SPEECH BY CHRISTOPHER TUGENDHAT, COMMISSIONER OF THE EUROPEAN COMMUNITIES, TO THE ASSOCIATION FOR THE DEVELOPMENT OF STUDIES IN BANKING AND STOCK EXCHANGE BUSINESS, AT THE UNIVERSITA CATTOLICA, MILAN, 25.1.80

EMBARGO: FRIDAY 25th JANUARY 1980, 17.30 H

TOWARDS A EUROPEAN SECURITIES MARKET?

I very much welcome this opportunity to speak to you on the important role which stock exchanges must play in the development of the European Community. I hope to be able to show you that the Commission of the European Communities attaches very great importance to the smooth operation of stock markets, and that we are in the course of establishing a real policy for the development of these markets. We are concerned both with the efficient functioning of stock exchanges on terms which protect the investor properly, and with the possibilities of a gradual strengthening of the links between stock exchanges in Member States: I shall address myself to both aspects in turn.

I believe there is a strong economic argument in favour of expecting an important role for stock exchanges in the 1980s. The industrialised Western world is in the grip of a prolonged recession. Restoring economic growth will require, I believe, a mix of prudent and constructive policies, more successful than those achieved during the 1970s. Combatting inflation will have to play a major role for such policies to succeed in restoring economic confidence, which again is the primary condition for a genuine revival of private capital formation. It is against this background that we must assess the future possibilites for - and demands on -

offering both risk taking capital and loan capital for the financing of new investment in industry. For this to take place, however, stock exchanges must inspire confidence and open a broad choice to investors for the deployment of their funds.

If the economy is to find the sources of finance which it requires, stock exchanges must offer attractive markets for investors. To this end, it is generally felt that two essential conditions must be met:

firstly, the securities traded on stock markets, and in particular securities representing venture capital, should be attractive to investors, and at any rate should be treated no less favourably than other forms of investment;

secondly, the stock markets themselves and the securities traded on them must inspire public confidence.

Securities should be attractive

The main attraction of securities for the typical investor is their overall return. Apart from the profitability, which obviously will depend on general progress towards price stability and economic growth, the overall return on securities is often influenced considerably by other factors, especially fiscal measures.

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One specific problem here is the existence of different systems of taxation of shares in the Community, a consequence of different corporation tax systems. It is the opinion of the Commission that there is an urgent need for harmonization in this sector of activity. The existing widely diverging systems in Member States present an ever growing risk of distortion not only of decisions on location of real investment and production but also of investment vehicle. I speak of a growing risk because as the possibilities across frontiers in the Community are increasing the distorting effect of differing fiscal treatment will grow. We cannot achieve our final objective of a European capital market without a common corporation tax system and rather narrow band of rates. The Commission has presented its proposal as long ago as 1975; it is based on the so called partial imputation system, which has spread to most Member States. I am well aware of the fact that you in Italy operate a combination of no imputation and full imputation for the two corporate taxes; taking the sum total we find, however, that the actual tax credit in Italy is practically in line with the Commission proposal. The Commission thinks, however, that only the partial imputation system has a realistic chance of forming the commonly acceptable solution. We must, when we look for the realistic solution, take into account that the budgetary problems facing the two Member States still adhering to the classical system, Luxembourg and the Netherlands, would be very serious if they were to move all the way from their present situation without any tax credit to the 100% tax credit of the full imputation system. We are still waiting for the European Parliament to deliver its opinion on this proposal, and we hope the Council will then attack this vital problem urgently, for it is evident that the actual implementation will presuppose a time consuming adjustment process.

When it comes to national tax measures serving as incentives to private saving and investment the experience of Member States during the last few years shows that there is considerable scope for active influence. The Commission will try to establish a systematic survey of these measures and their supposed effects, but I want to make it clear now that in my view when such measures are applied they ought to be neutral with respect the investor's choice between domestic securities and securities from other Member States. I also think that such measures should at least not discriminate against investment in shares as compared with other securities, given our dependence on supply of risk taking capital.

