European Commission launches broad strategy to prevent financial and corporate malpractice

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The European Commission has adopted a strategy for co-ordinated action in the financial services, company law, accounting, tax, supervision and enforcement areas, to reduce the risk of financial malpractice. The Commission’s Communication recommends timely and effective implementation of the Financial Services Action Plan (see IP/04/696) and the Action Plan for Company Law and Corporate Governance (see IP/03/716) which provide an effective EU framework for dealing with most of the financial issues raised by the recent scandals, as well as strict control of the application of legislation. The Commission suggests new policy initiatives in tax and law enforcement. The key elements are: enhanced transparency, improved traceability and better co-ordinated enforcement.

"The Parmalat affair showed how some companies use complex and opaque structures to reduce the transparency of their activities to investors" said Frits Bolkestein, Internal Market and Taxation Commissioner. "The risk of such financial scandals must be reduced. Policy needs tightening up in certain areas. Scandals damage financial markets. Confidence declines. Investors are put off. The cost of capital could rise. These issues must be tackled with rigour to flush the crooks out and deal with them early, before they do damage."

The Communication proposes a broad strategy, covering financial services, justice and home affairs and tax policy. The objective is to reinforce the four lines of defence against such practices: internal control in the company, mainly through board members; independent audit; supervision and oversight; and law enforcement.

The Financial Services Action Plan and the Action Plan for Company Law and Corporate Governance already provide an effective EU framework to deal with the financial services issues raised by the recent scandals. But there is a need for timely implementation of these Plans and for strict oversight and effective control of the application of legislation. More transparency is needed about special purpose vehicles in balance sheets and reflection should begin now on whether the bond market is sufficiently transparent.

In the tax field, the Commission suggests more transparency and information exchange in the company tax area so that tax systems are better able to deal with complex corporate structures. Issues that will be examined include possible improvements to the Mutual Assistance Directive (77/799/EEC), developing common definitions of tax fraud and avoidance, exchanges of experience and best practice between tax administrations, the use of new technology to improve information exchange, and, in the longer term, examining with Member States the use of a common company identification number for company tax purposes.

The Commission also wishes to ensure coherent EU policies concerning offshore financial centres, to encourage these jurisdictions also to move towards transparency and effective exchange of information.

With regard to law enforcement activity, the Commission wishes to develop an EU instrument to tackle obstruction of justice, a Community policy on corporate liability involving effective, proportionate and dissuasive fines for failure to comply with existing legislation and an EU instrument on asset sharing and restitution of confiscated proceeds.