# THE FINANCIAL MARKET, ITS REGULATION AND SUPERVISION

## DEVELOPMENT AND TRENDS IN THE EU

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### The Single European Market

Creating the single (common) European market has been a long-term process, and is now approaching its culmination. The current stage of works for creating a common market began in 1985, when the White Book was published, containing 300 measures necessary for creating a single European market. The establishment of the European Monetary Union has made the need to create a single market ever the more urgent. On 11th May 1999 the European Commission adopted the Action Plan for Creating a Single Financial Market. The plan contains draft priorities and schedules for legislative and other measures that need to be adopted in order to establish a single financial market by 2005. The plan marks out three strategic goals to be achieved through the creation of a single market:

1. To ensure a single market for all financial services,
2. Open and safe retail markets,
3. Prudence rules and supervision.

In this process it is necessary to overcome four sets of barriers:

• Legal barriers – restrictions preventing free access to national markets, different fiscal regimes, barriers to the free movement of capital and access to stock markets,

• Economic barriers – various deformations of free competition, access to information, dominant market position abuse,

• Intersectoral barriers – insufficient harmonisation, different levels of regulation,

• Social barriers – mainly the language barrier, social and cultural difference as obstacles to internationalisation.

The Action Plan contains five fields which it is necessary to concentrate on so as to protect investors and ensure the trustworthiness of financial markets:

1. Corporate governance – the responsibility of management, roles of supervisory bodies, position of minority shareholders, preparation of financial information and other issues,

2. Accounting Standards – all listed companies in the EU countries will by 2005 have to maintain accounts according to IAS standards. Convergence is also necessary between the IAS and US GAAP in this timeframe,

3. Audit issues, auditor independence, application of ISA (International Standards on Auditing),

4. Rules on the prudent conduct of business – minimisation of risk, ensuring the long-term healthy development of companies, implementation of the Basle 2 criteria also in the field of the insurance and securities sectors,

5. Disclosure – the regular provision of financial information of a high quality in accordance with standardised requirements for publication (prospectuses, statements, annual reports) as the basis for safe decision making by investors.

Regulation plays an important role in the creation of a single financial market. A breakdown of the Action Plan's tasks in this field is contained in the "Committee of Wise Men" final report, approved by the Council of Europe in March 2001 and accepted by the European Parliament on 5th February 2002. The report contains the Lamfalussy Approach (Drafts) for reform.

### A four stage approach:

Stage 1 – contains legal acts (directives and recommendations), which need to be changed, or adopted.

Stage 2 – a European Securities Commission has been created, which is to be the future regulatory committee, and which will assist the European Commission in adopting the respective measures. These measures should ensure that directives will be adopted in accordance with market development.

Stage 3 – measures should have the aim of improving the common and unified implementation of legal acts of the first and second stages in EU member states. The Committee of European Securities Regulators has been created for this.

Stage 4 – the European Commission will strengthen the enforceability of common legal acts. The regular Action Plan Implementation Progress Report (6th report, June – July 2002) states that to date 29 measures for its implementation have been adopted, 13 of which have been in the legislative field. This concerns the preparation of new directives, or amendments of all key directives concerning the financial market. As regards an evaluation of the fulfilment of the three strategic goals attention has been concentrated on these fields:

### Goal 1 – a single financial market for financial services

a) Increasing capital in the framework of the EU as a whole – A directive on the issuer's prospectus is in its final stage, though work on the governance of regular reporting requirements has been delayed.
b) creating a legal framework for an integrated securities and derivatives market – without time delay (ISD directive and directive on market abuse),
c) building an integrated system of statements for listed companies – an innovation of measures in the accounting field,
d) managing system risk in settling securities,
e) creating a safe and transparent environment for cross-border restructuring – three-year delay in preparing a directive on takeover bids, other measures in the field of commercial law are being fulfilled,
f) investor protection – the adoption of the directive on the transparent supervision of supplementary pension funds is delayed,
g) consultations on joint cross-border clearing and settlement of trades in Europe have begun, with the aim of identifying priorities and those measures that need to be adopted for ensuring them.

### Goal 2 – an open and safe retail market

a) preparation of directives on insurance brokerage and guarantee schemes in insurance,
b) electronic commerce in financial services,
c) a common EU legal framework for payments on internal markets,
d) action plan for preventing fraud and forgery in payments systems.

### Objective 3 – prudence rules and supervision

a) preparation of directive on capital relationships in banks and investment companies – expected implementation date is coordinated with work on Basle 2 (by 31.12.2006),
b) directive on rules for prudent conduct of business for financial conglomerates,
c) supervision framework for reinsurance and long-term project of a new framework for evaluating insurance company solvency (2005),
d) directive on money laundering.

Besides those measures directly connected with fulfilling the strategic goals, it is also necessary to mention measures of a broader scope, but which are not a condition of the optimal functioning of the single financial market. In this field emphasis is placed mainly on measures in field of taxation (interest on savings, cross-border income, etc.) and the principles of tax administration.

