COUNCIL OF
THE EUROPEAN UNION

Brussels, 6 December 2002 (10.12)
(OR. fr)

14832/02

EF 94
ECOFIN 400
MI 281

COVER NOTE

from	:	Secretary-General of the European Commission, signed by Mr Sylvain BISARRE, Director
date of receipt	:	2 December 2002
to	:	Mr Javier SOLANA, Secretary-General/High Representative
Subject:		Seventh interim report on the implementation of the Financial Services Action Plan – Meeting the Barcelona Priorities and Looking Ahead: Implementation

Delegations will find attached Commission document SEC(2002) 1314.

Encl.: SEC(2002) 1314

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 29.11.2002
SEC(2002) 1314

COMMISSION STAFF WORKING PAPER

Meeting the Barcelona Priorities
&
Looking Ahead: Implementation

EUROPEAN
COMMISSION

Financial Services

Meeting the Barcelona Priorities
&
Looking Ahead: Implementation

Seventh Report

INTRODUCTION

Since the last progress report, the economic recovery has been weaker than expected. The sharp correction in equity prices has continued, driven by investors concern about corporate earnings and corporate governance scandals in the US which have rippled across to EU capital markets. But this must not distract the political need to implement the Financial Services Action Plan (FSAP) effectively by 2005 and the Risk Capital Action Plan (RCAP) by 2003, in line with successive European Council Conclusions. Building an integrated EU capital market is still one of the optimal routes for bringing real benefits for European citizens, businesses (including SMEs) and society in terms of increased confidence, economic growth, more jobs and sustained prosperity. Economic evidence supports this (see below).

In March, the Barcelona European Council reaffirmed the objectives of the FSAP as a key priority of the Lisbon economic reform agenda, and set 2002 as a clear deadline for the adoption of eight specific measures. Progress in adopting these new legislative measures to timetable has been generally good. Progress has also been made on a wider front under the Danish Presidency on many proposals: 31 of the 42 original measures have been finalised.

Against this backdrop, this report - drawn-up again with the assistance of the Financial Services Policy Group (FSPG), which is composed of high level personal representatives of Finance Ministers - contains four central messages:

– an integrated European financial sector remains as crucial as ever as a motor for growth, employment and as a buffer against volatility. In view of the imminent enlargement of the EU, progress should accelerate;

– there has been sustained progress in adopting new legislation to timetable since the last report. There is increasing confidence that the FSAP can be delivered in line with the agreed European Council timeframe. Mid-2004 remains the final date for adoption at EU level - to allow 18 months for transposition;

- as FSAP measures are adopted, policymakers, regulators and the financial sector must begin focussing on consistent implementation and enforcement;

- the regulatory procedures of the Lamfalussy process start to apply next year for securities, so careful preparation is now needed to ensure that these are successful and respect fully all aspects of the political agreements between the European Commission (Commission), Council and European Parliament.

ECONOMIC BENEFITS

The major benefits of EU financial integration are becoming increasingly clear. In addition to the economic estimates presented by the European Financial Services Round Table in March 2002[1], the results of studies commissioned by the Commission (see section "Looking ahead") also indicate that significant economic gains and efficiencies can be achieved if the EU capital markets integrate further; in particular while financial integration proceeds smoothly in the wholesale field, it is especially lagging in retail markets. Measures in this area are key priorities of the FSAP (see Box 1).

Box 1

Economic benefits of EU financial integration

- A single market for securities and improved market access could result in an increase of 1.1% in EU GDP in the next decade (1);
- A single infrastructure for clearing and settlement could be expected to reduce costs further by as much as 42 – 52% (2);
- Further integration of retail financial markets might yield potential gains in terms of interest rates of 0.7% of EU GDP (2);
- Up to 2003, cross-border credit transfers have been considerably more costly to consumers than purely domestic ones. A reduction of the costs of cross-border credit transfers aligned on the most "cost efficient" one would yield no less than 41% in savings(2);
- M&A activity in Europe has so far mainly been domestic. Cross-border M&A activity could reduce operating costs by as much as 1.2-1.3% (2);
- There has been a slight deterioration in the efficiency levels of EU banks. A loss in efficiency, when important, translates into higher costs for the use of capital. The elimination of the present inefficiencies in the banking sector could result in potential gains of about 1.4-1.6% of GDP (2).

