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The Regulator

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**The Forum of European Securities
Commissions (FESCO)
Harmonisation for the European Single
Market in Financial Services**

**Report at the IOSCO Annual Conference
Plenary Session 3 - The Regulator**

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Anrede,

It is a pleasure for me to participate in today's panel session. Under the heading, "the regulator", I will present to you the work of the Forum of European Securities Commissions (FESCO).

By way of introduction, there are two issues I would like to look at. First, the challenges both legally and economically which the European regulatory authorities face today and secondly FESCO as the model of co-operation that the EEA regulatory authorities have developed in reaction to these challenges.

European regulators, as you may know are faced with unique challenges and opportunities. The realisation of the European single market for financial services is moving ahead, and markets, investment services firms, issuers and investors are increasingly active across European borders. This is not entirely new. Some of the European Directives that form the basis of this development date as far back as the 70's. However, recently the introduction of the Euro added decisive momentum to the European integration. The Euro works as a powerful catalyst in the development towards an integrated European capital market. With the single European currency and the elimination of currency exchange risks, one major obstacle for cross-border investment services has been removed. Investors also benefit from increased transparency in the pricing of all financial services. In addition to this, modern communication technology, foremost the internet, makes it easy for investors and

for investment services firms alike to extend their reach throughout the European Economic Area (EEA).

All these important developments should not divert us the fact, that the European single market for financial integration is still far away from completion.

The European Directives follow a minimum harmonisation approach, but due to rapid innovation and national specificities, many Directives also are implemented with a variety of choices and options by member states. The resulting divergence in the national regulatory frameworks of the EEA states, together with the fact that many directives are rather outdated and most lack consistency, causes considerable concern for the future. Moreover, important areas such as market manipulation have not been harmonised on the European level. The same is of course true for new regulatory phenomena such as alternative trading systems, electronic systems for the trading of securities which are not exchanges. Here and in other areas of securities regulation a significant effort will have to be made to remove barriers for cross-border activities in Europe, which result from different regulatory standards.

In order to respond to these challenges with one voice, 17 European supervisory authorities in December 1997 founded FESCO, the „Forum of European Securities Commissions“. Members of FESCO include the securities supervisory authorities of the 15 member states of the European Union as well as those of Iceland and Norway as contracting states of the Agreement on the European Economic Area. The members of FESCO have committed themselves in a binding charter to work closely together and to develop common regulatory standards for the supervision of financial markets. Such

standards cover areas which are not harmonised by the existing European directives and where a common approach is appropriate. The goals of FESCO are in particular to improve investor protection and to increase the integrity and transparency of the capital markets.

Rather than examining the structure of particular regulatory authorities, a closer look at this model of regulatory co-operation in the European Union should be of interest. FESCO, I believe is unique in its approach to harmonisation. It deals only with harmonisation in an area that is already on the way to a single market. The goal of its work is to identify those topics that block or slow down the further integration of these markets. To achieve this, experts groups are formed to develop standards on certain issues in close co-ordination with the European Commission, and with consultations of the affected industry and consumers. In this context FESCO makes an important contribution to the goals of the so called action plan for financial services which has been adopted by the European Union. It means the sweeping review of the European legal framework for financial services as far as this is necessary to realise a truly European market. This unique possibility to consolidate the outdated or obsolete and inconsistent patchwork of directives with the cohere and set of rules is a wonderful opportunity to equip Europe with an appropriate legislation for the new millennium. It is recognised in the action plan that the European commission will base its work to update or to elaborate new directives on the regulatory standards resulting from the work undertaken by FESCO.

FESCO shows how regulators can be instrumental in moving a process like the integration of the European financial markets forward having always in mind the global perspective and, in particular, the consistency with the work achieved within FESCO.

In discussing the activities of FESCO, I would like to concentrate on two particular issues that FESCO is currently working on, the cross-border provision of investment services and the European regulated markets, i.e. the exchanges.

The European Investment Services Directive (ISD) has liberalised the provision of investment services throughout the EEA to a significant degree. Under the ISD, any European investment services firm has the so-called European passport, this means any firm may offer its services to customers in any EEA state. Firms may do so by setting up a branch in that member state or by simply providing services across borders to investors in that member state - in the language of the directive the so-called "host member state". In the two scenarios, no licensing is required, merely a notification to the competent authority of the host member state must be made. The host member state authority has to rely on the supervision in the firm's state of origin, the so-called home-member state. This division of regulatory responsibility is the overriding principle of the ISD, which also applies to exchanges - the principle of home member state control. Effective supervision in this context requires of course that all EEA regulators have complete confidence in the supervision effected by the other regulators. Therefore, harmonisation of standards for home country control mentioned before is of particular importance in this context.

