

The Committee of European Securities Regulators



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Half-yearly report on the activities of
the Committee of European Securities Regulators
to
the European Commission
the European Parliament
the European Securities Committee

SEPTEMBER 2005



1. Introduction

The present interim report complements CESR's Annual Report for 2004, published on 7 April 2005, and provides a half yearly update on the activities of the Committee of European Securities Regulators (CESR) to the European Commission, the European Parliament and the European Securities Committee. The report focuses on the functioning of CESR: the "Level 2" work where CESR provides advice to the EU Commission on possible implementing measures of Directives, and the "Level 3" work where CESR Members work together to ensure convergence of their regulatory and supervisory tasks. The report also deals with CESR's inter-institutional relationships, with the two other Level 3 Committees, CEIOPS and CEBS, as well as with CESR's current dialogue with third countries, which is at present primarily focused on the US. Finally, it provides an indicative timetable of CESR work plan for the next half of the year, and practical information about the running of CESR.



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3. Market Participants Consultative Panel

The Market Participants Consultative Panel (MPCP) met twice in Paris, on 17 March and on 14 June 2005.

Discussion by the MPCP on these occasions has primarily focused on the following subjects: analysis of major trends and evolutions in financial markets, EU/US regulatory and supervisory issues, problems of listing of EU companies in US exchanges and the exercise of corporate rights in investment management.

At their meeting on 17 March, the members of the panel focused their discussion on major trends and evolutions in financial markets, dividing the discussion into wholesale, retail markets and the process of consolidation of trading and post-trading infrastructures. Concerns were voiced about the bonds markets not being accessible in an effective manner for small and medium sized enterprises. The members of the Panel considered hedge funds and private equity important developments to be followed more closely in the near future. The MPCP advocated more transparency of all activities of portfolio managers as investors. The members of the Panel also recalled the significant role of investor education.

A need to evaluate the general competitiveness of EU markets, in all sectors, was also stressed by the Panel.

On the subject of EU/US regulatory and supervisory issues, members of the panel were updated on the recent initiatives of cooperation between CESR and the CFTC on financial and commodities derivatives markets.

At the following meeting on 14 June, the members of the panel considered the problems of listing of EU companies on US exchanges and the exercise of corporate rights in investment management. The discussion regarding listing on US exchanges focused on three aspects: the problem of delisting and

deregistration, the impact of the Sarbanes Oxley Act and the EU and US accounting regimes. As conclusion of the discussion on all these three aspects, it was agreed to adopt the same approach: i.e. to enhance the equivalence of management and accounting systems based on agreed principles in order to facilitate equivalence or mutual recognition, rather than to promote their convergence.

During the discussion on investment management, the members focused on the issues arising from the activity of investment funds with particular regard to the use of their corporate rights, and considered that the principle contained in the UCITS Directive, according to which UCITS should be prevented to exercise significant influence on the management of companies, remains valid.

At this meeting, a discussion on the Post-FSAP also took place. Based on the Green Paper adopted by the European Commission, members of the Panel discussed the priorities after the Financial Services Action Plan. Whilst of the view that the document does not contain a clear message, they noted that it reflects the main conclusions of the works of the four Forum Groups established by the Commission. One member of the Panel considered it disappointing that the Green paper does not mention the reform of the structure of financial supervision, and asked CESR to react since this might give the false impression that it is not an issue.

The Chairman of CESR reported on the debate and the discussions following the "Himalaya Report". In particular, he mentioned three issues: it is essential that all regulators share equivalent powers for the proper functioning of the home/host relationships and to ensure good cooperation on cross-border inquiries and investigation; there is still strong support to the development of level 3, even though this is not legally binding; concerning the adoption of pan-European decisions some support has been expressed only in the field of IFRS, whilst delegation of powers and tasks has been positively accepted. He also mentioned that regulators are developing tools to enhance the cooperation to conduct market abuse investigations, particularly where financial



instruments were traded in more than one market and that crisis management tests are planned in cooperation with CEBS and CEIOPS.

Members of the panel invited CESR to evaluate in details the experiences of the integration of some markets (Euronext and OMX) to further explore means of enhanced coordination between regulators. They also invited CESR to conduct a pilot exercise on conflicts of interest to address consistency across the different financial sectors.

The members of the CESR's Market Participant Consultative Panel are:

- Pr Luis Miguel Belez, Consultant of the Executive Board, Banco Comercial Português
- Dott Salvatore Bragantini, Vice-President IW Bank
- Dr Rolf E Breuer, Chairman of the Supervisory Board, Deutsche Bank AG
- Mr Donald Brydon, and Chairman of AXA Investment Managers
- Mr Ignace Combes, Vice-President, Management Committee of the Board of Directors, Euroclear Bank
- Mr P.P.F. de Vries, Director, Association of Shareholders, Vice-President, Euroshareholders
- Mr Lars-Erik Forsgardh, Chairman of World Federation of Investors and CEO, Swedish Shareholders Association
- Mr Dominique Hoenn, Deputy General Manager of BNP Paribas, Vice-Chair of the Supervisory Board of Euronext
- Ms Sonja Lohse, Group Compliance Officer, Nordea AB
- Mr Theodoros Philippou, General Manager, The Institute of Certified Public Accountants of Cyprus
- Mr Mariano Rabadan, Chairman of the Spanish Association of Investment and Pension Funds (INVERCO)
- Mr Wieslaw Rozlucki (Chair and CEO of the Warsaw Stock Exchange)
- Pr Rüdiger von Rosen, Managing Director, Deutsches Aktieninstitut
- Mr Zoltan Zpeder, Vice-President and CEO, OTP Bank RT.

