

Chapter 2

The Financial Services Action Plan

Andrew Marsh

2.1 Introduction

The main aim of the Treaty of Rome was to achieve the four freedoms of movement of goods, persons, services and capital¹ (substantive provisions to this effect were set out in Titles I and III of the Treaty). Of particular relevance in the context of financial services are the provisions of Chapter 2 of Title III, which prohibit Member States from restricting the right of establishment,² and Chapter 3 of that Title, which makes equivalent provisions with respect to the free movement of services.³

The provisions of Titles I and III of the Treaty provide the principal legal bases for the creation of the internal market. Although the European Court of Justice has attempted to expand the scope of the internal market in a number of legal judgments based on these Articles,⁴ the impact of the Articles has been limited by the derogations that they contain.⁵ An alternative mechanism for creating an internal market is the passing of harmonisation legislation in accordance with the procedure set out in Article 94 of the Treaty (in the case of the single market in financial

¹ See Article 3(1)(c).

² Articles 43 to 48.

³ Articles 49 to 55.

⁴ For example the well-known jurisprudence of the European Court of Justice developed in *Cassis de Dijon* (*Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein* Case 120/78 [1979] ECR 649) and related cases, which elaborated on and expanded the provisions for the free movement of goods contained in Article 28.

⁵ For example the derogation contained in Article 46(2) in relation to the right of establishment, under which Member States can restrict the right of establishment for non-nationals on grounds of “public policy, security or health”.

services such legislation dates back to 1973).⁶ However, the usefulness of the Article 94 legislative process has been hampered by:

- (a) the requirement that there must be unanimity in the Council of Ministers; and
- (b) the practice of drafting highly detailed legislation.

Notwithstanding the limitations surrounding the Treaty, progress towards the creation of the internal market was significantly enhanced by the passage of the Single European Act in 1986 ("SEA 1986").⁷ One of the central provisions of the SEA 1986 involved the introduction of qualified majority voting in the Council of Ministers with regard to legislative proposals aimed at harmonising Member States' laws. Another important change post-SEA 1986 concerned the type of harmonisation legislation passed; less-detailed framework legislation was adopted at Community level and greater use was made of:

- (a) the principle of mutual recognition; and
- (b) lower-level standardisation measures to fill the gaps left by the framework Community legislation.⁸

The Financial Services Action Plan ("FSAP") should be viewed as a key step in the evolution of the internal market, as envisaged by the original Treaty and accelerated by the SEA 1986. The FSAP focused on the freedom to provide financial services across the Community. Although progress towards the completion of the single market following the SEA 1986 has been most evident in the area of free movement of goods, the SEA 1986 does address the four freedoms set out in the original Treaty, including the free movement of services. However, progress reports on the internal market since 1992 commented on the lack of a single market

⁶ See for example the Directive on the Abolition of Restrictions on Freedom of Establishment and Freedom to Provide Services in respect of Self-employed Activities of Banks and Other Financial Institutions (73/183/EEC) and the First Non-Life Coordination Directive (73/239/EEC).

⁷ The SEA 1986's aim was to complete the internal market by the end of 1992. See Article 14(1) EC, introduced by the SEA 1986. The policy document behind the SEA 1986 was the Commission's White Paper "Completing the Internal Market", 14 June 1985 (COM (85) 310).

⁸ This approach was not provided for by any specific Treaty change arising from the SEA 1986 but became the practice of the Community institutions and grew out of proposals made in the Commission 1985 White Paper. An elaborated version of such an approach to legislative procedure has been put forward in the context of the FSAP by the Lamfalussy Report. See Chapter 1 for further discussion.

in financial services and contemplated measures which became part of the FSAP.⁹ The introduction of the euro on 1 January 1999 helped to create the conditions necessary for the successful completion of the single market in financial services and, with this in mind, in June 1998 the Cardiff European Council invited the Commission to “table a framework for action . . . to improve the single market in financial services”.¹⁰ This was the political birth of the FSAP.

2.2 Why was the FSAP introduced?

As with the whole single-market project, the principal ostensible motivation behind the FSAP was economic. It was envisaged¹¹ that the successful completion of the single market in financial services would bring substantial economic gains to the Community. These prospective gains were both macro- and microeconomic. At the macro level, capital and labour productivity were expected to grow as a result of increased efficiencies resulting from the creation of a single market in financial services. The Lamfalussy Report called for a quantitative study of such prospective benefits, as was carried out in the context of the SEA 1986 and the drive for completion of the internal market in the late 1980s by the Cecchini Report.

At the microeconomic level, it was envisaged that the single market in financial services would mean that:

- (a) capital could be raised more easily by European companies; and
- (b) the demand for capital could be matched more easily with its supply.

In the FSAP the Commission often emphasised (in the context of improvements to the wholesale financial services market) the need to make more flexible and readily accessible forms of financing available to innovative start-up companies. On the retail side, the aim was to ensure that consumers have access to a greater choice of financial products.

⁹ For example the Commission Communication “Action Plan for the Single Market”, 4 June 1997 (CSE(97)1).

¹⁰ Pt 17, Presidency Conclusions from Cardiff European Council (15–16 June 1998).

¹¹ By the Commission in both the Framework for Action and Action Plan documents (see 2.3 and 2.5 for further discussion of both documents).

