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## EUROFI PRELIMINARY REPORT

BY JACQUES DE LAROSIERE, DANIEL LEBEGUE AND DIDIER CAHEN

# AN INTEGRATED EUROPEAN FINANCIAL MARKET

26<sup>TH</sup> NOVEMBER 2002

## PREAMBLE

Following its Forum on “European banking and finance after the euro” in September 2000<sup>(1)</sup>, Eurofi decided that its next focus should be raising awareness of the Convention on the Future of Europe and of the European Institutions in general with regard to the creation of a single European capital market by 2005.

The aim of this initiative is to reflect the needs of market players – issuers, investors, financial intermediaries and savers – who want a single financial market without technical, regulatory or fiscal barriers. It also aims to strengthen the euro’s external credibility and to hasten the emergence of a financial governance model that can respond to enlargement.

In May 2002, Eurofi set out to define an appropriate framework for this integrated European financial market, and to review the operational and institutional means needed to achieve it.

The association therefore surveyed 180 European institutions and companies, comprising issuers, banking and financial institutions, stock exchanges, middle and back office service providers, financial regulators and supervisors. Its questionnaire sought their opinions on a number of issues ranging from issuance, private equity, stock exchanges and market infrastructures to asset management, insurance, regulation and supervision. The objective was to generate reactions rather than to impose any particular vision of a single financial market.

This written consultation, carried out in partnership with the Euro 50 Group and with the collaboration of management consultants Atos Odyssee was also accompanied by interviews.

A Steering Committee, co-chaired by Jacques de Larosière and Daniel Lebègue (see Appendix 1), was set-up to analyse the survey results and to reflect them in this report. This report also proposes ways to identify immediate priorities and sets out ideas for relevant articles that might be included in the future EU Treaty.

This report reflects the answers to our questionnaire received from 55 institutions, together with 61 interviews carried out between September and November 2002. The results of the survey are presented in Appendix 6. We would also draw readers’ attention to the methodology used to analyse and weight the answers to the questionnaires. As a result, the percentages presented in Appendix 6 of this document have to be treated with care.

As with any report of this scope, we encountered a range of opinions among the organisations we approached as well as within the steering committee itself. This preliminary report attempts to reflect the main views expressed although they are not necessarily those of all individuals involved.

This document should be seen as a preliminary report, as it will be subject to change after further consultations. Our final report is due to be presented by June 2003.

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<sup>(1)</sup> The conclusions of that event are contained in « Banking and Financial Europe after the euro », Revue d’Economie Financière, N° 62, 2001.

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# PRELIMINARY EUROFI REPORT ON AN INTEGRATED EUROPEAN FINANCIAL MARKET

## 1. THE STAKES

1. To ensure its development and enhance its status as a global economic player, the European Union (EU) needs an integrated market as quickly as possible. The aim is to make it easier to raise the capital needed to finance investment, and thus increase capital productivity, growth and employment. This will also strengthen the euro and enhance its international role.
2. The European Single Act and the Euro have already changed the economic behaviour of market players. The introduction of the single market, restructurings and mergers/acquisitions, increased financing requirements and the rapid spread of new technologies are all factors in the expansion of cross-border economic activity. This process has also fostered the emergence of cross-border entrepreneurs and cross-border investors, and is inducing markets to merge to maximise efficiency and meet rising expectations.
3. Economic and Monetary Union (EMU) has provided additional impetus to the efforts over the last 20 years to promote a genuinely European financial market. This single market in banking and financial services is also urgently needed to respond to the legitimate expectations of businessmen, consumers and savers, who are increasingly keen to operate in the euro area as though it were a genuine domestic market, without time-consuming and costly technical or regulatory barriers.
4. For the Euro to be a complete success, the structural reforms under way regarding products, services, and both labour and capital markets need to be taken further. EU member states need to demonstrate strict financial discipline as regards the visibility and consistency of their economic policies. The recent discussions surrounding the Stability Pact underline the important role played by these mechanisms. If they function smoothly they can make a decisive contribution to the euro's credibility.
5. The economic benefits of an efficient financial market cannot be over-emphasised. An integrated European market will stimulate innovation, intensify competition in banking services, widen consumer choice and reduce the costs of intermediation. A Europe wide market will therefore offer economic players improved financing and investment conditions. It will boost capital productivity and ensure a better allocation of assets, thereby fostering a proper match between savings and investment. This in

turn will enhance material wellbeing throughout the European Union, through a general increase in growth and employment.

6. These improvements are a prerequisite for sustainable economic development. But to achieve this greater efficiency, Europe first needs clear operating rules. These must be able to:

- widen and deepen the European financial market and make it more liquid;
- reduce operating and marketing costs for financial products and services.

Such recent studies as that by the European Financial Services Round Table in February 2002, have estimated that the lack of a single market in banking and financial services currently costs investors and consumers €15 billion a year.

According to a report conducted for the European Commission<sup>(1)</sup>, a single market for financial services would bring significant benefits to businesses, investors and consumers. The new research forecasts that integration of EU financial markets would increase European Union growth by at least 1,1 per cent over the next decade, adding euros € 130 bn (in 2002 prices) to Europe wealth and substantially reducing the cost of raising capital for business : integration of EU equity markets would reduce the cost of equity capital by 0,5% and a 0,4% decrease in the cost of corporate bond finance would be expected to follow ; there would be a further reduction of 10 basis points arising from reduced clearance and settlement costs;

This study, published on 12 November, states that growth will be fairly evenly spread across the 15 member states, most of them being expected to benefit from an increase of GDP of between 0,9 and 1,2 per cent.

The Commission's paper also indicates that the integration of EU financial markets would boost EU employment by 0,5%. Lower costs should trigger a sharp rise in business investment, which is set to rise by 6% over the next decade.

The above results are, of course, subjected to some uncertainties.

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<sup>(1)</sup> The full results of this Commission report , based on a year long study, are available on the Europa website : [http:// europa.eu.int/comm/internal\\_market/en/finances/mobil/overview.htm](http://europa.eu.int/comm/internal_market/en/finances/mobil/overview.htm).

## 2. THE GOALS

### 2.1 DEFINITION OF AN INTEGRATED FINANCIAL MARKET

7. A fully integrated financial market implies a common currency to eliminate exchange risks and contribute to the alignment of interest rates <sup>(2)</sup>. A well functioning market nonetheless can operate with different currencies so long as there is strong economic convergence.
8. An integrated European financial market is based on the core principles of an open market economy in which competition is free and where investors protection is real and based on core principles. It also requires the dismantling of obstacles (legal, technical, regulatory and tax differences...) that hinder free competition between providers of cross-border services.
9. In this open and competitive market, customers are free to buy financial services products from anyone and anywhere they want in the EU. A single capital market requires European payment systems with efficient, secure and low-cost electronic instruments.
10. Financial services integration must also favour therefore financial innovation and market development. Integration does not mean unification and innovation must come from the market itself, and must be spread throughout the EU by easy and understandable rules that will be applied and sanctioned in a similar way in all Member States. Adequate flexibility of the regulatory and supervisory systems will facilitate the development of market innovation by making it more attractive.
11. The creation of a single European financial market does not at this stage require systematic tax unification, but there remains a need to identify and to suppress financial product taxes that can have a distorting effect on capital movements.

So far as harmonisation is concerned, it is important to distinguish indirect taxes (stamp duties, capital gains...) from direct taxes (revenues, household...). The priority has to focus on harmonising indirect taxation.

The ultimate aim should be to provide for the approximation of tax rates where needed, as well as minimum standards and tax bases in the areas of saving and company taxation to ensure that the proper functioning of the single market is not affected by harmful tax competition and unjustified differences.

