



HM TREASURY



The EU Financial Services Action Plan:

Delivering the FSAP in the UK

May 2004

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HM Treasury contacts

This document can be accessed from the Treasury Internet site at:

www.hm-treasury.gov.uk

For further information on the Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4574

E-mail: ceu.enquiries@hm-treasury.gov.uk

ISBN: 1-84532-023-9

Bank of England contacts

Public Enquiries Group
Bank of England
Threadneedle Street
London
EC2R 8AH

Tel: 020 7601 4878

E-mail: enquiries@bankofengland.co.uk

Financial Services Authority contacts

The Financial Services Authority
25 The North Colonnade
Canary Warf
London
E14 5HS

Tel: 020 7066 1000

Fax: 020 7066 1099

www.fsa.gov.uk

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EXECUTIVE SUMMARY

Developing the Single Market in financial services has been a key element of EU Member States' commitment to economic reform in Europe. The EU Financial Services Action Plan (FSAP) is the vehicle that has provided the legislative framework to achieve this objective.

By the end of April 2004, 38 out of 42 FSAP measures had been adopted in the EU. They now need to be put into effect – implemented – in Member States. This document sets out the key issues for implementing the FSAP and other EU legislation affecting the financial sector in the UK. It aims to help UK-based financial services firms to identify the impacts on their own businesses and to prepare for them.

The key points highlighted in this document are:

- **The implementation of the FSAP into national law represents a significant challenge for the UK authorities**, in particular the Treasury and the FSA. They will seek to ensure that implementation takes place in an effective, proportionate and consistent manner. The document describes some of the practical steps being taken to achieve this.
- **The challenge for UK-based financial services firms is no less significant**, in terms of the need to assess the strategic implications of the changing business environment in the UK and more widely in the EU, and to make the changes to systems and practices that will be necessary to ensure compliance with the new rules.
- **Over 20 EU measures likely to affect the financial sector will be implemented in the UK over the next three to four years.** Many of these measures interact or overlap. Business and the authorities need to consider the cumulative effects.
- **The UK authorities are working closely together and with the financial sector** to ensure that implementation of the FSAP and related measures takes place on a transparent, planned basis. As part of this approach, the Treasury and the FSA will aim to provide at least three months of certainty before firms are required to operate within new rules. Business will be consulted throughout the process.
- **The UK authorities are working closely with their counterparts in other Member States** to encourage the development of mechanisms to improve implementation across the EU, for example by identifying examples of “best practice”. The UK authorities will also take into account how other Member States choose to implement financial services directives, given possible impacts on the competitiveness of UK-based firms.

Looking to the future, **the UK authorities believe that an improved approach is needed to progress financial integration**, taking on board lessons from the FSAP process. The future EU financial services agenda should focus in particular on: better implementation and enforcement; seeking alternatives to EU legislation; applying “better regulation” principles where new legislation is necessary; making the Lamfalussy arrangements work well; and recognising that the EU financial sector operates in a competitive global environment. The UK authorities' approach to this future programme is set out more fully in a separate document, *After the EU Financial Services Action Plan: A new strategic approach*.

THE IMPLEMENTATION CHALLENGE

1.1 Developing the Single Market in financial services has been a key element of EU Member States' commitment to economic reform in Europe. An effective, integrated financial services market would:

- reduce the cost of accessing capital and improve the allocation of capital across the EU;
- give firms increased opportunities to access markets in other Member States and to carry out business effectively on a cross-border basis; and
- give retail consumers access to a wider range of more competitively priced financial services products.

1.2 The EU Financial Services Action Plan (FSAP) has been the legislative framework for developing the Single Market in financial services. Between its endorsement by the European Council in Lisbon in March 2000 and the end of April 2004, 38 out of 42 measures in the FSAP were adopted in the EU.

1.3 As the adoption phase of the FSAP draws to a close, the focus is now on how measures related to the FSAP are implemented and enforced in individual Member States. Effective implementation of these measures, while avoiding unnecessarily burdensome regulation, will be important for making the Single Market work efficiently – it will be critical to delivering the potential benefits of the FSAP. This is the challenge that faces the authorities in the UK and the rest of the EU.

1.4 In July 2003, the Treasury, Financial Services Authority (FSA) and Bank of England published jointly a document explaining the FSAP – *The EU Financial Services Action Plan: A Guide*. The purpose of this new joint document is to focus on the implementation of the FSAP and related measures, in particular in the UK, and to help UK-based financial services firms to deal with the impact on their business and to prepare for compliance with these measures. It covers three areas:

- the UK's approach to implementing the FSAP and related measures;
- the latest state of play in negotiating and implementing these measures; and
- the UK authorities' priorities for the future integration of financial services in Europe.

1.5 By way of context, this introductory chapter provides a short guide to progress at the EU level and describes further the challenge of implementation facing the UK and other Member States.

EU DEVELOPMENTS

The FSAP 1.6 In June 1998, the European Council in Cardiff invited the European Commission to prepare a framework for action to develop the Single Market in financial services. In May 1999, the Commission published a Communication containing a Financial Services Action Plan, which was endorsed by the Lisbon European Council in March 2000. The FSAP consists of a set of 42 measures intended by 2005 to fill gaps and remove remaining barriers to provide a legal and regulatory environment that supports the integration of financial markets across the EU.

FSAP objectives **1.7** Within the overall aim of completing the Single Market in financial services, as part of the wider need for economic reform in Europe, the FSAP has the following specific objectives:

- **a single wholesale market:** to enable corporate issuers to raise finance on competitive terms on an EU-wide basis; to provide investors and intermediaries with access to all markets from a single point of entry; to allow investment service providers to offer their services across borders without encountering unnecessary barriers; to establish a sound and well integrated prudential framework for investment by fund managers; and to create a climate of legal certainty so that the carrying out and settling of trading in securities are safe from counterparty risk;
- **an open and secure retail financial services market:** to give retail customers the information and safeguards they need to participate in the single financial market; to remove unjustified barriers to providing cross-border retail financial services; to create the legal conditions for electronic commerce on an EU scale; and to enable consumers to make small value cross-border payments without excessive charges; and
- **state-of-the-art prudential rules and supervision** that have the flexibility to evolve with changes to the regulatory environment and changes in industry risk management practice.

Recent developments **1.8** In the past few months, many of the remaining measures in the FSAP have been agreed. In particular:

- the **Investment Services Directive**¹ has been adopted, including key amendments made by the European Parliament, supported by the Government;
- the **Transparency Directive**, which aims to increase transparency on EU capital markets, has received political agreement: it includes a recognition that mandatory quarterly reporting by firms with shares on EU markets is not necessarily the best way to achieve transparency of financial information, as the Government has argued;
- there has been political agreement to extending the so-called “**Lamfalussy arrangements**”, strongly promoted by the UK authorities (see Box 1), for taking decisions on financial services legislation, from the field of securities to banking and insurance, and on the location of the new committees of supervisors of banking and insurance in London and Frankfurt respectively;
- the Lamfalussy arrangements have been demonstrated to work effectively by the adoption of further implementing measures on the **Prospectus Directive** and the **Market Abuse Directive**, following extensive open consultation by the Committee of European Securities Regulators with a wide range of providers and users of financial services, and greater transparency by the Commission.

¹ The Investment Services Directive was adopted in April 2004 under the title of the Markets in Financial Instruments Directive but is referred to in this document as the ISD as that is the name by which it is familiar.

1.9 In the case of other remaining FSAP and related measures, developments are continuing:

- the Commission has recently published a proposal for a **Reinsurance Directive** that would allow for greater integration of this sector in the EU economy while ensuring proper regulation of reinsurance firms;
- a proposal is expected shortly on the 3rd **Capital Adequacy Directive** that would apply the new international prudential capital regime being agreed by the G10 countries (called “Basel II”) to EU-based financial institutions;
- final adoption of the remaining **International Accounting Standards** awaits the outcome of discussions between the Commission and the International Accounting Standards Board; and
- ideas are being exchanged about the future direction of **integration of financial services in Europe** (referred to in Chapter 4 and covered more fully in a separate joint document²).

THE IMPLEMENTATION CHALLENGE

What is implementation?

1.10 Legislative measures in the EU are proposed by the European Commission and – in the case of nearly all the measures under the FSAP – are adopted by co-decision under which the Council of Ministers and the European Parliament consider, amend and agree on the final content of each legislative measure³. These measures are published in the *Official Journal of the European Union* and can take the form of:

- **regulations** – rules that apply directly in each Member State, and which do not require transposition into the respective national laws (although there are often some associated legal changes in Member States’ law that are required to achieve the full effect of the regulation); or
- **directives** – rules that must be incorporated in the national law of each Member State, generally by introducing or amending national laws, within a deadline of usually 18-24 months after publication.

1.11 Converting this EU legislation into national law is the first element in implementation. The second is the putting in place of the relevant administrative arrangements on the ground, to ensure that the new rules are observed, again in a proportionate and consistent manner. Businesses must sometimes also change practices as part of the implementation process in a Member State. The third element, sometimes referred to as enforcement, is ensuring that the new rules work effectively and are complied with across the EU.

Responsibilities

1.12 In the UK, transposition of EU legislative measures relating to financial services is usually carried out by a combination of amendments proposed by the Government to primary or secondary legislation and amendments made by the FSA to its Handbook of rules and guidance. The Treasury has lead responsibility for most financial services issues, although the Department for Trade and Industry (DTI) has responsibility for certain areas such as consumer credit and corporate governance. The Bank of England has responsibilities relating to financial stability and the oversight of payment systems.

² After the *EU Financial Services Action Plan: A new strategic approach* (HM Treasury, FSA and Bank of England, May 2004)

³ FSAP measures often provide for EU implementing measures – regulations or directives – to be adopted subsequently.

Box 1: The Lamfalussy arrangements

The Lamfalussy report proposed a new approach to European securities regulation. These new arrangements were introduced in 2001. The four-level approach is as follows:

- **Level 1** consists of legislative acts, namely directives or regulations, proposed by the Commission, following consultation and adopted under the “co-decision” procedure by the Council of Ministers and the European Parliament. In adopting each directive or regulation, the Council and the Parliament agree, on the basis of a Commission proposal, on the nature and extent of detailed technical implementing legislation to be decided at Level 2.
- At **Level 2**, the European Securities Committee (ESC) assists the Commission in adopting relevant implementing measures. Such measures will be used to ensure that technical provisions can be kept up to date with market developments.
- At **Level 3**, the Committee of European Securities Regulators (CESR) has the objective of improving the consistent implementation of Level 1 and Level 2 legislation across Member States. It also aims to improve enforcement by exchanging information on regulated bodies, and seeks to adopt best practice and ensure consistent regulatory approaches. CESR plays a significant role in providing technical advice to assist the Commission in its development of legislation at Level 2.
- At **Level 4**, the Commission, Member States and financial supervisory authorities work to ensure the implementation and enforcement of EU law.

In December 2002, ECOFIN agreed to extend the Lamfalussy arrangements from the securities sector to the banking, asset management, and insurance and pension sectors; the European Parliament endorsed this approach in March 2004. Two new Level 2 committees are being created – the European Banking Committee (EBC) and the European Insurance and Occupational Pensions Committee (EIOPC). The new Level 3 banking and insurance committees have already been established, with the Committee of Banking Supervisors (CEBS) based in London, and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) based in Frankfurt. The existing Committee of European Securities Regulators (CESR) is based in Paris.