It was also hoped that integration of the financial services sector would help the EU to compete more effectively in economic terms with the US. The large integrated economy of the US provides small and medium-sized US companies with easy access to capital and makes the cost of raising capital much lower than it is in Europe. The efficiency of the US financial market makes it more difficult for EU firms to compete effectively. The then European Commissioner for the Internal Market, Fritz Bolkestein, in a speech to the Comité Européen des Assurances on 21 September 2000, noted that "the absence of a single European capital market puts European firms at a disadvantage compared to US competitors". These sentiments were echoed by Marc Lackritz, President of the US Securities Industry Association, in his testimony to the House Committee in its hearing on the implications of the FSAP for the American financial services industry.¹² He commented that EU companies were impeded by the complexity of cross-border capital raising and thus, compared with their US counterparts, were subject to higher costs.

2.3 A framework for action

In June 1998, the European Commission was invited by the Cardiff European Council to table a framework for action in order to improve the single market for financial services.¹³ Although the Cardiff Council concluded that good progress had been made in modernising and simplifying the single market, it emphasised that further work was required if the single market was to make "its full contribution to competitiveness, growth and employment". In preparing its framework for action, the Council invited the Commission to examine how effectively existing legislation was being implemented and to identify any weaknesses in existing legislation that would need to be amended.

The European Commission responded to the Cardiff Council's invitation by publishing a paper on 28 October 1998 – "Financial Services: building a framework for action" ("the Framework Paper").¹⁴ The Framework Paper acknowledged that the advent of the single currency was helping to modernise European wholesale markets, but it noted that this alone

¹² The House Committee was chaired by Senator Oxley and the hearing took place on 22 May 2002.

¹³ Presidency Conclusions from Cardiff European Council (15 and 16 June 1998) (press release number 00150/98).

¹⁴ COM (1998) 625.

would not ensure removal of barriers to cross-border trade and the delivery of a competitive single wholesale market. It therefore outlined a series of measures aimed at ensuring that the EU's financial services sector realised its full potential against the background of the introduction of the euro and would be capable of sustaining competitiveness in the long term.

The Commission concluded that the EU required a more flexible regulatory framework capable of responding quickly to changes in financial services markets. It commented specifically on retail financial markets and the cross-border sale of financial products to consumers and noted that consumer confidence in the EU was hampered by administrative requirements, insufficient tax harmonisation and a lack of transparency. The Commission said that it hoped to enhance consumer confidence by promoting full market integration while ensuring high levels of consumer protection. It also highlighted the importance of supervisory and regulatory cooperation in safeguarding financial stability.

The Commission's Framework Paper outlined six key aims:

- (a) developing a legislative process which would streamline the drafting of legislation and be more responsive to new regulatory developments and challenges;
- (b) the elimination of market fragmentation to make capital-raising cheaper;
- (c) achieving a single market for retail financial services which benefits from a high level of consumer protection;
- (d) promoting closer cooperation between supervisory authorities;
- (e) developing an integrated EU infrastructure to underpin retail and wholesale financial transactions; and
- (f) the removal of disparities in tax treatment.

The Commission concluded that existing legislation did not need to be completely remodelled to achieve these aims. Instead, the Commission called for "pragmatic but decisive action to turn new opportunities to our best advantage".

2.4 The Financial Services Policy Group

The Framework Paper was intended to act as the basis for establishing a clear set of priorities for future work. The Council, European Parliament and the Commission were charged with undertaking further work

to identify and prioritise a set of actions to be presented to the Council by June 1999.

To help maintain the momentum generated by the publication of the Framework Paper, the Commission recommended that a Financial Services Policy Group ("FSPG") be established. The FSPG, a high-level group chaired by the Commission,¹⁵ held its first meeting on 28 January 1999 to identify and prioritise a series of actions to present to EU Finance Ministers and the Council. The FSPG was asked to focus its efforts on four specific areas, namely to identify:

- (a) where new legal initiatives would be required;
- (b) where existing provisions would have to be adapted to take account of new developments;
- (c) where existing provisions would need to be simplified; and
- (d) where existing provisions needed to be made more coherent.

Mario Monti, the then European Commissioner for the Internal Market and chairman of the FSPG, called for cooperation and open-mindedness in agreeing a series of measures which would promote the cross-border provision of services whilst maintaining investor and consumer confidence.

2.5 The Financial Services Action Plan

On 11 May 1999, following three meetings of the FSPG to discuss and build on the Framework Paper, the Commission published its FSAP.¹⁶ The FSAP, which set out the overall policy and steps required to improve the single market for financial services, was endorsed by the European Councils in Lisbon and Stockholm in March 2000 and March 2001 respectively. At these meetings the European Council set 2005 as the deadline for implementation of the FSAP and the integration of the financial markets, and 2003 as the target date for integration of the securities market.

The FSAP recommended priorities and timescales for legislative and other measures to tackle the following three main strategic objectives:

¹⁵ The FSPG's members were personal representatives of the EU's Finance Ministers and the European Central Bank.

¹⁶ COM (1999) 232, 11 May 1999.

- (a) completing a single market for wholesale financial services;
- (b) developing open and secure retail markets; and
- (c) ensuring the continued stability of EU financial markets through adequate prudential rules and supervision.

The FSAP also referred to more general conditions for ensuring an optimal single financial market, such as the elimination of disparities in tax treatment and differences in corporate governance arrangements. By grouping the suggested measures together in one document it was hoped that, collectively, they would have a higher priority than would have been possible to achieve if each measure had to be pursued independently. Each of the FSAP's three main strategic objectives is considered in more detail below.

2.5.1 A single market for wholesale financial services

In the FSAP the Commission emphasised the impact of the introduction of the euro on the wholesale provision of financial services in the EU. It commented that major restructuring was already underway in this sector, as evidenced by the relationships between different exchanges and the consolidation of payment and securities settlement systems. The Commission regarded the wholesale sector as the engine-room behind consolidation of a European market in financial services and its aim was to eliminate the "present mass of legal and administrative barriers" to allow this market to function and develop as freely and effectively as possible.

