



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

on Preventing and Combating Corporate and Financial Malpractice

1. Introduction

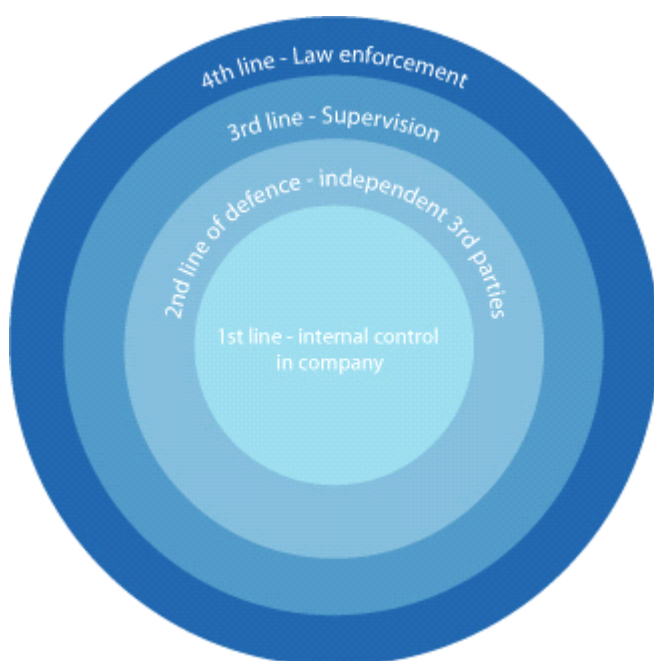
Recently, a number of scandals have caused uncertainty in capital markets, damaging the overall economy. In one year Enron shareholders lost around US-dollar 67 billion leaving employees and former employees with meagre retirements¹. The market capitalisation of Parmalat depreciated by more than 90% in only three months. Enron, Parmalat and no doubt other companies used and will continue to use complex and opaque structures, including subsidiaries in offshore financial centres (OFC), Special Purpose Vehicles (SPV) and complex financial transactions, often with the complicity of third parties, to reduce the transparency of their activities to investors. The risk of such practices must be reduced.

The Financial Services Action Plan (FSAP) and the Action Plan for Company Law and Corporate Governance (Action Plan)² already provide the right policy response for an effective EU framework for dealing with most of the financial issues raised by the recent scandals. There seems no need to significantly change or add to these action plans; rather to press ahead with their timely implementation and ensure strict oversight and effective control of the application of legislation. The aim of this Communication is to provide a holistic approach on how to reduce the risk of financial and corporate malpractice covering also taxation and law enforcement.

2. Conceptual framework

There are four lines of “defence” against corporate malpractice. The first line is the internal control in a company, in particular by the board members.

Fig. 1: Conceptual framework



¹ Los Angeles Times: “Enron is Proving Costly to Economy”, 20 January 2002

² COM(1999)232 and COM(2003)284 final

The second line of defence is primarily the auditors. Auditors must be independent and certify that a company's accounts give a true and fair view of the financial situation of a company. This line of defence also includes advisors e.g. corporate lawyers, financial intermediaries and investment banks when they e.g. advise on how to use SPVs, incorporate companies' offshore, issue bonds etc. Also rating agencies and financial analysts are part of this line of defence. The overriding problem is to ensure transparency and reduce to a minimum - and at least effectively manage - conflicts of interests. E.g. intermediaries should not assist in issuing corporate bonds, if they are aware that a company is insolvent, nearly insolvent or likely to be unable to repay the debt instruments.

The third line of defence is supervision and oversight. Investors rightly expect supervisors to ensure that laws are being respected. However, recent scandals show scope for improvement, including the cooperation between supervisors across sectors and borders with sufficient powers given to supervisors.

The fourth line of defence is law enforcement. It covers criminal prosecution and primarily concerns police, judicial authorities and other public authorities responsible for combating financial crime, including illegal activities harmful to the EC's financial interests. In combination with dissuasive sanctions, law enforcement can have both punitive and preventive effects. In all cases there is an overriding need for close co-operation between law enforcers and the bodies that carry out supervision and oversight.

3. Background

The latest in a series of major global financial scandal is Parmalat. Criminal investigations are ongoing and it is too early to draw any definitive conclusions. It appears, though, that Parmalat had annual losses of €350 to 450 million from the mid 1990s to 2001. Yet the company accounts showed positive earnings. With the assistance of financial intermediaries billions of euro-bonds were issued despite the weak real financial situation of the group. Retail investors ended up with a substantial proportion of these bonds. Why did the lines of defence fail?

Parmalat had a complex web of subsidiaries, a number offshore, to take advantage of flexible legal, financial and tax environments. Beneficial ownership was not always clear. It used complex structures involving SPVs incorporated in OFCs to finance its debt and to keep large parts of its business off balance sheet. Parmalat - a milk company - took financial engineering to an extreme using these techniques over a period of many years and in many different jurisdictions within and outside the Union.

