

**FINANCIAL SERVICES ACTION PLAN:
PROGRESS AND PROSPECTS**

SECURITIES EXPERT GROUP

FINAL REPORT

MAY 2004

Executive summary

The Group recognises that Europe's securities markets are becoming more integrated, but considers it **too early to judge** the impact of the Financial Services Action Plan (FSAP), which contained a number of legislative measures affecting securities markets.

The main emphasis should now shift from introducing and agreeing legislation to **implementation and enforcement** and the correction of poor legislation.

Clearing and settlement should also be a future priority; and there is important work to be taken forward on risk-based capital and corporate governance.

The Group supports the objectives of the **Lamfalussy process** and its extension to banking and insurance. The **Lamfalussy principles** should be expanded and should form the explicit basis for regulation. The emphasis should now switch from speed to improving the quality of the output by improving the process. However, fast-track solutions will also be essential to remedy or repeal bad legislation.

The Group considers that regulation requires justification in order to avoid overregulation. Underlying policy-making must be **evidence-based** and subject to **regulatory impact analysis**. Effective coordination within the Commission, Council and the European Parliament is key to avoiding overlapping and conflicting rules.

Non-legislative solutions should be considered ahead of regulation. **Competition policy** also has a role in tackling remaining barriers.

Regulation must also take account of its impact on Europe's **international competitiveness**, both by ensuring that European firms can access international financial markets in an environment that represents a level playing field, as well as by recognising the needs of non-EU market participants carrying out business in Europe. The aim should be that Europe is the securities market of choice for issuers and investors worldwide.

The Group recognises the value of close **international cooperation** to achieve regulatory equivalence.

Innovation is essential for a vibrant financial market. Care must be taken so that the regulatory process does not inhibit innovation and its quick dissemination, whilst guarding against potential prudential risks that may result from new developments. It is essential that Level 1 texts are drafted as framework legislation that can accommodate innovation through timely adaptation at Level 2. **Securitisation** is a particularly good example of valuable financial market innovation. The Group considers that a more coordinated EU approach might better facilitate increased growth and competitiveness in the European segment of this vital market.

Transparency should be enhanced at all stages of the regulatory process. The Commission needs to draw a realistic work programme. CESR should be allocated sufficient time to provide advice to the Commission on implementing measures, so that industry professionals can provide effective input through **consultation**. All Member States should also consult market participants on changes to laws and regulation at national level and publish information on implementation activity. The Council and the ESC should conduct all discussions relating to legislative measures in public.

The Group considers that **enforcement needs to be improved**, including of basic Treaty freedoms. Good implementation in the Member States is fundamental. In this context the Group endorses the role of CESR in securing even implementation. Good coordination within CESR (at Level 3) should also facilitate the identification of bad legislation that needs reform.

DG MARKT of the Commission should be allocated appropriate **resources** to fulfil its responsibilities relating to implementation and enforcement of financial markets regulation.

The Group considers that **effective mechanisms** must be established to deal with concerns from market participants. In particular, a European ombudsman should be established.

The Group believes that national supervisors should **enhance cooperation** to assist market participants engaging in cross-border activities. It is too early to consider establishing a single European supervisor. Priority should instead be given to developing and improving coordination of national supervisors through the Lamfalussy process. However, this issue may need to be considered in the future if cooperation between supervisors proves insufficient to foster a true single market for securities.

The Group emphasises the need to examine the regulatory challenge of **real-time monitoring** by trade execution venues in order to ensure orderly secondary markets.

Corporate governance codes across Europe show a high level of convergence. The Group considers that, at this time, there is no need for a single EU code, but common guidelines should be adopted at EU level, taking into account different methods and organisational models.

The principle of agreeing and using a set of universal **accounting standards** would greatly assist in making company accounts more reliable, transparent and comparable. It is important that the IASB takes into account the needs of all users of accounts and that the IASB consults effectively and assesses the economic impact of IAS standards.

The Group considers that the dissemination of **disclosable corporate information** needs to be fast and simultaneous throughout the EU.

The Group regrets that **barriers remain** to the setting up and running of companies on a cross-border basis, including those relating to taxation, in particular the application of VAT to intra-group transfers.

The group considers that a harmonised and strengthened regime for close-out **netting** in the event of a firm's default would improve the competitive position of European financial markets.

The Group notes that the role of **credit rating agencies** is being examined in a number of fora. It considers that credit rating agencies must be looked at in a global context and that any regulatory action must be proportionate and evidence-based.

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Annex 1: Members of the Expert Group

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1. HOW INTEGRATED ARE EUROPEAN SECURITIES MARKETS?

1. European securities and derivatives markets have experienced considerable change in recent years, in part as a result of changes in European law and the launch of the euro in 1999.

1.1. WHAT EVIDENCE IS THERE OF INTEGRATION?

2. Securities markets are gradually becoming more integrated¹, as evidenced by:

Europe's securities markets are becoming more integrated

- **Higher trading volumes and increased liquidity**, accompanied by a marked **reduction in yield spreads**, in national **government bond markets**, as the introduction of the euro in 12 Member States and the development of structured trading platforms, such as those of the MTS Group, have increased competition between government bond issuers to access a common investor base;
- **Converging corporate bond yield spreads** across different European markets (and only slightly higher than those for government bonds), indicating that the European corporate bond market (which, whilst relatively young compared to the US and Japan, have grown strongly since the introduction of the euro) is reasonably well integrated;
- The **increasing importance of news in one market as a driver of returns in another**. This indicates a considerable degree of integration, not just within the EU but globally. The falls in market capitalisation of EU stock exchanges since 2000 were driven partly by de-listings but also by contagion from shocks in other markets, for example historic over-valuation (particularly in the IT and telecoms sectors) and accounting and corporate governance-related problems in US markets;
- The **expansion of stock and derivatives exchanges across national borders**, driven partly by increased interest in cross-border equity trading, itself perhaps a reflection of the increasingly global nature of the sector, and partly by technological development;
- **Corporate finance services** becoming more integrated. Fee levels for intermediaries have converged as a result of enhanced competition, particularly for larger bond issues, where underwriting fees for the euro bond segment are now comparable to the US \$ segment. Integration is also evident from less frequent coincidences of issuer and intermediary nationality, again particularly for larger bond issues, and also in the syndicated loans market. However, no clear trends can be observed for equity issues where, moreover, the decline in fees has not been so strong. This may point to lower integration and a greater importance attached to local factors;
- **The emergence of on-line securities trading** provided by e-banks and investment firms on a cross-border basis, for instance in the Nordic countries.

¹ Annex 2 features three charts illustrating certain aspects of integration of Europe's securities markets.

3. Nevertheless, there are some areas that the Group considers are less integrated and where market participants would benefit from further EU level action, including **clearing and settlement, risk-based capital and corporate governance**.

