



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 28.10.1998  
COM(1998) 625 final

COMMUNICATION FROM THE COMMISSION

**FINANCIAL SERVICES:  
BUILDING A FRAMEWORK FOR ACTION**

EXECUTIVE SUMMARY

Financial services<sup>1</sup> represent about 6% of EU GDP and 2.45% of employment. According to the Commission's Employment Rates Report (COM (98)572) they are one of the sectors where Europe has the greatest potential for employment expansion. The integration of financial markets will offer new business opportunities in the financial services sector while allowing consumers to get more value for money. They will be offered a wider choice of financial services and products such as mortgages, pensions, and insurance, at more convenient prices.

Efficient and transparent financial markets also help to optimise the allocation of capital. By facilitating the access to equity financing and risk capital, they allow SMEs and start-up companies to fully exploit their growth and job creation potential.

However, compared to the situation in other industrialised countries, the EU financial services sector is still lagging behind.

Though substantial progress has been made, Europe is still a long way from achieving the potential benefits of the Single Market in financial services. The introduction of the Euro, by removing one major source of market segmentation – different currencies – increases the potential benefits of a single financial services market. It is also a major catalyst for change.

As for retail financial markets, despite the progress that has been made in the completion of a single financial market, cross-border sales of traditional financial products to individual consumers remain the exception. In particular, insufficient tax harmonisation, administrative requirements and limited lack of transparency constitute important barriers to the completion of the Single Market and help to explain a certain lack of consumer confidence in cross-border transactions.

There is therefore a need to find pragmatic ways of reconciling the aim of enhancing consumer confidence by promoting full financial market integration while ensuring high levels of consumer protection.

This Communication concentrates on two main aspects of completion of the Single Market in financial services, whose potential is enhanced by the Euro:

- deep and liquid European capital markets which serve both issuers and investors better;
- removal of remaining barriers to cross-border provision of retail financial services in order to ensure consumer choice while maintaining consumer confidence and a high level of consumer protection.

International financial turbulence is not a reason to abandon this approach. The structural improvements to the European economy that will result from a genuine single financial market will maximise both the direct and indirect contribution to long-term growth, competitiveness and jobs. But a single European financial market, in an increasingly

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<sup>1</sup> Banking and insurance sectors.

integrated global capital market, must be accompanied by more effective prudential regulation and supervision at both European and global level. This needs to be pursued through improved co-ordination between regulators and supervisors in which the Commission has an important role to play.

The Commission welcomes the timely invitation, issued by the European Council at Cardiff, to prepare a "framework for action" for financial services. This Communication highlights a range of issues, which need to be addressed to equip the EU with financial markets capable of sustaining competitiveness and weathering financial instability. The conclusions drawn by the Commission are based on extensive consultation of Member State experts, users of financial services and market practitioners.

The Commission concludes that the EU's framework of prudential legislation does not require radical surgery. We need a leaner more modern regulatory apparatus in the fast moving environment of financial services. It therefore calls upon the Council and the Parliament to explore ways of delivering a more streamlined, flexible and faster legislative approach. Supervisory authorities can play their part by strengthening co-operation in order to ensure application of a uniform understanding of prudential rules. Mechanisms are also required to reinforce collective discipline in the implementation and enforcement of EU legislation in the financial services sector.

The prospect of the single currency is spurring a market-driven modernisation of EU wholesale markets. However, the single currency will not of itself deliver an optimally functioning single wholesale market. A coherent programme of action to smooth out remaining legislative, administrative and fiscal barriers to cross-border flotations and investment-related activities can deliver significant economic dividends. These benefits can be realised without revolutionary changes by adjusting the present arrangements for prospectuses, public-offer listings, financial reporting, and rules applying to investment service providers. Unless such steps are taken, we will forego the potential reduction in the cost of EU capital offered by the single currency. The Commission urges Member States to finalise and implement a set of priority actions to promote the efficient integration of wholesale financial markets as a matter of urgency.

As for retail financial markets, despite great progress in the completion of a single financial market, the cross-border sale of traditional financial products to individual consumers remains the exception. The Commission will intensify efforts to complete a single market for retail financial products on an incremental basis. First, it will promote a clear and common understanding of the distinction between professional and non-professional users of financial services. In keeping with relevant provisions on international private and EU law, efforts will be made to limit additional host country requirements to consumers acting in a non-professional capacity. Second, the Commission will identify and catalogue substantive differences between legal provisions, which presently are seen to call for application of, host country rules. This will improve transparency and make easier to ensure that imposition of host country rules is proportionate. Third, the Commission will continue to promote the convergence of national practices towards a high level of consumer protection where this is necessary and proportionate response to consumer concerns. The Council and Parliament are invited to co-operate with the Commission to the fullest extent in order to give effect to this evolutionary approach.

#### Supervisory and regulatory co-operation within the EU and at international level.

As the regulatory framework for a single financial market crystallises, fault-lines at the level of supervision become more prominent. The Commission considers that structured

co-operation between national supervisory bodies – rather than the creation of new EU level arrangements – can be sufficient to ensure financial stability. At present, this co-operation is organised on an ad hoc basis and will need to be upgraded. In the area of securities markets supervision in particular, present arrangements are unable to keep pace with the sudden acceleration in market integration. The Commission would see great merit in a clear blueprint defining the responsibilities and mechanisms for co-ordination between all different national and EU-level bodies engaged in financial supervision.

The opportunities and challenges of maintaining financial stability do not stop at the boundaries of the Union. The EU is not isolated from turmoil, which is currently sweeping through international financial markets. The Commission and Member States must actively contribute to the promulgation of an international base line of fundamental prudential requirements and assist in the widest possible dissemination of best supervisory practice. The EU has a particular vocation to give effect to these objectives in respect of candidate countries of Central and Eastern Europe.

**Creating the general conditions for a fully integrated EU financial market** requires action in the following areas:

Provide for an **integrated infrastructure**: Interaction between national securities and payment systems needs to be improved as well as the development of appropriate mechanisms to combat fraud and money laundering.

To ensure a level playing field for financial operators is one of the key elements of an integrated single market for financial services. Financial market integration must therefore be enhanced by strict application of the Treaty rules on **competition and state aid**. An increased effort will be needed in this area, as competition in the financial services sector is likely to become fiercer after the introduction of the Euro.

**Taxation**: With the disappearance of exchange risks as a deterrent to real pan-European investment strategies, disparities in tax treatment is already emerging as a significant distortion of the allocation of resources. Political agreement has been reached to address the most pressing tax distortions to the single market- namely, tax distortions to the allocation of savings and harmful tax competition between financial centres. Work must also be taken forward in respect of key financial products; such as life insurance and pension funds, where tax treatment prevents cross-border marketing.

#### **Building a consensus:**

The Council and the Parliament are now invited, with the Commission, to take forward the debate. To maintain political momentum, the Commission proposes that personal representatives of Finance Ministers should be nominated by Member States and meet in a Financial Services Policy Group, chaired by the Commission.

