EU Securities Market Regulation

Adapting to the Needs of a Single Capital Market

Report of a CEPS Task Force

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This report is based on discussions in a CEPS Task Force on Updating EU Securities Market Regulation. The group was initially chaired by Dr Luigi Spaventa, President of Consob, who was succeeded by Dr Alfred Steinherr, Chief Economist and General Manager at the European Investment Bank. The Task Force organised a special Roundtable with Alexandre Lamfalussy on 29 November 2000, to discuss the preliminary report issued by the Committee of Wise Men on the regulation of Europe's securities markets. A list of participants and invited guests and speakers appears at the end of the report.

This report was prepared by Karel Lannoo, Chief Executive and Senior Research Fellow at CEPS. The members of the Task Force participated in extensive debate in the course of several meetings and submitted comments on earlier drafts of this report. Its contents contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position reached among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong.

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Executive Summary and Policy Recommendations

The aim of securities market regulation is to ensure proper disclosure and enforcement via a complex set of intermediaries and institutions. This is achieved not only via legislation, but also by stimulating a process of competition between intermediaries on the basis of reputation and allowing the market to take responsibility for part of the regulatory and enforcement work.

EU securities markets are characterised today by much greater integration as a result of EMU and technological progress, which has forced European policy-makers to revisit the regulatory set-up governing these markets. A first step was the publication in May 1999 of the financial services action plan (FSAP), which called for a single financial market by 2005. The next step was the establishment of a Committee of Wise Men last year by the EU Finance Ministers to examine ways to strengthen the EU regulatory framework. Chaired by Alexandre Lamfalussy, former President of the European Monetary Institute, this group has focused largely on EU legislative procedures, but has in our judgement probably given insufficient attention to the process of stimulating well functioning securities markets across all the intermediaries and institutions involved.

Several EU directives have attempted to harmonise a broad range of securities market activities. Rules are in place covering issuers in capital markets, intermediaries, investors and investment products. Owing to the large differences in the legal and institutional structure of securities market supervision in Europe, however, implementation has met with mixed results and mutual recognition has functioned unevenly. The objective should be to eliminate the remaining obstacles that prevent mutual recognition from working efficiently, but to stop short of excessive harmonisation. The single passport should be strengthened by removing remaining barriers at national level. EU action should at this stage concentrate on introducing light amendments to existing legislation.

The CEPS Task Force has discussed the market developments and examined the framework of EU securities market regulation and the relevant elements of the FSAP. It has not been able to conduct an exhaustive review of the latter, however. Below we present the Task Force's principal recommendations organised into two categories, regulation and supervisory and institutional matters.

Regulation

1. **Clarify the objectives, principles and optimal institutional design of securities market regulation via a broad-based debate at European level.** This debate should clearly bring out whether there is a need for further regulation, and if so, how it should be enacted (by government institutions or self-regulatory organisations) and on which level. These discussions would provide the necessary basis for embarking on new framework legislation in this area.

2. **Consistently interpret and enforce EU rules to ensure a well functioning securities market.** This recommendation applies not only to statutory organisations, but also when work is delegated to self-regulatory entities and market intermediaries, in order to stimulate a competitive process on that level.

3. **Amend existing legislation in areas where a broad consensus already exists.** In principle, framework legislation is a good basis for future EU securities markets regulation, but risks at present leading to long and protracted discussions that would delay the immediate amendments needed. Regulations under EU law may be appropriate in certain circumstances, but are not a panacea.

4. **Strengthen mutual recognition via selective harmonisation.** Immediate action is required to adopt country-of-origin rules for the application of conduct-of-business rules in cross-border securities trading, at least for professional investors. Full harmonisation is not realistic, however, nor is it even desirable since some degree of competition between jurisdictions can do no harm.

5. **Revise the key investment services directive (ISD), but in a limited way**. The ISD came into being after lengthy discussions in the early 1990s, a repetition of which would at this stage best be avoided. The liberalising effects of the directive should be strengthened through limited revisions, which would minimise the likelihood of provoking political gridlock. This revision should essentially cover two issues:

   i. The directive should clarify that professional investors are subject to country-of-origin conduct-of-business and marketing rules only when trading on a cross-border basis (Art. 11). The current definition of professional investors as proposed by the Forum of European Securities Commissions (FESCO) and suggested by the European Commission is insufficient for these purposes.

   ii. Listing and trading functions should be explicitly de-coupled. The directive stipulates that an exchange has to be active in the listing business as a pre-condition for trading. This presents problems in efforts to split off the listing function as part of the restructuring of the European stock exchange industry.

   Both of these changes could be made in small textual amendments, thereby avoiding a radical and lengthy overhaul of the ISD. Other protectionist devices contained in the directive could at the same time be scrapped, such as the concentration rule (Art. 14.3) and the ability of member states to restrict the establishment of new markets on their territory (Art. 15.5).

   On the other hand, the regulatory issues raised by the emergence of alternative trading systems (ATSs) do not require a change to the ISD, but only a consistent and coordinated approach by the supervisory authorities. The same applies in the case of remote access to central securities depositories (CSDs), which requires only a uniform interpretation of Art. 15.1.

6. **Harmonise securities prospectuses and listing particulars directives**. The forthcoming review of the directives, as foreseen in the FSAP, must be far-reaching in scope, otherwise mutual recognition will not work. It should also encompass and replace the 1979 listing admission directive, and allow listing authorities to develop independently from exchanges. This would achieve far more at this stage than would a radical overhaul of the ISD, and therefore should be treated as a greater priority.

Supervisory and Institutional Matters

7. **Standardise the responsibilities and powers of securities market regulators in order to achieve greater market integration, a level playing field and more effective enforcement**. The wide differences in the scope of responsibilities and powers exercised by securities market regulators today encourage market fragmentation and hamper cooperation among supervisory authorities.

8. **Create a single, high-profile EU Securities Committee with strong regulatory powers in order to be able to more quickly introduce changes to financial legislation**. The committee, with powers to adapt elements of EU securities directives, should comprise the heads of the national securities commissions and other member state officials. Such a body, however, cannot be formed quickly. If a Securities Committee were to be created as currently permitted under existing legislation, its powers would be very limited. Substantial changes to all pieces of EU securities market legislation would be required to put a structure in place as envisaged in the Lamfalussy report, or alternatively, the Securities Committee legislation would need to modify all existing pieces of relevant legislation. Broad-based public consultations and transparency in the decision process of the Committee should be standard practice.

9. **Reinforce FESCO (Forum of European Securities Commissions) to enable it to adequately respond to growing demands.** In the first instance, the Forum needs to have a larger secretariat. National securities commissions should also draw more attention to their affiliation and cooperation with FESCO, to show markets and investors that market integration is becoming a fact, even at the level of supervisors. Market consultations on draft FESCO standards should become normal procedure.

10. **Promote independent listing authorities**. Admission to listing, in the sense of admission to public offer and the enforcement of the ensuing disclosure obligations, is a public good function that is increasingly difficult to maintain under the same roof as the exchange. The listing function of an exchange dates from an era when exchanges were a public good and operated as quasi-monopolies. Now that most of them have been privatised and compete for blue chips, the listing function should be transferred to the supervisory authorities, or to an independent authority separate from the exchange, but subject to standards set by the authorities. In the long run, a single capital market should have a limited number of competitive listing authorities. The transfer of the listing function to an independent authority, however, does not mean that exchanges cannot differentiate in their conditions for admission to trading.

11. **Strengthen disclosure through a European "Edgar".** Now that there will be a single European prospectus and greater comparability in European company accounts as a result of the proposed move to adopt International Accounting Standards (IAS), a single electronic European business register, modelled on selective aspects of the SEC's Edgar (electronic data-gathering analysis and retrieval) system, should be created. Introducing a comparable system in Europe will strongly enhance the integration of European capital markets.

12. **Stimulate cooperation between self-regulatory bodies.** Self-regulatory organisations play an important role in ensuring the appropriateness, quality and enforcement of securities markets regulation. Stronger cooperation amongst them is an important building block in strengthening the overall functioning of EU securities markets.

13. **Strengthen cooperation between competent supervisory authorities for securities clearing and settlement systems.** Given the increasing integration of these systems in Europe, the need arises to identify institutional mechanisms to reinforce multilateral cooperation and exchange of information among the competent authorities, primarily securities regulators and central banks.

14. **Maintain a framework for competitive securities markets on all levels: trading platforms, clearing, settlement and custody.** The rationalisation and reconfiguration of the existing securities market infrastructure should be carefully monitored by competition policy authorities to maintain a competitive and open environment, meeting the needs of issuers, intermediaries and investors alike. Exceptions to EU competition rules should be clearly based on grounds of economic and user benefits. Access to market facilities should

be open and granted on the basis of transparent criteria. On the other hand, elements that maintain fragmentation, such as the requirement to go through a local central securities depository (CSD) for monetary policy operations with the ECB, should be eliminated.

15. **Promote self-regulatory dispute-settlement devices.** Non-professional retail investors will continue to be subject to *their* home country consumer protection provisions. To encourage market integration and facilitate consumer confidence at European level, the European Commission could urge member states to promote self-regulatory or informal mechanisms to settle disputes between providers and users of investment services.

Urgent Priorities: A Recap

1. Take rapid action on three fronts:
   - Member states should ensure consistent implementation of the single passport and remove remaining obstacles to its use.
   - The EU should strengthen the investment services directive via light amendments.
   - The European Commission should strengthen enforcement of rules.
2. Harmonise the securities prospectuses and listing directives leading to a truly single passport for issuers.
3. Create a single high-profile EU Securities Committee with regulatory powers, composed of the heads of securities commissions and member state officials.
4. Clarify the objectives and level of securities market regulation as a necessary basis for framework legislation.
5. Stimulate competition between the different layers involved to ensure a well-functioning securities market.
6. Strengthen disclosure through the creation of a European "EDGAR".

EU Securities Market Regulation: Adapting to the Needs of the Single Capital Market

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Introduction

Capital markets in Europe are at last becoming more integrated and truly European. Equity markets are in the process of deep restructuring. Government bond markets have become integrated, with one dominant trading platform having emerged for the euro-zone. A liquid risk capital market exists for bonds as well as for equity. Investment research has become truly European and portfolios have become diversified by sector at European level. The euro can be credited with triggering a radical transformation in European capital markets which no other measures had been able to bring about before.

At the same time, technological change is altering the interaction between markets and investors. Technology has banished physical trading floors and replaced them with anonymous virtual trading platforms. Internet technology now allows retail investors to invest directly in the stock market, and to easily gain access to information that was previously available only to analysts.

This revolution, as one might call it, poses serious challenges to the traditional capital market infrastructure: the exchanges, the clearing and settlement systems, the custody business, as well as intermediaries.

Nevertheless, important elements are still in place that contribute to continued market fragmentation and inefficiency. Trades in stocks of the pan-European Stoxx 50 index, for example, still have to be executed on a multiple of exchanges, cleared through different clearing and settlement systems and using a number of custodians. This is very inefficient and adds to the costs of doing business. Likewise, regulations are a source of market segmentation. Insufficient harmonisation nurtures a home bias or makes cross-border investments more risky. It also inhibits certain market segments, such as IPOs and repo markets, from becoming more European.

Back in 1998, a CEPS Working Party chaired by Tommaso Padoa-Schioppa, then Chairman of CONSOB, the Italian securities market regulator, issued a series of recommendations on changes required in the regulatory framework for euro capital markets.[1] Many of these recommendations have since found their way into the policy process. In May 1999, the EU Council approved the Commission's Financial Services Action Plan, which covered, inter alia, adaptations required in EU securities market regulation that are now being discussed. This plan apparently did not go far enough, however, and more action was thought to be needed on the response to the changes underway. Hence, on 17 July 2000, the Ecofin Council set up a Committee of Wise Men on the regulation of Europe's securities markets, under the chairmanship of Alexandre Lamfalussy, to further scrutinise the framework and to report by early 2001.

Taking these key developments as background and as a point of departure, the CEPS Task Force attempted to analyse three principal questions:

[1] See Lannoo and Gros (1998).

1) Which elements of the regulatory framework hamper capital market integration and development, and therefore need further harmonisation?
2) What degree of regulatory competition is acceptable?
3) Is a more integrated supervisory framework required?

The answers to these questions must be specific to European circumstances, i.e. only when national solutions are inadequate can European solutions be considered. In other words, as long as the minimum standards adopted in the basic EU directives allow mutual recognition to work, there is no need for further harmonisation or for more centralised solutions.

This report addresses these questions with a view to proposing a series of policy recommendations. Before doing so, we first review recent developments in the European securities market industry and assess European securities market regulation and supervision.

I. The European Securities Market Industry

A revolution is underway in European financial markets that has fundamental implications for the securities industry. The European securities market industry has traditionally been characterised by vertical integration – a structure that could be easily maintained as a result of the currency segmentation of markets. With the introduction of the euro, however, a new structure is emerging that primarily affects the exchanges and the clearing and settlement systems, but that also has ramifications for markets, institutions and private individuals.

It has often been taken for granted that the future European structure will replicate one of those existing at the national level, or possibly the American structure, with a single or limited number of exchanges and a fully integrated clearing and settlement system. Will this be the case in reality, however? Or will we have a single global exchange, open day and night? Much will depend on the economic structure of the exchange industry, the existence of economies of scale, the importance of location, and the exchanges' relationships with their key clients, firms and financial institutions.

1. What is an exchange?

The answer to this question has become increasingly difficult with the advent of virtual trading platforms. But it has always been difficult to supply a watertight definition, as demonstrated by the lively discussions surrounding the 1992 investment services directive (ISD). For an outsider, however, it seemed easy, since he always could point to the local stock exchange, situated in one of the smarter sections of town, and could learn what was going on inside the building by reading the financial section in the next day's newspaper. This same outsider, however, was probably not aware of the changes that began taking place inside the exchanges in the late 1980s, when floor trading began to be replaced by electronic order matching and routing and dealers were relegated to an office where they sat nervously in front of their computer screens. European exchange buildings today in fact are little more than an empty shell, where the hum of computers has replaced the cries on the trading floor.

Among other things, the bidding process for the London Stock Exchange (LSE) has had the beneficial effect of revealing for many what an exchange is really about. OM Gruppen, the Swedish exchange that recently made an unsuccessful bid for the LSE, is essentially a transaction technology company specialised in running trading platforms for shares, derivative products and commodities. It specialises in bringing together sellers and buyers of these products on the basis of a virtual platform indicating price, volume, etc.

An exchange has two essential characteristics:

- a trading system that delivers regular price discovery, order routing and execution of securities, derivatives and commodities products; and

- some form of open membership (which does not necessarily lead to co-ownership). Members are asked to respect certain rules when trading on the exchange.

The business of an exchange is the revenue generated through some or all of the following activities: fees earned on transactions, price information services and membership. Moreover, many exchanges also act as a listing authority. Some have consulting arms and make considerable income from training. Clearing and settlement are not necessarily an essential part of an exchange, but are still strongly integrated in the business structure.

Most European exchanges generate the largest share of their income through transaction fees, followed by services (such as clearing and settlement, membership fees and data dissemination) and listing. Trading is also the main source of revenue for North American exchanges, but this is followed by listing and services in second and third place, respectively (see Table 1).

Table 1. Exchange revenues by source, 1998

	Europe	North America
Listing fees	19.3%	32.1%
Transaction fees	45.1%	39.7%
Services	24.4%	22.6%
Other	11.2%	5.7%

Source: Di Noia (2001) based upon FIBV data.

The output of an exchange is thus composed of several elements. This heterogeneous composition of services, which differs across countries, dates back to an era when exchanges were a public good, and exercised a de facto monopoly. The exchange was a status symbol, which every market economy felt it needed to have as evidence of their market economy credentials. The grandiose buildings that house exchanges in most European capitals testify to this way of thinking. The Central and East European countries (CEECs) have followed suit, having created very early on in the transition process their own national exchanges, but few of these have any traffic, and in some countries, such as Albania, an exchange “exists” but no stocks are quoted.

The current competition between exchanges was triggered in the second half of the 1980s by SEAQ International’s drive to attract professional cross-border equity trading away from Europe’s continental exchanges. With SEAQ, the London Stock Exchange introduced a screen-based quote-driven system, which provided a deep market and a great degree of immediacy for large blocks of trade. The continental European exchanges, which still had their slow and lowly developed call auction markets, reacted by fully automating their central order matching system, and succeeded in gaining back some of their former business from the City. Trading floors were abolished, trading was dematerialised, and the market became the computer screens in front of the traders. This process was further stimulated by the entry into force of the EU’s investment services directive (ISD), which gave exchanges a single licence to place their screens, and thus offer their business, all across the EU.[2]

As a result of these changes, large European universal banks started to concentrate their trading activities in one or two European centres, although they still needed to be members of several exchanges, pay the membership fees and respect the local trading rules. The switchover of wholesale markets to the euro and the ensuing increased Europeanisation of capital markets made the national segmentation of markets look increasingly outdated. The time was right to begin a process of consolidation and restructuring of European exchanges.

[2] See Steil (1996) and Gros and Lannoo (2000) for more details on this process.

This process of liberalisation of securities markets was accompanied by changes in the governance structure of stock exchanges. In the past, all exchanges were mutuals, which were owned equally or with differentiated voting power by their members, brokers and/or banks. A de-mutualisation process started in the early 1990s, when exchanges themselves were reformed to become public limited companies (companies having a share capital). The main reasons for this change were related to the investments required in technology in order to keep up with the competition and demand, and (consequently) the need to make ownership and governance more flexible. The trend was first evident in the smaller exchanges, and has now been extended to the larger ones.

One can easily interpret this process of de-mutualisation, however, as a hybrid form of privatisation since the shares have in most cases stayed in the hands of the old mutual owners, in the same proportions as had existed before. These former mutual owners have now become the principal users of the exchange. There is thus only a limited distinction between ownership and usage, i.e. there are conflicts of interest between the brokers and the banks acting as owners of the exchange on the one hand and as users of the exchange on the other. Only a few exchanges in Europe also belong to shareholders other than their users, and are fully and openly traded. Tradepoint, a pan-European trading platform, is quoted on the AIM market. OM Gruppen is also quoted, but this company owns more than simply the Stockholm stock exchange. Approximately 50% of OM’s shares are in the hands of various holding companies, investment and pension funds. The rest is widely held and frequently traded. The London Stock Exchange, on the other hand, while being formally quoted (but not on an exchange), is not really traded. Table 2 has thus to be interpreted with care. While most European exchanges have been de-mutualised, only a few are truly public limited companies. Moreover, the structure of the so-called privatised exchanges is often highly complex, and no two are comparable (in terms of governance and degree of horizontal or vertical integration). The ambiguity and difficulty in defining a stock exchange can thus be easily understood.