Parmalat's internal controls did not function properly. Corporate leadership and governance were lacking, leading to the breakdown of the first line of defence.

It appears there also have been significant audit failures, leading to the break down of the second line of defence, which may have been assisted by the way some banks and investment banks, rating agencies and financial analysts acted. Certain intermediaries and advisors no doubt knew Parmalat was a highly risky asset, but some may only have used that information to pass on the risk to others minimising their own risks or to generate profit for themselves.

Also the third line of defence seems to have fallen. Clearly one problem that can occur is insufficient cooperation from offshore jurisdictions. The sheer number of authorities involved in supervising multinational companies and financial institutions present in different jurisdictions can be very large and the enforcement powers may be insufficient. Even at national level there often can be more than one supervisor involved.

The use of complex company structures, compounded by complex regulatory structures can weaken control and can lead to gaps in effective regulation and supervision³.

Given the role that banks, investment banks, rating agencies and financial analysts may have played in the Parmalat-affair, the transfer of risk to the retail part of the financial system and insufficient transparency in the corporate bond market deserves more attention. As complex financial arrangements are often used to blur the ultimate beneficial owners of companies, the Commission will analyse what further action is needed.

4. What can be done to strengthen the four lines of defence?

All lines of defence taken together must be robust enough to prevent and discourage corporate malpractice. The key elements are: enhanced transparency; improved traceability; and better coordinated enforcement. Each has a value in itself but they are also linked. E.g. having strict rules on transparency, or auditor rotation, only helps if they are enforced.

Below is a presentation of EU initiatives to reinforce the four lines of defence⁴.

4.1. First line of defence – Internal controls in the company and corporate governance

Boards of companies have fiduciary obligations towards the company itself, its shareholders as well as obligations to stakeholders at large.

EU-level

As announced in the Action Plan the Commission will:

- In the short term⁵, clarify the collective responsibility of the board members for financial statements and key non-financial information, enhance transparency for intra-group transactions as well as transactions with related parties (including SPVs) and oblige all listed companies annually to make public a corporate governance statement;
- In the longer term, the Commission will look into criteria for disqualification of directors and wrongful trading;

³ HSBC operating in 79 jurisdiction and claims it has to deal with more than 370 authorities at a cost of around €320 million per year. (Annual report HSBC Holding PLC pp 7 and 30). After enlargement, there are around 50 authorities in the EU alone to supervise ever more complex transactions and products.

⁴ In annex 1 some international initiatives are set out

⁵ Short term means before the end of 2004; medium term means before December 2005; and longer term initiatives means after 2006.

Bearer shares and bonds can be used to blur the ultimate beneficial owners and financial flows. The Commission will look more closely at the use of such instruments and make proposals to alleviate any problems.

Following the Directive on Markets in Financial Instruments⁶ the Commission will analyse bond market transparency, including risk transfer to the retail sector. Depending on the outcome, further initiatives may follow.

4.2. Second line of defence – independent third parties

The most important third party is the auditors. But included are also, accounting firms, banks, investment bankers and lawyers, as well as rating agencies and financial analysts.

EU-level

Following the Action Plan the Commission has *proposed a directive on statutory auditing* to inter alia require: full group auditor responsibility for consolidated accounts; audit committees in public interest entities; auditor rotation; and to strengthen sanction regimes⁷.

In the area of customs cooperation the Commission has *proposed a regulation to prevent money laundering*. The regulation requires cash control based on a declaration system for amounts above €15.000 and it provides for powers and penalties to enable customs authorities to enforce the regulation.

As part of the FSAP the Commission has *proposed a third anti-money-laundering-directive* to cover also trust and company service providers, even though France, Sweden, Greece and Luxembourg have not yet fully transposed the second anti-money laundering directive⁸. The proposal also requires all financial institutions based in the Community to apply anti-money-laundering provisions in all their branches or majority owned subsidiaries carrying out business offshore.

In the short term a *regulation will give effect to FATF Special Recommendation VII on terrorist financing* and require full originator information on all electronic funds transfers leaving the EU.

The meeting of the ECOFIN-council in Oviedo 2002 invited the Commission to look closer at credit rating agencies (CRAs) and financial analysts. Regarding *CRAs* four issues are of interest: legal uncertainty on access by CRAs to inside information from issuers; the way CRAs carry out their credit assessment; entry barriers in the industry; and conflicts of interest. On 5 July 2004 the Commission requested CESR⁹ to analyse this area as a basis for a Commission report to be presented before 31 July 2005 as requested by the European Parliament.

⁶ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004.

⁷ Proposal for a Directive of the EP and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC – COM(2004)177 final, 16 March 2004.

⁸ Directive 97/2001/EC of the European Parliament and of the Council of 4 December 2001 on prevention of the use of the financial system for the purpose of money laundering.

