

Strengthening Europe's Capital Markets

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Since the collapse of Enron in late 2001, countless articles have been written about the crisis of capitalism. It is tempting to think that all the reasons why that crisis happened have been thoroughly debated, analysed and discussed. Whether this is the case in Europe is another question, at least in relation to the way the stock market is organised and regulated. To a large extent, the subject is unexplored in European public debate, where it should now occupy a central position.

If investor protection is to be improved in Europe, then integrating stock market regulation must urgently become part of the European policy agenda in order to reach decisions in the near future, as is required by the current insecurities in global capital markets.

Why regulation matters

The development of public regulation of stock markets follows the extraordinary success of those markets throughout the past century and their growing significance to the economies of industrialised countries. Regulation is closely linked to the markets performance itself; although 'regulation' smells of state intervention, the inescapable fact is that market regulation is at its strongest in those liberal economies where capital markets are thriving and that it is generally weak where capital markets are less developed.

Though it is probably superfluous to highlight the positive contribution capital markets have brought to developed economies, and in spite of their current lethargy, those markets remain a major source of external financing for corporations, through issuing equity or bonds. Large companies which do without them, such as France's Auchan or Germany's Bertelsmann, are a small and shrinking minority. Between 1999 and 2002, the total amount raised on Europe's primary equity markets (initial public offerings, capital increases and issuance of convertible bonds) reached an average of € 221 million per year¹. Trends are no less spectacular in bond markets, where debts are traded without the intermediary role of a commercial bank: between 1998 and 2002, the proportion of European corporations' total debt held by commercial banks declined from 78% to 73%, and the proportion of tradable bonds has grown accordingly. Thus, there is some convergence between features in the European market and the US market, where less than 40% of corporate debt is owned directly by commercial banks².

Capital markets emerged in Europe during the 19th century, but their most spectacular growth has been in the United States, where New York became their global capital city early in the 20th century and remains so today. However, during the last two decades, European capital markets have developed rapidly if somewhat differently across various countries. It is becoming more difficult to describe capital markets as a "financial sphere", hermetically separated from the "real economy". On the contrary, the developed economies where growth has been weakest lately, such as Germany and Japan, are those where capital markets are comparatively less significant. The current setback of market financing following the fall of stock market valuations with a near-stop of IPOs and rise of alternative

¹ *Les Echos*, January 10-11, 2003.

² Patrick Artus, *Flash CDC Ixis* Nr. 2002-253, October 24, 2002.

financing techniques, can probably not last without severely damaging the economy in Europe as in the USA.

The public regulation of capital markets has been set up gradually, its aim is to reinforce public trust in the correct functioning of the marketplace wherever mere self-regulation has proved insufficient. Regulatory reform has almost always followed market crises where public trust has been brutally hit. Indeed, modern stock market regulation was established as a consequence of the most severe stock market crisis in 1929. The number of individual investors, at the time, is estimated at around 20 million; half of their holdings proved valueless. Congress reacted after Roosevelt's election by voting the Securities Act of 1933 and the Securities Exchange Act of 1934, thus establishing firm principles and rules to be enforced by the Securities and Exchange Commission (SEC), also created in 1934. The spirit and content of that legislation is summarized in two simple ideas:

“Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing”,

and furthermore,

“People who sell and trade securities – brokers, dealers, and exchanges – must treat investors fairly and honestly, putting investors' interests first”³.

This summarizes the very straightforward task of stock market regulation. Firstly, impose minimum standards of information disclosed by companies who issue publicly-listed shares or bonds, secondly control the quality of that information; thirdly police the marketplace, in partnership with the judiciary, by sanctioning breaches of equality of treatment towards investors, such as insider trading.

