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## First Progress Report on Supervisory Convergence in the Field of Securities Markets for the Financial Services Committee (FSC)

### Executive summary and key priorities

The present progress report on supervisory convergence for securities markets introduces the various activities that the Committee of European Securities Regulators (CESR) has either conducted or is developing at Level 3 under the Lamfalussy approach, in order to facilitate the day-to-day application of the FSAP directives in the area of securities. The report also includes, in specific boxes, current limits to supervisory convergence to which the attention of FSC members is drawn.

As a general statement, it should be said that since the creation of CESR, enormous progress has been made by the members of CESR to enhance their mutual understanding and to narrow down the differences of supervisory practices. Now that the focus is moving to the daily implementation of Level 1 and Level 2 texts, it appears also that CESR and its members need more than a common willingness to succeed.

CESR takes the opportunity of this report to the FSC to suggest some political conditions that are necessary to support the work of CESR:

1. Stable relations with the EU Institutions: this would include clear and solid working relationships with the European Commission, regular political impetus from Council Committees (in particular the FSC); clearer accountability links with the European Parliament and a commitment from Member States to provide their respective securities supervisors with the necessary authority and resources to fulfil their obligations under the FSAP directives;
2. A political backing of peer pressure tools developed at Level 3: the monitoring of convergence by the Review Panel, as well as an effective mediation mechanism, might lead to changes in national supervisory practices, which will therefore require the support of the national constituencies of the securities supervisors;
3. A clear focus for the future: the role of CESR at Level 2 was clearly stated and has contributed greatly to the success of the FSAP; at Level 3, the EU Institutions have not yet expressed in detail what they expect from CESR. Support for the development of peer-pressure tools and a better articulation between Level 3 and Level 4 would significantly assist.
4. The debate on a future EU supervisory structure should be closely connected to developments in markets: CESR advocates for an adaptive strategy where the development of EU supervisory tools should follow the rhythm of integration of securities activities in the single market.



## Introduction

1. At its July meeting, the FSC invited the three 'Level 3' Committees (CESR, CEBS, CEIOPS) to report regularly on efforts made to ensure supervisory convergence<sup>1</sup>. This was welcomed by the EFC<sup>2</sup>, which furthermore invited the Committees, "*by the Spring 2005 Financial Stability Table and after a preparatory discussion with the FSC, to present the main priorities, challenges and timetable in this area, including an assessment of possible needs to enhance cross-border supervisory cooperation at the EU level*".
2. The Commission Decision establishing the Committee<sup>3</sup> define the two main tasks of CESR (and that of the other 'Level 3' Committees), as follows:
  - To provide advice to the Commission on implementing measures for EU regulation ('Level 2' of the Lamfalussy process); and
  - To contribute to consistent implementation of EU legislation, convergence of supervisory practice and co-operation between supervisors ('Level 3' of the Lamfalussy process<sup>4</sup>).
3. The Council in its recent conclusions on financial integration<sup>5</sup> has stated that "*the emphasis should be on convergence of supervision and implementation*". Furthermore, it has emphasised that "*consistent implementation and effective enforcement by Member States must have top priority*". Clearly, much weight is attached to the tasks of the 'Level 3' Committees, particularly under Level 3 of the Lamfalussy process. Furthermore, also from a *financial stability* perspective, further supervisory convergence is called for.
4. The request by the FSC for CESR (and its fellow Level 3 Committees) to regularly report on supervisory convergence is strongly welcomed by CESR as an effective means of further enhancing CESR's accountability. Furthermore, as concluded by the FSC, regular reporting by CESR on supervisory convergence should enable the Council, through the FSC to get a clear picture of the barriers to further convergence that the Committees have identified in their work and of the nature of such barriers. In this way, regular reporting may indeed help identify potential areas for improvement.
5. This note therefore attempts to set out the various actions and initiatives that CESR has undertaken to ensure greater convergence of supervisory practices. This note is presented in

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<sup>1</sup> As set out in the minutes of the meeting of the FSC of 9 July 2004 (doc. FSC 4161/04), the letter of the Chairman of the FSC to the President of the EFC dated 22 July 2004 and the FSC report to Council on financial integration, dated 5 November 2004 (doc. FSC 4168/1/04)

<sup>2</sup> EFC report to the informal meeting of Finance Ministers: "*Next steps in developing the EU framework for financial stability and crisis management*", 11 September 2004 (ECFIN/CEFCPE (2004) REP/50244 FINAL.

<sup>3</sup> Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators (2001/527/EC) as amended by Commission Decision of 5 November 2003 (2004/7/EC).

