### **Annual Report of**

THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

TO THE

European Commission

EUROPEAN PARLIAMENT

Ecofin Council





## Foreword by the Chairman

On behalf of my colleagues in the Committee of European Securities Regulators (CESR) and with the support of the Vice-Chairman, Kaarlo Jännäri, I am pleased to present the 2003 Annual Report of CESR.

Following turbulence in Europe's financial markets, restoring confidence in the financial markets has been a key task for CESR members during the course of 2003 and is likely to continue to be a high priority in 2004. In trying to do so, securities regulators will be assisted by the fact that the necessary modernisation of the EU legislative framework has made considerable progress thanks to the Greek and Italian Presidencies, and a high level of commitment from the European Parliament.

In 2003, the focus was on enhancing the quality of financial information and reinforcing the fight against fraud. The results of this will be seen in an updated and enriched set of EU Laws in areas such as: Prospectus, Transparency obligations for issuers, use of International Financial Reporting Standards, all of which will form a robust and credible regime that should allow investors to obtain the necessary and accurate financial information they need when investing in EU financial markets. Looking ahead, CESR eagerly anticipates the modernisation of the 8th Company Law Directive ensuring independence of Auditors. Furthermore, the integrity of markets will be enhanced by the Market Abuse Directive and the adoption of its subsequent implementing measures. These measures provide, in particular, an accurate set of provisions for investors to ensure that they are not misled by false or disingenuous information, and are made aware of any potentially significant conflicts of interest.

At an institutional level, the adoption of such Level 2 measures is a testament that the "co-operative game" between the EU institutions and CESR, as elaborated under the auspices of Baron Lamfalussy, works efficiently. This also demonstrates that the consultation process, which allows a high degree of input from market participants to EU regulatory work, is instrumental in producing rules that both protects investors effectively and is proportionate. Indeed, the Inter-Institutional Monitoring Group (IIMG) highlighted twice the importance of proper consultation and has encouraged CESR to progress further in this direction.

Having demonstrated in 2003 that Levels 1 and 2 of the Lamfalussy process to develop European legislation is functioning, attention is now shifting on to how these new legislative texts will be applied. The consistent and harmonised day to day implementation of this new regulatory framework, known as Level 3, is the key challenge for CESR. With the Review Panel assessing implementation, and our two operational groups in the area of Enforcement (CESR-Pol) and Financial Information (CESR-Fin), we are progressively putting in place the necessary tools to ensure convergent supervision of the Single Market. Our objective is to intensify the co-ordination and the exchange of information between regulators, and also to develop more efficient and effective forms of co-operation. For that purpose, we will scrutinise all co-operation obligations included in the new directives and define, according to what is expected from us, the best way to achieve this. For example, this may involve as suggested by the IIMG, implementing further practical arrangements to increase the fluidity of co-operation between CESR members and to give more authority to commonly agreed approaches to supervision.

In 2004, the work of CESR will focus on the regulation of redesigned market structures and firms operating on those markets. The adoption of the Financial Instruments Markets Directive (ISD2) will create the need for numerous implementing measures to be prepared and in turn, this will mean that CESR's agenda will be heavily dominated by the need to prepare this technical advice as it is requested by the European Commission. In addition, we hope that the joint work with the ESCB on Clearing and Settlement will reach a conclusion and that this set of Standards will form part, along with other initiatives, of more secure Clearing and Settlement Systems in Europe. We thank, in particular, the Members of the Market Participants Consultative Panel for their important contributions, at an early stage, on both these key structural issues.

At the behest of the Ecofin Council and the EU Commission, and following a positive reaction to CESR's consultation, CESR will start work in the area of Investment Management, including UCITS, where calls for consistent implementation are often heard.

During the course of the year, CESR had the opportunity to meet the US Authorities and to better explain the role of CESR and its members in the regulation of EU Financial Markets. Such dialogue might well lead to close co-operative links with the US SEC in 2004, with the objective of improving the oversight of EU and US capital markets through increased information sharing; this should enable regulators to anticipate more effectively regulatory problems.

CESR welcomes the establishment of the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) as independent committees of regulators. We will be putting rapidly in place a co-operation process with these two new Level 3 Committees' so as to ensure a joined-up approach to regulatory and supervisory matters were these are best handled at a cross-sector level.

Finally, I would like to thank the current and future members of CESR for their renewed confidence and support, without which a second mandate as Chair of CESR would not be possible. I take this opportunity to thank my fellow colleagues Claes Norgren, Luigi Spaventa, Howard Davies and Jean-François Lepetit for their outstanding contributions to the establishment and the work of CESR, and at the same time welcome Ingrid Bonde, Lamberto Cardia, Callum McCarthy and Michel Prada to our "team". We also look forward to welcoming as full members on 1st May 2004, the securities regulators of the accession countries, who have participated as Observers since January 2003.

With a strengthened and solid secretariat, and an increasing commitment by the members to provide CESR with the necessary human and financial resources, we look forward to taking up the challenges of 2004 and reporting on our results.

Arthur Docters Van LEEUWEN

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## Snap shot introducing CESR

CESR is an independent Committee of European Securities Regulators. The role of the Committee and its operational arrangements are set out in the CESR Charter (available on CESR's website).

The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/527/EC). It is one of the two committees envisaged in the Final Report of the Committee of Wise Men on the regulation of European securities markets, chaired by Baron Alexandre Lamfalussy. The report itself was endorsed by Heads of State in the European Council (Stockholm Resolution of 23 March 2001) and the European Parliament (European Parliament Resolution of 5 February 2002). The role of CESR is to:

- Improve co-ordination amongst securities regulators: developing effective operational network mechanisms to enhance day to day consistent supervision and enforcement of the Single Market for financial services; having agreed a Multilateral Memorandum of Understanding (MoU), CESR has made a significant contribution to greater surveillance and enforcement of securities activities;
- Act as an advisory group to assist the EU Commission: in particular in its preparation of draft implementing measures of EU framework directives in the field of securities;
- Work to ensure more consistent and timely day-to-day implementation of community legislation in the Member States: this work is carried out in particular by the Review Panel under the Chairmanship of CESR's Vice Chairman.

The CESR Chair and Vice-Chair are elected from among the Members for a period of two years. The Committee meets at least four times a year, with expert and operational working groups of national experts meeting on a regular basis and working at a distance as necessary. CESR works with the support of a secretariat conducted by a Secretary General.

A representative of the European Commission is entitled to participate actively in all debates (except in confidential discussions related to individuals and/or firms).

CESR forms part of the Lamfalussy approach that can be summarised very briefly as follows: Level 1 measures set out the high level objectives that the securities legislation must achieve. Level 2 measures set out some of the technical requirements necessary to achieve these objectives. Level 3 measures are intended to ensure common and uniform implementation by the use (amongst others) of common interpretative guidance and standards agreed amongst regulators in CESR. Level 4 measures relate to the enforcement of the legislation. CESR is therefore particularly active in carrying out functions described under Level 2 and 3 of the Lamfalussy process. A detailed explanation of the Lamfalussy process can be found in the Annex (Chapter 10).

CESR has close relationships with European Institutions and has expanded during 2003, the range of it's working relationships with several EU Committees.

CESR submits an Annual Report to the European Commission, which is also sent to the European Parliament and the Council. The Chair of CESR reports regularly to the European Parliament and maintains strong links with the European Securities Committee.

CESR is now invited to contribute to the bi-annual analysis on macro-economic trends of European financial markets conducted by the Economic and Financial Committee (an advisory body of the European Council) (see Chapter 4).

CESR was also called to contribute to the work of the Inter-Institutional Monitoring Group (IIMG) to assess the evolution of the Lamfalussy procedure.

CESR has observer status in the following European Committees: the Financial Services Committee (FSC), the European Securities Committee (ESC), the UCITS Contact Committee, the Accounting

the Regulatory Committee (ARC) and the European Financial Reporting Advisory Group (EFRAG). CESR has requested that it be given the same

## CESR in context: CESR's Inter institutional relationships.

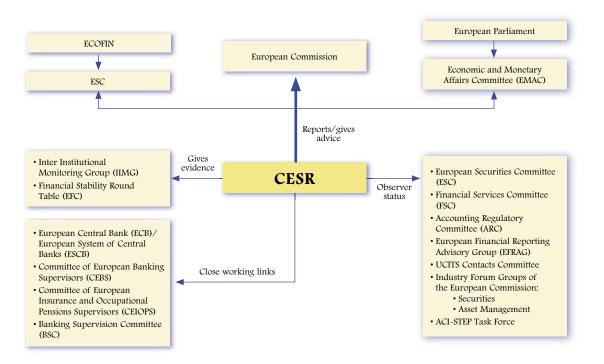
status in the future committee which will be formed following the reform of the 8<sup>th</sup>

Company Law Directive in the field of auditing.

In addition to these committees, CESR attends working groups led by market participants in various fields of financial market's regulation as an observer; these include the Forum Groups established by the European Commission on Financial Analysts; the Groups on Post-FSAP (securities and asset management); and, the ACI-STEP Task Force on Short-Term European Papers.

CESR will also co-operate with the other Level 3 Committees recently established by the European Commission. The first concrete example of this co-operation will be realised in the field of credit risk transfer on the basis of a mandate given by the Economic and Financial Committee to finalise a report in 2004.

CESR also has close contacts with the European Central Bank (ECB) and the European System of Central Banks (ESCB), particularly in the field of securities clearing and settlement systems, where a joint group was established to adopt standards at EU level.



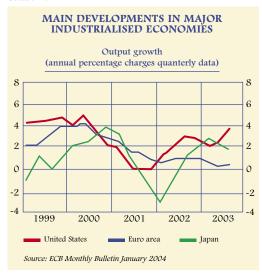
## Overall market trends

This chapter gives a very brief overview of major European economic trends in 2003, which can be interpreted as having had a significant impact on the performance of securities markets. The chapter also includes a summary of CESR's contribution to the Economic and Financial Committee and its work on hedge funds and market volatility.

From a global perspective, economic growth was slow in the early part of the year, but strengthened in the course of 2003.

The Euro area however, was the weakest performer among the major economic blocs during 2003 (see chart 1: output growth).

Chart 1:



The economic performance in the Euro area underlines the need for structural reforms, such as the implementation of the Internal Market Strategy, as recently pointed out by the European Commission in a report on the subject. The European Commission has forecast growth in the Euro area for 2004 of 1.8%. This recovery in the Euro area is expected to gain momentum as exports benefit from stronger US growth although recent exchange rate developments are likely to have some dampening effects on Euro area exports (see chart 2 below with patterns in exchange rate USD/€). The broad-based US-dollar decline occurred amid ongoing market concerns over the financing of the US current account deficit and continued despite further evidence of a strengthening of the US economic outlook.

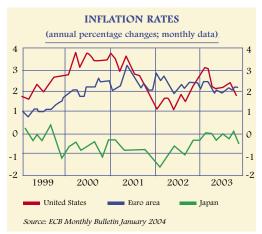
Chart 2:



#### Patterns in exchange rate USD/€ Major international stock indices

Domestic inflationary pressures remained subdued in 2003 and the rate of inflation is expected to fluctuate around 2% in the eurozone during 2004, according to the ECB (see chart 3: inflation rates). The appreciation of the Euro should continue to dampen the cost pressures at various stages of the production chain through its effects on import prices. In summary, economic analysis suggests that in the medium term, the rate of inflation will not rise.

Chart 3:



In capital markets, 2003 was a year in which equity markets rebounded sharply after March (see chart 4 on page 8 on major international stock indices), fuelled by an acceleration in earnings growth and growing investor confidence in the autumn. Bond markets however, went down consi-

derably from June onward (after a rally in the first half of 2003) with a temporary negative effect on issuance plans in the international debt securities market in mid-2003.

Chart 4



## Update on CESRs involvement in analysis of economic issues / market developments

The Economic and Financial Committee (EFC), an advisory body tasked with preparing the work of the ECOFIN Council, and in particular charged with keeping economic and financial conditions under review, invited CESR to submit its views on market conditions and developments from the perspective of securities regulators at the Financial Stability Round Table.

CESR noted in its submission to the EFC, the following development in financial markets:

- a change in investor perceptions about the riskiness of equities markets over the last few years, a shift in behaviour of retail investors from equities markets to other markets (including bonds, bond funds, real estate). As the nature of this development is unclear, it is still too early to determine the long term impact of this change;
- depending on the size of the firms, a different outlook on risks in the securities and fund industry. In general, bigger, internationally active firms may respond differently to changes in the markets than the smaller, domestically oriented firms;

 although market segments' activities and details of institutional pre-conditions differ from country to country, CESR observed that regional similarities, especially in accession countries, play an important role as well. Financial activities in these countries are dominated by banking activities and transactions in government bonds.

The overall conclusion of CESR is that the markets have shown remarkable resilience to the shocks which took place in the (first half of) 2003.

