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**PRELIMINARY PROGRESS REPORT**

**WHICH SUPERVISORY TOOLS FOR THE EU SECURITIES MARKETS?**

**AN ANALYTICAL PAPER BY CESR**

**OPEN TO CONSULTATION**

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## Executive summary

The purpose of this preliminary analytical paper by the Committee of European Securities Regulators (CESR) is to contribute to the creation of an efficient EU single market for financial services. This consultative report is a first attempt to define how securities regulators can play their role in order to ensure full and consistent implementation as well as effective enforcement of all measures included in the Financial Services Action Plan in the area of securities, in the next five years. The work concentrates on the objective of securities regulators which are to maintain fair, transparent and secure securities market; it does not cover issues related to the prudential supervision of banks or insurance companies which are of fundamental different nature and focus.

This analysis concentrates on the supervisory and enforcement functions and decisions by securities regulators when applying the FSAP Directives. It does not cover law and rulemaking matters for which the Lamfalussy approach provides with a satisfactory response.

This work by CESR should be understood as a preliminary contribution to the debates on the content of the post-FSAP phase. It does not constitute in any manner a final opinion on this matter but is rather a preliminary analysis of current challenges and possible solutions for which guidance from the EU institutions and comments from the market participants are necessary before reaching a definitive conclusion. Comments are particularly welcomed on the definition and functioning of additional supervisory tools to improve the Network of securities regulators (Part IIc) and the Home/Host(s) relationship between competent authorities (Part IIIb).

At this juncture the main interim results of this analytical work by CESR can be summarised as follows:

1. The integration of the securities markets in the EU varies significantly according to the sectors and the categories of market players considered. In the securities field, less integrated and more integrated sectors will co-exist on a long term basis. It is difficult to predict the speed of integration of the specific areas of the securities market before contemplating the progressive effects of the entry into force of the various FSAP Directives.
2. EU securities regulators should therefore develop an “adaptive” strategy to face the progressive integration of the securities markets in Europe. This requires them to evaluate properly the supervisory tools (“tool box”) they will need to react properly and proportionally to the evolving reality of the markets. It is not proposed to create new institutions embedded in the Treaty with no precise idea of their role but rather to pragmatically adapt the EU supervisory arrangements to what will occur in the European securities markets. CESR believes that once it has completed the very significant task of dealing with the FSAP measures, there is great scope to adapt the supervisory arrangements.
3. The FSAP directives impose on the securities regulators additional heavy obligation to cooperate. It is CESR’s view that these new legal obligations require all European securities regulators to have the same capacity to act. Any credible Home/Host relationship or Network arrangement cannot work if the relevant authorities do not have equivalent and rigorous powers to supervise, investigate, sanction and exchange information regarding investment services, issuers, auditors, regulated markets and UCITS. Annex 3 of this report shows that the powers legally attributed to regulators are not equivalent in all areas at this juncture. The granting of powers to the competent authorities which is in the hands of the Member State could also cover, within the national constitutional arrangements, equivalent rule making powers.
4. CESR would like also to highlight the considerable progress made under the Lamfalussy approach to create a solid legal basis for a Single Market for Financial Services as well as for enhanced convergence in supervisory practices. Institutional and external reports, as well as the interviews carried out in the course of this work, have shown that CESR is seen as a success and is proving to be on the right path. However, some have voiced criticism about the possible democratic deficiency at Level 3 and the weak EU legal basis of CESR. To face this evolving market reality, the greatest priority of CESR members is to deepen the



cooperation arrangement under the FSAP legal framework to enhance better the Home/Host(s) supervisory relationships and to improve the convergence of approaches and decisions within the Network of securities regulators. As regard the Home/Host(s) relationship the report envisages several additional supervisory tools that could be rapidly put in place and others that should be considered soon or could be activated at a later stage. As regards the capacities of the Network, the report lists possible new improvements so as to enhance the convergence in supervisory enforcement and decision making (including an extended mediation mechanism); to develop significantly, within the legal limits, the role of CESR as “supervisor of national supervisors” through thorough peer pressure instruments; the possible definition of a “mission statement” for EU securities supervisors; and finally, developing a better access by regulators or by the general public to regulatory information on an EU-wide basis. When developing these supervisory tools, CESR is determined to enhance democratic and political accountability links with the European Parliament, the Financial Services Committee and the European Commission.

- 5) The purpose of the publication of this consultative paper before having reached a final conclusion is also to seek guidance from the EU institutions and comments from the market players and users of financial services on how deep this improvement of the Network should be. CESR believes that all possible tools under the present legal framework of the FSAP should be explored before envisaging more far reaching approaches. However, this analysis would be incomplete if it would not flag that the need to consider supervisory tools carrying a trans-national dimension is closer than it was four years ago when the Committee of Wise Men, chaired by Baron Lamfalussy, was set up.
- 6) The mention of trans-national options is risky in the sense that the focus of attention is likely to move too soon into this field. CESR believes that these options should be considered only if it is very clear that the present system cannot be developed to provide proper solutions to the questions of supervisory convergence. If the Network is allowed to do so, it is manifest that the present system is capable of significant development and improvements in ways described in the paper. These improvements have the prospect of providing EU-wide solutions through the passport system. CESR therefore attaches priority to making these practical improvements and to providing all European securities regulators with equivalent powers and similar capabilities.

CESR stands ready to explore further any of these preliminary suggestions with the interested parties and, following reactions from the EU institutions and from the markets will review this first tentative agenda and transform it into a more definitive work programme for the future. Further work will cover in particular the monitoring of the powers and the necessary resources given to CESR Members, the legal definition of a coordinating supervisor for trans-European market players and the development of the peer pressure instruments to enhance supervisory convergence.



## Introduction

On 2<sup>nd</sup> June 2004, the ECOFIN Council endorsed the FSC report on Financial Integration and underlined that the full and consistent implementation and effective enforcement of all FSAP measures must have now the priority. The same message was strongly voiced by the Commissioner for the Internal Market and by the Chair of the EMAC at the last conference organised by the European Commission on 22<sup>nd</sup> and 23<sup>rd</sup> June. The members of CESR fully share these objectives of the EU Institutions and have therefore decided to carefully analyse what is expected from them in the process of implementation and enforcement of the FSAP. By doing so CESR is contributing to the creation of an efficient single market for Financial Services, which is a prerequisite for the competitiveness of the EU economy in view of the Lisbon objective.

In addition, the Lamfalussy process will be fully evaluated at the end of 2004 and CESR wants to actively contribute and be involved in any debate concerning its own future.

The purpose of this preliminary analytical report on the regulation and supervision of securities activities in Europe by CESR is twofold. The first objective is to take stock of progress made through the Financial Services Action Plan (FSAP) for the integration of the EU Single Market for Financial Services in the field of securities. The second objective is to identify and analyse the supervisory tools necessary to implement the FSAP and to anticipate the expected evolutions in the next five years so as to allow securities regulators to fully play their role in maintaining fair, transparent and secure securities markets in Europe.

This report concentrates on the regulatory and supervisory issues related to investor protection and the proper functioning of securities markets. In addition, the focus of the paper is the implementation of EU securities laws. As regards the elaboration of EU laws and implementing measures, CESR fully supports the existing arrangements under the Lamfalussy approach and expresses the wish to continue to play an advisory role vis-à-vis the European Commission, once the draft Constitution is ratified.

The Chairs of the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS) have been fully informed of this CESR initiative as many of the issues discussed here will be of interest to them. This work does not cover prudential issues related to the prudential supervision of banks and insurance companies which are of fundamental different nature and focus.

The possible evolutions described in this paper are developed, in consistence with the current institutional boundaries vis-à-vis the European Commission, the European Parliament and the Member States. Every time ideas put forward go beyond the scope of the powers of the members of CESR, and the current FSAP legal framework, this has been duly highlighted.

A specific Task Force within CESR was in charge of preparing this analytical report. The Task Force was primarily guided with the idea of understanding the needs of the markets and their degree of integration. For that purpose the members of the Task Force conducted numerous interviews with key market participants and major players within the EU institutions. A seminar with leading academics was also organised on 6<sup>th</sup> September 2004.

It came out clearly from these interviews that CESR should have an “adaptive” and forward looking strategy depending on the evolutions in the market, rather than trying to suggest the creation of new institutions without precise idea of what their role would be.

With this in mind, this first progress paper is structured along the following lines.

- How integrated is the EU Securities Markets?
- The challenges faced by the Network of regulators and its possible improvements;
- The challenges faced by the mutual recognition model and its possible improvements.



This preliminary paper will be presented to the EU institutions and is open to public consultation by 31<sup>st</sup> January 2005. Unless specifically specified, all comments received will be published on the CESR website.

Guided by the reactions of the EU institutions and comments received, the Members of CESR will reconsider the accuracy of this preliminary analysis and elaborate a more detailed and structured agenda for the next five years.



## **D) How integrated is the EU Securities market?**

In this section it is CESR's intention to acknowledge the conclusions of existing analysis of the status of integration both from an economic and legal perspective<sup>1</sup>. In addition, CESR exposes its own tentative conclusions from what it experiences both at the level of markets and during the FSAP work.