<sup>4</sup> See also Annex I of the *Final report of the committee of wise men on the regulation of European securities markets*, Brussels, 15 February 2001, for developments concerning Level 3.

<sup>5</sup> Council Conclusions of 2 June 2004 and of 16 November 2004.



conjunction with the 2004 Annual Report of CESR to the European Commission, the European Parliament and the ECOFIN Council, where additional details on the activities of CESR can be found.

6. Firstly, as this is the first report to the FSC, it sets out briefly how CESR has organisationally structured itself to deliver greater supervisory convergence, in a section entitled 'structure and process'. Secondly, the paper sets out concrete results on specific areas of 'Level 3' work which is underway with the specific objective of establishing convergence in day-to-day supervisory practice. Thirdly, operational networking initiatives such as, IT tools that have been developed and, the work of the Review Panel to assess implementation of standards, for example, amongst other initiatives is described. Finally, whilst the paper addresses under each section any limits that have been encountered to the extent to which supervisory practice can converge, the final section considers general challenges encountered.

## **I Structure and Process**

7. Delivering supervisory convergence has been a key priority from the very inception of CESR (and its predecessor – FESCO). With the creation of CESR, it was felt that to meet this challenge effectively certain tools and fora should be developed which suited the more ongoing nature and constancy of the work required to deliver convergence of supervisory practices. Delivering convergence can in many ways require a degree of sustained attention and action. Currently the work of CESR at Level 3 can be separated into three different activities.
8. The first one relates to the elaboration of standards, recommendations and guidelines. The need for such Level 3 rules has different origins: it can be required explicitly by Level 2 implementing measures, it can be requested by the industry or by the need to ensure greater transparency on the way supervisors will apply a directive on a daily basis and, finally, it can be developed where there is no EU Law but a common approach from supervisors is felt necessary. (In this latter case, close links with the EU Commission are necessary in case of possible legislative initiatives.)
9. The second set of activities by CESR at level 3 covers a series of tools aiming at enhancing the pressure of peers in order to achieve more rapid and efficient supervisory convergence. For example, the Review Panel has the on-going task to monitor the day-to-day application of standards and legislation and to identify best practices. The Review Panel is also tasked with ensuring that standards which are no longer necessary are removed, particularly where they have been replaced by legislation or are simply outdated due to the development of supervisory practices and that of financial markets. In effect, ensuring CESR is mindful of de-regulation wherever possible. This former aspect is in its earliest stages and will become an area of greater focus during 2005/6.



10. Finally, the third bloc of activities developed at Level 3 relates to operational networking work. To facilitate this CESR has created more permanent groups. The first one relates to the work of enforcement – for which it established CESR-Pol. This draws together those responsible for day-to-day enforcement at all levels within the members' authorities, to form an active network. Both for the purposes of exchanging supervisory information of suspicious transactions/behaviour on an ongoing basis and during specific investigations but also in carrying out the responsibilities set out by the Market Abuse Directive, in particular, publishing the accepted market practices recognised by each national competent authority. The second area relates to endorsement and enforcement of financial reporting standards, for which purposes CESR-Fin was developed. This group is also tasked with assisting 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, as well as reviewing the day-to-day application of the financial reporting in order to identify and assess where greater convergence might be necessary.

## II Concrete results on Supervisory Convergence

11. In this section the emphasis is on delivery of concrete results in relation to specific supervisory areas.
12. CESR has undertaken concrete action to ensure greater supervisory convergence in relation to the following issues:
- Market Abuse;
  - Prospectuses;
  - Financial Information;
  - Investment Management;
  - Clearing and Settlement.
- **Measures to promote supervisory convergence in relation to Market Abuse**
13. The Market Abuse Directive came into effect on 12 October 2004 and while some delays in the transposition of this legislation into national law had been anticipated, CESR has continued moving forward to prepare the ground for the implementation of the new regime by ensuring a common approach to the operation of the Directive throughout the EU amongst supervisors.
14. To this end CESR developed some preliminary guidance in the paper entitled "Market Abuse Directive: level 3 – preliminary CESR guidance and information on the common operation of the directive" (Ref: CESR/04-505). The guidance was designed to provide convergence in supervisory practice and to provide further clarity for market participants regarding the operational requirements of certain significant areas of the Directive.