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<sup>(2)</sup> This observation doesn't entail any change of position from some institutions, which have always wanted to be neutral on the euro subject.

The results of the Eurofi survey show that the most important step is to harmonise tax bases, while letting member states fix their own tax rates.

12. An efficient and integrated market also requires a European framework for company law. Its design and its implementation have to be taken together and should cover accounting rules (principles and also the definition of practical modalities including convergence between IAS standards and US GAAP), corporate governance, take-over rules, merger and acquisition laws, registration modalities, bankruptcy law, collateral and ownership. Its overall aim must be to promote free movement of firms within the European Economic Area.

The European Company Statute, as decided by the European Council in Nice (December 2000), and due to be introduced in 2004 is a key component. To make it a success, it must be accompanied by an appropriate tax regime.

13. In this context, a comprehensive European (and international) approach to financial supervision and regulation is crucial if the EU is to create a level playing field in international financial services and avoid “regulatory shopping”.

In a European marketplace where cross-border and cross-sector activities are becoming more and more frequent, there is need for a “functional approach” to regulation. Under this, the regulatory regime would be determined by the inherent risks in that activity, not by reference to the type of financial institution undertaking that activity.

14. In a European market with full mobility of capital and financial services and where financial institutions and markets operate freely across national frontiers, a much more in-depth harmonisation and co-ordination of national regulatory rules becomes necessary.

Financial regulation and supervision should therefore operate at the same level, meaning that they must progressively become broadly European, even through complying with the demands of subsidiarity. Providing these rules and standards are defined on a common basis, monitoring can be done at national level.

15. Establishing a European regulatory framework is an evolutionary process. Many of the answers to Eurofi’s questionnaire suggested that respondents believe it is a process that will lead over time to the creation of some form of a European financial regulatory framework.

Such a framework would not mean a new centralised bureaucracy. It could be based on the ESCB model and would be run by a common decision making process.

The development of cross-border institutions could lead to a form of a European supervisory system.

The survey results point to a Treaty based system (see appendix 4),

The European framework should consist of easily understandable rules, that will enable the market to be open, attractive and competitive. Other views expressed are summarised in Appendix 6.

## **2.2 CHARACTERISTICS OF AN INTEGRATED FINANCIAL MARKET**

Its key attributes are :

16. Removal of the main barriers to cross-border business, leading to increased transparency and competition.
17. Companies should be able to raise capital easily and cheaply across the EU. This means having access to a wide range of investors in deep and competitively priced markets with high liquidity, competitive insurance costs and simple and straightforward procedures (fund raisings, stock exchange membership...). European standards are needed in such areas as for accounting norms, corporate governance and financial information.
18. Although SMES (small and medium –sized enterprises) often need to be governed by specific rules, it is nevertheless true that the same basic rules and principles must be applied to both listed companies and SMEs. SMEs need longer to conform to these rules and should generally be subjected to less binding constraints.
19. Financial institutions must be free to offer services across the EU. A European “passport” should allow fund managers to sell their financial products in all the member states without needing to create a subsidiary in a host country. Mergers between funds of different nationalities should also be possible.

A single market in pensions needs to be established. The adoption of a common legal framework for pension funds would facilitate pan-European pension funds which in turn would mean a substantial European sector and the economy as a whole with all the expected benefits for promoters, fund members, retired people and firms: economies of scale, development of monitoring of European capitalisation, increase of labour mobility.

20. In terms of trading activities several platforms should be able to coexist once there is a level playing field in which a European legal and regulatory framework eliminates competitive distortions. All barriers (legal, regulatory arbitrage...) should therefore be eliminated so as to allow exchanges to compete fairly.

The Eurofi survey has established that a number of respondents advocate now moving towards a situation in which there will be a few regulated markets in Europe sharing a centralised orders system, and this would offer greater liquidity and

transparency. They believe that this model should co-exist with appropriately regulated Multilateral Trading Facilities (Electronic Communication networks and Alternative Trading Systems) and internalisation of order flows by brokers

These respondents are also generally against intervention by national authorities in the concentration of stock exchanges and market systems. They consider that only the market is capable of generating integration in this sector.

21. Clearing and settlements must at the very least be interconnected. This integration also needs to be market driven and a number of respondents wished to clearly separate activities managed by settlement agencies and by commercial banks.

22. Electronic instruments like cards and transfers are privileged means of payment in the single financial marketplace. National payment have strong cultural roots that technocratic initiatives will not be able to harmonise.

A single payment area therefore needs :

- A competition framework that leaves banks free to select the services and infrastructures they want.
- A comprehensive legal framework covering bank accounts (value, dates...), security of payments (smart cards, digital signatures), alternative dispute resolution mechanisms...
- Anti-fraud measures at European level (common obligations of security set up by national Central Banks...)based on close co-operation between national police and judiciaries.
- A market driven approach combined with effective cooperation between European banks, and different payment systems.

23. Investors must be able to choose a wide range of standard and comparable products that would be available and competitively priced for the whole European single market. These products should be available in any member state in the knowledge that buyers are properly protected by Europe-wide rules.

Investors will remain unwilling to buy cross-border financial services unless they have confidence in the product they are buying, and know too they have clear recourse if something goes wrong. At the same time every effort must be made to ensure that consumer protection does not stifle competition or erect barriers to market growth.

24. The management structures of European business are progressively becoming aligned across the EU. However, the tax (and legal) structures of these businesses remain fragmented. The EU economy is thus less efficient and suffers from these negative effects.

25. An integrated European financial market needs common rules and standards that will be applied and sanctioned at national level. Such a Regulatory and Supervisory framework should ensure :

- Fair competition and openness between participants (investors, entrepreneurs, financial operators..).
- Freedom for participants to operate throughout the European Economic Area as in a true internal market without legal or technical barriers.
- Appropriate protection for investors that is “harmonised” on the basis of core minimum rules and effective resolution procedures for cross-border consumer complaints. This protection of EU investors must be available at a non prohibitive cost.
- Equality of treatment for all market players.

This Regulatory and Supervisory framework should be able to anticipate the possible prudential implications of new market developments, and thus reinforce the competitiveness of European financial institutions.

### 3 THE MEANS : OUR PROPOSALS

Eurofi's survey underlining the view of the practitioners and market users, taken together with the deliberations of the "Eurofi Steering Committee" has given rise to the following proposals:

26. The creation of a European financial market means achieving a degree of harmonisation, mutual recognition, co-ordination and the identification and then removal of major obstacles to cross-border services.

The ultimate goal is a single EU financial market with common rules, standards and procedures that offers a level playing field for all market participants. Mutual recognition arrangements and continued domestic controls represent acceptable interim solutions but will nevertheless result in an imperfect degree of market integration, because cross border regulatory differences for financial services providers and final customers will remain.

27. European Directives should focus on essential principles, and should also be transposed by Member States more rigorously and rapidly. To avoid lengthy and inexact national transpositions, a stronger mechanism is needed which would ensure that directives are properly implemented and enforced.

Another solution would be to have recourse to a Regulation, which is directly applicable, and would focus on common principles not detailed rules.

Moreover a simplification and a specialisation of the legal norms hierarchy would offer an increased transparency for all market users.

28. Financial service providers, market users and other key players need to be more closely consulted at each stage of preparing new legislation and regulations. Consultation should take place:

- At the highest level, before the drawing up or reviewing of primary legislation (core principles).
- At the secondary regulation level, market participants' opinion should be systematically sought.
- Panels of practitioners on primary and secondary legislation levels should be formed and systematically consulted with a mechanism of written answers by the regulation authorities when their advice is not taken into account.