This will provide the basis on which to explore and analyse the issues raised by the regulation and supervision of securities activities in an increasingly integrated EU market. And indeed the more integrated the market, the more the cross-border dimension becomes all pervasive and therefore the greater the challenges faced by regulators.

This chapter will therefore touch, first, on the integration of the market from the perspective of the market infrastructure, investment firms, issuers, investment products and investors. The key theme is that the level of integration is patchy and occurring at variable speeds as a result of difference framework where the theme is that the framework has undergone an almost complete overhaul. It is too early to conclude as to whether the market players will take advantage of this framework to act as players in a single market.

### **Ia) The degree of market integration**

#### **Market infrastructures**

Overall, after a very active phase, the pace of integration is slow but gathering significant momentum. On the regulated markets side, there are a number of models that have emerged (Euronext, the OM/Norex group) or are developing within different jurisdictions through the sharing of technology, the development of new market segments to increase competition and through multilateral trading systems. The picture for second and third tier markets is less clear and the focus remains predominantly national.

Concerning post-trading infrastructures, progress is also slow. Cross border clearing and settlement costs are, according to the Giovaninni report substantially higher than for domestic transactions thus suggesting the existence of significant barriers to market integration. However, mergers and consolidations are happening increasingly visible in areas such as clearing systems and custodians.

Finally, CESR notes positive integration developments in payment systems which are a key component of the securities market value chain even though generally not part of the responsibility of securities regulators.

#### **Investment firms**

Here the integration story is mixed. Cross border business is developing through the use of technology, improved remote access to markets and the greater integration of wholesale markets (see below). However, there is as yet little sign of cross border mergers/takeovers of investment firms, whether it be brokers or fund managers except when it is needed for access to the EU's wholesale markets. Furthermore, apart from one or two non-EU firms, there are few examples of firms that operate in a truly single market fashion. The overwhelming majority of firms are still national in terms of management and strategy.

#### **Issuers**

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<sup>1</sup> For instance please see the FSC „Financial Integration – Final Draft“ (3. March 2004), and European Commission „Financial Integration Monitor 2004“, Commission Staff Working Document.



On the debt markets there is a high degree of market integration although use of debt markets as opposed to more traditional bank finance by companies varies significantly across the EU. On the primary equity markets, the degree of integration is higher for “blue chips” included in major indexes: public offerings are often extended on several EU financial centres. Secondary trading on “blue chips” is very liquid and increasingly index based. For this category of issuers EU capital markets provide sufficient financing. Primary and secondary markets for SME’s are more nationally orientated and attract more proximity investors.

### Investment products

#### **The state of integration in wholesale markets**

Wholesale markets with standard products (money markets) are fully integrated market in the unsecured Euro area money market. Integration is somewhat lower in the secured money markets (e.g. the repo-market). The trend points towards full integration of all segments of the inter-bank market with integration of the fixed-term deposit market achieved early on.

#### **Wholesale markets with non-standardized products**

Bond markets in general and the government bond market in particular, are integrated. The elimination of monetary policy differences has led to a convergence of eurozone bond pricing. Wholesale equity markets seem less integrated than the markets considered so far using as indicator the average proportion of stock price variations and the proportion of shares held by non-residents in European exchanges is between 20%-30%. This figure includes a large participation of third country institutional investors.

#### **The state of integration in retail markets**

Retail markets are not integrated. There is no evidence of substantial cross-border share trading activity. The rapid increase since 1999 in the share of foreign assets in balance sheets comes from investment funds, and in particular equity mutual funds.

### Investors

Retail investors do not as a general rule operate cross-border. Those who do invest in shares directly will tend to do so in their own national market and still rely on collective investment schemes to get exposure to non-domestic markets. However, professional investors are increasingly viewing the EU as a single market and demanding indices and other tools to reflect their changing priorities. Finally, the major market participants (market counterparties) continue to be active right across the wholesale markets.

## **Ib) The degree of legal integration**

### Supply side

On the supply side there are five legislative elements to look at when assessing the current state of integration: **the Prospectus Directive (“PD”)** harmonizing the initial disclosure obligations for issuers of securities who initiate a public offering and providing issuers with a European passport that allows them to raise capital all over the European Union with only one prospectus; **the Markets in Financial Instruments Directive (“MiFID”)** establishing admission requirements for financial instruments to trading; **the “Product” Directive for Undertakings for Collective Investments in Transferable Securities (“UCITS”)** defining a range of financial products that UCITS benefiting from a single license may invest into; **the Market Abuse Directive (“MAD”)** establishing uniform publication requirements for price sensitive information and implementing common standards against market abuse throughout the EU; the **Directive on Transparency** setting requirements



aimed at upgrading the information available to investors. MiFID and the Transparency Directive are still awaiting their Level 2 Measures. The other directives are in the early stage of implementation.

### **Demand side**

The PD by supplying the demand side with information regarding a financial instrument has investor protection at the core of its regulatory targets for both, institutional and retail investors. It also comprises several exceptions where a prospectus does not have to be issued for offers intended for institutional investors (e.g. offering of at least €50,000 per investor). The MAD intends to support integrity and efficiency on financial markets and regulates the investigation and sanctioning of abusive practices thus also providing for the protection of investors. A third dimension of investor protection is the Takeover Directive which deals with the rights of shareholders in companies targeted for a takeover by establishing a set of rules a potential purchaser has to adhere to when attempting a takeover.

As far as the regulation of the institutional side is concerned one has to look at the Institutions for Occupational Retirement Provision Directive (“IORPD”) harmonizing the running of pension funds and the UCITs Directives that have extended the scope of funds that could benefit from an EU passport.

Access by investors to security markets has been increased also by the E-commerce and distance selling directive. However, the impact of different tax and marketing regimes will make the development of European retail products difficult.

### **Intermediaries and market infrastructures**

The MiFID deals with a European passport for investment firms who can provide investment services across the European Union, once they have been admitted in their home member-state. They are also entitled to establish branches, access regulated markets and clearing and settlement systems in the territory of another member-state. In addition, the MiFID incorporates a variety of requirements for intermediaries in relation to risk management, outsourcing, management of conflicts of interest and best execution, thus providing for a level playing field within the EU. It should be noted that increasingly trading activities are organised according to market segmentation rather than geographical localisation.

The MiFID sets out detailed regulations for transparency requirements on regulated markets, multilateral trading facilities, systematic internalisers and over the counter trades, intending to provide a level playing field for the different kinds of trading models existing in the market place.

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Overall the FSAP has reset the legal framework in a manner that will favour the integration of the EU’s single financial market. Through the level 1 directives and their level 2 implementing measures, the directives have on the whole set the appropriate level of harmonisation to allow for the principle of home state, mutual recognition to operate in an increasingly integrated market. The new legal framework introduces certain additional concepts to support the principle. These developments will be the subject of the next chapter.

The pace of integration suggests that obstacles still exist to the integration of securities markets. These obstacles will need to be systematically identified and subjected to careful analysis before deciding that further changes to the legal framework is necessary. Areas where this analysis needs to be undertaken include clearing and settlement, fund management, including UCITs.





For several different reasons therefore (wholesale/retail, remaining barriers, nature of the financial product or service...) the degree and speed of integration varies from segment to segment of the EU securities market. Therefore it is likely that the appropriate supervisory tools at EU level would need to be different from one segment to the other.



## **II) The network of the EU Securities regulator: challenges and improvements**

With the transformation of the network of European securities regulators into a formal Committee of the Union, by the Stockholm resolution, the resolution of the Parliament and by a Decision of the Commission, CESR has been entrusted with a role to ensure more consistent and convergent application of EU laws in the securities field.

To face the challenges of the progressive integration of the various segments of the EU securities markets, the first priority of CESR is to define and use all the possibilities within the Level 3 of the Lamfalussy approach and the additional supervisory tools provided by the Financial Services Action Plan. In this preliminary analytical paper, CESR is proposing a gradual approach to adopt the supervisory tools to the degree of integration of the Single Market. The first and immediate step is the application of the role of CESR at Level 3 as defined in the final paper on Level 3 (Ref. CESR/04-104b) published in October 2004. The second step would be to intensify the capacities of the Network by deepening cooperation between the Members (with some supervisory tools to be considered soon and others depending highly on market evolutions) and developing a rigorous policy to enhance the role of CESR as “supervisor of national supervisors” through serious and effective “peer pressure” and an efficient mediation mechanism. Should the EU institutions develop more far reaching options, CESR suggests that the discussions could explore the possibility to provide the Network with additional legal and supervisory tools.

The Network has the capacity to respond to a rapid and deep integration of the EU securities market as envisaged in the FSAP. CESR will, however, remain vigilant and monitor the efficiency of the current supervisory tools as the Network has its mutual limits: common approach by CESR Members are non-binding legal instruments at EU level and are based on voluntary implementation. In addition, the legal accountability of each CESR Member is established at national level vis-à-vis their respective domestic constituencies.