1.2. FSAP IS OVERHAULING REGULATION OF SECURITIES MARKETS

4. The FSAP, which set out to create integrated, efficient, deep and liquid financial markets, is nearing legislative completion. However, the FSAP has to a large extent not yet been implemented into national law. The FSAP is comprised of a significant number of legislative measures: 39 of its 42 measures have now been agreed. Many of these measures were aimed at integrating Europe's securities markets. The FSAP's objectives in this area have been:

FSAP has focused in particular on securities markets

- **Revising the common legal framework for integrated securities and derivatives markets** (new directive on financial instruments markets, formerly the Investment Services Directive);
- **The removal of outstanding barriers to raising capital on an EU-wide basis** (directives on transparency obligations for listed companies and prospectuses);
- **Ensuring the continued stability of European financial markets** (amending the money laundering directive, new directives on market abuse and on financial conglomerates, proposals to amend the capital framework for banks and investment firms, creation of two securities committees);
- **Moving towards a single set of financial statements for listed companies** (amendments to the 4th and 7th Company Law Directives and the adoption of International Accounting Standards);
- **Creating a secure and transparent environment for cross-border restructuring** (agreement on proposals for European Company Statute and takeover bids Directive and cross-border mergers of companies with share capital);
- **Providing legal security to underpin cross-border securities trades** (Directive on cross-border use of collateral, European Community signing up to the Hague Convention).

5. Several of the measures underpinning these objectives were recognised as priorities in the final report of the Committee of Wise Men on the regulation of European securities markets of February 2001 (the 'Lamfalussy report').

6. The Group supports the objectives of the FSAP, one of which was to create a framework of basic rules for an integrated securities market. However, it is too early to ascertain whether the measures now being agreed will deliver the desired economic benefits, such as reduced transaction costs or a lower cost of capital, or whether they might in some areas cause harm, for example by imposing restrictions that are unfocused, unnecessary, or disproportionate to their regulatory aim.

Too early to judge if FSAP will deliver expected gains or whether it will cause harm

7. The Group therefore decided to concentrate its report on the primarily procedural lessons that can already be learned from the process leading up to the finalised legislative measures. A frank assessment of the effect of the principal FSAP measures against the aims of the FSAP (as set out above) should be undertaken once such an assessment can fairly be made, perhaps around the end of 2006, by when the main FSAP directives should have been implemented into national law.

2. HOW SHOULD SECURITIES MARKETS REGULATION BE DEVELOPED IN THE FUTURE?

2.1. WHAT SHOULD FUTURE PRIORITIES BE?

8. The FSAP has prompted a significant overhaul of Community legislation affecting securities markets. The Group therefore believes that **the main emphasis should now shift from introducing and agreeing legislation to implementation and enforcement**. This should be coupled with a review of how existing legislation and new FSAP measures are working, with a view to identifying gaps and deficiencies or any areas where legislation could be reduced or removed. The aim should be to allow investors, issuers, market participants, regulators and supervisors to adapt to the new rules and make them work in practice. This 'breathing space' will be particularly important in the ten new Member States, where ensuring that the *acquis* is fully functioning should remain a priority.

Main emphasis should now be implementation and enforcement

Laws should be reviewed to identify gaps and deficiencies

9. Nevertheless, the Group does not reject all further initiatives affecting the securities sector. The Lamfalussy report identified the development of infrastructure that facilitates efficient cross-border clearing and settlement of securities transactions, and custody services, as a key priority for the markets and the Commission will shortly consult on new proposals in this area. The Group agrees that the removal of barriers to the finalisation of cross-border transactions on the one hand, and competitive distortions that prevent market forces from delivering more efficient post-trade services for cross-border activity on the other, as highlighted in the two 'Giovannini' reports, should be a future priority.

Clearing and settlement should also be a future priority

10. In addition, there is important work to be taken forward on risk-based capital; on removing overlaps in existing directives; and on harmonising existing definitions throughout financial services directives (eg 'professional investor', 'security'); and on corporate governance. The Group also saw some merit in starting a debate on whether and how retail markets should be further integrated. Any such action should be subject to pre-consultation, evidence-gathering and regulatory impact assessment by the Commission.

Other priorities include risk-based capital; removing overlaps and harmonising definitions in Directives; and corporate governance

11. There are also considerable differences across the Member States in the balance between freedom of contract and the level of prescription within public law. The Expert Group favours greater freedom of contract and considers that more thought could be given to means by which the European Community and the Member States could align their laws to allow greater scope for freedom of contract.

12. The Group recognises the enormous improvements that have been made as a result of the introduction of the Lamfalussy procedure and its development. Nevertheless, the Group considers that the political deadline for the FSAP put an undue emphasis on speed, making the timetables within which the Lamfalussy process operates too tight for sufficient industry consultation and impact assessment. The Group considers that, in the future, there needs to be a better balance between speed and quality of legislation, whilst recognising that ‘fast-track’ solutions – such as agreements after just one reading in the European Parliament – may occasionally be necessary at Level 1. Fast-track solutions will also be essential to remedy bad legislation. It is a major defect in the legislative process that there still exists no mechanism to achieve quickly targeted and focused changes to legislation, when it is clear that it will have an inappropriate, unfavourable or unintended consequence.

But fast-track solutions are required to remedy bad legislation

13. Care needs to be taken to ensure coherence across all regulation impacting on financial markets. Effective coordination within the Commission, the Council and the European Parliament is therefore key in avoiding overlapping and conflicting rules, including measures initiated by other Commission Directorates-General that impact on securities markets.

Effective coordination is required between all stakeholders

14. The Group considers that DG MARKT of the Commission should be allocated appropriate resources to fulfil its responsibilities relating to implementation and enforcement of the regulation of financial markets and that DG MARKT should ensure that a sufficient part of its budget is allocated for this purpose. Now that the Commission has enhanced responsibility under the Lamfalussy process to bring forward detailed Level 2 implementing measures, it is essential that DG Markt recruits to key positions not only civil servants who are following the general Commission career path, but also staff from outside the Commission with extensive securities industry experience.

DG MARKT requires appropriate resources to fulfil its changing responsibilities

2.2. THE LAMFALUSSY PROCESS – THE WAY FORWARD

15. The Expert Group supports the aims and objectives of the Lamfalussy Process and supports its extension to banking and insurance. The advantages of the process are an increase in speed and flexibility in developing technical detail in legislation and a new dynamic involving greater interaction, consultation and transparency between the EU institutions, financial regulators and market participants (both intermediaries and users).

Extension of Lamfalussy to banking and insurance is supported

16. Further work should be done on improving the way in which the Lamfalussy Process operates but, in general, the Expert Group endorses the findings of the Second Report of the Inter-Institutional Monitoring Group on the operation of the Lamfalussy Process.