29. If the Lamfalussy process –which marks a decisive progress- is extended to banking and insurance, as it should be, it will evolve naturally.

To be fully successful, it should require several conditions to be met:

- Staffing of committees should be reinforced with competent and technically trained staff seconded by national regulators and supervisors. Different secretariats will be needed for regulation and for supervision.
- Lamfalussy level 2 should have a specific mandate for looking into the creation of a level playing field and common rules for all EU member states.
- Specific Rules adopted at national level must not offer artificial means of restricting cross-border competition.
- Members of the Committees should be the relevant decision-makers in their own countries, with relevant competencies and decision making abilities.

Appendix 3 presents ways of extending the Lamfalussy mechanisms to the banking and insurance sectors.

30. It is especially important, in particular in the light of EU enlargement, that each national regulator and supervisor should be able to offer a level of service - equivalent instruments, status, competencies, enforcement capability and methodology - for an effective application of the mutual recognition. In this respect, the specific mandate mentioned in § 29 above is crucial.

31. The Lamfalussy report stated: "Increased integration of securities markets entails more interconnection between financial intermediaries on a cross-border basis, increasing their exposure to common shocks." Given the growing interlinkage between all segments of the securities markets and their financial intermediaries, systemic risk can only be dealt with at European level. This would involve a new approach that should be as reactive as the methods used in the United States.

Such an approach would entail the establishment of a permanent – albeit very light - structure that would be in a position to rapidly analyse and act in crisis prevention or crisis resolution and also to have established specific procedures enabling it to interact with the ECB.

Officials from Central Banks and government authorities would draw on the reflections and experience of this structure which would incorporate professionals who operate closely with market players and meet them on a regular basis.

This structure should, of course, coexist with national supervisors who will continue to work at national level but the interface between national authorities (and the ECB) and this structure could only be helpful in dealing with systemic issues.

32. Establishing a regulatory and supervisory framework is an evolutionary process. In the short term, better co-ordination along the lines suggested above- should prove adequate.

But more integration will probably be needed in the years ahead, and could lead progressively, according to many of those who answered Eurofi's survey and took part in subsequent interviews, to an adequate European system of regulation and surveillance (see appendix 4).

## 4 SHORT-TERM PRIORITIES

33. The European Commission is at present implementing the Financial Services Action Plan, which should in theory be completed in 2005. Various draft directives (concerning prospectuses, pension funds...) are still under discussion between the Parliament and the Council. Some have failed or are in abeyance, while others have been adopted (Regulation on insolvency proceedings, use of collateral, market abuse, conglomerates, principle on accounting standards, Lamfalussy reform...). These advances have been real but are not sufficient, and the rate of progress needs to be stepped up.

The Eurofi interviews have shown that there now needs to be a prioritisation of short-term actions:

### 4.1 FREE PROVISION OF SERVICES

34. Implementation of the mutual recognition principle.

35. Definition of core standards and rules for investor protection :

- The definition and implementation of a European Company Law, and the existence of a single prospectus, accompanied by access to reliable, readable, and homogenous financial information across Europe, are essential criteria for the protection of European investors.
  - The core principles for the protection of investors need to be defined with enough precision: transparency conditions (understandable nature of product services, price, definition of the market –regulated or not-, date of engagement, non-abusive commercialisation, fees, suitable investment advices, rights and obligations of the parties in written contract...), information obligations (nature of risk of the product, regular information on performance, procedures for solving cross-border complaints...).
  - Integrity of the market, insured, inter alia, by honestly, fairly and professionally managed investment firms (independent portfolio management in accordance with the objectives of the customer, appropriate disclosure by investment firms to their customers, fair management of conflicts of interests...).
36. The reversal of the onus of proof: A national authority that wants to protect itself from the activities or products of a financial institution based in another EU member state should not be allowed to unilaterally forbid such activities or products in its own

burdens. It should have to call on the home country of this competitor to argue its case that the agreement granted by this national authority does not comply with common European rules and standards. It would not be consistent with a fully integrated EU financial market if national rules on investor and consumer protection were substantially different, as that could only lead to distortions.

There continues to be discussion on how to define “home country”, raising the question of which authority should give its initial agreement. One view is that as long as harmonisation of rules and standards is not total, the home country must be where the issuer has its registered office. This approach would be in line with the principle of home country control, on which the EU’s Internal market is based.

However, once the harmonisation of rules and standards is complete, thus creating a common level playing field, total freedom of choice for all issuers, irrespective of where their registered office may be, would be appropriate.

#### **4.2 INTEROPERABILITY OF FINANCIAL PRODUCTS**

37. The implementation of an appropriate framework for pension funds would guarantee the interoperability of their products in the European market. A common legal framework for pension funds is needed to encourage pan-European retirement funds, with all the expected benefits for promoters, fund members, retired people and firms, and also offering an improvement in workers’ mobility (see 19).
38. The establishment of an effective European “passport” for financial products (equities, bonds, private equity funds, UCITS, hedge funds, pension funds...). would allow collective and management investment funds to market financial products or services throughout the EU without requiring the creation of a subsidiary in other EU states (for financial products not specifically covered by Community legislation in force).
39. Requirements for capital to be invested in capital in national stocks or bonds, especially for insurance companies and pension funds should be suppressed. These could eventually be replaced by ratios of European stocks. Prudent investment management does not require restrictions that impose limits on eligible instruments or quantitative limits. Funds must be able to invest in a wide range of financial instruments including money market instruments, bank deposits and, derivative instruments.
40. The implementation of a European Private Equity Fund Structure, with a single legal and fiscal statute, would make it easier to raise funds. It would allow companies and start-ups to raise funds throughout Europe, and invest regardless of national considerations.

- 41 To address both consumer and market needs and the economic and industrial stakes, priority should be given to the development of truly European payment schemes, specially for bank cards and transfers.

### **4.3 TAXATION**

42. The identification and removal of financial product taxes that can have a distorting effect on capital movements. To deal with these matters , it could be helpful to make a distinction between general or structural barriers (tax treatment of dividends and capital gains, retail investment in private equity vehicles, stock options...) and specific obstacles to cross-border activities (for example, in the insurance sector).

In the short term, enactment of legislation targeted at particular obstacles should be removed ; in the longer term, development of a systemic and comprehensive solution to all cross-border issues that would provide companies with a common consolidated tax base for all their activities in the EU.

### **4.4 FINANCIAL INFORMATION**

43. Common accounting standards : A definition of the practical modalities, involved, including international convergence between IAS and US GAAP, but not meaning an alignment on US rules.
- 44 Charter of corporate governance to be entrusted to a committee of wise men, notably on the basis of the 'Winter Report of the high-level group of company law experts on a modern regulatory framework for company law in Europe': A common set of best practices, independence of analysts to avoid conflicts of interest, definition of functions of the Board of Directors, definition of an independent Director, shareholders' representative at the Board, an advisory role for external auditors, judicial resort....

### **4.5 COMPANY LAW**

- 45 Take-over bids, mergers-acquisitions, bankruptcy laws (collateral, ownership), registration modalities to promote free movement of firms within the European area.
- 46 Legal agreement of securities (notably ownership rights) : priority for most financial institutions and issuers (and not for some CSDs). Legal agreement for securities (notably ownership rights) : priority for most financial institutions and issuers (and

not for some CSDs). The need here is to clarify and harmonise the scope of the right of ownership in respect of securities (stocks and flows) and the arrangements for holding them, which vary between countries (mandate, trustee, stewardship, dematerialisation or otherwise of securities...). Holders of European securities cannot specialise in 12 or 15 bodies of national law. They must know the scope of their rights in respect of capital and coupons.

