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The Development of the European Capital Market

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Ladies and Gentlemen,

It is a great honour for me to speak in this prestigious series of lectures. I am very grateful to Howard Davies for his invitation and his introductory words. I take it as a positive sign of traditional British international openness – including towards things European - that the European Lecture Series takes place in the Hong Kong theatre and not the Brussels one. A fitting reminder that Europe's, indeed all our futures, lie not in introspection but in opening up to the outside world – and mastering globalisation.

Jacques Delors once asked rhetorically "*Who can fall in love with a common market?*". Of course he expected "no one" as an answer. He was surely right; the single market is not a subject to make the heart-beat race. But it is at the heart of the European project nevertheless. A project that approximates more closely to a well-tested, reliable, sound and practically advantageous marriage, than a fly-by-night emotional fling. Something that has been there for so long that partners have come to take it for granted. Something that improves everyday life; makes it easier in many ways – something you would only realise when it's gone.

Like an old marriage the common European market needs constant care and attention to keep it functioning. And here is where the analogy ends: Where marriages can be threatened by extra-marital activity, the common market is now being threatened by not enough openness, by

shutting borders, by protectionism and market closure. A common market needs competition - from within and from the outside.

Protectionism denies everyone in Europe the economic benefits of market integration – higher growth, and more jobs. This is why I have made defending the common market freedoms my credo in Brussels.

European companies must be able to adjust quickly to the new global business realities. Those realities include securing the economies of scale that come with takeovers: Scale for best-in-class marketing. Scale for best-in-class technology. Scale for best-in-class research and development. Scale for best-in-class procurement and supply chain management. Scale for best-in-class innovation.

To build these scale economies companies must be allowed to acquire, merge, and restructure - be it nationally or on a cross-border basis in a fair and openly competitive environment. This is essential for competitiveness and economic efficiency, for keeping management dynamic and alert, and for the rational allocation of capital.

My job is to promote and defend the principles that underpin the internal market and the free flow of capital, goods, services and workers.

Does anyone really think that I am going to turn a blind eye to the cosy old-boy networks between politicians and managers of companies? If they do, they are living in a fool's paradise.

Recent anti-foreigner sentiment in several Member States is the antithesis of what the European Union is all about. The attitude of workers whose jobs appear vulnerable may be understandable. But what is unforgivable is for Governments to feed misconceptions and to mislead people about the economic facts of life. To pretend that there is a future behind a closed door. It is backward and dangerous economically. And cowardly and unacceptable politically.

The new wave of protectionism is of the utmost concern to me and my fellow Commissioners. It is contrary to the public good, contrary to consumer interests, contrary to shareholder interests, and contrary to the goal of creating sustainable long term employment.

For those prepared to adapt and to make the necessary preparations, the opportunities in the world of globalization of open and competitive marketplaces will be enormous. But not a day goes by lately without European governments commenting on, interfering in or trying to bluntly block the free flow of capital. Be it banks in Italy or Poland; a steel company in Luxembourg; energy companies in Spain and France. Everywhere you see the same outdated instinct, the same recipe of protection of the status quo, of governments promoting national champions, of shutting out competition. This type of policy will not lead

to a strengthening of EU industry as they claim. Nor strong, sustainable growth. Nor new jobs. The policy is in fact a betrayal of Member states' own workers, own investors and own savers.

Let me make one thing clear to Member States, large and small:

When it comes to tackling protectionism, I will not stand idly by.

I and my colleagues in the Barroso Commission will use every tool in the box to tackle Member States who dream up new protectionist means or who seek to erect unjustified barriers to prevent cross-border deals. Let nobody be in any doubt: Where artificial barriers remain or new ones are introduced, I will go after them; where competition law is not complied with, authorities at national and European level will act; where regulation is not complied with, infringements and prosecutions will follow. The time for compromise and shilly-shallying is over. The competitiveness challenge in Europe is too big and too urgent.

Protectionism is a proven route to economic stagnation and decline.

I saw it with my own eyes when I was a politician in Ireland. I never believed in keeping the chill winds of competition out – and consequently spent the first half of my political life out on the draughty backbenches. But Ireland woke up – even though it took a major economic crisis. And in a relatively short period of time a European loser has been turned into a European champion. A country of emigration into a destination for immigration. With low unemployment and fast economic growth.