## Hedge funds and market volatiliy: at present no need for legislative action

On the basis of a mandate received by CESR from the informal Ecofin Council held in Oviedo in April 2002, CESR reported in March 2003 on "the financial markets issues involved in relation to complex derivatives and hedge funds". In order to take stock of the state of affairs regarding these issues in the various jurisdictions, CESR circulated two questionnaires among its members. Considering all factors, there was a wide consensus among CESR members that, at present no legislative action at EU level was necessary or appropriate in response to market volatility.

A one-day CESR-seminar, held in April 2003 and chaired by Jean-François Lepetit, Chairman of the COB, was dedicated to the subject of market volatility. Within this context, special attention was given to the issues of "short positions" and "passive management" and their impact on market volatility. The issue of "passive management" refers to the growing interest of investors in index-linked investment strategies and the impact these strategies may have on market developments. CESR concluded that this development should be followed closely and measures considered could include increased transparency for short positions.

## CESR consultation practices

CESR and its Expert Groups are committed to working in an open and transparent manner. In its 'Public Statement of Consultation Practices' (issued in December 2001, Ref. CESR/01-007c), CESR established the way in which it will consult and stressed the need to consult widely, and at an early stage, with market participants, consumers and end-users. The Public Statement on Consultation practices notes that:

**The aim of consultation** is to build consensus, where possible, between all interested and affected parties on what legislation or regulation is appropriate and to improve the decision making process of CESR by:

- benefiting from the expertise of market participants and operators, consumers and end-users, notably in assessing and analysing regulatory issues and possible solutions;
- assisting determination of whether a problem exists which requires a regulatory action, and if so, what form of regulatory actions is appropriate;
- providing opportunities for alternative approaches to a given issue to be considered;
- obtaining information and views on the potential impact of proposals;
- obtaining feedback on CESR's work;
- promoting understanding of the work of CESR and its role.

### To deliver this aim, CESR emphasises:

- the need for all involved to "play a cooperative game". This places mutual obligations on CESR and those consulted to work in a manner that promotes the success of the process. This has particular significance at Level 2, where the scope and timetable of CESR's work is determined by mandates from the European Commission;
- the need for a flexible and proportionate approach to consultation that can be adapted according to the significance of an issue.

## Notwithstanding the need for flexibility, CESR is guided by the following principles:

CESR members aim through the consultations to:

- target the full range of interested parties, including market participants, consumers and end-users;
- make consultation proposals widely known and available through all appropriate means, in particular, the Internet;
- consult at national, European and international levels.

CESR practice when consulting is as follows, CESR:

- publishes an anticipated annual work programme so that all interested parties know when to expect output from CESR;
- publishes any mandate received from the European Commission as soon as practical after receipt;
- organises upon request informal discussions at an early stage with those most likely to be directly affected;
- consults at a sufficiently early stage to enable CESR to take the responses into account;
- allows those consulted adequate time to respond, given the complexity of the issue and the time available. For significant issues, CESR will aim to allow a three month consultation period.

#### CESR is committed to:

- provide an opportunity for interested parties to make submissions on receipt and publication by CESR of a mandate from the European Commission;
- when necessary, CESR will release its thinking at various stages, this may include the use of concept releases;
- produce reasoned consultative proposals, based on thorough analysis of the issues and objectives of the proposal and, where possible, on statistical information, expressed in concise

### CESR consultation practices

and clear language, and, if possible, include in proposals preliminary information on their impact;

- establish working consultative groups of experts where appropriate;
- consult using a variety of media, including public hearings/roundtables, written and Internet consultations. In the interests of efficiency, use of the Internet will be encouraged and facilitated;
- use appropriate processes when necessary to target consultations more effectively and to engage specific parties affected (this can include for example, face-to-face meetings).

On how it responds to consultation, CESR will:

- give due consideration to responses received;
- make public all responses to formal consultations, unless the respondent requests otherwise, or make public a summary of the responses received;
- publish a reasoned explanation addressing all major points raised (Feedback Statements);
- consult for a second time if the response to the first consultation reveals significant problems, or where revised proposals are radically different from the original proposals on which consultation was based;
- publish all formal proposals and advice, including advice to the European Commission given under Level 2.

If it is not possible for CESR to follow the principles described above, CESR will publish its reasons. When necessary, CESR will review the statement of consultation practices.

Broadly speaking, after two years of experience, the consultation policy of CESR has proven very efficient. The possibility for market participants (practitioners, consumers and end-users) to anticipate and input the EU regulatory work, has significantly increased. For each specific area of work, this annual report provides illustrative examples and figures of the consultative process. It is CESR's objective to improve its consultation policy on a continued basis and in particular to follow the recommendations of the Inter Institutional Monitoring Group in this regard.

## The Market Participants Consultative Panel

The Market Participants Consultative Panel was established by CESR in June 2002, following a suggestion of the European Parliament and the Committee of Wise Men.

The role of the Panel is to:

- · assist CESR in the definition of priorities and work programme;
- · provide comments on the way in which CESR is exercising its role and, in particular, implementing its Public Statement of Consultation Practices;
- · alert CESR on regulatory inconsistencies in the Single Market, identify and suggest areas where CESR should undertake further work to improve supervisory co-ordination (e.g. launch a Level 3 initiative such as providing guidance or developing a common supervisory standard);
- inform CESR on major developments in financial markets and to identify new elements for preliminary discussion by CESR.

The Panel consists of 11 members who are appointed in a personal capacity.

The members of the CESR Market Participants Consultative Panel are:

- Pr Luis Miguel Beleza, Banco Comercial Português;
- Dott Salvatore Bragantini, Centrobanca S.p.A.;
- Dr Rolf E Breuer, Deutsche Bank AG;
- Mr Donald Brydon, UK's Financial Services Practitioner Panel and AXA Investment Managers SA;
- Mr Ignace Combes, Management Committee of the Board of Directors, Euroclear Bank;
- Mr Peter Paul F. de Vries, Association of Shareholders, Euroshareholders;
- Mr Lars~Erik Forsgardh, World Federation of Investors and Swedish Shareholders Association;
- Mr Dominique Hoenn, BNP Paribas, Euronext;
- Ms Sonja Lohse, Nordea AB;
- Mr Mariano Rabadan, the Spanish Association of Investment and Pension Funds (INVERCO):
- Pr Dr Emmanuel D. Xanthakis, Marfin Bank and Marfin Portolio Investment Company.

The Chairman of CESR, the Chairs of the Expert Groups and CESR's Secretary General meet with the Panel regularly (the Panel met three times in 2003) to maintain a dialogue with market participants and update the Panel on CESR's work. The conclusions of the meetings are made public (and are published on CESR's website).

Following the initial meetings, mainly devoted to establishing internal procedures and working methodologies, meetings of the Panel are organised along the following lines: one technical session which is devoted to discussing topical issues in the regulation of financial securities markets, on which CESR will form its views either in delivering technical advice to the Commission or in adopting regulatory standards at Level 3 of the Lamfalussy procedure; followed by another session to discuss aspects related to the Lamfalussy procedure, the consultation policy of CESR, as well as CESR's priorities (as identified in a work-plan) and working methods.

In the course of 2003, the members on the panel discussed and gave presentations on the following technical issues:

- quarterly reporting of issuers whose financial instruments are admitted to trading in regulated markets;
- pre-trade transparency under the revision of the Investment Services Directive;
- · clearing and settlement in Europe;
- · best-execution and execution-only business.

#### Quarterly reporting

Following a presentation by Salvatore Bragantini, most members of the Panel favoured the introduction of mandatory quarterly reporting in Europe. The discussion focussed mainly on the following points: the advantages and disadvantages of such a requirement, content of reports, audit requirements and the timing of adoption.

Concerning the content of quarterly reporting, the panel considered it necessary to include, net financial positions (liquidity position for banks should be treated according to specific needs) and earnings per share, in addition to the requirements set forth in the Commission proposal.

### The Market Participants Consultative Panel

In relation to the application of the duty to report, the Panel were of the view that no distinction should be made on the basis of the size of the issuer and that no exemption should be granted to Small and Medium sized Enterprises (SMEs). Most members of the Panel favoured the require~ ment for a form of review by the auditors of quarterly reports, in order to keep European legislation in line with the US. Some members felt that an intervention of the auditors would be appropriate, on a voluntary basis at this juncture, to increase the confidence of the markets; one member suggested that the requirements established in IAS 34 should be applied to quarterly reporting. As regards the timing for adoption of quarterly reports, the panel were of the view that reports should be approved within 45 days after the expiry of the relevant period.

### Internalisation and pre-trade transparency

Following a presentation by Rolf Breuer, the members of the Panel shared their views on the overall objectives of the revision of the ISD, in particular enhancing the level of competition among trading venues, as well as the benefits and advantages of internalisation as alternative means of executing client orders.

In respect to establishing the appropriate level of regulation for the internalisation of client orders (to be understood as orders executed in-house, off-exchange and against the investment firm's proprietary book), the Panel considered it essential to introduce post-trade transparency requirements, as well as enhancing the role of freedom to contract both from the investment firm's side (capacity to refuse entering into a transaction because of risk assessment of the counterparty) and the client's side (choice of execution venue). Several members of the Panel noted that pre-trade transparency in cases of internalisation, as requested by Article 25 of the Commission proposal for the revision of the ISD, is inappropriate, as it does not take into consideration the underlying business model, where investment firms put their own capital at risk. In contrast, some members of the Panel considered that pre-trade transparency is essential to enhance the level of competition among different market-places; one member stressed the need for a price discovery mechanism at EU level, the absence of which makes it difficult for investment firms to establish that best-execution has been attained for the client.

Conditions to allow for 'internalisation' were also discussed and, in particular, the requirement that transactions should be executed at a price comprised in the spread of available conditions in the reference or benchmark market. The 'best-execution' rule was also considered by the Panel to be essential, even if the text of the Commission proposal needed some adjustments; in particular, it was felt that due consideration should be given to the different needs of professional and retail clients, as well as the definition of this rule in terms of process rather than mere reference to price.

#### Clearing and Settlement

Following a presentation by Dominique Hoenn, and opening remarks from Ignace Combes, the discussion concentrated on CESR/ESBC Draft Standard N°9 on collateralisation, and particularly on the scope of application of this standard to institutions of a significant size. It was noted that the definition of systemically important banks should be refined to reach a more balanced approach. Members of the Panel noted that settlement and credit risks, in principle, are addressed by banking prudential regulation. It could be argued that there was a danger of duplicating regulation which was intended to target the same risk and that this therefore seemed inappropriate. In particular, Members of the Panel indicated that further analysis as regards to the impact of the Standards should be conducted by the Expert Group. Members of the Panel expressed support for the exercise and for the functional approach which has been adopted by the Expert Group.



### 'Best~execution' and 'execution~only'

In relation to the question of 'best-execution' and 'execution-only', following presentations by Sonja Lohse and Donald Brydon, members of the Panel suggested that common principles should be established to ensure uniform application across Europe. Nevertheless, a certain degree of flexibility should also be allowed to enable supervisors to address domestic specificities which are necessary to reflect the different market structures and models that exist.

Level 3 work might complement, in the future, regulation in this area. It was also noted that a proper distinction should be made between professional and retail clients in particular where this affected the elements and factors to be taken into consideration to ensure best-execution. Members of the Panel advocated that full information on execution policy should be given to retail clients, and that they should give their express consent for both on and off-exchange transactions. In addition, some members stressed the importance of making reference to the concept of 'relevant market'. Members of the Panel invited CESR to consider the appropriate level of detail in providing technical advice for the implementing measures under the revised ISD. They proposed the following criteria should underpin CESR's advice: the need for ensuring legal certainty, on the one hand, and the need to avoid unnecessary cost, on the other. In relation to execution-only business, the significance of this low-cost service for a number of clients was noted.

Members of the Panel considered that due attention should be paid to the awareness and consent of clients to the limited extent of this service and the differentiation in terms of risk of products offered in the course of providing this service. In this regard, no suitability test should be conducted for each transaction, but some sort of assessment of adequacy at the beginning of the relationship would seem to be necessary.

Members of the Panel have also contributed to highlight recent market trends and overall conditions of European financial markets. Following a request to CESR to contribute to the analysis conducted on the conditions of the European financial markets from the Economic and Financial Committee, the members of the Panel provided advice, particularly in the area of credit risk transfers. Members of the Panel considered that financial markets had not been particularly volatile given recent difficulties which might imply that, overall, markets had functioned properly. Nonetheless, they recommended continuous monitoring to ensure authorities avoided over-reliance on this fact. The Panel indicated regulators should require more transparency in certain market activities, particularly "over-the-counter" transactions. It was felt that even market participants would benefit from more information available in the market and would therefore accept these requirements as it would be in their own interest. Aspects affecting the role of insurance companies and particularly re-insurance companies should be addressed by insurance regulators. CESR members should adequately monitor the possibility for retail investors to invest in complex products, including hedge funds. The role of investor education and improvements in standards for corporate governance were stressed as tools, among others, to restore confidence of investors in financial markets. In addition they indicated that changes in interest rates and prices of real estate should also be monitored for their potential impacts on mortgages.