Although the common approaches reached by CESR members have no legal meaning at EU level, they increasingly produce effect in the day to day supervision of the Single Market and for that reason, creates accountability expectations. Therefore, in its Level 3 capacity, CESR is firmly determined to develop its political and democratic accountability links vis-à-vis the Financial Services Committee, the European Commission and the European Parliament.

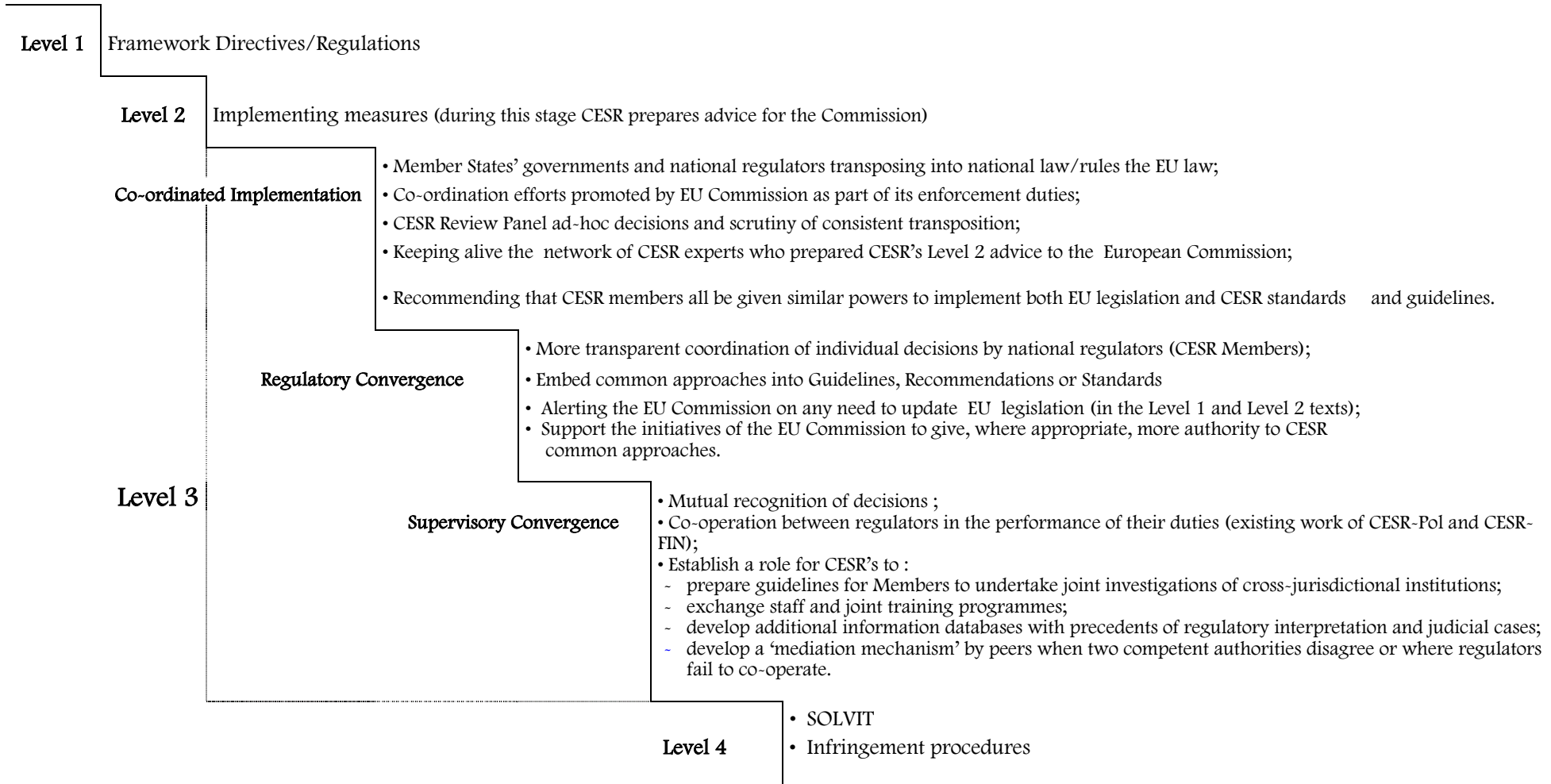
### **Ila) Current role of CESR at level 3**

CESR has set out in a recent paper the way in which it intends to play its role at Level 3 under the four level Lamfalussy approach in order to respond efficiently to the current state of integration of the EU securities markets.

The key functioning tools that CESR will develop in the coming months can be summarised as follows:



## Level 3 Framework in context





Level 3 is therefore a key pillar in ensuring that Home/Host arrangements function effectively in the EU. CESR has consulted on its level 3 role and the final paper is published alongside this one. It is therefore important for readers of this paper to have a full understanding of the potential of Level 3 action in order to understand the context in which CESR's analysis is undertaken in this section of this analytical paper.

## **IIb) The challenges that CESR Members will face when the FSAP is implemented**

As just described, at the heart of CESR's mission is an obligation to deliver convergence of policy, supervision and enforcement. The issues and challenges that will develop once the FSAP directives will start producing their effects are numerous. They can be broken down into three major questions:

### **❖ How convergent is the approach to supervision by the Network of European securities regulators?**

Convergence of approach. While all securities regulators have objectives around market confidence and investor protection, there are different general approaches to what this means in practice. What, for instance is an acceptable level of risk that should be borne by the investor? How active should regulators be to build market confidence? How much weight should be attached to the benefits of market innovation? Is regulation the appropriate answer to a market failure? All regulators are also entrusted with the task of keeping market confidence. However, in the EU, there are different approaches at this juncture about the role of regulation in restoring market confidence? The spectrum of views range from those who focus more on market failure analysis and the economics of regulation to those who focus more on measures to build investor confidence and thus allow markets to function properly with a better interaction of supply and demand.

The calibration of regulation. Across the EU, and within each jurisdiction, there is a wide diversity in the provision of financial services. This poses a particular challenge to ensure that regulation is appropriately calibrated. The areas requiring particular attention include:

- Variety of financial markets – equity, bonds, derivatives, commodities
- Small markets –e.g. the handling of programme trades; the role of research
- Low liquidity – all markets have financial instruments that are illiquid.
- Operation of wholesale markets
- Operation of retail markets

### **❖ Is there enough common approach and reliance between European Securities regulators? Are the EU directives always fairly applied by CESR Members?**

Powers of the regulator and mutual reliance. As described Annex 3, securities regulators have a diversity of powers both in terms of scope and in terms of rule making, supervisory and investigative means. This will deliver a wide variety in the supervisory results faced by market participants across the EU. With this diversity, what is necessary for CESR members to rely on the other's supervisory work for its domestic market? Can a network function efficiently if its members are not on an equal footing to act? Can supervision ex-ante be reconciliated with supervision ex-post when applied to the same subject matter?

Supervisory intensity. The resources devoted to supervision of the given legal framework, and how they are deployed including the degree of autonomy of the supervisor in allocating its resources, vary widely in the EU. For example, in the vetting of prospectuses, some authorities employ considerable resources in checking



the contents of prospectuses, others rely more on the legal responsibility of the issuer and possible civil actions from shareholders. How can supervisory intensity be measured in this context?

Misapplication of directives. Securities regulators could be tempted to apply a directive in a manner that protects the interest of their national market places. Would this provoke breaches in the Level playing field? How can CESR intervene to prevent this behaviour? Is naming and shaming sufficient and could it be applied under the present liability rules? At what moment should the Commission act at Level 4?

Measuring performance. Once individual regulatory or supervisory action occurs, how does one benchmark performance? Can peer review be made to work? What happens when one member fails to reach an acceptable level of performance in a particular area?

Co-operation. The new legal framework will impose rights and duties. Are these similar enough across the different areas of the capital markets? Are there gaps in the legal framework for co-operation? What can be done in the event of a failure to co-operate? Is mediation sufficient? Are more incentives for co-operation required?

❖ **Is there enough coordination of decisions by the European securities regulators?**

Consistent decision making. Market participants, in particular trans-European market players, are expressing the need to have confidence that regulatory and supervisory decisions will be broadly consistent. What are the areas where it is necessary to ‘think European’ before ‘acting nationally’? To what extent can the decisions of individual regulators be reviewed by their peers either ex-ante or ex-post? And what is the value of these peer judgements given the national legal framework in which individual regulators operate? Are there areas for which it is necessary to ‘think European and act European’?

Market crisis. A special case is in the event of market disruption caused by either an external shock disrupting the normal functioning of a major market infrastructure or through a confidence crisis whether the network has the structures to function effectively? Indeed, what should its role be? How will the interests of the single market be reflected in the solutions to the crisis which might have a more local origin? Do those not directly affected by the crisis have any rights?

Identification of emerging issues. Innovation in markets will be dispersed around the EU with any innovation initially affecting a minority of the EU states. How does a Network respond to something that by definition affects a minority of its members? Moreover, given that an innovative new product may well spread across the EU over time, is there a role for CESR to play? Indeed should all significant innovations be subject to a pan-EU assessment at an early stage without impairing market developments?