⁹ Committee of Securities Regulators

Regarding *financial analysts*, the key issues are to ensure that investment firms have effective systems in place to prevent or manage conflicts of interest; that the investor's interests are protected; and that issuers show good conduct in their dealings with analysts. In 2005, the Commission will propose measures to implement the Directive on Markets in Financial Instruments, on prevention and management of conflicts of interest relating to the production of investment research by investment firms. Implementation of the Market Abuse Directive¹⁰ sets out a disclosure regime for investment research which complements this.

4.3. Third line of defence — Supervision

Member states must implement and enforce EU legislation. National supervisors have a key role to play here and must cooperate at domestic, EU or international levels. Failure to implement and enforce EU legislation is a major barrier to fighting corporate malpractice.

EU-level

As part of the Action Plan the Commission has proposed a Directive on Statutory Auditing that requires *adequately funded, effective and independent public supervision* for all statutory auditors and audit firms; cross border cooperation; and it sets a framework for cooperation with third countries. The proposed directive should be finally adopted at the latest by June 2005.

Among Member States, there is often more than one authority involved in supervising the institutions operating on their *financial markets*. These different authorities must cooperate to ensure that regulatory controls are effective and adequate.

At European level steps towards improved cooperation among supervisors were taken, primarily to assist the Commission in drawing up implementing measures at European level¹¹. But it is also important for developing deeper day-to-day cooperation between supervisors. E.g. CESR members have a framework for voluntary cooperation¹². It covers securities supervisors' inspection and enforcement of e.g. insider dealing, market manipulation and other fraudulent or manipulative practices. The framework gives the signatory authorities the option to conduct joint investigations, share the work and responsibilities and co-ordinate follow-up actions. The obligation for supervisory authorities to cooperate cross border has indeed been introduced in some recent directives e.g. the Market Abuse Directive.

CESR has adopted a standard on coordination of enforcement activities¹³ on financial information to inter alia ensure that EU supervisors can get information about decisions taken across the EU. CESR and the other Committees also provide for sessions where supervisors can coordinate their work and exchange experiences. However, recent events

¹⁰ Commission Directive 2003/125/EC

¹¹ The European Securities Committee (ESC), European Banking Committee (EBC), European Insurance and Pension Committee (EIOPS); Committee of European Securities Regulators (CESR); Committee of Insurance and Occupational Pension Supervisors (CEIOPS) and Committee of Banking Supervisors (CEBS).

¹² Multilateral Memorandum on the Exchange of Information of Securities Activities of January 1999

¹³ CESR / 03-317c

have indicated that there could be a need to strengthen further the cooperation between supervisors, e.g. by making joint investigations an obligation in cases of complex companies operating across a range of Member States; by using risk mapping as a basis for supervision; and by developing guidelines for peer reviews, including publication of the results to help assess best practice.

To match the increasing complexity of financial transactions and institutions supervisors from the securities field, the banking area and the insurance area must cooperate ever more closely. A clearer division of labour should be created between the European level and the national level e.g. by dealing with complex institutions that operate cross border only at European level.

To *improve transparency of tax systems* it is necessary to facilitate access to, and exchange of information. Information available to other supervisors may be relevant for tax purposes and could be passed on to tax authorities, outside the scope of judicial cooperation, to better identify a group's structure and location in offshore centres.

To facilitate financial flows traceability between companies and provide information to tax authorities on their beneficiaries, the Commission will in the long term examine with Member States the possibility of using a single direct tax identification number for companies, drawing on the experience of the VAT number.

To remove remaining obstacles to exchange of information between tax authorities, two issues in particular would need to be considered. Firstly, it needs to be examined whether the current limitations of the Mutual Assistance Directive¹⁴ hamper the exchange of information and obstruct the detection of complex structures such as those used in the case of Parmalat, and, if so, whether it would be desirable to amend these at least to the extent that they relate to corporate taxation. Secondly, the EU should take account of the ongoing work at the OECD on improving access to bank information for tax purposes and examine how these developments could be reflected in the existing Community instruments.

In the short term *improved administrative co-operation* through better use of existing EU instruments and the exchange of best practices between Member States should be promoted. Fiscalis¹⁵ seminars will address this with focus on how to tackle tax fraud cases involving complex corporate structures.

In the medium term, administrative co-operation could be improved by broadening the scope for joint investigations in direct tax matters¹⁶, between different Member States and, at national level, between different services.

¹⁴ In particular article 8 of the Mutual assistance directive which imposes "no obligation upon a Member State from which information is requested to carry out inquiries or to communicate information, if it would be contrary to its legislation or administrative practices for the competent authority of that State to conduct such inquiries or to collect the information sought".

¹⁵ DECISION No 888/98/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 30 March 1998 establishing a programme of Community action to ameliorate the indirect taxation systems of the internal market

¹⁶ Regulation 1798/2003 already provides for joint investigations in the indirect tax area

In the longer term drawing on the experience with automatic exchange of information from the Directive on taxation of savings income, it could be explored whether this practice could be extended to other areas of direct taxation or other types of income, possibly by making better use of new technologies such as existing secure systems at Community level¹⁷. Regarding exchange of information on request, accelerated procedures could help to respond more quickly and effectively in cases of tax fraud or avoidance, and common definitions of such concepts could be developed for direct tax purposes in line with the OECD work in this area.