#### **4.6 LEGISLATION, REGULATION AND SUPERVISION**

Achieving an integrated and efficient European financial market represents a significant challenge to all the economic players involved. It also calls for a sustained long-term effort, tenacity and a pragmatic approach, while at the same time demanding a careful approach to the needs of a functioning market that is devoid of any institutional dogmatism.

The success of the Lamfalussy process now appears to be a decisive factor in the adoption of truly European approach to financial regulation and supervision.

If this process is fully to succeed, we need to achieve a de facto integration of both regulation and supervision. That in turn would underpin the prospect of a Europe that transcends national frontiers and barriers and which, should the market's own development demand it, will see the creation of a truly European system of financial regulation and supervision.

Annex 4 of this report presents some of the steps which might appear in the Treaty.

## Appendix 1 : Composition of the Eurofi Steering Committee

### *Presidents*

|                             |  |
|-----------------------------|--|
| <b>Jacques de Larosière</b> | Honorary Governor of Banque de France and Advisor of BNP Paribas |
| <b>Daniel Lebègue</b>       | Chief Executive Officer, Caisse des Dépôts et Consignations      |

### *Participants*

|                               |   |
|-------------------------------|---|
| <b>Edmond Alphandery</b>      | Chairman of Directory Board, Caisse Nationale de Prévoyance   |
| <b>Claude Bébéar</b>          | Chairman of Supervisory Board, AXA  |
| <b>Antonio Borges</b>         | Vice-Chairman, Goldman Sachs International  |
| <b>Hervé Carré</b>            | Economic Director of Euro Area, General Director of Economic and Financial Affairs, European Commission |
| <b>Philippe de Buck</b>       | General Secretary, UNICE  |
| <b>Tom de Swaan</b>           | Member of the Directory Board, ABN AMRO Bank  |
| <b>Bill Eldridge</b>          | Public affairs Director Barclays, plc   |
| <b>Robert Goebbels</b>        | Member of the European Parliament   |
| <b>Pehr G. Gyllenhammar</b>   | Chairman, CGNU Itc  |
| <b>Alain Lamassoure</b>       | Member of the European Parliament   |
| <b>Alexandre Lamfalussy</b>   | Emeritus Professor, Institut d'Etudes Européennes   |
| <b>Cees Maas</b>              | Chief Executive Officer, ING Group NV   |
| <b>Rainer Masera</b>          | Chairman, SanPaolo IMI  |
| <b>Philippe Maystadt</b>      | Chairman, European Investment Banking   |
| <b>Giovanni Ravasio</b>       | President of the European Investment Fund   |
| <b>Jean-François Théodore</b> | Chairman, Euronext  |
| <b>Brian Williamson</b>       |   |
| <b>Erberhard Zinn</b>         | Member of the Directory Board, Bayerische Landesbank  |

### *Rapporteur and Secrétariat*

|                     |  |
|---------------------|--|
| <b>Didier Cahen</b> | General Delegate of Eurofi Association |
|---------------------|--|

### *Members of the "Bureau " of Eurofi association*

|                              |  |
|------------------------------|--|
| <b>Christophe Bourdillon</b> | Vice –President of Eurofi, Deputy General Manager, CDC IXIS Private Equity |
| <b>Jean-Jacques Bonnaud</b>  | Treasurer of Eurofi ; Chairman , Euro Titrisation                          |
| <b>Arianne Obolensky</b>     | Chairman, Banque du Développement des PME (BDPME)                          |
| <b>Michel Renault</b>        | Chairman, Groupement des Cartes Bancaires 'CB'                             |
| <b>Robert Raymond</b>        | Chairman, Cercle National des Professions Financières                      |

## Appendix 2 : List of the respondents and interviewed professionals

| <b>RECEIVED ANSWERS</b>   |  |
|---|--|
| ABN AMRO  | FESE (Federation of European Securities Exchanges) |
| AFG ASFFI   | FFSA   |
| Allianz Group   | FSA  |
| ASIP/GIP  | Goldman Sachs                                      |
| Association of German Banks   | HSBC (with HSBC AME)                               |
| Aventis   | ING Group  |
| Aviva   | Lafarge  |
| AXA   | LIBA   |
| Banco Santander   | LSE  |
| Banque Populaire Asset Management   | Morgan Stanley                                     |
| Barclays PLC  | Paris Europlace                                    |
| BASF  | Polish Chamber of Insurance                        |
| Bayerische Landesbank   | Standards and Poors                                |
| Banque Européenne d'Investissement  | Sanpaolo IMI                                       |
| BNP Paribas (dont BNP Paribas Asset Management,<br>Securities Services, Equities) | SCOR   |
| British Bankers' Association  | SEB Merchant banking                               |
| CDC   | Société Générale                                   |
| CDC IXIS  | Suez   |
| CNCE  | Swiss Life   |
| CNP SA  | Swiss Re   |
| CNPF (Cercle National des Professions Financières)                                | Unicredito (Italie)                                |
| Crest   | UNICE  |
| Deutsche Bank   | Direction du Trésor Italie                         |
| Deutsche Börse  | Direction du Trésor France                         |
| Deutscher Sparkassen und Giroverband  | CEF (Comité Economique et Financier)               |
| Dexia   | Commission Européenne                              |
| Euroclear   |  |
| Euronext/Clearnet   |  |