The importance of implementation

1.13 As described above, effective implementation of the FSAP and related measures across all Member States is key to delivering the potential benefits of economic integration from EU financial services legislation, whilst avoiding costly burdens on business. Without this crucial step, financial services firms cannot rely on their rights to do business across borders or to access other markets and consumers cannot rely on the level of financial supervision in other Member States, for example.

Challenge

1.14 The challenge for the **UK authorities** is to implement EU measures in an effective, proportionate and consistent manner, working closely with their counterparts in other Member States. If implementation is not completed in full or on time, the Commission may take action against the Member State concerned. Given the number and complexity of the measures, the FSAP poses a particular challenge. The challenge for **business** is to contribute to the process of implementation by the public authorities, especially by engaging actively in consultation processes; to assess the strategic implications of the changing business environment in the UK and more widely in the EU and to amend their business plans accordingly; and to make any necessary changes to systems and practices to comply with new rules.

IMPLEMENTING THE FSAP IN THE UK

The task ahead of us

1.15 Of the 42 original measures in the FSAP, some are non-legislative, a few have taken the form of regulations (requiring little or no changes to legislation in the UK), while nearly 30 are directives (normally requiring implementation through transposition into national law). Several of these directives have already been implemented – including the Collateral Directive, the 2nd Money Laundering Directive, the Electronic Money Directive and the Credit Institutions Winding-Up Directive. But many of the agreed directives arising from the FSAP remain to be implemented in the UK, along with several other related EU measures that will have an impact on the financial sector and its users. This document deals with the current wave of measures due for implementation that are likely to affect the financial sector, irrespective of whether they were included in the original FSAP.

1.16 The next two chapters of this document set out how the public authorities are rising to the challenge of implementing the FSAP and related measures in the UK:

- **Chapter 2** describes the UK's overall approach to implementing these measures, taking into account the Government's commitment to the “Better Regulation” agenda in Europe;
- **Chapter 3** provides a more detailed timetable, description and reference for each measure currently being, or about to be, implemented in the UK, and sets out the steps that the authorities are taking to help business prepare.

2

THE UK'S APPROACH TO IMPLEMENTING THE FSAP

2.1 The public authorities involved in the implementation in the UK of the FSAP and other EU measures affecting the financial sector – the Government, FSA and Bank of England – are determined to ensure that implementation is effective, proportionate and consistent. This is necessary to realise the potential benefits from the FSAP and related measures, while avoiding unnecessary burdens on business. With such a range of measures being introduced in a short time period, the FSAP puts a premium on doing this task well. That will include:

- taking account of the **demanding timetable**;
- **helping businesses** rise to the challenges that they face;
- **communicating and consulting** effectively with all relevant stakeholders; and
- **working with counterparts** across the EU.

TIMETABLE

A challenging timetable

2.2 Over 20 EU measures likely to affect the financial services sector will be implemented in the UK and other Member States over the next three years or so. They are set out in Chart 1, which provides timelines between now and the end of 2006 for such measures, updating the chart in *The EU Financial Services Action Plan: A Guide*. Chart 1, which in many cases is based on estimates and forecasts, distinguishes between:

- measures that have been adopted at an EU level but not yet implemented in the UK;
- measures that have been proposed formally by the Commission but not yet adopted by the Council and the European Parliament. In some cases, such as the Transparency Directive, they are very close to formal adoption; and
- measures that have not yet been proposed formally by the Commission but which are expected to be proposed in the near future.

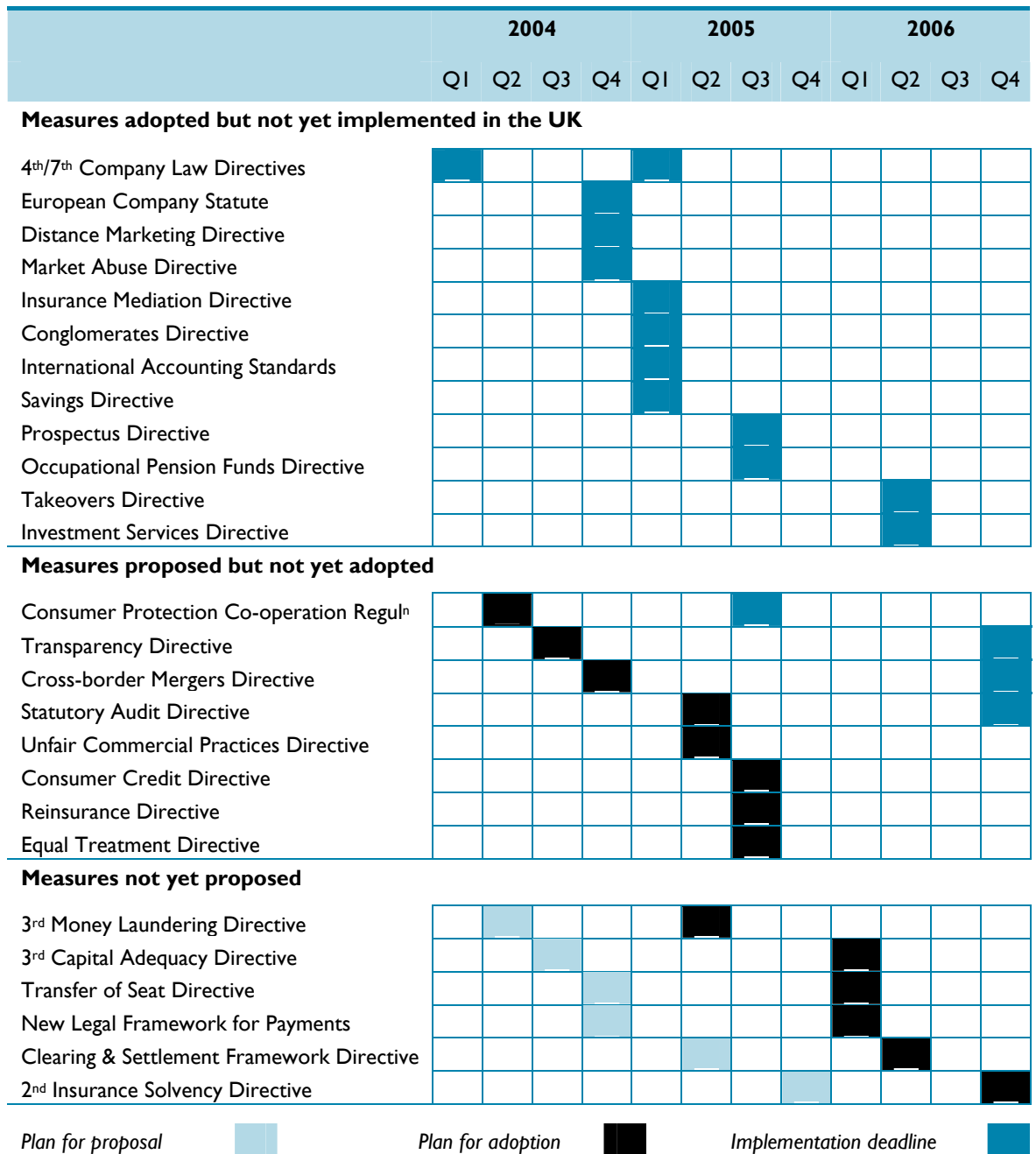
Uncertainty

2.3 In all cases, there are elements of uncertainty about this timetable. But the overall pattern is clear: there is an emerging challenge for the public authorities in the UK – and other Member States – to implement EU measures affecting the financial sector to tight timescales, and for the business community to respond to the changing strategic and regulatory environment in Europe.

Interactions

2.4 What Chart 1 cannot show are the interactions between these legislative measures. Some of these are described more fully in Chapter 3. Generally, interactions between individual directives (e.g. where different directives affect the same markets) make it even more important for the UK authorities, as for the authorities in other Member States, to take a strategic, consistent approach to implementation, rather than implementing each directive in isolation.

Chart I: Expected timeline for FSAP and other EU measures affecting the financial sector, 2004-06



Source: Based on information available at 30 April 2004

CHALLENGES FOR BUSINESS

Strategic and practical challenges

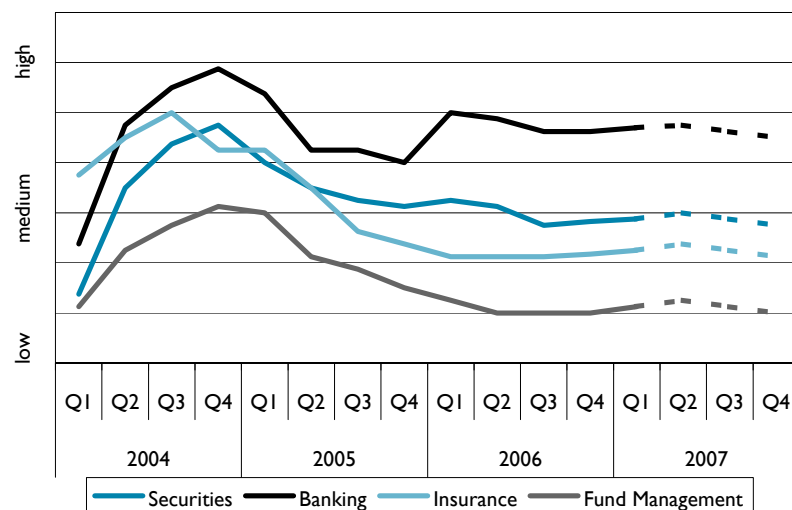
2.5 Business needs to be prepared for the changes that the implementation of these new EU measures will bring, both in the UK and other Member States. Broadly speaking, firms need to:

- prepare for the **strategic** implications of the changing market-place. A more integrated market should be more open to competition: this presents commercial opportunities for business and benefits for consumers, but is also a challenge. Measures will affect some business models and markets in different ways from others. Firms need to consider these implications and assess how to take advantage of them; and
- ensure that business **practices and systems** are compliant with new rules.

2.6 The impacts will vary between different sub-sectors, and from business to business. Businesses will need to take their own views about the steps that they will take, drawing on help from trade associations, public authorities and other sources. It is likely that the changes will require the involvement of senior management as well as staff in the compliance and operating departments. Chart 2 gives a rough idea of the scale of the impending implementation task¹. Key issues that businesses will often need to address include:

- **awareness of senior management** about forthcoming changes, in the UK and in other Member States in which firms operate or want to do so;
- **readiness of IT systems**; and
- **knowledge and training of staff**.

Chart 2: Estimated resource impact of measures affecting financial sub-sectors



¹ Estimates have been made about how resource-intensive (e.g. management time, staff training, IT systems work) it will be for firms to comply with each FSAP and related measure. These impacts have been aggregated and projected over time.

Involvement in consultation **2.7** Businesses will typically have at least three months of certainty in which to finalise their arrangements for dealing with the implementation of EU directives in the UK. They will however often want to become involved in understanding these challenges before then. An advantage to becoming involved earlier is that firms will be able to take the opportunity to influence and inform the implementation of EU measures in the UK, by responding to consultation exercises.