Its immediate objectives are twofold: first, the Group should identify and prioritise a set of actions by June 1999 to be presented to the Council.

The second task of the Group, during the period prior to June 1999, is to define a number of immediate priorities to guarantee momentum to the process.

The Group will also assist the Commission in collective monitoring of implementation and enforcement of financial services legislation.

The Commission intends to report back to ECOFIN on a regular basis.

The Commission will also establish a High-Level consultation mechanism to ensure that both market practitioners and users of financial services are able to make a full contribution to the formulation of policy in this area.

# FINANCIAL SERVICES: BUILDING A FRAMEWORK FOR ACTION

## COMMUNICATION OF THE COMMISSION

### INTRODUCTION:

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1. A single deep and liquid financial market which can serve as the motor for growth, job-creation, and improved competitiveness of the European economy is within reach<sup>1</sup>. The introduction of the euro is the logical conclusion of the single market and offers a historic opportunity to draw the full benefits of open and integrated markets. The disappearance of exchange risk and the single monetary policy of the euro area will give a major impulse to the integration of money, debt and equity markets.

2. Users of financial services will benefit from more competitive and innovative high-street financial services, whilst continuing to enjoy high levels of consumer protection. The financial services industry will benefit from new business opportunities in wider and deeper capital markets. Integration of capital markets will also reduce the cost of capital for industry by leading to lower interest rates as well as by facilitating access to equity-financing and risk-capital. This is of particular importance for SME's and start-up companies who will be able to look beyond the expensive and inflexible debt-financing on which they presently rely<sup>2</sup>.

3. The introduction of the euro and existing single market rules are necessary, but not sufficient conditions for the emergence of a fully functioning single EU market for financial services. Current arrangements also need to be reviewed in order to ensure that EU financial industry can contend with competitive challenges which are being intensified by the globalisation of financial markets.

4. The need to examine further improvements was recognised by the European Council at its meeting at Cardiff when it instructed the Commission to table a "framework for action" to improve the single market for financial services, in particular to examine the effectiveness of implementation of current legislation and to identify weaknesses which may require amending legislation. In response to this request, the Commission tables this framework which aims to:

- equip the EU with a legislative apparatus to meet present and future challenges;

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<sup>1</sup> According to the Commission's Employment Rates Report (COM (98) 572) financial services are one of the sectors where Europe has the greatest potential for employment expansion.

<sup>2</sup> Dependence on debt as a source of corporate finance ranges from 50% in the Netherlands to over 70% in France, Germany and Italy, and 80% in Spain (compared to 20% in the US).

- eliminate remaining capital market fragmentation to minimise the cost of capital raised on EU markets;
- make the advantages of open markets available to both users and suppliers of financial services;
- encourage the closer co-ordination of supervisory authorities;
- promote the emergence of an integrated infrastructure at EU level;
- reduce barriers to the single market resulting from disparities in taxation.

The analysis presented in this text draws on wide-ranging consultation of European level representative bodies of financial services users and industry, market practitioners and national administrations.

5. Meeting these challenges does not require a complete recasting of existing legislation. It calls for pragmatic but decisive action to turn new opportunities to our best advantage. A deteriorating international economic outlook is no reason to delay necessary adjustment. Indeed, it strengthens the case for effective action.

## **A LEANER AND MORE EFFECTIVE REGULATORY APPARATUS**

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### **1. KEEPING UP WITH THE TIMES:**

6. The prudential legislation for a single financial market must be kept under continuous review in order to ensure an effective bulwark against financial instability. The Union's robust prudential safeguards, rigorous supervision and effective transparency has helped Europe to avoid the worst effects of the turbulence now sweeping through international financial markets. However, there is an ongoing need to adapt our legislation to take account of developments in financial markets, instruments and products, as well as with systemic risks resulting from the increasing inter-dependency of financial markets. Our prudential rules must also be kept up to date in order to ensure that they serve the goal of job-creation and competitiveness as effectively as possible. Realising this objective requires action on two fronts:

- speedier adjustment of legislation;
- a streamlined approach to drafting prudential regulation.

7. *Faster response-times are critical.* Legislating less and legislating better is not the whole story. We must legislate more quickly. As technology advances and market integration increases, our legislative process often lags behind changes in the market. By the time directives are proposed, debated and adopted they can amount merely to detailed solutions to yesterday's problems. Delays in modernising EU rules to comply with internationally accepted best practice handicaps regulators and supervisors in maintaining the stability of the financial system. It has already proved costly in terms of competitiveness by denying financial operators the benefit of "state-of-the-art" regulation and speedier supervision (Figure 1). The work in hand to review core elements of the EU's capital regime for banks takes place in parallel with work in the Basle Committee on Banking Supervision. It is essential that the end results in Brussels and Basle are not only consistent but also come into force at the same time (see paragraph 39 for the need for the EU to play its role in the Basle process).

► **Figure 1:** *In 1996 US banks were allowed to use sophisticated computer models to calculate their 'market risks' and were subject to more accurate (and lower) capital requirements. In the EU some 2 ½ years were needed to introduce the necessary amendments to our directives before our banks could operate under equivalent competitive conditions.*

8. Speeding up our legislative process is therefore crucial but we also need to take into account the wider debate on the use of comitology procedures in EC decision-making. The Commission will explore, with the other institutions, the possibility of agreeing fast-track procedures which would apply to financial services in accordance with the Treaty and in line with the Commission's proposal for a review of comitology procedures.

9. **Streamlining legislative techniques.** The Commission will explore how to strike a better balance between defining objectives and spelling out the detail in our legislation. Current legislation contains an unnecessary degree of detail: this often results from detailed amendments to the Commission's original proposal (Figure 2). Avoiding over-complex legislation in the future will call for a degree of self-restraint from the institutional partners and from the Commission itself.

► **Figure 2:** *How NOT to regulate for a single financial market:*  
*While the Commission's original proposal for a Capital Adequacy Directive was 26 pages, after finishing the legislative process the version adopted by the Council was 79 pages. This included 42 pages of annexes of minute numerical detail outlining, inter alia, complex mathematical models to calculate capital requirements. An amending Directive came four years later: it was a further 28 pages long.*

10. A more pragmatic approach for financial services regulation – rather more qualitative and less quantitative – should be explored. New legislation relating to service providers or products could be confined to prescribing the fundamental requirements and basic requirements that the legislation seeks to achieve. Detailed and/or quantitative specification of the best means of meeting these objectives need not be spelt out in detail in this “framework” legislation. Where detailed guidance is necessary it could be provided in a more flexible supplementary form. Options could include Commission communications; recommendations; or Commission decisions (which would be subject to appropriate “comitology” arrangements). The choice of option would be determined as a function of the degree of legal certainty and/or availability of ready-made technical solutions. The Commission will consider the approach in more detail to permit a discussion with Member States and the European Parliament in the coming months.