17. The Group endorses the recommendation put forward by the Inter-institutional Monitoring Group in its Second Report² that Level 1 legislative measures should consist of framework principles; and that Level 2 measures should be as lean as possible as well as unambiguous, in order to ensure consistent implementation in the Member States. The Group also recommends that FSAP measures are monitored in order to determine their effect on integration.

2.3. SECURITIES MARKETS REGULATION SHOULD BE BASED ON SOUND PRINCIPLES

18. The Group considers that the principles set out in the Lamfalussy report should be properly written into current legislation and regulations (preferably by means of an EC Regulation). Doing this would embed a clear set of principles against which particular pieces of legislation could be benchmarked.

The 8 principles set out in the Lamfalussy report should form the explicit basis for regulation...

19. The principles set out in the Lamfalussy report are as follows:

- To maintain confidence in European securities markets;
- To maintain high levels of prudential supervision;
- To contribute to the efforts of macro and micro prudential supervisors to ensure systemic stability;
- To ensure appropriate levels of consumer protection proportionate to the different degrees of risk involved;
- To respect the subsidiarity and proportionality principles of the Treaty;
- To promote competition and ensure that the Community's competition rules are fully respected;
- To ensure that regulation is efficient as well as encouraging, not discouraging, innovation;
- To take account of the European, as well as the wider international dimension of, securities markets.

20. The Group urges the addition of the following principles:

- To promote a reduction in the cost of capital for issuers and/or increased real returns for investors;
- For legislation to be evidence-based and subject to regulatory impact analysis;
- Non-legislative solutions should be encouraged;
- To promote the development of financial markets by taking into account international competitiveness as a fundamental consideration.

...and an additional 4 principles are supported by the Group

² See http://europa.eu.int/comm/internal_market/en/finances/mobil/docs/lamfalussy/2003-12-monitoring_en.pdf?REQUEST=Seek-Deliver&COLLECTION=com&SERVICE=all&LANGUAGE=en&DOCID=502PC0460

21. The Group also endorses the recommendation contained in the Lamfalussy report that the obligation to follow a principles-based approach should be made explicit through a Regulation or Treaty amendment. All the European institutions must ensure that the Principles listed in paragraphs 19 and 20 above are paramount whenever legislative or regulatory action at EU level is contemplated or being developed. The Commission has a particular responsibility to ensure that these principles are upheld and are not undermined by protectionist interests. The Group sets out further recommendations relating to the development of the Lamfalussy process in Chapter III.

2.4. POLICYMAKING SHOULD BE EVIDENCE-BASED

22. Policy-making is often viewed as more legitimate, and is easier to enforce, when it is seen as relevant to the needs of those affected by it. The Group emphasises the need to avoid over-regulation, which can increase costs for market participants and reduce returns to investors. In other words, where new rules are introduced, the underlying policymaking must be **evidence-based**; they must bring benefit and not simply increase costs; they should not conflict with other rules; and they should be repealed when no longer relevant, with consideration given to use of 'sunset clauses'³.

Over-regulation should be avoided

Evidence-based policy making

23. The Group considers that, before legislative proposals are made at Level 1 or Level 2, more work needs to be undertaken by policymakers to identify the existing content of laws and rules in the Member States and the underlying position within the financial markets in the Member States. This would allow for clearer objectives to be set for proposed legislation and for flexibility in implementation to be decided as a matter of policy at Level 1. This would help to avoid difficulties in securing political agreement that can lead to ambiguously worded text, particularly at Level 1 (but also at Level 2), pushing the disagreement down to Level 3. In this context the Group considers that legislative coherence would be enhanced through a more project-based approach.

24. The Group therefore recommends that the **Commission** and **CESR** should, aided by consultation where appropriate:

Commission and CESR should carry out impact analyses, draw on evidence gathered through consultation, before proposing new legislation

- Gather evidence on current practices and existing regulatory approaches in the Member States. This should be done before preparing a formal proposal or where there are significant changes to an existing proposal (in the case of the Commission) or advice (in the case of CESR). The starting presumption should be that no regulatory action is proposed in the absence of evidence of a problem;
- Obtain information analysing the implications of, and comparing, possible policy responses – including 'do nothing' and non-legislative solutions;
- Use the evidence obtained to conduct a **regulatory impact analysis**.

³ By 'sunset clause', the Group is referring to a legislative mechanism whereby either legislative provisions or implementation powers delegated to the Commission are repealed or expire after a certain deadline has elapsed, unless extended.

25. The aim of the regulatory impact analysis should be to:

- (i) set out clearly the identified problem and the objectives of any solution; and
- (ii) assess, to the extent possible, the impact of different solutions to the identified problem in terms of their impact on the various stakeholders involved and thus judge the subsidiarity and proportionality of each solution before taking final decisions on a policy approach.

Pursuing an evidence-based approach should help establish at an early stage the objectives and impact on stakeholders of different solutions to an identified problem

26. The Group considers that anticipated costs and benefits should be quantified on the basis of evidence gathered during the consultation exercise. In this context, however, the Group notes the need for impact analyses to be prepared on a pragmatic basis, recognising that some benefits that accrue to the wider market-place, for example, enhanced financial stability, may be difficult to quantify.

27. Impact analyses associated with legislative proposals should accompany such proposals on their way through the adoption procedures in the Commission, the Council and the European Parliament. In this way, a good impact analysis carried out at the start of the process could serve as a useful tool in highlighting the likely effects of any course of action that might subsequently be examined in the Council or the Parliament.

28. The Group notes that it is now routine for the European Parliament to justify significant amendments during the legislative process and urges that the Council do likewise.

2.5. NON-LEGISLATIVE SOLUTIONS SHOULD BE CONSIDERED

29. The Group considers that, given that regulation of the EU's financial markets is both extensive and detailed, consideration should first be given to market-based, non-legislative solutions, including self-regulation, where new problems are identified. Competition policy also has a role to play in tackling remaining barriers.

Non-legislative solutions should be considered ahead of regulation

30. Non-legislative solutions may offer a faster and more flexible response to market developments, thus allowing more room for innovation, though they may not be appropriate in all situations (prudential regulation, for example, requires rules). Regulatory impact assessments will still be appropriate where self-regulatory rules directly affect market participants.

Competition policy also has a role to play

31. Bilateral or multilateral agreements between local or national regulators, either through mutual recognition, CESR standards or agreements brokered through CESR, might avoid the need for harmonisation. Alternatively, where one country has pioneered a product, service or delivery mechanism, national regulators might share expertise through CESR as a method of developing their own frameworks.