2.8 Trade associations and other practitioners' groups have a pivotal role to play in assisting their members through the implementation phase. They will need to remain engaged in working with the public authorities throughout this period, to help inform their approach to implementing specific measures in the UK and elsewhere. They will want to work with their counterparts across the EU and provide evidence-based input to consultation processes (e.g. on Level 2 implementing measures). Trade associations should also keep the implementation pressures on their member firms under regular review and advise the UK authorities of any significant changes.

RISING TO THE CHALLENGE OF UK IMPLEMENTATION

Steps being taken by the UK authorities

2.9 The Government, the FSA and the Bank of England are drawing on previous experience to ensure that FSAP and related measures are implemented effectively, proportionately and consistently in the UK. The Cabinet Office has published various studies and recommendations about implementation of EU measures in the UK². The steps being taken by the authorities towards delivering EU financial services measures can be grouped into three categories:

- **internal arrangements** – joined-up project management and analysis within the Treasury, the FSA and other relevant public authorities;
- **working with business** – better consultation and communication with affected business sectors;
- **co-operation with authorities in other Member States** – through bilateral arrangements, through making use of existing institutional structures and through pressing the Commission and other bodies to set up enhanced co-operation arrangements.

Internal arrangements

2.10 Building on previous experience, and developing procedures used when negotiating EU measures, the Treasury, the FSA and other authorities in the UK will:

- **work closely together**, in joint project teams, to ensure that implementation is handled as seamlessly as possible;
- put in place **project management procedures** to ensure that issues are handled consistently where appropriate;
- ensure that **expertise** developed in the negotiation of directives is used in their implementation;
- **analyse a range of different options** for implementing directives in the UK (see Box 2); and

² These documents are available on the Cabinet Office website at www.cabinet-office.gov.uk.

- **avoid adding to the regulatory change burden** through UK-inspired rule changes (e.g. the FSA has decided to postpone further policy work designed to introduce domestic rules on securities transaction monitoring and rules on “best execution” for securities trading because they are covered by the new Investment Services Directive).

Box 2: Options for implementation

All Member States, including the UK, face choices when implementing EU measures on financial services, such as:

- whether to transpose a directive in exactly the same words in national law or use different text to that of the directive;
- whether to impose only the minimum standards required by a directive or impose higher standards, where the directive permits this;
- whether to apply the obligations in a directive only to the minimum description of persons and circumstances required or extend the application to a wider scope;
- whether to make use of derogations, optional exemptions, etc; and
- when to implement a directive.

The UK authorities have made commitments about how they will make choices on financial services measures:

- the Government and the FSA are committed to consult before taking such decisions about implementation, and to produce a Regulatory Impact Assessment, complete with a cost-benefit analysis, at an early stage of the implementation process;
- Government policy is not to go beyond the minimum necessary to comply with a directive unless the benefits of doing so are demonstrably greater than the associated costs; and
- the FSA has committed not to go beyond the minimum standards necessary when implementing EU law on financial services, except where a demonstrably convincing case can be made for them on the basis of the FSA’s statutory objectives and principles of good regulation, including cost-benefit analysis.

The UK authorities will also take into account the approaches taken by other Member States when implementing financial services directives and the potential impacts on the competitiveness of UK businesses.

Working with the financial sector

Consultation and information

2.11 The UK authorities already lead their counterparts across the EU in the extent and nature of consultation with business. The Treasury, DTI, FSA and Bank of England have substantial contacts with business about EU financial services matters, such as:

- regular “stocktake” meetings at least every two months, chaired alternately by the Treasury and FSA, attended by relevant trade associations, to keep them informed about progress in negotiations of EU measures;

- “roundtable” discussions on individual EU financial services measures at appropriate points during their preparation and subsequent negotiation;
- formal consultations on negotiating some measures (e.g. the Treasury's recent consultation on the 3rd Capital Adequacy Directive, which involved over 80 organisations or institutions) and on implementing them in the UK, as the FSA is required to do and the Government does as a matter of good practice;
- participating and speaking in conferences, and hosting them (e.g. the FSA's conference on the FSAP on 19 May 2004);
- encouragement of, and liaison with, key stakeholders participating in EU-level consultation arrangements (e.g. discussions held with payment experts on the Commission's Communication on a *New Legal Framework for Payments*);
- other informal contacts with business, including between the UK Permanent Representation to the EU (UKRep) and financial services stakeholders visiting Brussels to present their arguments to the EU institutions.

2.12 These arrangements will continue to be developed in the context of financial services regulation. In particular, the Treasury and FSA will:

- continue to provide updated information about progress in implementing EU measures as well as in negotiating them (e.g. through continued “stocktake” meetings and updated documentation);
- publish joint consultation documents, where appropriate, and take account of industry concerns, while recognising that the authorities will be constrained by the terms of the EU measures concerned and that there will sometimes be tensions between different industry interests (e.g. between achieving legal certainty about the meaning of some rules and retaining flexibility in the way that business and the authorities can interpret them);
- develop and publish cost-benefit analyses of different approaches to implementation;
- aim to provide, in line with Cabinet Office guidance, at least three months of certainty before firms are required to operate to new rules and, where possible, six months;
- encourage trade associations to work with their member firms to highlight possible difficulties of implementation, particularly those of a practical nature, as early as possible during the negotiation or implementation process; and
- continue to involve consumer representative bodies in the process of implementing EU legislation, as well as the negotiation of it, to ensure that the needs of consumers are taken fully into account.

Working with EU partners

2.13 Effective, proportionate and consistent implementation across the whole enlarged EU is necessary to realise the potential benefits of financial services legislation. This has often proven difficult in the past, and the UK authorities welcome the renewed effort by all authorities in the EU to work together in implementing EU legislation, and to minimise needless, costly differences in doing so. This is particularly important, as businesses want both to operate throughout the Single Market and to avoid unnecessarily burdensome regulation in their key markets. Sometimes there is a tension between achieving these two goals. Enhanced dialogue at EU level during early stages of implementation should help to address some of these problems.

2.14 Effective implementation of existing legislation, along with promotion of best practice, should minimise the need for new EU legislation. With this in mind, the UK authorities seek to highlight the importance of implementation issues during negotiations of financial services measures. In particular, when any such new EU legislation is being considered in future, the UK authorities will continue to emphasise the significant benefits to be gained at the implementation stage from sequencing of legislative measures, taking due account of interactions between them. Furthermore, the UK authorities strongly believe that the Commission, with appropriate help from Member States and firms, needs to transform enforcement into a credible tool that will increase the incentives for Member States to deliver effective implementation.

Improving EU implementation

2.15 The Government and the FSA have encouraged the development of mechanisms to improve implementation of financial services measures across the EU, including:

- pressing successfully for the establishment of the new **Lamfalussy arrangements** to allow enhanced co-operation, especially between financial supervisory authorities. The FSA is working together with its counterparts through these regulatory networks to ensure that joint action is taken to facilitate the smooth operation of the Lamfalussy arrangements (e.g. CESR has already established several panels and operational networks to help with this – see Box 3);
- encouraging the establishment of **implementation groups**, inviting all Member States' finance ministries and supervisory authorities to share ideas and experience (e.g. on the Market Abuse and Prospectus Directives);
- supporting the use of “**transposition tables**” that should make the transposition of directives into national rules more transparent³;
- developing **strong links** with finance ministries and supervisory authorities in the ten new EU Member States which will be critical to ensuring effective implementation in the enlarged Single Market.

2.16 In line with views expressed by the financial sector across Europe, the UK authorities will also continue to press for best practice to be extended, such as:

- for consultation and transparent decision-making to be the norm for the new Level 3 committees – CEBS and CEIOPS – as it has become for CESR;

³ Transposition “tables” or “notes” explain how the elements of a directive have been, or will be, transposed into national law.

- for Commission proposals for new legislation to be subject to market failure analysis, full impact assessment – including cost-benefit analysis of different options – and consultation⁴.

Box 3: Panels and operational networks established by the Committee of European Securities Regulators

CESR has to date established several arrangements to encourage co-operation:

- **Market Participants Panel** – has an explicit obligation to alert CESR to regulatory inconsistencies in the Single Market. This panel of senior market players and consumer representatives includes Donald Brydon, Deputy Chairman of the Financial Services Practitioner Panel in the UK.
- **Review Panel process** – involves a self-assessment of the status of implementation of CESR's own standards. The plan is to extend it to self-assessment of the implementation of EU measures. The assessments will be published to allow market forces to bring pressure for improvements.
- **Operational networks** (e.g. CESRpol, CESRfin) – encouraging greater discussion between regulators on how they deal with individual cases should produce a much better understanding of the day-to-day implementation of the legal framework.

2.17 Better implementation and enforcement of EU measures remains a key priority for the Government's future approach to the integration of financial services in the EU (discussed more fully in Chapter 4). The Government is succeeding in achieving wide agreement to this priority across the EU, such as in the work of the Financial Services Committee, reporting to the Council of Ministers, and it has been strongly endorsed by industry representatives.

⁴ On 8 March 2004, President of the Commission Romano Prodi committed the Commission to preparing impact assessments for all legislative proposals in its Work Programme for 2004 (COM(2004) 645 final).

3

LATEST DEVELOPMENTS IN IMPLEMENTING MEASURES AFFECTING FINANCIAL SERVICES

- Purpose 3.1** This chapter outlines, for each measure:
- the **aim** and a **description** of the measure – including the reference number and formal title, where this differs from that most commonly used;
 - **key issues for business**;
 - **steps being taken by the authorities** to implement the measures in the UK; and
 - the anticipated legislative **timetable** and any **key events** relating to the measure, such as consultation exercises.
- 3.2** As described in paragraph 2.2, measures are grouped as follows:
- those adopted at EU level but not yet implemented in the UK;
 - those proposed formally but not yet adopted; and
 - those where formal proposals have not yet been made but are expected (these are considered in Chapter 4).
- 3.3** In the case of three measures – International Accounting Standards, the Investment Services Directive and the 3rd Capital Adequacy Directive – the significant linkages between them and other measures are illustrated. The linkages shown are not exhaustive, but they highlight the need for the authorities and industry to look at implementation as a whole.

MEASURES ADOPTED BUT NOT YET IMPLEMENTED

4th and 7th Company Law Directives

Titles: Directive 2001/65/EC of 27 September 2001 on the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions (the “Fair Value Directive”); and

Directive 2003/51/EC of 18 June 2003 on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (the “Modernisation Directive”)

Implementation deadlines: 1 January 2004 and 1 January 2005 respectively

- 3.4** The FSAP includes two measures to modernise the four existing accounting directives (Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC), known as the “Modernisation Directive” and the “Fair Value Directive”:
- the **Modernisation Directive** is designed to bring various aspects of EU accounting requirements into line with modern accounting practices and requires Member States to make certain changes to national law concerning the form and content of company accounts and the content of directors’ and auditors’ reports; and

- the **Fair Value Directive** is designed to enable EU companies to account for some of their financial instruments at “fair value” in accordance with IAS 39 on financial instruments recognition and measurement¹.