#### Next Steps

The next meetings of the Panel will take place on 11 March 2004 and 10 June 2004. The Panel will discuss the following issues: corporate governance, the relationship between CESR and the US SEC and the overall transatlantic relationship, priorities for the post-FSAP phase, the consultation practices of CESR and financial analysts.

Finaly, members of the Panel discussed different criteria for the renewal of the Panel. A clear preference was indicated in favour of keeping the existing members in place during 2004 and to enlarge its composition to 15 members. However, from 2005 it is envisaged that three blocks of members will be selected on a random basis for partial renewal in the following years.

## Areas of Activity

### Level 2 Expert Groups

#### 7.1 Market Abuse

#### Chairman's Message



Stavros Thomadakis, Chairman, Hellenic Capital Market Commission (CMC)

"CESR's Market Abuse Expert Group, with valuable input from the consultative process, has produced two sets of advice for the Commission, which, when implemented, will deliver a consistent and appropriate regime to counter the abuse of financial markets in Europe. Our advice has sought to balance the burden imposed on industry with the benefits that harmonised regulation in this area will bring to market integrity. The benefits of a coherent framework in Europe to fight market abuse are numerous. The confidence of investors in Europe's markets will rise. Intermediaries will find it easier to pursue cross-border business opportunities, and Europe will enhance its position as a place for global players to do business."

#### **Background**

The Market Abuse Directive was adopted on 3 December 2002<sup>1</sup>. It is the first Directive whereby, in accordance with the Lamfalussy process, the details are established by Level 2 implementing measures based on CESR's advice.

CESR provided technical advice at the end of 2002 on the first mandate in line with the timetable set by the EU Commission. This covered five main areas: the definition of inside information; the definition of market manipulation; the appropriate disclosure of inside information by issuers; standards of care to be observed and disclosures to be made by those producing and disseminating research; and safe harbour provisions concerning share buy-backs and stabilisation.

#### Mandate of the Market Abuse Expert Group:

In addition to the first set of mandates issued by the European Commission, the Commission published on 31 January 2003 an "additional mandate to CESR for technical advice on possible implementing measures concerning the Directive on Insider Dealing and Market Manipulation (Market Abuse) (Ref: MARKT/G2 D(2003)".

This second mandate had five main areas: guidelines for determining accepted market practices, inside information on commodity derivative markets, the maintenance of insider lists by issuers, the disclosure of transactions by senior managers and the obligation by persons professionally arranging transactions to report suspicious transactions.

The Commission set the deadline of 31 August 2003 for CESR to deliver its second piece of advice and this was met.

The implementing measures - in the form of two Directives and one Regulation - were approved on 29<sup>th</sup> October 2003 by the European Securities Committee (ESC). Following this, the European Parliament has indicated a positive opinion on this set of measures and the European Commission adopted them on 22 December 2003<sup>2</sup>. This marks the first concrete result of the Lamfalussy approach to securities regulation in Europe.

During 2003, CESR focused its market abuse work on the second mandate from the EU Commission. The details are set out below.

#### Process

The CESR Expert Group on Market Abuse was responsible for developing both sets of advice to the Commission. The chair of this group was Stavros Thomadakis, Chairman of the Hellenic Capital Market Commission and the rapporteur, Nigel Phipps, of the CESR secretariat. A Consultative Working Group (the "CWG") established under the terms of CESR's Public Statement of Consultation Practices advised the Expert Group. Joint meetings were held with the CWG. Members of the CWG were also asked to submit written comments during the formulation stage of the advice.

- The members of the Consultative Working Group are:
   Mr Ulrich Bosch, Deutsche Bank AG
  - Mr Antonio del Campo de los Santos, Banco Bilbao Vizcaya Argentaria
  - Mr Sjoerd Eisma, De Brauw Blackstone Westbroek
  - Mr Christian Hausmaninger, Hausmaninger Herbst Wietrzyk
  - Mr Michael McKee, British Bankers Association
  - Mr Lars Milberg, The Swedish Shareholders Association
  - Mr Carmine Di Noia, Assonime
  - Mr Frede Aas Rognlien, Association of Norwegian Stockbroking Companies
  - Mr Johan Thiriart, Luxembourg Stock Exchange
  - Mr Patrick Verelst, Interbrew NV

On 7 February 2003, CESR published a 'Call For Evidence' (Ref. CESR/03-037) inviting all interested parties to submit views by 28 February 2003 on the issues which CESR should consider in its advice to the Commission on the additional mandate.

On 15 April 2003, CESR issued a consultation paper (Ref. CESR/03-102b) on the full text of the additional mandate. This included a number of specific questions to be answered by respondents. Responses were invited and the consultation period closed on 15 June 2003. A public hearing was held in Paris on 12 May to facilitate the consultation.

The Expert Group held regular meetings from March to July 2003. Four drafting groups were established to prepare in draft form parts of the advice to be considered by the meetings of the Expert Group.

CESR provided the Commission with its advice (Ref. CESR/03-213b) on the second set of implementing measures at the end of August 2003. The Commission has now published its draft legal texts. This second set of implementing measures, which is in the form of a Directive, is due to be finalised by May 2004. This Directive and the implementing measures should be fully in place and implemented by Member States by October 2004.

# Summary of work done ~ an outline of CESR's Second Set of Advice

### Guidelines for determining accepted market practices (AMP)

CESR's advice deliberately does not seek to create a definitive, universal list of AMPs as this would hinder creativity and innovation, particulary, if only those practices that had been approved and placed on such a list were allowed. Instead, it includes the procedures regulators should adopt

when they consider whether or not a market practice is acceptable and the principles that should guide them in assessing whether a market practice undermines market integrity, such as the need to safeguard the proper interplay of supply and demand within markets and that markets should operate efficiently and fairly.

In all cases, regulators should consult with market participants and with other regulators to increase the harmonisa-

tion and convergence of AMPs. The decisions adopted by regulators, and the factors underpinning them will be published by CESR and the Member State regulators to increase transparency.

"CESR's advice deliberately does not seek to create a definitive, universal list of AMPs as this would hinder creativity and innovation, particulary, if only those practices that had been approved and placed on such a list were allowed. Instead, it includes the procedures regulators should adopt when they consider whether or not a market practice is acceptable and the principles that should guide them in assessing whether a market practice undermines market integrity"

### Inside information on commodity derivative markets

CESR's advice recognises the diversity of commodities markets and stresses the need for adequate disclosure in a timely fashion. The Expert Group was greatly assisted in developing its advice by an ad-hoc group of experts from Europe's commodity markets and by an expert from the US Commodities and Futures Trading Commission (CFTC), with whom they met once and then subsequently received a number of additional written submissions.

### The maintenance of insider lists by issuers

CESR's advice clarifies how firms may meet their obligation under the Directive to maintain and update lists of people who have access to inside information. After substantial consultation and revision, CESR adopted a more flexible approach which proposes that these lists should capture those who have habitual access to inside information and those who have occasional access.

### The disclosure of transactions by senior managers

The disclosure requirements proposed for those individuals with managerial responsibilities and those closely associated to them, are intended to ensure transparency in their transactions in shares (or derivatives) of the listed company in which they hold a management position. CESR chose to advise against introducing a threshold, believing them to be arbitrary and to invite circumvention. There was one dissenting view on this position.

## The obligation by persons professionally arranging transactions to report suspicious transactions

CESR's advice establishes the criteria for determining how and when the competent authority should be notified of a suspicious transaction and standardises the minimum information that should be provided within the notification. After consultation, CESR's advice was modified to ensure a balance between the need to notify suspicious transactions and the danger that an excess of such

reports would render them useless. As a result, a firm will not require hard evidence before it reports suspicious transactions, but it should have 'sufficient indications' that a transaction might be regarded as insider dealing or market manipulation.

#### Next Steps

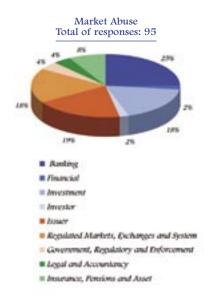
Having completed its mandate in full, this Expert Group has been disbanded. Further work relating to the legal transposition of the Directive will be co-ordinated by ad-hoc sessions under the auspices of the Review Panel. In addition, CESR-Pol will take forward further operational work, such as, the development of the approach to monitor and implement the 'accepted market practices' regime, the co-ordination of cross-border investigations and the enhancement of co-operation.

#### Statistics of meetings in 2003

The Expert group met on a larger number of occasions (as indicated below), however, drafting continued through virtual networks throughout the year.

- 5 expert group meetings took place 4 sub-group meetings took place and a great deal of drafting was done at a distance via the network.
- 1 open hearing took place.

Statistics on the number of responses to consultation undertaken on the second set of implementing measures of the Market Abuse Directive



#### 7.2 Prospectus Expert Group

#### Chairman's Message



Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Markets Commission (CMVM)

"During 2003, CESR has responded to the mandates from the European Commission arising from the Prospectus Directive. This work has focused on establishing the information requirements that issuers should comply with in order to benefit from the EU-wide "Passport for issuers" provided by the new Prospectus Directive. Our entire 'building block' approach has been driven, firstly by the need to cater flexibly for the enormous range of issuers and financial instruments and, the varied type of European investors. And secondly, by the need to ensure that the information issuers disclose provides a useful and relevant basis for investors to make informed decisions. With this forward looking and supple approach, we expect transparent and efficient primary markets to develop rapidly."

#### Background

The Directive establishing the information to be published in a Prospectus when securities are offered to the public or admitted to trading (Prospectus Directive 2003/71/EC) was finally adopted on 15 July 2003<sup>1</sup>. This Directive sets out the high level political objectives of the legal framework for Prospectus (commonly referred to as the Level 1 measures). The Directive will be complemented by provisions, known as "implementing measures"

#### Mandate of the Prospectus Expert Group

The mandates from the European Commission were formalised on 1 October 2003 after the adoption of the Prospectus Directive. Prior to this, CESR undertook its work on the basis of provisional mandates to ensure the overall timeframe for adoption of the Directive was respected. On this basis, the European Commission identified three deadlines for CESR to submit parts of its advice to the European Commission as follows: 31 July 2003, 30 September 2003 and 31 December 2003.

CESR's advice to the European Commission has focused on six different areas covered by the mandates, which can be summarised as follows:

- Minimum Information (disclosure requirements to be included in different models of prospectuses according to Article 7 (1) of the Prospectus Directive)
- Incorporation by Reference Article 11 (3)
- Publication of the prospectus Article 14 (8)
- Format of the prospectus Article 5 (5)
- Annual Information Article 10 (1) and (4)
- Advertising Article 15 (7) of the Prospectus Directive

(or Level 2 measures). As these technical 'implementing measures' will take the form of a Regulation, they will be directly applicable and will not need to be transposed by Member States into their own national law.

Both the Prospectus Directive and the draft Regulation for Prospectus will replace Europe's existing legislation in this area which has been in force for more than twenty years and only sets out disclosure regimes for shares, bonds and depository receipts. In order to take into account the technical developments on financial markets, CESR Prospectus Group has produced advice that lays out different disclosure requirements for different types of securities and issuers.

The Prospectus Directive requires in certain cases the European Commission to adopt implementing measures within 180 days after its entry into force. These time constraints meant that CESR had to start working well in advance of the final adoption of the Directive. For this reason, CESR began to work in March 2002 in response to two provisional mandates received from the Commission on 18 March 2002 and 5 February 2003. The mandates were completed by 31 December 2003 and during this period CESR carried out a significant amount of work which contributed decisively to ensure the Directive is applied uniformly.

#### **Process**

The Expert Group was chaired by Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Commission assisted by the rapporteur, Javier Ruiz from the CESR secretariat. A Consultative Working Group (CWG) of eleven experts, drawn from across the markets and reflecting investors' interests, was established to assist the Expert Group. The CWG contributed with useful technical advice and expertise for the working group throughout the drafting process.

The members of the Consultative Working Group are:

- Ms Ann Fitzgerald, Irish Association of Investment Managers
- Mr Wolfgang Gerhardt, Sal. Oppenheim Jr and Cie
- Mr Daniel Hurstel, Willkie, Farr & Gallagher, International Bar Association's Issues and Trading in Securities Committee
- Mr Pierre Lebeau, Petercam
- Mr Lars Milberg, Shareholder Ombudsman (shareholder association)
- Mr Victor Pisante, EFG Eurobank-Ergasias, S.A.
- Mr Regis Ramseyer, Certified Internal Auditor of the Institute of Internal Auditors
- Ms Kaarina Stahlberg, Nokia
- Mr Torkild Varran, Avanse Forvaltning (investment-fund)
- Mr Stefano Vincenzi, Mediobanca
- Mr Jaap Winter, Unilever

CESR consulted extensively with market participants and the broader public before finalising its advice. This included an invitation to submit comments on the proposals in writing at key stages on each 'package' of advice to be submitted. In addition, three public hearings in CESR offices in Paris were also organised to facilitate this dialogue. All comments received during the consultation process are available on CESR's website.

Based on CESR's advice, the European Commission published on December 2003, a draft proposal for a Regulation which is currently before the European Securities Committee (ESC) for approval and with the European Parliament for comments. This draft regulation is intended for adoption by the Commission and for publication by June 2004 according to the Prospectus Directive.