In the short term, the Commission will work with Member States to develop concrete proposals targeted at cases of tax fraud and avoidance involving complex and opaque structures, such as those used by Parmalat.

Efforts to improve transparency and exchange of information only have little effect if limited to the EU. Non-transparent structures provided by offshore jurisdictions were used by Parmalat. Therefore the European Union must promote far greater transparency and exchange of information with third countries as well as dependent or associated territories to ensure their adoption and implementation on as wide a geographical basis as possible. In order to do so better consistency is essential in defining EU policies towards cooperative and non cooperative tax havens. The time has now come for concrete actions to ensure that our partners are transparent.

First, the EU partners should support transparency and exchange of information in the financial and tax fields in their relations with the EU. The Commission intends to discuss this in its policy dialogue with third countries and dependent territories, as well as possibly when negotiating or updating an association agreement, with a view to identifying possible ways forward. This could be applied to ongoing negotiations such as the economic partnership agreements with the African, Caribbean and Pacific or other countries. In addition to this, in order to achieve our objectives, the EU should be prepared to assist partner countries to put in place regional rules on these issues. It should however not be considered as a scoreboard aimed at setting up a basis for conditionality or selectivity, but as a tool for practical improvements in standards.

Second, positive actions could help cooperative partners to overcome difficulties of regulatory, technical or economic nature when introducing more transparency, in the form of reinforced technical assistance, where the EU as a whole has a considerable experience, or through some form of economic support for a limited period of time. Several instruments are available, e.g. the Cotonou agreement. The annual and mid-term reviews of Country Strategy Papers could also provide for appropriate actions. The Commission will monitor the efficiency and the progress made by OFCs towards more transparency.

Third, the implementation of the cooperative tax havens' commitments, and of transparency rules, relies on bilateral exchange of information agreements with individual OECD member countries. The Commission recommends EU Member States to rapidly conclude such agreements.

¹⁷ CCN/CSI platform

4.4. Fourth line of defence – Law enforcement activity

Investigations and prosecutions coupled with dissuasive sanctions have a preventive and repressive effect. The Millennium Strategy¹⁸ gave recommendations about: penetration of legal persons by organised crime groups; fiscal fraud; approximation of legislation regarding minimum standards of constituent elements of financial crime offences; and review legislation on tracing, freezing and confiscation of criminal assets. The Scoreboard¹⁹ reviews progress of measures adopted or underway.

A Framework Decision (FD) was agreed in 2001²⁰ to ensure that certain types of fraud are recognised as criminal offences and subject to dissuasive sanctions in all Member States. A FD of June 2001²¹ aims to ensure that Member States allow freezing and confiscation of laundered assets and that money laundering applies to a wide range of offences. An implementation report (2004)²² concluded that most Member States had implemented this FD.

All Member States have Financial Intelligence Units (FIUs). Since money laundering knows no borders, effective co-operation among FIUs is essential. At EU level, such co-operation is addressed by the Council Decision of October 2001²³. The Commission financially support cooperation via the FIU NET, which aims to establish an automated communication platform.

A FD of July 2003 sets out principles of mutual recognition regarding orders freezing property and evidence. A draft FD on harmonisation of confiscation measures²⁴, establish that if a person is convicted of organised crime offences a Court may order the confiscation of assets even though these are not the proceeds of the crime for which the person is convicted. This draft FD is still subject to parliamentary reservations even though it received agreement on a general approach in December 2002. A third draft FD establishes mutual recognition for confiscation orders between the judicial authorities of the Member States²⁵. It received agreement on a general approach in June 2004 but is still subject to a number of parliamentary reservations by Member States.

¹⁸ The Prevention and Control of Organised Crime: A European Union Strategy for the Beginning of the New Millennium, OJ C 124 of 3.05.2000, p. 1

¹⁹ Biannual Update of the Scoreboard to Review Progress on the Creation of an Area of “Freedom, Security and Justice” in the European Union (Second Half of 2003) 30.12.2003 COM(2003)812 final

²⁰ Council Framework Decision of 28 May 2001 combating fraud and counterfeiting of non-cash means of payment (2001/413/JHA) OJ L 149 of 2.6.2001 p.1

²¹ Framework Decision on money laundering, the identification, tracing, freezing, seizing and confiscation of instrumentalities and the proceeds of crime. 2001/500/JHA OJ L 182 of 5.7.2001

²² Commission report based on Article 6 of the Council Framework Decision of 26th June 2001, COM(2004)230 final of 5th April 2004

²³ Council Decision of 17 October 2000 concerning arrangements for co-operation between financial intelligence units of the Member States in respect of exchanging information. 2000/642/JHA

²⁴ Draft Framework Decision on Confiscation of crime-related proceeds, instrumentalities and property OJ C 184 of 2.8.2002

²⁵ Draft Framework Decision on the execution of confiscation orders, OJ C 184 of 2.8.2002, p. 3-5.