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Public confidence must be reinforced

Making securities more attractive, for instance through fiscal measures, is one way of combatting investors' disaffection with venture capital investment. As I said a moment ago, steps must also be taken to reinforce investors' confidence:

- firstly, in stock markets themselves, and
- secondly, in the securities traded on these markets.

Over the years the Commission has endeavoured to contribute to the achievement of these objectives.

(a) Confidence in stock markets

As regards the aspect of reinforcing investors' confidence in stock markets the Commission believes that investors must first of all be assured that they will all be placed on an equal footing. This means that all necessary steps must be taken to prevent fraudulent manoeuvring such as insider trading, or price manipulation, designed to benefit certain persons at the expense of others. It was with this in mind that, on 25 July 1977, the Commission addressed a recommendation to Member States concerning a European code of conduct relating to transactions in transferable securities. As you know, this code is designed to subject the activities of financial intermediaries to a certain discipline.

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I would like to take this opportunity of saying how pleased the Commission was to see that the recommendation was sent by the Italian Ministry for the Treasury to the representatives of the main associations concerned, and that such associations have been invited to take all necessary steps for their members voluntarily to observe <u>all</u> the rules contained in the recommendation, even where such rules are not entirely in conformity with Italian practice. The Commission considers that the code forms a whole, and that it is the entirety of the principles and rules that it contains whose application must be recommended. It is not, therefore, a question of considering the principles and rules as an "à la carte" menu, from which one can pick and choose. In those circumstances, the European code would disappear, to be replaced by a juxtaposition of national codes. I am happy to note that the Italian Ministry for the Treasury shares this opinion, and can only express my hope, as the Ministry has done already, that all the Italian professional associations to whom the Code has been recommended should do all that is necessary for their members to respect it as a whole. The Commission quite understands, however, that it will take time to change long-standing ways of doing things.

I would like to call your attention particularly to one of the principles of the Code, which aims at securing equality of treatment for market participants.

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It is striking that in some Member States - and I am thinking particularly of Italy and Denmark - transactions effected on the stock exchange account only for between 10 and 20% of total transactions involving securities quoted on the stock exchange. It is therefore clear that measures should be taken to help concentrate these transactions on stock markets.

It is for this reason that the European Code of Conduct already provides that financial intermediaries should execute the orders which they are given on an organized market. The Commission intends, however, to examine this problem in greater detail, and to study what further steps might be taken at European level to ensure a more effective implementation of this rule.

b) Confidence in securities

I now come to the second aspect of investor confidence. This, as I have already said, is investors' confidence in the securities which are traded on stock markets

It goes without saying that the quality of securities should be as high as possible. However, there can be no question of protecting the public by listing only issuers offering some sort of guarantee as regards their soundness and profits capacity. In my view, the correct approach is to enable the public to protect itself.

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This principle is mainly of practical application as far as concerns the disposal of blocks of shares; thus, one of the Code's rules states that it is desirable that in these circumstances all the shareholders of the company concerned should be given the chance to sell their shares on the same conditions, and also that such transactions should not take place in a surreptitious fashion. These principles are not generally respected in Italy at the moment, because the majority of transactions take place outside the Stock Exchange on terms which do not always respect the principle of equality of treatment for all shareholders. I trust I am not too bold in hoping that in the future the Code's rules in this connection will receive a greater measure of respect, given that they are very much concerned with public confidence in the market.

It is similarly with a view to reinforcing investor confidence in the proper functioning of stock markets that the Code of Conduct sets out several measures designed to combat insider dealing. In addition the Commission has started work on a proposal for a directive which will lay down in a more precise way the various restrictions to be placed on persons possessing inside information.

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In addition to confidence in equality of treatment and therefore equality of opportunity for all, steps must be taken to strengthen investors' confidence in the prices fixed by the stock exchanges. These prices must therefore be as realistic as possible. This is why the Commission entirely shares the view of stock exchanges that orders should be concentrated as much as possible on stock exchanges. Such a concentration of purchasing and selling orders would also have the advantage of considerably increasing business on stock markets and thus of bringing about the liquidity and depth of the market necessary for reinforcing investors' confidence in these markets.