#### Summary of work done ~ an outline of CESR's Advice

#### The "building block approach"

While developing these different disclosure requirements the group has followed the building block approach. This approach means that the issuers must combine several "blocks" in order to draft their prospectus. The combination will depend on the type of issuer and security concerned. This approach was particularly favoured because of the flexibility it offers, especially looking ahead as new products are developed.

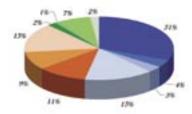
The blocks have been developed following the subdivision provided for by Article 5 (3), of the Prospectus Directive between the securities note (SN), which contains the information concerning the securities offered or to be admitted to trading

#### COMPILATION OF ALL PROSPECTUS CONSULTATIONS AND CALLS FOR EVIDENCE



Results of CESR's public consultation (Ref. CESR/02-185b) on possible implementing measures of the future Prospectus Directive. This advice formed the basis for part of the July package of advice submitted by CESR, and covered minimum information to be included in a Prospectus; Incorporation by reference and the availability of Prospectus.

#### Consultation Ref. CESR/03~185b Total number of responses: 92

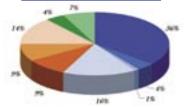


on a regulated market, and the registration document (RD), which contains the information related to the issuer. CESR has set out a table in its advice to clarify the possible combinations to be used when preparing the prospectus for the offer or the admission to trading on a regulated market of the most frequent types of securities.



Results of CESR's second public consultation on the consultation papers (Ref. CESR/03~066b & CESR/03~128) on possible Level 2 implementing measures of the future Prospectus Directive. This formed the basis for part of the July package of advice from CESR. The first consultation paper (Ref. CESR/03~066b) covered International Accounting Standards and Minimum information Requirements for the following schedules: the equity registration document; the proforma for financial information; equity securities; debt registration; debt securities notes; guarantees building block; asset backed securities registration; document and asset backed securities, securities note). The second consultation paper (CESR/03~128) covered the wholesale debt Registration Document building block; depository receipt prospectus schedule; banks registration document building block and the specialist building block.

#### Consultation Ref. CESR/02~286 Total number of responses: 69



Results of CESR's public consultation on the Addendum to the consultation paper on possible implementing measures of the future Prospectus Directive (Ref. CESR/ 02-286). This advice formed the basis for part of the fully package of advice submitted by CESR. The consultation on the addendum covered several disclosure requirements specific to certain issuers (banks) or certain securities (wholesale debt, derivatives or asset backed securities) in relation to the presentation of information in the registration document or in the securities note.

### Disclosure Requirements for offers that refer to the issuer

Three main categories of securities notes have been covered: equity, debt and derivative securities. In relation to the disclosures that refer to the issuer, CESR has developed two main registration documents: for equity and for non-equity securities. The latter will be used by issuers of debt and derivative securities.

The system described above already constitutes a

considerable improvement in comparison with the current regime that only provides a passport and disclosure requirements for shares and debt securities.

In fact, CESR has gone further and has produced more sophisticated disclosure requirements to cater for the particular needs of certain securities and/or issuers and adapted these to meet the needs of different types of investors. The result of this policy approach has led to the development of a menu of different schedules and building blocks. This approach, however, has also been thoughtfully weighted against CESR's objective to keep the system as simple as possible and a careful balance has been struck.

Examples of adapted disclosure requirements for which CESR has produced specific schedules include: disclosure requirements for issuers of asset backed securities; issues by Member States; issues by non-EU States and their regional or local authorities; including issues on behalf of public international bodies; and, for banks issuing non equity securities or for depository receipts issued over shares.

### Disclosure Requirements for wholesale markets

The specific disclosure requirements developed for the wholesale market deserve special attention. The approach adopted in CESR's advice applies to securities which have a denomination per unit of at least Euro 50,000, as defined by the Directive 2003/71.

These harmonised requirements have been based on the current disclosure regime aimed at wholesale investors that have been successfully operated in a number of Member States across the EU.

CESR's approach in relation to a differentiated set of disclosure obligations has been tailored to suit the needs of the wholesale investors and the information they would consider valuable in making their investment decision.

### Disclosure Requirements for Frequent Issuers

A key objective enshrined in the Prospectus Directive was to ensure that frequent issuers were granted sufficient flexibility. CESR's advice sought to find parallels between well functioning systems, such as those applied to issuing programmes of



medium term notes or derivative securities programmes, and to apply these principals in the approach adopted. The solution proposed was the development of one type of base prospectus that might be used alone to issue most types of securities and enables a large majority of issuers to stick to one base prospectus only. However, in order to ease investors understanding of the base prospectus, CESR's advice requires in cases of a multiproduct base prospectus that the specific product related information be given on different instruments and that this is kept clearly segregated.

### Treatment of historical information

The registration document of an issuer draws heavily on their historical financial statements in order to provide a full picture of the issuers' position. For EU companies, this will be based on IAS/IFRS standards as established by the Regulation 1606/2002. For those issuers incorporated outside the EU, this raises the key question of whether they will also have to adopt these standards or whether they will be able to include in their prospectuses, financial statements prepared under their own accounting principles. CESR has tackled this issue in its advice to the European Commission by proposing that a procedure should be in place to harmonise the decisions on whether third countries' GAAPS are suitable for European prospectuses. In the meantime, CESR has proposed some transitional measures that would enable third countries' issuers having securities already admitted to trading to continue to have access to EU markets until 2007 under the current requirements.

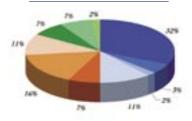
#### Beyond disclosure

As indicated the main focus of CESR's advice on the Prospectus mandates has related to disclosure requirements that issuers will have to comply with if they want to offer securities to the public or have their securities admitted to trading on an EU regulated market. However, CESR has also produced advice for the European Commission on other important elements of the Prospectus Directive, such as incorporation by reference, publication and format of the prospectus, the requirement to publish annual information or the dissemination of advertisements.

#### Next Steps

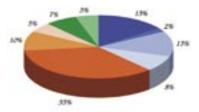
Having completed all the advice on the Level 2 implementing measures of the Prospectus Directive, CESR will assess during 2004, whether further work in this area is needed in order to ensure a harmonised implementation by Competent Authorities of the Directive and the Regulation on Prospectus. One such area might include guidance on how to complete a prospectus and in particular guidance on financial information requirements.

#### Consultation Ref. CESR/03~162 Total number of responses: 44



Results of CESR's public consultation on the consultation paper (Ref. CESR/03-162) on possible Level 2 implementing measures of the future Prospectus Directive. This formed the basis of the September package of advice. The consultation therefore covered minimum disclosure requirements for the following derivative securities and offering programmes; prospectus as a single document including the summary; base prospectus and supplement; disclosure requirements for securities issued by collective investment undertakings of the closed ended type, wholesale debt securities and an additional building block concerning the underlying of the equity securities that are linked to another product (the underlying). It also included re-consultation on some of the elements of the July Package of advice.

#### Consultation Ref. CESR/03-210b Total number of responses: 61



CESR consults on minimum disclosure requirements for Sovereign issuers and financial information on prospectus (Ref. CESR/O3-210b). This consultation formed the basis of CESR's December package of advice and covered in particular: the minimum information to be included in any EU prospectus (new schedules); historical financial information; dissemination of advertisements and the financial information to be disclosed by third country issuers.

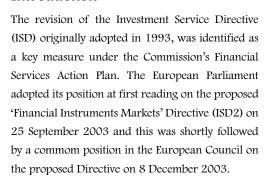
#### Statistics of meetings in 2003

The Expert Group met on a larger number of occasions (as indicated below), however, drafting continued at a distance throughout the year.

- 8 expert groups meetings took place
- 10 drafting/sub groups meetings took place
- 3 open hearings took place.

# 7.3 The Financial Instruments Markets Directive (ISD2)

#### Introduction



As a result, CESR's work in this area, which will consist of providing technical advice to the Commission, did not begin until January 2004. Nevertheless, in anticipation of the provisional mandates, CESR considered during the last quarter of 2003, how it would structure its own expert working groups to deliver the advice requested by the European Commission and established a specific Consultative Working Group (CWG).

### The structure of CESR's expert groups

The three ISD Expert Groups are structured as follows:

• Expert Group on Markets: This Expert Group will be chaired by Jacob Kaptein (Commissioner at the Dutch securities regulator, the Netherlands Authority for Financial Markets) and the rapporteur will be Jari Virta from the CESR secretariat. This Expert Group will cover the provisional mandates relating to: the admission of financial instruments to trading; pre-trade transparency requirements for multilateral trading facilities (MTFs) and regulated markets; post-trade transparency requirements for MTFs and regulated markets; post-trade disclosure by investment firms.

- Expert Group on intermediaries' issues:
- The Expert Group will be chaired by Callum McCarthy (Chairman of the UK's Financial Regulator, The Financial Services Authority) and the rapporteur will be Carlo Comporti from the CESR secretariat. This Expert Group will cover the provisional mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best-execution; client order handling rules, with particular regard to prompt, fair and expeditious execution of client orders.
- Expert Group on cooperation and enforcement issues: This Expert Group will be chaired by Michel Prada (President of the French Securities Regulator, AMF) and the rapporteur will be Alexander Karpf from the CESR secretariat. This Expert Group will cover the provisional mandates related to: transaction reporting, co-operation between competent authorities and exchange of information.

A steering group has also been established to consider horizontal issues and to ensure overall consistency in the advice prepared by each Expert Group.

This will be composed of the three chairmen of the Experts Groups and chaired by CESR's Chairman, Arthur Docters Van Leeuwen.

### The formation of an ISD Consultative Working Group

As indicated in the introduction, a consultative group of market participants (practitioners, consumers and end-users) has also been appointed to provide technical advice to the expert groups. The market participants are experts drawn from across the European markets.

They are not intended to represent national or a specific firms' interest and do not replace the important process of full consultation with all market participants.

#### The members of the Consultative Working Group are:

- Dr Heiko Beck, DekaBank Deutsche Girozentrale
- Dr Michele Calzolari, Assosim and CENTROSIM S.P.A.
- Mr Jean~François Conil~Lacoste, Powernext SA
- Mr Henri de Crouy-Chanel, Aurea Finance Company
- Mr Peter De Proft, Bank Nagelmackers
- Mr Mark Harding, Barclays Bank Plc
- Mr Brian Healy, Irish Stock Exchange
- Mr Henrik Hjortshøj~Nielsen, Nykredit
- Mrs Marianne Kager, Bank Austria
- Mr Socrates Lazaridis, Athens Stock Exchange
- Mr Jacques Levy-Morelle, Solvay SAMs
- Ms Louise McBride, Consumers Association of Ireland
- Mr Gyorgy Mohai, Budapest Stock Exchange
- Mr Peter Norman, Sjunde AP-fonden
- Mr Anthony Orsatelli, CDC Ixis
- Mr Joao Martins Pereira, Banco Espírito Santo

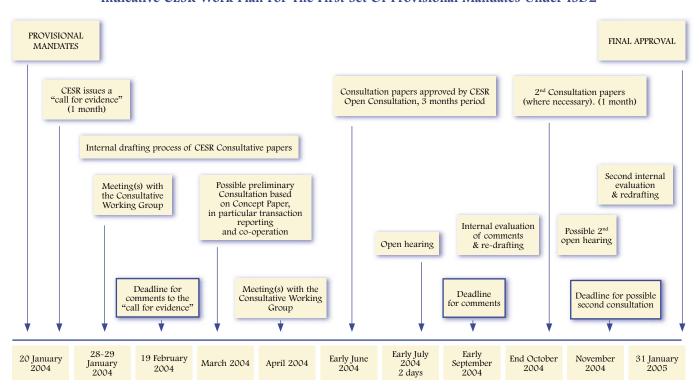
- Mr Frede Aas Rognlien, Association of Norwegian Stock broking Companies
- Mr Roger Sanders (OBE), FSA~SBPP, Association of Independent Financial Advisers
- Dr Jochen Seitz, Deutsche Börse Group
- Mr Erik Thedéen, The Swedish National Debt Office
- Mr Juan Carlos Ureta, Renta 4
- Mr Renzo Vanetti, SIA S.p.A
- Mr Jan-Willem Vink, ING Group

### Next Steps ~ Call for evidence and work programme

The first step in CESR's consultation process began with a 'call for evidence' from all interested parties. Responses were requered by 19 February 2004.

CESR identified the key milestones in CESR's work programme for this Directive in an indicative timetable set out below.

#### Indicative CESR Work Plan For The First Set Of Provisional Mandates Under ISD2



## Areas of Activity

### Level 3 Expert Groups

## 7.4 Clearing and Settlement

#### Message from CESR's Co~chair



Eddy Wymeersch, President of the Belgian Commision Bancaire, Financière et des Assurances (CBFA) "We have made significant progress in our joint work with the ESCB during 2003 in the field of clearing and settlement. The purpose of this work is to avoid systemic risk, protect the assets of investors, and to enhance the safety, soundness and efficiency of securities clearing and settlement in the EU. The publication of the consultation paper "Standards for securities clearing and settlement systems in the EU" along with the note "Scope of application of the CESR~ESCB Standards" published by CESR and the ESCB on 1 August of 2003, builds on work undertaken in 2002 following a call for contributions in March of that year. The consultation has led to a lively discussion and we have received a good cross~section of responses from all stakeholders involved. The present challenge lies in finding common ground with a view to the adoption of the Standards in the course of 2004."

