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Speech by Gerben Everts, European Commission

“The Impact of Financial Regulation on Legal Practice”

Introduction

It is an honour to be invited to this conference and to be the first speaker today. The momentum couldn't have been chosen better. The end of the year always provides a good opportunity to look back. To stand back from events. We are now roughly halfway through the timeframe for the implementation of the Financial Services Action Plan. And are in the final stage of putting in place the fundamentals for a Single Financial Market in Europe.

But at a time like this, it is natural to be a bit weary. These grey December days are very hard! Is it worth all the effort? What do we really need to do? Will we be stuck in a cycle of endless legislation? How can we ensure it works effectively?

I understand this weariness. But before we get too downhearted, let us bear in mind that we went through this exact same feeling before the introduction of Euro notes and coins at the start of this year. Enormous efforts and investments were made the years before, for benefits to be gained in the future.

In today's speech I would like to address three issues: First, the fundamental question why efforts are needed to integrate financial markets in Europe. Then, I will present what we do to deliver this integration, the state of play. Finally the question “How?”, and I will touching upon the new regulatory structure adopted this very week.

Why do we need an integrated financial market in Europe?

The principles for the EU single market originate from the EU Treaty, updated in Maastricht, Amsterdam and Nice. To ensure free movement of goods, persons, services and capital, Member States had to take away existing barriers. This was a major breakthrough. But an important aspect remained unsolved. European financial markets are still too fragmented. Levels of stock market capitalisation and cross-border activity are still far too low. European companies are being held back.

We need effective funding, or better “oil”, for the system to function. The freedom of movement remains a passive right. As long as barriers exist, competition within Europe is sub-optimal. We need to actually stimulate movement. To act in anticipation. To stimulate competition. To take away barriers, if necessary, even before they have become obvious.

To be able to anticipate or even respond, we have to understand and analyse the changes that occur in the financial market.

The first important change is the scope of our environment. Events – not only in Europe – but in the whole world, can have severe impact on each individual market. We have experienced this rather recently in the Asian, Russian and Argentinean crises. And, you must admit: your pension capital has also suffered from the US affairs of Enron and Worldcom. Even though crises will always occur, an integrated and well functioning financial sector is the best defence to counter these attacks, or to smoothly absorb them, if necessary.

The second change we must anticipate, is the scale of innovation in the financial sectors. A stock exchange today is not comparable to an exchange only a decade ago. The line between banks and insurance firms is also blurring with the creation of financial conglomerates.

A third type of change occurs as a reaction to earlier, separate events. The Euro is irrevocably changing the European financial landscape, making markets far more transparent, but at the same time, its introduction has exposed many previously hidden shortcomings. We must tackle these shortcomings. EU Enlargement is another example. This will fundamentally change the financial services sector in the coming years.

All these changes occur and we need to anticipate or react appropriately. But, there is also the change that we in the EU are looking to bring about ourselves. Making the European economy the most dynamic and competitive knowledge-based economy in the world.

Europe’s Heads of State and Government adopted this ‘Lisbon strategy’ two years ago. A tangible goal. Our political leaders have grasped the link between financial integration and economic growth and job creation. Reports have shown that integration could add as much as 1,1 per cent in the next decade to EU’s output, or

roughly 130 billion Euro. The cost of capital could decrease by 50 basis points. Business investment levels will grow with 6% and employment will increase by 0,5%.

The study also shows that all Member States – even the most developed - will gain. These are only conservative estimates of real, direct and sustainable profit. The real impact could be far higher, as increased competition and innovation are not taken into account yet.

But, as we try to anticipate and create change, the question comes up: 'How?'

What we do to deliver an integrated financial sector; The state of play

First, let me explain anecdotally the way decision making in Europe takes place. I am struck by how many visitors from across Europe, across sectors, say they agree with all legislative proposals. But, then list twenty things that they don't like with proposal X, and a further ten that they can't stand in proposal Y. The next visitor then says the same thing, but point out twenty diametrically opposed problems. And these same people will be the ones who will complain if we do not come out with a final product. If we accepted both, we would have no proposal left. Left standing still – death by a thousand amendments.

This is why we came forward with a plan of 42 legislative and no-legislative measures, the Financial Services Action Plan in 1999, with a clear and single goal: to integrate the financial services market. And, we have set tight targets for its completion: 2005 for the entire plan, and 2003 for securities aspects.

With the plan, there is an urge to reach compromise, as we have to deliver the plan on schedule. Vested interests are no excuse for delay anymore. The proof of the pudding is in the eating; as Europe we have to prove that we can function with 15 or 25 different interests. That we can set clear goals and achieve them.