EU-level

Co-operation and information exchange regarding investigation and prosecution must be strengthened. Therefore Europol was set up to facilitate the task of law enforcement agencies when they carry out investigations in two or more EU countries. One key problem, however, is the reluctance of Member States to transmit information and intelligence to Europol, which affects Europol's capacity to provide the necessary added value in criminal analysis at EU level. In 2002 Eurojust was created to improve coordination and cooperation between national authorities investigating and prosecuting serious crime involving two or more Member States. Eurojust and Europol have developed a close working relationship, and in June 2004 they signed a cooperation agreement.

Co-operation at the level of supervisors and law enforcement is essential. Investigation and successful prosecution of corporate malpractice require a broad range of skills and expertise. Co-operation between regulatory bodies and law enforcement services must be promoted. One possible way could be Memoranda of Understanding for co-operation in the fight against financial crime. The Commission will further explore this.

Co-operation in exchange of bank accounts and other bank-related information can be relevant. The Protocol to the Convention on Mutual Assistance in Criminal Matters²⁶ provides for Member State authorities to provide details of bank accounts and banking operations of identified persons as well as the ability to monitor such transactions. The Protocol has yet to enter into force. However, the Commission has suggested that the proposed European Evidence Warrant²⁷ should replace the Protocol as regards requests for details of the existence of bank accounts (where data is available) and of previous banking transactions on such accounts. At a later stage, further mutual recognition instruments would be introduced and in this process, the remaining provisions of the Protocol, notably monitoring of banking transactions, will be addressed.

Co-operation between the financial and other business sectors and law enforcement authorities at EU level has a significant role in the prevention and detection of corporate offences. On the one hand it is believed that a significant volume of corporate malpractice offences goes unreported. On the other it is perceived that many reports on suspicious transactions are made but not followed up. The Commission intends to promote co-operation between the private and public sector via the EU Forum for the Prevention of Organised Crime; by encouraging more research work; and by developing an EU Action Plan on partnership between the public and private sectors.

Financial investigation plays a key role in fighting corporate malpractice. The Commission will in the medium term elaborate an EU programme to promote financial investigation. In both the Enron and Parmalat scandals, the wilful destruction of documents seems to have been a serious obstacle for financial investigators. Such activity should carry a severe EU-wide minimum penalty. To this effect, the Commission will consider developing an appropriate instrument in the medium term.

²⁶ Established by Council Act 2001, OJ C 326 of 21.11.2001, p. 1.

²⁷ COM(2003)688.

The *traceability of financial flows* is crucial to prevent corporate malpractices. No systematic traceability exists for on-line transactions. To address this there could be a need to explore whether electronic payments even over open networks, should be recorded and stored. CTose²⁸ is currently being set up within the CTose Foundation; it could enable gathering of electronic evidence that will stand up in criminal court proceedings.

There are hardly any reliable figures on the extent to which e-commerce, e-cash activities or other Internet based financial transactions, are used for criminal activities. Hence a project to identify and quantify financial crime activities and trends using the Internet as payment infrastructure, including potential solutions for enhanced traceability is planned.

Currently *effects of disqualifications* are limited to the territory of the Member State that ordered the disqualification. Certain categories of disqualifications should be recognised and enforced throughout the EU. The Commission will in 2004 make proposals to improve the exchange of information on criminal convictions and disqualifications. An efficient mechanism for transmission of this information is necessary to ensure that disqualifications are applied throughout the EU²⁹.

On the basis of thorough analysis of *corporate liability* an EU policy on this could, if appropriate, address fines and other penalties for failure to comply with existing legislation. The common criteria for these sanctions would be that they should be effective, proportionate and dissuasive.

On 28 May 2003 the Commission adopted a Communication on a comprehensive *EU policy against corruption*³⁰. The Commission is actively following up on the Communication by urging Member States to meet their obligations.

Effective *identification, freezing, seizing and confiscation of laundered proceeds* would be enhanced if Member States establish specialised national bodies. An informal co-operation network among such bodies would further enhance their effectiveness. In the longer term the Commission will examine whether there is a need for a further instrument on asset sharing and restitution of confiscated proceeds.

Further initiatives are ratification of the *2nd protocol of the PFI Convention*³¹ and Proposal on Mutual Administrative Assistance on *Protection of Community Financial Interests*, which aims to reinforce mutual administrative assistance and the exchange of information in fighting EC fraud and related money laundering.

5. Conclusion

Although many of the EU's policies underway deal with a wide range of issues identified there is a need now to accelerate the implementation and enforcement. However, as this

²⁸ Cyber Tools On-line Search for Evidence

²⁹ See also COM(2004)221

³⁰ COM (2003) 317 final

³¹ Protocol to the Convention on the protection of the European Communities' financial interests (OJ C 313 of 23.10.1996, p. 1) THE COUNCIL OF THE EUROPEAN UNION

paper shows, new policy initiatives are required in the tax and third pillar areas to reduce the propensity of corporate and financial malpractice.