The following areas were identified by the Commission as requiring specific action:

- (a) common rules for integrated securities and derivatives markets;
- (b) raising capital on an EU-wide basis;
- (c) financial reporting;
- (d) a single market framework for supplementary pension funds;
- (e) collateral; and
- (f) a secure and transparent environment for cross-border restructuring.

2.5.1.1 Common rules for integrated securities and derivatives markets

The Commission emphasised the importance of the Investment Services Directive ("ISD")¹⁷ to this area and highlighted the need for reform of

¹⁷ Directive 93/22/EEC.

the procedures adopted under it. The Commission believed that the ISD required urgent attention if it was to “serve as the cornerstone of an integrated securities market” (in the Commission’s view, effective cross-border provision of investment services and the application of a uniform set of conduct of business rules across the Community were critical factors to the development of a single market). The Commission also recognised the need for differentiation between the conduct of business rules applicable to professional investors and those applicable to less sophisticated investors. It suggested that the full protection of domestic rules should be required only in the latter case, leaving professional investors free to take advantage of a uniform Community-wide regime.

The Commission also believed that new technologies required a modern legal framework for secondary markets and a common understanding of certain basic issues. For example, there needed to be agreement on the definitions of markets and exchanges to ensure that responsibility between different authorities for authorisation and supervision is clear. In addition, a common approach to the authorisation and supervision of alternative trading systems and safeguards against market manipulation were required.

All of these issues were addressed in the Markets in Financial Instruments Directive (“MiFID”).¹⁸ MiFID itself was adopted in April 2004. At the time of writing, level 2 implementing measures for MiFID have not been finalised. When it comes into force (which at the time of writing seems likely to be 1 November 2007) MiFID will replace the ISD in its entirety.

In tackling the issue of market manipulation the Commission proposed a directive on insider dealing and market manipulation. On 30 May 2001 the Commission presented a proposal for a Market Abuse Directive¹⁹ and on 19 July 2002 the Council adopted its common position on the Directive. The Council and the European Parliament were urged to adopt the Market Abuse Directive as early as possible in 2002, and on 3 December 2002 the Directive was adopted by the Council.

2.5.1.2 Raising capital on an EU-wide basis

The Commission had hoped that the 1989 Prospectus Directive²⁰ would achieve mutual recognition of prospectuses between Member States.

¹⁸ See Chapter 4.

¹⁹ COM (2001) 281. See Chapter 5.

²⁰ Directive 89/298/EEC.

However, this goal was never realised because Member States introduced and imposed their own super-equivalent provisions. Mutual recognition was granted only to prospectuses that contained certain information and were approved by home-state authorities. However, the host country authority was entitled to require additional information about the domestic market and differences in national requirements made it difficult and costly to raise capital throughout the EU because they required the production of multiple sets of official documentation before issuers could offer securities in other Member States.

The Commission indicated in the FSAP that changes to the Prospectus Directive might be made, and on 30 May 2001 it published a proposal for a new directive on prospectuses (an amended proposal was published on 9 August 2002 and the Council reached political agreement on the directive on 5 November 2002 – a common position on the directive was published on 24 March 2003).²¹ The new Prospectus Directive was adopted in November 2004 and was required to be implemented in Member States on 1 July 2005. It is based on the concept of a “single passport for issuers”: the idea that once a prospectus has been approved by the home state’s authority it must be accepted throughout the EU for public offers and admission to trading on regulated markets. It was hoped that this system would be more effective than the existing mutual recognition system, making it easier and cheaper for issuers to raise capital throughout the EU.

2.5.1.3 Financial reporting

The Commission also saw a need for financial information to be comparable and transparent if cross-border investment was to be encouraged. It believed that the preparation of financial statements on the basis of a single set of financial reporting requirements would help companies to raise capital throughout the EU. However, the Commission acknowledged that comparable accounting practices throughout the EU needed also to be aligned to international best practice.

A regulation on the application of International Accounting Standards (“IAS”) was adopted by the Council in June 2002.²² This regulation required all EU companies listed on a regulated market to prepare and publish their consolidated accounts in accordance with IAS with effect from 2005 onwards. However, the regulation provided that the

²¹ COM (2001) 280. See Chapter 6.

²² Regulation 1606/2002 was published in the Official Journal on 11 September 2002.

international standards could only come into force if they were specifically adopted by the Commission in accordance with a procedure set out in the June 2002 regulation. The adoption process was not straightforward. IAS 39, on accounting for financial instruments, was adopted just weeks before the 1 January 2005 start date, subject to two carve-outs relating to “the full fair value option” and hedge accounting. These carve-outs were made because of concerns expressed by the European Central Bank and others. They were intended to be temporary, pending adoption by the International Accounting Standards Board (“IASB”) of “improved” standards. Following publication by the IASB of an amended IAS 39 with a more restricted fair value option, the Commission adopted the amended standard in November 2005, with retroactive effect to 1 January 2005. At the time of writing, however, the carve-out in relation to hedge accounting remains in place, resulting in potentially significant differences in the way in which different EU listed issuers report on their financial position.

In the FSAP the Commission also proposed legislation to amend the accounting provisions of the fourth and seventh Company Law Directives. Amendments have been made to those directives by Directives 2003/38/EC (as regards amounts expressed in euros) and 2003/51/EC (as regards general modernisation and updating of accounting rules).

