



**International Secretariat
Brussels Office**

Place du Luxembourg 2-3

1050 Brussels, Belgium

Tel: 32-2-540 9061

Fax: 32-2-502 6752

brussels@transparency.org

<http://www.transparencyinternational.org>

**Submission to the European Commission consultation on
“Financial Markets Supervision”**

**- Transparency International’s recommendation to improve the
integrity of the financial markets -**

The economic crisis increases potential risks for fraud and corruption in the EU. When the economic parameters are getting tighter a much stronger temptation to focus on pure survival will prevail. Poor business practices, cutting corners and corruption could become a tempting way to attempt survival in the midst of the global economic crisis.

For this reason Transparency International (TI) emphasised the vital importance of ensuring greater transparency and accountability in all aspects of economic and financial policy-making and implementation by all institutions, both public and private, in the immediate period ahead.

The reforms that we urge the EU to adopt and promote on a European level as well as on a global scale must be founded in transparency, accountability and integrity from the start. All concrete measures, taken in order to fight the current crisis and prevent similar ones in the future, must relate to enhancing transparency in areas where a lack of it directly caused, or failed to counter, the global crisis.

In this respect TI welcomes the Initiative of the High Level Group to analyse EU financial supervision to detect lacks and recommend possible solutions. Moreover, TI follows the Communication on European Recovery of the European Commission with great interest and would like to formulate the following remarks and constructive recommendations upon the new EU reform programme:

1. Supervision

1.1. TI supports the approach to review the EU financial supervision system and recommends adopting a far more consistent and internationally coordinated framework of regulation and supervision of all financial institutions. In this respect, TI:

- Welcome to equip supervisory authorities in all Member States with *strong, equivalent and deterrent supervisory power* as well as sanction regimes to counter all types of financial crime and to ensure compliance of financial institutions with the applicable rules (rec. 6);
- Emphasise the importance for a better supervision through the enhancement of *transparency of OTC-products* in the financial market, i.e. the set up of a *central clearing house for OTC-CDS* (rec. 8).

1.2. In general, TI recommends to

- Undertake a comprehensive inventory of all types of risks taken by banks and other financial actors which led to the crisis;
- Ensure that ongoing activities of official agencies with responsibilities in this area are much more frequently, fully and effectively reported to the general public; and
- Enhance international cooperation between the supervisory agencies.

2. Regulation

2.1. TI welcomes and agrees with the EU Commission to fill gaps of insufficient or incomplete regulation in the financial sector.

- Introduce stricter rules for off-balance sheet items like introduced in the High Level Expert Group Recommendations (rec. 1).
- Support the recommendations of the High Level Expert Group regarding the “parallel banking system”, securitised products, derivatives and investment funds to enhance transparency and a tighter oversight (rec.7, 8, 9).

2.2. Moreover, TI recommends extending the European Commissions measures as in the following:

- Increased cross-border coordination of accounting standards in the financial area is crucial, with all countries requiring disclosure of all forms of derivative products and off-the-book entities of financial institutions.
- Encourage the revision of international accounting standards for more transparency in the activity of multinational companies abroad.
- Halt use of offshore havens and other non-cooperative centres in corruption schemes
- Ensure that these centres cooperate fully with other national and international authorities on the exchange of information in corruption-related investigations
- Initiate actions to make clear to all financial service firms that their licenses are at risk in the EU financial market if they act intentionally to use foreign centres to evade full reporting of their client’s accounts to the tax, customs and judicial EU authorities.
- Make it a legal obligation for multinationals to detail in their annual reports results and risks they incur through financial activities in tax havens. Official supervisory authorities should ensure that global banks make certain their units in offshore havens are audited properly for consolidation purposes; and that the goals pursued and the material risks incurred by their activities in offshore havens are disclosed in their annual reports.
- Establish a European or respective national registers of all trusts and investment funds with investor relationships under their jurisdiction. In case the parent companies are incorporated in offshore havens or other non – cooperating financial centres, then these registries should detail for public inspection the identities of the founders of the trusts and the beneficiaries, as well as the names and qualifications of the trustees themselves.