## II. MAKING THE MOST OF EXISTING RULES:

11. We can also make better use of the business opportunities provided by the existing rules. Shortcomings in our legislation can be rectified by better implementation by Member States, by stricter policing of the legislation by the Commission, and by clearer and more uniform interpretation of EC legislation.

12. **Timely and effective implementation of existing legislation.** Despite protracted delays, the implementation of financial services directives by Member States is now



almost complete. Late (or often incomplete or incorrect) implementation has already imposed considerable costs on market participants, and led to single market distortions and inefficiencies disrupting the effective functioning of the single market<sup>3</sup>. Nearly five years after the entry into force of the bulk of financial services legislation, the situation as regards transposition of financial services Directives is broadly satisfactory. 12 Member States have taken steps to implement the full corpus of banking, insurance and securities legislation, and the average transposition rate for EU-15 is 98.94%. However, there have been significant accumulated delays in implementing agreed rules during the intervening period. Henceforth, it will be essential to keep any implementing delays to a minimum. Attention must also turn to ensuring that national implementing measures allow for effective enforcement throughout the EU. This needs a full and committed engagement by each Member State to the process, perhaps reinforced by some form of self monitoring to improve collective discipline. The Commission will explore with Member States how best to take this forward.

13. *Clear and common interpretation of the rules.* The rules the Member States apply must be clear and interpreted consistently throughout the Union. Discrepancies can be eliminated by interpretative communications issued by the Commission, based on ECJ jurisprudence. Non-legislative and self-regulatory solutions between supervisors can also promote a wide understanding of operational concepts that are needed to secure an effective single market. Divergent approaches in implementing common rules need to be analysed, their costs fully understood, and "benchmarking" developed from best supervisory practice with the aim of eliminating these divergences. Indeed, such supervisory co-operation will be increasingly important as investment services and cross-border trading in securities become more widespread - mutual understanding and transparency will be essential especially for conduct of business rules. There needs to be a deepening and strengthening of such processes: the recently established FESCO<sup>4</sup> can play a central role in this respect. The Commission will strongly encourage such developments.

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<sup>3</sup> The delayed implementation of the Investment Services Directive has caused market rigidities as a result of lack of competition and difficult market access. Market innovation has been stifled whilst investment firms are less than optimally prepared for the readjustment and enhanced competition that the euro will bring.

<sup>4</sup> FESCO is the Forum of European Securities Commissions

## POINTS FOR ACTION

### *The Commission*

- ✓ *will continue to enforce the timely and effective implementation of directives and will explore how to take this forward*
- ✓ *will come forward with interpretative communications to give guidance to Member States and market participants*
- ✓ *will present detailed suggestions for discussion on a better approach for future prudential financial services legislation*

### *The Council and the European Parliament*

- ✓ *are invited to work together with the Commission to explore a possible inter-institutional agreement enshrining the modalities for stream-lined, flexible and speedier legislation in the single financial services market.*
- ✓ *should be committed to exercise a degree of self-restraint in the legislative process to avoid over-complex legislation.*

### *Member States*

- ✓ *should urge their supervisory authorities to enhance their self-regulatory role by deepening and strengthening processes to strengthen regulatory standards and operational practices for an effective single market*
- ✓ *should commit themselves to the effective and prompt implementation of directives.*

## INTEGRATED WHOLESALE MARKETS ARE WITHIN REACH:

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14. The introduction of the euro will stimulate the development of a large and liquid pan-European capital market. But it will not, of itself, integrate capital markets. Market fragmentation will continue because of residual regulatory, administrative and tax obstacles. Such fragmentation, together with distortions elsewhere in the financial and corporate governance system, means that capital markets in a number of Member States are significantly under-developed.<sup>5</sup> This carries a heavy price tag. Some financing mechanisms, such as equity and bond issues, are not sufficiently utilised by corporate borrowers in many EU countries. Similarly, risk-capital financing for innovative start-ups clearly lags behind US practice.<sup>6</sup>

15. The markets themselves are already gearing up for pan-European securities trading. The first strategic alliances between exchanges are tackling issues that are indispensable for the emergence of pan-European securities trading. Solutions are being found to ensure technical compatibility of securities trading systems and the co-ordination of market conventions.

16. The consultations undertaken by the Commission have identified a number of problems that relate to the access to capital markets; the restrictions on investment of assets and the activities of investment service providers. These are examined below from the perspectives of the demand and supply of capital (although some cases cover both sides of the spectrum).

***1. On the demand-side, issuers should enjoy easy access to pan-European capital markets on competitive terms.***

17. Efficient and integrated wholesale markets offer the possibility of external equity-financing to all corporates. At present, access to equity-listing is not an option for many companies - particularly small innovative start-ups who wish to float on stock markets but do not currently have access. The following areas call for further action if the vision of a single deep and liquid capital market is to become a reality.

- ***Mutual recognition of prospectuses:*** National authorities have traditionally imposed demanding and frequently differing information requirements on issues. This discourages issuers and intermediaries from placing securities such as shares and bonds on a cross-border basis, and therefore prevents investors from benefiting from a wider choice of products. The 1989 Listing and Prospectus Directives have failed to resolve these difficulties. The Commission will propose improvements both by amending legislation and closer co-operation between supervisors.

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<sup>5</sup> Stock market capitalisation in the EU (with the exception of UK and NL) pales into insignificance when compared to that of US (32% of EU GDP compared to over 100% in US).

<sup>6</sup> 70% of issuance in the EU is accounted for by more-secure assets (credit rating Aa2 and above) as opposed to the USA where the equivalent figure is 30%. The creation of a deep and liquid corporate bond market in the EU will allow a higher yield segment to develop.

- **Financing unlisted start-ups:** Efficient specialised equity markets should be made available and put to work for fast-growing, unlisted innovative start-up companies. The Commission has recently established in co-operation with the European Investment Fund an instrument which will help specialised venture-capital funds to mobilise capital.<sup>7</sup> The Commission is also exploring whether further legal initiatives could help specialised venture-capital funds to mobilise capital on a pan-European basis for financing new start-ups<sup>8</sup>.
- **Corporate governance:** There is no single model of good corporate governance which could facilitate increased integration of wholesale markets. However, there is an emerging consensus around a number of common principles that can underpin it. These include the equitable treatment of shareholders and the transparency and accountability of the corporate process. The Commission will continue to support public and private sector bodies in their efforts to improve the regulatory framework for corporate governance. Nevertheless, differences in styles and forms of governance can limit cross-border investment and hinder the creation of supra-European corporations. Among the key harmonisation proposals on which progress is required is the legal structure of corporations for the transfer of seats (10<sup>th</sup> Company Law Directive) and, in the Council, take-over bid procedures and the European company statute (ECS). Achievement of a ECS, itself a Single Market Action Plan priority, could greatly assist realisation of the Single Market. However, it is important that any ECS model be neither unduly rigid nor inflexible.

**II. On the supply-side, investors should be free to invest their assets without encountering legal, administrative or information barriers.**

18. Three specific aspects are discussed below: the divergences in accounting and disclosure rules; investment restrictions through currency matching requirements; and a level playing field for fund managers.