2.5.1.4 Single market framework for supplementary pension funds

The FSAP noted that supplementary pension funds (i.e. those which are employment related) should operate within a single market framework. The Commission commented that an appropriate prudential framework was necessary to allow fund managers to improve fund performance without compromising the protection of the fund’s members. The development of funded pension schemes within the EU had become an increasingly important issue in the light of the move away from reliance on state-funded pensions. The importance of this issue was acknowledged by the Lisbon European Council, which called for the elimination of barriers to pension scheme investment; it recognised that the development of funded private sector supplementary pension schemes would offer a major source of capital for business within the EU.

The measures outlined in the FSAP included a possible directive on the prudential supervision of pension funds. A directive was formally adopted in June 2003.²³

²³ Directive 2003/41/EC.

2.5.1.5 Collateral

The stability of the EU financial system relies on the mutual acceptance and enforceability of cross-border collateral. In the FSAP the Commission noted that there was considerable uncertainty surrounding the enforceability of cross-border collateral arrangements in the event of the insolvency of the collateral provider. It believed that failure to resolve these issues would result in higher transaction costs and increased risks. In an attempt to address these potential problems, the Commission said that it would be developing proposals for a collateral directive. The Collateral Directive, which aims to create a clear and uniform EU legal framework to limit credit risk in financial transactions through the provision of securities and cash as collateral, was published in the Official Journal on 27 June 2002.²⁴ It was required to be implemented by Member States before 27 December 2003.

2.5.1.6 A secure and transparent environment for cross-border restructuring

In the FSAP the Commission considered cross-border restructuring of the financial services sector in the wider context of the widespread industrial restructuring which the EU is currently undergoing. It commented that initiatives such as the Takeover Bids Directive and the European Company Statute would help with the restructuring of the financial services sector.

The Takeover Bids Directive²⁵ was finally adopted in April 2004 after many years of political disagreement and negotiation, and was required to be implemented in Member States by 20 May 2006. The political compromises necessary to enable the directive to be adopted have meant that some significant differences of approach to takeover regulation within Europe will remain unresolved. The European Company Statute was adopted at European level in 2001 and the *Societas Europaea* has theoretically been available for use since October 2004, but take-up of this option has been limited.

The Directive on Cross-Border Mergers,²⁶ adopted in October 2005, is intended to facilitate mergers of limited liability companies governed by the laws of different Member States. It is due to be implemented in Member States by December 2007.

²⁴ Directive 2002/47/EC. See Chapter 8.

²⁵ Directive 2004/25/EC.

²⁶ Directive 2005/56/EC.

2.5.2 Open and secure retail markets

The FSAP outlined a number of measures designed to remove legal, administrative and other obstacles which prevent:

- (a) consumers from being able to shop around for basic financial services; and
- (b) suppliers from being able to provide services across the EU.

These measures were aimed at promoting consumer confidence (by ensuring that consumers are given sufficient information and protection) and increasing suppliers' freedom of market access (by removing burdensome rules relating to the sale of financial products, such as national marketing rules which create barriers to the cross-border provision of services). The FSAP identified the following six specific areas for action:

- (a) information and transparency;
- (b) redress procedures;
- (c) balanced application of consumer protection rules;
- (d) facilitation of e-commerce based retail business;
- (e) insurance intermediaries; and
- (f) cross-border retail payments.

These areas are considered in more detail below.

2.5.2.1 Information and transparency

The Commission emphasised that consumers need clear and comprehensible information when they are investing. For example, one of the measures which the Commission referred to in the FSAP was a recommendation on the information to be supplied to consumers in connection with mortgages. On 1 March 2001, the Commission adopted a recommendation laying down guidelines on the information to be made available to consumers.²⁷ The guidelines were agreed in the form of a voluntary code of conduct between the mortgage-lending industry and consumer groups.

The Commission also developed a directive concerning the distance marketing of consumer financial services.²⁸ The text provides protection

²⁷ Commission Recommendation 2001/193 to support best practice in respect of information provision (mortgage credit) (COM (2001) 477).

²⁸ Directive 2002/65/EC. See Chapter 10.

for consumers who enter into contracts for financial services under an organised distance sales or service provision scheme, which includes services sold by telephone, internet or mail. The Directive imposes pre-contractual information obligations on the service provider and provides the consumer with a right of withdrawal and other rights of redress.

2.5.2.2 Redress procedures

The FSAP also highlighted consumers' needs for effective and efficient mechanisms for settling cross-border disputes. The Commission referred to the development of an EU-wide complaints network and measures to encourage extrajudicial bodies to cooperate to resolve cross-border disputes. On 1 February 2002 the Commission launched FIN-NET, a network of Member States' out-of-court redress bodies, to enable consumers to pursue financial services complaints cross-border. On 17 September 2002 the Commission announced steps to pave the way for extending the geographical scope of FIN-NET to include future Member States.

2.5.2.3 Consumer protection rules

The Commission's view, as set out in the FSAP, was that equivalence between Member States' rules on consumer protection should be such that one Member State would allow a financial services provider authorised in another Member State to deal with its citizens without imposing any additional requirements. Although the implication is that harmonising European law is not required, the Commission proposed a study into equivalence between national rules on consumer protection which could serve as a basis for future action. It suggested a report on the obstacles to cross-border business-to-consumer transactions for financial services to determine whether, how and why host country consumer rules apply and to determine the conditions under which equivalence of national rules does or does not exist.