Annex 1: International level

Below is set out some international initiatives that will contribute to reinforcing the lines of defence.

1st line of defence - International level

Accounting standards are crucial to the first line of defence. Therefore the accounting standard setting process itself must be as transparent as possible. The Commission has engaged in a reform process to make the International Accounting Standards Board (IASB) improve its working methods. The reform should be carried through by 2005.

2nd and 3rd line of defence - International level

Both the EU and the OECD achieved significant progress in tackling harmful tax practices based inter alia on non-transparency. Part of the OECD work is oriented towards so-called tax havens, and more than 30 offshore financial centres committed to the OECD principles of transparency and exchange of information in tax matters. An OECD Model Agreement on Exchange of Information on tax matters was jointly elaborated by OECD countries and cooperative tax havens. Its implementation is subject to OECD members and cooperative tax havens together setting those standards of transparency to be applied to access relevant information, detail the type of information to be made available, the persons concerned and how to record the accounts.

Although, subject to their EU commitments, EU Member States are free to define their position on direct tax matters within the OECD, the Commission considers it desirable that they have a more coordinated approach in setting standards to be applied in offshore financial centres, to ensure that such standards adequately facilitate information exchange with the EU.

The implementation of the cooperative tax havens' commitments, and of transparency rules, relies on bilateral exchange of information agreements with individual OECD member countries. The Commission recommends EU Member States to rapidly conclude such agreements to better promote transparency towards offshore financial centres.

The EU has strong relationships with some offshore centres that lack transparency, in which Parmalat had subsidiaries, and that were scrutinized by international initiatives promoting transparency. These EU relationships could be used to promote the principles of transparency and exchange of information, in line with the guiding principle the Commission adopted in 2001 that *“better consistency should be sought in defining EU policies towards cooperative and non cooperative tax havens.”* The time has now come for concrete actions to ensure that our partners are transparent.

First, the EU partners should support transparency and exchange of information in the financial and tax fields in their relations with the EU. The Commission intends to discuss this in its policy dialogue with third countries and dependent territories, as well as possibly when negotiating or updating an association agreement, with a view to identifying possible ways forward. This could be applied to ongoing negotiations such as the economic partnership agreements with the African, Caribbean and Pacific or other countries. In addition to this, in order to achieve our objectives, the EU should be prepared to assist

partner countries to put in place regional rules on these issues. It should however not be considered as a scoreboard aimed at setting up a basis for conditionality or selectivity, but as a tool for practical improvements in standards.

Second, positive actions could help cooperative partners to overcome difficulties of regulatory, technical or economic nature when introducing more transparency, in the form of reinforced technical assistance, where the EU as a whole has a considerable experience, or through some form of economic support for a limited period of time. Several instruments are available, e.g. the Cotonou agreement. The annual and mid-term reviews of Country Strategy Papers could also provide for appropriate actions. The Commission will monitor the efficiency and the progress made by offshore financial centres towards more transparency.

Financial market supervisors cooperate internationally Securities supervisors within the International Organization of Securities Commissions (IOSCO). Banking supervisors within the Basel Committee; Insurance supervisors cooperate within the International Association for Insurance Supervisors (IAIS). Pension regulators also have an international network. The Basel Committee, IOSCO and IAIS have established a Joint Forum to examine supervisory issues of common interest. The Joint Forum is currently analysing Credit Risk Transfer and it has recently published a report on enhanced disclosure.

Within IOSCO the following aspects are subject to scrutiny: corporate governance and the role of independent directors; auditor oversight and the effectiveness of audit standards; regulatory oversight; use of complex corporate structures (e.g. special purpose vehicles and complex shareholding structures); role of market intermediaries and market “gatekeepers,” such as investment banks and broker-dealers; role of private-sector information analysts (e.g. securities analysts and credit rating agencies); and offshore financial centres. In IAIS a discussion is how the US accreditation system can inspire an international accreditation system for supervisors supervising reinsurance companies.

As in the field of accounting, the Commission considers it important that *global standards are used in auditing*. The Commission has proposed in the 8th Company Law Directive that all statutory audits prescribed by Community law should be carried out in accordance with International Standards on Auditing (ISAs). Adoption by the Community of ISAs will be subject to strict conditions, such as the respect of proper due process. A final decision on whether and to what extent to endorse ISAs will depend largely on satisfactory governance arrangements relating to the operation of the International Auditing and Assurance Standards Board. This will help to secure the recognition of EU audited financial statements also in third country jurisdictions. It is also a logical consequence of the introduction of International Accounting Standards in the EU. The objective is that ISAs are applied worldwide.

4th line of defence - International level

The *UN Convention against Corruption* will be signed by the Commission on behalf of the EC, upon receipt of the necessary authorisation by the Council. The majority of Member States and acceding countries signed the UN Convention in December 2003.