Joseph Kennedy, first chairman of the SEC and father of the late president of the United States, firmly established the SEC as an essential piece in the American institutional and economic landscape. Since then, the powers of the SEC have been reinforced after each successive market crisis, especially in 1964, 1975, and 1988-90. This tendency has been again illustrated in 2002, following the collapse of Enron, Andersen and WorldCom. The SEC was given oversight of the audit profession, which until then used to set most of its own rules and enforce them through self-regulation. The new Public Company Accounting Oversight Board created by the Sarbanes-Oxley Act of July 2002 directly reports to the SEC which controls its members and activities. The SEC also has authority over accounting standard-setting and indirectly over stockmarket listing rules. Its position makes it the unique point where the ruthless rules of capital markets can be influenced by concerns about the public interest and, particularly, investor protection.

The central role of public regulation of capital markets by the SEC is recognized and accepted by all market players in the U.S., including those who can least be suspected of statist leanings. While trying to summarize the momentous year 2002 into seven major lessons, *Business Week* concluded that “Regulation matters” as Lesson No. 2 (No. 1 was that “The problems revealed by the scandal were systemic, not the result of a few bad apples”)⁴.

In Europe, the emergence of autonomous stock market regulatory authorities has lagged in time. Belgium was an early exception: in 1935 it granted its existing Banking Commission authority to control stock issuances. But the next move was not before 1967, when France created the Commission des Opérations de Bourse (COB)⁵, followed by Italy in 1974. Latecomers include Spain in 1988,

³ Source: www.sec.gov

⁴ *Business Week*, “What we learned in 2002”, December 30, 2002.

⁵ In France, the COB is the main stock market regulator but some regulatory tasks are carried out by the Conseil des Marchés Financiers (CMF). This specific setting is to be suppressed in 2003 by the merger of COB and CMF into a new agency called Autorité des Marchés Financiers (AMF).

Luxemburg in 1990 and Germany, which created a federal regulator as recently as 1994 while leaving many of its regulatory tasks to the German *Laender*.

An alternative model has been chosen first by the Nordic countries and later by the UK when it reformed the oversight of its capital markets in the late 1990s. The Financial Services Authority (FSA), created in 2000, encompasses stock market regulation but also banking prudential supervision (which in other countries, including the U.S., is a task of the central bank) as well as insurance supervision. However, this combination of powers creates additional complexity in operations resulting in less-than-optimal functioning of the FSA. The efficiency of this model, where all financial regulatory powers are put together under one roof, remains disputed⁶ although it has now been adopted by a majority of European countries, including Germany since 2002. By contrast, the institutional setting of the SEC, which deals only with stock market regulation, has shown remarkable resilience during the last few decades.

In the current European Union of 15 member states, six⁷ now have an independent stock market regulator whose mission compares with the SEC's, and eight others⁸ have adopted the all-encompassing regulatory model of the FSA, where banking and insurance supervision are also included. Ireland is a particular case, where the central bank itself regulates the stock market.

A growing imbalance in Europe

The situation in Europe offers a striking and growing contrast. On the one hand, its capital markets are integrating rapidly, to a point that in many areas national borders are becoming increasingly irrelevant. On the other hand, those same markets' public regulation remains a pure national matter in each European Union (EU) member state as if the national borders were as tight as they used to be. The resulting imbalance between increasingly integrated markets and nationally divided regulation has negative consequences in terms of investor protection and market performance.

There are many powerful reasons why European markets are integrating alongside the growing interdependence of Europe's many economies. Of course, the creation of the euro has played a catalyst role. By eliminating the exchange risk in any portfolio of Euro-zone securities, it has encouraged investors to think of their investment choices at a European, rather than national, level. The evolution will be completed if the UK also decides to adopt the euro as its currency.⁹

A number of other developments illustrate the closer integration of European markets. For example, stock exchanges' cross-border mergers are a powerful agent of change towards the elimination of national borders. Little more than one year after the birth of the euro, in March 2000, the Paris, Brussels and Amsterdam stock exchanges announced their merger, which was completed in September 2000 under the name Euronext (the Lisbon stock exchange joined later in 2001). At the same time, merger plans between the London Stock Exchange and, alternatively, the Stockholm and Frankfurt exchanges, came near completion although they ultimately failed. At the end of 2001, Euronext purchased LIFFE, the London marketplace for derivatives. Further consolidation will probably take place in the years to come.