2.5.2.4 E-commerce

The Commission has acknowledged that the advent of e-commerce means that contracts can be readily concluded across national boundaries at a minimal cost. In the FSAP it noted that the proposals for e-commerce and distance marketing directives would facilitate the provision of such services and help to promote market integration. However, the Commission expressed concerns about whether existing financial legislation provided an appropriate legal environment for the promotion of e-commerce based financial services business. It said that it would be publishing a Green Paper to ascertain whether existing legislation provided an appropriate framework within which financial

services business could thrive while ensuring consumers' interests were still protected. On 7 February 2001, the Commission published a Communication on e-commerce policy for financial services²⁹ examining the steps to be taken to deal with the interface between e-commerce and financial services, to enhance consumer confidence and end fragmentation of the retail financial services market.³⁰ The Commission issued another Communication in May 2003, providing guidance on the application to financial services of particular provisions of the E-Commerce Directive.³¹

2.5.2.5 Insurance intermediaries

The FSAP noted that a clear and common approach was needed to the regulation of insurance intermediaries to enhance the functioning of a single insurance market. On 25 September 2000, the Commission adopted a proposal for a directive on insurance intermediaries.³² The Insurance Mediation Directive (2002/92/EC), which was approved by the Council of Ministers on 30 September 2002 and published in the Official Journal on 15 January 2003, aims to make it easier for insurance intermediaries to sell their products within the EU (while at the same time protecting consumers' interests) by providing that an intermediary who is registered in one Member State can provide services in another Member State. The Directive outlines common rules for the registration of intermediaries on the basis of minimum requirements relating to adequate experience and knowledge, financial capacity, reputation and possession of professional indemnity insurance.

2.5.2.6 Cross-border retail payments

The Commission saw a need for an integrated retail payments system for secure and competitive small-value cross-border transfers. In the FSAP it commented that the extra costs associated with cross-border payments were hampering the growth of a single market in retail financial services by dissuading consumers from taking advantage of the services offered in other Member States.

On 19 December 2001, the regulation on cross-border payments in euros was adopted.³³ From 1 July 2002, charges for the use of credit and payment cards, initially for payments in euros up to €12,500, have been

²⁹ COM (2001) 66.

³⁰ See Chapter 11.

³¹ COM (2003) 259.

³² COM (2000) 511. See Chapter 13.

³³ Regulation (EC) 2560/2001.

required to be the same whether payments are made in the country where the card is issued or in another Member State. With effect from 1 July 2003, the same principle of equality has applied to credit transfers of up to €12,500 between bank accounts.

In July 2005 the Commission issued a proposal for a regulation on information relating to the payer to accompany transfers of funds. The intention is to ensure that relevant information relating to the payer is immediately available to the appropriate law enforcement authorities and thereby to assist in the detection, investigation and prosecution of crime.

2.5.3 State-of-the-art prudential rules and supervision

The Commission believed that effective regulatory and supervisory regimes were central to the effective functioning of the internal market in financial services. It emphasised that EU regulatory safeguards needed to be flexible to ensure that they could be kept up to date to reflect new sources of risk and take account of market developments.

In the area of supervision, the Commission noted the importance of mutual confidence between national supervisors. Increased market integration following the introduction of the euro meant that there was a greater need for collaboration between financial supervisory bodies across the EU. In particular, the Commission highlighted the growing cross-sectoral complexity of financial supervision and called for greater collaboration between different sectoral supervisors, as well as increased monitoring and understanding of the risks in all sectors. The Commission also called for increased cooperation in securities markets and even suggested the possibility of a single European authority to oversee securities markets supervision.

In terms of legislative proposals, the Commission noted that it would be presenting proposals to maintain high standards of banking, insurance and securities prudential legislation through the adoption of a directive on the winding up and liquidation of banks³⁴ and insurance companies³⁵ and a directive on electronic money.³⁶ The Commission also proposed

³⁴ The Directive on the Reorganisation and Winding Up of Credit Institutions (2001/24/EC) was adopted in 2001.

³⁵ The Directive on the Reorganisation and Winding Up of Insurance Undertakings (2001/17/EC) was adopted in 2001.

³⁶ See Chapter 16.

amendments to the Money Laundering Directive³⁷ and proposals to amend the solvency margins for insurance companies³⁸ and the capital framework provisions for banks and investment firms (contained in the Banking Consolidation Directive and the Capital Adequacy Directive).³⁹

Work by the Commission on draft legislation to amend the EU legislation dealing with capital adequacy for credit institutions and investment firms proceeded in parallel with the work of the Basel Committee on major amendments to the Capital Accord, with the intention that the EU regime should be fully compatible with the new Basel standards. The European Commission had substantial input into the Capital Accord revision process, which culminated in June 2004 with the publication of the new standards in a document known as the "Basel Framework". EU legislation will⁴⁰ take the form of a re-casting of the Capital Adequacy Directive and the Banking Consolidation Directive, the re-cast directives being referred to in this context as the "Capital Requirements Directive". It will follow the Basel Framework reasonably closely, but its scope of application will be wider in that it will apply to investment firms and a wide range of credit institutions whereas the Basel Framework applies formally to internationally active banks only.

The FSAP also noted that the Commission was to start work on a directive dealing with the prudential supervision of financial conglomerates. A proposal for a directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate was adopted by the Commission on 24 April 2001⁴¹ and political agreement was reached in the Council on 7 May 2002.⁴² It was required to be implemented by Member States so as to require supplementary supervision for financial years commencing in 2005.

³⁷ See Chapter 15.