15. The three main areas covered by the guidance on "Accepted Market Practices" include: the establishment of a common framework to assess such practices; further clarity on practices that CESR members consider to be market manipulation; and, the establishment of a common format for reporting suspicious transactions, including appropriate guidance.
16. In the event of a person manipulating a market, the Directive provides a defence if the transaction was legitimate and in accordance with market practices accepted by the competent authority – the so called Accepted Market Practices (AMPs). The paper includes the following AMPs that are currently being considered in three EU jurisdictions:
  - Bond valuation transactions both in Germany and Austria;
  - The first price of an IPO when issuing on more than one German exchange;
  - The obligations on long position holders on the London Metal Exchange.
17. The paper also sets out a standard format that will be used by the regulators when assessing AMPs.
18. In the second part of the guidance, CESR members identified types of market manipulation which have occurred in recent years and which, in the view of CESR members would breach the prohibitions on market manipulation contained in the Directive. The examples of types of practice set out in the paper are deliberately described in non-legal technical terms and it is emphasised that the descriptions are not intended to affect the scope of interpretation of the Directives.
19. Finally, the Directive introduces the obligation for market participants to report suspicious transactions to the competent regulator and therefore the guidance sets out might be the indications of suspicious transactions which may involve insider dealing or market manipulation. Furthermore, the paper proposes a standard reporting format which should be used by market players to report suspicious transactions to the relevant authority. The paper has been subject to CESR's usual consultation process and was therefore issued for consultation paper on 28 October 2004 until 31 January 2005 and 30 written responses were received.
  - **Guidelines on joint investigation**
20. In 2004, CESR (through CESR-Pol) revised and enhanced the CESR Standard Format Request to be used by members when requesting information from each other. A Service Level Guidance was also developed and this details best practice, using the experience of CESR members who have conducted joint investigations. This work follows on from the 'Service Level Agreement' adopted in 2003. In addition, during 2004, CESR-Pol members have established ad hoc groups of the enforcement officials undertaking investigations into specific cases of potential improper behaviour by firms across a number of markets. This has enabled them to keep each other up-to-date with the latest findings of each authority's investigation in relation to specific cases and



to share information under the CESR multi-lateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (MoU) established in January 1999.

In addition, during 2004, the members of CESR drew extensively on the CESR-Pol network to inform other CESR members of unauthorised offers of financial services by investment firms or individuals without being licensed to do so. The secretariat regularly circulates warning notes issued by CESR members to all other CESR members. This allows identification of those illegitimately providing investment services by the same provider in multiple jurisdictions in a quick and efficient manner and enables CESR-Pol to intensify co-operation and to identify where it might be appropriate to act in a joint manner. Additionally, this warning mechanism also serves to equip CESR members with timely information to alert potential investors in their jurisdiction and therefore to minimise the risk of consumers being defrauded.

**Limits to convergence:**

As regards market integrity, one of the key limits of convergence is the late transposition of the Market Abuse Directive (MAD) in Member States, which is creating legal uncertainty for cross-border investigation. In addition, the different timing of the appointment of competent authorities by Member States is disrupting the cooperative arrangements. Providing CESR members with the necessary supervisory and investigative powers and the appropriate resources is now a matter of urgency.

As regards Accepted Market Practices, it should be noted that the Directive requires national authorities to inform (but not to seek agreement) other national authorities of AMP which they will accept and CESR's role will be to publish these. This does not however mean that the AMP recognized by one CESR member will necessarily be recognized as an AMP by fellow CESR members. Indeed, there is a strong argument why this lack of convergence initially, may be considered appropriate (and that all that is considered necessary is transparency of where it is accepted), certain AMPs are very specific to a type/size of market and may therefore have no application or relevance in another market. Nevertheless, given that CESR will publish these AMP, where certain authorities have similar markets (and have not made a similar decision regarding a specific AMP), they may come under some pressure to accept a practice on which they think to be inappropriate.

This limit is therefore imposed by the Directive itself. It will be some time before we can fully assess, the extent to which this lack of convergence causes difficulties or whether it might lead to a more organic convergence overtime, particularly, if there is a willingness to re-visit on 'a good will basis' by the national authority who took initial decision, however, they may face considerable national pressure not to change an existing position and have less flexibility as a result.



- **Prospectuses**

21. The new regime for prospectuses will come into effect on 1 July 2005. During the preparation of CESR's technical advice on the implementing measures of this Directive, market participants requested greater practical information as to how certain elements of the new regime would be applied on a day-to-day basis and stressed the importance of having these recommendations published as soon as possible in order to have enough time to prepare themselves to comply with the new regime. Recognising that some timely guidance, which, stopped short of imposing further obligations on issuers, might indeed assist in delivering convergence across the EU of the Level 2 Regulation, CESR began developing guidance which was finally approved and published on 10 February 2005, following an extensive consultation phase. The guidance will be applied on a voluntary basis by CESR members but the way in which these recommendations will be applied will be reviewed regularly by CESR through the monitoring function of the Review Panel.