Table 2. Exchange de-mutualisation

Exchange	Year of privatisation	Quoted/liquid market
Stockholm Exchange	1993	X (OM Gruppen)
Deutsche Börse	1993	IPO February 2001 (25%)
Helsinki Exchange	1995	
Copenhagen Exchange	1996	
Amsterdam (AEX)	1997	X (not liquid)
Brussels Exchanges	1997	
Borsa Italiana	1997	
Athens Stock Exchange	1999	
London Stock Exchange	2000	X (quoted but not liquid)
Euronext	2000	IPO May 2001
Nasdaq	2001 (?)	End 2001

Source: Updated from Cybo-Ottone et al. (2000).

Exchanges have two main direct customers: firms wanting to be listed and intermediaries wanting to trade on an exchange. Exchanges can specialise on the basis the kind of firms and intermediaries they wish to attract. This difference will also be visible in their income structure. Established exchanges try to earn more from listing and membership fees, whereas new exchanges focus on trading services, and will have low membership fees. The membership fee at Tradepoint, for example, is £1000, whereas it may be over $1 million at the NYSE.

A company will choose an exchange on the basis of its particular objective in going public. For some companies, funding is the key element, and most of the shares are publicly traded on the exchange, with a high free float (high-tech IPOs). For others, it may be more a matter of having a permanent market valuation of the company (family businesses, with low free float and majority of capital in the hands of owners). For others, it may be just a matter of prestige.

Also from the point of view of the intermediaries, the choices differ. Some look for the ideal environment in which to trade large blocks of shares, while others may demand speed of execution, market-making opportunities, liquidity or a reliable price discovery mechanism, others seek diversification, and some the assurance of trustworthy regulatory regimes, but all will look for the opportunity to make money.

The key objective of an exchange is to achieve a critical mass of attractive listed companies and sufficient users who in turn generate a large volume of trading and thus a high degree of liquidity (Di Noia, 2001). The higher the liquidity, the lower the spreads and the cost of trading, the stronger the price discovery mechanism and the greater the investor confidence. Exchanges are often compared to the functioning of a network, in the sense that the greater the number of customers, the higher its utility. Firms want to be listed where other firms are listed and where most intermediaries trade. The more traders to access a certain system, the greater will be the scale economies in terms of lower costs per trade.

It is questionable, however, whether exchanges are indeed networks, and really do benefit from network effects, as opposed to scale economies and agglomeration effects. A network implies very high initial costs, which can only be borne if there are many users. Networks are often natural monopolies, in the sense that the cost for the users of having two is higher than one (depending on the market definition). Examples of true networks are airline hubs or water networks. The cost of establishing an exchange today is not that high, thanks to technological progress. The UK-based Tradepoint, for example, claims its initial investment costs were only $10 million.

The network discussion has important implications for competition policy. If an exchange is considered to be a real network, the authorities may be prepared to treat it more leniently as an essential facility, which can qualify for certain exemptions from competition policy rules. The prior discussion about the core business of an exchange and the initial costs, however, make this a doubtful proposition. Thus, a competitive environment for exchanges, or trading networks, needs to be ensured.[3]

This whole process of liberalisation of the trading environment has gone hand in hand with the technological revolution. Technological progress allows the removal of various layers of intermediation. The less intermediaries, the lower the cost for an investor. If the role of the broker may be eliminated, they too may find themselves cut out of the process. Could exchanges themselves disappear? This is doubtful, as there will likely remain a specific niche for firms specialised in transaction technology and in making markets.

The spread of Alternative Trading Systems (ATSs) is proof that there is a thriving market for firms specialised in market-making. An ATS is commonly defined as "an entity which, without being regulated as an exchange, operates an automated system that brings together buying and selling interests – in a system and according to rules set by the system's operator – in a way that forms, or results in, an irrevocable contract" (FESCO, 2000a, p. 4). The FESCO paper identified 27 systems in Europe that fit within the ATS definition, 16 of which are authorised to operate in the UK, 6 in Germany, and one each in Belgium, France, Ireland, Italy and the Netherlands. In markets where an organised central market exists, an ATS attracts business by offering functionality or services not available from the local exchange. Where there is no organised central market, an ATS offers greater efficiency and transparency

[3] See also Everett and Mann (2000).

in price formation, as, for example, in the bond markets. From a regulatory point of view, they are mostly registered as broker-dealers. In some cases, they are registered as exchanges.

2. The bond markets

In the past, the market for bonds was over-the-counter (OTC). Bonds were also quoted by the stock exchange, but not much trade occurred there. This was essentially provided for the retail market or for regulatory (tax) reasons.

Primary bond markets are not yet fully liberalised. Primary dealer markets do not fall within the scope of the investment services directive, i.e. there is no single licence yet. They still enjoy some form of protection in the EU member states through different language and qualification requirements. Some countries, however, have already opened their markets and do not require primary dealer firms to establish themselves within their territories.

The switchover to the euro in the EU-11 bond markets and the harmonisation of trading and market conventions have allowed the integration of bond markets, and the emergence of electronic trading platforms. The largest one, Euro-MTS, lists bonds of the main Eurosystem member countries.[4] In contrast to stock exchange platforms, however, Euro-MTS is quote-driven, mainly because of a lack of permanent liquidity, and it does not act as a central counterparty. Members of Euro-MTS are required to indicate buy and sell prices. Euro-MTS is currently operating as a broker/dealer in four jurisdictions (France, UK, Belgium and the Netherlands) and as a regulated market in Italy and Portugal (FESCO, 2000a, p. 6). The strength of Euro-MTS is based on the successful experience of its mother company MTS (Mercato Telematico dei Titoli di Stato) in the Italian market. MTS became fully automated in 1994 and moved to anonymous trading in 1997, which increased liquidity and reduced volatility (Scalia and Vacca, 1999).

3. Can exchanges merge?

Europe currently hosts 32 stock exchanges at a national level (not including the regional or specialised exchanges), 16 of which are in the EU, compared to seven in the US.[5] Some exchanges have a large number of listed companies and a big turnover whereas others are much smaller, or have seen much business disappear as a result of market restructuring and the consolidation among financial institutions (See Tables A1 and A2 in Annex 1). These exchanges grew under the protection of national borders, but they are now facing more competition. There is pressure for consolidation, but at the same time, new competitors are emerging on the horizon.

Many elements are hampering mergers between exchanges. There are the differences in technology, the heterogeneous income structure of exchanges (discussed above), differences in governance and company law, language and culture. In a recent paper on scale economies in stock exchange activities, Malkamäki (2000) foresees opportunities for cost reductions in alliances among European exchanges, but not in all operations of exchanges. Only for the very large exchanges, such as the NYSE, did Malkamäki find scale economies in the

[4] Euro-MTS provides a screen-based service for trading benchmark euro-denominated government bonds in lot sizes of € 5 million. The system engenders considerable benefits in terms of straight-through processing by offering direct settlement links. It automatically provides instructions for both sides of the trade to the appropriate central securities depository. Euro-MTS began its operations at the end of March 1999, and has already become the largest trading platform for government bonds. The Chairman of Euro-MTS is Alexandre Lamfalussy.

[5] The seven US exchanges are: NYSE, NASDAQ, Boston, Cincinnati, Chicago, Philadelphia and the Pacific Exchange (Los Angeles and San Francisco). Amex merged with NASDAQ in 1999. The regional exchanges in the US do not function as a listing platform for regional firms, but as a parallel market for the big exchanges. They can attract orders thanks to lower costs. The two major exchanges, NYSE and NASDAQ, command 95% of the business.

combined operations. For small and medium sized exchanges, pooling of activities does not result in cost-savings.[6] When placed against the background of Europe's regulatory and cultural diversity, these findings led Malkamäki to conclude that European exchanges should search for function-specific scale advantages in partial mergers, first and foremost, by centralising trading systems. Functions that draw heavily on local knowledge and institutions are best kept decentralised.

These findings predicted the outcome of the two exchange mergers that were widely discussed over the summer of 2000. The partial integration of Euronext has moved ahead, whereas the full merger of iX collapsed. Euronext took the cultural and institutional differences into account, whereas iX probably underestimated their importance. As emphasised in their documentation, the exchanges were motivated to enter into the mergers by the potential scale economies and the resulting benefits for shareholders and customers. As Don Cruickshank, the former chairman designate of iX-international exchanges, put it: "The critical mass and significant synergies created by this merger will bring lower dealing costs, better prices and unprecedented access to a wide range of international investment opportunities and markets".[7] The press release further indicated that the merger should generate economies of scale and scope, higher liquidity and thus narrower bid-ask spreads, and more competitive pricing.

The OM bid for LSE, by contrast, did not emphasise scale and critical mass, but focused on specific competence and know-how. In announcing its offer to purchase the LSE, OM observed: "The success of stock exchanges in the future will be determined by their operational efficiency, brand strength, technological superiority and their ability to provide systems dependability at the lowest trading cost for customers. The European exchange that performs best on these criteria will win increasing trading volume, generating the deepest pool of liquidity for investors. Other exchanges will lose trading volume to the best performers".[8] OM's technology is said to be years ahead of LSE's, with volumes that can be dealt with much faster than at LSE. OM Gruppen strongly criticised the iX merger on the grounds that as it would give away one of the most important elements of the LSE, the brand name.

The bidding process for the LSE has had the effect of correcting certain common misconceptions about exchanges, notably that the exchange is a public good and a natural monopoly. It permitted the public to see what an exchange is really about, and will further stimulate a fundamental restructuring of the securities market industry. It also demonstrated that liquidity is not the only issue; there is also technology and the need for an open and competitive environment. In the future, a more horizontal market structure can be expected to emerge, with several trading platforms, a limited number of clearing and settlement systems, and a global custody industry.

4. The changing European clearing and settlement infrastructure

Securities clearing and settlement systems form the backbone of financial market infrastructure. We are more familiar with the settlement and custody side of the business, where national central securities depositories (CSDs) and the international central securities depositories (ICSDs), Euroclear and Clearstream International (the latter formerly known as Cedel), are active. The former were designed to serve the needs of the national markets, whereas the latter provide settlement for internationally traded securities, essentially bonds. The importance of this function has until recently been underestimated as it was largely seen

[6] Table A3 in Annex 1 also supports this view, since there does not seem to be a pure logic in the ranking of the total trading costs as compared to the size of the exchange. NYSE comes first, but followed by France, Belgium, the Netherlands and Germany.

[7] iX press release, 17 July 2000, London Stock Exchange.

[8] OM Group press release, 29 August 2000.

as an administrative, back-office task. The fragmentation of clearing and settlement systems seriously hampers the integration of European securities markets, as cross-border is more expensive than domestic business.

Clearing and settlement are services that arise from securities and derivatives trading. The discussion of clearing and settlement is complicated by the lack of exact definitions of key terms. Moreover, the different terms are often used interchangeably, which adds to the confusion. Before embarking on a discussion of their role, it is therefore useful to start with a clarification of both services.[9]

Clearance in the securities business is the process that occurs between trading and settlement, involving the netting of positions between the different parties to establish what each party is due, prior to the establishment of final positions for settlement. A clearinghouse clears financial market transactions and provides a range of services related to clearing and the management of risk associated with such contracts. It can either be a department of an exchange, or a separate legal entity, either under the holding of an exchange or not. A clearinghouse can act as a central counterparty (CCP) by being a legal counterparty to both sides of a financial market transaction. The clearinghouse becomes the buyer to every seller, and the seller to every buyer, and replaces the original bilateral contractual obligations. This process is generally known as "novation". A CCP thus replaces several counterparty exposures and reduces the risk for the participating groups, but creates risks at the level of the clearinghouse: counterparty, market and operational risk. A CCP therefore operates in the context of a selective and strict membership structure.

Settlement is the completion of a transaction, in which the seller transfers securities or another financial instrument to the buyer and the buyer pays the seller. It is very important at this stage to make the asset commitment period (ACT) as short as possible. Ideally, final settlement should coincide with the payment transfer. In some cases, the settlement system handles the clearing and the securities side of the settlement directly, while the cash side of the settlement is usually effected through the banking/payment system.

The confusion between clearing and settlement arises from the fact that "clearing" is sometimes used to refer to the *transfer* of securities on the settlement date. However, the transfer is really part of the settlement process. Few clearinghouses in equity markets also act as central counterparty.

The advantages of consolidation

As compared to trading platforms, clearing and settlement represent clear scale economies and network externalities. Economies of scale stem from the fact that clearing and settlement systems require large investments in information technology and communication networks, which can only be recovered if a critical mass of customers use the same service. Greater integration of clearing and settlement systems would allow the fixed costs to be spread over a larger number of customers, thereby lowering the unit costs of each transaction. Economies of scope arise from the fact that they can provide a wide range of products and services related to clearing and settlement, such as netting, risk management, cash and custodial services, in order to attract customers. Two or more clearing and settlement systems together can provide a larger portfolio of services at a lower unit cost than if they were acting alone. Thus, the more they are integrated, the greater the potential economies of scope. Network externalities in the industry arise from the fact that use of the network generates positive effects for the user in terms of services and costs.

[9] This section draws upon Stadler and Lannoo (2000), presentations by John Burke of London Clearing House and Yves Poullet of Euroclear to members of the Task Force, and discussions with other experts.

At the level of clearing, consolidation of CCP reduces the capital needs of capital market participants, simplifies risk management and eases operations across markets. In securities settlement, more integration depends upon on the degree of homogeneity of financial products and markets. At this point in time, financial products within the EU can clearly not be considered homogeneous, and markets are still fragmented. Securities market products differ across countries, and market participants have different preferences, depending on their priorities and orientation. Nevertheless, market conventions and legal frameworks are starting to become more harmonised, and integration is progressing. This will further advance the centralisation of services – a trend that can already be observed.

Consolidation was difficult to achieve in the old model of vertical integration of European financial market infrastructure, as each central securities depository (CSD) was linked to the national trading platform. In order to achieve a more horizontally integrated model that transcends national borders, the tight link between trading, clearing and settlement should be loosened. It thus acts as a barrier to consolidation and rationalisation of the industry. Thus, for consolidation of CSDs to occur, independence at the level of central counterparty and settlement should be assured.

The link between stock exchanges and settlement systems is particularly strong – mainly because the national settlement body is often owned by the national stock exchange itself. The link has historically been less strong in the fixed income market, as most trades were conducted on an OTC-basis and could therefore be cleared and settled in any system. However, now that bond trading increasingly takes place on trading platforms, the consolidation of the settlement industry is becoming more of an issue in the fixed income market as well.

Fragmentation of the European clearing and settlement business increases the cost of trading and hampers pan-European asset diversification. Data show that 'external' transactions, this is transactions with another CSD system, generally are ten to twenty times more expensive than 'internal' transactions (see Table A4 in Annex 1), or 8 to 10 times higher than in the highly centralised US system. However, these data have to be interpreted with care. CSDs make a strong difference between member and non-member charges. External transactions are also inflated by the inclusion of charges at the level of the correspondent.

The structure of the CSD industry is also influenced by the way monetary policy operations are executed in the Eurosystem. The local CSD is instrumental in mobilising collateral for banks in liquidity-providing operations within the European System of Central Banks (ESCB), also on a cross-border basis. The structure that is used today, the so-called correspondent central banking model (CCBM), maintains the fragmentation of the industry, as it obliges banks to go through the local CSD, via its central bank, to mobilise collateral. Remote access to other countries' CSDs for monetary policy operations is at present not permitted, thereby restraining competition between CSDs.

A likely consequence of the growing competition and restructuring among exchanges is the loosening of their links with the clearing function and the settlement bodies. This will facilitate independence of the CSDs and may encourage further horizontal integration amongst them. In settlement, 23 European CSDs and the two ICSDs, Euroclear and Clearstream, have remained in operation.[10] In CCP clearing, 3 "silos" – Clearnet (for Euronext), London Clearing House (for LSE, Tradepoint) and Eurex Clearing – act in

[10] Clearstream is the entity that was created after the merger of Cedel and Deutsche Börse Clearing. CBISSO (IE), CAT and LdT (IT) closed; Espaclear merged with SCLV and a further merger between SCLV and CADE and the creation of Iberclear is foreseen for next year.

parallel. The US, by comparison, has three CCPs and two securities settlement systems, while it has a much more developed securities market.[11]

Proposals have been put forward for achieving further integration of the clearing and settlement industry in Europe. On the settlement side, one can distinguish three different models, although this is to a certain extent arbitrary. One aims at maintaining the existing structure of national CSDs by linking the different national systems (the "Eurolinks" model). The two others are based on an increased centralisation of services, while maintaining more (Euroclear) or less (Clearstream) of the existing national CSDs. The latter two have or are also developing their own clearinghouse. It is no coincidence that two of these models are linked to two dominant models of integration of equity markets, Euroclear with Euronext and Clearstream with the Deutsche Börse. These models are analysed below.

- ***The Eurolinks model of ECSDA***

Anticipating the increased competitive pressure on infrastructure providers, the national CSDs of the EU formed an association in 1997. The network, known as the European Central Securities Depository Association (ECSDA), proposed linking together the existing national CSDs in the Eurolinks model. It was aimed at establishing standards for linking CSDs, regardless of their participation in the association.

The Eurolinks model attempted to cater to the increased incidence of cross-border transactions that was expected to accompany the creation of the single currency. The plan was for each national CSD to build a link with every other national CSD, thereby creating a web of bilateral relationships.[12] In this model, each CSD would become a gateway into every other CSD, thereby providing a single point of entry into the European market for the national investor. For this to work, each CSD would have to have an account at every other CSD. If a home investor in this model owned foreign securities that had been issued in country A, the "home" CSD would hold these securities on behalf of the investor in an account at the CSD of country A. To illustrate: if an Italian investor owned French government bonds, his home CSD (Monte Titoli) would hold the bonds, on his behalf, in an account at the French CSD (Sicovam). The holdings of the individual investor would only be documented in the home CSD – in this example, the Italian one. The law of the issuing country would therefore govern these holdings.

The ECSDA model was motivated mainly by the desire of the national CSDs to compete with ICSDs by offering a comparable type of service for cross-border use of securities. It is not clear, however, whether cost savings will be sufficient to generate a competitive advantage over the other two models. Rather than integrating systems, the ECSDA model merely envisages linking the existing infrastructure of the individual systems together. Technical integration is therefore limited, as will be any cost savings. Even though there are market pressures to develop cheaper technology, there may be too many players and national interests to find a consensus. Furthermore, new investments are needed in order to provide facilities for cross-border transactions. This could even increase costs.