#### Mandate of the joint CESR/ESCB Clearing & Settlement Expert Group

In October 2001, the Committee of European Securities Regulators and the Governing Council of the European Central Bank agreed to conduct joint work on issues of common interest in the field of securities clearing and settlement systems. The work is based on the 2001 CPSS/IOSCO "Recommendations for securities settlement systems" which were developed for application internationally, and were felt to serve as a solid basis on which to build further and, to adapt in order to provide for a robust approach tailored to European needs. The European Standards, when adopted, will therefore continue to ensure Europe's compliance with the international standards established in the CPSS/IOSCO recommendations.

In order to fulfil this task, a Joint Working Group was established, composed of representatives of the ESCB and the 15 EU national central banks and representatives of CESR. In order to reflect the co-operation between CESR and the ESCB, the Group has a co-chairmanship with Eddy Wymeersch, President of the Belgian Commission Bancaire, Financière et des Assurances, chairing on behalf of CESR, and Jean-Michel Godeffroy, Director General of the Directorate General Payment Systems, on behalf of the ESCB. The Group meets on a revolving basis in Paris and Frankfurt. The secretariat of this Group is also jointly performed by a member of the CESR-secretariat, Wim Moeliker, and an ESCB staff member, Elias Kazarian.

Both CESR and the ESCB sought technical advice on the proposals from market participants. CESR formed a Consultative Working Group which was appointed to provide advice to the Expert Group. The members were experts drawn from across the European Markets. They are not intended to represent national or a specific firms' interest and do not replace the important process of full consultation with all market participants.

The Group has also undertaken institutional consultations with, for example, the Banking Supervision Committee (BSC).

### The formation of a Consultative Working Group

A consultative group of market participants has also been appointed to provide technical advice to the Expert Group. The market participants are experts drawn from across Europe. They are not intended to represent a national or a specific firms' interest and do not replace the important process of full consultation with market participants.

The members of CESR's consultative working group are:

- Mr Edouard F. Delencquesaing, AFTI
- · Mr Mark Gem, Clearstream
- Ms Marye Humphery, Morgan Stanley
- Mrs Henny Kapteijn, ABP
- Mr Janne Lauha, HEX
- Mr Jesús González Nieto-Márquez, Bolsa Madrid
- · Mr Ludwig Nießen, Wiener Börse
- · Mr Giovanni Sabatini, Monte Titoli
- Mr Anso Thiré, Euroclear
- Ms Karin Wallin~Norman, VPC

## Summary of work done: an outline of key proposals in the consultation paper

Work by the Joint Working Group began with a call for evidence in March 2002. This first step offered market participants the opportunity to present their views on the most important issues to be solved in this area. A summary of responses was published in August 2002. The responses provided a firm steer for the Joint Working Group and with this feedback in mind, the Working Group developed its proposals and published this in the form of a consultation paper in August 2003. The consultation closed in October 2003. The Joint Working Group hosted a public hearing, a summary and copies of the responses are available on the CESR website.

As explained, to conform to the spirit of the international recommendations, the text of the proposed Standards follows the text of the nine-teen CPSS/IOSCO recommendations to the extent

possible. As a result the proposed recommendations cover the same subjects in a form which is adapted to reflect the EU environment. These subjects relate to, for example, the need to have an adequate and consistent legal framework in all jurisdictions (Standard 1), harmonised practices as regards trade confirmation and settlement cycles (Standards 2 and 3) and the importance of consistent and effective regulation, supervision and oversight (Standard 18). Each Standard is accompanied by a clear indication of whom the Standard is addressed to.

The most debated issue in the consultation period of August - October 2003, is the proposal to extend, compared with the existing CPSS/IOSCO recommendations, the scope of the Standards towards systemically relevant providers of clearing & settlement services (mainly, the so-called global custodian banks). The extension of the scope as proposed by CESR/ESCB aims to ensure systemic risk is avoided and to create a level-playing-field in the area of clearing & settlement, based on a functional risk-based approach. From a functional point of view, the systemically relevant entities play an important role in the settlement process by their handling of settlement flow and deposit of securities. However, custodian banks are against the extension of the scope of the standards to cover their clearing and settlement activities. This is on the basis that they are subject to comprehensive banking regulation and that the proposals will therefore be unduly burdensome. Others however, support the proposal of CESR/ESCB to extend the scope of the Standards in order to ensure a level-playing-field.

Reflecting the need for central banks and supervisors to co-ordinate in this area, a delegation of the Joint Working Group met with a representative from the Banking Supervision Committee on 21 November 2003 to review and discuss linkages between the proposed Standards and prudential banking legislation.

#### Next Steps

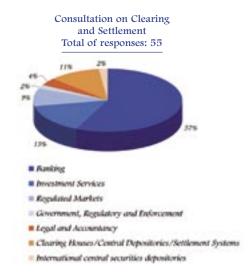
CESR/ESCB will review all comments received in the consultation period and will make proposals for amendments, in accordance with CESR's usual approach to consultation. Adoption of the Standards is envisaged during the course of 2004.

The dialogue between the Banking Supervision Committee and the Joint Working Group will continue as the process to finalise the standards continues.

#### Statistics of meetings in 2003

The Joint Working Group met on a larger number of occasions (as indicated below), however, drafting continued at a distance throughout the year.

- 4 expert group meetings took place
- 6 drafting/sub group meetings took place
- 1 open hearing took place.







## 7.5 Investment Management

#### Mandate of the provisional Expert Group on Investment Management

The UCITS Contact Committee, established by the European Commission on the basis of Article 53 of the UCITS Directive 85/611/EC, will soon transfer its responsibilities to the European Securities Committee and to CESR. This follows the final report of the Economic and Financial Committee (EFC), endorsed by the Ecofin Council on 3 December 2002, and a formal Commission proposal on the extension of the Lamfalussy procedure<sup>5</sup> and subsequent arrangements for other financial services' sectors.

The decisions establishing CESR and the ESC have therefore been amended to reflect the extension of their respective competences to encompass the Investment Management sector and to re-allocate the existing powers of the UCITS Contact Committee to the ESC and CESR. These amendments will enter into force at the same time as the amending Directive<sup>6</sup>.

CESR decided to establish a Provisional Expert Group on Investment Management which will meet during the 1<sup>st</sup> quarter of 2004. The mandate for the Provisional Expert Group on Investment Management is currently being finalised. The appointment of a Chairman to lead this group will be made shortly. In addition, CESR is also recruiting an additional permanent member of the Secretariat to take this work forward.

#### Background

In order to pave the way for the legal changes which will formalize this transition (described above), CESR considered it appropriate to start working in the area of UCITS and asset management, in order to provide a coherent response to regulation and supervision across Europe, including providing input to the UCITS Contact Committee. CESR attends the meetings of the UCITS Contact Committee as an observer.

### Summary of proposals in CESR's Consultation Paper

CESR published a consultation paper (Ref. CESR/03-441), following a discussion during an adhoc meeting of CESR experts on UCITS and asset management and taking into consideration the list of issues presented by representatives of the EU industry to CESR, which was discussed during an open hearing on 20 November 2003 in Paris. CESR set out in this consultation paper how it intends to develop its new role in the regulation of UCITS and asset management activities.

In particular, CESR identified in the consultation paper four general principles in this context:

- any future work done by CESR regarding UCITS would have to be conducted in full coherence with the EU institutional framework;
- II. CESR should take in a global vision of the so-called "buy side", and not limit its activities to investment funds;
- III. CESR should not start to work on matters where the UCITS Contact Committee is about to finish its work (e.g. simplified prospectus, derivatives);
- IV. account should be taken of the outcome of work already done by International Organisation of Securities Commissions (IOSCO).

Furthermore, CESR proposed four areas of possible intervention and priority work streams:

- I. areas where supervisory convergence should be achieved:
- II. areas where input to ensure the harmonized implementation of the UCITS Directive could be provided to the UCITS Contact Committee, ideally on its request;

<sup>&</sup>lt;sup>5</sup>The Proposal for Directive of the European Parliament and of the Council amending Council Directive 73/239/EC, 85/611/EEC, 91/675/EEC, 93/6/EEC and 94/19/EC and Directives 2000/12/EC, 2002/83/EC and 2002/87/EC of the European parliament and of the Council, in order to establish a new financial services committee organizational structure, presented by the Commission on 5 November 2003, COM(2003) 659 final

<sup>&</sup>lt;sup>6</sup> Decision of 5 Nov 2003 amending Decision 2001/527/EC establishing CESR (2004/7/EC) Decision of 5 Nov 2003 amending Decision 2001/528/EC establishing the ESC (2004/8/EC)

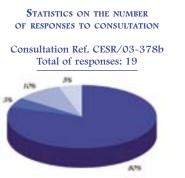


III. areas not narmonised at EU level but where a common approach by regulators is necessary;

IV. areas where consistency with other EU Directives are needed.

#### Next steps

Following the generally supportive response to the consultation received from market stakeholders during the public consultation, CESR decided to establish a provisional Expert Group on Investment Management. The Expert Group will further elaborate on the specific mandate(s) to be approved by CESR's Chairmen early 2004. In addition, CESR will set up a Consultative Working Group of market participants in this sector, to provide technical expertise to the Group. The Consultative Working Group will also provide advice on the proposed priorities for CESR's work in this area.



- Asset Management
- Nanking
- # Government, Regulatory and Enforcement
- Regulated Markets, Exchanges and Trading Systems

## Areas of Activity

### Level 3 Operational Groups

#### 7.6 CESR~Fin

#### Chairman's Message



John Tiner, Chief Executive of the UK Financial Services Authority (FSA)

"Moving to international accounting standards (IAS/IFRS) in 2005 will represent a major challenge for the 7000 European listed companies. Both markets and investors will need to adapt to the new way financial information is prepared and presented under this latest development in accounting language. Implementation of the international accounting rules will improve transparency and comparability of financial reporting in Europe, thereby increasing confidence in financial markets. This change marks an important watershed in accounting and regulators have recognised the need to engage from the very beginning in this process. Equally, enforcement of financial reporting under the new standards should remain a high priority for regulators. In this respect, the work undertaken by both the Sub-committee on International Standards Endorsement (SISE), chaired by Philippe Danjou, Chief Accountant at France's market regulator, the Autorité des Marchés Financiers (AMF); and, the Sub-committee on Enforcement (SCE) chaired by Angelo Apponi, Chief Accountant at the Italian securities regulator (CONSOB) have made a significant contribution to realising these important objectives and ensured CESR is well placed to actively participate in these developments."

#### Mandate of CESR~Fin

CESR-Fin is a permanent Operational Group with the role of co-ordinating the work of CESR members in the area of endorsement and enforcement of financial reporting standards in Europe.

CESR-Fin enables CESR to play an effective role in the implementation and enforcement of IAS/IFRS in the European Union (EU) in the context of the EU's new accounting framework that will become compulsory for all European listed companies as of 2005. This allows CESR to participate pro-actively during the formation and implementation of the international accounting standards (IAS/IFRS) through an engaged dialogue with all the key policy makers involved throughout the European endorsement process. Furthermore, CESR-Fin's role is to assist CESR members in delivering a co-ordinated and effective application of IAS/IFRS by EU listed companies, through the preparation of standards and guidelines on supervision and enforcement of financial reporting in Europe.

CESR-Fin has also been tasked with monitoring developments in Europe in the field of auditing.

Until November 2003, CESR-Fin was chaired by Henrik Bjerre-Nielsen, Director General of the Danish authority, Finanstilsynet. CESR would like to take the opportunity of this Annual Report to thank Henrik Bjerre-Nielsen for his valuable leadership of CESR-Fin and his outstanding contribution to setting up and establishing CESR-Fin during its first years of functioning. CESR Members have nominated John Tiner, Chief Executive of the UK's Financial Services Authority, as the new chairman of CESR-Fin.

To deliver the objectives outlined above, CESR-Fin has established two sub-committees: the Sub-committee on Endorsement of International Financial Reporting Standards (SISE), chaired by Philippe Danjou, and, the Sub-committee on Enforcement (SCE) chaired by Angelo Apponi. The work of these groups is supported by a permanent member of the secretariat, Michel Colinet.

It should also to be noted that the European Commission is represented in the meetings of CESR-Fin and its two Sub-c ommittees as an observer.

#### Background

CESR began some time ago to establish the impact that these changes will have on the wider accounting framework and on financial reporting matters generally, including the way listed firms are independently audited. CESR's priorities have therefore been focused firstly, on ensuring that the transition to IAS/IFRS is well prepared and in particular, that there is a strong emphasis on communication with the market to ensure appropriate and seamless information is received throughout the transition. Hand in hand with this, comes the need to ensure CESR designs proper solutions for a harmonised and robust enforcement system of financial information throughout Europe. Secondly, to effectively enforce financial information, regulators have sought to keep in perspective the broader picture, by which we mean, ensuring that the additional issues which have an impact on the validity of financial information are kept under review. This includes developments in relation to:

- auditing standards, including independence and ethics of auditors;
- auditors quality assurance systems and public oversight;
- interpretations of accounting standards, with an objective of robustness and consistency throughout the EU.