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[1] See the Sixth FSAP Progress report (http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm) and the Report to European Services Round Table: "The benefits of a working European retail market for Financial Services" (www.zew.de/erfstudyresults/)

Sources[2]: (1) LE study for DG Internal Market
(2) IVIE

These potential benefits reinforce the need for the FSAP to be completed on time.

2 As the benefits presented in Box 1 come from two different studies, they should not be aggregated.

Meeting the Barcelona Priorities

The Barcelona European Council called for the ECOFIN Council and the European Parliament to approve in 2002 eight priority FSAP measures. Considerable progress has been made under the Spanish and Danish presidencies to meet these priorities (see Box 2). Almost all of the measures identified by the Barcelona European Council will have been adopted by the end of 2002, or will be in their final phases of adoption. This demonstrates the ability, political will and momentum in Council and European Parliament to work together and strike the necessary compromises.

Box 2

The Barcelona Priorities (European Council)	
Regulation on International Accounting Standards	Adopted (19 July 2002)
Collateral Directive	Adopted (6 June 2002)
Distance Marketing Directive	Adopted (23 September 2002)
Insurance Intermediaries Directive	Adopted (30 September 2002)
Financial Conglomerates Directive	Adopted (20 November 2002)
Market Abuse Directive	Common Position (19 July 2002) Adoption envisaged 3 December
Pension Funds Directive	Common Position (5 November 2002)
Prospectus Directive	Political Agreement (5 November 2002)

State of play on remaining Action Plan measures

Legislative progress

Good progress is being made in the institutions on the remaining measures of the FSAP, as indicated also in the sixth progress report presented by the Commission on 4 June 2002 to the ECOFIN Council. Since the last progress report, agreements have been reached in respect of the following:

– final adoption in a single reading of the Regulation on International Accounting Standards[3]. This is a major achievement particularly after such a short a period of negotiation;

– the Directives on Collateral[4], Distance Marketing[5], Insurance Intermediaries[6], and Financial Conglomerates[7] have been adopted by Council and the European Parliament;

– the Directive on Market Abuse[8] is expected to be adopted by Council on 3 December;

– common position on the Directive on Pension Funds[9] and political agreement on the Directive on Prospectuses[10] have been achieved in the Danish presidency with final adoption expected in 2003.

The Commission's legislative workprogramme is explained in box 3.

3 Regulation (EC)1606/2002 – 19 July 2002
4 Directive 2002/47/EC – 6 June 2002
5 Directive 2002/65/EC – 23 September 2002
6 PE-CONS 3639/02 – 16 July 2002
7 CONS 9754/3/02 Rev. 3 – 12 September 2002
8 CONS 9359/6/02 Rev. 6 – 19 July 2002, as amended by EP-PE:_TC2-COD(2001)0118
9 CONS 11212/02
10 CONS 13593/2/02 Rev. 2

Box 3

Legislative workprogramme 2003

Proposals scheduled for adoption by EP/Council

- Pension Funds Directive
- Prospectuses Directive
- Take Over Bids Directive
- Modernisation of the accounting provisions of the 4th and 7th Company Law Directives

Expected Commission Proposals

- Transparency Directive
- Follow-up Report High Level Group of Company Law Experts
- 10th Company law Directive
- 14th Company law Directive
- EU Legal Framework for Payments in the Internal Market
- Reinsurance Supervision
- Third Money Laundering Directive
- Clearing and Settlement

Continuing work on other key FSAP measures

- Investment Services Directive upgrade
- Review capital requirements financial institutions
- Insurance Solvency II

Apart from the Directives on Pension Funds and Prospectuses, two other proposals are expected to be adopted by European Parliament and Council next year :

- The Commission has presented a new proposal for a Directive on Take Over Bids[11], taking into account the recommendations of the High Level Group of Company Law Experts. It addresses the three principal concerns of the European Parliament: the issue of the "level playing field", a definition of an "equitable price" and the possibility for a majority shareholder to buy out a minority shareholder ("squeeze-out");

[11] COM(2002)534 – 2 October 2002

- On 28 May 2002 the Commission presented its proposal to amend the Directives on the Annual and Consolidated Accounts of certain types of companies (respectively 4th and 7th company law directive)[12] and on insurance undertakings. The proposal aims at modernising the accounting directives and to bring them up to date with the regulation on International Accounting Standards (IAS) adopted in July 2002. It is expected that the European Parliament will adopt the compromise proposal – including the extension to the Bank Accounts Directive[13] agreed by Council on 30 September 2002 – in a single reading early next year.