CESR might play a role in brokering agreements between regulators

32. One example of a non-legislative means of furthering integration in Europe's capital markets might be to harness the expertise of exchanges and information providers, which sell information services on a pan-European basis to market participants, to develop pan-European approaches to dissemination of information. A further example is the European or global standard form documentation, often prepared by industry associations, which has already demonstrated its ability to solve difficulties in cross-border business (for example ISDA standard agreements for derivatives). Finally, attention should be paid to the efforts by the Reference Data Coalition (REDAC) and the Reference Data Users Group (RDUG) to develop a global standard for security identification that can meet the criteria of uniqueness, timeliness and commonality in a way that existing standards (such as ISINs) fail to do.

Examples of non-legislative solutions include the development of a pan-European approach to information dissemination, standard documentation and the development of unique security identifiers

33. The Group proposed, as a further option, co-regulation, where the main regulatory rules are set out in legislation but the details are worked out between the industry and the regulator and then included either in industry guidance or in market participants' compliance procedures. An example is the UK's money laundering framework.

Co-regulation also an option

2.6. INNOVATION IN SECURITIES MARKETS

34. Innovation is an essential part of a vibrant financial services market and regulatory measures must not impede the innovative process. The development of new financial services and products might be considered the area in which the case for further EU action is the most obvious, in order to facilitate the rapid acceptance of innovative products. This is important in order to conform to the objectives of the Lisbon agenda and to develop the right framework for a dynamic EU economy.

Innovation essential for a vibrant financial market

35. The Group considers that the regulatory process needs to be adapted so that it does more to encourage innovation whilst guarding against potential prudential risks engendered by new developments. Regulators need to keep abreast of products and services under development.

Regulatory process should not inhibit innovation

36. The Group recalls that the Lamfalussy report was inspired in part by the need for financial services legislation in Europe to keep pace with innovation in financial markets. It urged the use of Level 2 measures "so that they can be quickly adapted to the rapid pace of technical changes and product innovation in the financial markets". The Group considers the Lamfalussy approach essential, not least since traditional (Level 1) legislation can take many years to develop from a Commission proposal to implementation in the Member States.

37. The Group also believes that more coherence is necessary as regards the level of detail used at different levels of the Lamfalussy process. It is essential that – in line with the logic of the Lamfalussy approach – Level 1 texts are drafted as framework legislation that is sufficiently broad, so that it does not require regular replacement. Instead, they should explicitly set out to accommodate innovation through timely adaptation at Level 2. The Group considers that to date, Level 1 provisions have left little scope for such flexibility and speed, instead focusing on ensuring uniform application of directives.

Level 1 measures should provide a framework that can accommodate innovation through adaptation at Level 2

38. New financial products and business functions are, quite often, first introduced only on a national basis. CESR should therefore seek to coordinate national rules at Level 3 in the first instance, as new products or services are approved or made available in one Member State. If necessary, relevant Community legislation could then be updated through Level 2 measures at a later stage, according to the demand for such products or services on a pan-European basis.

39. One of Europe's most innovative and rapidly growing financial market sectors is **securitisation**, which has developed as an alternative capital markets financing, funding, arbitrage and risk-shifting mechanism. Nevertheless, the Group considers that considerable progress could still be made in terms of convergence of market practices, instruments and legal rules (regulation, capital, tax, and accounting).

*More coordinated
EU action
required on
securitisation*

40. While several Member States have taken steps to create a more hospitable environment for securitisation, and many of these initiatives are similar in concept and purpose, the Group believes that more coordination of some aspects of the legal framework applicable to these operations is necessary at EU level, thereby facilitating a more harmonised framework while simultaneously encouraging innovation in securitisation markets across Europe. Such coordination might logically take place through CESR. This could also lead to a substantial reduction in the costs currently associated with using such a technique. The aim should be to encourage innovation and further expansion of securitisation markets on a pan-European scale and thus make a positive impact on the European industry's global competitiveness.

41. The on-going work in the context of the review of capital requirements for banks and investment firms, and in the context of the implementing measures for the Prospectus Directive, provide a good opportunity for progress in this area.

2.7. PROMOTING THE INTERNATIONAL COMPETITIVENESS OF EU SECURITIES MARKETS IS VITAL

42. The Group endorses the proposition that the EU needs good standards of financial regulation. Nonetheless, it considers that the FSAP did not sufficiently recognise that European securities markets operate in a global and strongly competitive international environment. It believes that European legislation and regulation has too often concentrated only on strategies which focus on what happens within the Internal Market, without taking into account either the fact that investors and issuers frequently take decisions on a global basis, or the need to ensure that the EU is the securities market of choice for issuers and investors worldwide.

*Markets are
global, and EU
regulation must
promote Europe
as the world's
preferred
financial services
market*

43. The Group discussed in particular the examples of the prospectus and transparency directives. Whilst these legislative measures should help to integrate EU capital markets by providing a passport to EU issuers to access a pan-European market for equity or debt, the Group is concerned that they will also reduce the willingness of third country issuers and investors to raise funds or to allocate capital in Europe.

44. The Group considers that it is in the interest of the EU that Community legislation and regulation takes better account of the needs of non-EU users of and participants in its securities markets. It considers that any impact analysis of regulatory changes must include an evidence-based assessment of the contribution of new legislation to the global competitiveness of the EU, and that international competitiveness must be one of the main guiding principles of European financial services legislation and regulation.

Global competitiveness should be included in principles of regulation and impact analysis

2.8. ACHIEVING A LEVEL PLAYING FIELD INTERNATIONALLY

45. The Group calls for a strong European voice in the decision-making process of international bodies and of financial centres outside Europe on all financial issues, such as banking supervision, accounting standards and corporate governance. It highlights the need for close international cooperation in order to achieve equivalence of regulatory standards and recommends that the Commission takes a proactive role.

International cooperation is key...

46. The Group would emphasise the enormous value of a continuous and formalised dialogue between the EU and the US, and other major financial centres worldwide, in promoting upstream convergence and ensuring that there are no adverse spillover implications for outside jurisdictions resulting from new regulation. It highlights the importance of IAS/US GAAP convergence. It also underlines the need to ensure that European firms can access international financial markets in an environment that represents a level playing field.

... as is an on-going formalised EU-US dialogue

3. GETTING THE LAMFALUSSY PROCESS RIGHT

3.1. REGULATORY TRANSPARENCY IS ESSENTIAL

47. The Group emphasised the importance of **transparency** in all stages of the regulatory process and in all the European Institutions. It sees transparency as a tool to avoid errors in implementation, to help business develop and to give them certainty by making the regulatory approach clear.

48. The Group recognises the significant increase in transparency that the Lamfalussy process has brought and welcomes, in particular:

The Lamfalussy process has increased transparency...