But, it is our firm belief that to create a single market, you first need an effective base of EU legislation. Without this, we would have other concerns. We would have 15 isolated islands, looking enviously at the successes of our Western neighbour, the US. Successes originating from a developed integrated market.

Up to now, we have delivered nearly three quarters of the Action Plan measures. The latest progress report, distributed this week to Ministers, and available on the Commission's website, concludes there has been sustained progress in adopting new legislation to the set timetable.

But, what are the measures of the Action Plan? I will not present each individual measure. Let me divide the elements of our ambitious Action Plan into three categories. The first is how to tackle barriers to investment and the raising of capital. The second is the protection of investors. And the third is about how we can organise effective supervision.

On tackling barriers to investment and capital raising, the most work had to be done and a lot of progress has already been made. Let me give you a few examples.

Earlier this year, we adopted the two so-called “UCITS” Directives, modernising the regulation of mutual funds. We are building on this with the Pension Funds Directive, requiring funds to properly and prudently diversify their investments. The EU recently adopted a Directive on Financial Collateral, establishing a uniform legal framework, and thus protect market participants.

Tackling barriers also means creating a level playing field and putting in place effective checks and balances. In some countries some shareholders are more equally treated than others. Especially minority shareholders need to have a backbone when confronted with a controlling shareholder. A pan-European market for corporate control can only function with a well-developed shareholder democracy. The appointed board has to work to the benefit of their shareholders. This is not only a fiduciary duty, it is an economic duty to the company. To employees, to investors, to financial markets. The threat of a take-over is believed the best discipline to firms and their management.

In a revised proposal for the Take Over Directive, published by the Commission two months ago, we therefore kept the ‘Neutrality principle’. The principle that during a Take Over Battle, the board of the target company has to refrain from action. To encourage cross-border investment, shareholders must be given control related to their investment.

This brings me to the second category of the Action Plan: the protection of investors. Last month, we reached nearly unanimous political agreement on the proposed Prospectuses Directive. European companies who want to raise capital will have access to investors across the Union, with one document, instead of 15, a so-called European Passport. Each issuer will only have to have it approved once. We needed to harmonise disclosure standards, as specific rules at national level too often form an artificial argument for restrictions in cross-border competition.

The proposal agreed upon includes a sufficient set of initial disclosure requirements. It does not effect supplementary disclosure by listing requirements, like size or financial history, or corporate governance regulation. It is an optimal balance.

Protection of investors implies setting free respectable market operators. And reining back the less scrupulous and the incompetent.

This brings me to the Enron affair. Whatever the final outcome turns out to be, it has brought light to a number of policy issues. I would like you to be aware that the specific issues on accounting, were already in preparation long before the Enron affair broke out. The measures were part of preventing that collapses like Enron could happen here. By making sure accounts are reliable. By creating more transparency and by requiring fuller disclosure for investors.

Let me give a few elements of the Action Plan related to EU's overall policy response to Enron.

First, financial reporting. A regulation has already been adopted requiring all listed companies in the EU to use International Accounting standards, the IAS, from 2005 onwards. We support the principles-based approach to financial reporting, as this reflects economic reality and gives a true and fair view of the financial position and performance of a company. Financial accounts will become more easily comparable, which will simplify life for both investors and companies.

Secondly, Corporate governance. The High Level Group of Company Law Experts, under the Chairmanship of Professor Winter, has been looking at this issue. The Experts provided the Commission with several recommendations on corporate governance and company law in October. Recommendations on disclosure by listed companies of their corporate governance structures and practices; co-ordination of Member States efforts in the area of corporate governance; reinforcement of shareholder rights ; management responsibility for financial statements; the role and composition of audit committees; the independence of non-executive directors and supervisory boards; and management remuneration.

It is too early to define the Commission's overall reaction on the content of the report. We are in listening mode, consulting widely with Member States, the European Parliament and other experts. We will come up with an Action Plan – consisting of both legislative and non- legislative measures – in the end of Spring next year.

This must also be seen in the context of the U.S. implementation of the Sarbanes-Oxley Act and the “spill-over effects” it raises. Even to obtain tailored exemptions for EU issuers and audit companies, we will have to prove that our laws and requirements address the same concerns that Sarbanes-Oxley intends to remedy. The more effective, co-ordinated and robust our approach, the stronger and convincing we will be vis-à-vis the U.S. And, of course, the stronger our financial markets will be.