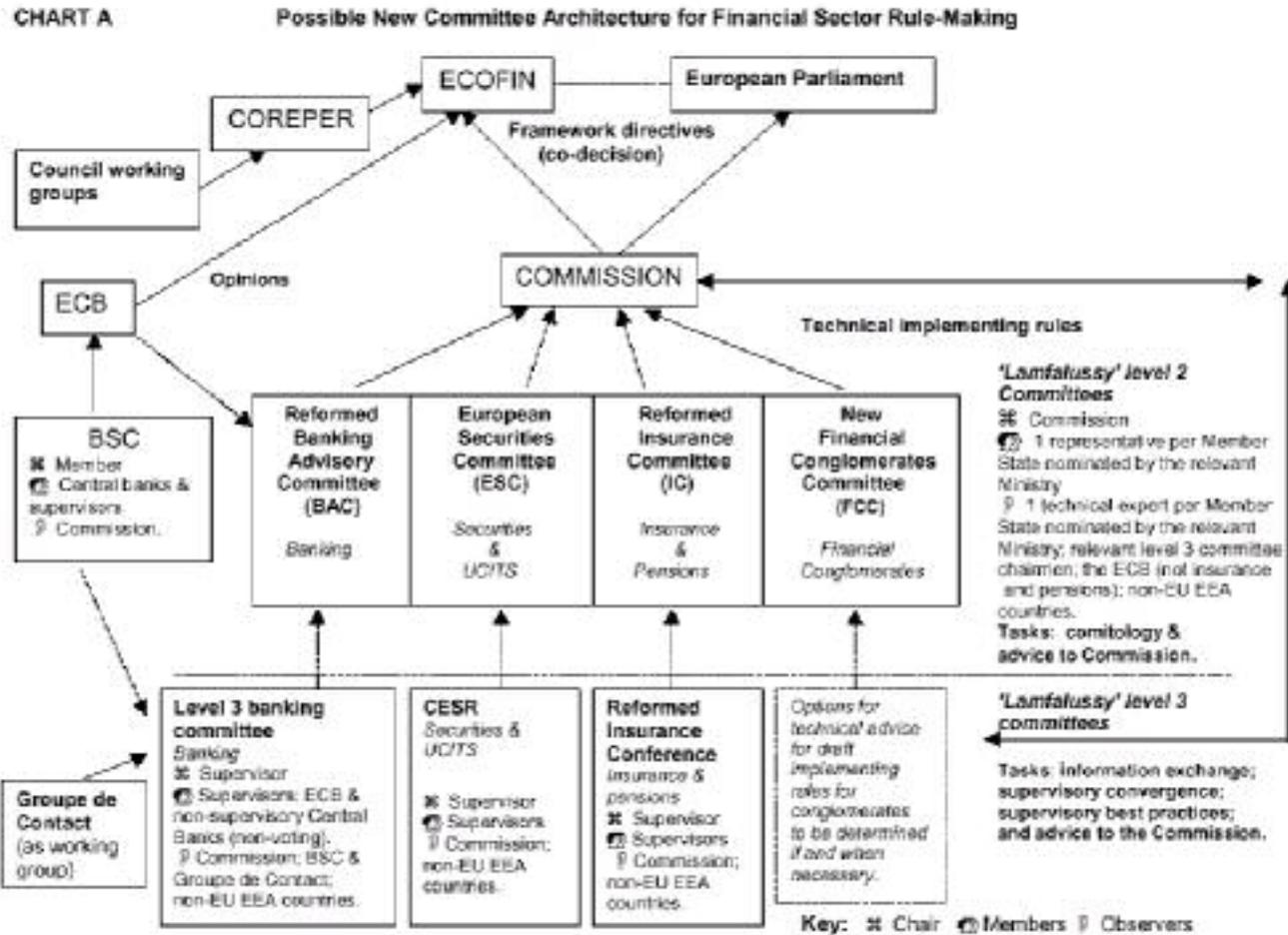
## INTERVIEWS

ABN AMRO (M. Zuidam)  
AFG ASFFI (M. Bollon)  
Aviva (M. Ball)  
Allianz Group (M. Schmockel)  
AXA (M. Florin)  
Barclays PLC (M. Eldridge)  
Banque Européenne d'Investissement (M. Maystadt)  
BDPME (Mme Obolensky)  
BNP Paribas (M. Hoenn ; M. Carmona ; Mme Gautié ; M. Francès)  
CDC (M. Flammarion ; M. Ghosn ; M. Ollivier)  
CDC IXIS (M. Orsatelli)  
CEA (M. Leglu)  
CNP SA (M. Alphandéry)  
CNPf (M. Robert Raymond)  
COB (M. Teyssier)  
Commission Européenne (M. Thébaut ; M. Wright)  
Conseil d'Etat (M.Devost)  
Dexia (M. Bruneel)  
Euroclear/Crest (M. Wicks)  
Euronext (M. Théodore ; Mme Olivetti)  
Euro Titrisation (M. Bonnaud)  
FSA (M. Davies ; M. Green)  
Goldman Sachs (M. Borges ; M.Toole)  
ING Group (M Maas ; M. van Barneveld)  
INSTINET (M Villeneuve)  
JP Morgan Chase (M. de Champvallier)  
LIBA (M. Baker ; M. Ridley)  
MEDEF (Mme Lepinay, J. Simon)  
Morgan Stanley (M. Walker)  
UNICE (M. de Buck)  
M. Cassou  
M. Prada  
M. Noyer

### **And most of Eurofi Committee's members :**

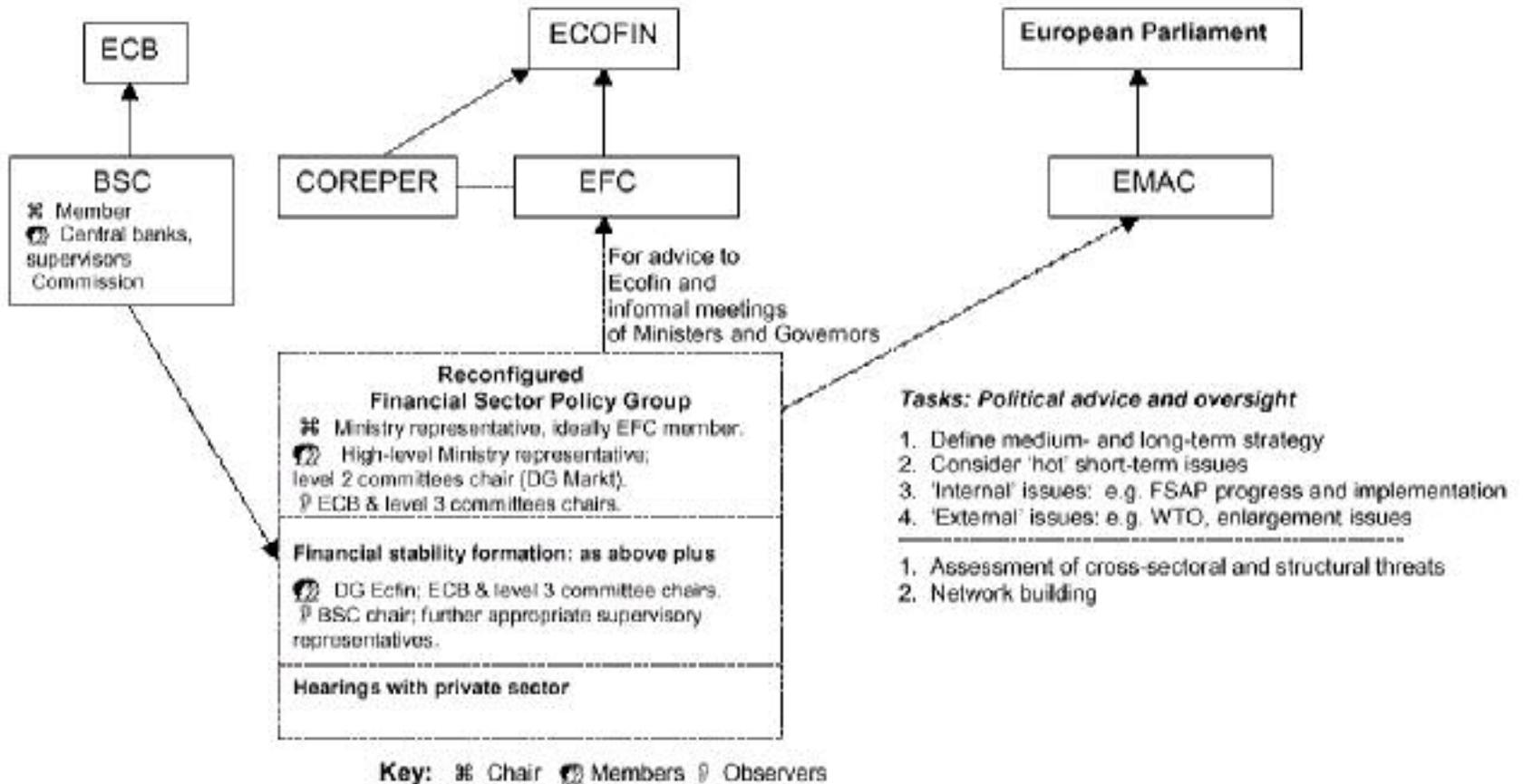
M. de Larosière  
M. Lebègue  
M. Alphandery  
M. Bébéar  
M. Berrigan  
M. Bonnaud  
M. Borges  
M. Carré  
M. de Buck  
M. Hoenn  
M. Lamfalussy  
M. Maas  
M. Maystadt  
  
Mme Obolensky  
M. Ravasio  
M. Raymond  
M. Renault  
M. Thébault  
M. Théodore

## Appendix 3 : Possible extension of Lamfalussy mechanisms to banking and insurance sectors



**CHART B**

**Possible New Committee Architecture for Financial Sector Policy-Shaping**



## Appendix 4: European Financial Market and the new Treaty

Financial integration is a priority for European Union. This is crucial for customers both within and outside the EU, whether they be retail investors, wholesale market participants or issuers of securities. Consequently, it has to be mentioned in the Constitutional Treaty.