- Feedback statements from CESR, summarising their views on the main themes raised in feedback received and explaining their reasons for not accepting any major recommendations;
- The Commission's new practice, first introduced with the Prospectus Directive, of publishing an explanation of the extent to which draft implementing measures differ from CESR's technical advice and the reasons why; and
- The publication of summary reports of European Securities Committee (ESC) meetings and would encourage as much transparency as possible in such reports.

49. The Group suggests the following further improvements:

- **The Commission, CESR, and national regulators**

- Should allocate sufficient time to consultation processes to ensure that they are as effective as possible; and
- Draw up preliminary work programmes to allow industry professionals to organise themselves better during the early stages of the policy-making process.

- **The Commission and national regulators**

- Should follow CESR and also publish some form of feedback statement after public consultations.

- **National regulators** (including, where applicable, stock exchanges)

- Should consult in advance of implementing Community legislation; and
- Should make their implemented rules easily accessible (for example via their websites), together with a regular and detailed commentary on implementation activity, including the reasons underlying their approach.

- **The Council and the ESC**

- Should ensure all discussions relating to legislative measures are fully conducted in public.

50. The Group recommends the following specific improvements to **Level 2 consultation procedures**, in order to provide for earlier consultation, as well as more time for market participants to address the implications of proposed rules, particularly with accession of ten new Member States; and to provide for more evidence-based policymaking:

- When preparing advice for the Commission, CESR needs to be provided with a timeframe appropriate to the complexity of the measure being considered, in order to enable it to work effectively with industry professionals. Normally this should not be less than 12 months;
- CESR should publish a comparative analysis of regulation in the Member States at an early stage, in order to identify how detailed or flexible EU-level rules or standards need to be;
- There needs to be more time set aside in CESR's work schedule to discuss translation issues with professionals. This is particularly important in cases where legal concepts do not already exist in a particular Member State;
- The Commission needs to set aside sufficient time for the industry to consider working documents from the Commission that may later become the basis of Level 2 legal texts.

...but further improvements are desirable across the board

Level 2 consultation procedures need to allow sufficient time for market participants to fully consider the implications of proposals

3.2. CESR PLAYS A KEY ROLE IN REINFORCING IMPLEMENTATION

51. The Group wholeheartedly supports the aim, put forward in the Lamfalussy report, of strengthened cooperation between regulators through CESR to improve implementation and application of European securities law. The Group notes the debate surrounding Level 3 – how it should be defined, what its objectives should be, and so forth. It believes it important that regulators, the Commission and market participants reach a common understanding on this issue; and that the role of CESR in Level 3 is clearly defined.

52. The Group considers that inappropriate implementation of Level 1 and/or Level 2 measures is a major risk to the establishment of the single financial market. It follows that efforts to enhance proper implementation are the first and most effective steps in enforcing European securities law.

Inappropriate implementation threatens the integrity of the single market

53. The Group considers that the three principal reasons for implementation problems in the Member States are accidental errors, legal differences and omissions.

Reasons for implementation failure

54. In order to enhance consistent implementation, the Group sees the role of CESR at Level 3 mainly as producing guidelines and recommendations for administrative regulation and in assessing regulatory practices, as well as conducting peer reviews. It agrees with suggestions that the European Commission should provide guidance and assistance to Member States on the transposition of directives. In this context, it notes that CESR will shortly launch a public consultation on the role of CESR at Level 3.

55. The Group discussed the different approaches of Member States when transposing directives. Generally, these involve a combination of national legislation and delegated powers to the competent authority. The Group considers that national governments and regulators should consult and conduct economic impact analyses at national level as well as at EU level, in order to increase transparency and aid understanding of how each country's rules and practices will be affected and altered. Such national consultations and economic impact analyses should be aimed primarily at determining the best way to implement EC legislation and not at reopening issues already dealt with at Level 1 and/or 2.

The Commission should provide assistance to Member States on implementation and Member States should consult at national level

56. Furthermore, the Group sees a role for CESR at Level 3 in coordinating impact analyses to ensure even implementation; in conducting consultations with market participants; in enhancing flexibility in the implementation process and recognising national legal differences while, at the same time, giving effect to EC legislation and taking account of market innovation; and in building on the internal market principles of home state, mutual recognition, core standards and operational convergence. The Group noted in this context that coordination at Level 3 also had a role in enhancing investor protection.

Need for transparency of implementation at national level

57. The Group emphasises that Level 3 should be used as a tool to achieve operational convergence in day-to-day supervisory practice, rather than a further push for standardisation of national legislation. The ECOFIN Council should be asked to underline the importance of this approach.

Coordination at Level 3 serves a number of purposes, including the identification of bad legislation that needs reform

58. A particularly important role for Level 3 will be to provide information about bad or unworkable legislation, as the start of a feedback process to enable Level 1 and Level 2 legislation to be upgraded.

59. The group suggested that an implementation group should be established under CESR auspices for each Level 3 activity, to provide a collective sense of responsibility for common implementation practices and peer group assessment. This body should publish a regular commentary. The Group also considers that CESR should continue to be mainly staffed by the various national regulators and supports the Inter-institutional Monitoring Group's recommendation that there should be exchanges of staff between national regulators.

An implementation group should be established under CESR

3.3. ENFORCEMENT ALSO NEEDS TO BE IMPROVED

60. Enforcement means action by the Commission in response to defective implementation or application of Community law by Member States. The Group endorses the Commission's view that enforcement, along with implementation, should become a priority as the main legislative phase of the FSAP draws to a close.

Enforcement should be a priority along with implementation

61. The Group stresses the importance of enforcement of, not only Level 1 and Level 2 measures, but also of the basic freedoms conferred by the EC Treaty, which it believes should be supplemented the application of competition policy to the securities sector.

62. The Group considers that, at present, enforcement is not sufficiently effective, in particular because of lack of political impetus, infringement procedures that are too time-consuming and insufficient allocation of Commission resources.

Enforcement is not sufficiently effective

63. Enforcement is seen by the Group as most effective when there is a high level of transparency. The Group considers that the Commission must continue to have the prime responsibility for enforcement. However, it notes that the key to good enforcement is good implementation. In this context it believes that CESR could also play a role by organising co-operation of regulators and improving standards.

Good implementation is key to good enforcement

64. The Group supports the European Commission in its strategy to improve enforcement as put forward in the ESC, namely:

Measures to improve enforcement

- the creation of a network of single contact points in the Ministry of Finances;
- organising technical meetings to support Member States in legislation;
- the set-up of a reporting system on ongoing transposition of Lamfalussy directives; and
- the publication of concordance tables reflecting the final transposition of the directives in each Member State.

65. In addition, the Group considers that Member States need more effective incentives to comply with Community law as appropriate, such as publicity or pressure through peer reviews; and it acknowledges that the industry should take more responsibility for monitoring and raising concerns. CESR's plan to set up an internal reporting system to review compliance is also worth pursuing.

