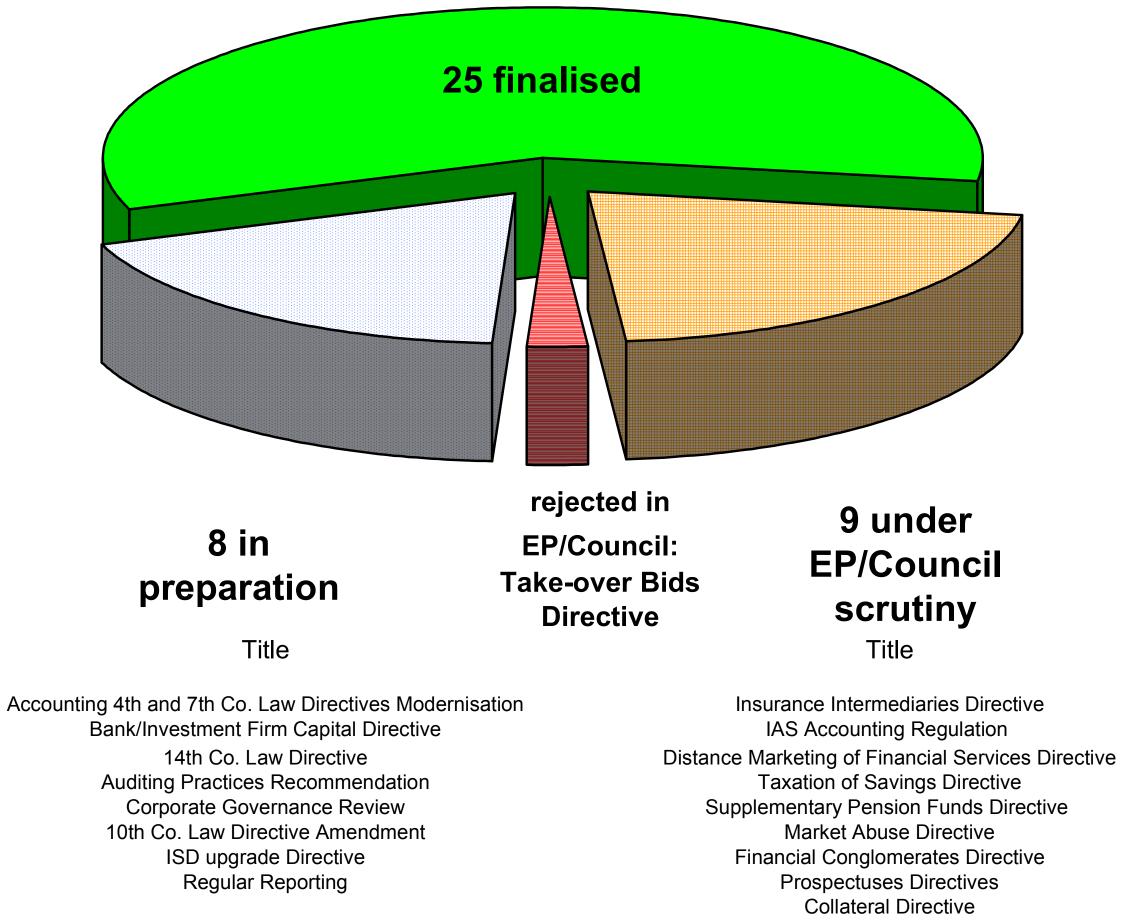
8 The final report of the Committee of Wise Men, chaired by Alexandre Lamfalussy and published on 15 February 2001, is available at http://europa.eu.int/comm/internal_market/en/finances.htm.

9 http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm.

10 Directives on UCITS, Insurance Solvency Margin I, Money Laundering, Winding-up of Banks, on Winding-up of Insurance Companies, on Electronic Money, on amendments to 4th and 7th Company Law Directives, on Information Exchange with third countries, and the European Company Statute Regulation.

11 For example, the Commission Recommendations on the marketing of mortgage loans and on Auditing Practices, the Communication on E-Commerce and Financial Services, and the Commission Decision to set-up a European Securities Committee.