I have mentioned the first two elements of the Action Plan: to tackle barriers to investment and raising capital, and to protect investors. But to make these elements effective, we must ensure effective supervision of companies and markets. Let me give you a few examples. The present work on the review of the Bank Capital Rules, which will introduce rules which are more risk sensitive and based on internal risk systems. Furthermore, last month a most innovative Directive on financial conglomerates was adopted. It introduces the concept of a lead supervisor for each financial conglomerate. This week the Council adopted the directive on Market Abuse, ensuring common standards and protection against insider dealing and market manipulation.

How to deliver the Action Plan; towards a more effective regulatory system

As members of the bar, you must be used to absorbing a lot of information in a short time. When I list the legislative programme of the Commission related to elements of the Action Plan, I always get a bit restless. And others as well. Isn't this too much? As we are steadily proceeding towards a Single Financial Market, it indeed becomes clear that it is not just a question of identifying problems. Or to come up with the most optimal legislative solutions. Actually, delivering results is even more important. I can already inform you that after 2005 we will not come up with a wave of 42 new legislative measures. To the contrary I should say. As the fundamentals will be there, we will shift our attention to the correct, timely and equal implementation and effective enforcement.

To get it right at a European level, we need to co-operate and to profit from the structures and knowledge already available. The opinions and advice of regulators, market participants and end-users from across Europe are the essential ingredients. Subsidiarity is important here. We will not introduce centralised European supervision, this is a step too far. We need to act as close to the market as possible, in a way that

is proportional to the issues addressed. Co-ordination of supervision must be further developed.

We need to continue our approach in consultation and transparency. The earlier we can spot potential issues and problems, the more effectively they can be dealt with. That is why we undertake extensive consultation on all our proposals, to improve the quality of policy making.

Increased consultation and transparency form the basis of the procedure we have adopted in the securities field, following the recommendations of the committee chaired by Alexandre Lamfalussy. This procedure leads to improvements in Community legislation, and will allow us in the end to speed up the process. It provides a system that is able to timely put in place laws adapted to changes in the market. Like Baroness Scotland said, during last year's conference: "The strength of our law is its susceptibility to practice. It is not a dry, theoretical thing. It is adaptive, evolutionary, flexible, responsive to changing needs". I cannot agree more.

Relying exclusively on co-decision for financial market regulation, which takes five years from identification, to the date of transposition into national law, simply does not work in a fast changing environment. This week EU Finance Ministers agreed to extend these rules already applied in the securities sector, to the banking, insurance and financial conglomerates sectors.

The Lamfalussy approach means that only framework directives will be adopted in co-decision between Council and European Parliament. Secondary legislation, or better: the implementing rules, will be adopted by Committees of both Ministry representatives and technical experts. Supervisory committees will provide input for the discussions there. Open and transparent procedures are key to the success of this decision making system!

The question rises what the European Parliament will ask as compensation for their loss of influence on implementing rules. As the Lamfalussy approach only foresees in a direct role for Parliament in the adoption of framework directives, Parliamentarians have already requested a right of call-back on secondary legislation. But, as this right of call-back right may also effect regulation in completely different fields, this discussion will be an element in the Intergovernmental Convention that is currently being held. The Commission published its own views on the Convention last Wednesday. We are clearly in support of Parliament's requests to increase its

legislative competencies. This discussion will, I suspect, continue over the next months.

Conclusion

Chairman, Ladies and Gentlemen, let me conclude. We stand at a crossroads of European financial history. There is a new sense of urgency on the Financial Services Action Plan. More and more people are behind us in our firm belief that the best way to boost our economy is to deliver quickly on our commitment to structural reform.

That means getting results. Results that will make our European Union stronger. Results that will protect investors and increase their confidence. Results that will break down barriers for the functioning of the Internal Market. That will get rid of irrational and protective national procedures. With the aim to benefit the welfare of our citizens. That is the noble goal we face.

The goal for Europe is to become the most dynamic and competitive knowledge based economy by 2010. But, it is only a first step. If we pick apart policies and process, we will never achieve the benefits forecast. All our efforts will be in vain. Europe will end up with something like the Tower of Babel. We need to compromise on difficult issues. To keep pace with financial markets. To shift our focus to effective implementation, enforcement, and international co-operation.

It is not about hollow ambitions, no undirected approach. And – and I like to stress this – not about protecting vested interests. This is about broad political commitment to fill the existing gaps and create a single EU financial market. It is about more efficiency. No longer having to specialise in 15 or 25 different systems of law. It is about a direct reward of 130 billion Euro. The European Circuit can play an important role in this. I hope we can count on your support.

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