³⁸ The "Solvency I" package was finalised in 2002 with the adoption of Directives 2002/12/EC and 2002/13/EC for life and non-life insurers respectively. Even before Solvency I came into effect in 2004, work had already begun on a much more far-reaching reform known as "Solvency II", which is still at a pre-proposal stage.

³⁹ Directives 2000/12/EC and 93/6/EEC respectively.

⁴⁰ At the time of writing the text appears to be in final form, but it had not been formally adopted or entered in the Official Journal.

⁴¹ COM (2001) 213.

⁴² See Chapter 14.

2.5.4 General conditions for an efficient EU financial market

The FSAP noted that disparities between Member States' tax regimes hamper the creation of a truly single internal market. The Commission believed that it would be "technically unbalanced and politically difficult" to realise a single market unless the parallel process of tax coordination delivered the expected results. The FSAP therefore underlined the need for the adoption of the proposed directive on minimum effective taxation of cross-border savings income and the implementation of the December 1997 Code of Conduct on Business Taxation. The Commission said that it would also present a proposal for a directive to coordinate tax arrangements governing supplementary pensions and examine ways to eliminate tax distortions on cross-border financial products.

The Commission also referred to the uncertainty that investors may face as a result of differences in corporate governance arrangements across the EU. It said that its objective would be to identify any legal and administrative barriers that existed in Member States' corporate governance regimes which might frustrate the development of an EU financial market. With this in mind the Commission published a comparative study of corporate governance codes in Member States on 27 March 2002.⁴³ This study highlighted the similarities and differences that existed in Member States' corporate governance codes, considered the extent to which the codes were enforced, and examined the efforts which were made by Member States to monitor compliance with their codes. It was submitted to the High Level Group of Company Law Experts for consideration and on 4 November 2002 the Group published its final report setting out recommendations on how to create a modern framework for company law, including corporate governance.

On 16 May 2002, the Commission published a recommendation on auditors' independence in the EU. This recommendation took the form of a set of high-level principles, the main focus of which was that an auditor should be prevented from carrying out a statutory audit if he had any relationship with a client which might compromise his independence. The recommendation (which was published in the Official Journal on 19 July 2002) required the auditor to consider independence threats and risks for each audit engagement.

⁴³ Available on DG Internal Market's website at www.europa.eu.int/comm/internal_market/en/company/company/news/index.htm.

In May 2003, the Commission published a Corporate Governance Action Plan⁴⁴ setting out a comprehensive and prioritised set of proposals aimed at reinforcing shareholder rights and employee protection and increasing the efficiency and competitiveness of business. In the first phase of implementation the Commission adopted two recommendations on directors and launched the revision of the Accounting Directives and the simplification of the Second Company Law Directive. The Tenth Company Law Directive, on cross-border mergers, was adopted in October 2005, and a proposal for a directive on shareholders' rights was issued in January 2006. The Commission launched a consultation on future priorities for the Corporate Governance Action Plan in December 2005, to elicit views on the continued relevance of the remaining measures identified in the plan and on future priorities.

2.6 Institutional framework for the progression of the FSAP

The momentum generated by the Framework Paper and the FSAP was maintained by a number of groups and committees established to help take the FSAP forward.

2.6.1 *Financial Services Policy Group and the Financial Services Committee*

The FSPG (*see* 2.4 above) met regularly to promote consensus between the national ministries involved in financial services regulation and to review progress made on the implementation of the FSAP.

On 18 February 2003, the Council adopted a decision to reconfigure and rename the FSPG. Under the name "the Financial Services Committee", the committee now came under Member State chairmanship and took on a political oversight and advisory role for the meeting of the Economic and Finance Ministers of the Member States (the "ECOFIN Council") on issues related to the regulatory framework for financial markets, including the progress of the FSAP. One of its major tasks was the preparation in May 2004 of a report (the "Asmussen Report") on financial integration for the ECOFIN Council.

⁴⁴ COM(2003) 284.

2.6.2 The Lamfalussy Committee

In July 2000, the EU's Economic and Finance Ministers noted that it was necessary to follow up the FSAP with discussions on the legislative measures and procedures required for implementation of directives. It appointed a committee of experts or "wise men" chaired by Alexandre Lamfalussy ("the Lamfalussy Committee") to investigate the remaining regulatory obstacles to an integrated European financial market, consider arrangements for the implementation of EU rules addressed in the FSAP and suggest approaches to adjust regulation and reinforce cooperation between EU regulators. In its final report published on 15 February 2001, the Lamfalussy Committee noted that urgent action was required to make the EU legislative system more efficient and achieve the goal of an integrated financial market. The Committee proposed a new four-level approach to preparing securities legislation which was designed to streamline and accelerate the legislative process and therefore progress the measures outlined in the FSAP.⁴⁵

2.6.3 Panel of financial services experts

In April 2002, the European Parliament's Committee on Economic and Monetary Affairs established a panel of financial services experts to advise it on proposals for directives and Commission consultation documents within the framework of the FSAP. The panel was officially launched on 28 May 2002. Its role was to analyse the implications of Commission proposals and, when considering proposals based on the Lamfalussy approach, to assess the appropriateness of the split which the Commission proposes to draw between level 1 legislative proposals and level 2 implementing measures to be adopted by the Commission and the European Securities Committee.

The experts were required to evaluate implementing measures by commenting on:

- (a) whether the measures proposed are likely to achieve the stated objectives of the Commission and the Committee of European Securities Regulators ("CESR") and whether they are in conformity with the intentions of the European Parliament and the Council as expressed in the primary legislation; and
- (b) any failure by the Commission or CESR to consult all interested parties fully and transparently.

⁴⁵ See Chapter 1 for a more detailed analysis.