66. **The Group therefore recommends that:**

- The **Commission**, as the key player on enforcement, should allocate sufficient resources to DG MARKT to monitor implementation and fulfil its enforcement obligations under the EC Treaty, and should publish regular reports on enforcement action; *Commission needs to allocate sufficient resources to enforcement*
- The **Commission** should set up a forum, including **market participants** as well as **CESR members**, to act as a **peer pressure group** charged with reviewing implementation by national regulators. The objective of the group would be to push for even implementation and provide an early warning mechanism, so that problems are brought swiftly to the Commission's attention. If, following such a warning, the Commission would have reason to believe that implementation is likely to prove deficient, it should raise its concerns with the relevant Member State(s) before implementation has been finalised; *Mechanisms must be established to facilitate complaints from market participants*
- A quick, flexible and, if necessary, anonymous process should be established for **market participants** – in both retail and wholesale markets – to raise concerns about insufficiently well-implemented securities regulation or supervisory decisions that are not considered in line with EC legislation. This process could be supported by a **European ombudsman service** for market participants, which should work on a transparent and public basis. If the Member State(s) concerned did not follow the recommendation of the ombudsman within a certain time period, then the Commission would take up the case. *A European ombudsman should be established for market participants*

3.4. SUPERVISORY COOPERATION

67. As mentioned in Section II, the Expert Group considers that the right approach to regulation in Europe at present is to develop the Lamfalussy process. In particular, national supervisors should enhance cooperation among themselves in such a way that market participants would be able to carry out cross-border activities without having to bear adverse consequences arising from the multiplicity of competent national supervisors. *Need for reinforced cooperation and networking between national supervisors*

68. The various national supervisors should be required to adopt a *modus operandi* that ensures a true commitment to a 'single market' dynamic, taking account of market participants needs resulting from market integration. This would especially call for practical arrangements, such as increased cooperation at all levels (authorisation, control, sanctions) as well as establishing strong networks. For instance, ad-hoc groups of supervisors, delegation of powers by appointing a lead supervisor and/or by creating joint supervisory arrangements, should be available and all legal obstacles to such arrangements should be removed. Moreover, such arrangements should be tailored to market needs involving the relevant national supervisors.

69. In this context, the Group discussed the question of a single European supervisor for the securities sector. It concluded that this was not the time to pursue such an option, but that it may need to be considered in the future if cooperation between supervisors proves insufficient to foster the functioning of a true single market for securities. The Group considers that any decision on this issue will need to reflect upon the objectives, competences and accountability of such a supervisor.

Too early to pursue single supervisor option but may need to be reconsidered in the future if supervisory cooperation proves insufficient to promote true single market

70. The Group urges that agreements and mechanisms are worked out between the national supervisors in order to facilitate the development of multi-jurisdiction service providers and market infrastructures. Moreover, existing processes should be optimised through incremental changes over the coming years, as outlined elsewhere in this report.

4. OTHER SPECIFIC ISSUES

71. The Group discussed some specific issues relating to listed companies: regulation of trade execution venues, corporate governance, international accounting standards, disclosure of corporate information; and other issues relating to companies, such as taxation. It also discussed greater harmonisation of netting legislation and considered whether there ought to be any European oversight of credit rating agencies.

4.1. ISSUES FOR LISTED COMPANIES

4.1.1. Regulation of trade execution venues

72. The Group acknowledges that the future directive on financial instrument markets will include reporting requirements that will assist regulators in monitoring multiple trade execution venues. Nevertheless, it suggests that it would be useful to identify the type of regulatory and supervisory powers that could, optionally, be kept by exchanges and to explore how national regulators might cope in an increasingly fragmented market in ensuring that effective and robust real-time market monitoring is carried out. In particular, it emphasises the need to look at the regulatory challenge of ensuring orderly secondary markets. The Group notes in this context the relevance of both IOSCO's recent study relating to these issues and CESR's current work on regulatory competences of exchanges and co-operation of supervisory authorities.

Real-time market monitoring is vital in ensuring orderly secondary markets

4.1.2. Corporate governance

73. The Group supports the conclusion of the EU Corporate Governance Action Plan that corporate governance codes across Europe show a high level of convergence, and that, at this time, there is no need for a single EU code. However, the Group recommends achieving a certain level of convergence through developing pan-European guidelines on corporate governance of listed companies. These would promote a “financial market approach” to corporate governance, whereby responsibility is shared between the company itself, its shareholders, and other intermediaries and agents in the financial market.

Endorsement of Commission’s Corporate Governance Action Plan

74. Areas for consideration in the guidelines might include:

- a definition of “corporate governance”;
- internal elements of corporate governance, including
 - **disclosure** – annual corporate governance statement; information about a company’s governance structure; plus information about the investment and voting policy of institutional shareholders;
 - **shareholder rights and responsibilities** – access to information (and the right for listed companies to know whom their shareholders are); participation in AGMs including exercising their ownership responsibilities (at least for institutional investors); voting *in absentia*; use of electronic voting (in particular to facilitate cross-border voting, which can otherwise be extremely complicated and costly); and
 - **boards of directors** – composition, directors’ responsibilities, various committees (including responsibilities for audit, remuneration etc);
- interaction of external elements (auditors, financial analysts, investment banks); and
- encourage greater compliance with corporate governance criteria (where the Group considers a potential role for index providers in enhancing standards, through the development of corporate governance indices).

Areas for possible inclusion in corporate governance guidelines

75. The Group emphasises that any guidelines would need to be drafted flexibly so that they can be accepted by each Member State and implemented according to the different methods and the different types of board structure in Europe.

4.1.3. International Accounting Standards

76. The Group believes that, in principle, agreeing and implementing a properly developed and comprehensive set of International Accounting Standards (IAS) throughout the EU, as well as internationally, would greatly help to eliminate barriers to cross-border securities trading by ensuring that company accounts are more transparent and comparable.

IAS should in principle enhance comparability of company accounts...

77. In order to get full commitment to such a set of standards, it is essential that the International Accounting Standards Board (IASB) takes fully into account legitimate concerns such as the economic impact of their standards on companies. The Group also believes that there is scope for improving the IASB's consultation procedures and welcomes recent moves toward a broader-based consultation. It considers that the Commission should clarify under what circumstances it believes that the EU should not endorse IAS, and should set out its views on how often IAS will be reviewed and endorsed.

...but the IASB needs to take into account legitimate concerns such as the economic impact of IAS on companies and consult effectively

4.1.4. Disclosure of corporate information

78. The Group would highlight the importance of disclosure of corporate information. It considers that two issues are important to consider: the best means to permit access on a cross-border basis to public corporate information which has been filed with the supervisors and the need for a pan-European approach to the dissemination of disclosable corporate information. With regard to the filing system, the Group considers that market-led solutions will prove the most appropriate.