Of course there is no one-size-fits-all solution. Every country and every circumstance needs a different mix of policy instruments. But they all must have a few things in common: let competition work; let businesses innovate; let capital find the best opportunities.

So one of my core themes over the coming years will be the question of cross-border consolidation. Since 1999, almost half of all merger volume in the non-financial sectors in Europe was cross border. In the financial sector this figure was only one fifth, suggesting sub-optimal market functioning. When you look at the structure of Europe's financial sector you see a lot of second division champions but few that compete or lead in the world league. Not the kind of structure you would expect in a fully functional and open market of 450 million consumers with a GDP of more than 10 trillion Euro.

Of course, cross-border consolidation is not an objective in itself. And even less should politicians try to pick winners or promote national champions. I occasionally back horses, not companies – more fun as a pastime for me, better for the companies, too.

But the current situation in Europe shows – and this is what market participants have also told us in a survey we carried out - that there are some bottlenecks or unjustified obstacles in the Internal Market.

We have to get rid of the unfavourable and even disabling environment for conducting cross-border transactions. Some supervisors and governments play fair, regrettably others do not. To clarify things the articles of the banking, securities and insurance directive relating to supervisory approval will be revised – and the room for supervisory malfeasance narrowed right down. I will go after every single misuse of supervisory power or political interference – as I have already done in a number of cases.

We also need to look at supervisory cooperation in the EU. The rules for the supervisory approval processes in the EU are too complex and costly at the moment. They must be streamlined and made more transparent. To stop the ability of protectionists to monkey around. To reduce cost for business.

There is a case for some limited action to improve the integration of retail financial markets. The consolidation in the financial sector would indeed be facilitated if we could find in Europe agreement on common and high level consumer protection rules. A proposal to harmonise rules for the provision of consumer credit is already on the table. We are also looking at the area of mortgage credit to assess whether there is economic added value to act at European level. Given the complexity of this issue, we plan to come forward with policy conclusions only early next year. In investment funds, UCITS is a recognised regulatory template in Europe and beyond – but it has to keep up with fast evolving new structures and new products. We will work for transparency; high standards of investors protection; for freedom for fund managers to make use of new

investment opportunities and more room for consolidation in the market to enhance efficiency.

The Commission has also put forward a proposal for a New Legal Framework for Payments. Within this context, industry has promised to establish a Single Euro Payment Area. I intend to continue working closely with the industry in order to achieve this by 2010.

On clearing and settlement, I was very pleased to meet industry leaders recently. There is wide agreement among industry on what the problems are - but not yet as to what the solution(s) could be. I have been clear that I am in favor of industry developing new and more efficient structures. This is a real opportunity for industry leadership. But I have also made clear this week with my colleague Neelie Kroes that we will not hesitate to consider other means if no progress is being achieved on the ground. If we come to the conclusion that the current market failures cannot be resolved, then from the public policy perspective we will act in a way that we consider is proportionate.

A challenging agenda for the coming years. But one that is focused not on increasing and producing red tape, but on bringing down obstacles to competition and opening up new opportunities.

The Capital market for long was the forgotten child of the common market project. Attention was focused on goods, the freedom to travel and work in other countries. But the integration of Europe's capital markets is catching up fast. The introduction of the Euro gave a strong

boost – even to the countries that did not join the Eurozone. The Commission followed-up with a comprehensive legislative programme aimed at opening borders and creating a level playing field, the Financial Services Action Plan. One of these rare plans, along with the Lamfalussy process – delivered on time – according to the instructions of the Heads of State and Government of the European Union.

So there is good news now: The foundations for an integrated financial market in Europe have been laid. We are now seeing real progress on the ground. A large, deep and well-functioning Euro bond market has been created. International issuance in Euros is increasing strongly – almost reaching the level of the US. Merger and acquisition activity is high. IPOs and private equity are strong. We do not have policies that dissuade outside investors from investing in our capital markets. No daft corporate governance rules. But we do have a common European framework rules for accounting, prospectus, capital adequacy, market abuse, transparency and investment services. Companies now have a much larger range of financing options. Our equity markets at the moment are solid; financial market players are realizing good profit levels. Pan-European financial business is developing. Optimism is high. And we encourage competition from all financial players in the world.