The course of work has also been affected, by the EU's expected expansion to 25 countries as of 2004, so as to fully take account of this expansion.

Work on directives in the field of collective investment, distance marketing of financial services, use of financial collateral, electronic money and the directive on the exchange of information in the field of insurance and investment services with third countries has already been completed.

### Financial Market Regulation

Discussions are concentrated on two areas:
1. contentual provision of regulation and supervision,
2. institutional provision of regulation and supervision.

**Point 1:**

The aim is to ensure that regulatory bodies:

• respond in a timely manner to the emergence of new sources of risk

• manage system risk and institutional risk (capital adequacy in the case of banks and investment companies, ensuring insurance company solvency)

• take account of new market aspects – the emergence of pan-European companies and financial conglomerates that operate in several sectors of the financial market concurrently,

• create an honest, efficient and transparent environment with sufficient investor protection.

This requires a higher standard of legal norms governing legislation in the field of financial market regulation. This will concern the process of implementing legal amendments adopted at the EU level into the national legislative environment (in the case of compliance with the Action Plan and Basle II deadlines this process is expected to be completed over the years 2005 – 2007).

It is also necessary to intensify intersectoral and international cooperation, consultations and discussions in particular in the field of the exchange of information, harmonisation of regulatory norms and to raise the effectiveness of supervision over multinational and multisectoral companies. In the field of capital markets the process of the Multilateral Memorandum of Understanding is being launched in parallel.

IOSCO members can accede to the Memorandum if they fulfil the accession conditions. It is necessary to prove that the acceding party has provided in national legislation sufficient authorisation to acquire information in the required scope and structure and is able to ensure confidentiality of the information acquired.

Most of the Action Plan's measures are aimed at fulfilling these tasks.

**Point 2:**

As regards institutional provision of regulation there are mainly two groups of problems under discussion:

a) whether it is necessary to create a European supervisory authority for financial services. There are a range of opinions on this issue; I shall give two opinions as representative of the breadth of this range. Rolf Breuer, president of the German Banking Association has stated that German banks support the creation of such an institution, independent of central banks. The institution should directly grant licences valid for the whole EU single financial market and would supervise how license holders adhere to the conditions of conducting business in the single market. On the other hand the German Minister of Finance Hans Eichel meanwhile does not see any need to create a single EU supervisory agency. On the contrary he proposes the creation of a financial "stability forum". Discussions on this issue will next continue at the September EU Ministers of Finance meeting.

b) What form national regulatory authorities should take. This issue is not dealt with by EU legislation (directives, recommendations). It is left in the full scope to national governments. This was also confirmed by the meeting of the Council of EU Economic and Finance Ministers held on 7 May 2002 in Brussels, where one of the conclusions is to adhere to the principle of neutrality in relation to institutional models of arranging regulation and supervision at the national level.

There are various forms of national governance in the EU. There is however a noticeable trend towards the integration of regulation and supervision into one institution, where mainly the following arguments are employed in favour of this:

- simplification of the licensing (authorisation) process in the case of institutions wanting to provide financial services in several sectors of the financial market,
- lower costs for supervision,
- the evolutionary trend on the financial market is accepted – creation of multisectoral financial conglomerates,
- creates room for comprehensive expertise and support servicing,
- the rules for individual sectors of the financial market sectors are becoming unified, transparency in respect of market participants is increasing,
- removes collisions in time arising through coordinating several institutions when resolving multisectoral problems.

The process of creating integrated authorities began in the second half of the 1980's. The first institutions of this type were set up in Scandinavian countries (Norway 1986, Denmark 1988, Sweden 1991), in Canada (1987), Japan, Australia and from the EU states Great Britain (1998) and Ireland, and recently in Germany, Austria, Holland and Iceland. In the V4 states each state has a different model of institutional provision for financial market regulation and supervision. Hungary has had an integrated model since 1997 and the conceptual plan for its realisation in the SR has been under preparation for some time. Work has reached the level of approving the plan for integrated supervision of the financial market, approved by the SR Government in March 2002, with the assumption that it will be implemented following 2005. Further development will be influenced by the conceptual plan for pension system reform in the SR.

## Conclusion

Development in the EU is clearly headed towards the creation of a single EU financial market following the 2005 time horizon on the basis of the approved, regularly checked and updated Action Plan. Its implementation will greatly affect changes to the EU legislative environment, with the aim of fulfilling the three main objectives of the Action Plan. These changes will have to be reflected also in EU member states' national legal systems, where the expansion to 25 member states (including the SR) is expected as of 2004. Therefore, it is a process that significantly sets the course of Slovakia's development over the coming years, and where we could take an example from the straightforward approach to implementing the adopted programme objectives (the Action Plan) and from the intensity of works necessary for ensuring them.

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