These elements have determined CESR-Fin's priorities and activities throughout this year and looking ahead will drive CESR-Fin's work in the coming year.

#### Report of activities

The release of two reports on 7 October 2003 by CESR based on the work of CESR-Fin and its two subcommittees on Endorsement of International Financial Reporting Standards (SISE) and on Enforcement of Financial Reporting (SCE) reflects CESR's commitment to contribute actively to the setting up of a proper financial reporting framework for European listed companies and to the development of strong and harmonised mechanisms for the supervision and enforcement of financial reporting throughout Europe.

### Endorsement of International Accounting Standards

#### **Background**

In the field of endorsement of International Financial Reporting Standards (IAS/IFRS), CESR-Fin, concentrated its activities on two major aspects through its Sub-Committee on International Standards Endorsement (SISE).

Firstly, SISE closely monitored the development of the new draft accounting standards (exposure drafts) published by the International Accounting Standards Board (IASB) and commented on new proposals through the European Financial Reporting Advisory Group (EFRAG) where SISE has a permanent observer seat. CESR-Fin also sent written comments to EFRAG on IASB's exposure drafts, the most important of which included the new proposed standards for First Time Adoption of IFRS; Business Combination phase I; Sharebased Payments; Improvements of IAS 32 and 39 and Insurance contracts phase I. SISE has also maintained direct contacts with EFRAG and the staff of the IASB, inviting them to participate in part of its meetings.

Through its observer status in the European Accounting Regulatory Committee (ARC), CESR has also actively participated in the preparatory discussion for the endorsement of existing accounting standards.

On 29 September 2003, the European Commission adopted a Regulation endorsing all existing International Accounting Standards (IAS) and related interpretations, with the exception of IAS 32 and 39 (and related interpretations) on Financial Instruments. Throughout this process, CESR's key objective has been to ensure investor's needs are kept at the very heart of the revised approach to financial reporting based on these new accounting standards.

Secondly, recognising that the transition to IAS/ IFRS in 2005 will undoubtedly pose significant challenges for the EU listed companies, CESR

transition. These recommendations set out how listed companies can ensure a seamless transition to IAS/IFRS focusing in particular, on the need for firms to implement a well thought-through communication strategy tailored both for the market and the investor.

prepared a draft recommendation to facilitate the

The draft recommendation was released on 7 October 2003 for a public consultation and the consultation closed on 20 November 2003. A public hearing was held on 12 November 2003 at CESR's offices in Paris to discuss the draft Recommendation. The final Recommendation (Ref. CESR/03-323e) was published on 30 December 2003.

#### Key recommendations

CESR has identified four milestones in the transition process, as follows:

1. The publication of the 2003 annual report (including the 2003 financial statements)

At this stage, it is recommended that companies explain how they intend to carry out the transition to IAS/IFRS (the plans and degree of achievement towards the transition). Listed companies are also encouraged to explain in a narrative form the key differences between their present accounting policies and the ones they know with sufficient certainty that they will have to apply under IAS/IFRS.

2. The publication of the 2004 annual report (including the 2004 financial statements)
CESR recommends that, as soon as a company can quantify the impact of the change to IAS/
IFRS on its 2004 financial statements in a sufficiently reliable manner, it is encouraged to disclose the relevant quantified information. Such disclosure should be made in a way that is not misleading (i.e. covering all possible impacts, both positive and negative). If the company is not in a position to provide this quantitative information, it is recommended to at least complete and update the narrative information referred to above (under para. 1).

### 3. The 2005 interim financial reports (half-yearly and quarterly financial reports)

The aim of the recommendation is not to mandate the publication of interim reports, as this aspect is governed by applicable national and European regulations. Interim reports can also be made on a voluntary basis.

Where interim financial reports are published in 2005, it is recommended that listed companies start applying from 1st January 2005 either IAS 34 "Interim Financial Reporting" or, if this is not possible, at least the IAS/IFRS recognition and measurement principles that will be applicable at year end. It is worth noting that many respondents to the consultation strongly supported the proposal that issuers start using IAS/IFRS recognition and measurement principles for interim financial reports in 2005.

Concerning the comparative information for the corresponding previous period, CESR recommends that companies not only provide these, but that they should also be prepared according to IAS/IFRS, using the same accounting rules as those used in 2005.

#### 4. The 2005 Annual Financial Statements

In most cases, the 2005 annual financial statements will be the first complete set of financial statements to be presented under IAS/IFRS by listed companies in Europe.

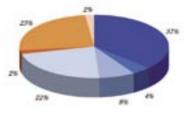
In this regard, CESR proposes not to go beyond the existing requirement that only one year of comparative accounts (e.g. 2004) be prepared and presented under IAS/IFRS. In order to address the various situations where companies are required or choose to present three successive periods, but have not restated under IAS/IFRS the earliest period presented (e.g. 2003), CESR proposes a format ('the bridge approach') for the presentation of the comparative figures (2004 and 2003 in the example), to enable as much comparability as possible, even though they would not have all been prepared under IAS/IFRS.

STATISTICS ON THE REPONSES TO THE CONSULTATION PAPER

'European Regulation on the application of IFRS in 2005'

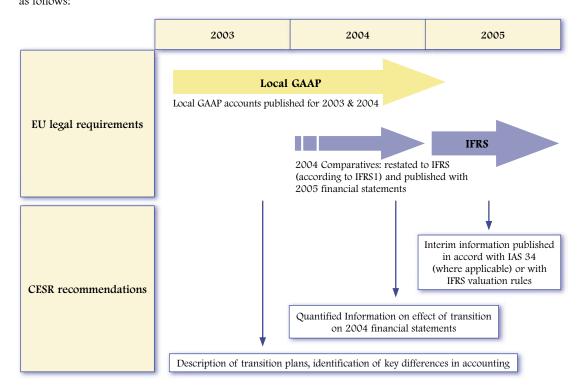
Draft recommendation for additional guidance regarding the transition to IFRS'

Consultation Ref. CESR/03~323b Total of responses: 55



- Banking
   Investment Services
- = Insurance
- 1 Issuers
- Regulated Markets
- Government, Regulatory and Enforcement
- Accountancy
- Investor respresentatives
- II Compilation of National Comments
- Financial Analysis

CESR's proposals to implement this phased approach and the key milestones can be illustrated as follows:



#### Next steps

In 2004, CESR-Fin will continue to have an important workload related to the continued process of endorsing international accounting standards that will constitute the stable platform of standards to be applicable by listed companies from 1st January 2005. SISE identified a number of other specific topics which need further consideration by European Securities Regulators if a proper implementation of IAS/IFRS is to be ensured. This includes notably the analysis of issues linked to the application of IAS/IFRS by "investment companies". Another important topic for consideration will include how companies which are not presently listed but intend to list in the future, could usefully apply the IAS/IFRS should they intend to list in the future listing (since the application of IAS/IFRS becomes compulsory as soon as the company is listed). In relation to this topic, SISE monitors how EU Member States intend to implement Article 5 of the EU Regulation 1606/2002 on the application of the IAS in Europe. Article 5 also offers to Members States an option to require or permit use of IAS/IFRS by non-listed companies or for non-consolidated accounts of listed companies.

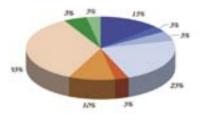
### Enforcement of International Financial Reporting Standards

### a) Background on the development of 'Standard N°1'

To contribute to the development and implementation of a common approach to the supervision and enforcement of financial reporting in Europe, CESR-Fin, through its Sub-committee on Enforcement (the SCE), established the first standard on enforcement of financial information (the 'Standard N°1' on Financial Information: Enforcement of standards on Financial Information in Europe). This Standard was published by CESR on April 2003, following a public consultation process

'Proposed statement of Principles of Enforcement of Accounting Standards in Europe' Standard n° 1

Consultation Ref. CESR/02~188b Total of responses: 39



which took place between 22<sup>nd</sup> October 2002 and 15<sup>th</sup> January 2003. The consultation included a public hearing held at CESR premises in Paris on 7<sup>th</sup> January 2003. CESR received 39 responses to the consultation. Standard N°1 was published, along with a feedback statement summarising the responses received, in April 2003.

#### Key Principles in 'Standard N°1'

The Standard consists of 21 high level principles addressing various enforcement areas which developed a common definition of enforcement and established the scope of what could be considered enforcement activities. The Standard also covers agreed methods for enforcement, such as a "selection method" which establishes the potential basis for regulators to prioritise their supervision of financial information produced by publicly listed companies or those seeking listing. It also established the kind of actions that might be adopted in case of a discovered infringement in the reporting framework.

#### b) Background on 'Standard N°2'

Building on this work, SCE developed a second draft standard on enforcement of financial information which proposes a number of mechanisms designed to establish appropriate co-ordination of enforcement practices on a pan-European level.

The key proposals of the 'Standard N°2' on financial information which, after approval by CESR was released on 7 October 2003 for public consultation (the consultation closed on 7 January 2004). In addition, a public hearing was held in Paris at CESR's premises, on 12 November 2003.

#### Key Proposals in 'Standard N°2'

The main elements of the proposals include:

 the development of a broader coherence and harmonised approach to enforcement decisions to include relevant non securities regulators, CESR proposes to discuss decisions and experiences with non securities regulators in a regular manner within a formalised structure and therefore proposes establishing

- 'European Enforcers Co-ordination Sessions (EECS)' to fulfil this function (Principle 4);
- the principle that all supervisors should take into account existing decisions taken by EU National Enforcers including not only CESR-Members but also delegated authorities that are non-securities regulators, for example, stock exchanges, or the UK review panel. These EU National Enforcers would form part of the proposed members of the EECS. Additionally, CESR proposes that where practicable within constraints of time and confidentiality, discussions with other EU National Enforcers should take place before significant decisions are taken (Principle 1);
- the development of a database as a practical reference tool which sets out decisions taken by EU National Enforcers, to provide a record of previous decisions reached in particular cases. The database of enforcement decisions will set out the principles upon which decisions have been taken by EU National Enforcers. The EU National Enforcers will also discuss and consider the decisions taken in specific cases in order to shape a more co-ordinated and similar reaction by supervisors when faced with comparable situations in the future. CESR will develop further guidelines shortly on how to manage this database (Principles 2 and 3).

The SCE has already started working in parallel on other projects in order to have in place the necessary standards and guidelines on enforcement of financial information in Europe for 2005 when, as described earlier, listed companies will have to move to the IAS/IFRS.

#### Next Steps

The SCE's first priority will be to develop further guidance and practical arrangements for the finalisation of the co-ordination mechanisms, and in particular, for the creation and management of the database of enforcement decisions taken by EU National Enforcers.

The SCE will also monitor other enforcement topics, such as:

- the powers given to enforcers to conduct investigations, including a review of the actions taken in cases of discovered infringements;
- enforcement of financial information in cross border listing cases; as well as the development of guidance on the methods of selection for determining the scope of enforcement.

#### Statistics of meetings in 2003

CESR-Fin met on a larger number of occasions:

- 2 expert group (CESR-Fin) meetings took place
- 11 sub group (SCE and SISE) meetings took place
- 2 open hearings took place.

In addition to the meetings listed above, all working groups undertook a large part of the drafting at a distance.



## 7 Areas of Activity

#### 7.7 CESR~Pol

#### Chairman's Message



Kurt Pribil, Executive Director of the Financial Markets Authority (FMA), Austria "The deepening of the single market in financial services, as a result of the EU's Financial Services Action Plan, with measures such as the Market Abuse Directive (adopted in 2003) increases the responsibilities of national securities regulators. With this comes not only a new found interdependence but also a greater need for a stronger and enhanced reliance amongst regulators, who must be equipped to co-operate more fully and effectively in the field of enforcement. For this reason, CESR-Pol's objective to enhance the sharing of information, co-operation and co-ordination of surveillance and enforcement activities between CESR members gains a new relevance and impulse to move further forward. CESR-Pol will play a key role in helping national regulators to deliver this new found confidence more effectively with the development of a common approach for the European securities enforcement environment."

#### Mandate of CESR~Pol

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CESR-Pol is a permanent Operational Group within CESR and is composed of senior officials of each CESR member that is responsible for the surveillance of securities activities and the exchange of information. Kurt Pribil, Executive Director of the Austrian Financial Market Authority (FMA) was appointed Chairman in September 2003 following the end of a two year term in which Susanne Bergsträsser chaired the Group. CESR would like to take the opportunity of the Annual Report to thank Susanne Bergsträsser, Head of the Insider Dealing and Market Supervision section of the German BaFin, for her invaluable contribution to the consolidation of the active network of enforcers. The ability of CESR-Pol members to co-operate in the field of enforcement has been established by Members signature of the CESR multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities ("MoU") in January 1999.