The following proposals might be introduced into the Treaty.

- 1 A new second paragraph would be added to Article 2 (tasks of the Community) of the Treaty establishing the European Community<sup>(1)</sup>: "The European Community and the Member States shall ensure the integrated European financial market and the financial stability, which are essential conditions for attaining these objectives.

This financial market has to be integrated that is to be opened, transparent and highly competitive, free of barriers to cross-border activities, efficient in meeting the needs of customers conducive to innovation and investor protection in the interests of an efficient allocation of capital. The establishment of this integrated European financial market shall be effective within two years following the entry into force of the Treaty (resulting from the 2004 IGC) and not later than 31 December 2005."

With reference to the Constitutional-Treaty Proposal presented by the Chairman of the Convention, this article should be introduced in the first part of the new Treaty : Article 3 : Objectives of the Union : strengthening of the Internal market and of the Economic and Monetary Union.

2. A new Article 104a would be inserted into Title VII (Economic and monetary policy) of that Treaty: "The Council, acting in accordance with the procedure laid down in Article 251, shall adopt the rules and procedures permitting an orderly functioning of an integrated financial market. Pending the establishment of those rules and procedures, the Member States shall closely co-ordinate, by the end of 2005, their action, particularly as regards compliance with market disciplines, in conjunction with the Commission.

A European Regulatory and Supervisory System could be established taking into account in the light of experience, the needs of markets and users' requests."

With reference to the Constitutional-Treaty Proposal presented by the Chairman of the Convention, this article should be introduced in the second part of the new Treaty: Article A- A1- III : Union policies and their implementation.

---

<sup>(1)</sup> It is important that any future changes to the Treaty should foster these key requirements.

This European Regulatory and Supervisory framework could be built on the following model (see next page).

To the greatest extent possible, the markets themselves should be given the freedom to develop and implement solutions and meet customer needs.

This clear and consistent regulatory system would be characterised by these main principles: transparency, fair competition, investor protection, macro and micro prudential stability.

This system would produce easy, understandable and applicable rules and standards defined on a common basis which ensure also equality of treatment among market participants. This will enable the market to be, open, attractive and competitive.

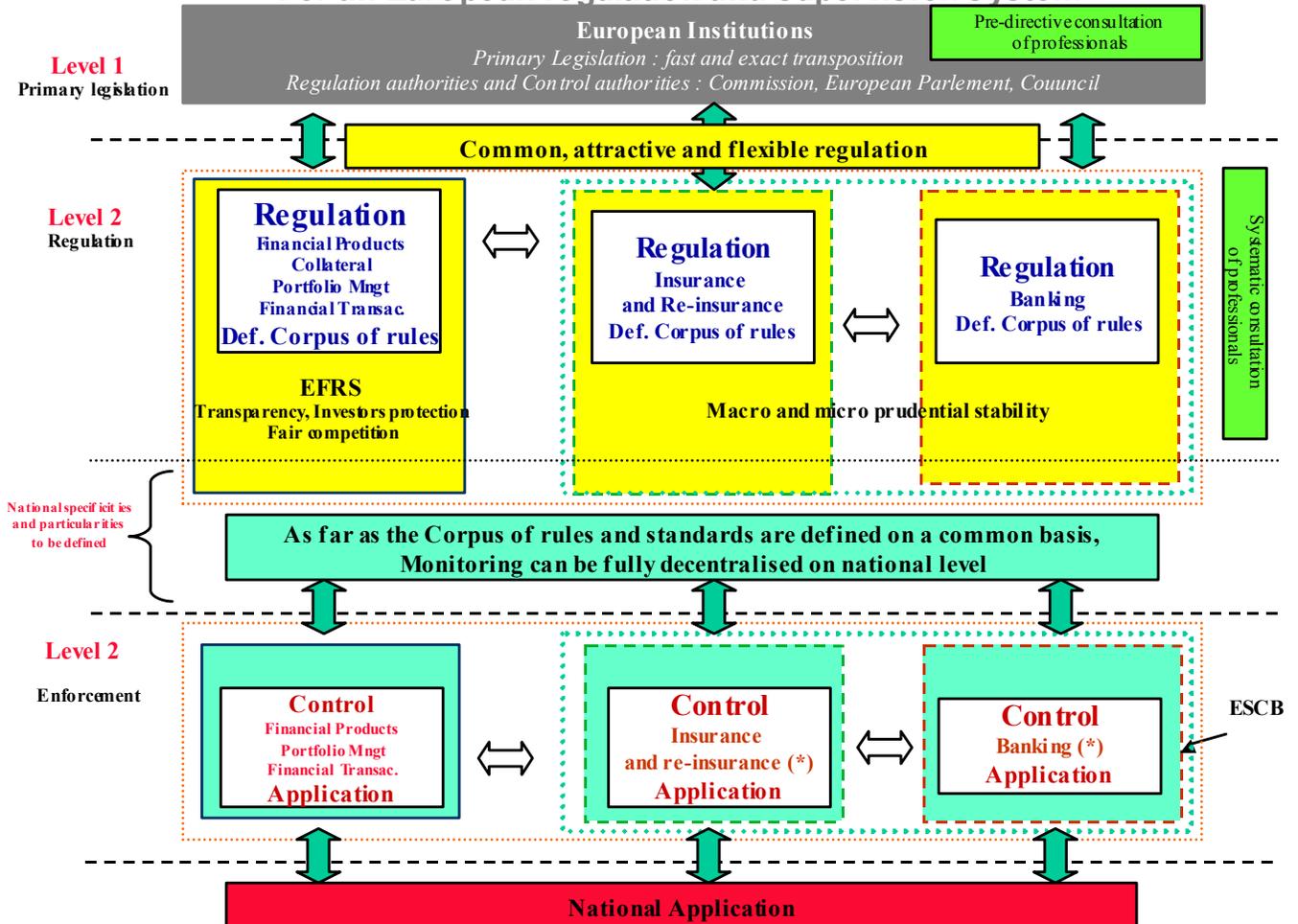
The system must be based on Democratic legitimacy : this system should answer for its acts to European Institutions. An appeals mechanism within the European Court of Justice will doubtless be necessary too.

It should not try to anticipate future commercial developments or determine market structure.

This two-level architecture is flexible enough to respond to future commercial needs. Such a framework should not be understood as leading to the creation of a new centralised bureaucracy. It would respect the subsidiarity principle as far as the core rules are common. Such a system which could be inspired by based on the ESCB model, would have to be run by a common decision making process while maintaining the national level for the application and enforcement of these rules. Investors and companies will continue to keep a link with the national regulator which would know their local environment.

This system would allow Europe to have its own authority with sufficient influence to carry weight in the development of international rules (accounting standards, corporate governance...).

## For an European regulation and supervision system



EFRS : European Financial Regulation System  
 Fair competition : main responsibility of the DG Comp (European Commission)

## Appendix 5 : Objectives and functioning of Eurofi 2000 Association

### 1. Objectives and functioning of Eurofi Association :

In accordance with its statutes, Eurofi 2000 Association was created on 11<sup>th</sup> April 2000 in order to promote 'European consolidation, by favouring in particular the increasing integration of the markets of banking and financial services'.

Constituted at the time of the French presidency (second half of the year 2000), its composition reflects its European objectives.

The joint presidency is shared by **M. Jacques de Larosière** (Honorary Governor of Bank of France and Advisor of BNP Paribas) and **M. Daniel Lebègue** (Chief Executive Officer of Caisse des Dépôts et Consignations), who are assisted by a secretariat, a Vice-Chairman, **M. Christophe Bourdillon**, and a General Delegate, **M. Didier Cahen**.