2.6.4 Commission progress reports and the mid-term review

The Commission published regular progress reports on the implementation of the FSAP; twice a year, it reported to the ECOFIN Council on the progress made. Ten such reports were published in total, the last one in June 2004.

On 22 February 2002, leading figures from EU institutions, governments, regulatory bodies and the financial services industry met at the invitation of the Commission for a mid-term review of the FSAP. The aim was to assess progress towards European financial integration and to determine concrete priorities and commitments necessary to deliver key FSAP proposals.

The first part of a full FSAP evaluation was published by the Commission in November 2005 (*see* 2.7 below); the second part will be carried out over the period 2006–2008, once all FSAP measures have been implemented at Member State level and there has been an opportunity to evaluate their effects.

2.6.5 The Inter-institutional Monitoring Group

The Inter-institutional Monitoring Group (“IIMG”) was originally set up in October 2002, and published three reports monitoring the Lamfalussy process. Following extension of the Lamfalussy process to include banking, insurance, occupational pensions and UCITS, the IIMG was relaunched in 2005 and met for the first time in September of that year. Its role is to assess progress on implementing the Lamfalussy process and to identify any possible emerging bottlenecks in the process. It is required to report annually. It is made up of six independent experts, two being nominated by each of the Council, Parliament and the Commission.

2.7 Evaluation of the FSAP

The FSAP was scheduled to have been completed by 2005. This highly ambitious timetable was in fact largely achieved. By the end of 2004, 39 of the 42 measures contemplated by the FSAP had been adopted. At the time of writing, only the proposal for a directive on the transfer of a company's registered office had not been adopted. These numbers refer only to adoption of the relevant level 1 measures; several significant level 2 measures had not been adopted by the end of 2004 and implementing measures for MiFID had still not been finalised at the time of writing.

Nevertheless, a very substantial body of legislation has been adopted in a short period of time, particularly when it is borne in mind that during the legislative process the scope of many of the measures expanded considerably beyond what had originally been envisaged in the FSAP. The European Parliament's conclusion that the FSAP can be "considered a success in legislative procedural terms"⁴⁶ is therefore undoubtedly correct.

This success can be attributed to a number of factors. The fact that the FSAP measures were proposed as a package, with a specific deadline for adoption, was undoubtedly important in mobilising political will and market pressure to ensure the FSAP was carried out as planned. On the whole there was also good cooperation between the EU institutions, especially during the latter part of the period, resulting in many directives being adopted in considerably shorter-than-average timeframes. This in turn was due largely to improvements in the Commission's consultation processes. Finally, and perhaps most importantly, use of the Lamfalussy process generally enabled level 1 directives to be adopted without the need for time-consuming negotiation of detailed technical matters.

Although the process was successful overall, it was not free of problems. The sheer volume of legislation to be adopted and the perceived urgency of some of it contributed to quality being sacrificed to speed in some instances. The amendments made to the UCITS Directive⁴⁷ were widely seen as unsatisfactory, resulting in significant ambiguities and important differences in implementation in Member States. The Second Money Laundering Directive, adopted in the immediate aftermath of the events of September 2001, was inadequate and needed to be supplemented thereafter by a third directive on the same issue. Corporate financial scandals in the US and the EU generated political pressure for something to be done and contributed to the various corporate governance measures in the original FSAP being expanded into a full-blown Corporate Governance Action Plan in 2003⁴⁸ – the Commission is now looking at whether that programme should be reined back or at least

⁴⁶ The European Parliament's Economic and Monetary Affairs Committee's report on the Current State of EU Financial Markets (report A6-0087/2005) The Commission's own evaluation of the FSAP concluded that "the FSAP seems to have worked extremely well as an over-arching programme and its completion within the deadline is regarded as a major achievement".

⁴⁷ Directives 2001/107/EC and 2001/108/EC.

⁴⁸ COM (2003) 284.

reprioritised.⁴⁹ Finally, the strong desire to bring to an end years of political deadlock, at times verging on desperation,⁵⁰ resulted in adoption of the Takeover Directive in a form which fell well short of initial expectations and which some even regard as a retrograde step.

Consultation was another issue that caused problems early on. The need for wide consultation on the FSAP legislation was emphasised from the start. However, the way in which it was initially conducted was not ideal. Consultation was limited to selected industry representatives and experts through various contact committees rather than being extended to the public at large. That this approach was a serious error, as the Commission later acknowledged, was brought home to the Commission by the process which led to adoption of the Prospectus Directive. The Commission's initial proposal for this was adopted after consultation limited to informal cooperation with national supervisors. The proposal then ran into serious objections from the Council and the Parliament and needed to be substantially rewritten. This experience resulted in a change of approach from the Commission. Much wider publication of legislative proposals became the norm, both in advance of formal Commission proposals for level 1 directives and in the formulation of level 2 implementing measures. Wider consultation has not necessarily led to quicker adoption of legislation, however, as the history of MiFID and its implementing measures has shown.

The Parliament has also been somewhat wary of the Lamfalussy process. This has been manifested in its desire to assert its authority as a co-legislator in relation to level 2 implementing measures even though the Treaty does not give the Parliament a formal role here. In practice, once the Commission and the Council are agreed on level 2 measures the Parliament has been given a period (usually up to three months) in which to express its opinion, and the Commission has committed to taking that opinion fully into account. Nervousness about lack of control over level 2 measures is also one of the major reasons why many detailed technical issues were included in the level 1 MiFID, somewhat undermining the intended operation of the Lamfalussy process.

⁴⁹ Consultation launched in December 2005.