In addition, analysts and investors are changing their working habits accordingly as they try to take advantage of the depth of the new European market thus created. They now can build Europe-wide sector-based strategies. For example, an investor willing to buy automotive stocks only in France would have a very limited choice between Renault and PSA; at European level, however, he can add several other choices such as Volkswagen, Fiat or DaimlerChrysler. Between 1997 and 2002, the share

⁶ *The Economist*, December 21st, 2002.

⁷ France, Spain, Portugal, Italy, Greece, the Netherlands.

⁸ UK, Belgium, Luxemburg, Germany, Austria, Denmark, Sweden, Finland.

⁹ The UK Government is due to make a first decision on whether the UK economy has converged sufficiently with the Eurozone economies by June 7th, 2003.

of European institutional investors with a country-based investment approach, as opposed to sector-based, fell from 70% to 21%¹⁰.

Ever-increasing numbers of cross-border mergers and acquisitions in many industries have also enhanced the integration of European markets. When those acquisitions are made through an exchange of shares, the acquiring company often chooses to be listed in the country of the acquired one, in order to facilitate trading by the latter's shareholders. For example, Vodafone, after its purchase of Mannesmann in 2000, is now listed on several German exchanges and many former German Mannesmann shareholders now hold Vodafone shares. Moreover, companies increasingly try to lure shareholders from other places than their country of origin. When Deutsche Post went public at the end of 2000, around 30,000 British individual investors were among the subscribers. Simultaneously, and partly under pressure from European legislation, tax regimes that contributed to the compartmentalisation of national markets are dismantled. In France, for instance, legislation on the PEA (*Plan d'Épargne en Actions* or share-based savings account) used to grant exclusive tax benefits to investments in French shares; the benefits have recently been extended to the shares of all companies headquartered in the Euro-zone.

Lastly (and so obviously that one could easily forget to mention it) the now universal use of English in the business community, on the one hand, and the generalized adoption of the internet, on the other hand, are powerful agents of integration among capital markets, in Europe as in the rest of the world. Financial media such as Bloomberg, Reuters or the broader-public-oriented Yahoo!Finance are used as real-time information tools simultaneously and in the same form throughout the world.

The increasing integration of markets has positive effects on the economy such as improving the liquidity of the marketplace, its reach and efficiency. European companies now have access to a larger base of investors and thus can lower their cost of capital and optimise their financing, which has a positive impact on economic growth.

However, the compartmentalisation of national stock market regulatory systems lowers the performance of the market. There is no European stock market law, let alone a European stock market regulatory authority. Recent steps forward are very limited and do not indicate that such an authority will be created.

In spite of increasing market integration, national (or regional¹¹) regulators still hold undisputed authority. The European Commission identified the need for coordination in 2000 and commissioned a group of "wise men" to report on stock market regulation in Europe; the group was chaired by Baron Alexandre Lamfalussy, the former chairman of the European Monetary Institute which paved the way for the ECB until 1998. Its report in February 2001 led to the creation of a Committee of European Securities Regulators (CESR), whose task is to supervise the elaboration of common rules which are then enforced by each national regulator in each member state. CESR also took over from FESCO (Federation of European Securities Commissions), an earlier group which had been created by the national regulators in 1998 as an informal place for discussion and coordination.

CESR's rules follow the "intergovernmental" model and its role is purely consultative, thus following the usual—if intricate—European pattern of "comitology". It only drafts rules which are then submitted to community decision processes. CESR, which started its operations in 2002, is sometimes described as an embryonic European stock market regulator. Today, though, it is far from being the case: CESR has no general competence over stock market regulation; its rulemaking activity is limited to specific areas and even then it has no decision power; moreover, it has no enforcement powers, as these remain a monopoly of national regulators¹². It is probable that CESR will be no much more than a multinational talking-shop which at best will be able to issue fairly general rules, as does the International Labour Organisation in the area of labour protection.