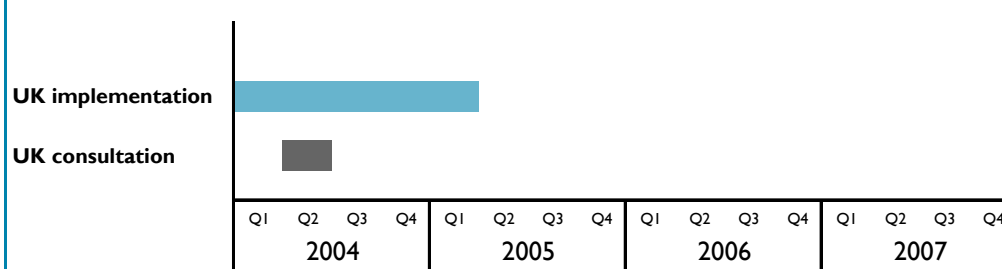
3.5 To obtain a full understanding of the expected changes in UK financial reporting, the legislative changes should be considered alongside the proposed strategy of the Accounting Standards Board (ASB) for converging UK accounting standards with International Accounting Standards (IAS). This was the subject of a separate consultation published by the ASB in March 2004. Consultation closes on 30 June 2004.

3.6 In some areas the Directives introduce mandatory new requirements, such as new disclosures regarding the fair values of certain financial instruments and additional matters to be included in directors’ reports, which will need to be implemented in the UK. Both Directives give Member States options in certain other areas.

3.7 The DTI and the Treasury published jointly a consultation document on the Modernisation Directive (covering building societies as well as companies) in March 2004². Consultation closes on 2 July 2004. The DTI consulted on the implementation of the Fair Value Directive in June 2003.

3.8 The Government intends to implement both Directives to be effective for financial years beginning on or after 1 January 2005. (The Fair Value Directive has an implementation deadline of 1 January 2004, but the Government has decided that it is preferable not to introduce the legislative amendments in this area until the International Accounting Standards Board completes its improvements to IAS 39. The Government has therefore elected to make implementation effective from 1 January 2005.) For the majority of companies that report on a calendar year basis, the first impact will therefore be on their 31 December 2005 statutory accounts.

Chart 3: Expected timeline for Modernisation Directive



¹ IAS 39 defines “fair value” as “the amount for which an asset can be exchanged or a liability settled between knowledgeable, willing partners in an arm’s length transaction”. This will often be the market value.

² *Modernisation of Accounting Directives/IAS Infrastructure*, March 2004 - www.dti.gov.uk/cld/pdfs/ias_infrastructure.pdf.

European Company Statute

Title: Regulation 2157/2001/EC of 8 October 2001 on the Statute for a European Company

Implementation deadline: 8 October 2004

3.9 The European Company Statute aims to provide for the formation of a type of company (“Societas Europaea” or “SE”) that can operate on an EU-wide basis and be governed by a single law directly applicable in all Member States. In areas where the functioning of the SE does not require specific EU rules, the applicable laws will be those governing public limited companies in the Member State in which it has a registered office. This new form of company will be available to commercial bodies with operations in more than one Member State; its use will be entirely voluntary. The corporate form that will emerge from the Statute will be an EU public limited liability company, registered in one Member State, with capital divided into shares and having legal personality. In particular, SEs will be able to be formed by cross-border merger and to transfer registration from one Member State to another without being dissolved and may therefore become a vehicle to promote cross-border corporate restructuring.

3.10 The Statute consists of a Regulation (setting out the core company law framework) and a linked Directive concerning employee involvement in SEs. Both of these come into effect on 8 October 2004. The DTI, which is responsible in the UK for policy with regards to the Statute, consulted on implementation of these instruments in October 2003³. The responses to that consultation are still being considered.

Distance Marketing Directive

Title: Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services

Implementation deadline: 9 October 2004

3.11 The Distance Marketing Directive aims to protect retail customers who deal with a financial services firm or acquire a financial product through the exclusive use of distance means such as telephone, Internet, fax or post. The Directive ensures that retail customers are given minimum specified information about financial services or products before contracting for them; and have the right to cancel some types of contracts after entering into them.

3.12 The impact of the Directive on UK businesses is unlikely to be significant since its provisions embrace established UK practice. The Treasury, which has overall responsibility for implementing the Directive in the UK (except for consumer credit activities for which the DTI is responsible), consulted on the implementation of the Directive in July 2003. For the firms and activities that it regulates, the FSA has implemented a number of articles of the Directive through amendments to the Handbook of rules and guidance⁴. The Treasury will make regulations before the deadline of 9 October 2004 that will implement the remaining articles of the Directive.

³ Implementation of the European Company Statute - www.dti.gov.uk/cld/condocs.htm

⁴ See FSA policy statement 04/11, *Implementation of the Distance Marketing Directive*, published in April 2004

Market Abuse Directive

Title: Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse)

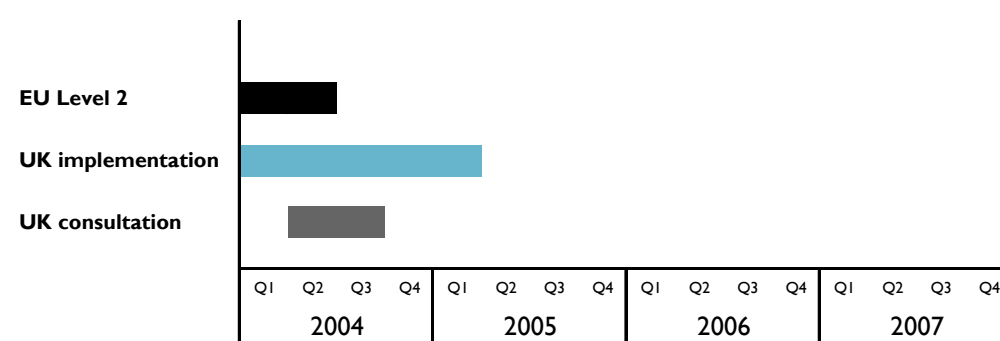
Implementation deadline: 12 October 2004

3.13 The Market Abuse Directive aims to ensure the integrity of financial markets in the EU, to establish and implement common standards against market abuse throughout the EU and to enhance investor confidence in these markets. The Directive introduces a comprehensive EU-wide market abuse regime, harmonising rules on the prevention of insider dealing and market manipulation in securities markets. The Directive defines a common, EU-wide approach to areas such as: the standards of care to be observed and the disclosures to be made by those producing and disseminating research; safe harbour provisions concerning share buy-backs and stabilisation; guidelines for determining accepted market practices; insider information on commodity derivative markets; the maintenance of lists of those who have access to inside information by issuers; and the obligation for persons arranging transactions professionally to report suspicious transactions.

3.14 This is the first Directive to be implemented under the Lamfalussy arrangements. The final Level 2 implementing measures were adopted by the ESC in April 2004. Overall, the impact of the Directive in the UK is expected to be limited as a similar, comprehensive market abuse regime is already in place.

3.15 Detailed discussions between the Treasury, the FSA and industry are continuing to take place to identify the key policy issues that need to be considered when implementing the Directive, such as how the changes to the UK's existing regime will be managed. There have been two "roundtable" meetings with industry and pre-consultation drafts of part of the UK implementing regulations have been circulated for comment. The Treasury and FSA intend to publish jointly a consultation document on the implementation of the Directive in the UK in late May 2004. Following on from this there will be an implementation conference. The Commission has held two meetings of Member States to discuss issues arising out of the implementation of the Directive to help ensure it is implemented on a consistent basis across the EU. The Directive is due to be implemented by 12 October 2004. Implementation in the UK is expected to occur in the first quarter of 2005.

Chart 4: Expected timeline for the Market Abuse Directive



Insurance Mediation Directive

Title: Directive 2002/92/EC of 9 December 2002 on insurance mediation

Implementation deadline: 14 January 2005

3.16 The Insurance Mediation Directive (IMD) aims to improve choice and reinforce protection for customers whilst helping insurance intermediaries (e.g. insurance brokers and banks) to market their services cross-border in the EU. The Directive sets common minimum standards across the EU for the regulation of the sale and administration of insurance. This includes secondary insurance intermediaries such as vets who sell pet insurance. The Directive provides rights for an insurance intermediary established in one Member State to operate in another Member State. Firms involved in insurance intermediation business must also have professional indemnity insurance.

3.17 The Directive will require modification of current UK requirements for the sale of long-term insurance products and will supersede existing voluntary arrangements for general insurance to which sections of the industry currently subscribe. The main impact of the extension of the regulatory regime is that many firms carrying on insurance intermediation will have to obtain FSA authorisation to continue in that business. Firms that are already authorised, but carry on activities that will become regulated, will require a variation of their permission.

3.18 The deadline for implementing the Directive is 14 January 2005. The Treasury issued a consultation paper on implementing the Directive in October 2002, and legislation flowing from this consultation was approved by Parliament in June 2003⁵. The FSA consulted extensively on their rules, publishing final rules on 20 January 2004⁶, giving businesses a year to prepare for their application. The FSA is taking extensive steps to help business prepare, including road shows and providing easy-to-follow briefing packs and guides.

3.19 Box 5 below describes the link between the IMD and the Investment Services Directive.

Conglomerates Directive

Title: Directive 2002/87/EC of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate

Implementation deadline: 1 January 2005

3.20 The Conglomerates Directive aims to introduce an enhanced prudential regime for the supervision of financial conglomerates, which are groups with significant activities in the banking and/or investment sectors on the one hand, and the insurance sector on the other. It does this by: setting out how to calculate capital adequacy requirements for financial conglomerates to eliminate double counting capital and excessive leveraging; requiring that financial conglomerates have enough capital to meet a binding capital adequacy test; and requiring groups to have adequate systems and controls to monitor intra-group exposures and risk concentrations across

⁵ The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2003, SI No. 2003/1476 and The Insurance Mediation Directive (Miscellaneous Amendments) Regulations 2003, SI No. 2003/1473

⁶ Details of the FSA's implementation area available at www.fsa.gov.uk/mgi/publications_homepage.html

sectors. The Directive also amends the existing sectoral directives to close gaps in their coverage. The Directive applies primarily to firms that are members of groups headed by a parent company in the EU, but it also requires equivalent group oversight of entities regulated in the EU with parents outside the EU.

3.21 The impact on UK-based groups will depend on their dominant sector. Insurance groups that own banks and investment firms will be particularly affected by a number of changes, designed to eliminate double counting of capital. For banking groups, the changes will be less significant as the current UK requirements are already compliant with the Directive.

3.22 The Directive requires the relevant legislation to be in place by 11 August 2004, though the new standards will only apply to financial years commencing on or after 1 January 2005. The Treasury and FSA are currently considering the responses to the joint Treasury/FSA consultation document⁷ on implementation of the Directive and plan to issue a formal response (including the final rules and regulations) by the end of June 2004.

International Accounting Standards

Title: Regulation 1606/2002/EC of 19 July 2002 on the application of international accounting standards

Implementation deadline: 1 January 2005

3.23 International Accounting Standards (IAS) – now referred to as International Financial Reporting Standards (IFRS) – aim to provide a single set of high quality and comparable global accounting standards. The standards are issued by the International Accounting Standards Board (IASB), which cooperates with national accounting standard setters to achieve convergence in accounting standards around the world. Although the IASB has no formal authority to require compliance with its standards, EU Member States agreed in July 2002 that all publicly traded companies in the EU must prepare their consolidated accounts on the basis of IFRS, as adopted for use in the EU.