22. The Prospectus Regulation (No 809/2005, implementing the Prospectus Directive) sets out different disclosure requirements depending on the type of security and the type of issuer. CESR has also adapted its recommendations to the different types of schedules. In particular, the recommendations seek to converge practice in the following areas:

- *Application of the Directive's provisions to Specialist issuers*

23. CESR has issued recommendations in order to facilitate co-ordination among competent authorities when applying Article 23 of the Regulation. This Article gives competent authorities the power to require adapted and additional information to some "specialist issuers" operating in certain specific sectors outlined in the Regulation (property, mineral, investment, scientific research based, start-up and shipping companies). CESR has outlined in its recommendations what information may be required for each types of issuer, with the exception of investment companies.

- *Clarification of the content of certain disclosure requirements*

24. In order to facilitate the understanding of certain disclosure requirements and with the aim of avoiding any kind of ambiguity that could lead to different interpretations of the rules and, therefore, hamper the functioning of the Single Market, CESR has drafted recommendations about some of the disclosure requirements included in the schedules.

25. Some of the recommendations deal with *financial information requirements*. The purpose of these recommendations is not to provide interpretations of International Financial Reporting





Standards (IAS/IFRS) or Member States' local GAAP, but to contribute by clarifying certain disclosure requirements where market participants, especially from the accounting profession, have requested some clarification. Among these are a selected number of financial information requirements, in particular in relation to: operating and financial review; capital resources; profit forecasts or estimates; restatements of historical financial information; pro forma financial information; financial data not extracted from the issuer's audited financial statements; interim financial information; working capital statements and capitalisation and indebtedness.

26. Recommendations are set out on a number of *non financial information items*, such as: property, plants and equipment; compensation; related party transactions; acquisition rights and undertakings to increase capital; options agreements; history of share capital; description of the rights attaching to shares of the issuer; statements by experts; information on holdings; interests of natural and legal persons involved in the issue and clarification of the terminology used in the collective investment undertakings of the closed-end type schedule.

- *Convergence on a number of issues not related to the schedules*

27. Article 4 of the Prospectus Directive sets out a number of exemptions from the obligation to publish a prospectus provided that a document is made available containing information on the number and nature of the securities and the reasons for and details of the offer.

28. Exemptions are granted in cases such as shares offered free of charge to existing shareholders or their admission to trading; dividends paid out in the form of shares; securities offered to directors or employees or their admission to trading. Following issuers' requests, CESR has also issued recommendations on the content of the type of document.

**Limits to convergence:**

CESR acknowledges the fact that there are many areas that have not been tackled where recommendations might be useful, one such area for example might be related to listings of complex financial instruments. However, CESR is also aware that the real assessment of consistent implementation across the EU can only be made effectively once the legislative measures will come into effect. Once CESR members have experience on the practical operation of the new rules and legislation, CESR will be in a position to assess whether the recommendations need to be updated and how to address any problems of co-ordination that might arise.

Having said this, one important provision of the Regulation of Prospectuses, needs to be reviewed to ensure proper information is given to investors regarding complex financial histories. CESR welcomes the open minded attitude of the Commission and the European Securities Committee in this area. Another area where further work might be helpful relates to the capacity for a competent authority to delegate the vetting of a prospectus to another EU authority (Art. 13.5). Legal and practical arrangements to delegate such powers, in this type of situation, should be explored before





it is put into action. Most importantly, this would form the first ‘practical test’ of the delegation of powers amongst different national competent authorities.

– **Financial Information**

- *Enforcement of financial information through Standard No 1 and 2: finalisation of the co-ordination mechanism*

29. CESR-Fin prepared two Standards on enforcement of Financial Information. Standard No 1 (Ref: CESR/03-074) was adopted in April 2003 and developed a common definition of enforcement and established the scope of what would be considered enforcement activities. The Standard also converged the methods of enforcement by supervisors and established the types of actions that might be adopted were an infringement in the reporting framework was discovered. Standard No 2 (ref. CESR/03-317b) as adopted by CESR in March 2004, on the other hand, established the framework to deliver greater consistency on a day-to-day basis regarding how the principles (identified by Standard No 1) were to be implemented. The standards, before adoption, were subject to CESR’s full consultation process in both cases.

30. In particular, Standard No 2 established concrete measures to ensure a co-ordination mechanism for enforcement was set in place in 2005 at a pan-European level to deliver greater convergence in practice. The key principles introduced by Standard No 2 include:

- discussion of enforcement decisions and experiences within a formalised structure which will involve all EU National Enforcers of standards on financial information, being CESR Members or not (‘European Enforcers Co-ordination Sessions’ - EECS);
- agreement on the principle that all supervisors should take into account existing decisions taken by EU National Enforcers. Additionally, CESR proposes that where practicable within constraints of time and confidentiality, discussions with other EU National Enforcers should take place before significant decisions which are likely to set precedents are taken;
- 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.