¹⁰ Source : Merrill Lynch.

¹¹ In Germany, the *Länder* still have a role in regulating local stock exchanges, along with the federal regulator; this leads to significant additional costs and inefficiencies. See "European Corporate Governance: a Changing Landscape?", MIT Sloan School of Management 50th Anniversary Research Project (<http://mitsloan.mit.edu/50th/corpgoveuropepaper.pdf>) : "the need for regulatory body consolidation" (page 42).

¹² Gérard Hertig & Ruben Lee, *Four Predictions about the Future of EU Securities Regulation*, unpublished document available on www.hertig.ethz.ch, January 2003.

Euronext is a specific case and at the time of writing this stock exchange company operates simultaneously in France, Belgium, the Netherlands and Portugal. In order to allow the merger which created it, the French, Belgian and Dutch regulators signed a temporary agreement in order to decide some matters jointly, but this fell far short of a single regulation. Therefore, Euronext is obliged to maintain separate national listings submitted to different rules, in spite of its will to create a single marketplace.

The division of stock market regulation in Europe has negative consequences for the markets and economy as a whole. First, it creates significant difficulties for companies who issue publicly-listed shares or bonds. A company with multiples places of quotation faces as many regulators as countries where it is listed, with a generally weak coordination. This makes operations longer, costlier and more uncertain. As an example, Vodafone, already mentioned as listed both in London and Frankfurt (as well as several other markets), must negotiate in parallel with Britain's FSA and Germany's BAFin for most of its stock market activity.

However, this additional cost for issuing companies is only one part of the problems created by the current situation. Much worse are the resulting flaws in investor protection. Companies are left free to choose between competing systems of regulation, and sometimes opt for the softest. It is known, for example, that large European companies have issued certain bonds in Luxemburg because they knew that they would be asked to disclose less or different information from what would have been the case in their home country. The existing competition among national stock market regulatory environments in Europe is often better described as a "race to the bottom" than a "race to the top": a tendency for companies to favour places where regulation is lax, rather than an alignment of all regulators on the best practice. One result is that the financial disclosure requirements remain generally much less constraining in continental Europe than in the United States. For investors and for companies themselves, it is currently significantly more expensive and difficult to have a precise and up to date situation of a listed company's shareholding structure in continental Europe than in the U.S. In France, a "shareholders' census" typically costs too much for an average listed company to afford it more than once a year.

Last but not least, the current organisation of Europe's stock market regulation results in a highly unsatisfactory process of setting new rules. As previously discussed, these rules remain overwhelmingly a matter of national decision, which starkly limits their effect¹³. The establishment of CESR provides a forum for harmonising some rules, but it can only have a limited impact: CESR-backed decision-making processes are both complex, because of the high coordination cost between 15 (soon 25) member states, and opaque, because CESR itself has only a technical and consultative role and is subject to no accountability mechanism. The European Parliament is wary of the possible emergence of uncontrolled power at CESR, but even if there were a direct oversight mechanism, the technicalities of CESR's debates would make day-to-day parliamentary control difficult.

CESR, a consultative and technocratic forum, cannot claim the legitimacy of a regulator accountable to a democratic government, as are most European stock market regulators or the SEC. Therefore, its creation will not materially change the current situation in which Europe's stock market regulation is divided and has no other option than to align its choices on those made in the US, notably by the SEC. An ominous example has been the Sarbanes-Oxley Act of July 2002, which has extraterritorial effect on foreign companies listed in the U.S. Europe's regulators have been largely absent from the heated debate on Sarbanes-Oxley's implementation, because none of them had a "critical mass" which could have weighed in its individual discussion with the SEC. The same applies to many other essential topics of stock market regulation. While recently discussing the role of financial rating agencies¹⁴, France's Finance Minister Francis Mer stated publicly

¹³ The same could be said about the enforcement of accounting standards, which is still an undisputed mission of national regulators with high risks of inconsistency from one country to another. This issue will be exacerbated after the general adoption of International Accounting Standards in Europe by 2005.