3.24 Revised versions of existing International Accounting Standards will continue to be referred to as IAS. Regulation 1725/2003/EC of 29 September 2003 adopted all IAS in existence at the time, except for two standards on financial instruments (IASs 32 and 39). IASs 32 and 39 have since been revised by the International Accounting Standards Board (IASB), and further changes to IAS 39, concerning the so-called “full fair value option”, were proposed in April 2004. The IASB has also issued five new IFRSs. IFRS 1 was adopted on 6 April 2004. The revised versions of IAS 32 and 39, along with the other four IFRS are planned for adoption later in 2004. It is expected that, should any IASB standards not be adopted in the EU, they will be available as guidance and for voluntary application to the extent that their use does not conflict with adopted IAS.

3.25 The new standards will apply to financial years commencing on or after 1 January 2005. The Government proposes to allow the use of IAS by publicly traded companies in their individual accounts, and by most other companies (and building societies) in both individual and consolidated accounts. Draft legislation to give effect to this option is currently the subject of a joint DTI and Treasury consultation (closing

⁷ CP204, *Financial Groups*, October 2003

on 2 July 2004)⁸. As noted earlier, outcomes on IAS will affect implementation of the Fair Value Directive. Important linkages between IAS and other measures affecting the financial sector are illustrated in Box 4.

Box 4: Key links between International Accounting Standards and other measures

- There are important links with the **Prospectus Directive** and the **Transparency Directive** given their respective requirements for historical financial information, and annual and interim financial reports, to be presented in line with IAS.
- A link also exists in relation to the anticipated **2nd Insurance Solvency Directive** in terms of the impact of fair value on the valuation of assets and liabilities, operational risk and disclosure. It will also be necessary to tackle these issues for non-IAS firms.
- There is also likely to be an impact of IAS Regulation on conglomerates, where definitions in the **Conglomerates Directive** have been taken from the Accounting Directives. The Conglomerates Directive covers supplementary supervision of credit institutions, insurance undertakings and investment firms. Some of the definitions are imported from the Accounting Directives, which, for entities covered by the IAS Regulation, would be superseded by relevant definitions from international accounting standards (e.g. IAS 27).
- Finally, there is the impact of fair value on the valuation of assets and liabilities, operational risk and disclosure under the **3rd Capital Adequacy Directive** regime. It will also be necessary to determine how to tackle these issues for non-IAS firms.

Savings Directive

Title: Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments

Implementation deadline: 1 January 2005

3.26 The Savings Directive aims to enable interest on savings received in one Member State, by individuals who are resident for tax purposes in another Member State, to be made subject to effective taxation in accordance with the laws of the latter Member State. The Directive establishes automatic exchange of information – not tax harmonisation – as the way of combating cross-border tax evasion on savings income.

3.27 The Inland Revenue has introduced a scheme to collect information about the payment of savings income to certain overseas residents and to exchange this with certain other countries. This scheme mainly affects banks, registrars, custodians and other financial institutions that make interest payments to individuals in prescribed territories. The Inland Revenue has consulted extensively with the financial services industry on transposing the Directive and the guidance notes. The scheme will come into effect on 1 January 2005, provided that the EU has decided by the end of June 2004 that the arrangements with the third countries and dependent and associated territories named in the Directive will be in place.

⁸ *Modernisation of Accounting Directives/IAS Infrastructure*, March 2004 – www.dti.gov.uk/cld/pdfs/ias_infrastructure.pdf

Prospectus Directive

Title: Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading

Implementation deadline: 1 July 2005

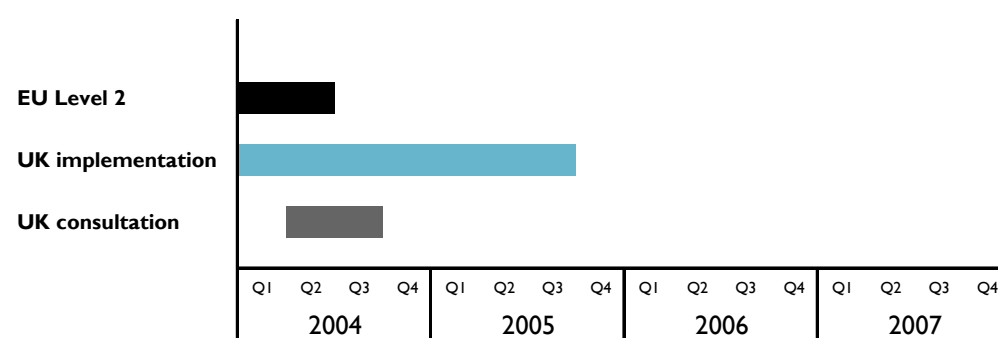
3.28 The Prospectus Directive aims to enable corporate issuers to raise finance on competitive terms on an EU-wide basis and to provide investors and intermediaries with access to all markets from a single point of entry. The Directive sets out the initial information and disclosure obligations for issues of securities that are offered to the public or are admitted to trading on a regulated market in the EU. The Directive is designed to provide issuers with a “passport” that enables them to raise capital across the EU on the basis of a single prospectus.

3.29 Implementation of the Directive in the UK will be closely linked to the regulatory framework for listed companies and markets such as the Alternative Investment Market. The UK Listing Rules are currently under review by the FSA and the UK authorities will seek to ensure that issues arising from the Directive that overlap with the regime for listed issuers are identified at an early stage.

3.30 A more specific industry issue is the potential effect of the requirement that, following expiry of certain transitional provisions, non-EU issuers must include financial information in their prospectuses in accordance with IAS or “equivalent” national accounting standards. The Level 2 Regulation does not specify which national accounting standards will be considered to be equivalent; CESR will be asked to provide further advice to the Commission and ESC on this issue.

3.31 The Directive is due to be implemented by 1 July 2005. The Level 2 Regulation, based closely on advice from CESR, was agreed by the ESC on 19 April 2004. The Treasury and the FSA will be carrying out discussions with the industry with a view to issuing a joint consultation document in mid-2004.

Chart 5: Expected timeline for the Prospectus Directive



Occupational Pension Funds Directive

Title: Directive 2003/41/EC of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision

Implementation deadline: 23 September 2005

3.32 The Occupational Pension Funds Directive aims to allow occupational pension funds to operate on an EU-wide basis. The Directive provides a common framework across the EU for pension schemes, relating to funding, regulation and information to members, and allows institutions for occupational retirement provision established in one Member State to be sponsored by employers in other Member States.

3.33 The Directive requires implementation by 23 September 2005. A consultation exercise carried out by the Department for Work and Pensions closed in December 2003. Implementation will be effected through the Pensions Bill (which received its first reading in January 2004 and is due to receive Royal Assent in November 2004).

Takeovers Directive

Title: Directive 2004/25/EC of 21 April 2004 on takeover bids

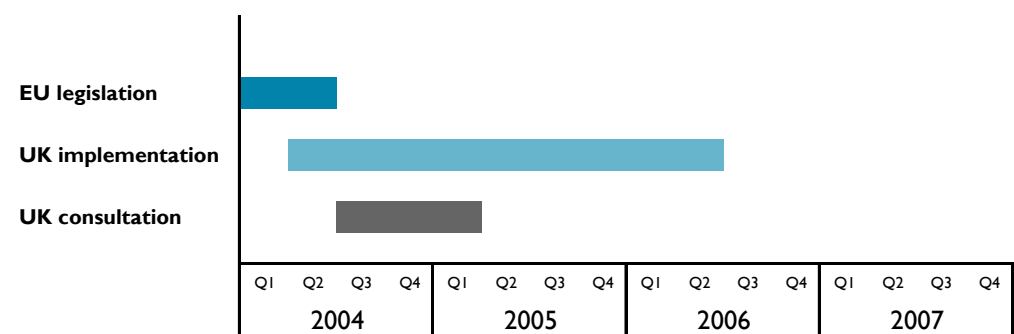
Implementation deadline: 20 May 2006

3.34 The Takeovers Directive provides an EU-wide framework for the regulation of takeover bids of companies with securities on regulated markets in the EU.

3.35 Much of the Directive is founded in the principles that underpin the UK's own system of takeover regulation set out in the City Code, although it does little to address barriers to takeovers within the EU. The Directive also contains other important provisions related to transparency and disclosure of control and governance structures and “squeeze-out” and “sell-out” rights to address the problems of residual minority shareholders following a successful takeover bid.

3.36 The implementation deadline for the Directive is 20 May 2006. The DTI is currently undertaking preliminary discussions with interested parties to consider implementation issues, and intends to consult publicly following those discussions.

Chart 6: Expected timeline for the Takeovers Directive



Investment Services Directive

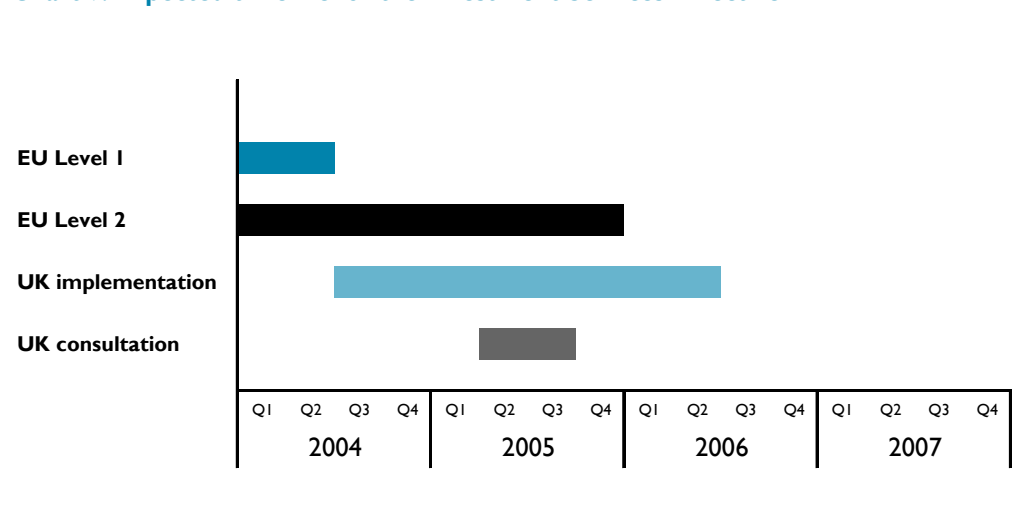
Title: Directive 2004/39/EC of 21 April 2004 on markets in financial instruments

Implementation deadline: 1 May 2006

3.37 The new Investment Services Directive (ISD) replaces Directive 93/22/EEC regulating the authorisation, behaviour and conduct of business of securities firms and markets. The Directive aims to provide for an integrated securities market in the EU and for the effective cross-border provision of investment services, whilst enhancing the protection of investors and market integrity.

3.38 There is much work to be done to agree a significant amount of Level 2 legislation and then to implement the Directive in the UK. CESR is already considering its advice on Level 2 measures and formal Commission mandates are expected in June 2004. Level 2 work is due to be completed by December 2005.