- *Guidelines for implementation of co-ordination of enforcement of financial information*

31. After the finalisation of Standard No 2, the Sub-Committee on Enforcement (SCE) focused its activities on the implementation of this standard. CESR-Fin prepared the draft guidance for implementation and the draft Terms of Reference for the European Enforcer Coordination Sessions (EECS) (mentioned above).



32. The Implementation Guidance (ref. CESR/04-257b) set out how the discussions of real enforcement decisions/cases would be organised through the European Enforcers Co-ordination Sessions (EECS, which is an extended session of SCE and involves CESR members and non-CESR members who are entrusted with national responsibilities in enforcement of financial information). The guidance also set out the characteristics of the database of enforcement decisions that will be created and managed by CESR in order to facilitate the harmonisation of enforcement practices in EU.
33. In the first months of 2005, CESR-Fin will continue to put in place the necessary tools for the actual start of the activities of the EECS and for the creation of the database of enforcement decisions. The most important issues will be to identify the best solution for allowing exchange of confidential information between CESR Members and non-CESR members and to ensure the IT technical aspects of the database effectively meet the needs of the users.
34. Going forward, the discussion of enforcement decisions on financial information as envisaged in Standard No 2 supplemented by the implementation guidance will become the core activity of CESR-Fin (as a CESR operational group). For that reason, implementation of the necessary tools for this co-ordination mechanism should become a priority for the group.
- *Ensuring consistency in approach to the transition to IAS/IFRS*
35. To converge supervisory and market practice during the transition to IAS/IFRS, CESR published a paper in 2003 recommending a series of milestones for companies to make information available to the markets on their preparations for 2005. CESR suggested that the 2003 annual accounts should explain the work being done to prepare for the change; whilst the 2004 accounts should if possible quantify the effects of the change, the 2005 interim accounts should be based on IAS principles.
36. Towards the end of 2004, however, CESR undertook a survey in order to assess how the Recommendation had been disseminated by CESR members nationally, and, to identify issues raised in relation to the implementation of this recommendation. CESR concluded that this Recommendation was still valid and additional issues were identified in relation to the transition to IFRS as a whole. However, a specific issue where convergence in supervisory approach was identified in the following months related to the implementation of IAS 39 (and more generally to situations where IAS/IFRS offer critical options to reporting entities) in particular, in situations where issuers, in accordance with EU endorsement decision, do not apply the complete set of provisions and stringent requirements provided by IAS 39 on hedge accounting. This work, for example, is taken forward through the permanent operational group CESR-Pol.

**Limits to convergence:**



It is important to note that convergence in the enforcement of financial information is not solely in the hands of CESR members, given the large number of different authorities. Nevertheless, the decision to find a way of sharing information with non CESR members through EECS is an effort to do as much as possible regardless of this constraint.

Even so, it must also be highlighted that the speed with which decisions will need to be taken on financial information, means that convergence will take place after the event and will therefore not be delivered overnight but rather in a more evolutionary manner. Considering the number of authorities involved beyond CESR members and the number of decision to be taken it is likely that different accounting treatment could be applied for the same issue and mislead investors. The need for more certainty in this area is likely to come rapidly and is at the top of the agenda

– **Investment Management**

37. CESR began its work in this area in April 2004 following the transfer of some responsibilities (in practice) from the UCITS Contact Committee. Following a public consultation, the Expert Group decided to focus its efforts to increase supervisory convergence in three areas:

38. Member States had to transpose and apply the amending UCITS Directives (2001/107/EC and 2001/108/EC) in their domestic laws or regulations not later than 13 February 2004. These amending Directives contain transitional provisions for: i) UCITS and ii) management companies established under the original UCITS Directive 85/611/EEC. As a result of divergent approaches developed by Member States on these transitional issues, the situation regarding the UCITS implementation was characterised by uncertainty.

39. After having consulted the European asset management industry and in full consistency with the work programme established by the European Commission and the European Securities Committee, CESR decided that the uncertainties in the practical application of the Directive had to be resolved as a matter of urgency.