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Investment in securities involves risks like any other investment. These risks are all the greater where the investment is in shares with their variable-yield. Investors must be aware of these risks and act on their own responsibility. However, they can only be expected to do so if they are able to exercise their judgement on the basis of full knowledge of the facts. In other words, if investors are asked to incur risks, they must, in return, be offered all the necessary information to assess these risks at their true value. It is therefore through an effective information policy that confidence in securities must be assured, and this information must be given at all stages and in a continuous fashion to enable the public to decide on investment or disinvestment in full knowledge of the facts.

In the case of securities we must in the first place demand a prospectus to be published on admission to the stock exchange. This should provide, in a detailed fashion, all information useful to the investor. Secondly, there should be an obligation for the publication of annual account and management reports and of one or more interim reports (six- or three-monthly) throughout the whole period of listing. Lastly we must prescribe the publication of any new fact which is likely to influence investors' assessment of the securities quoted.

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As you will know, the Commission has already taken several steps in this field. We have submitted to the Council of Ministers three proposals for Directives designed to coordinate, at Community level, the information to be published on securities whose admission to official stock exchange listing is requested or which have already been admitted to official stock exchange listing.

Two of these directives have already been adopted by the Council: the first in March 1979, coordinating the conditions of admission to stock exchange listing and the obligations which arise as a result of listing, including the obligation to publish without delay any information likely to exert a significant effect on prices; the second was adopted by the Council in December 1979; it coordinates the contents of the prospectus to be published when securities are admitted to listing. The third proposal concerns the coordination of information to be published on a regular basis by listed companies; it is still under examination by the Council.

<u>Stock exchanges should satisfy the requirements of industry</u>

Turning now from the requirements of the investor to those of industry wanting to obtain funds, one crucial problem is the size or the capacity of the stock market.

To be able fully to assume their role as providers of capital, the size of stock markets must be adapted to firms' capital requirements. At national level, some stock exchanges may already be finding it difficult to carry out this function as efficiently as desired. Seen from a Community point of view I think that it is fair to say that most stock exchanges in Member States do not have the capacity to cope with the new demands and possibilities that Community wide transactions provide and that much remains to be done to enable them to carry out the financing role which should be theirs. There are several possible ways of improving this situation and of converting European stock exchanges into financing instruments adapted to the new dimension open to firms within the European Community.

One way of achieving this objective is to promote as thorough an interpenetration as possible of national securities markets. Here we are up against two problems. We have to eliminate obstacles of an institutional or technical nature; and we must secure a gradual removal of restrictions to the freedom of movement of capital.

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Abolition of technical barriers

As for the technical barriers to the interpenetration of securities markets, the Commission started work on their elimination as long ago as 1968. The problem was one of abolishing the institutional or technical obstacles which prevented issuers of securities in one Member State from gaining access to stock markets in other Member States, or which at least made such access difficult. The first step was - again here - the drawing up of the Community prospectus for admission, of which I have already spoken. Besides providing the public with the necessary information, the Directive also serves the purpose of promoting the admission of securities on several stock exchanges throughout the Community by coordinating requirements of the information to be published. The fact that issuers have hitherto been confronted with information requirements which were different for admission to stock exchange listing in the different Member States may have had the effect of discouraging them from applying for the admission of their securities to stock exchanges in other Member States. The coordination of the content of this information is therefore designed to eliminate one of the obstacles to the listing of a given security on several stock exchanges.

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The Directive of March 1979 coordinating stock exchange listing conditions pursues similar goals, as does the proposal relating to regular information to be published by listed companies.