Overall, the fundamental flaw of the ECSDA model is the extreme difficulty of linking together such a large number of systems. With 23 (29 at the time the ECSDA model was conceived) CSDs in the EU, a very large number of links is necessary to create such a web of relationships. If n CSDs form a system of bi-directional links, the total number of connections will be $n(n-1)$. This means that 506 bilateral links (23*22) would theoretically be necessary to

[11] The 3 CCPs in the US are National Securities Clearing Corporation (NSCC) for equity and corporate bonds, GSCC for government bonds and OCC for options. The 2 settlement systems are Deposit Trust Company (DTC) and the Federal Reserve. DTC and NSCC are owned by the Depository Trust and Clearing Corporation (DTCC). See DTCC (2000) and Table A5 in Annex 1 for an overview of the structure of CSDs and CCPs in Europe and the US.

[12] This model is also sometimes called the "spaghetti model".

link together all the national CSDs. The progress achieved so far illustrates the problems involved. To date, only 61 links have been found to comply with ECB standards for monetary policy operations.[13] In addition, it might not be profitable to build links between some countries, for example between Portugal and Ireland. Indeed, neither of these countries (nor Greece) has a single ECB-approved link, nor is there any business justification for them to implement a network of links. This highlights the fundamental weakness of Eurolinks' approach to achieving integration, which only works if most of the existing CSDs are linked together. Moreover, a complex web of bilateral linkages is a source of operational risk in itself.

Since the "spaghetti link" has proved to be unrealistic, ECSDA has recently elaborated another more sophisticated model, called the "relayed link" model. In this model, one CSD could be connected to another CSD, using its link with a third intermediary CSD. The model can be considered as a particular case of indirect linkage where the intermediary is not a credit institution but another CSD. Relayed links are essential for the implementation of the other two models explained below. Despite these weaknesses, national interests are likely to work in favour of this model – for a while at least. As long as key elements in euro area financial products remain heterogeneous (as discussed above), national markets will continue to exist. This situation will initially favour the ECSDA model, but as integration continues, ECSDA's fortunes will undoubtedly diminish. This is already happening in fact as a result of the alliances between markets. Several ECSDA members are at the same time a member of the two other models explained below.

- ***The Euroclear integration model***

Initially, Euroclear promoted the hub and spoke model, in which national CSDs (the spokes) would be linked to a central hub (Euroclear). Over time, the model has become more complex as a result of market developments. Different models were set up in response to different national markets and the particular sensitivities of different players. In some cases, Euroclear has pursued outright mergers, whereas in others, it has continued to work with bilateral links.

Although the hub and spoke model had implicitly existed for some years, Euroclear only formally proposed to adopt it in May 1999. At that stage, Euroclear attempted to merge with Cedel in order to provide a single European hub. Cedel rejected the offer and instead merged with DBC to form the European Clearinghouse (later called Clearstream) in the same month. Euroclear then formed a strategic alliance with Sicovam, which was an important step towards a more integrated settlement landscape in the euro area. Euroclear formally merged with Sicovam on 1 January 2001. As a subsidiary of Euroclear, Sicovam, now called Euroclear France, concentrates on the settlement of equity in Euronext, while Euroclear continues to focus on debt markets. Clearnet is the clearinghouse and central counterparty of Euronext, merging the three clearinghouses of the Amsterdam, Brussels and Paris exchanges.

Initially, the process of creating these links was slow, but it has recently become more successful, but less clearly defined. Apart from its strategic alliance with Sicovam, Euroclear negotiated a merger with the Belgian CSD CIK and the Dutch Necigef, concluded a bilateral link with Italy's Monte Titoli and took over all settlement of the Irish government bond settlement CBISSO. By the end of 2000, there were four different forms of cooperation: 1) the Euroclear/Sicovam merger, with centralised settlement and deposit (not yet fully integrated); 2) the merger with CIK and Necigef, with integrated settlement but decentralised deposit; 3) the cooperation for settlement with CBISSO; and 4) the bilateral links with Monte Titoli and CREST.

[13] European Central Bank (2000) and ECB press release of 28 December 2000. There is an odd number of links, because it considers one direction only. For instance, the link from Deutsche Börse Clearing to Euroclear is not eligible, whereas the link in the reverse direction is eligible. The objective of the ECB's standards is to protect the bank from the risks in the settlement of operations. It concerns criteria on legal soundness, settlement, custody, supervision, transparency and risk management procedures.

- ***Clearstream's European clearinghouse model***

Rather than establishing links between the existing CSDs, Cedel opted from the beginning for a merger between all the national CSDs and Cedel. This would create a single European settlement platform and would remove the separation between domestic and cross-border transactions. If a CSD was reluctant to agree to an outright merger, however, it would also have the option of creating a bilateral link with Cedel.

The first, and so far only merger of this type was the one with Deutsche Börse Clearing (the CSD of Deutsche Börse). The new legal entity, Clearstream International, is 50% owned by Cedel and 50% by Deutsche Börse Clearing (DBC). At the time of its creation, Cedel and DBC argued that the European Clearinghouse would allow standardised access to all markets; establish an in-house clearing facility to enhance collateral management, borrowing and stock lending; and offer greater efficiencies via aggregation of volumes. It was estimated that the eradication of duplicated processes would save the market up to $250 million per year. Full integration of both businesses is expected by the end of 2002.

Separately, Deutsche Börse is also developing its own CCP, Eurex Clearing, based on the model that existed already in the context of the Eurex derivatives market.

The future of the different models will to a large extent be determined by the strategic decisions taken by the participants. CREST, the prime mover behind Eurolinks of ECSDA, is as large as Clearstream, which in turn is larger than the Euroclear/Sicovam Alliance. CREST and the Swiss could still play a major role in shaping the future CSD landscape by bringing together one or the other of the rival alliances with some of the undecided parties. CRESTCo acts as a clearer for Irish and UK equities of Tradepoint, a European equity trading platform, which formed an alliance with the Swiss Exchange in July 2000.

The needs of the European market

Market developments seem to favour a greater integration of services, as is suggested by developments in the stock exchange industry. It is not clear, however, whether we are heading towards a single clearing and settlement system for Europe. This may happen over time, but it might not. There is at present no consensus on what is the best and most cost-efficient solution for the European markets. The trend towards more horizontal integration is not particularly pronounced, and is confused with vertical integration at the same time, as witnessed by Euronext/Euroclear and Deutsche Börse/Clearstream. The four main user groups – the broker-dealers, the large universal banks, the global custodians and the European regional banks – have different priorities. One year ago, it seemed that they would favour a single CSD; today, they prefer to give competition free rein. These market segments are the most important shareholders of the CSDs, and will thus determine the future structure of the industry.

The European Securities Forum, a grouping of the largest investment houses and universal banks in Europe, asserts that a single integrated process for clearing and settlement of equity and debt transactions is needed to realise the efficiency gains of a single European capital market. This process should deliver: reliability, integrity and scalability; risk reduction; and lower investment and running costs. It should be based on the most appropriate technology and be capable of processing an exponential increase in the volume of transactions. The Forum insists that industry is not prepared to pay directly or indirectly for the duplication of services. To counter the problems of dominance, it argues that a specific governance system will need to be worked out. It remains to be seen, however, whether these intentions are sincerely shared by its members and whether the Forum will be able to overcome internal differences. As major owners of the CSDs, the Forum members can largely determine the future structure themselves.

At this stage, the strongest case for integration is at the level of central counterparty (CCP), probably starting for the different product groups, i.e. equities, bonds/repos and derivatives products. A single CCP that spans several markets can act as a hub among several settlement institutions and depositories. Such a CCP can reduce capital requirements for participating institutions, realise economies of scale and simplify operations across markets. Under such an arrangement, settlement can continue to take place at the level of the local CSD. In this way, national sensitivities will be taken into account. This model is promoted by London Clearinghouse (LCH), currently CCP for LSE, Tradepoint, Liffe and the commodities futures markets of the City.[14]

The crucial issues for such integrated CCPs are the membership rules, governance structure and the risk management techniques. These arrangements constitute the critical lines of defence which help the system to withstand default by important participants and ensure that the CCP does not itself become a systemic threat. Thus, the risk management and reduction safeguards operated by clearinghouses are currently the object of careful scrutiny by the central banks. Market supervisors should also be involved, but this is not easy in light of the diversity of the supervisory structure in Europe.

Competition policy authorities are equally concerned. Eligibility standards for members should cover capital, operational capabilities and trading practices, but membership should be open to all those meeting the standards. One of the problems with user-governed structures is that the major players in the markets become dominant on the managing boards of these entities and take decisions in favour of their own interests. One way to counterbalance this effect is to adopt a formal mechanism that allows each new entrant to the market to participate in the governance. Another problem, however, is pricing: the members can set the tariff structure in such a way that it maximises the monopoly rents.

II. Securities Market Regulation and Supervision in Europe

Financial market regulation can be divided into two parts: regulation of the institutions that are active in these markets, and regulation of the markets themselves. While the objectives of regulation in both cases are the same – the protection of depositors or investors and the maintenance of market stability – agreement on how to reach these goals is clearer for intermediaries than it is for markets. For intermediaries, the key issue is control of the solvency of institutions, for which globally agreed principles exist. Commonly agreed rules on a minimum solvency ratio for banks, for instance, have been in place since 1988 (the Basel Capital Accord) and are being further refined.

For securities markets, by contrast, there is less consensus on global principles to serve the objectives of regulation. The International Organisation of Securities Commissions (IOSCO) has promoted agreement on common standards for market integrity and surveillance. In September 1998, it published a paper entitled "Objectives and Principles of Securities Regulation", but the report makes little headway in defining the principles of securities market supervision. Rather, they remain vague, undefined and of a very institutional nature. Moreover, considerable latitude is left to the national regulators in interpreting these principles.

This lack of consensus reflects the divergent views that exist among regulators on the priority of principles to serve the objectives of regulation. For some, fairness and transparency predominate, whereas for others, it is efficiency and liquidity. Moreover, these principles are difficult to define. When is trading information sufficiently transparent? When is a market fair and where does one draw the line between legitimate, well informed trading and insider trading? Can efficiency and liquidity eclipse transparency? Finally, differences exist on the extent to which these principles should be mandated, or whether market participants should decide amongst themselves on the appropriate level of transparency, i.e. whether it should be implemented through regulation or self-regulation.

[14] DTCC (2000) and Burke (2000).

Another reason for the state of flux in market regulation is its scope, which is often difficult to define. Market regulation includes regulation of securities products, the issuing and trading, and the markets themselves. Through the regulation of markets, the intermediaries are also affected, as members of a market. Accounting rules also have a strong effect on the comparability of products.

1. European securities market regulation

Securities market regulation is governed by provisions that have, to a certain extent, been harmonised at European level.[15] It encompasses basic rules for disclosure of financial and non-financial information, stock exchange listing and trading conditions, markets and intermediaries, and investment products. The main EU harmonising directive regarding capital markets is the investment services directive (ISD), which sets the conditions for the single licence for investment firms and exchanges to provide services across borders in the EU. As compared to banking, the regulatory framework in securities is in urgent need of adaptation to the emerging euro capital market, which was acknowledged in the Financial Services Action Plan (European Commission, 1999).

The FSAP was the first Commission document to map out a coherent strategy for the regulation of securities markets. It proposes to radically overhaul the ISD, improve the public offerings and listing particulars directives, and institute cross-border recognition of collateral and a single accounting standard. The plan was given the highest level of political endorsement by the Lisbon European Council (March 2000), which urged its final adoption by 2005. Creation of a Committee of Wise Men in July 2000 has invested the whole project with even greater political weight.

Basic rules for issuers on capital markets

Two directives set the basic standards for issuers in capital markets, covering the minimum financial and non-financial information that must be published, and ensuring mutual recognition: i) the *listing particulars* directive, which covers the listing particulars of securities in an organised market in the EU; and ii) the *prospectus* directive, which concerns initial public offerings of securities in EU capital markets in general.

The 1980 listing particulars directive was amended in 1987 to introduce mutual recognition and in 1990, to introduce mutual recognition of public-offer prospectuses as stock exchange listing particulars.[16] In theory, one member state's approval for listing is extended mutual recognition by the others. Listing on the basis of the home country disclosure requirements, which are at least as strict as the minimum required by the directive, is to be recognised mutually.

The 1989 prospectus directive applies to debt, equity and euro securities, with many exceptions (Art. 2).[17] It defines the required content of securities prospectuses when they are offered to the public. They must contain sufficient information to enable the investor "to make an informed assessment of the assets and liabilities, financial position, profit and losses

[15] This section draws upon and was updated from the paper published by the author with the European Capital Markets Institute (ECMI), see Lannoo (1999). An overview of the different securities market directives is given in Annex 2.

[16] Council Directive 87/345 of 22 June 1987 amending Directive 80/390 co-ordinating the requirement for the drawing-up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, OJ L 185 of 4.7.1987; Council Directive 90/211 of 23 April 1990 amending directive 80/390 in respect of the mutual recognition of public-offer prospectuses as stock exchange listing particulars, OJ L 112 of 3.5.1990.

[17] Council Directive 89/298 co-ordinating the requirements for the drawing-up, scrutiny and distribution for the prospectus to be published when securities are offered to the public, OJ L 124 of 5.5.1989.

and prospects of the issuer and of the rights attaching to the transferable securities" (Art. 11). Once a prospectus is approved in one member state, it receives mutual recognition in the others. The prospectus directive allows for a 12-month validity.

The problem with the listing particulars directive is that it failed to remove many impediments to a greater integration of securities markets and left open opportunities for host countries to exercise control. The minimum disclosure standard of the directive is often too low for mutual recognition to work. It would mean that the listing particulars of less developed capital markets of the EU would have to be accepted in the more developed markets. De facto, the directive was not sufficiently comprehensive and gave member states substantial discretion to limit the liberalising effects in the implementing legislation. For example, listing particulars need to be published in the language of the host country; they may be required to carry information on the income tax system; and they cease to be valid after three months.

The utility of the prospectus directive is undermined by the fact that euro securities have been interpreted by most member states as being (euro)bonds. Furthermore, advertising rules can be restricted by the host country. More fundamentally, mutual recognition of the prospectus is sometimes simply not provided for in national law. As a consequence of these problems, the offering of equities on a pan-European basis is severely hampered. Issuers wanting to work in Euroland as a single securities market are caught in a maze of legal technicalities. There is ample room for member states to obstruct pan-European capital-raising exercises.

In response to these problems, the European Commission signalled its intention in the Financial Services Action Plan to amend the directives to allow mutual recognition to work effectively. In the response to this signal, FESCO proposed to create a genuine single European passport by increasing the disclosure standard and moving to an automatic procedure of notification to the host country of the approved prospectus (FESCO, 2000b). It would allow for the de-coupling of listing (in the sense of admission to public offer) from trading, since once a prospectus is accepted by one authority, it should automatically be recognised by other authorities for trading on any recognised regulated markets. Responsibility for vetting the content of the initial disclosure (and updated information) will reside with the home country authorities – and the home country only. Exchanges that wish to admit securities to trading will be required to verify that the initial disclosure information has been verified by a competent authority. On that basis, it will be able to determine criteria for *admission to trading* for those securities for which it wishes to provide a trading venue. Admission to trading thus becomes a commercial decision for an exchange/ATS that can now be taken independently of any requirement to monitor compliance with listing requirements. But the concept of admission to an official list will lose all its meaning.

Language should not form a barrier, since competent authorities must accept a prospectus drafted in English on grounds of mutual recognition. This may be unacceptable, however, to certain member states, such as France, which recently indicated that all prospectuses for securities for sale in France must be drafted in French. A second problem will be the proposed disclosure standard, which still awaits a more precise definition.

Stock exchange admission

As early as 1979, the Community adopted harmonised requirements for the admission of securities to official stock exchange listing. The directive specifies the conditions for admission of equity and debt securities, as well as obligations for issuers. To qualify for a stock exchange listing, a minimum of 25% of the subscribed capital of a company should be distributed to the public. When shares are admitted, companies need to extend equal treatment of shareholders, ensuring that they are able to exercise their rights and have access to all necessary information. Shareholders need to be informed of meetings and be able to exercise their right to vote. Major new developments which might lead to substantial movements in share prices, changes in share rights and the shareholding structure need to be made public as soon as possible.

The European Commission recently proposed to replace the stock exchange admission and listing directives by a single text.[18] The consolidated text makes no substantive changes to the acts in force but aims at making them simpler and more transparent. Clearly, even if this exercise was part of the earlier planned codification project, it should have been delayed to fit into the major overhaul of legislation contained the FSAP. Moreover, a separate stock exchange admission directive will no longer make any sense once a truly single passport for issuers, discussed above, is in place. The rules on stock exchange admission date from the time when exchanges were public entities. Now that most of them have become private entities, it is no longer appropriate to insist on harmonised exchange admission criteria, apart from the harmonised rules on regulated markets. Admission to stock exchange listings can better be renamed as admission to trading, which is fully in the hands of the securities exchanges. By setting their own admission to trading criteria, exchanges can differentiate and compete on the strength of their respective reputations.

Securities disclosure and trading rules

Once a stock is listed on the exchange, several directives specify the rules that must be respected concerning information that is given to the market in order to protect the investor.

i. The **insider dealing directive** of 1989 coordinates the rules governing treatment of this activity and makes it a statutory offence. Unlike the practice in the US, a charge of illegal trading is not based on breach of fiduciary trust, but on the unfair use of non-public price sensitive information, (information that would have a significant impact on the stock price, if it were to be made public). Primary insiders are prohibited from either trading or tipping, and secondary insiders are prohibited from trading, but are not subject to anti-tipping provisions. Beforehand, some member states placed no statutory restraint on insider dealing, and the regulations that did exist differed widely. As with the major holdings directive, implementation was uneven. Germany, for example, only implemented the directive in 1995, four years after the required date. One of the reasons was that Germany had no regulator to enforce the law. The competent authority, the BAWe, was only created in the same year.

ii. **Disclosure of major holdings** was made the subject of a separate directive. The directive covering the publication of information on major holdings (1988) sets minimum rules for the disclosure of information when a major shareholding in a company listed on an EU stock exchange is acquired or disposed of. Information has to be made public when the proportion of voting rights held reaches, exceeds or falls below the thresholds of 10%, 20%, 33%, 50% and 76%. It took several member states considerably more time than anticipated to implement and enforce the directive. Major German banks and insurance companies, for example, only started to reveal their holdings in 1996. The practical implementation of the major holdings directive was not satisfactory, enforcement was lax and filing of information has been uneven, impractical ("of the stone age") and incomparable across borders, for a host of reasons (Becht, 1997).[19]

iii. The **regulation of take-over bids** is, in a European context, not part of securities law, but of company law. An agreement on the take-over bids directive was reached on 21 June 1999 (formal common position on 19 June 2000) after more than ten years of discussions. This directive defines the role of supervisory authorities during a take-over

[18] Proposal for a directive of the EP and of the Council on the admission of securities to official stock listing and on information to be published on those securities, COM(2000)126 final of 20.07.2000. The directive is 117 pages long.