## **IIc) The adaptative improvements of the Network of securities regulators**

To confront the challenges set out above, CESR has identified several additional tools it can develop from an effective supervision of the markets resulting from the implementation of the FSAP. All the tools set out below will need to be developed in greater detail before being applied. However, they are included here to provide an opportunity for preliminary comment.

CESR has identified several additional tools that can be articulated along the following objectives:



**i) The Convergence in Supervision, enforcement and decision making**

Market participants with trans-European reach are rightly seeking a more consistent approach in the day-to-day supervision of their activities and on the enforcement of securities law across the Union. The fluidity of cross-boarder provision of services is directly dependent on the legal predictability of the national securities regulators working together within CESR.

As expressed in Part III of this paper all improvements of the Home/Host relationship would strongly favour convergence of supervision and enforcement. CESR will also contribute to this convergence at Level 3 under the Lamfalussy approach. Should the degree of integration accelerate and the interdependence between CESR members intensify, some additional tools will have to be considered by CESR. The additional tools to be considered soon are set out below and those tools that are likely to be activated later are in italics. The tools cover the following areas:

**For supervisory convergence:**

- Where necessary, definition of a ‘coordinating’ supervisor on a case by case basis by the relevant supervisors. For certain supervisory tasks or investigations of market abuse, depending on the jurisdiction of the transaction or the market players, the definition of a “coordinator” between the supervisors involved could enhance considerably the results of supervision or enforcement action;
- A more ambitious policy of secondment of staff between CESR members;
- Specify the role of securities regulators in the management of identified crisis. In particular, identify the priorities in case of shocks disrupting the continuity of markets.
- *Discussion at CESR level of supervisory programmes by its members so as to set priorities and allocate resources accordingly;*
- *Elaboration of a standard MOU for the supervision of trans-European market participants. Should the number of trans-European market players develop in Europe, a standard MOU describing the cooperation obligations and the appropriate governance of the Home/Host(s) relationships would significantly enhance the capacity of supervisors to react and would also provide a supervisory level playing field in Europe? This MOU should recognise that different market models present different supervisory challenges and that diverse cooperation models will be required.*

**For enforcement coordination:**

- A more active use of joint investigations by the supervisors involved;
- Creation of databases of sanctions;
- *A more active role given to the Chairs of CESR-Pol and CESR-Fin to coordinate enforcement action for multi-jurisdictional live investigations or cases. Where more efficient, this would include the possibility to set up ‘investigation teams’ under the umbrella of CESR-Pol or CESR-Fin;*
- *More automatic mediation by CESR in case of lack of cooperation.*

**For decision making convergence:**

- Enhance the transparency to CESR members of individual decision through more intensive specialised discussion and/or the consultation of databases of decisions;
- *Without impeding innovation, offer the possibility for promoters of pan-European innovative products or services to seek a ‘pre-clearance’ at CESR level before applying for national authorisations and/or passporting;*
- *Where relevant for the Single Market, envisage the obligation for a CESR member to consult the other members before taking decisions that would*



*have significant impact on other market players (extend the approach put in place for accepted market practices under the MAD). By doing so, a member of CESR would seek the opinion of its colleagues before deciding to allow the performance of a new service or the offering of a new financial instrument that could have a significant impact on other market places.*

## **ii) The fair implementation and application of directives**

An EU supervisory system based on the mutual recognition of decisions by national regulators needs mutual reliance in the day to day application of the FSAP directives. It highlighted in Part III of this paper that similar rule making, supervisory and enforcement powers would considerably enhance the degree of trust between European securities regulators. In order to enhance mutual reliance and, in addition to the legal powers granted to supervisors, the members of CESR should apply the same supervisory intensity to the same issues and also benefit from equivalent financial and human resources. It is CESR's serious objective to enhance significantly its roles as "Supervisor of national supervisors" in evaluating the intensity of supervisory efforts applied to similar tasks. The purpose is here to improve the self discipline of supervisors when applying directive through toughened peer pressure. In addition to the existing tools at Level 3 of the Lamfalussy approach (Part IIa), in situations where the degree of integration and interdependence of interest will increase, CESR could+ envisage putting in place the following other tools (additional tools to be considered soon are in normal characters, those which are likely to be activated later are in italics):

- A more active and systematic role for the Market Participants Consultative Panel to point out inadequate applications by regulators of directives that create barriers to the Single Market;
- A more intensive use of the Review Panel to check the transposition of standards, recommendations and guidelines;
- A larger scope for the mediation mechanism within CESR aiming at resolving conflicts of interpretations of directives between Home/Host(s) competent authorities that would accept the say of group of peers. This could be articulated by the compulsory obligation to enter into mediation for Home supervisors disagreeing, as it is today required by the MAD in cases of lack of cooperation;
- *Increase the peer pressure between members of CESR by launching systematic peers reviews (very focused in scope) that could be conducted by 'mission teams' going on-site to collect information about possible inadequate applications of directives by members;*
- *More systematic use of publicity of inadequate application of directives by Members as a threat.*

## **iii) Definition of a Mission Statement for EU securities regulators**

When performing the supervisory tasks, the EU securities regulators would need at some point to better define in detail the content of their general objectives. Common understandings and approaches to market integration, investor protection, transparency of markets and market integrity will become more important the more the inter-dependence of decisions will grow. CESR can play an active role in fostering convergence of approach. This might even lead to the definition of overarching principles at EU level. This would need to take into account the global dimension of securities markets and the particular link created by CESR with the US Authorities (SEC and CFTC).

## **iv) The access by regulator or by the general public to regulatory information on an EU-wide basis**



The MiFID and the Transparency directive will require respectively investment firms to report transactions to the regulators and issuers to disclose at EU level financial information. Depending on structural effects of these directives, CESR could be led to envisage EU-wide solutions (including market led solutions) to facilitate compliance by investment firms and issuers with their obligations and provide with more cost efficient solutions. This could cover:

- *The creation of a central, or centrally accessible transaction reporting system under the MiFID accessible by all competent authorities;*
- *The creation of a central or centrally accessible storage of regulatory information from listed companies under the Transparency directive in a manner that makes it accessible to the general public.*

These projects would require significant IT investments.

## **IId) Improvements that might be considered by EU Institutions (Commission, Council and European Parliament)**

The priority for CESR Members is to deepen the possibilities of the Network to face the market evolutions generated by the FSAP. All possible tools under this legal framework should be envisaged before looking for more far reaching solutions. It is difficult at this juncture to predict the speed and the intensity of the integration of the Single Market but it cannot be excluded that there could be cases where the tools available to CESR and its Members could be complemented, in certain circumstances, by the legal possibility for the Network, rather than an individual member through mutual recognition, to take single EU decisions.

Any move in this direction is the exclusive prerogative of the EU institutions. The preliminary view of CESR is that to trigger the need for single EU decisions the following five tests would need to be satisfied:

- **Efficiency.** There should be demonstrable evidence that the existing and improved tools of the Network does not allow for an efficient supervision or predictable and legally certain decisions for market participants and investors. (This should include a costs effectiveness and cost-benefit analysis, including resources);
- **Subsidiarity.** There should be demonstrable evidence that for decisions that affect the vast majority of Member States it is more cost / efficient to take one single EU decision for the matter involved rather than one mutually recognised decision nor 25 coordinated decisions;
- **Balance.** There is a real paralysis of the supervisory cooperative arrangement due to a significant imbalance in the supervisory relationship between Home and Hosts competent authorities of the market player involved (the major business units are located in Hosts jurisdictions or the trans-European market player represents a very significant percentage of the activity in given Host jurisdictions);
- **Integration.** There should be a high degree of integration at EU level of the securities activity (or market segment) involved;
- **Uniformity.** Rapid and uniform effect of this supervisory decision throughout the Union is not provided anymore by the mutual recognition system.

In addition, any supervisory issues that would require a single EU decision would need to be identified and selected in advance through a transparent and democratic process. Such a selection would have to be done progressively, once the conditions are met, through modification by co-decision of the existing directives by replacing the current mutual recognition system by a single EU decision system. By following this process, all upgrading of competences at EU level will be publicly debated and politically agreed.

Should a political decision be taken in this direction, the capacity to take EU single decision would provide each CESR Member with an additional capacity to act for matters





in complement to the existing national powers? Those decisions would need to be taken by the Members of CESR acting collectively in order to ensure a full consistency with the other decisions taken by them nationally or within the Network. This would also ensure a full consistency of application of the decision in each jurisdiction. In certain cases, this would imply that national regulators accept to mutualise at EU level certain decisions that they currently take individually at national level.

The capacity to take EU decisions represents a change in the way in which CESR operates and would require upgrading the legal profile of CESR. Such changes would include, in particular, the specification of the way in which such decisions are taken (including voting methods), the legal liability of the members of the Network and how third parties can appeal against such decisions. This would require also keeping the independence of CESR and reinforcing accountability links with the EU institutions. The modification of the legal profile of CESR would require the proposal by the European Commission for a Directive or a Regulation which would invest CESR with such powers and the adoption of such a legal text by co-decision by the Council and the European Parliament.