40. Following consultation the guidelines (ref. CESR/04-434b) prepared by the Expert Group and published in February 2005 aim in particular to clarify and establish convergence on supervisory treatment of issues related to:

- the marketing of funds and the simplified prospectus (e.g. in case the home Member State regulator has not yet issued detailed guidance on the simplified prospectus);



- the scope of permissible activities of grandfathered management companies (e.g. with respect to the launching of “passportable” UCITS III funds);
  - UCITS launched after February 2002 which benefit from a “grace period” (e.g. smooth convergence to the new UCITS regime, coordinated approach to a transitional treatment by statements of conformity etc.); similar issues related to grandfathered UCITS I umbrella funds which have launched further sub-funds after February 2002;
  - practical questions related to the scope of the European passport and problems resulting from the relationship between the management company’s passport and the fund’s passport.
41. The guidelines provide an adequate balance, taking into account the difficulties the industry and the authorities have faced, but at the same time encouraging towards compliance with the UCITS III Directive. The solutions agreed by the guidelines therefore reflect a concrete effort to converge and streamline the different administrative practices Member States have developed and to put an end to the uncertainties during the transitional periods allowed by the Directives.
42. Looking ahead, CESR’s work will focus next on the simplification of the registration procedure for UCITS, conduct of business rules in collective investment management, outsourcing and issues related to non-harmonised funds. For example, the requirements for fund registration and the documents required differ from market to market. CESR therefore intends to streamline fund registration by building on the initial work undertaken in relation to transitional provisions and in this second phase, to develop consistent standards for the registration requirements foreseen by the UCITS Directives. A further example of the work foreseen relates to non-harmonised funds which at present are not able to benefit from the single market. CESR proposes to undertake an inventory of non-harmonised collective investment schemes marketed throughout Europe, which will prepare the ground for a common view of certain issues such as prudential rules or rules on adequate disclosure.
43. CESR’s work will also focus on the consistency between the UCITS Directives and other EU Directives and ensuring the convergence of supervisory systems in the different jurisdictions.

**Limits to convergence:**

The pre-Lamfalussy nature of the UCITS Directives is a significant impediment to greater convergence. However, it should also be noted that there are also significantly different approaches to the regulation of UCITS which are reflected in the compromises found in the Directive and which also impede greater convergence in the regulation of UCITS and these cannot always be overcome at Level 3.



CESR is currently conducting supervisory convergence work in this area at the request of the Commission and the ESC without a clear distinction between Levels 1, 2 and 3. Political choices, binding technical rules and supervisory convergence work need to be better articulated for UCITS and investment management activities. CESR looks forward to the transformation of the UCITS directives into “Lamfalussy” type directives.

– **Clearing and Settlement:**

43. CESR and the ESCB announced the initiative to work on the development of joint standards in relation to clearing and settlement in October 2001. The objective of this work was to ensure the strengthening of the CPSS/IOSCO Recommendations enabling international convergence and to adapt these to the European context.

44. The adoption by CESR and the Governing Council of the ESCB in October 2004 and the subsequent publication of the Standards for Securities Clearing and Settlement in the European Union (Ref. CESR/04-572), based on the CPSS/IOSCO Recommendations, followed significant consultation and was developed very mindful of the need to avoid duplication.

45. Before these standards become applicable, the Joint Expert Group will continue its activities in a number of areas during 2005. This follow-up work to ensure convergence in practice and impact are fairly balanced, will mainly consist of:

- The development of an assessment methodology in order to provide a tool for assessing the implementation of the Standards.

The format of the methodology will be similar to the format developed by CPSS/IOSCO for the assessment of its Recommendations. On the basis of the key-elements identified in each of the Standards, precise questions will be formulated allowing national authorities to assess the compliance with the Standards according to an agreed standardised methodology.

- Further work in the area of central counterparties:

CPSS/IOSCO has announced that it expected to publish a separate set of Recommendations for central counterparties by the end of 2004. Against that background, CESR/ESCB decided early in the process that the deepening and strengthening of Standard 4 on central counterparties would be limited to the issue of cost-benefit analysis and that risk-management issues would be kept unchanged awaiting the final report of CPSS/IOSCO for this type of intermediaries.



- The elaboration of a number of open issues, in particular the concept of “significant custodian”:

The third strand of follow-up work relates to technical issues such as the need to harmonise settlement cycles and the effects of central securities depositories to engage as principals in securities lending. As far as the concept of “significant custodian” is concerned, it is envisaged to investigate whether a set of criteria could be developed which would help national authorities to identify in a convergent manner, if, and when, a custodian is of significant importance.

46. A third public consultation on these follow-up activities is envisaged for July 2005. In the area of clearing and settlement, major political decisions are expected to be taken in the next years by the EU institutions. CESR and the ESCB will then review the standards and amend them as necessary to ensure they are consistent with any EU laws adopted.