The purpose of CESR-Pol is to facilitate effective, efficient and pro-active sharing of information, in order to enhance the co-operation and the co-ordination of surveillance and enforcement activities between CESR members. CESR-Pol's key objective is to make cross-border information flow equally rapidly amongst CESR members as it would in a domestic matter and, by so doing, enhance the transparency, the fairness and the integrity of European markets as a whole. The work of this group is supported by a member of the secretariat, Christian Dier.

#### Work done ~ an outline of CESR~Pol's initiatives and the progress made

In 2003, CESR-Pol focused its work on the following areas:

#### Request Format & Scope of Co-operation

A 'Service Level Agreement' was adopted in 2003, following the development of a standardised format for requests. This 'Service Level Agreement'

sets out common agreement on how they wish to see their requests for assistance directed to fellow members treated under the CESR multilateral MoU and how members will treat these requests.

'Best practice' guidelines are being developed on the basis of reports by CESR-Pol members with special experience in the field of joint investigations.

# Monitoring of the operation and updating of the CESR MoU

CESR-Pol was tasked with the role of keeping the operation of the CESR MoU under review and to monitor and update this were necessary to ensure its efficacy from CESR-Pol's outset. Following, the first review in 2000, a second review in 2003 sought to identify any need for change in the MoU or in its operation and to assess whether the implementation of the Financial Services Action Plan (in particular, the implementation of the Market Abuse Directive and the future Financial Instruments and Markets Directive (ISD2)) required any change to the MoU. An analysis of data gathered on requests for information for the years 2001 and 2002 showed that a further 'fine tuning' of the statistical data might facilitate better comparison of the data submitted by the members in the future and might lead to a more effective basis upon which to establish the need for change if necessary. Speedy and comprehensive implementation of the new Directives will be crucial for the work of CESR-Pol.

### **Shared Enforcement Priorities**

Work in this area commenced with a questionnaire to CESR-Pol members which established a basis for more in-depth discussions. The results of the questionnaire enabled a draft paper on 'Shared Enforcement Priorities' to be discussed in CESR-Pol and will be presented to the CESR Chairmen at one of its next plenary meetings in 2004.

### Surveillance of securities activity on the Internet

CESR-Pol undertook a survey of current internet surveillance activities and automated tools for detecting illegal securities activities. The exchange of experience in this field will facilitate the development of new methods of surveillance, as well as the evaluation of possible common approaches. Looking ahead, CESR-Pol will establish a network of persons responsible for internet surveillance. The sharing of information proactively is envisaged under Article 3 (4) of the MoU and may include within its scope the sharing of experience on the inclusion of electronic evidence in Courts.

### Relation with un-cooperative jurisdictions

Under this mandate, CESR-Pol decided to start more detailed work on selective European jurisdictions. A first analysis under review of collected case material suggested a broader approach would be appropriate and this will seek to identify all those jurisdictions where problems are at present commonplace. Work is underway to assemble case files on these jurisdictions in order to identify the approach CESR-Pol might adopt.

### Other areas of work:

### European Convention on Human Rights (EHCR)

CESR-Pol discussed possible impacts of the European Convention on Human Rights (ECHR) on the activities of securities regulators. Considering the substantial increase of cases submitted to the ECHR in recent years and the evolution of its jurisprudence, as well as the risk that regulators may be challenged under the ECHR, it was agreed that members will have the opportunity to inform each other about pending cases before the ECHR and national courts at meetings of CESR-Pol. If CESR-Pol observes developments of major importance for regulators in this area, they will inform CESR and where necessary, CESR will consider further action.

### Next Steps

Besides further work on the existing mandates in 2004, CESR-Pol will focus primarily on Level 3 work to implement the Market Abuse Directive, this will include for example, establishing a database to identify 'accepted market practices'. In addition, the successful integration of the members from the EU Accession Countries into the existing environment of European securities regulators will be a major objective for CESR-Pol. A further seminar for the Accession Countries on the CESR MoU will be held in Budapest, Hungary on 26 February 2004, building on the seminar held in Paris in 2003.

### **Statistics**

In addition to carrying work forward at a distance (electronically), CESR-Pol met three times during 2003 and met a further time in order to hold a seminar for the Accession Countries.

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# 8 The Review Panel

### Chairman's Message



Kaarlo Jännäri, Director General of the Finnish Financial Supervision Authority and CESR's Vice Chairman

"The Financial Services Action Plan sets out a challenging legislative programme to accomplish the Single Market in Financial Services and to bring European regulation up to date. Its success will be measured not by meeting deadlines but by the concrete results in terms of increased cross-border business. Crucially, this means we must move beyond paper and words and see real and effective implementation on the ground so that these benefits can be realised. The Review Panel has a key role to play here, not only by holding up the mirror to determine what has been implemented and how, but also, by ensuring coherence of the rules that have been implemented, enabling both regulators and legislators to be better placed to identify any issues that need to be tackled and to establish the way to move forward on a solid basis."

### Mandate of the Review Panel

The 'Stockholm Resolution' adopted by the European Council on 23 March 2001 states:

'The Committee of European Securities Regulators should also contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective co-operation between national supervisory authorities, carrying out peer reviews and promoting best practice.'

To fulfil this important task, CESR established the Review Panel in March 2003. The Panel, chaired by Kaarlo Jännäri, Vice Chairman of CESR, is a permanent group comprising the Internal Co-ordinators of each CESR member and observer.

The Review Panel is mandated to assess the implementation by all CESR members of EC legislation, CESR standards and guidelines into national rules.

At present, the Review Panel is monitoring the status of implementation of:

- the CESR Standards on Investor Protection (Ref. CESR/02-098b and CESR/01-014d);
- the CESR Standards for Alternative Trading Systems (Ref. CESR/02~086b).

In the course of 2004, the Review Panel will:

- conduct a similar exercise to review implementation of CESR's Standard N°1 on Financial Information (Ref. CESR/03-073), adopted in March 2003;
- call ad-hoc sessions which will discuss the steps taken in Member States by the competent authorities in the transposition of the Market Abuse Directive and corresponding Level 2 implementing measures will be discussed.

The work of this group is supported by a permanent member of the CESR secretariat, Alexander Karpf.

### **Background**

CESR agreed to review the status of implementation of the CESR Standards on Investor Protection (Ref. CESR/02-098b and CESR/01-014d) and the CESR Standards for Alternative Trading Systems (Ref. CESR/02-086b), which CESR had adopted in 2002 under the current Investment Services Directive (93/22/EEC). This exercise has enabled CESR to establish the principles to guide how this process of review is carried out in the future, particularly, when reviewing implementation of the legislative initiatives launched in the framework of the Financial Services Action Plan.

In considering which standards to use in this first 'trial' of the process, CESR decided to go ahead with a review of the Standards of Investor Protection and Standards on Alternative Trading Systems, recognising that this might be affected by the current revision of the Investment Services Directive (ISD2). CESR members agreed that they should not wait for the ISD2 to be adopted before implementing these CESR Standards into their domestic regulation. This decision was made on the basis that the implementation of the ISD2 could take considerable time and the CESR Standards would most likely be reflected in the CESR advice for technical implementing measures under the new ISD2.



This first exercise was not only conducted by CESR members, but also by the securities regulators of all the Accession Countries.

### Approach adopted

The exercise was initiated by a self-assessment by each member on the status of implementation of the CESR Standards in its respective jurisdiction, setting out in "correspondence tables", Standard by Standard, the implementing measures already in place in the respective jurisdiction. This includes a description of the implementing authority and the implementing measures, and any additional comments, particularly as regards initiatives at domestic level to ensure implementation (such as consultations with the industry on draft changes to legislation, contacts with other authorities competent to transpose the Standards, or the establishment of internal groups to assess steps to be taken).

The CESR Secretariat conducted a preliminary review of the responses in order to ensure consistency with the methodology developed by the Review Panel. As a next step in the review process of these Standards, the status of implementation in all Member States is going to be reviewed in a common exercise by the Review Panel, which will be conducted in the first half of 2004.

In addition, 'synthesis tables' have been completed, in which it is indicated for each Standard and for each country whether a Standard can be regarded as 'implemented', 'partly implemented' or 'not implemented' according to the responses provided in the correspondence tables. The correspondence tables and the synthesis tables, which will be updated on a regular basis, will be published on CESR's Website.

### Summary of initial findings

The first, interim results, which will be presented in the Review Panel's 'First Interim Report', provide an encouraging picture on the implementing progress already made in Member States, both as to the Standards on Investor Protection and Alternative Trading Systems. Certain differences in the level of implementation in some jurisdictions are mainly due to the issue of divergent implementing powers of CESR Members and the wish, in some cases, to wait for the new ISD2 to be adopted, particularly where CESR members are not the only authority competent to implement the change.

### Next stebs

The Review Panel will conduct a similar exercise in the course of 2004 for Standard N°1 on Financial Information adopted by CESR in March 2003. Moreover, ad-hoc sessions will be held to discuss the steps taken by CESR members and observers in the transposition of the Market Abuse Directive and corresponding Level 2 implementing measures, as foreseen in the European Council's Stockholm Resolution.

### Statistics of meetings in 2003

The Panel did much of the work at a distance but met twice in 2003 to discuss the approach to be adopted and to review findings. The number of meetings in 2004 are set to rise with the new areas of work identified above.

# 9

# CESR work programme for 2004

### Secretary General's message:



Fabrice Demarigny, CESR's Secretary General

"In 2004, CESR's work programme will be dominated by the preparation of our advice for the EU Commission on implementing measures for the Financial Instruments Markets Directive (ISD2) and possibly, for the Transparency and Take-over Bids Directives. For these technical issues, consultation will require particular care and time. Attention will be focused on the ability of CESR to demonstrate its efficiency at Level 3, for which a clear strategy will be defined. The capacity to ensure real convergence in the transposition and the implementation of recently adopted EU law and implementing measures will need strong support from CESR members and from the EU Commission. CESR will also be keen to intensify the discussions with the US SEC in order to improve oversight of US and EU Capital Markets through increased information sharing which will enable better anticipation of possible regulatory problems. CESR will seek to contribute to the debate on the definition of priorities for the post-FSAP phase. Finally, the information policy to make CESR's work and role better known and understood will produce its first results through a new website, and possibly the organisation of a one day conference in towards the end of 2004."

CESR priorities for its workplan in 2004 were agreed upon by members in the course of 2003. The workplan, amongst other things, anticipated potential future mandates from the European Commission.

Table 1 provides lists with indications of timings.

Table 2 shows statistics on the number of meetings held by CESR in 2002 and 2003.

The work-load of the secretariat has increased in 2003, both in the numbers of groups and in terms of meetings. Unless new projects are decided by CESR during the course of 2004, the number of groups should remain the same (Market Abuse and Clearing and Settlement will finish their work; new groups will start for Investment Management and possibly to cover issues arising under the Transparency Directive).

The density of meetings for the ISD2 work is likely to be high, and the increasing presence of CESR in various EU Committees as well as co-ordination with the other Level 3 Committees will require careful and proper preparation. In addition, the arrival of ten new members (the Securities Regulators of the Accession Countries) and permanent staff to the secretariat, will engender an increase

in functioning costs. For this reason, Members have decided that the additional resources resulting from the individual contribution of the new members should be used to increase CESR's functioning budget, which will amount to 2.2 million Euros in 2004 (2 million Euros in 2003).

In 2003, CESR recruited 5 additional permanent staff for its secretariat which now numbers 13 people, including the remote members of the secretariat. Additional recruitments will take place in 2004, in particular to assist with work on Investment Management and ISD2.