The Commission continues to focus its efforts on presenting the remaining key FSAP measures:

- the Commission's proposal for a Transparency Directive will be presented in early 2003 and should be agreed in 2004;
- following the events of September 11 last year, the legal framework to combat money laundering and terrorist financing may need further strengthening by a third Money Laundering Directive in 2003;
- the Commission is continuing its reflections on the clearing and settlement of securities after the end of its consultation, one of ten consultations it has carried out in the last year;
- the Commission agreed on its proposal for an upgrade of the Investment Services Directive on 19 November after an intensive two year industry consultation process;
- an ambitious timetable underpins the implementation of a revised capital framework for banks and investment firms by 2006, following discussions in the G10-Basle Committee. The Commission has started

12 COM(2002)259 – 28 May 2002
13 Directive 86/635/ECC – 8 December 1986

a dialogue with industry and intends to present its proposal for a Directive in 2004[14];

- the initial review of insurance solvency rules[15] has demonstrated the need for a more fundamental overhaul of the present approach ('Insurance Solvency II') and a framework for reinsurance supervision;

- as requested at the Oviedo Informal ECOFIN meeting, a new market focused forum group on financial analysts has been set up. The group will make recommendations to Commission Services on the best regulatory and market practise framework for financial analysts in an integrated EU Capital Market.

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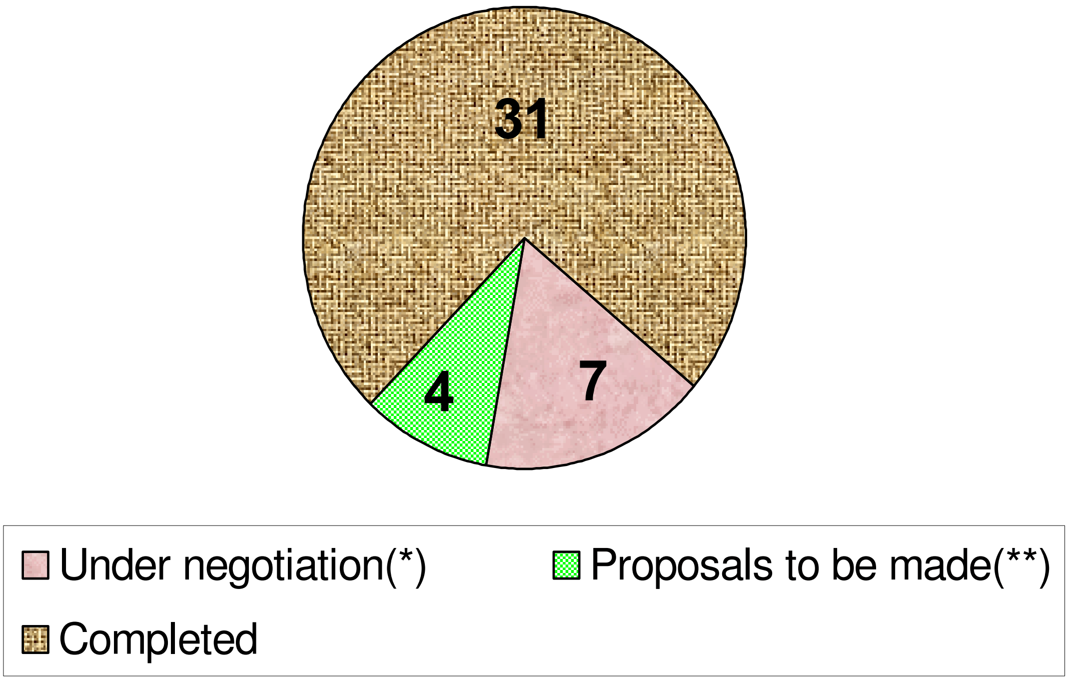
14 http://europa.eu.int/comm/internal_market/en/finances/capitaladequacy/index.htm

15 Directives 2002/12/EC and 2002/13/EC – 5 March 2002

Further detailed information about progress on all individual FSAP measures remains available through a detailed and regularly updated overview on the Commission's website[16].