- **Disclosure:** From 1999, many companies will publish their financial statements expressed in the euro even though they are not prepared on the basis of the same accounting rules (Figure 3). The introduction of the euro thus raises the question whether further accounting harmonisation within the EU is needed.

► **Figure 3:** *The number of European companies with NYSE and NASDAQ listings in the US has increased nearly fivefold since 1990 to almost 250 in 1998, with a cumulative market capitalisation of about \$300bn. There is thus growing pressure to bring our directives in line with international accounting standards to avoid having to apply different standards to produce different financial statements.*

<sup>7</sup> Notice of implementation of the EIF Start-Up facility and the SME guarantee facility under the Growth and Employment Initiative. OJ C 302/8, 1-10-1998

The objective is to stimulate cross-border investment through more transparency and better comparability of accounts. The Commission will consider whether any of the options provided for by our accounting directives are no longer necessary or appropriate. In addition the Commission will review whether listed companies should be required to prepare their financial statements in conformity with a more harmonised framework, such as IAS. A common understanding of the role of the statutory auditor in reporting to investors and capital markets within the EU will also be explored.

- ***Eliminating investment restrictions:*** Pension and life insurance fund managers manage a growing proportion of EU's vast reserves of saving.<sup>9</sup> Most are obliged, through currency matching requirements, to invest predominantly in assets denominated in the local currency. There are also quantitative restrictions that prescribe the type of asset in which investments can be made. Such restrictions heavily distort the structure of institutional investor portfolios<sup>10</sup>. Even marginal improvements in risk-return performance can generate substantial benefits for pension plan-holders and alleviate some of the burden of pension financing in the context of demographic developments. What is required is sensible, prudential rules that allow pension funds to optimise their portfolio structures with appropriate allocations of pan-European equity, international equity, real estate and fixed income assets. The Commission, in the follow-up to its Green Paper on supplementary pensions in the single market is exploring ways of alleviating the burden of restrictions in this field without threatening the prudential soundness of funds. This can be done, for example, by ensuring that there is appropriate diversification of the assets, transparency for pension plan-holders, and emphasis on rigorous supervision<sup>11</sup>. This could ultimately contribute to job-creation and employment, while improving security of savings for old-age retirement provision.
- ***A level playing field for similar financial products:*** Broadly substitute products such as pension funds, life assurance and UCITS are subject to different forms of regulatory requirement and tax treatment in each Member State. This can lead to arbitrary differences between products and unfairly tilt the balance in favour of some asset managers. The Commission will strive to achieve greater policy coherence whilst enhancing transparency for consumers and effective competition.

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<sup>9</sup> Pension fund assets are projected to grow from \$630 billion to \$1,800 billion between 1996 and 2001. Insurance company assets are projected to grow from \$2,600 billion to \$6,300 billion over the same time frame. Unit trust assets are predicted to amount to \$3,230 billion in 2001 as opposed to \$1,680 billion in 1996. (Bank of England, 1998).

<sup>10</sup> The share of equity in these portfolios varies from 71% in the UK to 14% in France and 15% in Germany.

<sup>11</sup> The Commission's Green Paper on "Supplementary Pensions in the Single Market" (COM (97) 283) discusses in detail aspects that are crucial for "second pillar" pension funds and "third pillar" life assurance provision.

**III. Investment service providers should be able to operate throughout the EU without confronting overlapping sets of legal and administrative formalities.**

19. Under the ISD, rigid and unqualified insistence on local trading rules leads to a patchwork of widely differing requirements and makes it difficult for investment service providers to have access to or to compete effectively within the framework of other Member States' "regulated markets". (During consultations, such problems are the most frequently cited concerns of market operators and representative bodies). Art. 11 of the Directive grants local supervisors substantial discretion in the application of local business conduct rules. There are differences as regards core concepts such as "fit and proper". Closer co operation between securities supervisors can improve this situation. The Commission for its part will seek to remove difficulties in the way the Directive is applied by promoting convergence of national approaches to conduct of business rules<sup>12</sup>.

20. There is little justification for restrictions on the professional investor or wholesale client who is better placed to assess the suitability of complex investments than is the retail consumer. The Commission therefore believes that cross-border activities should not be subject to unnecessary host-country trading rules. Home-country authorisation and the supervision of the institutions offers the professional investor the necessary guarantee.

**POINTS FOR ACTION**

***The Commission***

- ✓ ***will propose improvements to the public-offer and listing prospectus directives to remove inconsistent national requirements and allow mutual recognition***
- ✓ ***will examine whether legal initiatives could assist specialised venture capital funds to mobilise capital on a pan-European basis for financing small-business start-ups***
- ✓ ***will review whether the company reporting options in the Accounting Directives are inappropriate in view of the need for further harmonisation of financial reporting***
- ✓ ***will, on the basis of a Communication, prepare a Directive for the dismantling of non-currency related asset investment restrictions on supplementary pension funds***
- ✓ ***will work towards a common understanding of the role of the statutory auditor in reporting to investors and capital markets***
- ✓ ***will continue to work alongside public and private bodies to improve the framework for corporate governance***
- ✓ ***will work towards maintaining consistency between EU financial reporting framework and international accounting standards developed by the IASC, including the introduction of fair value accounting to the EU framework.***
- ✓ ***will determine the most expedient (legislative or non-legislative) means of upgrading the effectiveness of ISD by promoting the necessary convergence of national approaches to conduct of business rules.***

<sup>12</sup> See section 7 above.

***The Council and the European Parliament***

***✓ are urged to make progress in the adoption of proposals for directives on take-over bid procedures and the European company statute (ECS).***

***✓ are invited to work towards early adoption of legislation, based on the Commissions proposals in respect of UCITS.***

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**MEMBER STATES' RETAIL MARKETS ARE NOT YET OPEN**

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21. Efforts to complete a single market have focused primarily on traditional high-street financial services. Prudential ground-rules prescribe the conditions under which financial service providers are authorised to offer a range of financial services. Once authorised by the supervisors of their country of establishment, suppliers are free to do business throughout the EU on the basis of a "single European passport". Inter-penetration of markets has taken place primarily through establishment, often achieved through acquisition of established operators. Direct supplier-to-consumer service provision remains largely undeveloped on a cross-border basis. For example, in the life insurance market, insurance companies in most Member States record no cross-border sales. The highest level recorded is 0.14% in the case of Danish companies. In non-life assurance, the situation is somewhat better with amount of turnover accounted for by cross-border sales ranging from 0.13% in Germany to 4.13% in Belgium.<sup>13</sup>

22. Efforts to construct a single retail financial market have not yet not resulted in the convergence of prices for financial products. Figure 4 indicates that the cost of obtaining a credit card in the most expensive Member State is three times higher than recorded in the least expensive. Disparities in respect of fixed commissions related to private equity transactions are even more pronounced, with fees in the most expensive country costing a staggering 17 times those charged in the least expensive Member State. Lack of convergence of prices in the single banking market has been attributed to the lack of a single money market, and to continuing differences in the cultural, legal and regulatory environment. Despite such difficulties, the single market programme has ushered in increased consumer choice and an overall improvement in the quality of financial intermediation.<sup>14</sup>

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<sup>13</sup> Amount of turnover accounted for by subsidiaries in other Member States fall within a range of 0-4% for life and attains a maximum of 34% for non-life in the case of Belgian companies. Luxembourg is an outlier in all cases, recording much higher levels of cross-border business.