Chart 7: Expected timeline for the Investment Services Directive



3.39 Box 5 describes important linkages between the ISD and other FSAP measures.

Box 5: Key links between the Investment Services Directive and other measures

- The ISD partly sets the scope for the **3rd Capital Adequacy Directive (CAD3)**, so the extension of its scope means that more investment firms may be subject to the capital requirements of CAD3. The ISD also requires that CAD3 should set capital requirements for regulated markets. It will be necessary to ensure that these requirements reflect that the risks involved in operating a regulated market differ from those for investment firms.
- It is also linked to the **Insurance Mediation Directive (IMD)**, as it requires firms that intermediate both investment and insurance business to hold additional levels of professional indemnity insurance (PII) and/or capital – rather than just holding either the ISD or IMD levels. This could discourage mixed business, which is carried out by many UK-based intermediaries. Also, the PII market is highly cyclical, so the requirement to hold prescribed levels of PII could lead to difficulties for firms, especially smaller ones, which could be priced out of the market. The Commission will review this issue in early 2005; industry participants are encouraged to input into that process.

MEASURES PROPOSED BUT NOT YET ADOPTED

Consumer Protection Co-operation Regulation

Title: Proposal for a Regulation on co-operation between national authorities responsible for the enforcement of consumer protection laws

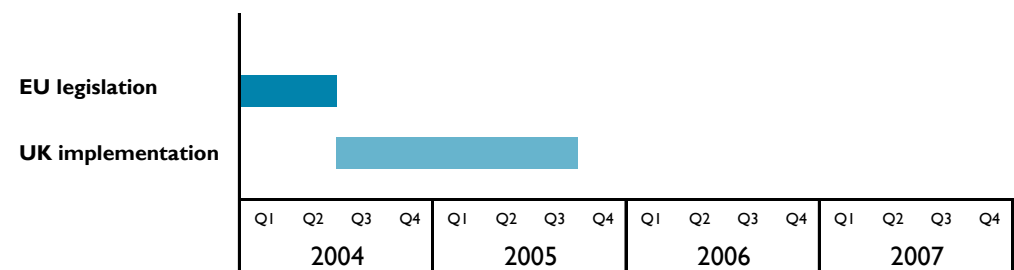
Implementation deadline: expected mid- to late-2005

3.40 The Regulation aims to improve consumer confidence in cross-border shopping by facilitating co-operation between national authorities in dealing with cross-border breaches of consumer protection laws. It provides for the creation of a network of national enforcement authorities to enable them to take co-ordinated action against rogue traders who abuse the freedom of the Single Market to deceive consumers. It removes existing barriers to the exchange of information between enforcement authorities, facilitates their co-operation and empowers them to obtain action from counterparts in other Member States.

3.41 The Regulation is chiefly aimed at enforcement authorities – such as the FSA – so its impact on business is likely to be relatively limited other than making life more difficult for rogue traders. However, firms that are the subject of mutual assistance requests may have to assist the relevant UK enforcement authority with their investigations into the matter, and respond to any enforcement measure taken.

3.42 Following agreement between the European Parliament and the Council on a compromise deal on 21 April 2004, the Regulation is likely to be adopted formally in May 2004. It will be applicable from one year after its likely publication in the *Official Journal* later in 2004.

Chart 8: Expected timeline for the Consumer Protection Co-operation Regulation



Transparency Directive

Title: Proposal for a Directive on the harmonisation of transparency requirements with regard to information about issuers whose securities are admitting to trading on a regulated market

Implementation deadline: expected late-2006

3.43 The Transparency Directive aims to enhance transparency on EU capital markets by establishing rules on periodic financial reports and on the disclosure of major shareholdings for issuers whose securities are admitted to trading on a

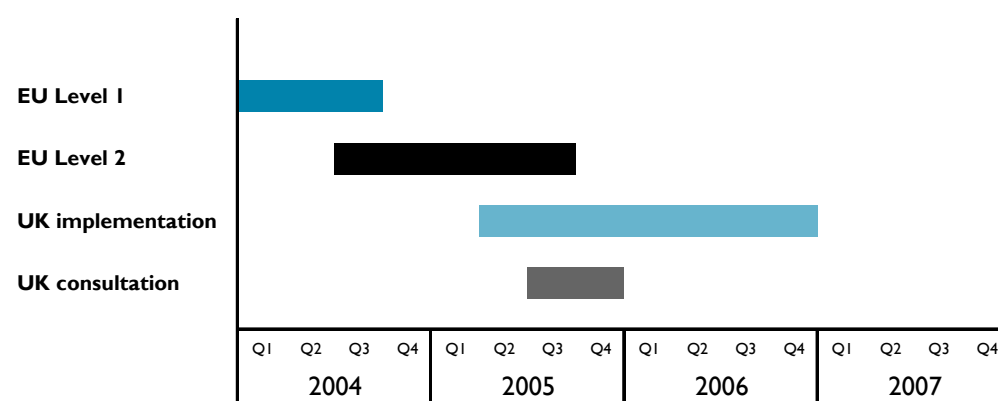
regulated market in the EU. The Directive also sets out the mechanism through which this information is disseminated.

3.44 The Directive raises the following key issues for industry:

- issuers that have securities admitted to trading on regulated markets in the EU will be required to disclose annual and half-yearly financial reports and, in the case of shares, interim financial statements. The content of this information is set out in the Directive; in addition, in the case of the annual and half-yearly financial reports, the standards to which this information has to be prepared make reference to International Accounting Standards;
- issuers will also be required to disseminate regulated information (periodic financial information, price-sensitive information as defined in the Market Abuse Directive, and changes in major shareholders) via a mechanism that is fast and pan-European; and
- institutions or individuals that have major shareholdings in an issuer whose shares are admitted to trading on a regulated market in the EU will be required to disclose changes in the size of these holdings as they cross certain specified thresholds.

3.45 Implementation of the Directive is expected to be in late 2006, two years after it is published in the *Official Journal*, which is expected towards the end of 2004. The UK authorities will be involving UK-based industry as much as possible during the Level 2 process, and will also be consulting about implementation of the Directive in the UK.

Chart 9: Expected timeline for the Transparency Directive



Cross-border Mergers Directive

Title: Proposal for a Directive on cross-border mergers of companies with share capital

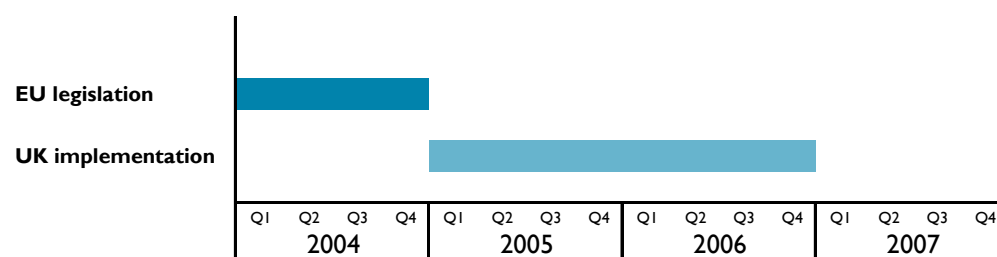
Implementation deadline: expected late-2006

3.46 The Cross-border Mergers Directive – formerly known as the 10th Company Law Directive – aims to facilitate corporate restructuring within the EU by laying down a legal framework for cross-border mergers of companies. It is intended to apply to private companies as well as public limited companies, to create a viable cross-border

restructuring vehicle for small and medium-sized companies. The Commission originally proposed such a Directive in 1984, but negotiations on that instrument stalled, not least because of differences of views amongst Member States on the issue of employee participation in decision making (e.g. employees on the board). The present Commission proposal draws substantially on the provisions of the 3rd Company Law Directive (78/855/EEC), which provides for domestic mergers of public limited companies, and the solutions achieved in the European Company Statute to allow European companies to be formed by cross-border merger.

3.47 The Directive is expected to be adopted in late 2004, with an implementation deadline of late 2006. The DTI is responsible for its negotiation and implementation.

Chart 10: Expected timeline for the Cross-border Mergers Directive



Statutory Audit Directive

Title: Proposal for a Directive on statutory audit of annual accounts and consolidated accounts

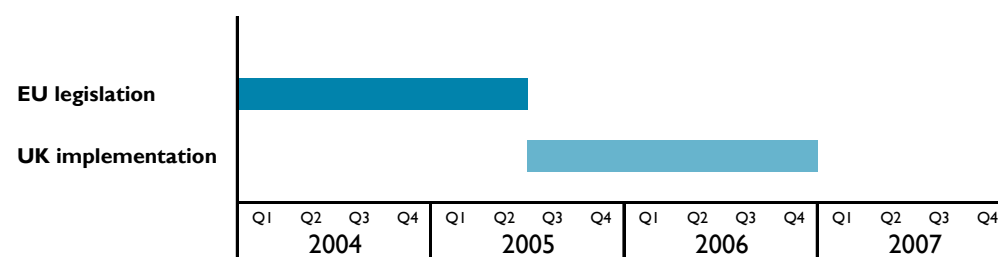
Implementation deadline: expected end-2006

3.48 The Statutory Audit Directive aims to modernise the 8th Company Law Directive (84/253/EEC) to ensure that investors and other interested parties can rely on the accuracy of audited accounts in the EU. It aims to clarify the duties of statutory auditors, their independence and ethics by introducing a requirement for external quality assurance and by ensuring robust public oversight of the audit profession. This considerably broadens the scope of the Directive 84/253/EEC, which only dealt with the approval of statutory auditors. The proposal also provides a basis for co-operation between regulators in the EU and with regulators in third countries, such as the US Public Company Accounting Oversight Board.

3.49 The Directive should have little direct impact on business in the UK, since many of its reforms reflect existing UK practice. However, it might place some new requirements on UK auditors, which could in turn feed through to higher audit costs for audited companies. Some provisions relating to the appointment of auditors and the role of audit committees could impact on the UK corporate governance regime.

3.50 The Directive is expected to be adopted by mid-2005, with an implementation deadline of late 2006. The DTI is primarily responsible for its negotiation.

Chart 11: Expected timeline for the Statutory Audit Directive



Unfair Commercial Practices Directive

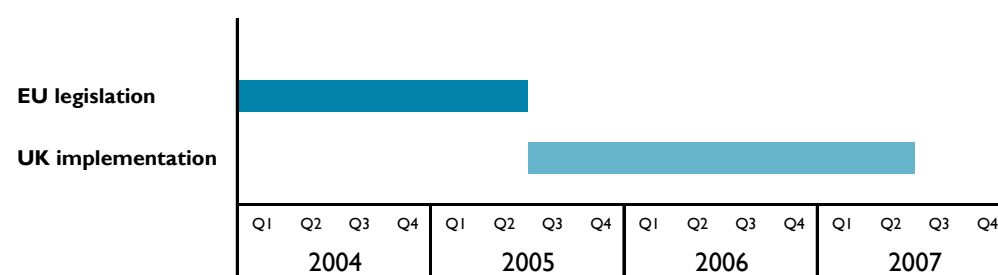
Title: Proposal for a Directive on unfair commercial practices

Implementation deadline: expected mid-2007

3.51 The Unfair Commercial Practices Directive will introduce an EU-wide duty “not to trade unfairly” when supplying any good or service to a consumer, which includes financial services. It aims to ensure that consumers will be protected against unfair practices that are not covered by sector-specific legislation, and will also protect against any new commercial practices that might arise.

3.52 Key issues for the UK are to ensure that the Directive does not erode consumer protection legislation and creates legal certainty, particularly with regards to the “professional diligence”, “material distortion” and “average consumer” test. The Directive provides scope for improving the UK’s consumer protection regime. The Directive is expected to be adopted in mid-2005, with a two-year transposition period, although it is possible that the Directive will move much more quickly.