<u>FIGURE 1</u> : Situation of individual measures of the FSAP[17]



(*) **Legislative proposals**: Prospectuses, Market Abuse, Pension Funds, Modernisation accounting provisions of 4th and 7th Company Law Directives, Directive on Cross-border Savings, Take Over Bids, Investments Services Directive upgrade
(**) **Legislative proposals**: Updating Transparency Directive, 10th Company Law Directive, 14th Company Law Directive, Review capital requirements financial institutions

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

17 The following follow-up measures or non legislative proposals are not included in the "proposals to be made" or "under negotiation": Follow-up High Level Group of Company Law Experts, EU Legal Framework for Payments, Report on implementation Settlement Finality Directive, Follow-up FIN-NET, Follow-up Action Plan to prevent fraud and counterfeiting in payment systems, Implementation of Code of conduct on business taxation, Taxation of cross-border occupational pensions.

Increasing investor confidence

FSAP emphasises the need to protect shareholders. Not only existing shareholders, but also potential shareholders, as they are an essential stimulus for growth. Recent corporate governance scandals have shown that even in a relatively well-developed financial market, lack of necessary protection can have serious negative effects. It is crucial for investors and for the effective functioning and stability of financial markets that companies provide a true and fair picture of the present, of their prospects for the future and the risks they encounter. Shareholders should demand high standards of governance, due diligence and disclosure.

In January 2002, The High Level Group of Company Law Experts, chaired by Professor Jaap Winter, was invited to "provide recommendations for a modern regulatory European company law framework". The Group considered the need for reform in a wide number of areas, and devoted special attention to key issues relating to corporate governance. The Group presented its recommendations on 4 November 2002[18]. Its general recommendations consider: disclosure by listed companies of their corporate governance structures and practices; co-ordination of Member States efforts in the area of corporate governance; and reinforcement of shareholder rights. The Group's more specific recommendations concern: the role of (independent) non-executive or supervisory directors; management remuneration; management responsibility for financial statements; and the role and composition of audit committees.

The Council invited the Commission to develop, in close consultation with Member States and the European Parliament, an Action Plan for Company Law including Corporate Governance as soon as possible and declared its intention to deal with this Action Plan as a matter of priority. The Commission is determined to follow-up quickly early in 2003. The Action Plan, based on the recommendations of the Group, should consist of legislative and non legislative proposals, as appropriate. Depending on the

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18 http://europa.eu.int/comm/internal_market/en/company/company/news/index.htm

priorities set in the Action Plan, the Commission could be in a position to launch some initiatives later in 2003, subject to consultation in line with the principles agreed in respect of the Lamfalussy report.

LOOKING AHEAD

Indicators to assist policy monitoring

In July 2000, the ECOFIN Council asked the Commission to set work in hand on developing a series of financial indicators to strengthen the monitoring process of financial markets in general and of the FSAP in particular. The results of this work are now available and will be reported to the ECOFIN Council in a separate report, which is being prepared with the help of an FSPG sub-group.

The indicators will provide an important basis for discussion with policy makers on the focus, targets and effects regarding integration of financial markets. The overall objective for the ongoing research on indicators is to help prioritise financial policy actions, in order to pursue those with the highest growth impact, and to guide them in designing the optimal way in which to achieve these potential welfare effects. The Commission intends to initiate discussions within the FSPG (or its successor – see below) on the first policy conclusions that can be drawn from the available data to monitor the financial markets and the effects of the FSAP.

Streamlining regulatory processes

From next year, all aspects of the 4-level regulatory approach for securities markets, proposed by the Lamfalussy report, following the political agreements with the Council and the European Parliament, will come into play for the securities field.

In July 2002, the Council confirmed further arrangements on the implementation of the Lamfalussy process with the European Parliament and the Commission by agreeing the mandate for the Inter-institutional Monitoring Committee. The Committee will assess the progress made on implementing the Lamfalussy process and identify any possible emerging bottlenecks. It will report results twice a year. Its first report is expected in Spring 2003.

On 8 October 2002, the ECOFIN Council broadly endorsed a report from the Economic and Financial Committee (EFC) on financial regulation, supervision and stability[19]. EFC recommends extending the Lamfalussy framework to all financial sectors. The report also suggests reconfiguring the FSPG under Member State chairmanship and to give it a political oversight and advisory role for the ECOFIN Council on issues related to financial markets, without becoming part of the legislative process. In addition, the envisaged structure should allow to reinforce the mechanisms for safeguarding financial stability

[19] http://europa.eu.int/comm/internal_market/en/finances/cross-sector/index.htm

at EU-level – which is needed to reap the full benefits of integration – by devoting increased attention to the changing features of the risks to the financial sector. The new FSPG would contribute to this regular financial stability discussion.