<sup>14</sup> In insurance, limited convergence of premia has also been observed. Car insurance premia can range from 346 ECU (Portugal) to 1391 in (Germany) reflecting differences in contractual terms and coverage, as well as in the level of compensation awarded by national courts. While these differences are a by-product of different legal traditions, they will continue to constitute a formidable barrier to cross-border tradability of financial products.

*Figure 4: Price dispersion for financial products in single market (1996).*

<i>Product</i> <sup>15</sup>	<i>UK</i>	<i>F</i>	<i>D</i>	<i>B</i>	<i>NL</i>	<i>I</i>	<i>E</i>
Commercial loan	7500	3885	2114	3755	2741	4843	6976
Credit card	35	33	32	71	27	40	43
Mortgage	475	626	245	408	180	552	540
Private equity transaction	18	51	20	13	13	3	13

All-prices in ECU. % range = maximum expressed as minimum. Source: Commission (1997).

### ***Balancing objectives.***

23. Achieving a truly single market for financial retail services demands a balancing of two sometimes competing objectives. First, consumers should be able to exercise choice in an informed manner, in full confidence that their interests are protected by robust consumer safeguards. Financial services are often complex and the assessment of the security/performance of the products and the reliability of the service provider is difficult for the non-professional. Transparent and effective safeguards create the confidence necessary for financial markets to flourish. The EU framework of prudential controls provides a substantial first line of defence for consumer interests and offers effective consumer protection from financial institutions who compete on the basis of a "single passport". The recent Commission Green Paper and the follow-up communication on "enhancing consumer confidence in financial services" identified supporting EU-level action to ensure that consumer interests are kept to the fore as the single market in financial services takes shape<sup>16</sup>. The Commission is committed to following-up the actions announced in this Green Paper.

24. A second objective is to increase competition and widen consumer choice by allowing financial intermediaries to do business with clients/customers anywhere in the EU on the basis of an authorisation from their home country supervisor. Financial intermediaries at present generally find themselves obliged to establish subsidiaries in other Member States for legal, tax or administrative reasons. In a true single market, financial institutions should be presented with an effective choice between cross-

<sup>15</sup> Definitions of products used in table: (1). Commercial loan: cost (incl. commissions and charges) to a medium-sized firm of a commercial loan of 250'000 ECU. (2). Credit card: annual cost assuming 500 ECU debit. (3). Annual cost of home loan of 25'000 ECU. (4). Commission costs of cash bargain of 1'440 ECU.

<sup>16</sup> Commission Communication on Enhancing Consumer Confidence in Financial Services (COM (97) 309 Final).



border expansion through establishment (of branches or subsidiaries) or provision of services from their home base.

25. Member States are concerned to protect their consumers from exposure to financial risk. The Treaty has been interpreted in such a way that the prerogative of Member States to apply local provisions where this is a necessary and proportionate means of upholding the consumer interest is upheld (the "general good"). The Rome and Brussels Conventions also enable consumers to rely on their local judicial systems and contract law as they see fit.

26. However, the need to ensure a high-level of consumer protection should be proportionate and not be used as an excuse to hinder cross-border business. Otherwise, the benefits of enlarged consumer choice and the prospect of real savings would be lost. It is probable that following the introduction of the euro, consumers will find it increasingly difficult to understand why financial services cannot easily be bought or sold across borders.

27. However, differences between Member States legal provisions on the provisions on bankruptcy, security, and applicable law means that such difficulties will persist. Pan-European products such as mortgages, life assurance, pension funds cannot be developed until underlying differences in these national provisions are co-ordinated and/or mutually recognised. It is presently impossible to open a standard bank account for a client in different European countries. Due to a range of legal, administrative and tax reasons, this will continue to be the case despite the introduction of the euro (figure 5).

*Figure 5: why a single bank account will not be available to financial customers in the euro zone.*

*Customers active in a number of Member States would draw benefit from the possibility of pooling their euro cash balances across the EU. This would allow the account holder's credit and debit balances denominated in euro and/or national currencies to be notionally offset for the purposes of maximising interest income. "Sweeping" funds into a single account would also give the account holder more flexibility in handling cash flows. These possibilities are currently excluded by a range of factors including the absence of any provision for offsetting loans or deposits in one jurisdiction against those in another. There are also complications relating to different national rules on handling of payment claims, investor/creditor protection in the event of bankruptcy, provision of collateral, and issues relating to liability of parent companies in event of default by subsidiary. There are a host of administrative issues relating to revocation of orders, conditions for calculating and payment of stamp duty. Finally, the movement of funds from accounts in one Member State to those in another has implications for tax revenues. This combination of factors will continue to impede the operation of a single bank account after the introduction of the euro.*

28. The necessary degree of convergence in core areas of national law is unlikely in the short term. There is therefore a need to develop pragmatic ways of reconciling the aim of promoting full financial market integration with that of ensuring high levels of

consumer protection and consumer confidence. The Commission will, with the cooperation of the Member States, intensify efforts to complete a single market for retail financial products on an incremental basis.

- First, it will promote a clear and common understanding of the distinction between professional and non-professional users of financial services. In keeping with relevant provisions on international private and EU law, efforts will be made to limit additional host country requirements to consumers acting in a non-professional capacity.
- Second, the Commission will identify and catalogue substantive differences between legal provisions which presently are seen to call for application of host country rules. This will improve transparency and allow EU authorities to ensure that imposition of host country rules is proportionate.
- Third, the Commission will continue to promote the convergence of national practices towards a high level of consumer protection where this is a necessary and justified means of ensuring that the benefits of an effective single retail market go hand-in-hand with consumer interests.
- Fourth, valuable work can also be done on a practical basis to ensure better co-ordination between national systems for redress in order to stamp out unfair trading practices on a cross-border basis.

The next section expands on how these steps can be applied in more practical ways to realise the objective of a single market for retail financial products which offers high levels of consumer protection.

### ***Making progress on a pragmatic basis***

29. First, we should develop targeted actions at a high level of consumer protection to bring about convergence of national practices towards a high level of consumer protection. The need to enhance transparency in the market and, notably information for the consumer in order to enable informed choices, will be addressed. Implementation of the measures identified in the Commission's Communication on enhancing consumer confidence will also contribute to an enhanced functioning of a single market which works to the benefits of consumers. In particular, the efforts at co-ordinating national practice in respect of insurance intermediaries can make a substantial contribution both to consumer protection and the increased tradability of insurance products. The Commission will come forward with specific proposals in the course of 1999.