Abolition of capital restrictions

When it comes to the question of removing obstacles to free capital movements there is both the problem of allowing investors to transact securities across the frontiers of the Community, and the problem of allowing firms to have their securities listed on stock exchanges in the other Member States. In principle, progress was made towards the solution of the former problem, when in 1960 and 1962 the Council adopted two Directives on freedom of capital movements. Unfortunately the Commission has had, however, to authorize several Member States to derogate from the Directives by introducing protective measures. This has been the case in Denmark where residents have been prohibited from acquiring foreign listed securities. Similarly, Ireland has been permitted to subject such acquisitions to exchange restrictions. As you will all know, Italy has been authorized to require residents to deposit with Banca d'Italia 50% of amounts invested abroad. I hope, however, that in the future the trend will be in the opposite direction. We have thus noted that France, which in the past received authorization to maintain restrictions on the purchase of foreign securities, does not apply them in practice And the most recent and most dramatic development in this field is of course the sweeping measure to liberalise all capital movements, taken by the British Government in October of last

In other words, Denmark, Ireland and Italy are the only Member States which in one way or another maintain restrictions on the right of their residents to carry out transactions in securities listed on the stock exchanges of the other Member States.

Progress towards liberalization of transactions in securities should be matched by measures to give Community firms access to stock exchanges in other Member States. This second problem of free access of firms to all Community stock exchanges is important from the viewpoint of the interpenetration of national securities markets. Again in this connection we unfortunately find Italy in a less advanced position, since there are practically no foreign securities listed here. Especially taking the size of the Italian economy into consideration, the present situation calls for marked changes to enable us to move gradually towards the realization of an integrated European securities market.

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EMS and its consequences

On balance we must admit that the Community has made rather slow progress during the 60s and 70s with respect to abolition of restrictions on capital transactions. I think the slow tempo to a great extent can be ascribed to the fears of monetary authorities that they would be unable or less able to manage their exchange rate policies, if speculative capital movements were given a free play across the frontiers. Such fears, it must be said, were unfortunately not unfounded. I believe it is now generally accepted that especially during the 70s large scale speculative capital movements have contributed to the lack of stability in international monetary matters, as witnessed for instance by the "overshooting" of adjustments for the freely floating currencies.

In his now famous speech in Firenze in October of 1977, Mr Jenkins, the President of the Commission, drew attention to the deplorable effects of this situation, which served to increase inflation and reduce the prospects for European integration. His conclusion was to call for new momentum towards a European Monetary Union, and we have since seen a strong political interest in the Community in the introduction of the EMS, the European Monetary System. The United Kingdom has not yet fully joined the system, but it is to be hoped that this is now a matter of time and of the need first to assess the effects of the wide reaching measures taken late last year in British domestic monetary policy and - as already mentioned - with respect to the abolition of capital restrictions.

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For the other Member States the experience with EMS has been quite satisfactory during the first 11 months. In spite of the fact that the greater part of 1979 was marked by strong currency unrest, not least flowing from speculation against the US dollar, the EMS enabled its members to fend off the consequences of these fluctuations on internal European stability. We have had a round of small adjustments of currency rates in September and an isolated further devaluation of the Danish Krone in November of 1979 which formed part of a domestic incomes policy package. However, these changes should not be viewed as shortcomings of the EMS-system, but as orderly and timely adjustments which form part and parcel of the system and serve to compensate for differences of inflation rates among Member States. There can be no doubt that without the coordination, discipline and credit arrangements of the EMS Europe would have faced a much more turbulent time in the current exchanges over the last year; the scope for speculative currency transactions would have been much wider.

The successful start of the EMS in a difficult period gives a realistic basis for a certain amount of optimism when we look to the future. In the hope that the United Kingdom will join in a not too distant future, and assuming further development of the system, for instance to avoid some of the more dangerous external tensions, we can look forward to a scenario marked by fewer, smaller and less dramatic exchange rate adjustments than we were used to in the past. Against this background of improved stability it is also realistic to hope that Member States will not feel the same need to maintain the existing restrictions on intra-Community capital movements. Although it can be argued that an increase in the volume of capital transactions taken by itself may add partially to the pressures on the EMS system, there is, I believe, a good case for expecting that the European Monetary System will enable substantial progress towards liberalization of capital movements in the coming years.