[19] See also annex 3 by Marco Becht.

bid, the equivalence of treatment of shareholders and the information that must be communicated to them, the transparency of the operation and the permissible defensive measures. To ensure equal treatment for all shareholders, it is required that a bidder who acquires a certain percentage of the voting rights of a company has to make a mandatory bid for all the voting stock. The draft only establishes some general principles that need to be implemented in national law, in line with national practice. Also the ability of the management of the targeted company to take defensive action once a bid has been launched is limited, unless prior authorisation of the general meeting of shareholders is obtained for this purpose during the period of the acceptance of the offer.[20] Implementation is required by 2005, if the measure is adopted following the procedure of conciliation between the EU Council and the European Parliament.

Appropriate disclosure to shareholders is also required under other EU company law directives, such as the first and second company law directives.

The regulation of intermediaries and markets in the ISD

The investment services directive (ISD) harmonises the minimum authorisation requirements for securities firms and sets the basic conditions for a securities market to be recognised as a "regulated market".

General provisions regarding securities firms concern initial capital requirements, the governance of the firm and its rules of conduct. The latter rules are very broadly defined in Art. 11 of the ISD. It requires that firms act honestly, with due care and diligence, while making adequate disclosure, in the best interest of its clients and the integrity of the market. Firms need to try to avoid conflicts of interest in the different functions they exercise, and when they cannot be avoided, to ensure that their clients are fairly treated. Compliance with these rules needs to be checked by the supervisors of the country where the service is provided. Host country member states can ask foreign firms to provide information regarding compliance with the local rules (Art. 19). Investment firms need to report all trades in shares, bonds and derivative instruments carried out on regulated markets to the competent authorities. The relevant files on all transactions must be kept for five years. Minimum capital requirements for these firms are defined in the capital adequacy directive (CAD).

The second freedom introduced by the directive is the freedom of an organised trading system, classified as a "regulated market", to offer remote access from another member state. The directive says that a member state must allow the regulated market of other member states to provide "appropriate facilities" within its territories, to give investment firms the freedoms of the directive (Art. 15.4). These facilities are screens by which an operator can have remote access to a market of another EU country. According to the directive, a regulated market is a market that:

i. functions regularly;

ii. is governed by regulations on operation, as approved by the authorities and on access, as set out in the 1979 directive on the conditions for official stock exchange listing (79/279/EEC) – which means that member states could require that an exchange can only trade in the shares that it lists as well; and

iii. complies with rules on reporting and transparency of trades as set by the directive (Art. 1.13) and fleshed out in Arts. 20 and 21.

The freedoms of the directive are thus only granted to markets that comply with these requirements. A first list of regulated markets was published in the EU's Official Journal (OJ C 203, 1997). Updates followed in December 1998 (COM(1998)780) and May 1999 (OJ C

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20 See EU Internal Market Council minutes and Commission memo on "Take-Overs Directive – Questions and Answers", 18 June 1999, memo/99/35.

151, 1999). It comprises all securities and derivatives markets of the EU. Some member states have also included their primary dealer markets.

Even if the harmonisation of the structure of securities markets was not part of the original Commission draft (1989), the concept of regulated markets emerged during the Council discussions. Regulated markets were contrasted with over-the-counter transactions (OTC), whereby the former were characterised by the principles of transparency, fairness and security; and the latter by the opposite, including fragmentation and reduced liquidity. The directive thus incorporates provisions to mandate that transactions are carried out on a regulated market (the "concentration" provision, Art. 14.3). To ensure liquidity and guarantee transparency, regulated markets need to respect rules on regular publication of prices and volumes (the "transparency" provision, Art. 21). The latter are narrowly defined, requiring publication at the end of each hour's trading in the market of the weighted average price and the volume, and every 20 minutes, the weighted average price and the highest and lowest prices. Exceptions apply for large (block) transactions of shares. They were incorporated to secure the approval of the UK, which, under the influence of institutional investors, insisted more on efficiency and liquidity than on transparency in securities transactions.[21]

As seen from the perspective of investment firms, the ISD has worked fairly well, if one considers only the number of firms that have made use of the single passport. In Italy, Sweden and Belgium, for example, there have been over 800 notifications for cross-border provision of services (European Commission, 2000b; see also Figure A1a and A1b in Annex 1). The main problem has been the application of conduct of business rules (Art. 11) in cross-border business, where investment firms may be subject to home and host country rules as a result of an unclear drafting of the directive. The directive says that compliance with conduct of business rules is the responsibility of the member state "in which a service is provided", which can either be the home or host country. An investment firm wishing to make use of the single licence may thus be required to comply with 15 sets of rules on conduct of business. This has also been applied to cross-border business with professional investors, although a special provision special provision for the latter is foreseen in Art. 11.3.

To clarify this special provision, FESCO proposed a waiver for certain conduct-of-business rules for professional investors. But FESCO does not address the question of whose rules will be applicable, the home or the host, implying that a total harmonisation of conduct-of-business rules is feasible, which seems fairly illusory at the present time. Secondly, the FESCO categorisation still leaves open certain questions, since some groups of investors, such as firms, holding companies, etc. will only be considered as professional *upon request*, subject to the discretion of national authorities.[22]

In its Communication on the subject, the European Commission has stated that the professional nature of the investor should not be seen as conditional on the prior harmonisation of the content of the conduct-of-business protection. It affirms that investment services provided to professional investors could be governed exclusively by the conduct-of-business rules in force in the country of the service provider ("home country") without prior harmonisation. But the paper follows, for the time being, the FESCO categorisation of professional investors, which, it adds, should be extended over time (European Commission, 2000c).

Also as regards markets, the ISD has functioned well, and has led to strong competition between financial centres. Investment firms have made extensive use of their rights to become remote member of a regulated market. The concentration rule (Art. 14.3) has been applied in at least four member states (Spain, France, Italy and Portugal), while another protectionist

[21] See Steil (1996, pp. 113-137) for further details on the directive and the negotiations resulting in the compromise.

[22] "FESCO agrees on a European definition of professional investors", press release of 15 March 2000, and FESCO (2000).

device of the directive, the possibility that member states may be able to restrict the establishment of new markets on their territory (Art. 15.5), has not been applied. The main problem is the lack of consistent application of the (albeit loose) definition of regulated markets by the authorities as regards ATS. FESCO has come forward with a proposal in its paper on ATS, but it is too early to judge its merits.

As regards access to clearing and settlements systems, certain provisions of the ISD have not yet been used, but they are becoming more important in view of market developments. Art. 15.1 stipulates that authorised investment firms can have remote access to clearing and settlement systems. In view of developments in the industry, discussed above, remote access is vital for allowing the reconfiguration to happen. This may however require a consistent interpretation of the ISD in national legislation (Franke et al., 2000). It may at the same time go against the ECB's policy to forbid remote access of banks to CSDs for monetary policy operations.

It is important to note that fairly substantial comitology procedures are foreseen in Art. 29 of the ISD, pending the adoption of a Securities Committee (see below). It concerns, inter alia, the clarification of definitions in order to ensure uniform application of the directive and to take account of market developments.

Protection for small investors is provided in the investor compensation schemes directive, which has been made obligatory (Directive 97/7/EC), following the same approach as the deposit protection directive.

The regulation of unit trusts

Free provision of unit trusts was instituted by the 1985 UCITS directive (undertakings for collective investment in transferable securities), which sets minimum standards to allow for a single licence for the sale of UCITS throughout the Community. Member states that apply more stringent standards may not forbid the sale on their territory of UCITS that are authorised in another member state. The directive sets out harmonised rules for the composition, management and investment of UCITS as well as information requirements. National marketing and tax rules do not fall within the scope of this directive. They remain under host country control, which means that UCITS must still comply with national regulations in that respect. The directive has been widely applied and has led to substantive cross-border competition in the provision of unit trusts. It has also allowed financial institutions to concentrate their back-office functions of unit trusts for the whole of the EU in certain financial centres. Luxembourg provides an excellent example of this phenomenon.

Two draft amendments, which were proposed by the European Commission in 1998 and are under consideration in the EU Council and Parliament, extend the single licence to companies managing UCITS and the types of funds that can be considered as UCITS. The first draft harmonises the prudential rules for companies managing funds and allows cross-border management of funds with a single licence, thus taking a step forward towards an EU-wide fund market. The second allows new forms of UCITS, such as funds investing in bank deposits and other liquid financial assets. A political agreement was reached on the latter on 17 October 2000. Progress is expected on the former by March 2001.

Comparability of the disclosed information

The European Commission recently clarified its position regarding International Accounting Standards (IAS). EU listed firms will be required to prepare consolidated accounts in accordance with IAS from 2005 onwards. The financial information currently published by companies listed in the EU is not sufficiently comparable to amount to a single market of financial information. The EU's accounting directives (fourth and seventh company law directives) did not go far enough in their harmonisation as a result of many implementation options and differences in interpretation. The move to IAS, combined with its growing international acceptance, should have a big impact on European capital markets.

The Commission proposal for a regulation will be submitted in 2001 and will enter into force by 2005 at the latest, assuming that it moves rapidly through the legislative process. The member states would have a transition period of no more than three years to introduce the IAS requirement after the adoption of the measure by the EU. In order to provide legal certainty on the standards that will be used in the EU, the legislative proposal will also establish an endorsement mechanism with a two-tier structure – consisting of a technical level and a political level – at EU level to verify that IAS respond to EU public policy concerns.

At present, only 275 EU companies apply IAS. The goal is to increase this number to encompass the 7000 EU listed companies by 2005. This transition period is necessary in order to give the accounting profession and companies adequate time to prepare themselves. By 2005, the market situation will also have become clearer. IOSCO will continue to look into the acceptability of IAS for multinational securities listings. It is expected that some of the remaining obstacles will have been removed by then so that EU companies applying IAS would face fewer difficulties when entering the US capital market.

It has often been argued, certainly from a US perspective, that IAS would be inferior to US GAAP (generally accepted accounting principles), implying that only the latter should be acceptable for quotation on US markets. Recent research by Christian Leuz (2000), however, found no significant difference in the quality of information produced by the two standards. Leuz' research was based on a comparison of the bid and ask spreads and trading volume of German Neuer Markt-quoted firms using either US GAAP or IAS, assuming that an imbalance, or "information asymmetry", with regard to the firms' financial performance would be reflected in higher spreads and reduced liquidity.

The Lamfalussy group

The FSAP was apparently not enough, or the consensus on the measures to be taken for an integrated capital market was not fully there, for the French Presidency of the EU Council took the initiative to constitute a Committee of Wise Men to discuss the regulation of European securities markets. On 17 July 2000, the Council of Finance Ministers of the EU agreed with the mandate and composition of a group chaired by Alexandre Lamfalussy, a former central banker, to follow-up the action plan. Its task was to:

- Assess the current *conditions for implementation* of the regulation of securities markets in the EU, mentioning specifically that the Commission remains in charge of the FSAP, but with a 2003 deadline;
- Assess what changes are necessary in the *mechanism for regulating securities markets* in view of market developments (alliances among exchanges, ATS); and
- Propose *scenarios for adapting current practices in supervision* to arrive at greater convergence.

The British government was firmly against the creation of the Wise Men's group, and tried until the last minute to block it. From the beginning, the initiative was seen in the City as an attempt by France to create a European SEC. Melanie Johnson, an Economic Secretary to the Treasury, represented the UK at the Ecofin Council on the 17 July and tried in vain to have a paper on the FSAP adopted by the Ministers to accelerate the implementation date to 2004, rather than agreeing to the creation of the Wise Men's group. The UK's opposition to a European SEC should be kept in mind when evaluating the final outcome of the Wise Men's group.

The group published an initial report on 9 November 2000 and released its final report on 15 February 2001. The Committee urged adoption of a coordinated plan to realise the full benefits of the single European capital market. It argued, however, that implementation of such a plan within the normal European legislative process would prove far too slow and complex and called therefore for political support at the highest levels of new "fast track" procedures. These would consist of framework legislation, broad implementing powers for a new EU Securities Committee, strengthened cooperation between national regulators and stronger enforcement (the "four levels", see box below). In combination, these steps should allow the Financial Services Action Plan (FSAP) for securities markets to come into force in 2004.

Box 1. Four levels of EU securities market regulation proposed in the Lamfalussy report

1. *Broad framework principles* of securities market regulation agreed by normal EU procedures (framework legislation). This could be the subject of a Council resolution to allow fast track procedures. Legislation could be adopted in the form of regulations under EU law, to improve transparency, speed and accuracy of implementation.

2. *An EU Securities Committee*, to be created, decides on technical implementation. It is composed of high-level representatives of the member states and the European Commission. An *EU Securities Regulators Committee* makes suggestions to the Securities Committee via the European Commission on the language for comitology and to fill out the detail that have been delegated by directives (note FESCO is performing part of this task today). They can be asked to implement supervisory practice constantly, or to agree on supervisory practice not covered by the directives. They could meet under different constellations, i.e. they are composed by whoever is competent for the issue under discussion. The Regulators Committee needs to consult market practitioners. The European Parliament will be fully informed about the Committees' decisions and can pass a resolution in case implementing powers are exceeded.

3. *Framework of enhanced cooperation and networking* between regulators in the EU Securities Regulators Committee to ensure consistent and equivalent transposition of levels 1 and 2 legislation.

4. *Strengthened enforcement of EU law* through more vigorous action by the European Commission (infringements).

The EU Securities Group, as envisaged by Lamfalussy, could be considered an embryonic SEC. With framework legislation, the powers of interpretation and implementation of the laws by the Securities Committee will be very large indeed, probably to an extent that does not exist in any other EU member state, but only in the US. Moreover, the Committee will vote by qualified majority, with the votes weighted on the same basis as the votes in the EU Council. The UK may thus have lost a battle, but not necessarily the whole fight.

To realise these objectives, the Lamfalussy Committee recommended that the Stockholm European Council (March 2001) should invoke a special European Council Resolution – similar to the one used to establish the 1997 Growth and Stability Pact – to ensure that the essential elements of the regulatory proposals are delivered by 2003. If this deadline is not met, a full review of the proposed structure will be required, involving possibly a Treaty change, "including the creation of a single EU regulatory authority for financial services" (Lamfalussy, 2000, p. 26 and Lamfalussy, 2001, p. 41).

2. European securities markets supervision

European securities markets are fairly heterogeneous in their supervisory structure and thus do not lend themselves to an easy comparison. Substantive differences exist in the institutional structure of supervision, the division between regulation and self-regulation, the reach of the securities market regulator and the powers of legal interpretation and enforcement. These differences work against any efforts to elicit cooperation among European supervisory authorities.

The national structure

Most local securities market authorities are of a fairly or very recent origin, in marked contrast to the US SEC, which was created in 1935. Initiatives by the EU have been an important stimulus in the creation of securities market supervisory bodies, certainly in those countries that had no regulator before. The 1979 directive on the conditions for admission of securities to the official stock exchange listing (79/279/EEC) required member states to designate which national authority or authorities were considered competent to decide on the admission of securities and to ensure that the directive was applied. These authorities are expected to cooperate and to exchange information. A second wave of directives followed in the mid-1980s with the unit trusts directive. A third round followed in the early 1990s, which again insisted on the need for adequate authorisation and supervision. But it took some countries, e.g. Germany and the Netherlands, until well after this third wave to establish their own supervisor.

The core roles of the securities market supervisors in Europe are quite comparable across borders. In most countries, they are in charge of supervising the markets, intermediaries and prospectuses. A few monitor the quality of accounting standards. But the institutional set-up, the dividing line between self-regulation and statutory regulation, and the rule-making powers of the supervisors differ in important respects. In seven EU countries, securities markets supervision is carried out by a separate institution and in three, it is integrated with banking supervision (Belgium, Luxembourg, Finland); in three others, it is part of a single authority (Denmark, Sweden, United Kingdom). In Austria, it is the responsibility of a government department and in Ireland, of the Central Bank.

First-line supervision of markets is in the hands of the stock exchange in Belgium, Ireland and, until recently, the UK. This also includes the control of insider trading and market manipulation. In Germany, the states (Länder) are in charge of supervising the markets and the brokers (Kursmakler), whereas the securities commission (BAWe) controls insider trading and ad hoc disclosure. The BAWe was created to implement matters of EU directives that were not regulated by national law, but considerable self-regulatory powers remain in the hands of the stock exchange. In some countries, authorisation of issues is in the hands of the stock exchange alone (Austria, Germany, Luxembourg, the Netherlands and Switzerland). In France, the main supervisory agent is the Commission des Operations en Bourse (COB), but it shares some responsibilities with the Conseil des Marchés financiers (CMF), a self-regulatory body, responsible for supervising market transactions, and the Commission bancaire, the bank watchdog, which supplies prudential supervision of brokers. This structure is currently under review, and CMF will be merged with the COB.

The control of clearing and settlement systems is mostly done by the local central bank, often in cooperation with the securities commission, but generalisations are again difficult to make. One can nevertheless say, however, that control of clearing and settlement of government debt markets is exercised by the central bank and the equity and private bond markets by the securities commission. In cases where a single supervisory authority is in place, it also looks after the clearing and settlement systems.

European supervisory cooperation

European cooperation in securities market regulation was initiated by the early efforts at EU regulation in this area, but has recently been stepped up with the creation of FESCO. A formal high-level Securities Committee is not in place, however, which means that almost all modifications of directives have to go through the formal legal procedure for amendments, and that a "comitology" procedure cannot be used.[23]

Two committees for regular consultation have been in place for a long time. One covers the listing and prospectus directives, and the other, the UCITS directive. Formally, however, their mandate is restricted to the scope of the directive under which each was created. And their comitology powers are restricted to minor elements of the directives. In the area of banking and insurance, by contrast, single regulatory committees with comitology powers have been in place for a long time. Proposals to create a more high-level Securities Committee in the

[23] "Comitology" refers to the delegation of implementing powers by the EU Council to the Commission for the execution of EU legislation. The procedure is regarded with some suspicion on the grounds that it lacks accountability.

context of the ISD and CAD failed because of deep divergences between the EU Council and the European Parliament on the issue of implementing powers, which persist even today.[24]

At the bilateral level, the European directives have created the framework for the exchange of information between authorities, and memoranda of understanding between the different national commissions are in place. Memoranda for exchange of information are also in place between stock exchanges.