Council of Europe:

<i>Council of Europe Conventions on corruption</i>	<i>Signature</i>		<i>Ratification</i>		<i>Entry into force</i>	
	<i>EU 15</i>	<i>New Members</i>	<i>EU 15</i>	<i>New Members</i>	<i>EU 15</i>	<i>New Members</i>
<i>Criminal Law Convention</i>	All MS except ES	All	B, DK, FI, IE, NL, PT, UK	All	DK, FI, IE, NL, PT, UK B	All
<i>Civil Law Convention</i>	All MS except ES, NL, PT	All	FI, EL only	All except LV and CY	FI, EL	All except LV and CY

The Council of Europe has established a monitoring mechanism (GRECO) in respect of the implementation of these Conventions. All Member States (except Italy and Austria) are members of GRECO.

A new Protocol to the Council of Europe Convention on Money Laundering is currently negotiated. Issues considered include preventive duties of control for money laundering purposes, terrorist financing and international cooperation in criminal matters that touch both on first and third pillar competencies.

Moreover, it is important to mention the anti-fraud agreement with Switzerland, which following a subsequent Council Decision will have to be adopted by the Community and the Member States.

Annex 2: Overview of initiatives to reinforce the four lines of defence

1ST LINE OF DEFENCE – INTERNAL CONTROL IN THE COMPANY			
	Short term – Actions completed before end 2004	Medium Term – December 2005	Long term
EU-action	<p>Revision of accounting directives (transparency in/of groups structure and activities, including any use of special purpose vehicles; clarify responsibility of directors for the financial statements and key non-financial information; and listed companies to publish annual corporate governance statement) (Lead: MARKET)*</p> <p>Recommendation on the role of (independent) non-executive or supervisory directors (Lead: MARKET)*</p> <p>Recommendation on directors remuneration (Lead: MARKET)*</p> <p>Set up Corporate Governance Forum (Lead: MARKET)*</p> <p>Follow the work of the IASB and endorse international accounting standards as appropriate (Lead: MARKET)*</p> <p>Initiate study on beneficial ownership (Lead: MARKET)</p>	<p>Final adoption of accounting directives by Council and EP – December 2005 (Lead: MARKET)*</p> <p>Final adoption of implementing measures for the transparency directive – 2005 (Lead: MARKET)**</p> <p>Proposal on facilitating the exercise of shareholders rights cross border voting – 2005 (Lead: MARKET)*</p> <p>Follow the work of the IASB and endorse international accounting standards as appropriate (Lead: MARKET)*</p> <p>Report on beneficial ownership – including recommendations for actions – December 2005 (Lead: MARKET)</p>	<p>Proposals on key aspects of directors' liability (disqualification of directors and wrongful trading) – 2006 (Lead: MARKET)*</p> <p>Follow the work of the IASB and endorse international accounting standards as appropriate (Lead: MARKET)*</p>
International level		<p>EFRAG and IASB reformed – June 2005(Lead: MARKET)</p>	<p>Worldwide application IAS standards (Lead: MARKET)*</p>

* Initiatives that were announced in the Action Plan on Company Law and Corporate Governance. The initiative regarding disqualification of directors and wrongful trading has been moved forward to 2006

** Initiative that is part of the Financial Services Action Plan

2ND LINE OF DEFENCE – INDEPENDENT THIRD PARTIES

	Short term – Actions completed end 2004	Medium Term – December 2005	Long term
EU-level	<p>Directive on statutory Auditing (revised 8th company law directive) (Lead: MARKET)*</p> <p>Third Anti Money Laundering Directive (Lead: MARKET)**</p> <p>Regulation to implement FATF Special Recommendation on Terrorist Financing (Lead: MARKET)****</p> <p>Report on Financial Analysts (Lead: MARKET)**</p> <p>Official position on rating agencies (Lead: MARKET)**</p>	<p>Final adoption of directive on statutory auditing by Council and EP– June 2005 (Lead: MARKET)</p> <p>Third Anti Money Laundering - Final adoption by Council and EP – first half of 2005 - (Lead: MARKET)**</p> <p>Poss. follow up on financial analysts – June 2005 (Lead: MARKET)***</p> <p>Poss. follow up on rating agencies – June 2005 (Lead: MARKET)**</p> <p>Implementing measures for Directive for Markets in Financial Instruments – Conflict of Interest - June 2005 (Lead: MARKET)**</p> <p>Adoption of the proposal on customs cooperation – December 2005 (Lead: TAXUD)</p>	<p>Implementing measures for Directive for Markets in Financial Instruments – December 2006 (Lead: MARKET)**</p>
International level	<p>Regulatory cooperation on Audit standards (Lead: MARKET)*</p>	<p>Influence ISAs - providing conditions are met ISAs will be endorsed – June 2005 (Lead: MARKET)*</p>	<p>Worldwide application of ISAs (Lead: MARKET)*</p>

* Initiatives that were announced in the Action Plan on Company Law and Corporate Governance.