***Limits to convergence:***

The clear limit to convergence in this area has been due to a change in political outlook during the intervening period that it took to complete the standards. Whilst, this work was initially encouraged and CESR members are committed to implementing internationally agreed standards by IOSCO, the potential of legislative action in this area, at some stage in the future, has led to concern that this work might in some way pre-empt any legislative proposal. CESR (and the ESCB) has been keen to indicate that should legislation be put in place, the standards would be adapted, but considers that in the meantime it is necessary to implement a framework according to each of the members’ international obligations.

CESR will continue to be accountable and transparent in the areas it will work. In particular CESR will remain mindful of potential future developments. In particular, seeking to ensure its work is carried out in a fully transparent manner, and allowing those responsible for initiating and adopting legislation, to participate and/or be kept fully aware of developments (hence the European Commission participated as an observer to date).

### **III Operational Networking**

52. In addition to the specific areas where CESR has been working to deliver convergence, as described above, a number of initiatives have been undertaken which will contribute to the specific efforts towards convergence. These include the development of: IT tools; the creation of a mediation mechanism; the development of a new self-policing approach to reviewing implementation by the Review Panel; the commencement of work to enable transatlantic convergence; and finally but not least convergence on a cross-sectoral basis through co-ordination and co-operation with the fellow Level 3 Committees, CEBS and CEIOPS.



The following section describes the concrete actions and results achieved in these areas set out above.

- **The development of IT Tools**

53. As a result of the FSAP and the need to ensure supervisory convergence, CESR has developed and is currently intending to develop several IT Tools. These tools can be separated into two different categories:
- *Database of decisions by supervisors*
54. The database used by the Review Panel enables the general public to view the degree of implementation of CESR Standards by the members (by set of standards and by jurisdiction). It also enables the CESR members to directly input information on a real time basis. This tool was developed during the first half of 2004 and is now being used for the first time by members as they review, at the European Commission's request, how two Commission's Recommendations on UCITS which deal with the use of derivatives by UCITS (2004/383/EC) and the contents of simplified prospectus of UCITS (2004/384/EC), have been implemented.
55. The European Enforcer Coordination Sessions (EECS) database will not only act as a practical reference tool by providing a record of previous decisions reached in particular cases by EU National Enforcers on Financial information, but will also have a tool which cross references entries to similar decisions which may or may not have been responded to in the same way and therefore will help the secretariat identify cases which might helpfully be explored how greater convergence might be achieved. As described in the section on financial information, CESR consulted on the categories of information the database would contain and is now finalising details regarding confidentiality of information that can be shared with non CESR members who will also have access to this database, to ensure that this does not result in lowest common denominator of information being shared but that the information available still confirms with legal obligations of confidentiality. Much of the work to build the database is completed and it should be operation during next few months.
- *EU IT systems for regulated information.*
56. As a result of the MiFID one of the possible models for exchange of information on transaction reports between competent authorities could be to create a central database. CESR is currently evaluating the feasibility of such an idea. Similarly, under the Transparency Directive the storage of financial information disseminated by listed companies could be organised in the form of a centrally accessible system. In both cases, depending on the IT model chosen, this could result in massive investments that so far have not been assessed. The engagement of such investments will require a strong political acceptance of the model chosen and a realistic assessment of the time necessary to put these systems in place (that it is likely to go beyond the





timings of the relevant Directives). CESR will inform fully the European Commission on the result of these feasibility studies.

**Limits to convergence:**

- The development of databases of decisions needs clarity of confidentiality requirements, and therefore a rapid appointment of competent authorities by Member States for the various FSAP directives.
- The development of EU IT tools requiring massive investments should be clearly identified and politically accepted.

- *Mediation mechanism*

57. Art. 16 par. 2 and 4 of the MAD require CESR to find rapid and effective solutions in case a competent authority does not provide the information, or conduct the investigation, requested by a competent authority in another Member State. For the purpose of this Directive, CESR has developed a specific mediation system within CESR-Pol. CESR was also encouraged by the Inter-Institutional Monitoring Group to set up an internal mediator system under its Charter in order to solve conflicts between national securities regulators. The ESC urged CESR to consider the creation of a more general mediation system, as well. Finally, market participants have expressed support for such a kind of mediation solution.

58. The objective of developing a mediation system is to provide a satisfactory mediation process that facilitates a rapid, effective and balanced solution to disputes between CESR members. Such a mediation mechanism could apply in a general way to cooperation and exchange of information under all EU Directives and Regulations applicable in the securities field, as well as to operational disputes arising under relevant EU laws providing for mutual recognition of decisions (e.g. authorisations, prospectus approval).