¹⁴ The financial rating agencies give investors a standard appraisal of the creditworthiness of bond issuers. This activity is currently concentrated among three global rating agencies (Standard & Poor's, Moody's and Fitch). These are highly profitable businesses, whose methods have been sharply criticized throughout 2002.

“We should not resign ourselves to a situation where the SEC, as the sole global regulator on this matter, should edict rules with effect over the rest of the world”¹⁵.

It is a fact that the same feelings can be expressed regarding the most essential framework of rules governing capital markets.

The upshot is that in a rapidly unifying marketplace, a fragmented regulation can only be partially effective, weak and lack the desired impact. This results in less developed, less liquid markets, lower market valuations, and a higher cost of capital. Therefore, one consequence of Europe’s underperforming stock market regulation is to make companies’ access to stable equity more difficult, which weakens their financial structure and hinders their growth. Even after the end of the technology bubble of the late 1990s, “young” companies (created, say, less than 30 years ago) are much more numerous among the largest businesses in the U.S. than in Europe. This stark contrast illustrates the lack of efficacy within Europe’s capital markets.

The lost debate

Having said that, we face something of a mystery. The issue of stock market regulation occupies a central place in Europe’s financial and economic setting; however, there is very little debate about it. Particularly since Enron’s demise, there have been scores of comments and discussions about the crisis of capitalism, but very few voices have been heard on this particular issue¹⁶. Even the English-speaking financial press, which had backed the idea of unifying Europe’s stock market regulation in recent years¹⁷, has become almost mute on the issue since the beginning of the wave of accounting scandals in late 2001.

There is one possible, reassuring explanation for this silence: according to it, the creation of CESR in 2001 has solved the issue by giving Europe a single place for setting and enforcing its stock market rules. But unfortunately, as previously exposed, this view just doesn’t fit reality. Therefore, other causes must be found for the absence of a proper debate.

A more convincing explanation, not specifically linked to stock market issues, is the general difficulty for Europeans to play a full part in debates on global economic issues instead of simply importing ideas formed in the U.S.¹⁸. The United States can rely of a highly efficient infrastructure for shaping an informed public debate. This infrastructure combines academic research with a high emphasis on the description of facts; a press with a strong commitment to objective analysis and investigation; think tanks where academic studies can find a large outreach; and Congress itself, with its capacity to draw on all sorts of expertise in its hearings and debates. The mobilisation of this impressive intellectual machinery following Enron’s collapse has produced an awesome mass of revelations, descriptions and analyses which overwhelmed European observers who had no matching information base at home. Therefore, the average French pundit is now much better informed on WorldCom’s or Tyco’s internal whereabouts than on Vivendi Universal’s or France Telecom’s.

In the particular case of capital markets more than in other policy areas, this intellectual imbalance across the Atlantic is echoed by a parallel one across the Channel. This is due to the leadership of the

¹⁵ Source: speech by Francis Mer, « 12^{èmes} entretiens de la COB », November 21, 2002.

¹⁶ Among those are DaimlerChrysler’s CFO Manfred Gentz (interview in *Handelsblatt*, July 29, 2002); Deutsche Bank’s chief economist Norbert Walter; and Eurofi, a French based business group with links in several other European countries.

¹⁷ *The Economist*, July 9, 1998 (“A better idea would be to create a single pan-European regulator. That is the approach America adopted with the SEC. It is time for Europe to follow suit”); *Business Week*, April 17, 2000 (“Europe’s stock markets need a good cop”); *The Economist*, June 8, 2000 (“The fact is that the present system (or lack of one) is not working”); *Business Week*, January 15, 2001 (“The European Union is a single market, right? Well, not for stocks. The EU has more than 30 regulators (...) such inconsistency isn’t just inconvenient. It also unnerves individual investors and frustrates institutions. Europe’s financial players want a common regulator like the U.S. Securities and Exchange Commission (SEC)”).