- For regulating and monitoring these financial entities cross-border cooperation between judicial authorities should be strengthened and ensure communication channels are more efficient.
- Adopt EU Code of conduct to discourage tax evasion and illicit capital flight, along with a monitoring mechanism such as the one which was recently discussed within the UN Committee of Experts.
- Strengthen the work of IMF and other international governmental organisations to publish information and assessments of countries compliance with anti-money laundering and transparency standards, and require financial institutions to take this into account.

3. Credit Rating Agencies

- 3.1. TI welcomes the intention of the EU Commission to regulate CRA's and review their business model.
- 3.2. TI recommends measures to prevent conflicts of interest in the activities of Credit Rating Agencies, and in the relationships between financial firms and the public sector.
 - Establish or strengthen regulatory authorities, with publicly accountable mandates and transparent approaches, to oversee the activities and the products of CRA's and accounting firms, as foreseen
 - Establish the developed standards across international financial sector.

Without such actions, public questioning of the integrity of current practices will persist.

4. Governance

- 4.1. TI welcomes the EU Commission's intention in the area of risk management and pay incentives in financial firms.
- 4.2. Moreover, TI recommends building stronger corporate governance in financial service firms with an emphasis on:
 - Executive compensation, which should be better aligned with the corporations' long-term interests, adequately approved by annual shareholders' meetings and exposed to the downside as well as the upside,
 - Risk management, especially strengthening the mandates and resources for banks internal control and audit functions re risk management is welcomed by TI.
 - Disclosure of risks associated to financial products,
 - Greater accountability of boards of directors,
 - Extending whistle blowing procedures and protection to confidential information on excessive risk-taking.
 - Ensuring all national stock exchange regulatory authorities and all other authorities, responsible for the oversight of financial firms, require companies to report publicly on the qualifications of all members of the board of directors

and publicly listed financial service firms and fully disclose to the public compensation committee decisions, the full compensation to senior corporate officers, any and all shareholdings owned by directors, and any stock transactions of directors and senior officers. This standard practice should become the norm globally and the EU should foster this approach towards its international partners.

5. Investigation and Sanctions

- 5.1.** TI agrees with the EU Commission to ensure more efficient sanctions against market wrongdoing. TI emphasises the review of the Market Abuse Directive and would recommend initiating this process as soon as possible.
- 5.2.** In addition, TI recommends the following:
- Claims for pursuing appropriate criminal investigations and impose strong sanctions where corruption, insider trading and other abuses are found.
 - Strengthen resources to investigate and prosecute fraud and corruption
 - Report comprehensively on initiations of major investigations to make heads of supervisory authorities far more accountable.
 - Enhance judicial cooperation and information exchange between Member States for a more effective regime especially to fight cross-border related cases.

About Transparency International

Transparency International (TI) is the global civil society organisation leading the fight against fraud and corruption. Through more than 90 chapters worldwide (i.e. in almost every EU Member State and in many developing countries world wide) and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption and works with partners in government, business and civil society to develop and implement effective measures to tackle it. There is strong evidence of the devastating impact of corruption on poverty reduction and sustainable and participatory development. Advancing development by fighting corruption is therefore one of TI's main areas of expertise and experience.

TI looks forward to continue discussing these issues with you. If you need further information, please contact:

Jana Mittermaier

Head of Brussels Office

Transparency International
Place du Luxembourg 2-3
B-1050 Brussels, Belgium
Tel +32 (0)2 504 90 61
Email: jmittermaier@transparency.org

Miklos Marschall

Regional Director for the Europe and Central
Asia Department

Transparency International Secretariat
Alt-Moabit 96
D-10559 Berlin, Germany
Tel +49 (0)3034382014
Email: mmarschall@transparency.org