So far, there is not unanimously voiced supervisory issue that would urgently and immediately require an EU single decision. However, and without applying the five tests, several categories of issues have been mentioned in the course of the interviews. These issues include:

- For EU-wide public offerings of highly standardised products, could the approval of the Securities Note at EU level (the Registration Documents being nationally approved) prove more cost / efficient?
- Could standardised UCITS be approved at EU level before being widely marketed in Europe through national channels?
- When market confidence is at risk, could a proper operational interface at EU level provide more expedient decisions on how best to apply accounting standards for listed companies and in tune with investors needs?
- CESR is currently studying the regulatory issues raised by credit rating agencies and has not yet reached a conclusion on this matter. It has nevertheless been highlighted that there are today 3-4 players in the market (mostly US) getting formal or implicit recognitions in the 25 Member States based on very different assessments. Should there be an understanding that the Home/Host(s) supervisory tools do not answer all the questions, would one single permit be more efficient?
- Could certain trans-European market infrastructures, (exchanges and related, clearing and settlement services, ...) that would expand significantly in a number of Member States and for which the supervisory arrangements based on the Home/Host (s) relationships (and their possible improvements) would appear to be insufficient, be more efficiently supervised at EU level?

Discussions have started between CESR Members on the relevance of these examples without reaching any conclusion at this juncture. It is expected that the consultation will provide more evidence to gauge their accuracy.

### **III) Mutual recognition: the challenges posed by multi-jurisdictional market players**

Supervision of financial services in the EU has traditionally been carried out by national competent authorities and based on the mutual recognition of their respective decisions. The framework developed by the FSAP directives for the supervision of the EU securities markets continue to be mainly based on the competences of the Home country competent regulators (i.e. where an issuer has its headquarters, where the licence to provide investment services has been granted, where a UCITS has been agreed, or where a regulated market has been recognised).

The FSAP framework has also considerably increased, cooperation obligations of the competent authorities. In addition to a well experienced bilateral relationship between the Home competent authority and the Host competent authority (Home/Host), the emergence of multi-jurisdictional market players has induced the creation of ad-hoc supervisory arrangements involving several authorities.

#### **IIIa) The Home/Host relationship: new challenges**

The increased flow of cross-border activity creates the need for a more intense and confident relationship between the Home and the Host competent authorities. One of the challenges faced in the day to day experience of the Home/Host cooperation appears when there is a difference of powers legally attributed to each of the authorities. The mutual recognition of the decision of another authority requires confidence in the capability to act of the Home competent authority. This confidence can be present if the Home competent authority has equivalent sufficient powers to supervise the entity or product at stake and applies similar supervisory intensity when deciding. How can a Host competent authority accept a passport if it is not sure that the appropriate controls have been conducted?

Similarly for market abuse investigation the competent authorities rely on the others to obtain information. How can an authority get this information if its counterpart do not have the legal capacity to obtain and exchange this information? Can this exchange of information be effective if the confidentiality requirements are not the same for the two authorities involved?

The emergence of significant multi-jurisdictional market players poses new challenges for the traditional Home/Host forms of cooperation. It is CESRs' intention to explore this area further based on detailed analysis of additional specific cases involving significant multi-jurisdictional market players.

The creation of Euronext has required all regulators involved to formalise an ad-hoc 'Memorandum of Understanding' to articulate the way in which regulators of a trans-European exchange should operate and coordinate the supervision of that exchange. This includes for example:

- The co-ordinated and simultaneous approval of the initial merger and listing of Euronext NV;
- The approval of harmonized rulebooks and trading procedures for cash and derivatives markets and for clearing;
- The development of a coordinated approach towards admission to membership to other Euronext markets of current non-ISD member firms;
- The sharing of risks identified on each market and allowing identification of risks common to more than one market, this enabling a coordinated mitigation of these risks.

The cooperative arrangements between the authorities involved derive directly from the Euronext business model that preserve national entry doors to a single list and trading platform. As a consequence all securities regulators involved in the supervision of



Euronext are legally 'equals' and preserve their rights. Irrespective of their legal means, their regulatory approaches and their effective resources, each of them has a 'veto right' on all matters regarding the whole entity. This cooperative arrangement has proved efficient for the development of Euronext given the business model chosen operates in five jurisdictions with five legal and regulatory regimes. So far there has not been a crisis breaking the continuity of functioning of the markets (as experienced on 09/11<sup>2</sup>), or other event that could expose visible legal gaps in the supervisory arrangements or create an inability to act rapidly and efficiently.

Regarding the supervision of *operators of regulated markets*, the Directive on Markets in Financial Instruments has established a common set of high level principles for authorization and supervision of market operators. Unlike investment firms, the Directive does not provide for the establishment of branches by market operators. The market operator may provide, without limitations, cross border arrangements in host member states so as to facilitate remote access. When, taking into account the situation of the securities markets in the Host Member State, the operations of a regulated market that has established arrangements in a Host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that Host Member State, the Directive provides that Home and Host competent authorities of the regulated market must establish proportionate cooperation arrangements. The Directive specifically intends to cover situations whereby a regulated market provides access to its facilities in another Member State (Host Member State) and the operations of the regulated market are considered to be of such importance in the Host State that proportionate cooperation arrangements are required between the relevant authorities.

These proportionate cooperative arrangements can differ according to the business model envisaged by the exchanges merging. In all circumstances, it is clear that equivalence of powers given to the competent authorities involved is a prerequisite to the proper supervision of any trans-European exchange.

Similar questions might arise for trans-European investment firms emerging in Europe. Broadly speaking, the FSAP directives provides with a satisfactory cooperative framework for entities where the main business is carried out from the Home country through subsidiaries and /or distance provisions of services in the Host country. Issues become more complex when the major business units are located in one or several Host Member States where the group is active (or where it represents a significant part of the sector). One example is the business model envisaged by Nordea (where most of the activity is anticipated to take place in Host Member States). Beyond the prudential supervisory issues raised by Nordea as a credit institution, several investors' protection issues can be highlighted:

- How to supervise the conduct of business rules of an intermediary with branches in several Member States and organised in a trans-national manner?
- Will the Home competent authority have enough resources to supervise compliance with conduct of business rules in all Host Member States?
- Will the investor compensation scheme of the Home Member State be sufficient to compensate investors in the Host Member States?
- Will host competent authorities accept to withdraw from certain supervisory tasks if the Home competent authority has not equivalent powers?
- If a trans-European investment firms internalises trades, would the sole Home competent regulatory authority be enough to supervise its obligations under the MiFID?
- How can a Host (or several Hosts) in the country of which most of the business takes place, participate in the supervision of a trans-European firm?

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<sup>2</sup> On September 11, 2001, CESR Members were by coincidence meeting in the same room and where table to take some coordinated decision (the suspension of trading of US shares in Europe). However, the dysfunction of the markets were not located in Europe and Euronext system was not at that time a fully integrated platform covering five jurisdictions.

Finally, difficulties can emerge when supervising the disclosure of financial information of a multi-listed issuer. Recent cases of a misapplication of an accounting standard by major listed companies have created a loss of confidence in the market. In some cases the Home securities regulator did not have the legal powers to require a change in the accounting treatment. The Host competent authority was therefore obliged, in liaison, with the US SEC, to require such a change. This situation raises the following questions:

- How can the Host competent authority rely on the Home competent authority of an issuer, if the power to require the disclosure of non-misleading information is not granted to the Home authority?
- Should securities regulators have more operational powers in the areas of application of accounting standards?
- Has Europe the appropriate supervisory tools to provide interpretations of IFRS in time for the markets and the protection of investors?

These examples show that the traditional Home/Host arrangements are currently testing the limits of a proper supervisory framework.

### **IIIb) Possible improvements of the Supervision of multi-jurisdictional market players**

Under the new FSAP framework several improvements are possible in order to avoid supervisory shortcomings, duplication of efforts and unnecessary burdens. These can give useful effect to the Treaty freedom to provide cross-border services.