In the case of cross border investment services, however, home member state control does not extend to investor protection rules, the rules of conduct. The supervision of rules of conduct is still a matter for the host state regulator. This means in practice that a firm that is active in all EEA states will have to comply with 18 different sets of rules of conduct, a monstrous task. In order to ease this burden, but also to ensure that retail investors enjoy the highest possible level of protection, while institutional investors are provided only with the necessary protection, FESCO is working on a harmonisation of the rules of conduct. This is a truly massive project. The compilation of existing rules alone filled a hundreds of pages.

One first important step in this work has been made with an agreement in February on a common definition of professional investors, for whom the rules of conduct are only partially applicable. This definition sets forth who can be considered a professional investor and who cannot be considered to fall within this category. This distinction is important for investment services firms and investors alike, because professional investors require far less protection than retail investors. This "less protection" translates into cost and time savings in securities transactions, where for instance risk disclosure can be less elaborate and detailed. The paper sets forth two main categories of professional investors. The first category is quite straightforward, these are the so-called "automatic professionals", such as authorised and regulated financial institutions. The second category are the "professional investors on request". Certain investors, for reasons of size, nature of business,

size of portfolio or professional background, may be presumed to possess adequate financial expertise with a right to request treatment as a professional investor, subject to verification by the investment services providers. This category could only be agreed on after significant debate. For all authorities, the implementation of this paper will require a change of rules and in some cases even of laws. To have reached this solution is evidence of FESCO's ability and determination to provide for real harmonisation rather than for the lowest common denominator of national rules.

The work of FESCO in this experts group will now proceed in two steps, first to harmonise the rules of conduct and secondly to agree which principle rules of conduct will not be applicable to professional investors.

Let me make clear once again that in providing these standards, FESCO does not intend to re-regulate the markets with a new bureaucratic structure at the European level, nor does FESCO set rules just for the sake of rulemaking. FESCO's aim is to facilitate the operation of the European single market in financial services. It is the areas where this operation is not as smooth and efficient as it should be that FESCO's work concentrates on.

Two other areas that are of great concern both for investment services firms and for investors are stabilisation and the allotment of securities. Here, FESCO's work is still in the early stages, but we are committed to provide a framework for stabilisation that provides a safe harbour against charges of market manipulation which will be recognised by the major world-wide capital markets. Here,

FESCO's ambition extends even beyond the European borders. This is necessary, because in these days with the increasing interdependence of markets, a stabilisation regime that focuses only on the EEA is simply of no use to the investment services firms who need just one set of rules that will be recognised for their operations world-wide.

For allotment, a European approach is sufficient. Here, the experts group working on this issue, chaired by Kaarlo Jännäri of the Finnish FSA will propose a "FESCO European Code of Allotment", that will combine current best practice from across FESCO members jurisdictions.

One of the most difficult challenges for European Regulators may be to find the appropriate regulatory solutions for cross border alliances of exchanges. European exchanges will have to consolidate in order to meet the demands of investment banks and institutional investors for a pan-European trading system. If they fail to overcome the fragmentation of securities markets in Europe competition by alternative trading systems which is in Europe less severe up to now, may be a real threat in future. Not surprisingly, a number of European exchanges are forming or considering cross-border alliances. Such alliances may range from simple cross-membership arrangements to linkages between regulated markets with common trading rules, and a common trading platform – like in the case of Euronext involving Paris, Amsterdam and Brussels – or a real merger between exchanges, as it was announced between Frankfurt and London. Cross-border alliances of exchanges are a serious challenge for national regulators to find the appropriate

answers. A careful analyses of the regulatory issues raised by such alliances at an early stage is certainly necessary to agree on the necessary arrangements between the regulators including the question of a possible lead regulator. The existing alliances and new projects of such alliances may only be transitional stages for a more comprehensive trading system for the European blue chip market. An alliance that truly transcends national borders to become a European trading system will certainly test the existing framework of European and national laws. It will also test the willingness and ability of national regulators and policy makers to adhere to the European challenge. Depending very much on the concrete concept of such cross border alliances, for instance the use of a common trading platform, innovative solutions may be necessary to find the appropriate answers.