Chart 12: Expected timeline for the Unfair Commercial Practices Directive



Consumer Credit Directive

Title: Proposal for a Directive on harmonisation of the laws, regulations and administrative provisions for credit for consumers

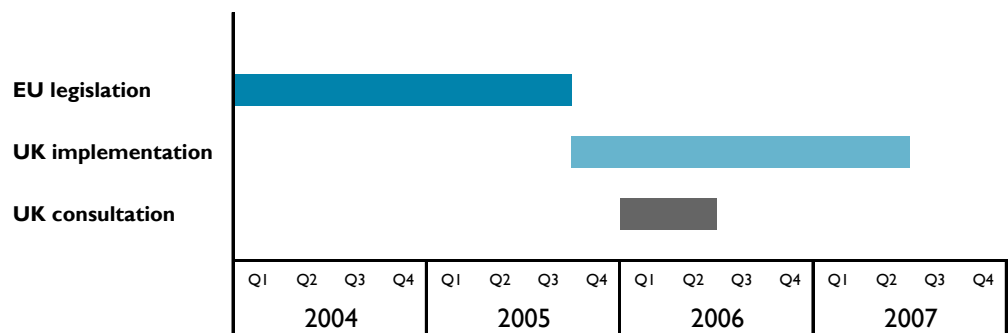
Implementation deadline: expected 2007

3.53 The Consumer Credit Directive aims to harmonise regulation of the terms under which credit is offered to consumers in the EU.

3.54 A key concern of the UK is that the Directive proposes a one-size-fits-all approach and does not reflect the diversity within the EU credit market. It is too early to be sure about the outcome of negotiations on the Directive. The Government and the FSA have made their concerns clear, working with the UK-based financial sector. The DTI, which is primarily responsible for the negotiation of the Directive, has held frequent roundtable meetings with the consumer credit industry.

3.55 The European Parliament completed its first reading of the proposed Directive in April 2004. Formal adoption of the Directive is not expected until mid-2005, implying an implementation deadline of 2007 at the earliest.

Chart 13: Expected timeline for the Consumer Credit Directive



Reinsurance Directive

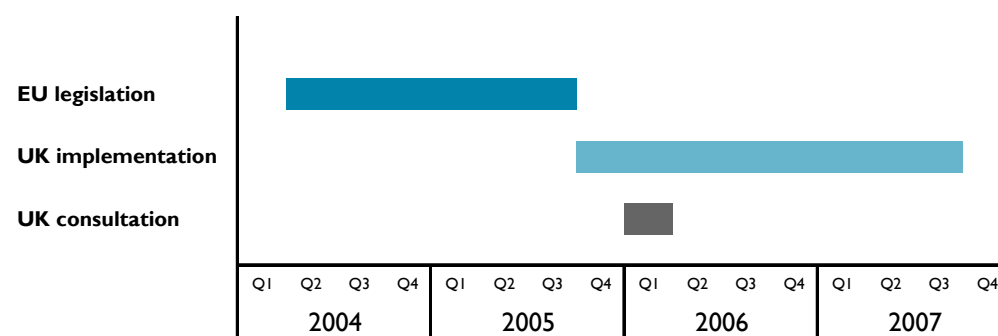
Title: Proposal for a Directive on reinsurance supervision

Implementation deadline: 2007 at the earliest

3.56 The Reinsurance Directive aims to establish a framework for reinsurance supervision in the EU for the first time, abolish some remaining barriers to cross-border reinsurance activities and provide greater policyholder protection. The Directive contains provisions to set up an EU-wide prudential framework that would take into account the recommendations of the Financial Stability Forum and the International Monetary Fund, leading to greater macro-economic stability and less systematic risk in the insurance sector.

3.57 The Commission published its proposal for the Directive on 21 April 2004. Council working groups are expected to start negotiations on the Directive soon. Given European Parliamentary elections, the European Parliamentary process is unlikely to begin until towards the end of 2004. The Directive is expected to be adopted in late 2005. The Treasury, with the FSA, has set up a roundtable with key industry representatives.

Chart 14: Expected timeline for the Reinsurance Directive



Equal Treatment Directive

Title: Proposal for a Directive implementing the principle of equal treatment between men and women in the access to and supply of goods and services

Implementation deadline: expected mid-2007

3.58 The Equal Treatment Directive aims to establish a framework for combating discrimination based on gender in access to and the supply of goods and services, with a view to putting into effect in Member States the principle of equal treatment between men and women.

3.59 Article 4 of the Directive would prohibit the use of gender as a criterion for the pricing of insurance and related financial services products. This would affect most annuities, life insurance, critical illness, income protection, health insurance, motor insurance and equity release scheme products.

3.60 An orientation debate in the Council on the Directive is planned for June 2004. Adoption is not expected before mid-2005. The Directive proposes an implementation period of two years from adoption, which would be around mid-2007 at the earliest. On the basis of the proposal, Member States would have the discretion of delaying for a further six years the implementation of the insurance proposals (i.e. the ban on the use of gender-based data).

4

FUTURE INTEGRATION OF FINANCIAL SERVICES IN THE EU

4.1 With the FSAP nearing completion, efforts must now be directed to ensure that its measures are effectively implemented and enforced in the UK and across the rest of the EU. In parallel, discussions are also under way on possible new proposals, and on future strategy towards financial services in Europe.

FURTHER MEASURES IN THE PIPELINE

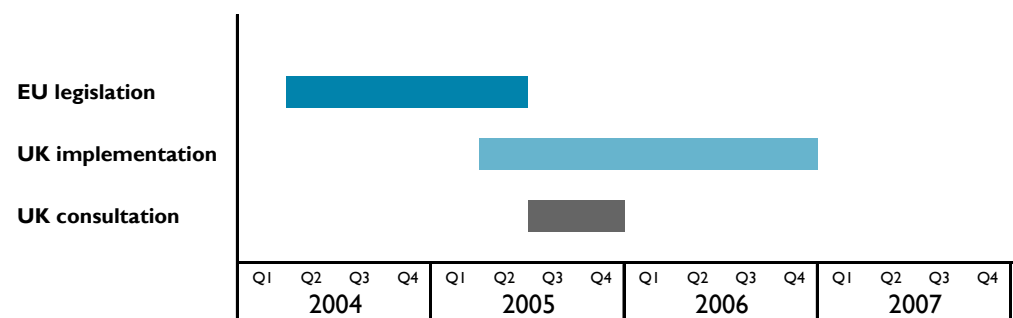
Some important measures still to come

4.2 The UK and other Member States as well as the Commission have all expressed a desire not to embark on another large new programme of financial services legislation. Rather, key stakeholders would not expect new measures to be proposed unless there was clear evidence that they would produce significant net benefits by further integrating the Single Market, removing barriers to integration or remedying clearly identified market failures. However, six important measures are currently in the pipeline, some not originally included in the FSAP. These are outlined below.

3rd Money Laundering Directive

4.3 The 2nd Money Laundering Directive (2001/97/EC) calls on the European Commission to propose a further Directive to amend the definition of “serious crimes” by 15 December 2004. The Commission has published preliminary draft articles of this 3rd Directive, which seeks to implement the revised 40 Recommendations on Money Laundering of the Financial Action Task Force (FATF), issued in June 2003. Progress on this Directive is at an early stage. The Commission has indicated that it plans to publish its formal proposal in June 2004, taking account of the views expressed by Member States. Negotiations between Member States will begin under the Dutch Presidency of the EU in the second half of 2004, which hopes to reach political agreement on the proposal before the end of 2004. A key issue for the UK will be the provisions on “customer due diligence” procedures. The Treasury is engaged in a process of ongoing consultation of public and private sector stakeholders and is also involved in a constructive dialogue with the Commission and other Member States. The implementation period for the Directive is likely to be 18 months from publication in the *Official Journal*, although this remains subject to negotiation.

Chart 15: Expected timeline for the 3rd Money Laundering Directive

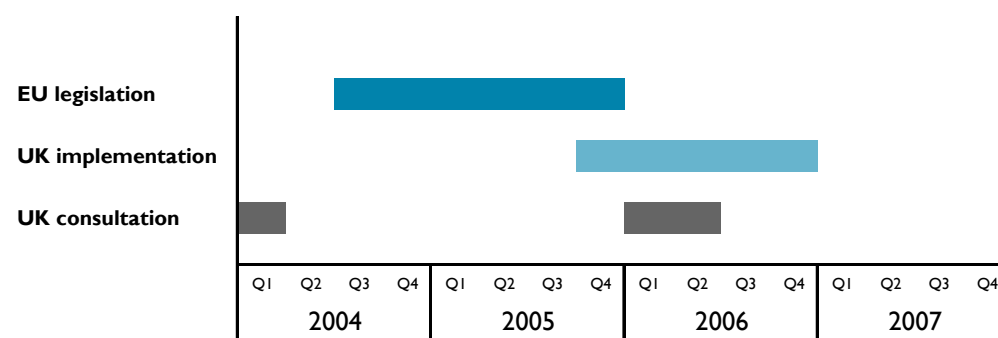


3rd Capital Adequacy Directive

4.4 The new Capital Adequacy Directive (CAD3) – also known as the Risk-based Capital Directive and the Capital Requirements Directive – is required to implement in the EU the proposed new Basel Accord (Basel II) that updates the existing capital adequacy rules for internationally active banks, and to extend the scope of application of Basel II to other credit institutions and investment firms, as in the case of the EU's implementation of Basel I. Basel II significantly improves the existing rules, for example by providing a better alignment of regulatory capital to risk and by creating incentives for better risk management.

4.5 Latest information suggests that the Basel Committee is aiming to publish the new Accord at end-June 2004. A consultation exercise by the Treasury ended on 5 March 2004 and a response document was published in April 2004. A Commission proposal is expected in summer 2004. Implementation will depend on the EU negotiation process but is not expected before end-December 2006.

Chart 16: Expected timeline for the 3rd Capital Adequacy Directive



4.6 Box 6 describes linkages between CAD3 and other financial sector measures.

Box 6: Links between the 3rd Capital Adequacy Directive and other measures

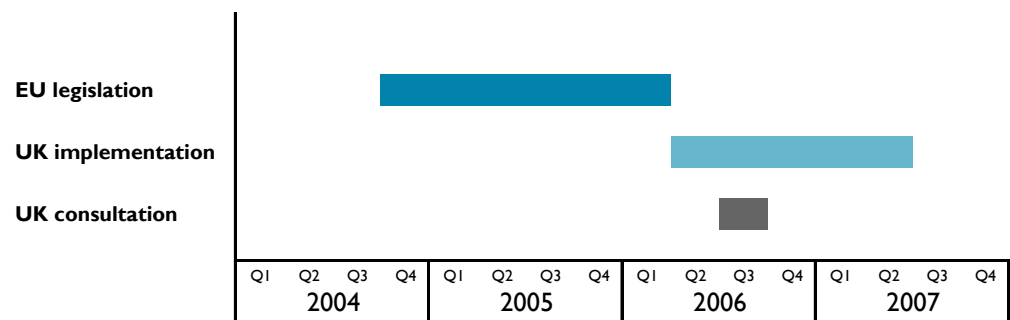
- The framework for the **2nd Insurance Solvency Directive** will be based on that adopted in CAD3.
- **Fair value accounting** will impact on the valuation of assets and liabilities, and on the income statements and disclosure requirements of financial institutions. There will also be a need to determine how to treat these issues for non-IAS firms.
- Investment firm activities caught within CAD3 will be dependent upon **Investment Services Directive** categories. The ISD essentially sets the scope of application of the new capital adequacy requirements in CAD3 to investment firms, which is very significant to firms that fall either side of the line (e.g. commodity derivatives businesses) and in terms of its potential distortionary effects on the market (e.g. in competition terms). Additionally, the draft CAD3 proposal holds no provisions for regulated markets – this will need to be addressed before adoption.