30. Second, although their systems appear different, Member States in many circumstances apply equivalent levels of consumer protection. *We should therefore identify and catalogue substantive differences between national arrangements to protect consumer rights.* Consideration should be given to limiting host country rules to these cases. Given the current lack of transparency concerning the application of consumer protection rules, mechanisms are required which allow Community institutions to build up a systematic picture of the extent to which local provisions are imposed.

31. Third, there are strong objective arguments in favour of greater differentiation between categories of financial service customer, as professional investors need less protection than general consumers.<sup>17</sup> Host country provisions should thus be directed to where they are most needed, that is to ensure a secure environment for consumers.<sup>18</sup> Therefore *the Commission will continue to pursue a policy distinguishing between consumers and operators acting in their professional capacity, in conformity with relevant law.*

32. Fourth, we should develop an approach which protects consumers against aggressive and unfair trading practices but which at the same time empowers them to engage in bargain-hunting. Obstacles to cross-border sale of retail financial products will become more obvious as new electronic technologies bring retail financial products and services to the attention of any consumer with an Internet connection. The Commission's recent proposal on distance selling (and shortly on electronic commerce) are intended to clarify issues relating to fair trading practices which are likely to arise with increased frequency as cross-border electronic shopping becomes more commonplace<sup>19</sup>. However, where consumers take the initiative of accessing Internet web-sites operated by financial service providers in another Member State, they should be willing to accept that the web-site is configured and operated in accordance with the laws of that country. This is without prejudice to the law applicable to contractual obligations and to the competent for a for the settlement of claims which are regulated by the Brussels and Rome Conventions.

33. Fifth, we should provide effective cross-border redress. Action is needed in the area of non judicial redress and the handling of complaints when they arise from a cross-border activity. Consumer organisations are invited to come forward with appropriate proposals to address these issues.

### **POINTS FOR ACTION**

<sup>17</sup> Seeking a differentiated level of protection for consumers is, of course, not new. The principle was established more than a decade ago by the Court of Justice which recognised that consumer protection "*grounds are not equally important in every sector ... and that there may be cases where, because of the nature of the (service) and of the party seeking (that service), there is no need to protect the latter by the application of the mandatory rules of his national law*". The Commission has already applied this principle to the activities of insurance and investment services. (ECJ case 205/84 1986, ECR 3755).

<sup>18</sup> The definition of "consumer" is already enshrined in relevant consumer protection legislation as "a natural person acting outside of his/her professional or business activity".

<sup>19</sup> In situations where financial institutions engage in active marketing and sale of financial services (either on or off-line), the distance selling proposal aims to ensure that all consumers benefit from uniform high level of protection in terms of reflection period prior to sale of contract and right of withdrawal under appropriate conditions.

*The Commission*

- ✓ *will follow-up the actions announced in its Green Paper on Consumer Confidence for Financial Services*
- ✓ *will make proposals to introduce an adequate level of consumer redress and complaints handling for customers of financial services, inviting consumer organisations to provide input*
- ✓ *will identify and catalogue differences between Member States' 'general good' rules for the protection of consumers in financial services area as a basis for agreed, targeted and proportional policy responses*
- ✓ *will adopt a policy distinguishing between wholesale professionals and individual consumers to direct regulatory efforts to where they are most needed and to avoid unduly high compliance costs*
- ✓ *will explore substantive new proposals to ensure that insurance intermediaries comply with stringent professional and other safeguards, with a view to enhancing consumer protection and the functioning the single insurance market*
- ✓ *will approach fundamental legal obstacles to financial products by way of an evolutionary approach in view of the deep-rooted differences in legal traditions*

*The Council and the European Parliament*

- ✓ *should adopt the E-Money proposal as soon as possible*
- ✓ *should adopt without delay the proposal for a distance selling directive for convergence of national marketing and selling techniques*

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**REGULATORY AND SUPERVISORY CO-OPERATION FOR FINANCIAL STABILITY**

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**SUPERVISORY CO-OPERATION WITHIN THE UNION:**

34. Co-operation between national supervisors has developed organically both to strengthen capacity to respond to cross-border problems (e.g. BCCI), and to develop common supervisory approaches in tackling new forms of prudential risk in banking, insurance and securities markets. The Committees which assist the Commission in implementation of single market legislation have emerged as a focal point for supervisory co-operation<sup>20</sup>. Other activities by supervisors, such as the creation of FESCO or the Banking Supervision Committee of the European System of Central Banks, can also help to promote co-operation in this area. Increased co-operation

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<sup>20</sup> Banking Advisory Committee, Insurance Committee, High Level Securities Supervisors, Accounting Committee, UCITS Contact Committee.

among supervisory authorities is key in the management of institutional/prudential risk.

35. As financial institutions reorganise themselves on a cross-border basis, their nationality may become less clear and ascertaining which supervisor should assume responsibility in the event of a solvency crisis could become difficult. Here too intensive co-operation between supervisors in problem detection and early-response is critical. Progress with the adoption in Council of the winding-up and liquidation directives in banking and insurance is a vital component of legal clarity in this area. The trend towards financial conglomeration is also blurring the dividing-lines between different financial activities and their related supervision. Co-operation between sectoral supervisors should be reinforced in line with progress in the Joint Forum. Similarly, the trend towards out-sourcing of some financial activities to external bodies complicates the task of supervisors in detecting and assessing behaviour of financial operators.

36. It is imperative that EU supervisors implement consistent approaches to management of such issues in order to safeguard the stability of the financial system in the single currency zone. Co-operation is necessary among supervisory authorities and between those authorities and the monetary authority responsible for the management of liquidity within the system. This will permit a clear allocation of responsibilities, so that a rapid response in any crisis situation is possible.

37. As supervisors are increasingly in the front-line in managing institutional and systemic risk on a cross-border basis, a well-developed approach to co-ordination is essential. The Commission sees merit in the elaboration of a "supervisors co-operation charter" which would clearly assign responsibility for performing different supervisory tasks on a cross-border basis and at the same time establish mechanisms for managing problems which raise different supervisory concerns.

#### **THE EXTERNAL DIMENSION OF INTERNATIONAL REGULATORY AND SUPERVISORY COOPERATION**

38. International developments reinforce the need for closer concertation between EU financial authorities. Globalisation implies that contagion effects are a foremost concern for supervisors and regulators. Recent developments have lent new impetus to cooperation at international level between regulators and supervisors. There is a growing sentiment that the global financial architecture which was conceived and established in the 1940s needs overhaul. A collective approach is needed if Member States are to secure the most appropriate supervisory arrangements for the Union.

*i) International regulatory cooperation:*

39. The Commission will continue to play a full and active role in forging an international consensus and widespread implementation of best practice in financial regulation. It will continue to support for the work of the IAS to secure a globally accepted set of financial reporting standards that will enhance financial transparency and facilitate the task of financial supervisors. Core elements of existing EU bank capital requirements are now being re-examined to bring them up-to-date with supervisory practices and banking trends. This process takes place in parallel with similar discussions in the Basle Committee on Banking Supervision in which the regulators of our main banking competitors participate <sup>21</sup>. The EU should take a leading role in tackling issues to maintain a level playing field (taking into account the heterogeneous structure of the EU banking sector). The Union must also take steps (See paragraph 7) to adapt its legislation as swiftly as the regulators of US, Canadian and Japanese banks.