59. In establishing a mediation mechanism, the basic principles to be applied could include the following:

- a mechanism of peers committed to ensuring the success of mediation (i.e. CESR members)
- safeguards to ensure an unbiased process
- geared to produce rapid and efficient decisions
- avoid any systematic questioning of the automaticity of mutual recognition
- a process to identify suitable cases for mediation
- not impinge on the prerogatives of the Commission and the European Court of Justice
- flexible enough to cater for different purposes (e.g. MAD, MiFiD, Prospectus Directive)
- outcomes are made public in a manner that protects business confidentiality



60. Further input could be gained from mediation mechanisms in place in other areas (e.g. the ECB target, WTO). The creation of a general mediation mechanism might necessitate an amendment to the CESR Charter.
61. Any CESR mediation mechanism should be elaborated in full respect of the competences of the European Commission at Level 4, and should not interfere with the respective roles of the European Commission and the ECJ in the interpretation and enforcement of EU Law.

**Limits to convergence:**

The existence of a “mediation” system poses a number of challenges which must be managed carefully. The process will be voluntary and ‘non binding’. To be efficient and credible it will need to be supported by the members of CESR and their respective constituencies in the Member States. In addition, any mediation system developed would have to respect the Commission’s enforcement competences. Nevertheless, it is too early to assess the limits of this type of mediation until the mechanism has been in place for a period and greater experience gained by ‘testing’ the mechanism with particular cases. As such further information will be provided in forthcoming reports to the FSC as the situation becomes clearer.

- **The Review Panel**

*62. First Interim Report*

In March 2004, CESR published the First Interim Report of the Review Panel on the review of the status of implementation of the CESR Standards on Investor Protection and the CESR Standards for Alternative Trading Systems (Ref. CESR/03-414b). This was published alongside (so-called) “correspondence tables”, in which the measures implementing these CESR Standards in all Member States (all in all more than 200 standards and rules) are set out in detail (for example including information on where and how they are implemented in rules/legislation etc). Given the enormous information this created a “synthesis tables” was published to assist in transparency, providing an overview of the status of implementation (implemented/partially implemented/not implemented) were stated clearly. The results were mixed and largely because many of the measures were anticipated to be incorporated in the MiFID and hence where it required a legislative change this resulted in a delay as the process did not want to be repeated within a short period. However, the information gathered in that process will considerably facilitate any future review of the implementation of the MiFID and its implementing measures and also enabled CESR to gain valuable experience on how to carry out such an exercise and reflected for example in the development of the database.



**Limits to convergence:**

The role of CESR in checking the efforts of its members to compare the common approaches they have agreed is crucial. This requires a real commitment to do so by CESR members and by their respective constituencies, even when this might lead to change in national rules or market practices. The commitment to comply with a common approach is the test of the credibility of the single market. This has been very strongly echoed by the industry that wishes to see concrete evidence that supervisors converge in their day to day practices.

- **Transatlantic convergence**

63. Given the international nature of the markets and the interdependency of the markets/players that CESR members supervise, it is critical that we also consider international convergence and transatlantic convergence. Regarding international convergence, CESR draws heavily on the work by IOSCO and that of other relevant international organisations and this often forms the basis of any standards/advice etc. developed. This is evidenced in the work on Credit Rating Agencies. Nevertheless, the transatlantic dimension warrants particular attention to ensure that the convergence achieved amongst CESR members is as convergent or at a minimum as compatible as possible with development of supervisory policy in the US by the SEC and the CFTC. CESR has therefore identified a number of concrete areas on which a more formalized dialogue will focus respectively (these are set out in the Annual Report in more detail Chapter 5. section 5.2).

- **3 Level 3 Committees**

64. CESR has begun a regular dialogue with the fellow level 3 committees (CEBS and CEIOPS) to ensure areas where consistency is required, are identified quickly and the solutions found are both convergent and compatible on a cross-sectoral basis. As such, contacts are maintained between the secretariats at all levels and papers for plenaries shared, in addition, members of the secretariats attend expert groups meetings as observers where the issues are of common interest. CESR, CEBS and CEIOPS have been invited by the EFC to propose to the Financial Stability Table of the EFC how best to report on cross-sector issues in a more regular and structured format. Cross-sector issues are therefore not included in this report.

**IV Challenges to greater convergence**

65. Having in mind the next five years, CESR has analysed limits to convergence in relation to specific issues. These were outlined in significant detail by CESR in the paper presented to the FSC entitled 'Which Supervisory Tools for the EU Securities Markets?' (Himalaya Report) that the FSC is assessing as part of its work of monitoring supervisory convergence. In this context, CESR believes that a close understanding and monitoring of the developments in the market will significantly help a proper debate on EU Supervisory structures.