Apart from these Contact Committees, a High-Level Committee of Securities Market Supervisors has been in place since 1985. This informal committee meets two to three times a year at the initiative of the European Commission and discusses regulatory and supervisory matters. It does however not possess "comitology" powers.

To overcome the lack of cooperation, the member states of the European Economic Area (EEA)[25] decided in December 1997 to create FESCO. The aim of FESCO is to enhance the exchange of information between the national securities commissions; to provide the broadest possible mutual assistance to strengthen market surveillance and effective enforcement against abuse; to ensure uniform implementation of EU directives; and to develop common regulatory standards in areas that are not harmonised by European directives. Each FESCO member is committed to implementing these standards in its home jurisdiction. Despite its recent creation, FESCO has rapidly gained wide recognition and support for its work. Concern has been expressed, however, that FESCO does not sufficiently consult with the market before publishing its standards.

The FSAP says that cooperation between securities supervisors has been improved through the creation of FESCO, but "the option of a single authority to oversee securities markets supervision may emerge as a meaningful proposition in the light of changing market reality" (European Commission, 1999). The Lamfalussy report on the other hand says that a European SEC is out of the question for the time being (Lamfalussy Group, 2000, p. 26), but proposed a four-layered structure, discussed above, that would be centered around framework legislation and a high-profile EU Securities Committee. In our view, a European SEC is not particularly desirable, since some degree of competition between jurisdictions can do no harm (Lannoo, 1999).

III. The Needs of a Single European Capital Market

1. The prerequisites of strong securities markets

The essential prerequisites are two: disclosure and enforcement. Well performing securities markets depend upon a complex set of laws and institutions that give investors good a) information about the value of a company's business, and b) confidence that the company's insiders won't cheat its investors (Black, 2000). A critical barrier that needs to be overcome is the asymmetric levels of information existing between the issuers of securities and the investors. Laws and institutions must ensure that credible information is delivered to investors, and that issuers receive a honest price for their shares or bonds.

An important role is being played by intermediaries – accounting firms, investment banks, law firms and stock exchanges – which put their reputation at stake to ensure the dissemination of information of the highest quality. These intermediaries will suffer a loss of reputation if they support a bad security on the market. A second tier of intermediaries consist of the investment and pension funds, which provide market demand for securities, and the

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[24] See Lannoo (1999) for a more elaborate description of the role of committees in EU securities market regulation and Lannoo (2000) for an overview of the supervisory set-up at EU level.

[25] Comprising the 15 EU member states takes plus Norway, Iceland and Liechtenstein. The EEA is a common economic area, which applies the EU Internal Market rules in full, including a common jurisdiction.

financial press. The intermediaries are controlled by government and self-regulatory organisations (SROs). The latter can be subdivided into voluntary (professional organisations) and mandatory (SROs mandated and controlled by government) organisations. Legal rules make intermediaries liable for faulty information. Table 3 presents this structure schematically.

Table 3. The different layers of securities market regulation

1. Issuers	Equity and debt securities
2. Reputational intermediaries	Accounting firms, investment banks, law firms and stock exchanges Investment funds, pension funds, financial press
3. Self-regulatory organisations	Professional federations Standard setters Exchanges
4. Government institutions	Securities Commission Courts
5. Laws	Securities laws Company laws Bankruptcy laws

This structure is highly complex and will require years before it is put in place. It requires five layers of institutions to work efficiently. Bad functioning by one element of a layer affects the whole chain. Formal rules are only a start. There are then the institutions and enforcement, which is the "more difficult task", including direct public enforcement, and indirect enforcement through the reputational intermediaries (Black, 2000, p. 17).

Compared to the US, which has a long history of securities regulation and a central securities regulator, Europe has some harmonised rules, but they are badly in need of updating and amendment. Its institutions are young or very young, and enforcement (and comprehensive policy management) is in its infancy. Europe needs to accomplish in a few years what the US has achieved in more than 50 years.[26] The task for emerging markets is even more complex, which explains why it is easier for the latter to develop bank-intermediated financing in the first place, requiring as it does a less complicated institutional and regulatory set-up. It also implies that there is a huge task in educating issuers and investors in capital markets about their obligations and rights.

Black sees limited room for "piggy-backing" on the reputation of foreign countries. The whole set-up is difficult to transpose, in as much as the functioning and reputation of the entire structure comes into play. The best run system will have the cheapest costs for raising capital. Regulatory competition should thus increase standards.

[26] As remarked by Alexandre Lamfalussy at the CEPS Roundtable Discussion on the Wise Men's Report, 29 November 2000 (see Annex 4 for an agenda of the meeting).

2. Regulatory matters

What kind of regulation?

The preceding discussion highlights two key elements in the European debate: the role of self-regulation, and regulatory competition. Since reputation plays a crucial role, self-regulation plays an important role in the whole set-up and fosters competition between jurisdictions. An important task of policy-makers is thus to promote self-regulation, and allow the markets to work out the solutions. Policy-makers should also be aware that complete harmonisation is not the optimal solution, but that regulatory competition should help in working out the best regime.

What kind of legislation?

The Lamfalussy mandate to examine the mechanism for regulating securities markets clearly hints at this question, which can be posed in terms of two options:

1) As is the case with most other segments of the internal market, should EU securities markets continue to be regulated principally through *directives*, that is, EU legislative instruments that are only binding as to the results to be achieved, but leave precise implementation to the member state, and, if so, what should these directives cover?

   or

2) Is more direct legislation necessary through *regulations*, that is, legal instruments that are directly applicable in all member states in their entirety, without requiring local implementation?

As compared to directives, regulations have the advantage of achieving faster action, in a more direct way, and they reduce legal uncertainty. In general, regulations are very detailed and therefore unsuitable for framework legislation. A regulation requires, however, that the European Union has strong competences in the field concerned: Is there a legal basis in the EU Treaty for the use of regulations in the area of securities markets? It also assumes that there is an urgent need to take this particular line of action, since it is generally considered less “democratic”, i.e. there is no second step of implementation through national legislation at member state level. Neither condition fully obtains in the case of securities markets.

An additional element that would make it difficult to work through regulations is the wide diversity of supervisory structures in the member states, discussed above. A regulation on securities markets would pre-suppose that all the structures for supervising securities markets in the member states are the same. Another disadvantage is that they may lead to longer negotiations, since they are immediately binding in the member states.

One of the reasons why regulations have re-emerged as a more feasible form of legislation is that directives have become so detailed that they are no longer directives. A directive, according to the EU Treaty, leaves the choice of form and methods for transposition to the national authorities. As a result of negotiations and political compromises, however, directives have become so detailed that they have become very difficult to work with and create legal uncertainty. Hence, the call for more “framework” directives.

Framework directives are no panacea either, however. Despite the best of initial intentions to keep them simple, the legislation often becomes more complex as a result of difficult deliberations with the member states in the EU Council or in the European Parliament. Furthermore, framework legislation is sometimes undermined by poor implementation at the national level. It therefore requires stronger cooperation between regulators. Today, none of the EU securities market legislation is of the framework type, with the exception of the takeover bids directive, which is close to being adopted (apart from being considered company law legislation).

The most important thing is that all the parties involved in the decision process are fully aware of the importance of the matter, and are prepared to act rapidly to allow the regulatory framework to be put in place rapidly. It is in this sense important that the major parties involved in the decision process, the European Parliament and the member states in the EU Council, are well informed early on about the importance of the regulatory package, and the need to have it in place on time. A prime example is the e-commerce directive, which was adopted by the European Parliament after one reading, since there was a broad awareness of the need to have the regulatory framework for this domain in place as soon as possible.

The home country or country of origin rule

The investment services directive (ISD) currently provides that the member state "in which" the services are provided has responsibility for the implementation of, and supervision of compliance with, conduct-of-business rules. Many member states treat this rule as entitling them to apply their conduct of business rules to a bank or investment firm providing cross-border services from an establishment in another member state solely on the grounds that the services are being provided to their residents (i.e. a "country-of-destination" approach). This is the case even though the state from which the services are provided (whether that be the firm's home state or a state in which the firm is operating from a branch) will also require the firm to comply with its own conduct-of-business rules in relation to the same business. This obliges financial services firms to comply with overlapping and often conflicting conduct-of-business rules, which constitute a major impediment to cross-border provision of services.

Adopting a "home state" approach to the application of conduct-of-business and marketing rules might seem to resolve this problem. A firm would only have to comply with one set of these rules in relation to all its business, namely those applying in its home state, i.e. the country in which its head office is established. However, this approach does not adequately address the treatment of branches. Where a firm provides services from a branch establishment in a state other than its home state, it is more appropriate for the authorities in the state in which the branch is established (rather than the authorities of the home state) to apply, and supervise compliance with, their conduct-of-business and marketing rules in relation to services provided from the branch (whether to local residents in that country or on a cross-border basis to residents of another member state). This approach recognises the practical reality of the management and supervision of branch establishments, provides competitive equality between services provided from establishments in the same state and is in line with the approach taken in the e-commerce directive. The latter assigns responsibility for supervision of these kinds of rules to the country from which the services are provided (i.e. the "country-of-origin" approach). One of two tests can be applied to identify the country of origin: place of establishment, where the operator pursues an economic activity through a fixed establishment (branch), or the test of the centre of activity.

Adopting a country-of-origin approach in the ISD would not undermine the role of the home state in relation to prudential matters. The home state would continue to be responsible for authorising the firm, as a whole, and supervising its compliance with regulatory capital and other prudential requirements. In this sense, the strict application of the home country control principle is crucial in ensuring that an institution is well supervised and that final consolidated monitoring takes place.

Derogation from the country-of-origin approach should be strictly limited to cases where it is necessary to provide local residents with the protection of the rules of their own country. This is the case in relation to some consumer protection rules applicable to services provided to unsophisticated individual consumers.

This approach is not just limited to conduct-of-business and marketing rules, but also for other rules, such as market abuse and insider trading.

Updating the regulatory framework

- **Revision of the ISD**

The investment services directive (ISD) came into being after long discussions in the early 1990s, a repetition of which would best be avoided. A radical overhaul, as proposed by the European Commission (European Commission, 2000b), would lead to long and protracted discussions that would create unnecessary uncertainty and would not guarantee a better outcome. There is no consensus in the market on what this radical overhaul should lead to, and there is at present no full understanding of all the issues at stake. The markets and market infrastructure are also in rapid transformation, meaning that a review risks being outdated by the time it comes into place. At this stage, the liberalising effects of the directive could be strengthened through *limited revisions* of the most striking problems:

1) The directive should make clear that *professional investors are subject to country-of-origin conduct-of-business and marketing rules only* when trading on a cross-border basis (Art. 11). FESCO has raised the possibility of applying a waiver for the application of certain conduct-of-business rules to professional investors. But this should not be seen as a condition for the prior harmonisation of the content of the conduct-of-business protection. Full harmonisation of conduct-of-business rules is at this stage an impossible task. Account must also be taken of the fact that conduct-of-business regimes in all member states already offer sufficient and comparable protection to professional investors, even if they may differ in practical implementation. Moreover, the definition of professional investors in the FESCO paper is inadequate at this stage, since a certain category will only be considered "professional" if they demand an "opt-up", subject to the discretion of national authorities. For unsophisticated retail investors, it cannot be assumed that they can assess the implications of another state's rules outside their own state of residence.

2) As far as regulated markets is concerned, *listing and trading should be decoupled*, and the reference to the listing directive in the definition of regulated markets removed. Art. 1.13 specifies that a "regulated market" must satisfy the requirements of the admission to official listing directive (79/297). Strictly applied, this means that an exchange has to be active in the listing business, in the sense of admission to public offer and the application of the ensuing disclosure obligations, as a pre-condition for trading. "Listing" of securities in conformance with basic standards was held to be one of the key features of a "regulated market", and acquisition of a single passport could therefore be made dependent on it (ESFRC, 2000). However, it dates from the time when exchanges were considered public entities. Maintaining the ambiguity could be used as a device to keep ATS (Alternative Trading Systems) out of the national territory and to protect the local exchange. It also causes problems for the exchange alliances today, as the listing of a firm falls under the home rules of one member of the alliance, which should be accepted for trading on other member exchanges. Moreover, the fundamental review of the prospectus and listing directives should make this reference superfluous.

3) *Other protectionist devices of the directive should be scrapped*, such as the concentration rule (Art. 14.3), the capability of member states to restrict the establishment of new markets on their territory (Art. 15.5) or the exemption of primary dealer markets (Art. 2.4). Art. 15.5 states that the definition of regulated markets "shall not affect the Member States' right to authorise or prohibit the creation of new markets within their territories". This could be used as a loophole by member states to hinder access for new trading platforms, and should therefore be removed.

On the other hand, the regulatory issues raised by the emergence of ATSs do not necessarily require a change to the ISD, but only a consistent and coordinated approach by the supervisory authorities, as proposed in the FESCO paper on the subject. An ATS should be licensed as an investment firm under the ISD. If they meet the criteria of a regulated market, they can be an exchange. This coordinated approach is however lacking today, since the ATS, in casu Euro-MTS, is licensed as a regulated market in certain markets, but as broker dealers in others. The same consistent and coordinated approach is needed for the implementation of the remote access provision to centralised settlement depositories (CSDs) in Art. 15.1 of the ISD.

- **A thorough harmonisation of the prospectus and listing directives**

The forthcoming review of the directives, foreseen in the FSAP, needs to be sufficiently far-reaching; otherwise mutual recognition will not work. Harmonisation of minimum disclosure standards will need to be extensive in order to foster investors' and issuers' trust in a European capital market as a whole, and not only in some of its constituent markets. The re-design should include or replace all the directives in the field: the prospectus and listing directives (80/390 and 89/298) and its successive amendments, and the stock exchange admission directive (79/279).

The recent proposal by FESCO ("A European passport for issuers") for an enhanced disclosure standard and automatic notification to host country authorities is exactly what is needed, but it leaves many questions unanswered. The disclosure standard needs to be defined and filled in, and it will have to be seen whether automatic notification will work, not least because of the language issue. However, it will do much more at this stage for the integration of European capital markets than would a radical overhaul of the ISD, as proposed in the FSAP, and thus is a greater priority.

Box 2. Mutual recognition of listings in Euronext

Euronext operates with three regulatory access points, making it possible for each of the three different home financial centres to continue to use their local primary market for listing companies. The listing requirements should be harmonised to such an extent, as will the ongoing information requirements applying to listed companies, that Euronext will operate as a single integrated market for all listed securities. Each listed security enters the market via a specific market (Belgium, the Netherlands or France), but once listed, the securities will be accessible to all members of Euronext, regardless of the nationality of the issuer or the member. The point of entry is therefore irrelevant, at least according to Euronext.

By choosing their entry point, they will automatically choose their preferred home market and home jurisdiction, being Belgium, France or the Netherlands. A listing via one of these three gateways will provide entry to the same integrated trading platform, but at the same time will provide the listed company with the benefit of its jurisdiction of choice. The supervisory authorities in the countries in question will conclude a Memorandum of Understanding to ensure full mutual recognition of listings. Progress on the "European Passport" for issuers should be very helpful in this respect.

However, the jurisdiction in which the listing agreement is concluded (Belgium, the Netherlands or France) is relevant for reporting by Euronext's market surveillance department to regulators of any irregularities in trading in the securities issued by a company (in particular in the event of suspected insider trading or market manipulation). The country of primary listing will determine which regulator has to be alerted.

Source: Euronext and national supervisory authorities.

3. The institutional structure

The need for more convergence in the institutional structure of supervision

More conformity in the responsibilities and powers of securities market regulators is required to allow greater market integration and a level playing field. Today, the responsibilities and powers of securities market regulators vary greatly, which has the effect of fragmenting markets and hampering cooperation among supervisory authorities. This is especially notable for the listing authority, whose housing under the same roof as the exchange is increasingly inappropriate. The listing function of an exchange, which comprises the admission to public offer and the ensuing continuous disclosure obligations, dates from the time when exchanges were a public good and quasi-monopolistic. Now that most of them have been privatised and compete for blue chips, the listing function should be transferred to the supervisory authorities, or to authorities independent of the exchange, but controlled by the supervisors. The most striking example of the conflict of interest inherent in maintaining both functions under the same roof is Deutsche Börse, which supervised its own listing![27] Can Deutsche Börse be expected to enforce its own disclosure as a listed firm? In the long run, a single capital market should have a limited number of competitive listing authorities. This does not mean, however, that exchanges cannot differentiate in their conditions for admission to trading.

The UK has set an example in this respect with the move of the admission to listing function from the London Stock Exchange to the Financial Services Authority (FSA). Although this was apparently done for competitive reasons, to be able to attract NASDAQ to London, it demonstrates that it need not represent a big loss for the exchanges. The modest fees earned from admission to listing can be replaced by admission to trading.[28] The consequence, however, is that it transfers the obligation to disclose financial information from the exchange to the listing authority. The creation of a European Edgar, discussed below, should help to fulfil this function efficiently.

Another anomaly in this respect is the control of insider trading, which in certain countries is exercised by the exchange.

Heterogeneity of the structure of securities market supervision renders cooperation at European level very difficult. The EU Securities Regulators Committee, as proposed by the Lamfalussy report, will be composed of 50 different competent authorities, depending on the particular set of issues on the agenda.

Creation of a Securities Committee with regulatory powers

The demand for faster changes to financial legislation should be met through the creation of an EU Securities Committee, which would have the power to adapt elements of EU securities market regulations or directives (comitology). This proposition is now commonly accepted, after it was formally proposed in the first interim report of the Lamfalussy Committee. It does, however, raise three immediate issues, on which there is less consensus: How rapidly can the committee be set up? How will accountability be assured? Who will sit on the committee?

Under current legislation, the powers of the two existing EU securities committees, described above, are very limited, and the one foreseen under the ISD, which would also have had limited powers, was never created. Thus, establishment of the powerful EU Securities Committee as proposed by the Group of Wise Men will require changes to all pieces of EU securities market legislation, or the Securities Committee legislation will need to modify all existing pieces of legislation. Neither step will be easy, and either will require a strong consensus at all the levels of the policy process to have it adopted within a reasonable time span. The earliest date by which it could be in place is early 2003.

However, comitology immediately raises suspicions within the European Parliament, and while this body may agree on exceptions for securities markets regulation, it will be afraid of creating a dangerous precedent for other areas of policy. The Lamfalussy report proposed that the European Parliament would by fully informed about the Securities Committee on the basis

[27] The only other comparable example is the Australian exchange, for whose admission to listing this function was provisionally transferred to the Australian SEC.