The core activities of the Association are the following :

- To carry out general and specific studies and surveys, led by experts, on all aspects of the banking and financial Europe,
- To organise forums and ad hoc working groups,
- To publish position papers and articles

**The main aim** of the Association is to contribute to a certain convergence of views between practitioners and public institutions (European Institutions, Finance Ministries, Central Banks) regarding the integration of the European capital market

### 2. Eurofi's financing :

- 2/3 of the resources come from public institutions (European Commission, Finance Ministry)
- 1/3 of the resources are provided by private funds (Euronext, Caisse des Dépôts et Consignations, Groupement des cartes bancaires "CB", Caisse Nationale des Caisses d'Epargne...)

## Appendix 6 : Synthesis of the answers to the Eurofi questionnaires: Main trends

Personal and confidential

Paris, November 2002



- **The questionnaires have been sent to 183 institutions; 55 answered.**
- **61 interviews were realised.**

The answers to the Eurofi survey will be available on a Eurofi web site as far as the respondent institutions agree and participate in the financing of this web site.

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\* This document takes into account both written answers to the questionnaires and interviews. All answers have the same weight.

The access to the European capital markets is today insufficiently developed, according to most of the financial market actors who have answered.

The reasons are numerous. A number of them are stressed in the replies to the consultation of European professionals organised by Eurofi.

This preliminary synthesis describes the main trends emerging from the consultation. It is, in no way the outline of the final report.

## **1. Organisation of the European capital market**

The large majority of our sample (79%) would like to keep some competition between at least two stock exchanges in Europe. In the same vein, they encourage the existence of ECNs. Both these trends stimulate competition and lower prices.

However, this competition should not be maintained at the expense of lower quality of service for issuers and investors. Quality has to be improved thanks to a better integration of the payment and back office systems and a more harmonised definition of norms.

A great part of the consulted professionals are in favour of a sufficiently harmonised set of rules (legal, regulatory and fiscal framework) for financial services and stocks in Europe, in order to facilitate the interconnection of settlement-delivery and payment systems. Such an interconnection would permit the savings of time and costs.

If participants generally advocate an evolution towards a few regulated markets with centralisation of orders, for the sake of more liquidity, effectiveness and transparency, several believe that this model could co-exist with decentralised and non regulated markets, in order to reconcile investor protection and transparency with diversity of investors' needs and liquidity for small stocks.

Maintaining competition between back office service providers is encouraged (56%). If not integrated, providers should be at least coordinated or interconnected.

A number of answers are against intervention of public authorities in the process of concentration of stock exchanges and market systems. They consider that only the market is capable of generating or not the integration of companies in this sector. Moreover, professional preferences between horizontal (37%) and vertical (30%) integration of the payment and settlement-delivery systems are not clear.

The asset management questionnaire shows, for this profession, a particularly high demand (mentioned by 74% of the respondents) for harmonisation and simplification of back office systems.

## **2. Legal, regulatory and fiscal framework**

### **2.1. Company law**

A very large majority of the professionals who have answered (88%), (all professions together), consider the harmonisation of European company law to be desirable but only 20% of them think it is absolutely necessary. These answers suggest that the basis of this European law should be mentioned in the Community texts.

This harmonisation would require the creation of a complete European company statute (one or more legal forms to be defined) (51%). Furthermore, the definition of corporate governance rules (41%) and a minimum harmonisation of tax norms (46%) are also requested by a number of professionals.

The lack of company law is viewed as a brake on entrepreneurship freedom (issuers...) and hinders « fair competition » between stock exchanges, as underlined in the interviews. Moreover, European company laws (takeovers and bankruptcy) could facilitate the free setting up of companies in the European internal market.

### **2.2. Issuing Prospectus**

The major part of consulted issuers and institutional investors (insurance and asset management) consider the creation of a single issuing prospectus in Europe as an essential step towards financial integration.

There is no consensus on the way to bring about this single issuing prospectus : the issuers prefer a harmonisation of the existing national models, but the other consulted actors (mainly the investors) wish a new redefined issuing prospectus (faster method).

### **2.3. Financial products**

The second priority (58% of answers) of asset managers, after the rapprochement of stock exchanges and back-office systems, concerns an increase in the range of instruments in which collective funds can place their assets (notably the possibility to invest in other funds, in market instruments not assimilated to securities, or in derivatives).

Professionals also would like the establishment of an effective European “passport” allowing collective investment funds to market a financial product in all the countries of the European Union without requiring the creation of a subsidiary in the host country (for financial products not covered by Community legislation in force).

Interviews, especially with insurers, show that the development of pension funds is considered highly desirable, as long as they respect a minimum of regulation and supervision rules. The adoption of a common legal framework for pension funds is seen as facilitating the establishment of pan European retirement funds, with all the expected benefits for promoters, fund members, retired persons and firms (economies of scale, development of monitoring of European capitalisation...).

## **2.4. Transparency and financial information**

Most of the professionals recognise the need for a European harmonisation in the field of transparency and financial information. A redefinition of the rules may be necessary on this subject, in the light of the current financial crisis.

The harmonisation of accounting rules is uniformly demanded by all types of actors.

The reinforcement of market surveillance, concerning notably market abuse and insider trading is also a market priority; as well as guarantees of the independence of financial analysts and rating companies and the clear definition of their respective roles.

The reinforcement of the obligations concerning public information about the accounting books - and the corporate events that affect their figures - is also an essential element for the establishment of a reliable market in Europe.

Finally, the Directive on market abuse and the different recommendations on account auditing are considered as insufficient to guarantee financial market integrity (55% of the consulted professionals).

## **2.5. Investor Protection**

According to our consultation, the implementation of a European company law and the existence of a single prospectus, accompanied by the access to reliable and homogenous financial information in Europe, are essential criteria for a fair protection of European savers.

A number of actors agree that the minimum and core principles essential to an appropriate protection of investors need to be defined : transparency conditions (price, date of engagement, non abusive commercialisation, fees...), obligations of information (nature of risk of the product, procedures for solving cross-border complaints ...).

## **2.6. Other regulatory aspects**

The harmonisation of European insurance law (contract law and customs) appears necessary according to the answers. This harmonisation should focus on national insurance codes.

A significant part of the respondents think that the harmonisation of the legal statute for securities (issuing rules, market model, operations on securities, date of property transfer) would be favourable to a growth and performance factor for the European capital markets.

## **2.7. Taxation**

A large majority of the survey participants (74%) consider that the current differences between the national tax systems are significant enough to impede competition on the financial markets.

There is no need for systematic tax unification but there is a need to identify financial product taxes that can have a distortive effect on the capital movements.

Issuers, stock exchanges and service providers (back office, settlement-delivery, clearing, payment...), insurers and asset managers detect as priorities to be addressed : withholding taxes and capital gain taxes. Insurers also stress the national taxes specific to insurance products.

A proposal, which is often mentioned in the answers, consist in the harmonisation of the tax base in order to benefit from comparable figures. The member States would keep freedom in determining the fixation of rates.

### **3. Regulation and supervision**

The current system of enforcement and sanction of rules at the national level does not satisfy all the actors of the financial markets (42% of “unsatisfied” answers).

Directives should be of a general matter and lay out principles whilst maintaining room for innovation opportunities. New methods should allow their adaptation in national laws in a faster and more exact way.