¹⁸ Europe’s weakness in the area of global policy debate has been described in another context by Jean Pisani-Ferry and Benoît Coeuré, “Un regard européen sur la réforme du système financier international”, *Commentaire* No. 94, Summer 2001.

City of London as a financial centre, which extends to the debate on the evolution of market structures. The Centre for Economic Policy Research, a leading European network of experts on economic policy issues, as well as the European Corporate Governance Institute, Europe's only research institution specialised in corporate governance issues, are both located in London¹⁹. In recent years, the two most significant independent studies on Europe's stock market regulation have been produced respectively by London-based Centre for European Reform²⁰ and by the head of Centre for European Policy Studies, based in Brussels but historically strongly influenced by Britain²¹. Most European finance newspapers are British (*The Economist*, *Financial Times*, *CFO Europe*) or owned by British companies (*FT Deutschland*, *Les Echos*); and the London School of Economics is certainly Europe's leading university as far as finance is concerned. All this reinforces the impact of ideas shaped in the English-speaking world on Europe's financial debate.

However, there are several structural differences between companies and markets in continental Europe and their counterparts in Britain and the U.S., which would justify an autonomous analysis. For instance, commercial banks play a larger role in corporate finance on the continent; large companies' shareholding is typically less scattered and frequently includes controlling blocks which give specific power to one or several shareholders; employees' representatives sometimes call big shots in corporate governance, as in Germany; and in several countries including France, historical legacy gives the state a significant role in meddling with market forces. But the weakness of public debate infrastructure dedicated to capital markets in Europe implies that these specificities are not properly analysed and taken into account in shaping policy.²²

Of course, the *status quo* over stock market regulation in Europe has many defenders, outspoken or not, and this also inhibits public debate. Some issuing companies, if probably a minority, take advantage of regulatory loopholes resulting from the division among regulators. Businesses which are directly subject to public regulation, such as stock exchanges and other financial intermediaries (eg, investment banks for some of their activities), are also generally opposed to change: the Federation of European Stock Exchanges (FESE) has officially rejected the prospect of a unified European stock market regulation in September 2000. It seems that the regulated bodies are not the warmest supporters of a move which would strengthen regulation.

Equally unsurprisingly, existing national regulators which now cooperate within CESR have expressed no will to go further, if that implies a loss of independence. The same applies for some central banks in the Euro-zone, which fear that a unification of stock market regulation could have a domino effect on banking supervision—as already mentioned, several countries have indeed tied both missions in a single agency, thus depriving them of one of their last autonomously managed tasks since the creation of the euro. Finance ministries have similar feelings, and they often prefer to keep a domestic regulatory partner, however independent in theory, than to see regulatory authority transferred to a pan-European body. And in Brussels, the Commission may in some ways also be satisfied by the current institutional setting where it is naturally asked to fill the vacuum left by the absence of independent European stock market regulation (CESR itself is formally subordinated to the European Commission, which would not necessarily be the case of an independent regulatory agency). In short, nobody has strong reasons to complain about the *status quo*—except investors and the general public, but investors and the public do not have the loudest voice in the current set-up in Europe's institutional framework.

There is an additional, perhaps deeper, cause for the absence of progress, which lies in the underdevelopment of financial culture in continental Europe. Without entering a long discussion about Max Weber and protestant ethics, it is quite obvious that capital markets hold a different position in many continental European cultures compared with Britain or the United States. In France, for example, the vocabulary itself of *les marchés financiers* is still often marked by a negative

¹⁹ ECGI, created in 2001, is legally headquartered in Brussels but its permanent staff is based in London.

²⁰ Alasdair Murray, *The Future of European Stock Markets*, Centre for European Reform, London, May 2001.