[28] The only exception is Luxembourg, where listing fees are a major part of the income of the exchange.

of regular reporting (as would be the case for the EU Regulators Committee), and that it can enact resolutions, but this does not seem to provide an immediate solution. More broadly, concerns have also been raised on how the market will be consulted by the Securities Committee, and how transparent the decision making of the Committee will be.

As regards composition, our preference is to constitute the Committee essentially by heads of securities commissions, eventually assisted or empowered by Ministry of Finance officials. Also the sister committees in banking (BAC) and insurance (IC), which have comitology powers, are composed of supervisors. A committee composed of high-level Ministry of Finance officials, as envisaged in the Lamfalussy report, will not work, simply because these people do not have the necessary experience to decide rapidly on these matters. It would also allow the elimination of one layer of the highly bureaucratic structure proposed by Lamfalussy. In this sense, the Securities Committee would interact directly with FESCO and its different committees, replacing the intermediate Regulators Committee.

To respond to concerns regarding accountability, an intermediate and immediate possibility is the creation of a Securities Committee as foreseen under the Article 29 of the ISD. Such Committee would already have important powers, as foreseen under the directive, but would in first instance raise less suspicions from the European Parliament. This Committee could gradually start to play a more central role for other directives, in the new directives and amendments to existing ones, as confidence in its role and procedures grows.

Reinforcement of FESCO

Three years after its creation, FESCO has already achieved a great deal, but is clear that its structure and personnel base need to be reinforced in order to allow it become a fully independent body. FESCO needs to expand its secretariat and acquire the means to interact more actively with the market and to launch wide consultations on its proposed standards. National securities commissions should also make more reference to their affiliation and cooperation with FESCO, to show markets and investors that market integration, also at the level of the supervisors, is becoming a fact. Something should also be done to involve Switzerland in the work of FESCO.

FESCO should interact directly with the proposed Securities Committee and act as the Regulators Committee of the Lamfalussy report. It would be a waste of time and energy to create a new committee, if a well functioning structure with the same mandate is already in place. On the other hand, the European Commission itself cannot manage the Regulators Committee in its different constellations. It has neither the expertise nor the means to do so. This can better be done within the existing FESCO structure.

Stimulate cooperation and competition between self-regulatory bodies

Self-regulatory organisations play and will continue to play an important role in ensuring quality and enforcement of securities markets regulation. Stronger cooperation amongst them is an important building block in strengthening the overall functioning of EU securities markets. It can improve standards of disclosure and enforcement by setting benchmarks of best practice. At the same time, different bodies must be in place to stimulate a competitive standard improving process.

Strengthened disclosure through a European "EDGAR"

Now that there will be greater comparability in accounts of European firms as a result of the proposed move to adopt International Accounting Standards (IAS), the creation of an electronic European business register, modelled on the SEC's EDGAR (electronic data-gathering analysis and retrieval) system, should be envisaged. Through EDGAR, the US capital markets have access to very accurate corporate financial and non-financial information. Information available on EDGAR has been accepted by the US SEC. Instituting a comparable mandatory electronic filing system in Europe would strongly enhance the integration of European capital markets.

A European EDGAR will also be required to allow the automatic notification system, as foreseen under the "European passport for issuers", to work effectively. Rather than having a system in which all authorities notify each other on a *bilateral* basis of the approved prospectus of an issue, such information could be amalgamated on a *multilateral* basis in a European data-base. This would thus provide a single point of entry for authorities, as well as for issuers and investors.[29]

Issues raised by the consolidation of clearing and settlement systems

The rapid consolidation of and linkages between clearing and settlement systems requires adaptations at the supervisory level. Today, the supervisory structure of clearing and settlement systems is very diverse, with many different bodies in charge of supervision following different practices. The question thus emerges whether this structure is still adequate. Euroclear and Clearstream are supervised by the regulators of the country in which they are based, i.e. by the National Bank of Belgium[30] and the Banque Centrale du Luxembourg respectively (see Table A5 in Annex I for an overview). Their increasing linkages with other European CSDs and the rise in cross-border activity means that this level of surveillance may no longer be adequate. With growing cross-border business, there is an exponential rise in transactions. Several systems are processing a multiple of the volumes they were designed to handle.

Against this background, it may be timely to give initial consideration to:

- Core operating principles for clearing systems (building on work by the International Securities Services Association (ISSA)).
- Strengthening the European dimension to prudential supervision of clearinghouses through reinforced cooperation in the Eurosystem.
- Providing for greater input from securities markets supervisors in the ongoing supervision of these systems, given the dramatic consequences of any clearing failure for conditions in the markets.

Closer involvement of the ECB raises a sensitive issue, however. By statute, the ECB has only a very limited role in ensuring financial supervision and stability, which remains the competence of the member states. This division of labour can only be changed by formal unanimous decision by the EU Council, on a proposal from the Commission under Art. 105.6 of the EU Treaty. What can be done at this stage, however, is to promote awareness of the possible problems raised by growing inter-linkages and the growth of business, and to create a cooperative structure at ESCB level to allow central banks to be mutually informed of the risks they are exposed to in supervising CSDs. Securities supervisors should also be involved in these cooperative efforts.

Moreover, policy-makers should consider to what extent the fragmentation of CSDs in Europe is actually maintained by the current structure of the Eurosystem. As outlined in Section I, the system of decentralised execution of monetary policy maintains fragmentation and protects the national CSDs. Allowing remote access by banks to host country CSDs would reinforce competition and strengthen European-wide consolidation.

[29] The proposal by Marco Becht for a European disclosure authority is a variant of this, see annex 3.

[30] Euroclear used to be supervised by the New York Fed and the State of New York Banking Department while it was managed by Morgan Guarantee Trust Company of New York. Since the introduction of the euro, it has been subject to the oversight of the National Bank of Belgium, as it changed its legal status to a cooperative bank under Belgian law.

The maintenance of a framework for competitive securities markets on all levels: Trading platforms, clearing, settlement and custody

The rationalisation and reconfiguration of the existing securities markets infrastructure should be closely monitored by competition policy authorities to maintain a competitive environment. Trading platforms are not networks but rather firms specialised in making markets. Open competition between them is required, since this is the environment that has made most European exchanges fully electronic and competitive. Clearing and settlement systems could more easily be considered as networks, or natural monopolies, but no consensus exists on the desirability of a single European system at this stage. Two other issues are of immediate concern: membership criteria and governance structure. Access to these market facilities should be open and based on transparent criteria, especially when the system is user-owned. The governance structure should not discriminate against smaller market players and allow new entrants to participate. Mechanisms should be put in place to review the pricing structure on a regular basis.

Attention should be paid to prevent excessive vertical integration and concentration, which could lead to abuse of dominant position. Today’s integration of securities markets is characterised by a combination of horizontal and vertical integration.

Strengthened consumer protection through informal redress procedures at national level

Non-professional retail investors will continue to be subject to *their* home country consumer protection provisions. To help market integration and facilitate consumer confidence at European level, the European Commission should recommend member states to create self-regulatory or informal mechanisms to settle disputes between providers and users of investment services. A key element to make such dispute settlement commissions work is the duty of care: the obligation of providers to respond to complaints.

IV. Conclusions and Outlook

Europe has historically had a strongly bank-based financial system. The foundation for a more market-based system is being laid, but there is much yet to be done and the challenges are complex. Markets with highly different traditions and institutions need to be integrated to create a more integrated European capital market – a level playing field, as was so often urged in the early days of the single market. At the same time, a huge effort is needed to educate issuers and investors in capital markets about their obligations and rights. Well functioning capital markets require a careful balancing act between the many parties involved: lawmakers, supervisors, self-regulatory organisations, market intermediaries, issuers and investors. The development of a mature market-based financial system in Europe will depend on the degree to which all these different parties fully assume their role, compete and cooperate.

This report is based on the proposition that securities market regulation is essentially about ensuring disclosure and enforcement. With that aim in mind, we suggest attention be given to the following priorities:

- A substantial redrafting of the directives covering securities prospectuses, listing particulars and admission to stock exchange listing and their replacement by a single text covering the admission to public offer and the procedure of continuous enforcement of disclosure rules by the authorities and the markets.
- The institution of a high-level Securities Committee with the powers to adapt elements of EU securities directives. Such a Committee should play an important role in ensuring uniform implementation of the directives and their adaptation to market developments.
- Limited amendments to the key investment services directive to strengthen its liberalising effects and ensure more consistent application.

- Stronger enforcement of securities market legislation by the European Commission and the supervisory authorities, but also by market intermediaries.
- Creation of an integrated system to strengthen disclosure and dissemination of corporate financial and non-financial information.

Europe is deeply engaged in an ambitious project to enlarge eastwards. Although most of the accession candidates have a functioning securities market and are well advanced in implementing the *acquis communautaire*, their financial systems are still strongly bank-based and the level of market development is well below EU levels. These countries face an enormous deepening of securities markets in Western Europe, and will be confronted, most likely just before accession, with important adaptations and simplifications in the regulatory framework. Candidate member states should be informed as soon as possible about the possible evolutions in the EU regulatory framework, to reduce the approximation work and allow them to make the necessary adjustments before accession.

Technology and innovation will continue to have an enormous impact on the state of securities markets, which makes it difficult to foresee how markets will look like in a decade or so. This needs to be taken into account in Community legislation and in the current process of revising the regulatory framework. European competition policy authorities will have to closely monitor new market models as they emerge to ensure that they respect the needs of an open and efficient market.

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Annexes

Annex 1. Statistics

Table A1. Listed companies, domestic and foreign

	1995	1996	1997	1998	1999
BXS Brussels Exchanges (B)	288	291	263	276	268
Copenhagen Stock Exchanges Ltd. (DK)	252	249	249	254	242
Deutsche Börse AG (D)[a]	678	681	700	741	851
Athens Stock Exchange (GR)	186	217	220	229	879
Bolsa de Madrid (E)	366	361	388	486	727
Parisbourse SBF SA (F)	904	873	862	962	1144
Irish Stock Exchange (IRL)	62	71	87	101	103
Borsa ItalianaSpA (I)	254	248	239	243	270
Luxembourg Stock Exchange (L)	284	278	284	277	277
Amsterdam Exchanges N.V. (NL)	433	433	350	359	387
Wiener Börse AG (AU)	133	129	137	128	114
Lisbon Stock Exchange (P)	0	158	148	135	125
Helsinki Exchanges (SF)	73	71	126	131	150
OM Stockholm Exchange (SW)	223	229	253	276	300
London Stock Exchange (GB)	2265	2868	2991	2920	2274
EU11 exchanges[b]	2732	2769	2845	3106	3888
EU15 exchanges[b]	5343	5779	6004	6251	6952
SWX Swiss Exchange (CH)	216	436	428	425	412
Oslo Stock Exchange (N)	151	172	217	236	215
Tokyo Stock Exchange (JP)	1714	1833	1865	1890	1935
NYSE	1996	2476	2626	2669	3025
NASDAQ	4717	5556	5487	5010	4829

[a] Sums exclude foreign listed companies for each year except 1999.

[b] Sums exclude foreign listed companies.

Source: FIBV (2000).

Table A2. Exchange statistics, end 1999

	Domestic market capitalisation		**Value of equity trading**		**Turnover velocity of domestic shares**
	€m	% GDP	Domestic, €m	Foreign, €m	%
BXS Brussels Exchanges (B)	186,139	81	50,746	4,596	27
Copenhagen Stock Exchanges Ltd. (DK)	105,021	64	59,730	543	57
Deutsche Börse AG (D)	1,428,873	72	1,305,484	167,345	91
Athens Stock Exchange (GR)	203,756	174	180,189	0	88
Bolsa de Madrid (E)	429,909	73	653,326	1,405	152
Parisbourse SBF SA (F)	1,499,495	107	721,942	8,764	48
Irish Stock Exchange (IRL)	68,815	73	46,721	0	68
Borsa ItalianaSpA (I)	726,566	64	507,637	3,356	70
Luxembourg Stock Exchange (L)	33,995	182	1,308	322	4
Amsterdam Exchanges N.V. (NL)	693,597	177	443,669	2,782	64
Wiener Börse AG (AU)	32,947	16	11,786	152	36
Lisbon Stock Exchange (P)	67,991	62	38,196	0	56
Helsinki Exchanges (SF)	348,590	272	104,824	20	30
OM Stockholm Exchange (SW)	372,523	155	209,615	64,044	56
London Stock Exchange (GB)	2,947,756	196	1,369,663	1,843,428	46
EU11 exchanges	5,516,917	87	3,885,640	188,740	70
EU15 exchanges	9,145,973	109	5,704,836	2,096,755	62
SWX Swiss Exchange (CH)	678,105	279	504,924	26,197	74
Oslo Stock Exchange (N)	63,386	47	51,170	2,792	81
Tokyo Stock Exchange (JP)	4,406,873	107	1,764,606	737	40
NYSE	11,316,288	132	8,665,805	686,637	77
NASDAQ	5,147,992	60	10,657,591	349,145	207

Notes: Listed companies include main and parallel markets; listed companies and market capitalisation do not include investment trusts, listed unit trusts and UCITS. The turnover figures are only indicative within certain stock exchanges and therefore cannot be used as a reliable basis of comparison between different countries.

Source: FIBV (2000); FESE (2000).

Table A3. Trading fees on main European exchanges

Country averages	**Price[a]**	**Commission[b]**	**Fees[c]**	**Mkt impact[d]**	**Total[e]**
NYSE	$39.79	13.70	0.53	10.32	24.55
France	$90.32	21.76	1.51	1.60	24.87
Japan - sells	$22.82	15.90	2.36	7.35	25.61
Japan - buys	$16.53	15.06	0.04	11.83	26.93
Belgium	$67.61	18.07	1.92	7.91	27.90
US - amer	$59.30	5.80	0.00	22.20	28.00
Netherlands	$41.53	20.99	1.23	6.21	28.43
Germany	$69.79	21.57	1.17	5.99	28.73
UK - sells	$8.51	16.78	0.48	13.24	30.50
Sweden	$21.33	22.33	0.57	8.56	31.46
US - otc	$40.62	2.44	0.40	30.44	33.28
Italy	$5.56	22.32	1.12	10.72	34.16
New Zealand	$2.63	30.17	0.10	5.07	35.34
Switzerland	$494.57	20.74	4.41	11.36	36.51
Canada	$20.73	18.35	0.00	21.56	39.91
Finland	$40.70	24.30	1.02	15.40	40.72
Denmark	$69.74	24.14	0.91	16.01	41.06
Spain	$20.96	24.35	1.28	16.65	42.28
Austria	$66.38	35.65	2.36	4.66	42.67
Portugal	$33.49	24.99	4.87	12.82	42.68
UK - buys	$8.61	18.10	48.43	4.61	71.14
Czech Republic	$13.83	39.94	11.72	19.55	71.21
Hungary	$18.09	48.03	7.02	16.58	71.63
Ireland	$9.47	21.15	41.86	8.86	71.87
Greece	$32.22	44.70	17.49	25.11	87.30
Luxembourg	$15.68	7.50	0.00	94.78	102,28
Total – 46[f]	$28.93	12.58	3.32	8.90	24.80

[a] Average price of stocks on exchange (US$)

[b] Average commission costs (e.g. broker, asset manager etc.) (basis points).

[c] Average fee (basis points).

[d] Average market impact, as measured by the spread in basis points from the benchmark (either volume-weighted average price or average price).

[e] Total costs of trade execution (basis points).

[f] Including other exchanges in countries outside Europe, e.g. Hong Kong, Brazil and South Africa. Total 46 countries.

Source: Elkins/McSherry Global Universe (2000).

Table A4. Settlement fees of Clearstream International
(per unit rates, in USD per settled transaction)

	Debt		Equities	
	Internal	External	Internal	External
Austria	1.25	35.00	4.50	35.00
Belgium	1.25	8.00	4.50	8.00
Denmark	1.25	21.00	4.50	25.00
Finland	1.25	30.00	4.50	40.00
France	1.25	25.00	4.50	25.00
Germany	1.25	8.00	4.50	8.00
Ireland	1.25	30.00	4.50	-
Italy	1.25	25.00	4.50	25.00
Netherlands	1.25	25.00	4.50	25.00
Portugal	1.25	15.00	4.50	45.00
Spain	1.25	12.00	4.50	30.00
Greece	1.25	60.00	4.50	100.00
Norway	1.25	25.00	4.50	75.00
Sweden	1.25	35.00	4.50	35.00
Switzerland	1.25	25.00	4.50	45.00
UK	1.25	10.00	4.50	-
Japan	1.25	25.00	4.50	22.00
US	1.25	10.00	4.50	5.00
AVERAGE	1.25	23.56	4.50	49.88

Note : 'Internal' means Clearstream to Clearstream, 'external' is a trade between a Clearstream customer and a non-customer located in that market. Rates within Euroclear are comparable.

Source: Danthine (2000).

Table A5. Distribution of competences in securities market regulation and supervision

	Approval of prospectus	Control and surveillance of markets	Control of intermediaries and UCITS	Control of clearing and settlement systems (CSDs)	Surveillance of takeovers
B	SC	SE/SC	SC	CB/SC	SC
DK	Securities Council/SE	Securities Council/SE	FSA	FSA	Securities Council
DE	SE	Länder/SE/SC	SC/BS	BS	
EL	SE/SC	SC	SC	CB	
E	SC	SC	SC	CB/SC	SC
F	SC	CMF/SC	BS/SC	CB/CMF/MoF	CMF/SC
I	SC/SE	SC/SE	SC/CB	CB/SC	SC
IRL	Gov	SE/CB	CB	CB/MoF	
L	SE	SC	SC	CB	
NL	SE	SC/SE	SC	CB/SC	
AU	SE	SC	SC/MoF	MoF	Take-Over Commission
P	SC	SC	SC	CB/SC	SC
SF	FSA	FSA	FSA	FSA/CB	FSA
SW	FSA/SE	FSA/SE	FSA	FSA	SE/Take-over Council
UK	FSA	FSA	FSA	CB/FSA	Take-over Panel
CH	SE	SE/SC	SC	CB	Swiss Take-over Board/SC
US	SC/CFTC/SE	SC/CFTC/SE	SC/CFTC	CB	States/SEC

Notes: SC = securities commission; SE = stock exchange; FSA= integrated financial sector supervisor; CB = central bank; BS = banking supervisor; MoF = Ministry of Finance. In case two bodies are mentioned for a certain function, they are given in order of importance. In Germany, the states (Länder) are in charge of supervising the stock exchanges and intermediaries. The French Conseil des Marchés Financiers (CMF) is a self-regulatory body. In the US, the derivatives markets are supervised by the CFTC (Commodirties and Futures Trade Commission).