Future Action

This scenario may have an optimistic ring, but as I say, I think it has a considerable probability. It is obvious that international crises could upset the picture and the dramatic events over the last months have reminded us that in addition to current uncertainties about the price and supply of oil, there can be other major changes in the international political climate with potentially profound economic consequences. Even so I would still consider that the continued satisfactory development of the European Monetary System must be the basis for our planning for the financial sector in the 1980s.

We need to undertake a systematic mental effort now in order to try to chart the consequences of a gradual abolition of capital restrictions in the years to come; perhaps even over a rather limited span of years. We must meet this situation well prepared; neither the Commission nor Member States would want to be caught unawares, and perhaps even have to maintain capital restrictions because some institutional problem had not been cleared.

In our forward thinking we should also consider the consequences for financial markets in Europe of progress with respect to harmonisation of corporation taxes and to the introduction of a common legal basis for "the European Company". Both are aspects which have developed in the recent past, but which will deserve a higher priority as the monetary integration gathers momentum; and they are aspects which in themselves will have a strong potential impact on the development of a European capital market.

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It is against this background we must assess our present activities and the need for future action in the field of stock exchanges. My conclusion is that we must approach these problems with a sense of urgency. The Community must in the short run implement the common regulations which are vital for transparency and, hence, confidence in securities and in stock exchanges, and the regulations which rule out institutional obstacles to the interpenetration of European stock exchanges. We must follow up on the Code of Conduct, and we must do all these things before we find ourselves in a situation when freedom of capital movements have created unforeseen difficulties, because we were not prepared.

We must also count on the possibility that the factors of change, I have mentioned, will influence the structure of European enterprise or at any rate its financing structure. We must be open to the possibility that future requirements for equity capital and for transactions in shares in general can best be solved through an advanced system of bridging national stock exchanges.

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The Euro-dollar market has shown us the advantages to be derived from a large international market. Even before it got the strategic role of recycling oil revenue it had come to play a major role in the financing of investment. Not only governments and semi-public borrowers have enjoyed access to this market, but also major private companies with an internationally accepted name.

We must consider the need and the possibilities of linking existing stock exchanges in order that they can obtain the strength and stability which a European-wide market can offer when it comes to major individual transactions, of which I believe we shall see more in the future.

I could envisage that we could add a new dimension to the activities of national stock exchanges by linking them in a simultaneous network for offer and demand of important internationally traded shares. Present computer technique would easily allow this.

By so doing, we would, in a sense, create an integrated European securities market, and it is interesting to note that a similar movement presently is being considered in the United States.

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I do not believe that viable markets can be created by the issue of a decree from the authorities. So also in this case. What we need is not a Community directive, but supply and demand. But the point is that we may very well be facing trends in supply and demand of capital which will make it desirable for both European companies and investors to see the realization of such an integrated securities market. It would undoubtedly also come to play a major world-wide role. It should, therefore, move well within our planning horizon for the 1980s, and I intend to convene a symposium later this year where representatives of the European stock exchanges, of the stockbrokers, of other financial institutions and of the authorities concerned in Member States, can undertake a thorough debate on the need for and possibilities of such an integrated market.

Let me finish by stressing the importance the Commission attaches to a close and frank collaboration with stock exchange circles. This cooperation is a necessary prerequisite for the success of our work in the field of transactions in securities. Both I myself and the service of the Commission which deals with these matters look forward to an intensified cooperation as our work gains momentum.

KOMMISSIONEN FOR DE EUROPÆISKE FÆLLESSKABERS – KOMMISSION DER EUROPÄISCHEN GEMEINSCHAFTEN –
COMMISSION OF THE EUROPEAN COMMUNITIES – COMMISSION DES COMMUNAUTES EUROPEENNES –
COMMISSIONE DELLE COMUNITÀ EUROPEE – COMMISSIE VAN DE EUROPESE GEMEENSCHAPPEN

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EXTRACTS FROM A SPEECH BY CHRISTOPHER TUGENDHAT, COMMISSIONER OF THE EUROPEAN COMMUNITIES, TO THE ASSOCIATION FOR THE DEVELOPMENT OF STUDIES IN BANKING AND STOCK EXCHANGE BUSINESS, AT THE UNIVERSITA CATTOLICA, MILAN, 25.1.1980

TOWARDS A EUROPEAN SECURITIES MARKET?