²¹ Karel Lannoo, *Does Europe Need an SEC?*, European Capital Markets Institute, November 1999. See also research by Ruben Lee (Oxford Finance Group).

²² For instance, the issue of possible conflicts of interest for large commercial banks which are present in their clients' boards is much more significant in continental Europe (or Japan) than in the UK or the US, and has been seldom debated in the many recent discussions over corporate governance.

connotation, in opposition to *le secteur productif* (farm, manufacturing and nonfinancial services) which alone is thought to create “real” output. The word *financiarisation* is frequently used disparagingly to describe capital markets’ growing influence over the economy.

Such historical and cultural factors are reinforced by the humble position of financial disciplines in the initial training of most of continental Europe’s elites. In France, the engineering *Grandes Ecoles*, the *Ecole Normale Supérieure* or even the public-servants-breeding *Ecole Nationale d’Administration* usually give their students a small-to-nonexistent training in finance or accounting²³. As an example, French courts which deal with financial matters are not as familiar with market mechanisms as their English-speaking counterparts such as media-savvy Eliot Spitzer in New York, and differences of initial training probably play a role in this.

Lastly—and maybe there lies in the essential cause of the absence of adequate debate—investors as such are far from being well represented in continental Europe. They would no doubt be among the first beneficiaries of an improvement of European stock market regulation, however their collective absence evidently inhibits the debate. In France, almost all large institutional investors are subsidiaries of banks or insurance companies and thus have a subordinate status. Their professional organisation, called AFG-ASFFI, plays a useful role but its weight remains extremely limited compared, for example, with the Council of Institutional Investors in the US. Apart from the weakness of their institutional representation, investors cannot rely in Europe on strong, independent voices like, for example, Warren Buffet’s in the United States. Indeed, they are largely absent from the public debate, including over issues which affect them directly. An extreme example of investor under representation has been in France the committee headed by Daniel Bouton, head of Société Générale (a commercial bank), which produced in September 2002 a report on corporate governance in publicly-listed companies, namely rules whose supposed aim is to protect shareholders from misalignment of managers’ interests. This committee was composed of fourteen members, of which nine CEOs of non-financial companies (almost two-thirds of the total), two commercial bankers, two representatives of business organisations (cross-sector MEDEF, and the insurance industry’s FFSA) and one accountant. Not one member was there to specifically represent investors.

Time for action

Yet despite the shortcoming of public debate, Europe now faces a situation of emergency which it no longer can afford to indulge in. Rapidly integrating markets call for quick action in the regulatory area; the loss of trust following Enron’s collapse make this requirement only more pressing. European Union member states should without delay envisage unifying Europe’s stock market regulation under a single agency, which would ensure consistency of market oversight and create a European counterpart to the SEC—which CESR certainly isn’t.

The creation of a single European stock market regulatory agency would undoubtedly demonstrate improvement from past initiatives. In his report which led to the establishment of CESR, Baron Alexandre Lamfalussy actually mentioned it in case the proposed approach at the time should not lead to satisfactory results²⁴. Today, even more than intrinsic weaknesses of the Lamfalussy process and CESR, the market crisis itself calls for renewed action. Because of the very depth of this crisis, any policy that may contribute to restoring investors’ trust acquires a high degree of priority, and establishing a credible European stock market regulation is an essential part of such policy.

²³ To be fair, this is at least partly changing. Since ten years, under spectacularly increasing pressure from international competition, many higher education institutions give their students a much better financial training than in the past, as well as a better training in English, the capital markets’ common tongue. This recent diffusion of market knowledge could have far-reaching consequences in the future.

²⁴ “If the full review were to confirm in 2004 (or earlier as the case may be) that the approach did not have any prospect of success, it might be appropriate to consider a Treaty change, including the creation of a single EU regulatory authority for financial services generally in the Community” - Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, Brussels, February 15, 2001, page 44.