Such complementary arrangements to bilateral/ad-hoc Home/Host(s) relationships are of different nature and have different degrees of urgency. Depending on the significance of multi-jurisdictional market players, a preliminary list of complementary supervisory tools can be drawn upon the following manner:

- **Cooperative arrangements that can be rapidly put in place:**
  - Planning and conducting joint inspections;
  - Consultation between the involved Home/Host regulators before decisions that might affect a multi-jurisdictional entity;
  - Mandatory information on sanctions and preventive measures so as to ensure all the relevant supervisors understand the impact on the market players to be active in the market;
  - Direct access to remote market members (established in a foreign Member State) in order to facilitate access to information on transactions happening remotely on a Home Exchange;
  - Relevant authorities put in place contacts and communication channels (including with senior managers of the market player) to ensure continuity of operation in case of crisis situation.
- **Cooperative arrangements to be considered:**
  - Exchange of supervisory programmes between the Home regulators and the supervisors of subsidiaries applying home based investor protection rules or decentralised marketing of product rules;
  - Where legally possible, delegation of supervisory tasks between members of the Network;
  - Notification obligation between authorities in case of emergency situations or adverse developments to allow all supervisors involved to react promptly and in an orderly manner to events affecting a trans-national market player;



- Secondment of staff (helpful inter alia to promote the ability of host supervisors to exercise effective host supervision on foreign entities);
  - Exchange of supervisory information between market supervisors along fast track procedures.
- **Cooperative arrangements that might be activated in the future:**
- Streamlining and enhancing consistency of reporting requests by regulators. The aim is to reduce the present lack of harmonisation of the reporting requirements and the timetable for reporting, hereby reducing the administrative burden, without impairing on the objectives of supervision<sup>3</sup>;
  - Common tools such as a “data room”. Such a tool would make available all types of information that may be of common interest to the group of regulators responsible for a multi-jurisdictional entity. This would benefit both the regulators and the supervised entity itself as it would reduce the need to send multiple copies of the same document.

**IIIc) Improvements that might be considered by Member States and the EU Institutions (Commission, Council and European Parliament) if the above fails to deliver supervisory convergence**

The preceding list of supervisory tools would significantly assist supervisors of accomplishing their tasks. However, one of the prerequisites for an efficient Home/Host(s) relationship is that the supervisors have equivalent powers. In addition, some existing tools are limited in scope and could at some point be extended to other segments or functions. Therefore, CESR puts forward in this analytical paper some additional forms of cooperation between Home/Host(s) regulators that require legal changes and that could be considered by the relevant political bodies at national and EU level.

**Consistent supervisory powers**

The first conclusion of this analytical work on the relevant supervisory tools is that the Home/Host(s) relationship can only work efficiently in the area of securities if the relevant authorities have equivalent and rigorous powers to supervise, investigate, sanction and the same capacity to exchange information regarding investment services, issuers, auditors, regulated markets and UCITS. The FSAP directives (MAD, Prospectus, MiFID and Transparency) have considerably streamlined the convergence of powers given to competent authorities defined as independent administrative authorities. Annex 3 shows that the current picture of the powers legally attributed to regulators is not satisfactory in all areas. Due to the fact that the FSAP creates new obligations to cooperate, it is highly desirable that in the process of transposition of these directives, Members States aim at empowering their national competent authorities with the necessary legal means to cooperate with each other on an equal footing.

PRO	CON
<ul style="list-style-type: none"> <li>• This will enhance mutual trust between Home/Host regulators;</li> <li>• Same supervisory intensity would progressively be applied by Home/Host(s) regulators;</li> <li>• This will ease considerably the governance</li> </ul>	<ul style="list-style-type: none"> <li>• This might take some time;</li> <li>• This might require revisiting in some Member States the sharing of competences by the securities regulators with other authorities (other financial regulators, judicial, ...);</li> </ul>

<sup>3</sup> See: Forum Group, n°10, Findings of the Forum Group, Reporting requirements, Final synthesis report. 14 October 2002.

of the Home/Host relationship.	<ul style="list-style-type: none"> <li>• This will require additional resources for the securities regulator.</li> </ul>
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**Delegation of powers**

The current Prospectus directive provides with a possibility for a Home competent authority to voluntarily transfer the approval of the Prospectus to another competent authority (limited in scope). The directive does not specify either the legal condition under which delegations can happen or the legal consequences (where can such approval can be appealed? What are the liabilities of the Home and the Host in case of delegation? How should the relationship between the delegator and the delegated supervisor be organised? How will this interact with the general national accountability of the delegated regulator?). To activate such possibilities under the prospectus directive these questions will need to be further explored in cooperation with the EU Commission. In particular, a distinction can be made between the delegation of tasks and a delegation of decision making responsibilities; the delegation can be total or partial, limited in time or not, bilateral or collegial.

The EU institutions could consider extending this legal possibility to delegate powers in other securities fields and for other supervisory functions than the vetting of prospectuses. For example, the supervisors involved in cooperation arrangements to supervise a multi-jurisdictional market player (investment firm or operator of a regulated market) cannot under the present EU legal framework distribute responsibilities (decisions) or tasks (supervision, oversight) by delegation (Home to Host or Host to Home) so as to allocate the supervisory effort and resources at the most cost efficient place according to the business model of the relevant multi-jurisdictional market player.

PRO	CON
<ul style="list-style-type: none"> <li>• This could facilitate a pragmatic case by case recognition of lead regulator;</li> <li>• This could facilitate a cost efficient distribution of supervisory tasks between the several regulators of a multi-jurisdictional entity;</li> <li>• This will authorise a better allocation of supervisory resources.</li> </ul>	<ul style="list-style-type: none"> <li>• The legal consequences of such cross-border delegation have not yet been fully explored;</li> <li>• Could be used to escape responsibilities which could result in a loss of supervisory intensity;</li> <li>• Could lead to a blurring of responsibilities and of accountabilities links with national political bodies.</li> </ul>



## CONCLUSION

In this preliminary analytical paper the members of CESR have come to the conclusion that to supervise the securities markets properly in the context of the new legal framework created by the FSAP, they will need to adapt their supervisory tools to a market reality that will progressively be more integrated but with this happening at different speeds. This paper does not touch the legislative and rulemaking issues for which the Lamfalussy approach provides a satisfactory system.

According to this analysis the natural sequence for the future resulting from the FSAP Directives and the Lamfalussy process could be summarised as follows:

- 1) The FSAP Directives provides with numerous supervisory tools that will assist competent authorities in the fulfilment of their tasks, and which are based on the mutual recognition of their decisions (use of passports and supervisory Home/Host relationship). It comes out from this analytical paper that any Home/Host relationship between authorities (as well as any further improvement) requires the securities regulators, entrusted with additional legal obligations to work together, to have equivalent powers and use them with the same intensity in terms of approach and resources in order to act on an equal footing and be inter linked by a stronger bond of mutual trust. The decision to grant legal powers to national securities regulators are in the hands of the Member States.
- 2) Institutional and external reports, as well as the interviews carried out in the course of this work, have shown that CESR is seen as a success and is proving to be on the right path. CESR's first priority is to implement seriously existing and potential supervisory tools within the legal FSAP framework both in the Home/Host relationship and when acting as a Network of national security regulators. This includes a variety of supervisory tools to better coordinate tasks between Home and Host(s) regulators as well as a number of action points for CESR as a level 3 committee under the Lamfalussy approach.
- 3) It comes out of this analytical paper that national regulators will be testing the limits of the traditional mutual recognition system. This may particularly be the case where the competences of the Home and the Host(s) does not coincide any more with the location of the business units or where there is an unbalance in the consequence of the supervision between the Home and the Host jurisdiction. Should the existing or improved supervisory tools, based on the mutual recognition or a voluntary network discipline revealed not sufficient, the EU institutions could consider granting CESR Members with additional legal supervisory tools.
- 4) The purpose of the publication of this consultative paper before having reached a final conclusion is also to seek guidance from the EU institutions and comments from the market players and users of financial services on how deep this improvement of the Network should be. CESR believes that all possible tools under the present legal framework of the FSAP should be explored before envisaging more far reaching approaches. However, this analysis would be incomplete if it would not flag that the need to consider supervisory tools carrying a trans-national dimension is closer than it was four years ago when the Committee of Wise Men, chaired by Baron Lamfalussy, was set up.
- 5) The mention of trans-national options is risky in the sense that the focus of attention is likely to move too soon into this field. CESR believes that these options should be considered only if it is very clear that the present system cannot be developed to provide proper solutions to the questions of supervisory convergence. If the Network is allowed to do so, it is manifest that the present system is capable of significant development and improvements in ways described in the paper. These improvements have the prospect of providing EU-wide solutions through the passport system. CESR therefore attaches priority to making these practical improvements and to providing all European securities regulators with equivalent powers and similar capabilities.



## ANNEX 1

### List of key personalities interviewed by members of the CESR Task Force

- Stephan Bichsel (ROBECO)
- Frits Bolkestein (EU Commission)
- Tim Boyce (ABN Amro)
- Rolf E. Breuer (Deutsche Bank)
- Philippe Camus (EADS)
- Tom de Swaan (ABN AMRO)
- Peter Paul F. De Vries (Euroshareholders)
- Kees van Dijkhuizen (Financial Services Committee)
- Jörg Eigendorf (Die Welt)
- Gianluca Garbi (MTS Spa)
- Simon Gleeson and Edward Murray (Allen&Overy)
- Patrick Goudou (European Aviation Safety Agency)
- Marjorie Gross, Manfred Schepers and Bertrand Huet-Delaherse (Bond Market Association)
- John Hollows (K&H Bank, KBC)
- Angela Knight (APCIMS)
- Alexandre Lamfalussy (Committee of Wise Men)
- Rudy Markham (Unilever)
- Tomasso Padoa-Schioppa (European Central Bank)
- Michel Peberneau (BNPParibas)
- John Plender (Financial Times)
- Markku Pohjola (Nordea)
- Stuart Popham and Chris Bates (Clifford Chance)
- Klaus Riehmer (Cleary Gottlieb)
- Jukka Ruuska (OMX)
- Werner Seifert (Deutsche Börse)
- Jean-François Theodore (Euronext)

All interviews were carried out by the members of the Task Force on a personal basis. The content of the interviews has considerably enriched the understanding of the issues surrounding the supervision of securities activities in Europe by the members of the Task Force. This analytical report does not reflect the views of the personalities interviewed. CESR would like to thank each of them for their time and their very valuable thoughts.