*ii) International supervisory cooperation:*

40. In an increasingly integrated global financial market, rules on supervision are of crucial importance. Recent events demonstrate that the EU cannot be complacent about its regulatory and supervisory systems. These must be continuously scrutinised, adapted and improved where necessary. However, EU efforts should form part of an orchestrated effort at international level to bolster the effectiveness of financial systems. In the context of forthcoming GATS discussions, the EU will press strongly for improved supervision and better regulatory and administrative transparency alongside less restrictive rules for foreign direct investment in the financial services sector. Together, these should contribute to the soundness of capital markets worldwide.<sup>22</sup> This issue is also likely to be prominent in the next round of GATS discussions. Greater attention to institution-building and supervisory infrastructure are increasingly at the heart of World Bank structural assistance. The Member State supervisors are called upon to contribute to this work by ensuring the success of recently instituted arrangements (EFEX) for mobilising financial sector expertise for embodiment in technical assistance to crisis-hit countries.

41. However, by far the most significant undertaking that the Community has engaged in is the export of its regulatory system for financial stability to Eastern Europe. Accession candidates are making steady if divergent progress in implementing EU financial services legislation. This progress has, in part, helped these countries to escape the worst ravages of the international financial crisis. This legislative framework must be underpinned by effective monitoring and surveillance

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<sup>21</sup> Membership of the Basle Committee includes 8 Member States: Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Sweden, and the UK. The Commission and the ECB have an observer role

<sup>22</sup> The Asian financial crisis has highlighted shortage of expertise in the areas of disclosure, bankruptcy and winding-up of institutions, and financial audit.

mechanisms. Increasingly greater emphasis is being placed on institution-building and supervisory assistance in the context of preparations for accession. The Commission is currently exploring new ways to work with Member State supervisors and applicant countries in order to accelerate this work.

#### **POINTS FOR ACTION**

##### ***The Commission***

- ✓ *will contribute to the elaboration of a "supervisors charter", setting down relative responsibilities and mechanisms for co-ordination between different bodies having a supervisory function at EU level;*
- ✓ *will re-examine, with the Member States and in parallel with the Basle Committee on banking Supervision, the EU bank capital rules to bring them up-to-date*
- ✓ *will consider the prudential issues that financial conglomerates may pose in the light of progress in the Joint Forum*

##### ***The Council and the European Parliament***

- ✓ *should adopt the proposals for winding-up and liquidation directives in banking and insurance*
- ✓ *should support the EU taking a leading role to ensure consistency and maintaining a level playing field in the re-examining of bank capital requirements within the Basle process*

##### ***The Member States***

- ✓ *should urge their supervisory authorities to contribute to the fullest extent to the improvement of the global supervisory infrastructures*
- ✓ *should made concrete offers of expertise for utilisation under EFEX arrangements*

### **GENERAL CONDITIONS FOR A FULLY INTEGRATED EU FINANCIAL MARKET**

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42. A regulatory framework – no matter how resilient and up-to-date – cannot by itself secure an optimally functioning single financial market. A number of wider conditions must be fulfilled that demand a coherent response from Member States in their capacity as regulator, supervisor and competition authority.

#### **INFRASTRUCTURE**

43. A fully effective single financial market needs the technical and practical means to allow settlement of cross-border transactions to take place as smoothly and efficiently as those within national boundaries. The emergence of remote trading under the ISD

confirms that the technical means to trade across borders exist. Stock exchanges and derivatives markets are already moving to capitalise on this technology. Strategic link-ups between markets are forcing the pace of change to allow for clearing and settlement of securities transactions. These links should continue to be market-driven.<sup>23</sup> However, it is not only a question of establishing technical gateways for exchanges to link up to a single platform. A range of legal and administrative issues must also be tackled.

- ***Closing legal loop-holes in payment and securities systems:*** The Settlement Finality Directive is a core element of a sound legal and operational framework which is capable of containing related systemic risks. The introduction of the euro will increase the number of transactions involving cross-border use of collateral. We must therefore ensure that collateral provisions are mutually compatible to avoid undue disturbances to financial markets, and potential repercussions for the EU economy at large. Workable solutions at EU level will also encourage market-driven progress towards an integrated infrastructure such as the envisaged development of linkages between EU securities depositories. In addition, the system should be sufficiently sound and safe and offer guarantees against money laundering and fraud prevention. Work has been set in hand on expanding the scope of the Council Directive on Money Laundering to encompass other actors in the economic sector.
- ***Retail payment systems:*** Progress in providing the technical capacity to handle small transfers by private individuals continues to lag behind that for large volume transactions. This situation will prompt bitter comment from individual consumers unless cross-border payments within the euro-zone can be effected at low cost. Part of the answer lies in scaling back the obstacles that arise from statistical reporting. The forthcoming adaptation of statistical methods provides an opportunity to introduce appropriate exemption thresholds to deal with such difficulties. The Commission as a matter of urgency, will also continue to encourage the banking sector to develop cross-border links between the automatic clearing houses of domestic retail payment systems

#### **COMPETITION POLICY AND THE APPLICATION OF STATE AID RULES:**

44. With the introduction of the euro, competition in the financial services sector - which can already be regarded as strong - will certainly become even fiercer. This calls for a strict application of the rules of the Treaty providing for control over the abuse of dominant positions, co-operation between undertakings, mergers and state aid measures.

45. As concerns co-operation between banks, and other financial services firms, the Commission recognises that it leads to efficiency improvements in many fields such as the creation of integrated trading platforms as well as settlement and payment systems. But the Commission will remain vigilant that such agreements do not contain restrictions of competition, by allocating business, fixing prices, or by imposing private barriers to the free movement of financial services. Such barriers will be

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<sup>23</sup> The experience in respect of common market conventions for the euro markets testify to the ability of markets to identify solutions.



treated with particular strictness. Also, the Commission is highly sensitive to the transparency of access rules to the various networks on which many financial services depend.

46. Given the intensifying competition it must be noted that each intervention by Member States in form of state aid risks to cause significant distorting effects, which can only be balanced by a Community interest carrying particular weight. Thus, the next years require an even increased effort of the Commission to create a level playing field by applying strictly the state aid rules of the Treaty.

47. In fact, the Commission has had to deal within the last years with an increasing number of state aid case concerning undertakings in the financial services sector. A number of state aid investigations to the financial services sector are currently ongoing. The Commission will, when it approves state aid for the restructuring of a financial institution, continue to ensure that some sort of compensation, e.g. a reduction in business of the supported undertaking, is imposed in order to offset the distortion resulting from a state aid.