"There is a strong economic argument in favour of expecting an important role for stock exchanges in the 1980s", the EC Commissioner said in a speech to the Association for the Development of Studies in Banking and Stock Exchanges Business in Milan.

"The prolonged recession of the industrialised Western world imposes the need to restore economic growth, and this will require more successful policies than those achieved during the 1970s. Combatting inflation will have to play a major role in restoring economic confidence, which is the primary condition for a genuine revival of private capital formation", M. Tugendhat said.

"The possibilities of linking existing stock exchanges in Europe should be considered", said the Commissioner. "I could envisage that we could add a new dimension to the activities of national stock exchanges by linking them in a simultaneous network for offer and demand of important internationally traded shares. Present computer technique would clearly allow this. By so doing we would, in a sense, create an integrated European securities market."

Turning to the factors influencing the overall return on securities, M. Tugendhat pointed to the existence of different systems of taxation of shares in the Community: "The existing widely diverging corporation tax systems in Member States present an ever growing risk of distortion ...", he said.

He also stressed the need of reinforcing the investor's confidence in the stock markets by ensuring that they will all be placed on an equal footing: "Steps must be taken to prevent fraudulent manoeuvring such as insider trading or price manipulation...", problems which the Commission has tried to cope with by addressing its recommandation to Member States for a Code of Conduct relating to transactions in transferable securities in July 1977, which was designed to subject the activities of financial intermediaries to a certain discipline. "The principles and rules of this code should not be considered as an 'à la carte' menu, from which one can pick and choose, although the Commission understands that it will take time to change long-standing ways of doing things", M. Tugendhat said.

"If in some Member States transactions effected on the stock exchange account only for 10 - 20 % of total transactions involving securities quoted on the stock exchanges, it is clear that measures should be taken to help concentrate these transactions on stock markets", M. Tugendhat said. The Commission intends to study what further steps might be taken at European level.

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M. Tugendhat briefly discussed other means of reinforcing investors confidence in securities, such as measures in the Code of Conduct designed to cambat insider dealing, steps to ensure realistic price fixing, and an effective information policy.

Turning to the requirements of industry, M. Tugendhat said that "most stock exchanges in Member States do not have the capacity to cope with the new demands and possibilities that Community wide transactions provide".

He argued for as thorough an interpenetration as possible of national securities' markets, and a gradual removal of remaining restrictions on the freedom of movement of capital. The Commissioner welcomed the measures to liberalise all capital movements, taken by the British Government in October last year. On the other hand in some Member States there are still restrictions on the right of their residents to carry out transactions in securities listed on the stock exchange of other Member States.

Turning to the EMS M. Tugendhat said that the experience has been quite satisfactory during the first 11 months, since the EMS enabled its members to fend off the consequences of currency fluctuations for internal European stability.
"There can be no doubt that without the coordination, discipline and credit arrangements of the EMS Europe would have faced a much more turbulent time in the current exchanges over the last year; the scope for speculative currency transactions would have been much greater", he said.

Concerning the United Kingdom he said that is was to be hoped that fully joining the system "is now a matter of time and of the need first to assess the effects of the wide reaching measures taken late last year in British domestic monetary policy and with respect to the abolition of capital restrictions".

"There is a good case for expecting that the European Monetary system will enable substantial progress towards liberalisation of capital movements in the coming years."

In conclusion M. Tugendhat stressed the urgency of implementing the common regulations which are vital for transparency and which rule out institutional obstacles to the interpenetration of European stock exchanges.
"Future requirements for equity capital and for transactions in shares in general can best be solved through an advanced system of bridging national stock exchanges."

The Commissioner announced that he intended later this year to convene a symposium where representatives of the European stock exchanges, of the stockbrokers, of other financial institutions, and of the authorities concerned in Member States, can undertake a thorough debate on the need for and the possibilities of an integrated European securities market.