Source: Adapted and updated from Lannoo (1999) on the basis of information obtained from task force members and other sources; for clearing and settlement systems, see Stadler and Lannoo (2000).

Table A6. Clearing and settlement organisations in the member states and the US

Market	Securities	Clearinghouse	CCP	CSD
Amsterdam SE (Euronext)	E	Effectenclearing	Effectenclearing (Clearnet after Euronext merger)	NECIGEF (Euroclear)
Brussels SE (Euronext)	E	CIK	Clearnet (after Euronext merger)	CIK (Euroclear)
Copenhagen SE	E	VP		VP
Deutsche SE	E/C/G	Clearstream		Clearstream
EOE (Euronext) Amsterdam	D	Effectenclearing (clearnet after Euronext merger)	Effectenclearing (Clearnet after Euronext merger)	
Eurex	D	Eurex Clearing	Eurex Clearing	
Euronext Paris, Amsterdam, Brussels	E/D/G	Clearnet	Clearnet	Euroclear
European Sovereign Debt OTC Repo Market	R	RepoClear (LCH)	RepoClear (LCH)	
London SE	E/C	CREST	LCH (from 26/2/2000)	CREST
LIFFE	D	LCH	LCH	
Madrid SE	E/C	SCLV		SCLV
Matif (Euronext)	D	Clearnet	Clearnet	
Oslo SE	E/C	VPS		VPS
Stockholm SE	E	VPC		VPC
Tradepoint	E/C	LCH	LCH	CREST/Euroclear/ Clearstream
Vienna SE	E/C/G	OeKB		OeKB
New York SE	E/C/G	NSCC	NSCC	DTC
NASDAQ	E/C	NSCC	NSCC	DTC
US Govt. Bonds, Treasuries (New York)	G	GSCC	GSCC	Federal Reserve

Key: C = Corporate Bonds; D = Derivatives; E = Equities; G = Government Bonds; R = Repos.
Note: US electronic communications networks (ECNs) and automated trading systems (ATSs) have their trades cleared through NSCC in a manner similar to the NYSE, NASDAQ and AMEX.

Source: Updated and adapted from DTCC (2000).

Figure A1a. Incoming service providers notified under Art. 18 ISD

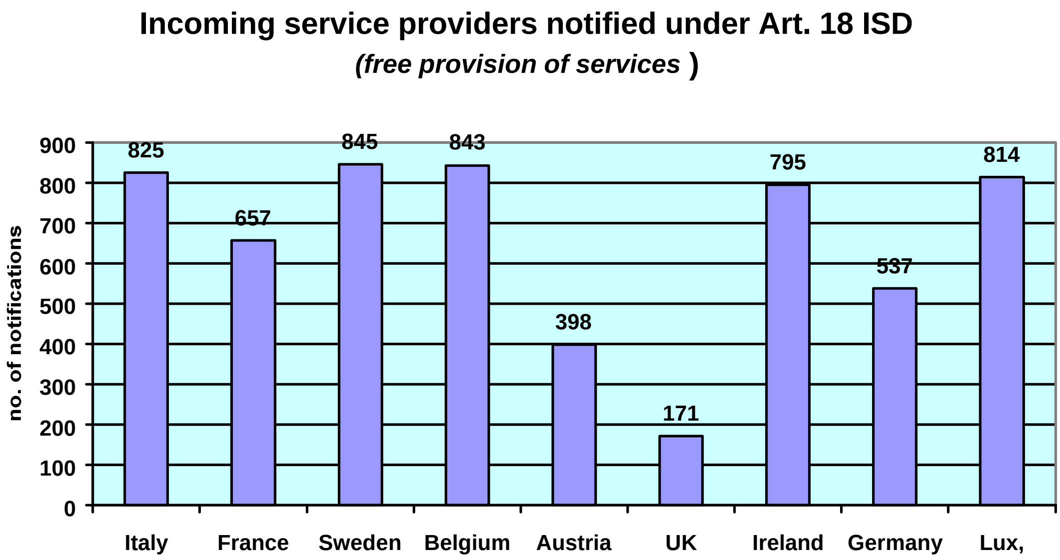
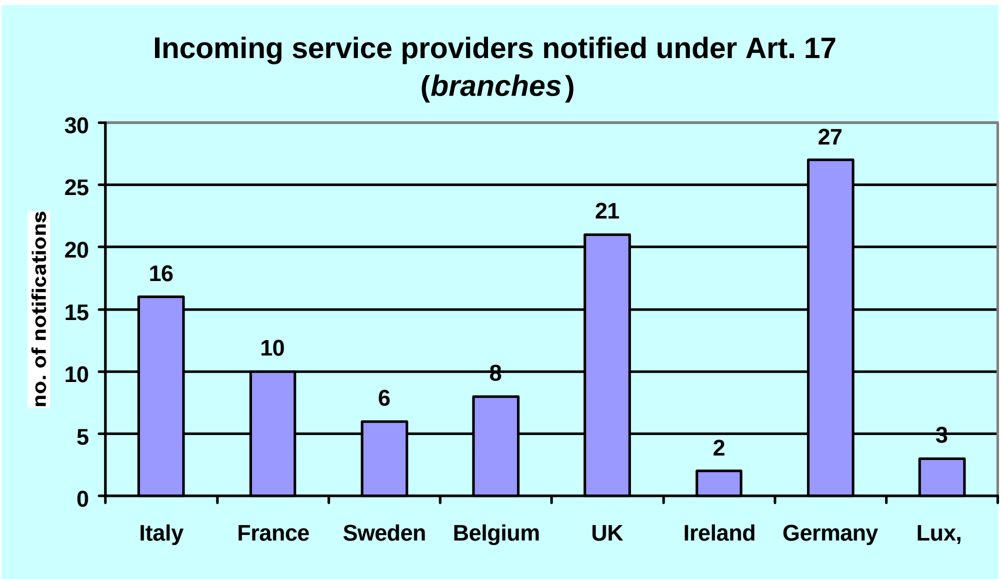


Figure A1b. Incoming service providers notified under Art. 17



Annex 2. Investment services: EU regulatory framework

The basic measure in the domain of investment service is the investment services directive (ISD), which defines the modalities for the free provision of investment services in the EU for brokers and securities markets. The ISD refers to the capital adequacy directive, which sets capital ratios for investment services firms, and for the trading books of banks. The investor compensation schemes directive introduces a minimum level of protection for (retail) clients of investment firms.

- **Investment services (ISD)**: Council Directive 93/6 of 10 May 1993 on investment services in the securities field, OJ L 141 of 11 June 1993.
- **Capital adequacy (CAD)**: Council Directive 93/22 of 15 March 1993 on the capital adequacy of investment firms and credit institutions, OJ L 141 of 11 June 1993; **Value at Risk amendments (CAD II):** Directive 98/31/EC, Official Journal L 204 , 21/07/1998.
- **Investor compensation schemes**: Directive 97/7/EC of the Council and the European Parliament on investor compensation schemes, OJ L 84 of 26.3.1997.

A second series of measures relates to the functioning of capital markets and exchanges, and sets minimum rules regarding particulars to be disclosed for stock exchange listings and initial public offerings, to allow for mutual recognition. Other directives make insider trading a statutory offence, require firms to disclose major holdings to the market, and contain harmonised procedures for takeovers.

- **Listing particulars:** Directive 80/390 coordinating the requirements for the drawing-up, scrutiny, and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, OJ L 100 of 17.4.80; amended in Council Directive 87/345 of 22 June 1987, OJ L 185 of 4.7.1987, and in the "Eurolist" amendments, Council Directive 94/18/EC, OJ L 135 of 31.5.1994.
- **Prospectus for public offerings of securities**: Council Directive 89/298 coordinating the requirements for the drawing-up, scrutiny and distribution for the prospectus to be published when securities are offered to the public, OJ L 124 of 5.5.1989.
- **Mutual recognition of public-offer prospectuses**: Council Directive 90/211 of 23 April 1990 amending directive 80/390 in respect of the mutual recognition of public-offer prospectuses as stock exchange listing particulars, OJ L 112 of 3.5.1990.
- **Stock exchange admission**: Council directive of 79/279/EEC coordinating the conditions for the admission of securities to official stock exchange listing, OJ L 66 of 16.3.1979.
- **Regulation of insider trading:** Council Directive 89/592 coordinating regulations on insider trading, OJ L 334 of 18.11.1989.
- **Publication of information on major holdings:** Council Directive 88/627 on the information to be published when a major holding in a listed company is acquired or disposed of, OJ L 348 of 17.12.1988.
- **Takeover bids:** Draft 13th company law directive concerning takeover bids, COM(95)655 of 07.02.1996.

The directives on stock exchange admission, listing particulars and major holdings were recently codified in a single directive, as part of the codification and simplification of Community directives (Proposal for a directive of the EP and of the Council on the admission of securities to official stock listing and on information to be published on those securities, COM(2000)126 final of 20.07.2000).

A final series of measures allows for the cross-border sale of unit trusts or collective investment undertakings in the EU. Two proposed amendments extend the scope of unit trusts and harmonise basic rules for the management of unit trusts.

- **Collective investment undertakings (UCITS):** Council Directive 85/611 on the coordination of laws relating to undertakings for collective investment in transferable securities, OJ L 375 of 31.12.1985; Council Directive 88/220 amending directive 85/611 relating to undertakings for collective investment in transferable securities, OJ L 100 of 19.04.1988.

- **UCITS Amendment 2**: Proposal for a European Parliament and Council Directive amending directive 85/611 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses, COM (1998) 451 of 17.07.1998.

- **UCITS Amendment 1**: Proposal for a European Parliament and Council Directive amending directive 85/611 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), COM(1998) 449 of 17.07.1998.

One "horizontal" directive also affects securities market supervision, especially the cooperation among authorities. It was enacted on the basis of the lessons drawn from the failure of the BCCI bank.

- **BCCI follow-up directive:** European Parliament and Council Directive 95/26/EC amending Directives 77/780/EEC and 89/646/EEC in the field of credit institutions, Directives 73/239/EEC and 92/49/EEC in the field of non-life insurance, Directives 79/267/EEC and 92/96/EEC in the field of life assurance, Directive 93/22/EEC in the field of investment firms, and Directive 85/611 in the field of undertakings for collective investment in transferable securities (UCITS), with a view to reinforcing prudential supervision, OJ L 168 of 18.7.95.

Annex 3. European Disclosure for the New Millennium
by Marco Becht[*]

Imagine a system that is easy to use, easy to file into and compatible with off-the-shelf word processing packages. Imagine a system that could accept graphics, tables and charts. Imagine a system in which John and Jane Q. Public could access a complete library of disclosure material in their home as easily as the most highly paid Wall Street analysts.

How do we get there? What is the best, the fastest, the cheapest way of providing that service? It is now possible to let in the light at almost the speed of light. Your ideas and your suggestions will help us attain that goal.'

Arthur Levitt, Chairman of the Securities and Exchange Commission, Opening Statement at the EDGAR Technology Conference, Washington, D.C. on 14 August 1995

The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market.

Treaty establishing the European Community, Art. 94 (ex Art. 100)

Disclosure is widely recognised as a crucial prerequisite for the functioning of equity markets. A disclosure system for stock markets that seek to attract listings and investors from the European Union as a whole must provide useful, accurate and timely information, irrespective of geographic location in a language investors understand. The system must be efficient and adaptable to changing needs. In this note I argue that our current systems do not meet these requirements.

In terms of content, European disclosure is inadequate. Shareholders are invited to appoint board members without knowing their experience or background. Shareholders vote on stock option plans without knowing the level of basic remuneration and the details of the plan. Related party transactions are often carried out in the dark.

In terms of working, we operate 15 disclosure systems based on company law that are combined with 15 systems of securities regulation, more than 15 stock market rulebooks and 11 languages. Most systems are enshrined in inflexible laws that prescribe paper filing in obscure places. The securities commissions are mere executors of the letter of the law and do not have the autonomy to create and adapt their system according to the needs of companies, stock markets and investors.

I propose to abolish paper filing, to scale down the disclosure requirements for listed companies based on company law, to replace and enhance them with securities regulation, to create a European disclosure authority, to make this authority only accountable to the European Parliament and to allow the authority to formulate standards and to design forms.

[*] ECARES, Université Libre de Bruxelles. This personal view was first presented at a meeting of the CEPS Task Force on 7 December 1999, and a revised version was subsequently presented at the Siena Conference on Company Law and Capital Market Law, 27 October 2000. The author is grateful to Marco Pagano and the other participants at the Siena conference for comments and suggestions.

Otherwise, in the new Millennium European markets will continue to lack pan-European disclosure standards or, (fortunately) *de facto* European standards will be set on other shores.

Where Europe falls short

The disclosure provisions in current European directives fall well short of international standards.

1. US SEC Form 20-F is becoming the *de facto* disclosure standard for European bluechips, particularly its non-financial disclosure sections. Form 20-F implements Section 12 of the 1934 Securities Exchange Act and requires any issuer of a security to file a detailed application with an exchange containing all relevant corporate financial and non-financial information.[31]
2. The IOSCO standard on the disclosure of non-financial information in cross-listings (IDSs) is imposing a standard at the level of the US SEC's Form 20-F on cross-listings with non-EU countries more generally.[i] Under the standard, EU registered companies listing in Poland comply with higher disclosure standards than companies with a cross-border listing inside the Union (at least as long as Poland does not join Union).
3. As a rule, shareholders are not provided with the equivalent of a proxy statement. Agendas of annual meetings are published in accordance with company law and (typically) do not explain the items shareholders are supposed to vote on.[ii]
4. Crucial items are virtually absent from European non-financial disclosure standards, for example the ownership of cash-flow rights, detailed group and control structures, board remuneration, stock options, related party transactions, conflicts of interest and anti-takeover provisions.

Why the existing European Directives do not work

1. Many Directives are the result of accidents, not of careful planning (e.g. the Large Holdings Directive, 88/627/EEC).
2. Directives are not the appropriate legal instruments for implementing disclosure regulation. The process from proposal (by the European Commission) over adoption to implementation is too slow and reform is even slower. European securities regulation should use the same instruments as merger regulation – Regulations, not Directives.
3. Unlike the U.S. SEC, most competent authorities in Europe do not have the power to make rules and create forms (like Form 20-F, 10K, 14A etc. in the United States).
4. The existing systems mainly rely on company registers. This is impractical, slow and expensive.

    4.1 Company register filings must be made on paper;

    4.2 Access to hard copies is often difficult and/or expensive, despite the provision that "a copy of the whole or any part of the documents or particulars (…) must be obtainable by application in writing at a price not exceeding the administrative cost thereof" (68/151/EEC, Art. 3-3);

    4.3. Access at administrative cost only applies to hard copies. The fees for electronic access can be much higher;

    4.4. In some countries company registers discriminate against users from other Member States; for example, the Dutch registers levy a surcharge of NLG15 when ordering documents from another EU country; the Spanish electronic register

[31] See http://www.law.uc.edu/CCL/34forms/form20-F.html, selected forms prescribed under the Securities Exchange Act of 1934

(www.registradores.org) requires a Spanish fiscal code (NIF) for credit card purchases.[iii]

4.5. For electronic access, the register often does not guarantee the accuracy of the retrieved information;

4.6. In many countries, there are too many registers (e.g. in Germany with ~720);

4.7. Most company web-sites do not display the company register name, place and registration number.

4.8. Company stationery does not have to provide the address, telephone number or e-mail address of the company register.

5. Most Member States have opted to implement paper-filing systems that favour selected local financial newspapers. These papers are often expensive and they are not necessarily circulated throughout the Union.
6. Many documents are filed in a language investors at large and regulators do not readily understand.

6.1. Company law provides for disclosure in the official language(s) at the place of incorporation;

6.2. Securities regulation provides for disclosure "in the official language or languages, or in one of the official languages, or in another language provided that in the member state in question the official language or languages or such other language is or are customary in the sphere of finance and accepted by the competent authorities" (79/279/EEC, 88/627/EEC, 82/121/EEC)

7. Enforcement is too lax because the regulators and market authorities have to waste too much time with administrating paper filings.
8. If the Investment Services Directive worked as intended, disclosure and supervision chaos would result. For example, a German registered company is listed on a Greek market but not on a German market. Its company law driven disclosure must be in German while its securities regulation driven disclosure must be in Greek. The German documents could be filed in the register of the city of *Giessen*, the Greek disclosure is filed in a Greek newspaper. Good news is published voluntarily on Bloomberg or Yahoo! in English. The competent authority for the Greek disclosure is the *Bundesaufsichtsamt für den Wertpapierhandel* in Frankfurt. The market makers could sit in France and Italy and most of the trading comes from an online broker in the Netherlands, with clients from all over the World. The French, Italian and Dutch authorities would supervise them respectively.