** Initiative that is part of the Financial Services Action Plan

*** Follows from the meeting in the ECOFIN-Council in Oviedo in April 2002. MEP Kataforis has also in a report by the European Parliament raised the issue of Credit Rating Agencies

**** Originally part of the planned new legal framework for payments but separated out.

3RD LINE OF DEFENCE – SUPERVISION AND OVERSIGHT

	Short term – Actions completed before end 2004	Medium Term – December 2005	Long term
EU-level	<p>Initiate study on consequences for retail investors and transparency in the bond market. (Lead: MARKT)</p> <p>Schedule Fiscalis seminars promoting best practices to deal with complex corporate structures(Lead: TAXUD)</p>	<p>Report on implications for retail investors – recommendations for action – December 2005 (Lead: MARKT)</p> <p>Examine with MS relevant information to be passed on to tax authorities (Lead: TAXUD)</p> <p>Working party to develop concrete proposals targeted at tax fraud and tax avoidance cases involving complex non-transparent structures (Lead: TAXUD)</p> <p>Consider developing common definitions of tax fraud and avoidance (Lead: TAXUD)</p> <p>Propose revision of the Mutual Assistance directive – December 2005 (Lead: TAXUD)</p> <p>Propose/consider improvements on access to bank information for tax purposes – December 2005 (Lead: TAXUD)</p>	<p>Explore extension and improvement of automatic exchange of information by use of new technology – 2006 (Lead: TAXUD)</p> <p>Examine with Member States the possibility of a company identification number for direct tax purposes (Lead: TAXUD)</p>
International level	<p>IOSCO task force on Parmalat (Lead: MARKT)</p> <p>Joint Forum Report on Enhanced Disclosure (Lead: MARKT)</p> <p>Further good governance on supervisory issues relating to tax, financial services etc. Ensure that EU partners support transparency and exchange of information principles in the financial and tax fields. Positive actions towards our most cooperative partners. (Lead: TAXUD)</p> <p>Recommend Member States to conclude exchange of information agreements with offshore financial centres. (Lead: TAXUD)</p>	<p>Joint Forum Report on Credit Risk Transfer – December 2005 (Lead: MARKT)</p> <p>Coordination between MS and the Commission on line to pursue in the OECD group on accounts (Lead: TAXUD)</p>	

- * Initiatives that were announced in the Action Plan on Company Law and Corporate Governance.
- ** Initiative that is part of the Financial Services Action Plan
- *** Follows from the meeting in the ECOFIN-Council in Oviedo in April 2002.
- **** Originally part of the planned new legal framework for payments but separated out.

4TH LINE OF DEFENCE – LAW ENFORCEMENT

	Short term – Actions completed before end 2004	Medium Term – December 2005	Long term
EU-level	<p>Framework Decision on confiscation of crime-related proceeds, instrumentalities and property (lead JAI)</p> <p>Framework Decision on the execution in the EU of confiscation orders (lead JAI)</p> <p>Communication on EU Disqualifications – could address an information exchange mechanism to ensure that disqualified professional persons including company directors, cannot re-enter that profession in another MS. (lead JAI)</p> <p>Commission Proposal on mutual administrative assistance on the protection of the Community's financial interests against fraud and any other illegal activities which has been adopted by the Commission on 20 July ((COM2004)509). (Lead: OLAF)</p>	<p>Improved cooperation among FIUs via FIU-NET – December 2005 (lead JAI)</p> <p>MoU – FIU and supervisors – December 2005 (Lead: JAI)</p> <p>Improved cooperation FIU's and other law enforcement authorities – December 2005 (Lead: JAI)</p> <p>Program on investigative techniques – December 2005 (Lead: JAI)</p> <p>Instrument on obstruction of justice to include such things as wilful destruction of documents to destroy financial paper trail. December 2005 (Lead: JAI)</p> <p>Develop enhanced co-operation between private and public sector stakeholders with a common interest to combat/reduce organised crime (EU Action Plan on Public Private Partnerships). (lead JAI)</p> <p>Traceability of on-line financial flows – Launch of Research Project re money laundering and other financial crime vulnerabilities of the Internet as payment infrastructure. (lead JAI)</p> <p>Promote establishment of national bodies specialised in identification, seizing, freezing and confiscation of criminal assets. Promote co-operation among such bodies including establishment of network of “asset recovery bodies”. (lead JAI)</p> <p>Ratification of the 2nd protocol of the PFI Convention (Lead: OLAF)</p> <p>Follow up to anti-fraud agreement with Switzerland by Council Decision on signature and conclusion of this agreement. Subsequent implementation the Community and Member States. (Lead: OLAF)</p>	<p>Instrument on asset sharing and restitution of confiscated proceeds (lead JAI)</p> <p>Corporate liability – develop EU policy on administrative, civil and criminal corporate liability. (lead JAI)</p>
International level			