# Table 1 ~ Areas of work and indicative timings

### a) CESR

Areas of work	Description	Timing
Website	Opening and progressive improvements	Q1
Membership	Full membership of Securities Regulators of Accession Countries	Q2
Market Participants Consultative Panel	Enlargement of the composition	Q2
One Day Conference	Organisation of a one day paying conference on topics of financial regulation related to CESR's activities	Q4

### b) Level 2

Market Abuse	Adoption by the EU Commission of the second set of implementing measures; monitor the translation into legal text		
	Expert Group to be disbanded once the legal texts are adopted. Follow up work by CESR-Pol	Q2	
Prospectus	Adoption by the EU Commission of the implementing measures	Q2	
Transparency	Provisional mandates	Q2	
	Establishment of an Expert Group		
FIM Directive (ISD2)	Work and consultation on the technical advice of implementing measures concerning the regulation of intermediaries, markets, co-operation & enforcement		

## c) Level 3

Elaboration of a level 3 policy	Publication of a Consultative Paper	Q1
CESR~Fin	General • EC communication on Audit	
	Endorsement of IFRS  • Recommendation on Transition to IFRS  • Companies seeking listing  • Follow up IASB and EFRAG work  • Common implementation of IFRS	Q1 Q2
	Enforcement of IAS	Q1 Q2 Q2
Investment Management	Establishment of a provisional Expert Group and a Consultative Working Group	Q1
	Provide input to the UCITS Contact Committee	Q2
Clearing and Settlement	Adoption of the Standards jointly with the ESCB	Q1/Q2
Review Panel	Monitoring the implementation of Standards on ATS and Investor Protection	Q1/Q2
	Exchange of views on the transposition of MAD	Q1/Q2
	CESR Standard N°1 on Financial Information	Q2/Q3
CESR-Pol	Current work:  • Internet surveillance  • Risk based enforcement	
	Revision of CESR Multilateral MoU	Q2
	Accession Countries joining the MoU	Q2
	Relations with un co-operative authorities	
	Assessment of the consequences of the adoption of the Market Abuse Directive (including monitoring of Accepted Market Practices)	Q2/Q3
Prospectus	Guidelines to complete a prospectus	Q4

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## d) Other areas of activity

Relations with US Authorities	Intensify dialogue with the SEC	Q2/Q3
Securities Analysts	Follow up of IOSCO and Forum Group reports	
Corporate Governance	Follow up of the EU Action Plan on corporate governance	
ACI~STEP	Observer in the work of the task force for short term securities	
Level 4	Defining a possible role for CESR in informing the EU Commission	
Macro-economic conditions	Participation to the EFC stability round table	
	One or two meeting(s) during the year	
Rating Agencies	Follow up of the IOSCO report	
Credit Risk Transfer	Joint work with CEBS and CEIOPS in response to the request from the EFC	Q2/Q3
Investor Education	One or two meeting(s) during the year	Q2/Q4
	Use of CESR website	



Table 2 ~ Statistics on meetings

Group	Meetings 2002	Meetings 2003
CESR	4	5
Expert Groups (drafting/sub-groups)		
Market Abuse	2	5 (8)
• Prospectus	1	8 (10)
Clearing and Settlement	4	4 (6)
Permanent Groups		
• CESR-Pol	3	3
• CESR-Fin	2	2
~ SCE	4	5
~ SISE	4	6
Review Panel	~	2
Ad-hoc Groups		
• ECHR		~
Investor Education	~	1
Financial Markets Research	~	2
• UCITS	~	1
Press Officers	~	2
Market Participants Consultative Panel	1	3
Public Hearings	3	7
Consultative Working Group (MAD & Prospectus)	4	5

NB. The figures in brackets represent additional meetings of the drafting/sub-groups. In addition to these meetings, much of the work is carried out at a distance.

# 10 Annexes

# Lamfalussy Process

In the European Commission Financial Services Action Plan of May 1999, strategic objectives were set out to create an integrated EU capital market by April 2004 (a single EU financial services market, open and secure retail markets, state-of-the-art prudential rules and supervision).

The Committee of Wise Men, chaired by Baron Alexandre Lamfalussy outlined in its report of 15 February 2001 several shortcomings in the legislative system for securities. The report proposed a four level approach with regard to the legislative process in order to solve these problems.

### European Securities Council (ESC)

The Lamfalussy Report proposed the creation of the European Securities Committee (ESC), which has a primarily regulatory function, was formally established in June 2001. The ESC has three main roles: i) act as a regulatory committee under Article 202 of the Treaty, ii) act in an advisory capacity to the Commission in particular on Level 1 legislation and, iii) advise the European Commission on Level 2 mandates for CESR. The members of the ESC are nominated by the Member States and the European Commission chairs the ESC. CESR has the status of observer in the ESC.

### **CESR**

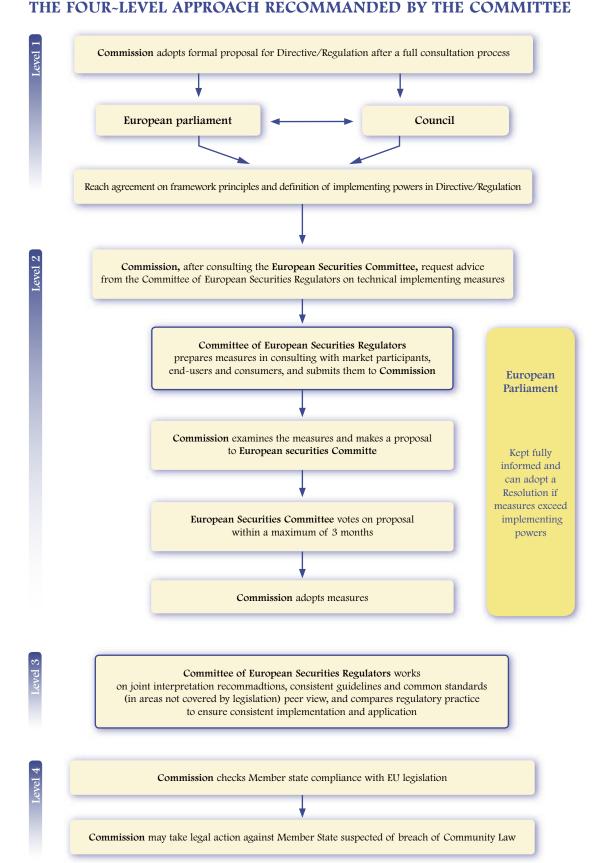
The Lamfalussy Report proposed the creation of CESR which was formally established in June 2001 and met first in September 2001. CESR plays an advisory role to the European Commission in a Level 2 capacity. In a Level 3 capacity CESR acts as a fully independent committee of national regulators to ensure more consistent implementation of Community law.

The members of CESR are the heads of the competent authorities for securities regulation and/or supervision. CESR's chairman is elected by the members of CESR. The Secretariat of CESR should keep close operational links with the European Commission for the work on Level 2.

The European Commission informs CESR of the political priorities and discusses emerging ideas with CESR. CESR produces an annual report on its work and submits this to the European institutions.



## THE POLID LEVEL ADDROACH DECOMMANDED BY THE COMMITTEE



### Level 1

The Lamfalussy Report expressed the view that all European services and securities legislation should be based around a conceptual legislative framework of essential principles. The advantage of this approach is that the legislative process can be speeded up as the Level 1 political co-decision negotiations between the European Commission, the Council of Ministers and the European Parliament only have to focus on the essential issues and not on technical implementing details.

### Level 1 ~ Step 1 and Step 2:

The Level 1 principles should be incorporated in new types of directives or regulations in the field of securities which are to be decided by normal EU legislative procedures (i.e. proposal by the Commission to the Council of Ministers/European Parliament for co-decision). The European Commission should consult, beforehand, with market participants, end-users (issuers and consumers), Member States and their regulators on any Level 1 legislative proposal. Furthermore, the European Commission should inform the European Parliament, the Member States and their regulators on an informal basis of forthcoming proposals.

### **Level 1 ~ Step 3:**

The nature and the extent of the technical implementing measures that should be taken at Level 2 have to be specified in the EU directives and regulations. This means that the European Commission has to seek understanding with the Council of Ministers and the European Parliament on the scope of Level 2 implementing measures.

With respect to *Level 2*, the Committee proposed a working method for CESR, the European Commission and the ESC to define, propose and decide on the technical implementing measures of Level 1 directives and regulations.

### Level 2 ~ Step 1:

The European Commission, after consultation with the ESC, asks CESR to draw up a technical advice for the implementing measures on the basis of a clear mandate of the European Commission.

### Level 2 ~ Step 2:

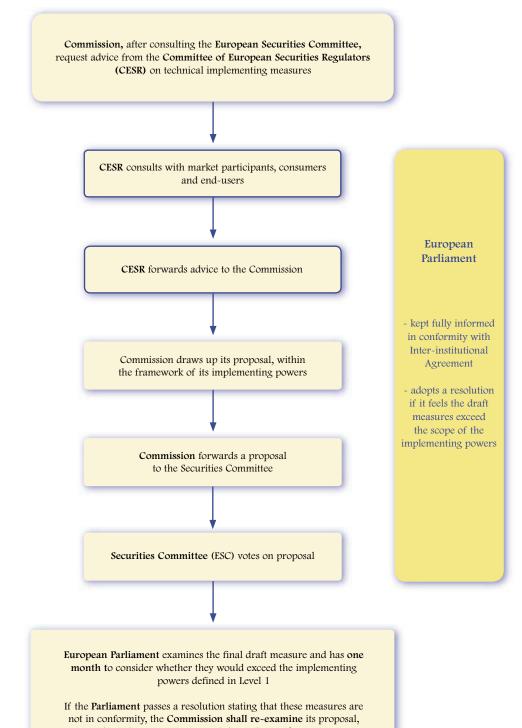
CESR will publish any mandate received from the European Commission to provide interested parties to make submissions. In addition, CESR will consult with the market participants, consumers and endusers on the basis of a draft advice at a sufficiently early stage to be able to take the responses into account. CESR may also establish consultative working groups where appropriate. After the consultation procedure, CESR draws up the final advice and sends it to the European Commission.

#### Level 2 ~ Step 3:

The European Commission presents a proposal for technical implementing measures to the ESC taking into account the technical advice of CESR. The European Commission ensures that the European Parliament is fully informed on all the proposals for implementing measures in order to ensure they conform with the scope of the implementing powers defined by co-decision in Level 1. After the ESC has approved the proposal of the European Commission, the technical implementing measures will be formally adopted by the European Commission.

Level 3 concerns a strengthened co-operation between national regulators to ensure consistent and equivalent transposition and implementation of Level 1 and Level 2 legislation. This requires an active role of CESR in the field of common and uniform implementation of EU legislation. CESR should fulfill this role by producing administrative guidelines, interpretation recommendations, common standards, peer reviews and comparisons of regulatory practice to improve enforcement of the legislation concerned.

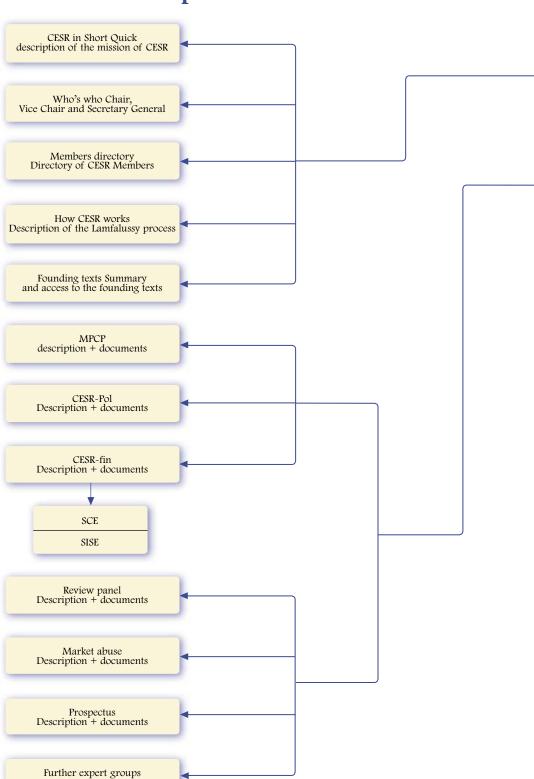
Strengthened enforcement of the EU legislation is identified by the Committee as Level 4. This is primarily the responsibility of the European Commission but Member States, regulators and the market participants have an important role in supplying information to the European Commission about any potential infringement of Community rules.



taking the utmost account of the Parliament's position

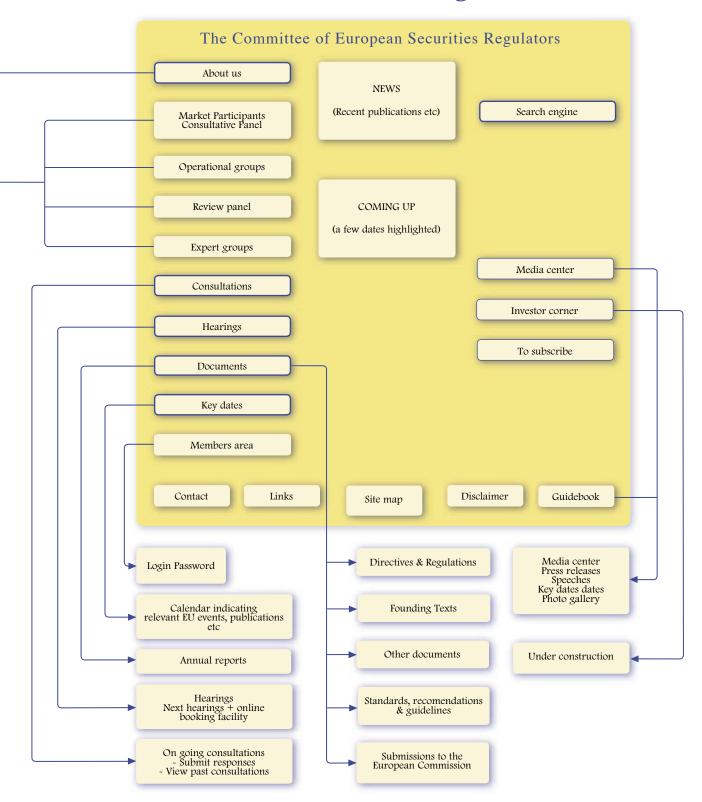
Commission adopts proposal

## Internet site map for CESR's new website



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## www.cesr~eu.org



# 10 Annexes

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Comments