The common European market has long become part of a wider, global fabric. Some try to portray this as a threat to Europe and its prosperity, values and traditions. I do not agree. It is an opportunity to seize!

Our aim with the global challenge we face should be to bring out the best in Europe. By reaching out to new trading partners and benefiting from new developments around the world. Europe's values and tradition cannot be the narrow-minded defence of the status-quo; neither can its prosperity be based on it.

And in the capital markets area Europe is gaining an excellent reputation as an open and reliable market-place that has got the balance between economic freedom and investor protection right. Our stock-markets are open for foreign companies to enter and leave. We have adopted international accounting standards which are being applied in more and more countries and are on the way to become a global standard. On top of that, many of our Member States also accept other third country standards as long as they are on the same level of quality. We have corporate governance and auditing rules that strike the right balance between letting market forces work and ensuring the necessary level of protection and stability.

This openness is a strength and not a weakness. Just look at the developments of international IPOs in London in comparison to US markets. And it is a strength that we want to build on together with our partners around the world.

With the US in particular we have established a close and productive dialogue about financial markets regulatory issues. The rationale behind this exchange is simple: In a world where companies do business in a global way, rulemakers have to think global too. No more

rulemaking that simply looks at domestic effects and forgets about its wider, global implications. It is not just stock exchanges which are connected by fibre optic around the world and which pass on information and orders with the speed of light. The effects of our rules and regulation travel similarly fast and far.

Many of the rules which are on our statute books at the moment do not respect these insights yet. This is why we have been working with the US towards convergence of our accounting standards and towards getting rid of costly reconciliation requirements. We are on a good path. Our aim is get there by 2009 at the latest. We have also been urging the US to change its rules on deregistration from its security markets for foreign firms. The SEC put forward a proposal before Christmas which takes a step in that direction – even though not nearly far enough. In cooperation with EU issuers and with the support of EU Member States the Commission has produced a number of practical and workable suggestions to the SEC how to improve the proposal. In a truly open transatlantic capital market companies should enter and leave capital markets following a business rationale and not be tied in by red tape – notably given the fact that our disclosure requirements are as good as those in the US - and US investors are perfectly happy to rely on them.

In the insurance field US rules still require EU reinsurers to post very high levels of collateral for their cross-border business. With the EU Reinsurance Directive which will do away with cross border collateral requirements in the EU and which is due to be fully implemented by the end of 2008, it is high time that the US recognises that these requirements are outdated and should be changed. The signals we get

from US regulators show that more and more of them have realised this. What we need know is concrete progress on the ground.

There is a common feature to both the accounting, the deregistration and the reinsurance issue. Where there are rules which have the same quality, where there is a similar framework of disclosure and reporting requirements both sides should recognise this equivalence and abolish extra requirements for foreigners. This is the recipe I would like to follow in many other areas too. We have to systematically look at our rules and check which ones have become redundant.

And the same has to apply to new rules. We talk a lot about better regulation, about impact assessments. A standard part of these assessments should be to look at the international repercussions of our rules. It is guess work, but surely if the US Sarbanes-Oxley Act had not been drawn up in a couple of months in closed and smoke filled rooms on Capitol Hill, but instead the views of stakeholders outside the US had also been taken into account in an open and inclusive consultation process, both the US and its trading partners would have benefited from it.

I also think there is still a need for deeper and closer cooperation between legislators, between the European Parliament, national parliaments and their counterparts in the US Congress and around the world. In the capital markets field this also means working cooperatively with our Japanese counterparts – and the new emerging capital markets in India, Brazil, China and Russia.

Conclusion

Ladies and Gentlemen let me conclude. The development of the EU capital markets gives many reasons to be optimistic. There is good progress on the ground. Our markets are open and competitive – but there are also reasons to be vigilant. Economic freedom, competition, the free flow of capital are not a given. They have to be defended and promoted every day. Europe has much to gain from more open markets – within and to the outside. That is where the focus of our policies should lie over the coming years.

I have said this before, but I repeat it today. The real challenge we face now is not to draw up framework rules at European level. That to a large extent we have done. No, the real challenge today is to make them right across the spectrum – the best in the world - and to ensure they are enforced and that the basic freedoms in the Treaty are upheld. That is our objective and we are determined to fulfil it.

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