Figure 1 Action Plan implementation



BUT SOME CONCERNS REMAIN

A major setback was the recent rejection – after 12 years of negotiation – by the European Parliament in conciliation of the proposed Directive on *Takeover Bids*. The measure was aimed – most importantly – at protecting minority shareholders in the event of a hostile takeover bid, and was identified by the European Council as an important element for creating a single financial market. The Commission will table a revised proposal early next year after having considered advice from a Group of high level experts now meeting[12].

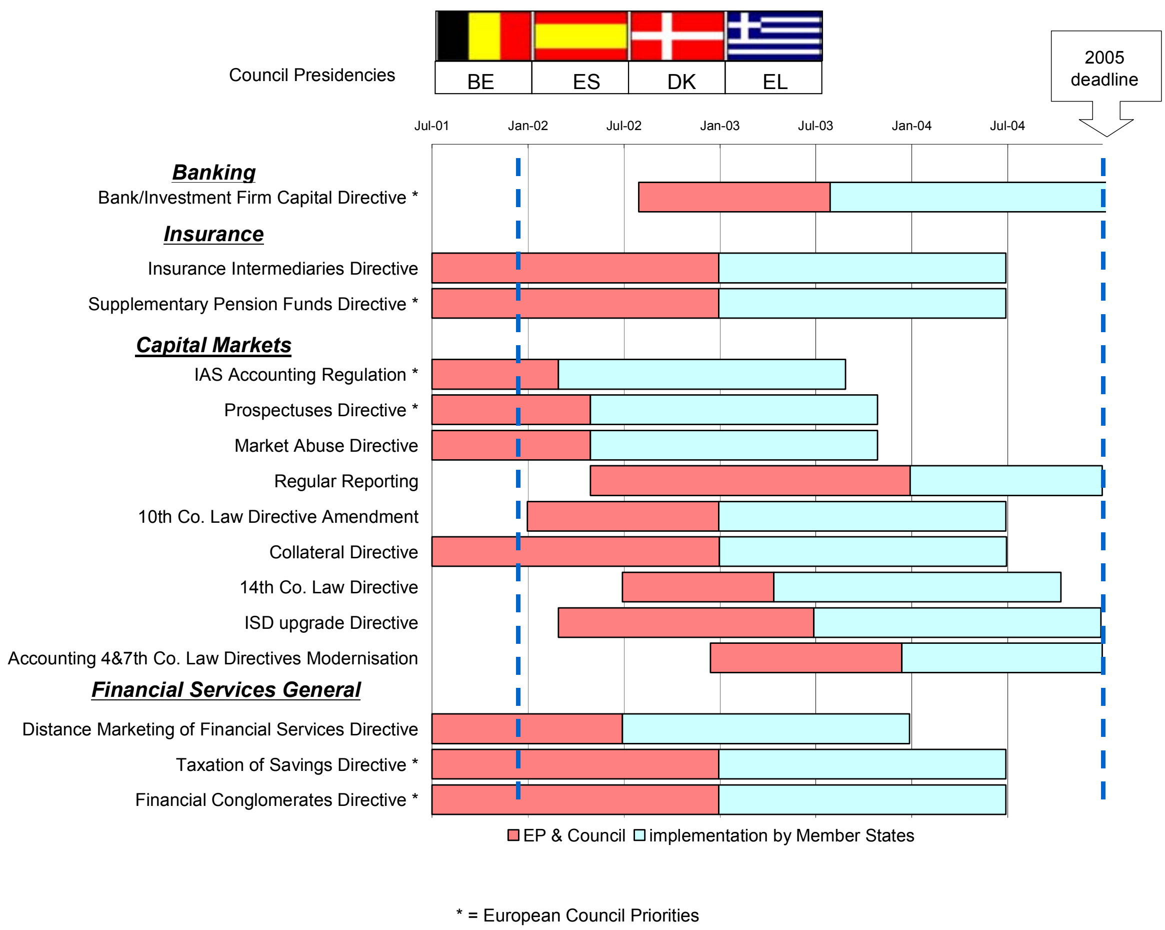
A second concern is the absence of decisive progress in the Council on the *Pension Funds Directive*. The proposal was tabled by the Commission in October last year, and is scheduled for adoption in the Action Plan by 2002. The Parliament has completed its first reading in July. But the critical points identified in the previous Progress report still remain to be settled: (i) the scope of the directive, (ii) quantitative/qualitative investment rules, (iii) the technical provisions, and (iv) cross-border membership. Progress is vital to secure a political agreement by the deadline of 2002.