Electronic filing

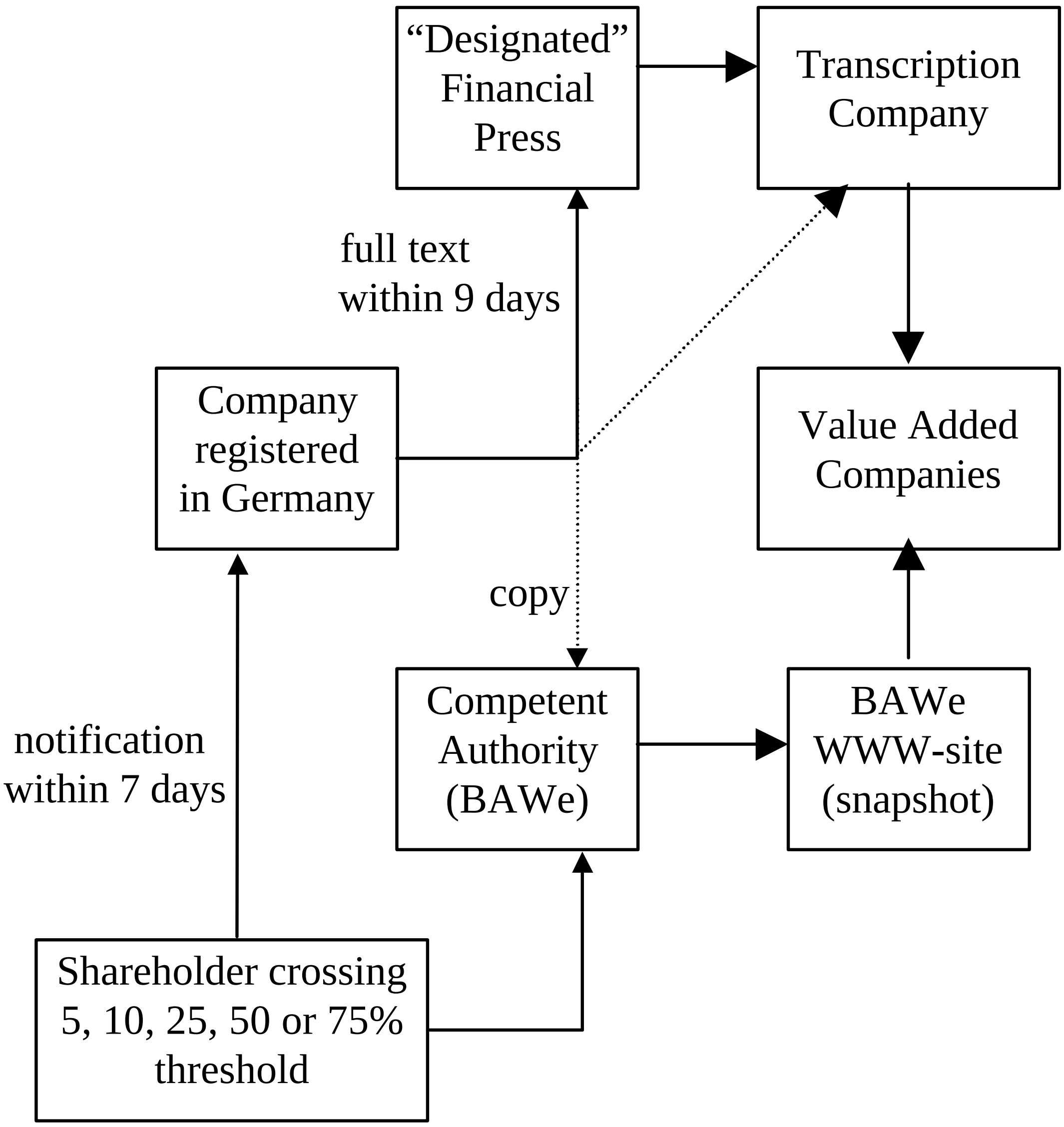
Europe has not adopted mandatory electronic filing. The mere attempt of creating a European electronic filing system would make the shortcomings of the current system painfully visible.

1. Electronic filing must be compulsory, otherwise "bad news" might be disclosed through the paper route.
2. Most existing attempts are electronic versions of the paper age; e.g. SOPHIE in France that contains facsimiles of thick hard copy documents.
3. True electronic filing uses standard, machine readable forms that can be processed automatically by value added service providers and/or sophisticated users, allowing for cross-reference searches and other computer aided analysis.
4. We now understand that network markets often generate powerful monopolies. There is a strong case for regulating and monitoring such monopolies.

Conclusion

1. If European securities markets want to succeed in the new Millennium, European politicians must accept that global investors, like airline pilots, communicate in only one language, English;
2. There are good reasons to believe that disclosure standards are associated with sizeable externalities and network effects. Disclosure is one of the areas where "harmonisation" (standard setting) by one European authority is preferable to mutual recognition (competition between disclosure standards).
3. We must create a European disclosure authority;
4. We must create a European, mandatory electronic filing system that is accessible from the internet free of charge;
5. The European disclosure authority must be given a clear mission: to ensure effective disclosure by all companies listed in the Union and for the benefit of all European investors, irrespective of their geographic location. To achieve this, the new authority must be able to formulate and reformulate its own disclosure rules and forms, while remaining democratically accountable;
6. We must create European disclosure standards and forms that are competitive and compatible with similar SEC standards, for example Form 20-F. The SEC has the task to develop standards that best serve U.S. investors, not European companies and investors.
7. The European Union must adopt international standards like IOSCO's IDSs and participate constructively and pro-actively in the development of such standards.
8. We must recognise that closely held companies and companies with large numbers of shareholders have different agency conflicts and hence different disclosure requirements.
9. Existing Directives must be consolidated, co-ordinated, brought up-to-date and preferably replaced by regulation.
10. Europe needs stronger and more integrated stock markets to (partially) capitalise its pension systems. The suggested improvements in European disclosure are essential for pension reform. The demographic clock is irreversible.

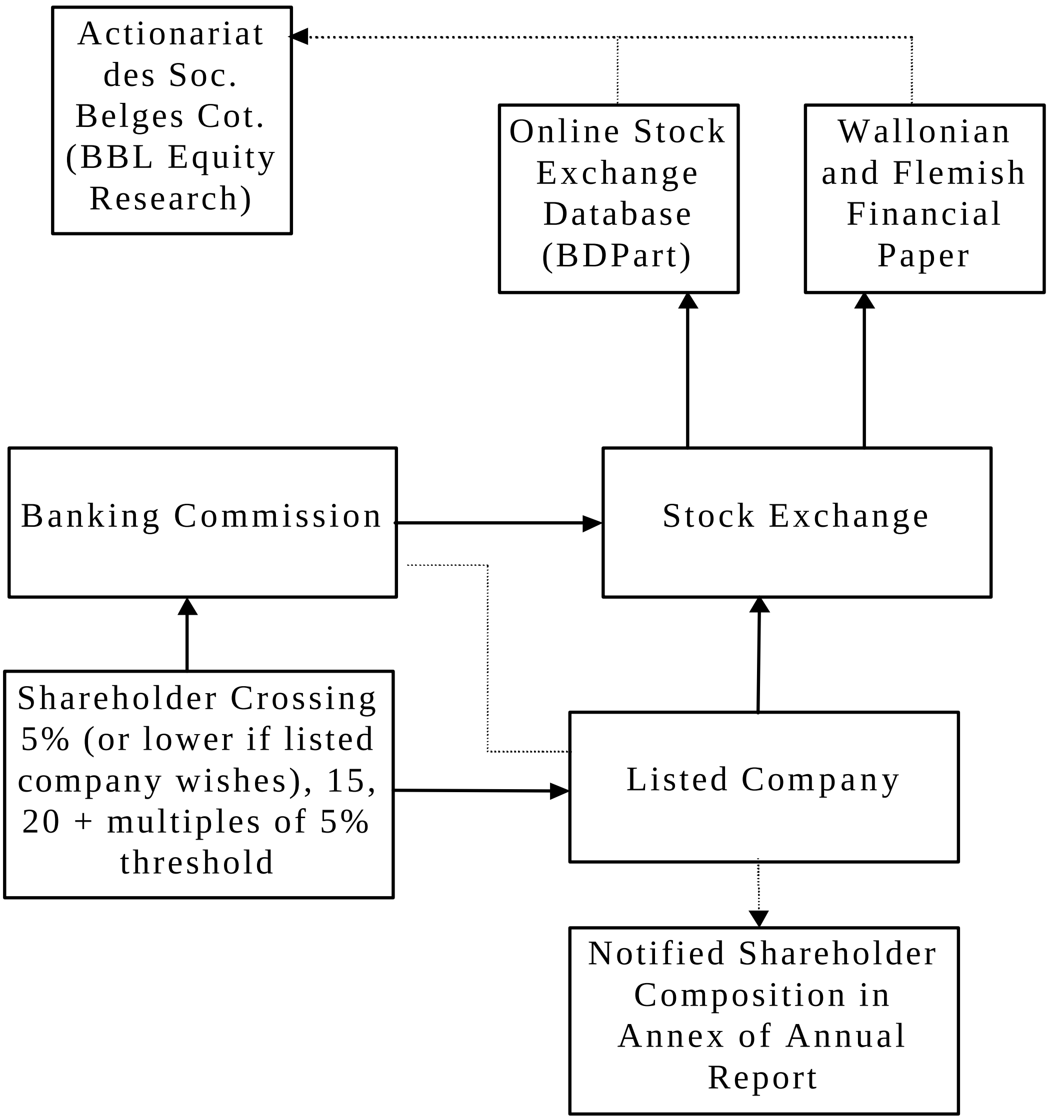
Figure 1. The Large Holdings Directive (88/627/EEC) in Germany



Note: The "designated financial press" are the designated newspapers in the country where the company is listed.

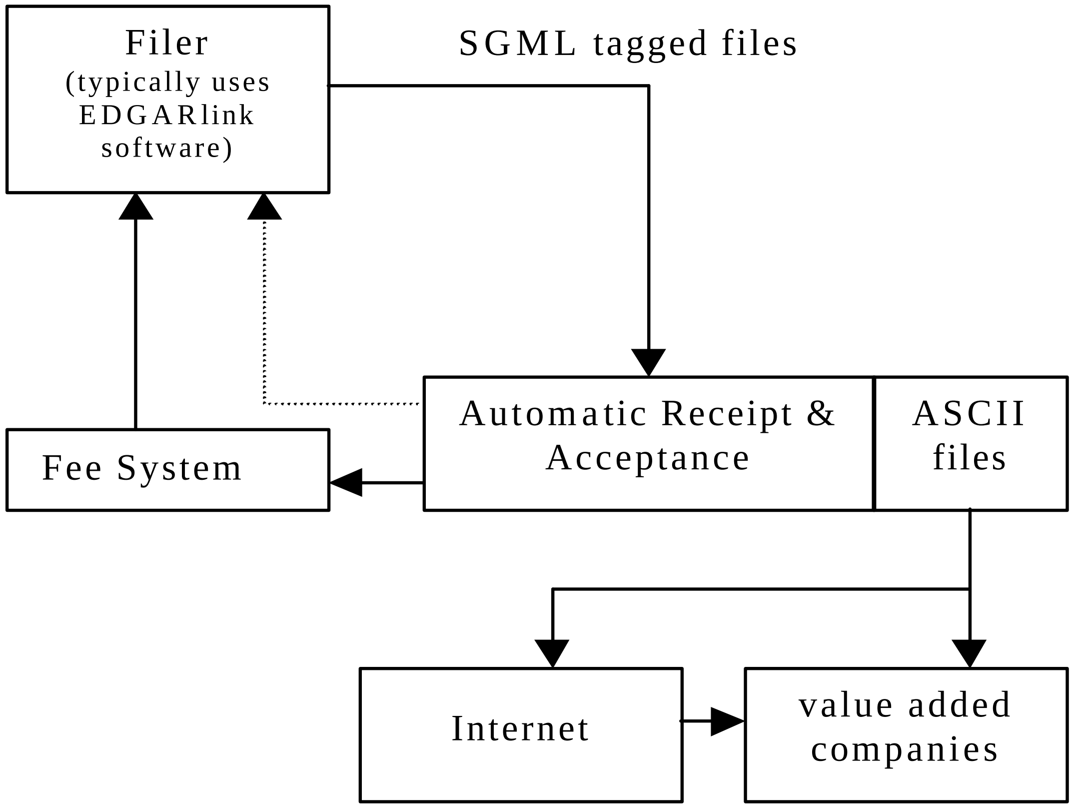
Source : Becht and Böhmer (1997), "The Transparency of Ownership and Control in Germany" in *The Separation of Ownership and Control: A Survey of 7 European Countries*, Preliminary Report to the European Commission. Volume 3. Brussels: European Corporate Governance Network (www.ecgn.org).

Figure 2.The Large Holdings Directive (88/627/EEC) in Belgium



Source : Becht and Chapelle (1997), "Ownership and Control in Belgium", in *The Separation of Ownership and Control: A Survey of 7 European Countries*, Preliminary Report to the European Commission. Volume 2. Brussels: European Corporate Governance Network (www.ecgn.org).

Figure 3. The (old) Edgar Filing System



Note : based on information obtained from Web-site of the US SEC (www.sec.gov).

Annex 4. Agenda of the Special Roundtable on the Findings of the Committee of Wise Men on the Regulation of European Securities Markets

Alexandre Lamfalussy, Chairman, Committee of Wise Men

CEPS, 29 November 2000

14:15 Registration and Coffee

14:30 Introduction
Alfred Steinherr, Chief Economist and General Manager, European Investment Bank

14:35 In-depth presentation
Alexandre Lamfalussy, Chairman, Committee of Wise Men

15:00 Structured interventions

1. **Ruben Lee**, Oxford Finance Group
2. **Christa Randzio-Plath**, MEP, Chairman of the Economic and Monetary Affairs Committee, European Parliament
3. **Marco Becht**, ULB-Ecares.
4. **Antonio Zoido**, President, Bolsa de Madrid
5. **Hans Berggren**, Member of the board, General Counsel, OM Gruppen
6. **Iain Saville**, Chairman, European Clearing and Settlement Depositories Association (ECSDA); President, CRESTCo.
7. **Chris Tupker**, Chairman, Euroclear and Senior Executive Vice President, ABN-AMRO
8. **John Stewart**, Senior Vice President, State Street
9. **Fabrice Demarigny**, Head International Relations, Commission des Opérations de Bourse (COB), Secretary General, FESCO
10. **Charles Goldfinger**, Chairman, Financial Internet Working Group (FIWG)
11. **Karel Lannoo**, Chief Executive, CEPS

16:30 Coffee break

17:00 Roundtable discussion

18:30 End of meeting

Venue: CEPS, 1 Place du Congres, 1000 Brussels

List of Abbreviations

ATS	Alternative trading systems
BCBS	Basel Committee of Banking Supervision
CAD	Capital adequacy directive
CB	Central Bank
CCP	Central counterparty
CONSOB	Commissione Nazionale per le Societa’ e la Borsa (IT)
CSD	Central securities depository
DTC	Depository Trust Company (US)
DTCC	Depository Trust Clearing Corporation (US)
DVP	Delivery versus payment
ECB	European Central Bank
ECN	Electronic communication networks
ECSDA	European Central Securities Depository Association
EDGAR	Electronic Data Gathering, Analysis, and Retrieval system (US)
EEA	European Economic Area
ESCB	European System of Central Banks
ESFRC	European Shadow Financial Regulatory Committee
FESCO	Forum of European Securities Commissions
FESE	Federation of European Securities Exchanges
FIBV	Federation of International Stock Exchanges
FSA	Financial Services Authority (UK)
FSAP	Financial Services Action Plan
GAAP	Generally accepted accounting principles
GSCC	Government Securities Clearing Corporation
IAS	International Accounting Standards
ICSD	International central securities depository
IOSCO	International Organisation of Securities Commissions
IPO	Initial public offering
ISD	Investment services directive
LSE	London Stock Exchange
MTS	Mercato Telematico dei Titoli di Stato (IT)
NASDAQ	National Association of Securities Dealers’ Automated Quotation (US)
NSCC	National Securities Clearing Corportation (US)
NYSE	New York Stock Exchange (US)
OCC	Options Clearing Corporation
OTC	Over-the-counter
Repo	Repurchase agreement
RTGS	Real-time gross settlement
SEAQ	The London Stock Exchange's electronic price quotation system for non-UK securities
SEC	Securities and Exchange Commission (US)
SSS	Security Settlement System
UCITS	Undertakings for Collective Investment in Transferable Securities

Glossary

Alternative Trading Systems (ATS): an entity which, without being necessarily regulated as an exchange, operates an automated system that brings together buying and selling interests – in a system and according to rules set by the system's operator – in a way that forms, or results in, an irrevocable contract (FESCO).

Central Counter Party (CCP): legal counterparty to both sides of a financial market transaction. A CCP replaces several counterparty exposures and reduces the risk for the participating groups, but creates risks at the level of the clearinghouse. A CCP therefore operates in the context of a selective and strict membership structure.

Central securities depository (CSD): Provides settlement for domestically traded securities.

Clearing: The process of transmitting, reconciling and confirming payment orders (or security transfer instructions) prior to settlement and the establishment of final positions for settlement.

Clearinghouse: Any institution that settles mutual indebtedness between organisations.

Collateral: Used to secure an obligation. Originally the US term for security. The US definition now includes goods, intangibles, paper and proceeds. In repo transactions, securities serve as collateral for a cash loan.

Credit risk: The risk that a trading partner does not fulfil his obligations in full on the due date or at any time thereafter. Includes replacement cost risk, principal risk and cash deposit risk.

Delivery versus payment (DVP): A system that ensures that the delivery of the securities occurs if, and only if, payment occurs. Such a link increases settlement efficiency of financial market transactions.

Dematerialisation: The process by which new digital signs of ownership are taking over old physical ones, such as certificates or other documents on paper. In the digital age, the ownership of a security exists only as an electronic accounting record.

Electronic Communication Networks (ECN): ECNs bring buyers and sellers together for electronic execution of trades. The SEC has defined ECNs as "any electronic system that widely disseminates to third parties orders entered into it by an exchange market maker or over-the-counter ("OTC") market maker, and permits such orders to be executed in whole or in part." See also ATS.

Electronic Data Gathering, Analysis, and Retrieval system (EDGAR): The Securities and Exchange Commission (SEC) uses an Electronic Data Gathering and Retrieval system to transmit company documents such as quarterly reports to investors and analysts. Information that is transmitted by EGDGAR has been formally approved by the SEC.

Generally Accepted Accounting Principles (GAAP): conventions, rules, and procedures that define accepted accounting practices, generally referring to the US.

Global custodian: The provision of custody services off securities on a global basis.

International Accounting Standards (IAS): a single set of global accounting standards, developed by the IASC. The IAS core standards provide a comprehensive basis of accounting. Many stock exchanges accept International Accounting Standards for listing purposes, with the exceptions of the United States and Canada.

Initial Public Offering (IPO): The process by which a firm sells its shares to the public. Also known as flotation.

International Central Securities Depository (ICSD): A depository (financial intermediary that accepts deposits) that settles trades in international and domestic securities.

Netting: Gross positions of two counterparties are set off against each other and the final positions for settlement are established on a net basis.

Over-the-counter (OTC): Securities trading taking place outside the stock exchange. In OTC markets, participants trade directly with each other or via brokers.

Repurchase agreement (repo): An exchange of cash for securities, with the agreement to reverse the transaction at a specific future date. The securities serve as collateral for a cash loan.

Securities settlement system (SSS): Include the central securities depositories (CSDs) and the international central securities depositories (ICSDs). The two international depositories in Europe are Euroclear and Clearstream International (previously Cedel).

Settlement: The completion of a transaction. The seller transfers securities, or other financial instruments, to the buyer and in return the buyer transfers money to the seller.

Undertakings for Collective Investment in Transferable Securities (UCITS): The framework under which fund management groups domiciled in one EU member state can market their products to potential investors in other member states. Established by the 1985 EU Council Directive (85/611/EEC), the UCITS Directive. The purpose of the Directive is to co-ordinate the laws of member states regarding collective investment undertakings so that the conditions of operation would be similar across the EU.

Members of the CEPS Task Force* and Invited Guests and Speakers

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Chief Economist, Head of Economics & Information Directorate
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