Solution on cross-border access to public corporate information filed with supervisors should be market-led

79. With regard to the dissemination of corporate information, it emphasises that it is vital that EU legislation ensures disclosure of both price-sensitive and periodic announcements is fast and simultaneous throughout Europe, so that all EU investors can invest from a level playing field. It recommends further legislative actions in the event that the transparency directive does not achieve this aim. Dissemination via a system of competing information providers would provide the best and most cost-effective service for issuers and investors.

Dissemination of corporate information needs to be fast and simultaneous throughout the EU

80. The Group also underlines the role of electronic financial disclosure mechanisms in combating market abuse practices. Such mechanisms provide the necessary audit trails and allow regulators to develop sophisticated software to track insider dealing and abusive trading.

Effective regulation of market abuse requires electronic dissemination of corporate announcements

4.2. OTHER ISSUES FOR COMPANIES INCLUDING TAXATION

81. The Group considers that the set-up and running of a company in compliance with the EU company statute is very difficult in practice, as compensation schemes are not sufficiently harmonised and national taxation systems impose additional barriers. In this context the Group recognises that taxation in particular is a significant issue for investment firms operating cross-border. For example, different VAT treatment of intra-group transfers can present investment firms with difficulties relating to restructuring operations or outsourcing on a cross-border basis and reporting intra-group transactions.

Barriers to efficient cross-border running of companies remain including taxation

4.3. GREATER HARMONISATION OF NETTING REGIMES

82. The Group acknowledges that inconsistencies among the current close-out netting⁴ regimes in Member States might constitute a barrier for an integrated European market. The Group considers that an expanded EU would benefit from greater harmonisation of netting legislation, providing minimum standards or benchmarks for effective and efficient netting of transactions.

Need for harmonised and strengthened close-out netting regime

83. A harmonised and strengthened netting regime would improve the competitive position of the European financial industry (banks and corporates) in international financial markets. In this context the Group considers that the appropriateness of further work on netting should be investigated.

4.4. THE IMPACT OF CREDIT RATING AGENCIES ON SECURITIES MARKETS

84. The Group notes that the role of credit rating agencies has been, and continues to be, examined in a number of international fora. The ECOFIN Council discussed the issue following the collapse of Enron, and the Parmalat case has once again brought the role of credit rating agencies (among others) under the spotlight. Initiatives have also been launched by the Financial Stability Forum (FSF), the International Organisation of Securities Commissions (IOSCO), the US Securities and Exchange Commission (SEC) and the European Parliament, which produced an own initiative report in February 2004. The European Commission has indicated that it will establish its own position by the autumn of 2004.

The role of credit rating agencies is being examined in several fora

85. The Group was not able to reach a single view on whether there should be a mechanism for European oversight of credit rating agencies, the aim of which would be to require that rating agencies have policies and procedures that are objective and transparent.

86. Nevertheless, the Group as a whole agrees that it is essential that issues relating to credit rating agencies are addressed within a global context, in recognition that both agencies, and the companies that they rate, compete in global markets. It therefore welcomes the European Parliament's recognition that the Commission needs to take into account work being undertaken in other fora and jurisdictions in formulating its own position.

Credit rating agencies must be looked at in a global context

⁴ In particular, bilateral close-out netting provisions are contractual terms calling for netting or set-off of amounts due to and from the two parties to the contract. Under a master agreement, the parties will enter into multiple transactions, each calling for payments to or from one or both of the parties over time. Each of these transactions is economically independent of the other, but all are subject to the master agreement that contains the bilateral close-out netting provisions. The master agreement generally calls for the close-out or termination of all transactions following certain events of default, including the insolvency of one of the parties. Following close-out or termination of each transaction, a close-out or termination amount is calculated for each transaction or group of transactions.

87. The Group also considers it essential that, should any regulatory action be taken, it must be proportionate and evidence-based. Moreover, the Group underlines that regulators must take care to avoid introducing burdensome regulatory requirements for rating agencies that would stifle entry into the market by new (including European) firms and that might lead to conflicts of interest between, for example, regulators and the agencies' sovereign rating activities. It is essential that the regulatory regime does not involve the fundamental credit judgement of the rating agencies or their independence.

Any regulatory action must be proportionate and evidence-based

5. CONCLUSION

88. In conclusion, the Group considers that priorities for the securities sector in the post-FSAP period should be:

- A stronger focus on implementation and enforcement of legislation coupled with the correction of poor legislation;
- Taking work forward on clearing and settlement, on achieving a sensible and differentiated conclusion to the work on the risk-based capital directive and on corporate governance;
- Improving the practical operation of the Lamfalussy process and particularly its responsiveness to innovation;
- Strengthening cooperation between national regulators and mutual recognition;
- Implementing information-gathering procedures prior to future policy-making and adopting an evidence-based approach to legislation, embedding regulatory impact assessment fully within the process;
- Promoting solutions other than legislation, such as self-regulatory responses to issues and the appropriate use of competition policy;
- Incorporating EU competitiveness as a fundamental consideration in the implementation of existing legislation including the FSAP and in all future legislative proposals. The international competitiveness of financial markets is vital if the EU is to become the securities market of choice for issuers and investors globally;
- International cooperation to achieve regulatory convergence;
- Increased transparency at all stages of the legislative and regulatory process;
- Sufficient Commission resources must be allocated to financial services – arguably the key driver of GDP growth across the EU;
- Overcoming barriers imposed on the cross-border running of investment firms by national taxation systems.

Annex 1: Members of the Expert Group

Dr Pier Luigi Angelini	Associazione Bancaria Italiana (ABI)
Mr Timothy Baker	London Investment Banking Association (LIBA)
Mr Alastair Ballantyne	Morgan Stanley International Ltd
Mr Philippe Bissara	European Association of Listed Companies (EALIC)
Mr Lars Blume-Jensen	Realkreditrådet (The Association of Danish Mortgage Banks)
Dr Matthias Bock	Goldman Sachs International
Mr Richard Britton	International Securities Market Association (ISMA)
Mr Clifford Dammers	International Primary Market Association (IPMA)
Mr Carmine Di Noia	Associazione Italiana fra le Società per Azioni (ASSONIME)
Mr Franco Gherra	Associazione Italiana Intermediari Mobiliari (ASSOSIM)
Mr Dominique Hoenn	BNP Paribas
Ms Marianne Kager	Bank Austria
Mr Adam Kinsley	London Stock Exchange
Ms Angela Knight	Association of Private Client Investment Managers and Stockbrokers (APCIMS)
Mr Klaus J Koehler	Verband unabhängiger Vermögensverwalter (VUV)
Mr Pierre de Lauzun	Association Française des Entreprises d'Investissement (AFEI)
Mr Olivier Lefebvre	Euronext
Ms Sonja Lohse	Nordea Bank AB (publ)
Ms Daniela Marilungo	International Swaps and Derivatives Association (ISDA)
Mr Michael McKee	British Bankers Association (BBA)
Mr Jean-Pierre Pinatton	Groupe ODDO-Pinatton
Mr Enrique Prados del Amo	Asociación de Mercados Financieros
Dr Scott Rankin	European Securitisation Forum
Prof. Rüdiger von Rosen	Deutsches Aktieninstitut (DAI)
Dr Dirk Schlochtermeyer	Deutsche Börse AG
Prof. Alberto Tapia	Universidad Complutense de Madrid