48. Following a request of the European Council at its meeting in Amsterdam in 1997 the Commission has prepared a report on "services of general economic interest in the banking sector" which shall be submitted to the ECOFIN Council in due time. That report examines whether in the different Member States credit institutions render services of general economic interest, whether the provision of a comprehensive and efficient financial infrastructure is regarded as such service, whether an exception under Article 90 paragraph 2 of the EC Treaty is claimed to be necessary for any of such tasks and whether or not the situations in the different Member States are comparable. Based on this report the Commission will apply in the future Article 90 paragraph 2 of the EC Treaty to the banking sector on a case to case basis.

## TAXATION

49. Taxation policies must be conceived and implemented in a manner which takes account of the common good flowing from an efficient and undistorted single financial market. With the disappearance of exchange risk as a deterrent to real pan-European investment strategies, disparities in tax treatment is already emerging as a significant distortion of the allocation of resources. Both the provision of services on a cross-border basis and the localisation of financial intermediaries are heavily influenced by the tax environment.

50. *Tax distortions to the placement of savings:* There is little point in removing the obstacles to free movement of capital if, in the end, the placement and processing of private savings is determined by disparities in the tax treatment of income on capital. Private savings of taxable individuals is a resource which is particularly prone to divergences in tax treatment of capital earnings: savings tax rates are bid downwards at the expense of the national exchequer. The location of economic activity engaged in handling and management of private savings is also distorted. The Commission's savings tax proposal is a specially targeted measure, which is designed to counter distortions by ensuring a minimum of effective taxation of cross-border savings income.

51. *Harmful tax competition between financial centres:* The Code of conduct Group is actively examining potentially harmful tax measures following the December 1997 agreement on a code of conduct on business taxation. The code aims at countering harmful tax competition which may affect in a significant way the location of business activity in the Community.

52. *Taxation of financial service products* (life insurance and pension funds). Substantial variations between tax systems increase direct costs for financial services providers. Life insurance and other savings products, for instance, need be tailored in order to have the characteristics required in the host Member State to benefit from tax relief. They must also comply with the various tax collections and information requirements. Instead of allowing service providers to benefit from economies of scale, this drives up costs and can act as a disincentive (or even acts as an insurmountable barrier) to cross border business. Such requirements lead providers to duplicate country specific infrastructure, forcing up operating costs and restricting competition. There are also clear obstacles, which accentuate the risk of double taxation at the level of the individual beneficiary, thereby discourage consumers from entering into cross-border contracts. In mortgage credit and life insurance for example, only the premiums paid to a domestic institution will receive favourable tax treatment (in terms of tax deductibility).<sup>24</sup>

53. *Tax obstacles to pan-European company structures and mobility of persons:* In an integrated economic and monetary zone, labour mobility is a factor of adjustment in case of asymmetric economic shocks. Eliminating obstacles which hinder labour mobility will provide a further element of stability for a smoothly functioning euro. Adjustments to taxation in the pension fund area can contribute to securing this objective. First, the mutual recognition of national fiscal regimes would facilitate the provision of pension services on a pan-European scale. Companies operating in several Member states would not be obliged to set up a specific fund in each and every country, with the associated negative impact on the cost of labour. An individual should also be able to continue to contribute to a single pension fund on a cross-border basis, without losing acquired rights or suffering tax disadvantages. Individuals (particularly for workers who are posted abroad for relatively short periods) could exercise their rights to work and reside in other Member States. This issue has partly already been addressed in Community legislation.<sup>25</sup>

54. *Address divergent tax treatment of debt and equities:* Efforts to improve EU financial markets will be undermined if the attractiveness of debt-financing continues to be artificially enhanced through the tax system. Interest income from debt (savings accounts and bonds) is generally subject to lower levels of taxation than dividend income on shareholdings in companies. Differences in the tax treatment of foreign dividend income relative to domestic dividend income persist despite the complex

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<sup>24</sup> Note that there are different financing methods for supplementary pension schemes (pre-financing, PAYG, book-reserve)

<sup>25</sup> cf. Directive 98/49/EC on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community. Tax-related issues are to be addressed in a separate proposal.

matrix of bilateral tax treaties between Member States. The Commission will continue to press for a change to a situation which results in perverse price signals to investors who are penalised rather than compensated for investing in riskier assets thus starving corporate issuers (and particularly small listed companies) of equity funding.

#### **POINTS FOR ACTION**

##### ***The Commission***

- ✓ *will make proposals to enhance legal certainty for the use of collateral on a cross-border basis*
- ✓ *will scale back statistical obstacles to handling small retail payments*
- ✓ *will submit a report to the Ecofin Council on Services of General Economic Interest in the Banking Sector and the application of the competition rules of Article 90(2)*
- ✓ *will submit a report on "Services of General Economic Interest in the Banking Sector" to the ECOFIN Council*
- ✓ *will make proposals to address the tax obstacles to cross-border membership of pension funds thus facilitating the development of pan-European company structures and encouraging labour mobility.*

##### ***The Council and the European Parliament***

- ✓ *adopt the proposal for a Directive on Savings Tax*

##### ***The Council and the Member States***

- ✓ *should ensure the implementation of the Code of Conduct on Business Taxation*

## BUILDING A CONSENSUS:

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55. This response to the European Council's request for a framework for action in the field of financial services is based on an extensive, though brief, consultation with all interests. The consultation signalled a number of key areas calling for action in the short, medium or longer term but also identified the euro as a powerful catalyst for change. The prudential foundations for managing the adjustment resulting from the single currency are sound. A far more integrated EU financial market is within reach. A number of relatively small steps – particularly in the wholesale markets – will allow the EU to benefit to the full from single currency. Its rewards are real and substantial – a globally competitive sector that can better meet the needs of investors, industry and the consumer without compromising the high standards of consumer protection nor undermining the market's capacity to weather instability, and ultimately contributing to increased growth.

56. The actions identified in this background paper are intended to provide a basis on which to establish a clear set of priorities for future work, a framework for financial services in which certain actions may take several years to complete.

57. The Council and the Parliament are now invited, with the Commission, to take forward the debate. To maintain political momentum, the Commission proposes that personal representatives of Finance Ministers should be nominated by Member States and meet in a Financial Services Policy Group, chaired by the Commission.

58. Its immediate objectives are twofold: first, the Group should identify and prioritise a set of actions by June 1999 to be presented to the Council.

59. The second task of the Group, during the period prior to June 1999, is to define a number of immediate priorities to guarantee momentum to the process.

60. The Group will also assist the Commission in collective monitoring of implementation and enforcement of financial services legislation.

61. The Commission intends to report back to ECOFIN on a regular basis.

62. The Commission will also establish a High Level consultation mechanism to ensure that both market practitioners and users of financial services are able to make a full contribution to the formulation of policy in this area.

ISSN 0254-1475

COM(98) 625 final

# DOCUMENTS

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09 10 08 01

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Catalogue number : CB-CO-98-616-EN-C

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Office for Official Publications of the European Communities

L-2985 Luxembourg