The general opinion is that the Lamfalussy report has brought a significant albeit not sufficient improvement. In a first stage, an extension to the bank and insurance sectors of the Lamfalussy mechanism is considered desirable by a great part of the professionals. It implies (according to the interviews) that the participants in the relevant committees are endowed with effective competencies and decision making abilities. It also requires that the rules set up as national specificities should not be artificial means for restricting competition and favour protectionist behaviours. Finally, the staffing of the committees should be sufficient.

The majority of the respondents (76% against 24% of negative answers) are in favour of a flexible European system of regulation and supervision in the long term.

This system would be based on the principle of subsidiarity : as far as the corpus of core rules is defined on a common basis, monitoring could be decentralised at the national level (we should carry out “as much centralisation as necessary, as much decentralisation as possible”). In this context, regulation and enforcement need to be separated.

The aim of the regulation system is to regulate activities rather than companies. This long term evolution should be based on the following principles : transparency, fair competition, development of financial innovation, investor protection and financial stability. Europeans should make sure that such a system would not lead to bureaucratic methods, which could slow down or artificially complicate the regulation process and the financial innovation.

The European system of regulation and the European system of supervision are generally envisaged as two separated functions.

The large majority of the respondents think that the professionals need to be systematically consulted at any stage of regulation and supervision, before the drafting of Directives and in the framework of both primary and secondary regulation. Their role and intervention modes should be clearly defined.

### **3.1. Loopholes in the regulation of insurance, banking and asset management activities**

- According to the examined answers, for the cross border operations, the current system which privileges mutual recognition and regulation by home country is a positive stage. However it could be extended by a more systematic application of the system and the dismantling of national protectionist (legal, technical...) measures.
  - The project of European Directive on conglomerates is only partly sufficient for the regulation of the totality of these activities.
  - Finally, professionals generally recognise that the dispersion of local regulation authorities creates competitive distortions, notably between insurance companies.

### **3.2. Regulation**

- Outlines of a European regulation system :

Were the creation of a single European regulation authority to be favoured, professionals would prefer a decentralised organisation maintaining the national level under a European coordinator given these national regulators must respect the corpus of common rules.

The adopted European regulation system should be composed of at least some representatives of the national regulators and some representatives of the professionals (organised by profession).

- Adaptation of texts and consultation role :

According to our survey, the regulator should have a consultative role in the primary legislation, by the mean of a consultation before the establishment or revision of the European Directives. The core mission of the European regulation system however remains the second level legislation, though the establishment of technical rules complementing the principles enacted by the Community institutions.

### **3.3. Supervision**

The need for a more coordinated system of supervisors, in an integrated and efficient European financial market, appears clearly in the questionnaires. The emergence and development of pan European companies, deploying their financial activities across the borders, implies a need for non centralised surveillance.

The general trend in our survey favours the separation between regulation entities and supervision ones. One can not imagine however to disconnect both entities; they need to be tightly coordinated.

- Outlines of a European supervision system :

The European supervision entity needs to be organised as a unified system maintaining however some autonomy for the differing professions which should be organised per type of activity (banking, insurance, financial markets).

A great majority of the respondents think that the European supervision entity, whatever its organisation may be in the long run, should be planned in the future Treaty.

#### **4. Short term priorities :**

The interviews show that a prioritisation of short term actions has to be achieved :

##### **Free provision of services :**

- Implementation of the mutual recognition principle
- Definition of minimum core standards and rules for investor protection
- Reverse the onus of proof : The country which wants to prevent a financial institution from proposing a product in its orders has to make the case that the institution in question has not respected the initial agreement granted by its home regulator.

##### **Interoperability of financial products :**

- Implementation of the appropriate framework for pension funds, guaranteeing the interoperability of their products in the European market.
- Establishment of an effective European passport for financial products.

##### **Taxation :**

- Identification of financial product taxes that can have a distortion effect on the capital movements

##### **Financial information :**

- Common accounting standards
- Charter of corporate governance (entrusted to a committee of wise men)

##### **Company law :**

- Takeover bids, mergers-acquisitions and bankruptcy laws
- Legal agreement of securities (notably ownership rights) : priority for most financial institutions and issuers (and not for some CSDs)

##### **Legislation, regulation and supervision :**

- Necessity to involve the market participants in each stage of the process (before the projects of Directive and in the context of secondary regulations)
- Directives transposed by the member states in a more rigorous and rapid way
- Necessity of a body of rules applied and sanctioned in a homogenous way in all European countries. This is an evolving process which, in the light of the implementation of Lamfalussy recommendations, should progressively lead, according to most answers of the questionnaires and interviews, to a proper European system of regulation and control.

## Appendix 7 : Eurofi survey, Methodology

### EUROFI SURVEY : METHODOLOGY

Eurofi sent a set of 6 questionnaires (Regulation, Supervision, Market and back-office, Asset management, Insurance, Crisis supplement) to 183 institutions.  
55 answers were returned (see the list in appendix 2).

Eurofi led 61 interviews among high-level professionals that had or not returned the questionnaires (see the list in appendix 2).

- All the data collected through the questionnaires and the interviews were exploited, using the following method :
- a) Listing of the sample of respondents
  - b) Statistical analysis of the questionnaires for multiple-choice questions (identical weight given to all answers). Identification of the subjects on which a convergence of opinions seemed to appear. The analysis was done by type of questionnaire (insurance, asset management, ...), in order to respect the specificities of each profession.
  - c) Qualitative analysis of the comments found in the questionnaires, that have been listed and synthesized when numerous respondents gave the same explanation.
  - d) Analysis and synthesis of the interviews, respecting the diversity of opinions.
  - e) Comparison of the data coming from the questionnaires and the comments gathered via the interviews.
  - f) Overall synthesis of both answers to questionnaires and interviews, in order to bring out the main trends regarding the integration and regulation of European markets.

All this analysis was done in respect of respondents opinions and in a non-oriented way.

- The weighting method (M1) used in the analysis of these questionnaires was selected with a view to transparency :

**Statistics are defined on the basis of the following two principles :**

- 1) **1 answer = 1 vote** : for each questionnaire (multiple-choice questions only), a single financial institution (ex : BNP Paribas) has the same weight as the association of several financial institutions (ex : LIBA).

- 2) **A single institution cannot weigh more than 1 vote** (ex : the several answers received from HSBC weigh one vote all together).

This is the method usually used by Atos Odyssee and its competitors to bring out the results of a survey. Although the absence of differential weighting prevents from reaching fully representative results, this method at least guarantees that the received answers are treated in a non-arbitrary way.

Note : The same technique is followed by the European Commission to set up the results of its consultations.

The received answers have not been weighed but have followed the core principle 1 institution = 1 vote (M2), because :

- 1) Introducing such a weighting would mean increasing associations' weight in proportion to their number of participating institutions. This would be prejudicial to both statistical consistency and representativeness of the sample.

**Example : Regulation questionnaire** (39 answers, of which 33 are exploitable in the statistics, i.e. ticking the proposed answers).  
Some of the 33 exploitable answers come from associations that are sometimes made up of a large number of banks or other financial institutions (German Banks Association : 263 institutions ; LIBA : 31 ; FESE : 19 ; Europlace : >100...).

Such a method would disregard the answers coming from single institutions (like BNP Paribas, CDC, Deutsche Bank, ING, HSBC...), and would turn the survey into the analysis of answers coming from a few associations.

- 2) Some of these associations could only be included in statistics as 'no replies', because they did not answer to MCQ but preferred to provide us with general answers in the form of position papers. They can only be integrated in the comments presented in the analysis.

**Example : The German Banks Association (x263), which answered via a general position paper, could not be included in the statistics, though LIBA's (x31) answers were taken into account as far as they covered specific questions.**

Thus, differences of opinion would not be properly expressed.