## ANNEX 2

### Programme for the Academic Experts Meeting on, the Future of Regulation of Financial Services in the EU (CESR, 6 September, 2004)

#### Morning Session - Part I The Present State of Affairs

The morning session mainly dealt with the present state of affairs. It included an analysis of the present state of integration of the financial markets, leading to an analysis of the integration – or non integration of the markets. It also dealt with the current supervisory framework and its challenges.

**Item nr. 1.**  
**Economic and Factual Analysis of the Current State of Integration of Financial Services Market in Europe and the Effect on the Present Regulatory Issues.**

Comments by Prof. Colin Mayer (Said Business School, Oxford) and Prof. Jan Pieter Krahen (Johann Wolfgang Goethe-Universität Frankfurt)

**Item nr.2**  
**What are the Current Regulatory/Supervisory Issues and Impediments on the Way to More Integration for the Financial Services Markets?**

*Comments by Prof. Richard Portes (London Business School)*

**Item nr. 3**  
**What are the Current Tools and Approaches for Supporting Integration?**

*Comments by Prof. Guido Ferrarini (Università degli Studi di Genova)*

#### Afternoon Session - Part II Towards a Future More Efficient Regulatory or Supervisory Framework

In the afternoon session, attention was devoted to different models that could in the future be developed: at least three models could be put forward: the first is based on bilateral or tailor-made solutions; the second on networking among supervisors, the third on full or part centralisation of supervision. On each of these models comments were expected from the angle of the European Community Law as it stands, and would be developed in the framework of the future Constitution.

**Item nr. 4**  
**Bilateral or Tailor-Made Cooperation Arrangements**

*Comments by Prof. Freddy van den Spiegel (Vrije Universiteit Brussel)*

**Item nr. 5**  
**The Network Approach**

*Comments by Prof. Eilis Ferran (University of Cambridge) and Prof. Michel Tison (Universiteit Gent)*

**Item nr. 6**  
**Centralised Decision Making**

*Comments by Prof. Christian de Boissieu (Université de Paris I et au Collège d'Europe Bruges) and by Mr Ruben Lee (Consultant)*



## ANNEX 3

### Re: Mapping Exercise on Powers of CESR Members in the Securities Sector

This annex summarizes the main aspects of the preliminary results of the mapping exercise of CESR Members' powers, which was undertaken in the course of 2004 by the CESR Review Panel, chaired by Mr Kaarlo Jännäri, Vice-Chair of CESR. These results provide a snapshot of the current situation in Member States. It can be expected that the consistent implementation of the FSAP legal measures in the securities area in all Member States will bring about considerable changes to the powers of CESR Members in a number of the fields of competences set out. CESR will conduct similar mapping exercises on a regular basis for which the results presented below will form the benchmark. It should also be taken account of the fact that the mapping exercise refers to legal provisions, and not to the application of these provisions and the actual intensity of powers.

The questionnaire covers the following core areas of securities law:

- Primary Markets
- Investment Services
- Market Infrastructures
- Investment Management
- Market Abuse
- Issuers

It also includes the following non-core areas of securities law:

- Investor Compensation Schemes
- Auditors
- Advertising
- Credit Rating Agencies

CESR Members provided information as to the following areas of powers: rulemaking powers, supervisory powers, investigatory powers, sanctioning and enforcement powers, and cross-border and cooperation powers.

According to the situation applicable in a Member State, each CESR Member was requested to complete the questionnaire according to the following four categories given, namely whether it has sole powers in a particular area ("1"), whether powers are nationally delegated to ("2") or shared with another entity ("3"), or whether the CESR Member in question has no powers at all ("4").

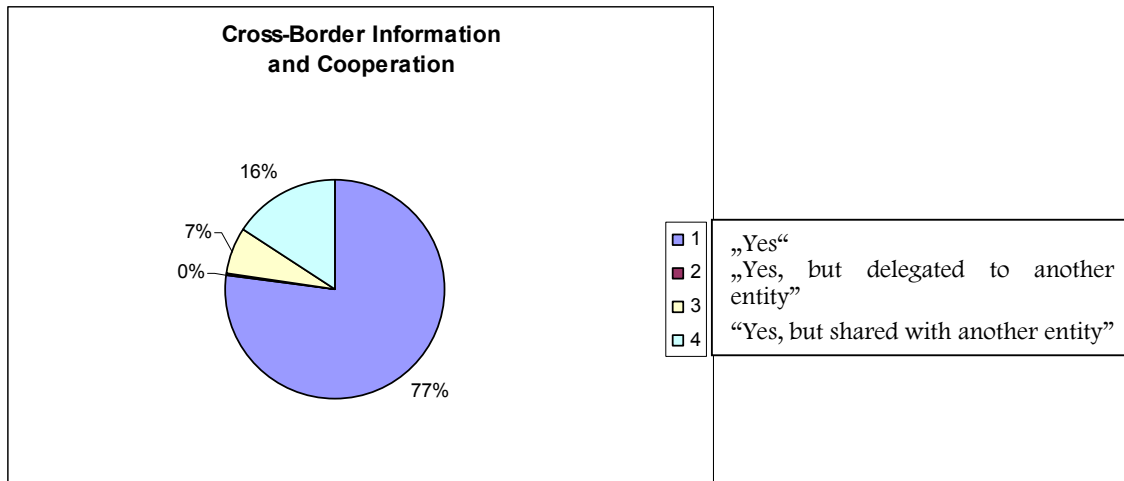
### PART I – Powers given to EU securities regulators

#### General results:

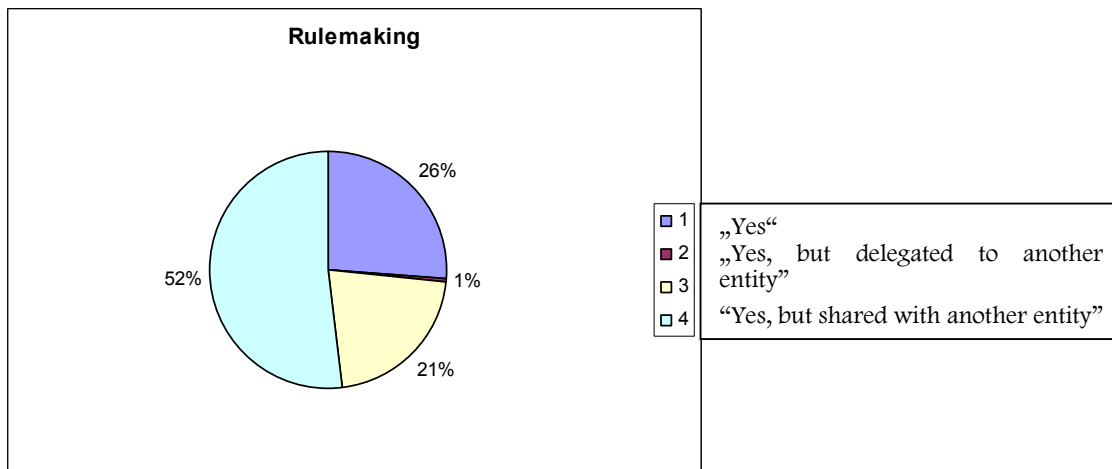
With respect to cross-border information and cooperation, on average, two thirds of CESR Members have sole powers to cooperate and exchange information with other competent authorities in the core areas of securities law, with the exception of corporate governance and accounting (see pie chart 1<sup>4</sup>). As regards the non-core areas of securities law, CESR Members generally lack powers as to cooperation and exchange of information on auditors and credit rating agencies.

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<sup>4</sup> For greater statistical soundness, each area of securities law included in the pie chart on cross-border information and cooperation and the one on rulemaking was given the same weighting.



With respect to rulemaking powers, a CESR Member would be considered having sole rulemaking powers even if a major part of a specific area is already covered by primary legislation. Since in some Member States primary legislation contains more detailed rules than in others, the rulemaking powers of CESR Members differ considerably. For reasons of simplification, this diversity is not reflected fully accurately in the results, but should nevertheless be borne in mind when comparing the figures presented. CESR might consider conducting a more detailed analysis on this specific issue in the future. As to the results (see chart below<sup>5</sup>), it can be observed that on average more than half of CESR Members do not have any powers to adopt binding rules in the core areas of securities law, with results statistically significantly above the average in the area of investment management, and below as regards allotment, corporate governance and accounting. The results regarding Alternative Trading Systems can be explained by the fact that in a number of Member States no such systems exist. With the inclusion of the non-core areas, the lack of rulemaking powers of CESR Members becomes even more visible with particularly low figures for auditors and credit rating agencies.