The Council emphasised that the institutional aspects and good relations with the European Parliament needed careful consideration, and existing political and legal agreements must be taken fully into account. The Council and the Danish Presidency asked the Commission to organise a consultation of the industry and other interested parties. This closed on 17 November 2002. The Presidency and the Commission are in close contact with the European Parliament on the extension of the Lamfalussy framework. Due to the institutional aspects involved, the outcome is not final. Council, Commission and the European Parliament will further discuss this over the coming period.

Follow-up on Oviedo informal Ecofin meeting

The present state of integration and cross-border business in the financial sector in the EU has led to considerable reporting requirements for financial firms, arising from prudential, monetary, statistical and other rules. The Oviedo informal ECOFIN meeting therefore requested the Commission to report on the possibility of streamlining these reporting requirements, after a consultation of the industry. The Commission is in the process of finalising the consultation of the market[20]. The views of the regulatory committees will also be sought. A report will be presented by the Commission early 2003.

Implementation and enforcement

Timely, accurate implementation and enforcement of well-designed Community legislation is crucial for level playing fields, legal certainty and delivering envisaged benefits. As a rule, the Commission services will start

[20] The recommendations of a Forum Group on this subject and the results of the consultation process are available on the Commission's website: http://europa.eu.int/comm/internal_market/en/finances/cross-sector/index.htm

bringing together Member States shortly after the adoption of directives by the Council and the European Parliament in order to promote a consistent transposition of measures into Member States' laws. The 'Lamfalussy' approach should also contribute to a much-needed convergence of supervisory practices, for example through the work of CESR in Level 3. Only to focus on extension of legislation is certainly not the preferred approach. The Commission will take its Treaty obligations for the enforcement of existing and new rules seriously.

EXTERNAL DIMENSION OF THE FINANCIAL SECTOR

Financial markets are increasingly global. The competitiveness of Europe's financial sector and the international role of the Euro depend on the smooth functioning of the international financial system. Close international co-operation is essential to achieve EU's objectives.

The decision to welcome 10 new Member States to enlarge the Union also brings particular challenges to present and future Member States. The new Member States continue their vigorous efforts to correctly implement the Community Acquis for financial services. The implementation of the FSAP measures will require further efforts from both sides. The Commission and the Member States' authorities will in particular have to continue to invest time and effort to ensure that the new Member States have the administrative capacity to implement and apply Community law correctly.

The Commission and Member States have also initiated a regulatory dialogue with the US Federal Reserve Board, the US Securities and Exchange Commission (SEC), and US Treasury on supervisory practices for financial conglomerates. A concrete work-programme is being developed. Technical discussions between the Commission and the SEC on trading screens and accounting standards are also underway. The adoption of the Sarbanes-Oxley Act in the US in September this year is another example of the global impact that local decisions can have on the financial sector as a whole. The Commission and the Member States are vigorously pursuing some of the unwarranted effects of this legislation and have identified a 7 category set of issues to be resolved, namely: registration of EU audit firms, US access to EU audit working papers, auditor independence, audit committee requirements, loans to directors, certification of financial reports and certification of internal controls.

Multilateral GATS (General Agreement on Trade in Services) negotiations, embedded in the broader Doha Development Agenda, are expected to accelerate in 2003. The Community has finalised its market-opening requests to other countries and has recently started to discuss its possible offers to third countries. Further steps in the integration and liberalisation of the EU market should continue to be matched by adequate market opening commitments by all third-countries.

CONCLUSIONS

The Barcelona Council set the benchmark for progress on the FSAP. Under the Spanish and Danish Council Presidencies, the Barcelona objectives have been largely met. But, this does not mean we can relax. Further effort is needed to complete remaining FSAP measures. The case for an integrated European capital market remains as strong as ever. This is cemented by evidence on the economic benefits of integration and by applying indicators to strengthen the monitoring process, providing a solid base for assessing and developing policy.

The FSAP is well on the way to completion. As the measures come into force, focus should now begin to be made on their correct and timely implementation, application and enforcement. Progress on extending the 'Lamfalussy' processes to all financial sectors is desirable. The European Parliament, the Council and the Commission all share the same objective. With a co-operative approach and a climate of confidence and trust, we will succeed.

The next Progress report will be sent to the ECOFIN Council by mid-2003.