[12] The Group of High Level Experts on Company Law was set up by the Commission in September 2001. More information on the Group is available at http://europa.eu.int/comm/internal_market/en/finances.htm.

A third concern relates to the three key financial services priorities identified by the European Council: the proposed Directives on *Prospectuses*, on *Financial Conglomerates*, and the proposed Regulation on *International Accounting Standards*. Continued progress is also needed on three other Action Plan measures: Insurance Intermediaries, Taxation of Savings, and Market Abuse.

Figure 2 sets out the stages and deadlines for the Commission, the Parliament and the Council, and the Member States to adopt and implement these measures, together with the forthcoming legislative proposals updating the Capital Framework for Banks and Investment firms, and the Investment Services Directive. The indicated timeframe reflects the optimal FSAP timeframe for the implementation of the individual measures set out in the Action Plan. Figure 2 underlines the amount of effort needed under successive presidencies to achieve concrete results.

Figure 2 Stages and deadlines for Action Plan implementation



A MID-TERM BOOST IS NEEDED FOR THE ACTION PLAN

Any sustained lack of progress may be perceived as undermining the credibility of political statements by successive European Councils. The Action Plan was formulated in May 1999. Most of the final legislative measures should be adopted by end 2002 if they are to be fully implemented by the agreed deadlines, which were themselves originally criticised by many as being too unambitious. The Commission will initiate a Mid-Term Review next February as the basis for high level political recommitment to the Action Plan and its deadlines. The Review will assess how far we have progressed; seek to reaffirm the central importance of an integrated financial sector for European competitiveness and growth; confirm a commitment at the highest level by all institutions concerned to achieve the Action Plan's objectives and set out the concrete priorities and commitments necessary to deliver key Action Plan proposals by agreed deadlines. The support, contribution and commitment of the Parliament, Member States, and market participants should be reinforced at the Barcelona European Council in March by underlining the key contributions that an EU integrated financial sector can make in securing the economic reform objectives established in Lisbon.

CONCLUSION

The case for integrated financial markets is stronger than ever – particularly as the economic outlook is deteriorating – as a motor for growth and employment and as a pole of financial stability for the benefit of EU citizens and businesses. Good progress on the implementation of the Action Plan has already been made during the Belgian presidency; 25 of 42 original measures have now been finalised.

But there still remains a real concern about the present pace of work if we are to deliver the Action Plan in line with its agreed timeframe. Repeated and unambiguous political declarations from successive ECOFIN and European Councils must now be translated into hard agreements and matched by real political progress. Any inability to find politically and technically viable solutions within the set timeframe will result in political and economic failure for the EU. The timeframe for progress in the European Parliament and the Council is equally pressing. By the end of next year 10 legislative proposals must be adopted to meet the Action Plan deadlines.

– In the *Spanish presidency:* directives on Distance Marketing, Prospectuses, Market Abuse, and the IAS Regulation; and

– In the *Danish presidency*: directives on Insurance Intermediaries, Pension Funds, Financial Conglomerates, 10th Company Law amending directive, Collateral directive, and Taxation of Savings.

Responsibility for progress on these crucial issues is shared by all institutions. The Commission, the Council and the European Parliament must shoulder their responsibility. For its part, the Commission reaffirms its determination to deliver the remaining legislative proposals in line with the priorities set out in the Action Plan : the Capital Framework for Banks and Investment Firms, the ISD Upgrade Directive, the Regular Reporting Directive, Amendments to the 10th and the 4th and 7th Company Law Directives, and a 14th Company Law Directive. Further legislation and an non legislative measures may be needed beyond those already set out in the Action Plan