Regarding the powers of securities regulators in other areas, the results are rather divergent reaching from a great majority of CESR Members having sole powers to supervise Investment Management activities, to practically no supervisory powers concerning auditors. As regards

<sup>5</sup> For greater statistical soundness, each area of securities law included in the pie chart on cross-border information and cooperation and the one on rulemaking was given the same weighting.



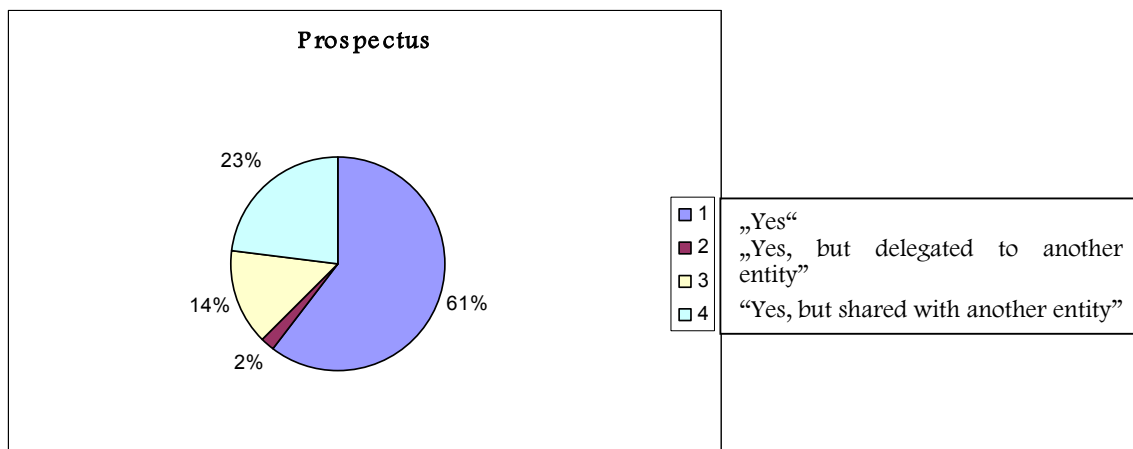
auditors, these results should be given particular consideration in light of the recent scandals in this area.

Finally, the general results suggest that only in very limited cases CESR Members have the legal competence to delegate powers to other national bodies.

### Primary Markets:

In the area of Primary Markets, the overall picture is much in line with the general results and tendencies explained above. The results for Allotment and Stabilisation show that the powers of CESR Members are more limited in these areas, with a great number of them having shared powers or no powers at all. It has to be underlined that at this juncture the powers to supervise the on-going and ad-hoc disclosure of information by issuers are not fully in the hands of CESR Members.

As regards the fields on Prospectuses for public offer and listing of securities (see chart below), these cover an area which has to be implemented by Member States pursuant to the Prospectus Directive. The current situation provides already for many CESR Members the powers necessary according to the Prospectus Directive, although it becomes apparent that in the area of listing regulated markets still have considerable powers, which might require legal changes according to Art. 21 of the Prospectus Directive, in particular after the expiry of a transitional period in the year 2011.



### Investment Services:

With respect to Investment Firms, which are among the core entities supervised by CESR Members, all Members have powers, even if sometimes shared with other entities, as to supervision and cooperation, but quite a large number of Members does not have any rulemaking powers in this field. As regards – independent – Investment Research and Analysts, many Members do not have any powers (or there is no regulation in place at all), which will have to change with the implementation of the relevant FSAP Directives.

### Market Infrastructure:

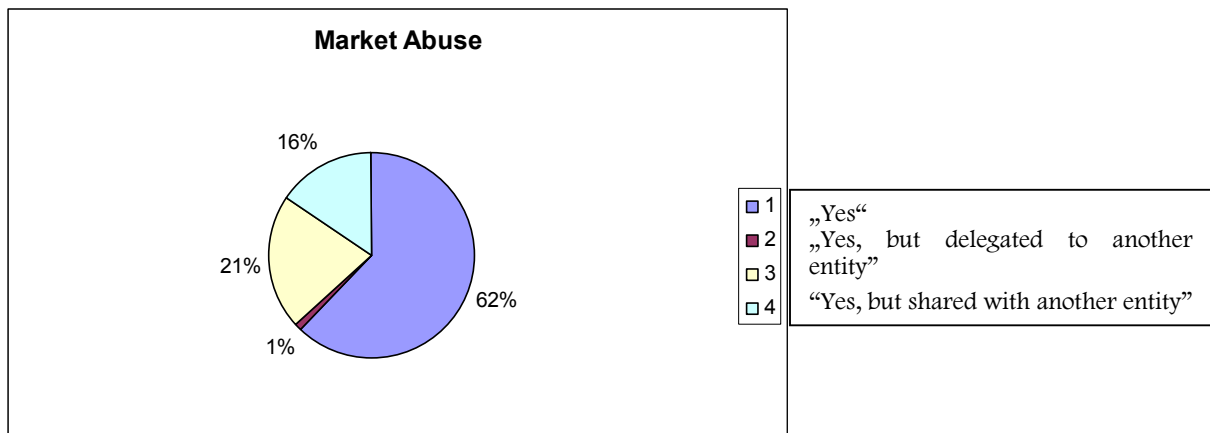
As regards Regulated Markets and Clearing and Settlement services, CESR Members possess wide powers, even though their rulemaking powers are again limited. As already mentioned above, concerning Alternative Trading Systems, about half of CESR Members do not have powers, a situation which is mainly due to the fact that Alternative Trading Systems do not exist in some Member States. However, this situation will have to change with the implementation of the MiFiD, which requires the authorisation of the operation of so-called Multilateral Trading Facilities.

**Investment Management:**

Concerning Asset Management Companies and Funds, it is usually CESR Members’ sole competence to supervise these entities. Nonetheless, their rulemaking powers are limited, in particular as regards non-harmonised funds, which could be detrimental to the development and implementation of a common approach in the area of non-harmonised funds at Level 3.

**Market Abuse:**

With respect to the area of Market Abuse (see chart below), which covers Insider Trading, Price Manipulation, Misleading Information and Transaction Reporting (as provided for in Art. 20 of the ISD), most of the Members have sole responsibility as regards supervision, investigation and exchange of information/cooperation. Regarding sanctioning of market abuse cases, the number of Members not having any powers might decrease following the correct implementation of the Market Abuse Directive (MAD), which requires an administrative sanctioning route in all Member States. Likewise, the lack of rulemaking powers of about half of the Members might require changes in some Member States in order to fully implement the MAD.



**Issuers:**

In general, the powers of CESR Members concerning Corporate Governance and Accounting issues are rather limited, with only about half of them exercising powers in these areas, including cooperation and exchanging information, where Members have wide powers in most other core areas. This might be caused by the lack of specific provisions on Corporate Governance or by the self-regulatory nature of some of the codes currently applicable in some Member States.

**Non-Core Areas (Investor Compensation Schemes, Auditors, Advertising and Credit Rating Agencies):**

As to these areas of the securities market supervision, the lack of powers of CESR Members becomes particularly apparent, in particular as regards Auditors and Credit Rating Agencies, where most Members lacks any of the powers set out in the questionnaire. The results are somewhat better with respect to Investor Compensation Schemes and Advertising.



## **PART II: Impact of the transposition of FSAP Directives on powers**

According to the responses to the question as to possible changes of the scope of competence of CESR Members, for a majority of them they will change with the implementation of the FSAP Directives applicable. However, in half of the Member States the extension of the supervisory or regulatory powers of the CESR Member could face constitutional interpretative constraints, in particular as regards sanctions, investigations and rulemaking.

## **PART III: Delegation of powers to another EU Securities Supervisor**

An overwhelming majority of CESR Members does not have the power to transfer supervisory powers in the securities sector to another authority in another Member State. It remains to be seen how Member States will transpose Art. 13 par. 5 of the Prospectus Directive, which provides for the possibility of the host competent authority to transfer the approval of a prospectus to the competent authority of another Member State.

## **PART IV: Ombudsman Schemes**

Regarding the issue of ombudsman schemes for investor complaints, quite a number of Member States provide for such formalised out-of-court settlement mechanisms. These mechanisms will become of even greater relevance because of Art. 53 of the MiFID, which requires Member States to encourage the setting-up of efficient and effective extra-judicial mechanisms for investors' complaints.

## **PART V: Accountability**

With respect to the question of political accountability of CESR Members, almost all of them are accountable to a political body in their jurisdictions, be it the Ministry of Finance, the government as a whole or the parliament. As regards judicial accountability for decisions (e.g. licences, fines), in a great majority of Member States the CESR Member's decisions are appealable to a national judicial body. Also, about half of the CESR Members are accountable to an administrative body, such as a supervisory board. With respect to financial accountability most of the Members fall under such obligations, usually the national court of auditors being responsible.



## ANNEX 4

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