⁵⁰ The then Internal Market Commissioner, Fritz Bolkestein, said that failure to compromise on the proposed directive "could have consigned us to Dante's Inferno with no exit".

This evaluation relates only to the process by which the legislation was adopted. The real test of the FSAP will of course be the extent to which it achieves its objectives in creating a single European market in financial services. It will not be possible to judge this until all the legislation has been fully implemented at Member State level and has shown its effects. Time will tell. For this reason the Commission is planning to publish Part II of its FSAP assessment over the period 2006–2008.

2.8 What happens next?

As the period of the FSAP drew to an end, the Commission set up four high-level expert groups in October 2003 to take stock of the extent to which integration had taken place and to identify the issues which might need to be addressed after conclusion of the FSAP. Separate groups were established to look at banking, insurance, investment and trading, and asset management. Drawing on the reports produced by these groups, in May 2005 the Commission published a Green Paper on Financial Services Policy 2005–2010. The response to the Green Paper was generally favourable, and in December 2005 the Commission published a White Paper. The White Paper identifies “dynamic consolidation” as the thread running through the Commission’s approach: in particular, consolidating progress made in financial services by completing unfinished business, enhancing supervisory cooperation and convergence and removing economically significant barriers to integration. Some of the important aspects of the White Paper are as follows:

- (a) Better regulation – the Commission will ensure that policy-making is open, transparent and evidence-based by carrying out open and transparent consultations and impact assessments. It will also monitor implementation of measures in Member States. Ex-post evaluation of the FSAP is a top priority in the five years to 2010, and the Commission is aiming to complete an economic and legal assessment of all FSAP measures by 2009. It will also investigate legal coherence to ensure that community and national implementing rules on financial services function as one coherent corpus of law. The Commission is planning to spread awareness of developments in financial services among consumers and promote consumer education in financial services. Finally, the Commission is planning to reinforce interaction between financial services and other policy areas such as competition, consumer policy and taxation.

- (b) Ensuring the right regulatory and supervisory structures – the Commission intends to develop the Lamfalussy process to ensure that it fulfils its maximum potential. The Commission will also work to reinforce the obligations to cooperate and exchange information between supervisors by clarifying and optimising the relative responsibilities of home and host state supervisors, exploring delegation of tasks and responsibilities between supervisors, improving the efficiency of supervision by avoiding duplicative reporting and information requirements, and working towards more consistent and timely cooperation and the development of a real pan-EU supervisory culture.
- (c) Ongoing projects – ongoing projects include the following:
 - (i) retail banking initiatives such as mortgage credit (a White Paper is to be released in 2006), consumer credit and the proposal for a Payment Services Directive;
 - (ii) Solvency II for the insurance industry – a single text proposal is expected to be published in mid-2007;
 - (iii) the review of the grounds on which national regulators can refuse consent to the acquisition of significant shareholdings, including work to review the Banking and Insurance Directives and to define common prudential criteria (a banking proposal is expected in mid-2006); and
 - (iv) a possible initiative on clearing and settlement, currently being considered by the Commission (which is likely to decide which course to take during 2006).
- (d) Continuing reflections – the Commission is looking at the following issues:
 - (i) eliminating unjustified barriers to cross-border consolidation;
 - (ii) whether to propose legislation in relation to Insurance Guarantee Schemes;
 - (iii) the Hague Securities Convention addressing conflicts of laws in relation to securities held with an intermediary – a legal assessment should help the Council decide whether to accept the Commission's current proposal for signature; and
 - (iv) the feasibility and usefulness of optional instruments (i.e. the idea of a "26th regime").
- (e) Areas in which no legislation is planned at this stage – no legislation is planned in relation to rating agencies, financial analysts, level 2 measures for the Takeover Bids Directive on requirements in the offer document, and capital requirements for regulated markets.

- (f) Future initiatives – the Commission considers that future initiatives may bring benefits in the areas of investment funds and retail financial services in relation to bank accounts and credit intermediaries.
- (g) The external dimension – the Commission is intending to deepen the EU–US dialogue in relation to financial markets and to widen dialogues and cooperation on financial issues with other countries such as Japan, China, Russia and India. The paper also emphasises that the EU needs to be strongly represented in international bodies.

The White Paper opens with a statement of the importance of the five years between 2005 and 2010 for the European financial services industry. There is a clear acknowledgement that “dynamic consolidation” in the European financial services industry is essential for the purposes of wealth creation, but also to address the problem of the coming pensions crisis.

The industry welcomed confirmation that it was not about to be faced with a further barrage of new legislation. However, further change clearly cannot be ruled out in the longer term – the Commission is intending a further review of all legislation in 2009 and those aspects that are not working properly will either be modified or replaced. In addition, the Commission has confirmed the position expressed in the Green Paper that there is a possible need for “carefully targeted” legislative initiatives in the areas of investment funds and retail financial services, the latter being an area where the single market is currently operating least effectively.

The emphasis on making existing legislation and structures work properly has also been welcomed. The White Paper indicates that the Commission is intending to undertake a serious review of Member State implementation of existing directives and take enforcement proceedings for any infringements. In particular, there seems to be a recognition of the real problems faced by financial services groups operating in multiple jurisdictions resulting from inconsistent regulatory approaches between the Member States – the paper states that these “regulatory costs [must be] reduced wherever possible”. It is clear that the Commission intends to keep faith with the Lamfalussy process as the means to achieve the desired consistency – there is no appetite at this stage for serious consideration of other possible structures such as a European super-regulator or a full-blown lead supervisor concept for financial groups.

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