As the Lamfalussy report makes it clear, creating a European stock market regulatory authority probably requires a change in the European Treaties. In any case and whatever the legal analysis, it would be a far-reaching political initiative, comparable in this to the establishment of the single currency—maybe no less important, although the impact on everyday life would certainly be less visible to the ordinary citizen.

A strong stock market regulation, capable of establishing stock market rules in a balanced dialogue with Wall Street and the SEC, would be an essential tool for a Europe pretending to develop its own model of a “social market economy”.

It would also represent a long and difficult technical process, as has been the single currency. For sure, unifying stock market regulation certainly does not imply unifying Europe’s company law, contrary to what is sometimes heard. In the U.S., the SEC has federal authority but company law is individually determined by each State (Delaware’s famously favourable company law makes it the home State of many large corporations). But merely unifying laws governing the stock markets and related legal sanctions will be a daunting task, with implied effects on jurisdictions as any decision by the regulatory authority must be contestable before a court. The project’s complexity also means that the future authority’s missions should be restricted to stock market regulation, as is the case of the SEC, rather than be extended to all financial services as for Britain’s FSA or its North European counterparts. This choice would also have the advantage of limiting the risk of giving excessive powers to the new authority, which seems even more appropriate as the FSA currently experiences significant difficulties in ensuring consistency among its many activities.

Beyond the issue of launching appeals against its decisions, a regulatory authority for the European stock market must be made fully accountable within a framework of democratic responsibility, which of course is impossible in the case of a technical committee like CESR. From this perspective, its position would be comparable to that of the European Central Bank. This leads of course to the question of democratic mechanisms and accountability within the European institutions themselves: therefore, any future system of accountability depends on the evolution in the near future of those institutions, which are currently being debated in the Convention on the Future of Europe. In any case, one thing is certain: only explicit democratic accountability, comparable to the kind exercised by the U.S. Congress over the SEC, can grant stock market regulation the legitimacy, authority and independence that it needs to be efficient²⁵.

In addition to the “top-down” legitimacy conferred by democratic oversight, there is a parallel need for a “bottom-up” legitimacy given by proximity with the local marketplaces and their constituting actors. This requires a high degree of decentralisation of the future authority’s organisation and day-to-day operations. A single but highly decentralized authority would appropriately mirror the current situation of Europe’s capital markets, which are rapidly integrating but maintain the existence of many local marketplaces. A decentralised organisation would also allow the conservation of considerable know-how acquired by existing national regulators, especially during the past decade. Finally, it would facilitate the production and processing of information in local language as well as in English, which will stay indispensable for many years in order to adequately protect individual shareholders. In short, a future regulatory authority could be in charge of defining market rules, including those rules enforcing accounting standards, with a delegation scheme to be defined with Europe’s political institutions (Council, Commission and Parliament); and its offices in the different geographical locations, based on the existing teams of national regulators, would be in charge of individual decisions based on common rules. Such a scheme would ensure proximity with local market players, consistency of rules and their enforcement over Europe, and a “critical mass” enabling the authority to play its role in the European and international discussions, not least with the SEC.

²⁵ Concerning congressional oversight of the SEC, and a comprehensive comparison between the SEC and France’s COB, see Pierre-Henri Conac, *La régulation des marchés boursiers par la Commission des Opérations de Bourse et la Securities and Exchange Commission*, Paris, LGDJ, 2002.

Finally, the question of the geographical reach of such an authority will inevitably be posed. Logically, it should cover the whole of the European Union. But a “continental” option could also be considered, at least initially, in case Britain should declare itself determinedly against such a project.

This project is ambitious, complex and difficult, but is also necessary. It requires political will and cannot be indefinitely delayed. The crisis in capital markets is so deep that it is now unacceptable to wait. The Convention on the Future of Europe and the preparation of an intergovernmental conference in 2004 provide the opportunity for inscribing this issue in the future revision of Europe’s Treaties. Accelerating the timetable for the unification of Europe’s stock market regulation should be a matter of priority for political action if Europe is to play a role in setting the rules to govern its own capitalism.

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