Transfer of Seat Directive

4.7 The Directive will enable companies to transfer their registered office from the Member State where they are registered (the “home” state) to another Member State (the “host” state), under an appropriate procedure providing legal certainty. A company transferring its registered office would be registered in the host Member State and would acquire a legal identity there, while at the same time being removed from the register in its home Member State and giving up its legal identity there. If necessary, companies would have to adapt their structures in order to meet the substantive and formal conditions required for registration in the host Member State. However, they would not be obliged to go through liquidation proceedings in their home Member State or to create a new company in the host Member State.

4.8 The Commission launched a consultation on 26 February 2004 on the outline of the planned proposal for a Directive. Two previous public consultation exercises, as well as the case law of the Court of Justice, have highlighted a need for clear EU framework legislation on this issue, so that companies can exercise their right across the EU. The consultation closed on 15 April 2004; the Commission is now considering the responses received, with a view to issuing a final proposal later in 2004.

Chart 17: Expected timeline for the Transfer of Seat Directive



New Legal Framework for Payments

4.9 Establishing a Single European Payment Area is viewed by the Commission as an important element of the integration of retail financial markets and crucial in facilitating the wider internal market. Previous legislation in this area – the Cross-border Credit Transfers Directive (97/5/EC) and the Regulation on Cross-Border Payments in Euro (2650/2001/EC) – have established minimum execution times for cross-border transfers and the principle of pricing equality for domestic and cross-border euro credit transfers. However, a true Single European Payment Area has yet to develop. The UK authorities would welcome the development of a coherent framework, proportionate to the risks involved, with clear and justified objectives; for instance by reinforcing and encouraging competition in payments systems. The Commission’s thinking on how to remove technical and legal barriers to the effective functioning of the Single Payments Area is set out in their recent Communication, published in December 2003¹.

¹ COM(2003)718 final

4.10 Due to pressures to meet the FATF deadline of February 2005 to implement Special Recommendation VII (concerning originator's information accompanying wire transfers), the Commission is expected to publish a legislative proposal on this measure in July and plan to publish a second legislative proposal covering the remaining parts of the New Legal Framework by November 2004. Special Recommendation VII will be implemented via a Regulation and the other measures will be contained in a Directive.

Clearing and Settlement Framework Directive

4.11 The Commission published a Communication on clearing and settlement on 28 April 2004, asking for comments from interested parties by 30 July 2004². The Government supports the overarching objective that the Commission expresses in the Communication of promoting safe and efficient cross-border clearing and settlement in the EU. In the Communication the Commission suggests following up the recommendations for tackling barriers to efficiency in cross-border clearing and settlement in the reports of the Giovannini Group with a co-ordinating group and groups of experts on tax and legal issues³. The Commission also suggests proposing a framework Directive on clearing and settlement covering rights of access, a common regulatory framework and governance arrangements. The Government will make a public response in due course.

2nd Insurance Solvency Directive

4.12 The Commission, jointly with Member States, is carrying out a fundamental review of the regulatory capital regime of the insurance industry (the "Solvency 2" project). The UK authorities welcome this review and strongly support its objective of establishing a solvency system that is better matched to the true risks of insurers, drawing on the experiences of Basel II in the banking sector. This new approach will result in a new Directive.

4.13 The Commission, in conjunction with the formative EIOPC, is currently in the process of drawing up mandates for CEIOPS to take forward work on more technical aspects of the project. The mandates should be finalised during the first half of 2004. The Commission is expected to produce a draft proposal for the Directive in early 2005, with a formal proposal following later in the year at the earliest.

FUTURE STRATEGY TOWARDS FINANCIAL INTEGRATION

UK priorities post-FSAP

4.14 With the FSAP now largely adopted, the Government believes a new and different approach is needed to take forward financial services integration. This approach builds on the lessons of the FSAP. It is centred on five priorities:

- **better implementation and enforcement of EU measures affecting the financial sector.** A significant number of the FSAP measures that have been adopted have still to be implemented nationally. That should be a top priority, together with their subsequent enforcement;
- **alternatives to EU regulation.** In general, EU legislation should be a last resort. Alternative approaches to policy making, such as more use of EU

² COM(2004)312

³ *First report of the Giovannini Group on Cross Border Clearing and Settlement Arrangements in the European Union* (November 2001) and *Second report of the Giovannini Group on Clearing and Settlement Arrangements in the European Union* (April 2003)

competition policy, market-based solutions, and initiatives at national level, should be considered first;

- **better regulation.** In some specific cases, market failure analysis may demonstrate that further new EU legislation on financial services could be necessary. When new EU legislation is being considered, a proper assessment of the costs and benefits should be undertaken, and financial market participants should be fully consulted;
- **making the Lamfalussy arrangements work well.** These new regulatory arrangements are now in place to supervise financial services across the EU. They have been shown to work for securities markets and are being extended to banking and insurance. They need to be further developed; and
- **recognising the global nature of financial services.** Finally, it is crucially important to remember that financial markets are global. A global perspective is needed when considering the impact of EU financial services regulation on the competitiveness of EU-based firms and financial centres, and international action will sometimes be needed to tackle global issues.

Better regulation **4.15** The UK is at the forefront of trying to improve the EU's regulatory framework, having endorsed in 2002 the Commission's Better Regulation Action Plan. The UK authorities firmly believe that continuing to advance the quality, robustness and application of impact assessments should produce better quality legislation. Moreover, the UK authorities believe that there is a need to ensure the views of industry are reflected in this consultation process, thereby further enhancing the quality of both the resulting impact assessments and the final legislation.

4.16 To build on the momentum of the 2002 initiative, the Finance Ministers of Ireland, the Netherlands, Luxembourg and the UK – the current and three succeeding EU Presidencies – published in January 2004 a joint initiative on Regulatory Reform, which aims to:

- enhance the quality of impact assessments by continuing efforts to develop capacity to produce and evaluate these assessments;
- use impact assessments to “competitiveness proof” all proposals by the Competitiveness Council;
- ensure that the analysis provided by impact assessments actually influences the decision-making process;
- encourage the Council, Commission and the European Parliament to make greater use of imaginative, outcome-based approaches to legislation; for example, mutual recognition can, in many areas, allow for greater progress in delivering shared objectives; and
- encourage the Commission to make greater use of review clauses in legislation (to provide triggers for evaluating the impact of legislation over time), extending them to a significant proportion of all new EU legislation.

Further information **4.17** These five priorities for the future of financial services in Europe are more fully discussed in the related document, *After the EU Financial Services Action Plan: A new strategic approach*.

A

SOURCES OF INFORMATION

A.1 Further information on the implementation of FSAP and related measures can be obtained from a variety of sources, including the following¹. These links can be accessed in dynamic form from the online version of this document, which is available at www.hm-treasury.gov.uk.

- The **European Commission** (DG MARKT) publishes six-monthly reports on Progress on the Financial Services Action Plan, which are available, along with a wide range of other material about the FSAP, at www.europa.eu.int/comm/internal_market/en/finances/actionplan
- Details of individual directives by subject (e.g. banks, insurance, securities) are provided on the European Commission's website at www.europa.eu.int/comm/internal_market/en/finances
- The **Inter-Institutional Monitoring Group** for securities markets has a website at www.europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm
- The **Economic and Monetary Affairs Committee** of the European Parliament carries relevant material on its website at www.europarl.eu.int/committees/econ_home.htm
- **HM Treasury** publishes summaries of the key issues on individual FSAP measures, and links to texts. Its website is at www.hm-treasury.gov.uk/documents/financial_services/eu_financial_services/fin_euf_actionplan.cfm
- The **Financial Services Authority** publishes consultation papers on FSAP measures and discussion papers on other relevant EU issues on its website at www.fsa.gov.uk/pubs/index-type.html
- The **Bank of England** publishes information on European issues relating to financial markets on its website at www.bankofengland.co.uk/publications/europe.htm
- The **Corporation of London** publishes reports on the regulation of European financial markets. This along with further information about the Corporation's new Brussels office can be found at www.cityoflondon.gov.uk/business_city/promoting/european.htm
- The **Committee of European Banking Supervisors** (CEBS) publishes material on banking directives on its website at www.c-ebs.org
- The **Committee of European Insurance and Occupational Pensions Supervisors** (CEIOPS) publishes material on insurance and occupational pensions directives on its website at www.ceiops.org

¹ The Treasury, FSA and Bank of England do not necessarily endorse any views or comments provided by these sources.

- The **Committee of European Securities Regulators (CESR)** publishes mandates from the Commission, and other material on securities markets directives under the Lamfalussy process, on its website at www.cesr-eu.org
- The **Association of British Insurers (ABI)** website includes a short section on EU regulation under 'Current issues/Europe', with contact details at the ABI, at www.abi.org.uk
- **ACI – The Financial Markets Association** holds conferences and publishes a regular 'Briefing', among many other activities relating to the wholesale financial markets. Its UK page can be accessed at www.aci-uk.com
- The **Association for Payment Clearing Services (APACS)** website includes information under 'Other payment issues' on EU regulation and current regulatory initiatives, specifically on retail payments, at www.apacs.org.uk
- The **Association of Private Client Investment Managers and Stockbrokers (APCIMS)** website includes APCIMS' responses to draft directives and its document, *Making the Financial Single Market Work*, which looks ahead to the effective implementation of the FSAP, at www.apcims.co.uk
- The **British Bankers' Association (BBA)** produces a regular EU newsletter for members. Its website includes BBA and European Banking Federation (EBF) submissions in response to consultations on directives at www.bba.org.uk. The EBF website is at www.fbe.be/
- The **Federation of European Securities Exchanges (FESE)** website contains position papers and submissions in response to consultations on FSAP directives at www.fese.be/initiatives/european_representation/index.htm
- The **Futures and Options Association (FOA)** makes response papers available to members, produces a bi-monthly on-line newsletter entitled 'Update' for members, and carries a section on European regulation on its website at www.foa.co.uk
- The **Investment Management Association (IMA)** website includes two relevant sections – a European section under 'Responses to consultations', and the study *Towards a Single European Market for Asset Management* can be found under 'Research' – at www.investmentfunds.org.uk
- The **International Primary Market Association (IPMA)** website includes relevant FSAP information and IPMA's submissions and position papers at www.ipma.org.uk/cu_index.asp
- The **International Swaps and Derivatives Association (ISDA)** website includes ISDA's comment letters on EU affairs under 'Committees/Regulatory' and 'Comment Letters' at www.isda.org
- The **London Investment Banking Association (LIBA)** website provides, for members, a market commentary on some EU directives, and includes a section on 'EU issues', at www.liba.org.uk
- The **London Stock Exchange** website includes a section providing the Exchange's responses to EU consultations, at www.londonstockexchange.com/consultationresponses