Observers:

Mr Carlo Comporti	Committee of European Securities Regulators (CESR)
Mr Mauro Grande	European Central Bank (ECB)

Chair:

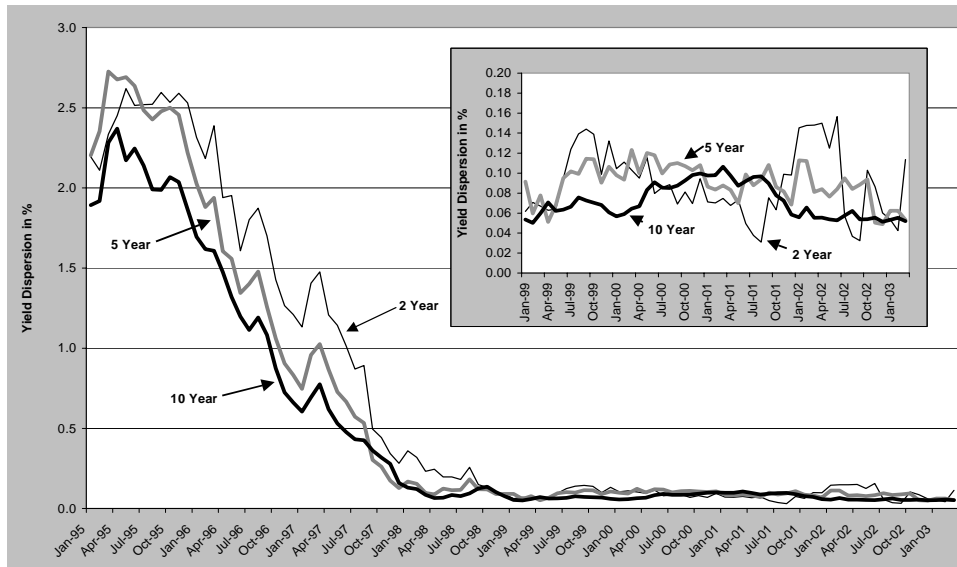
Mr Pierre Delsaux	European Commission
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Secretariat:

Dr Walter Götz	European Commission
Mr Simon Jowers	European Commission

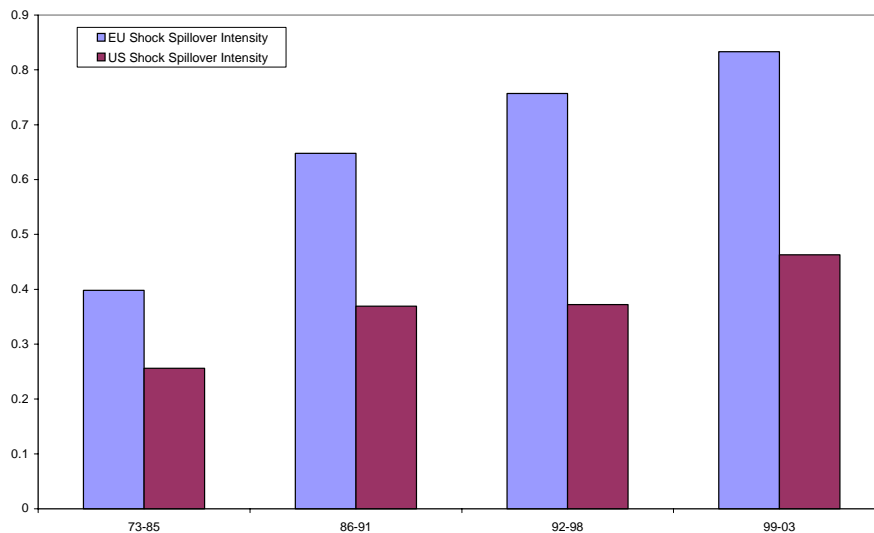
Annex 2: Charts

Chart 1: Dispersion in Government Bond Yield Spreads for 2, 5, and 10-year maturity



Source: ECB

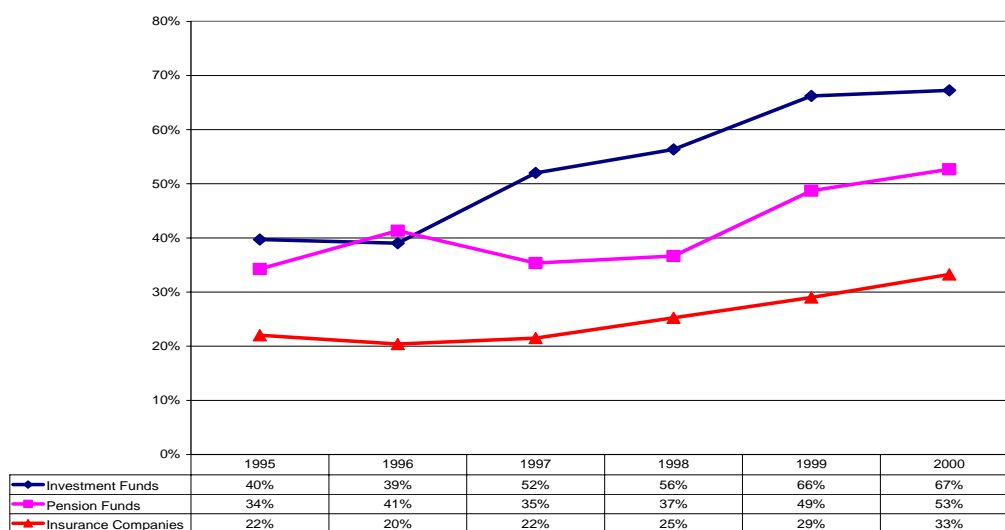
Chart 2: Proportion of variance explained by European and US shocks



Source: Datastream and ECB calculations

Note: This graph reports, for each period, in the first column the unweighted average intensity by which euro area-wide equity market shocks other than from the US are transmitted to the local euro-area equity market, and in the second column the unweighted average intensity by which US equity market shocks are transmitted to the local euro-area equity market.

Chart 3: Average Proportion of non-domestic equity holdings in euro area investment funds, pension funds, and insurance corporations



Source: FEFSI, Intersec Research Corporation, ECB calculations