Renewal of the panel

Five members of the Market Participants Consultative Panel, will be renewed by CESR before the panel's next meeting in November.



4. Regulatory harmonisation (Level 2)

4.1 MiFID

Mandate and structure of CESR's Expert Groups for MiFID

In order to be able to deliver CESR's technical advice to the Commission in an appropriate and timely way, CESR decided to establish three Expert Groups:

– **Expert Group on intermediaries:** This Expert Group is chaired by Callum McCarthy (Chairman of the Financial Services Authority [FSA]); rapporteur of the group is Carlo Comporti. This Expert Group covered the mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best execution; order handling rules, eligible counterparties, definition of investment advice and definition of commodity derivatives.

– **Expert Group on cooperation and enforcement:** This Expert Group is chaired by Michel Prada (President of the Autorité des Marchés Financiers [AMF]); rapporteur of the group is Alexander Karpf. This Expert Group covered the mandates related to transaction reporting between competent authorities and exchange of information. A technical task force of the Expert Group undertook work as to technical issues related to the exchange of transaction reports.

– **Expert Group on market:** This Expert Group is chaired by Karl-Burkhard Caspari (Vice-President of the Bafin); rapporteur of the group is Jari Virta. This Expert Group covered the mandates relating to admission of financial instruments to trading, post-trade transparency disclosure by investment firms, pre-trade transparency requirements for MTFs, post-trade transparency requirements for MTFs, pre-trade transparency requirements for Regulated Markets and post-trade transparency requirements.

A **Steering Group** was established to consider horizontal issues and to ensure overall consistency in the advice prepared by the three Expert Groups. This Group is composed of the three chairmen of the Expert Groups and chaired by CESR's Chairman, Arthur Docters Van Leeuwen.

Following its first technical advice submitted to the Commission on 31 January 2005 (Ref. CESR/05-024c), along with a feedback statement (Ref. CESR/05-025), CESR submitted its final set of advice on possible implementing measures under the MiFID on 30 April 2005 (Ref. CESR/05-290b) and the corresponding feedback statement (Ref. CESR/05-291b).

The advice covers issues on which advice was requested in the formal mandate from the

European Commission on 25 June 2004. As such, it included clarifications on the scope of the Directive (definition of investment advice and commodities derivatives); some aspects of regulation on intermediaries (including investment research, the suitability test, execution-only services, best-execution and eligible counterparties) and all areas on market transparency and requirements for admission to trading of financial instruments.

MiFID forms one of the cornerstones of the EU's securities regulatory regime, and is intended to deliver an effective 'single passport', allowing investment firms and regulated markets to operate across Europe, under a common set of rules, thus enhancing the protection of European investors.

CESR's advice seeks to propose proportionate solutions which take into account the varied nature of the market participants involved, and the varied complexity of the products and services offered to their clients. At the same time, the advice seeks to provide market participants with the necessary clarity and legal certainty to enable them to innovate with a large degree of confidence whilst ensuring that the advice is proportionate. The amount of detail included in each part of the advice was therefore carefully evaluated on a case by case basis, with a particular emphasis on the need to avoid over prescription and excessive detail wherever possible.

Technical Task Force

Considering the complexity of the technical systems in Member States and the transposition deadline, CESR saw the need for an in-depth analysis and for work on how to exchange transaction reporting data between competent authorities. Therefore, in October 2004, CESR decided to set up a Technical Task Force ("TTF") as a subgroup of the Expert Group on Cooperation and Enforcement.

The Mandate of the TTF comprised two components:

- As a matter of priority, work was undertaken on common data formats and common file formats;



- As a matter for the medium term, work was conducted on common quality standards, infrastructure, and ways and means of the exchange of information between competent authorities.

The final report was approved by CESR in June 2005 and was also presented to the European Securities Committee.

The main conclusions of the report, which must be considered without prejudice to the current work undertaken by the ESC and the European Commission at Level 2, on how to handle the MiFID requirements regarding the exchange of information related to transaction reports are the following:

- Very concrete and operational proposals are presented regarding the data formats and file formats. These formats are designed to allow the effective exchange of transaction reports between competent authorities;
- There is a need to create and maintain several reference databases in order to allow the proper identification of certain items (e.g. financial instruments). These databases are to be run either at a centralised or decentralised level. More detailed work on this topic needs to be done by CESR;
- The report presents some essential recommendations on quality issues concerning the frequency and the timeliness of the exchange of transaction reports between competent authorities, as well as on issues related to security and error correction. These issues are key to the overall quality of the arrangements for exchanging transaction reports and further work needs to be done, which was not possible in the limited timeframe available;
- The work on how transaction data can be exchanged, shows that this can be done via a centralised, decentralised, mixed solution, or through a Common Database (as proposed by the EU Commission in the

latest working document on implementing measures of the MiFID – Doc. ESC/7/2005-rev2 of 13 May 2005). The evaluation of the pros and cons of these options and to establish the costs has not been easy. Although they should not be taken as a scientific and exact exercise, they indicate, in particular, that:

- all options are technically feasible, even if there is a preference amongst several CESR Members for a mixed solution which should be built in a way to allow for further centralisation in the future, if need be;
- some functions will have to be centralised in all options;
- the cost will be substantial (overall costs for the creation of the system for exchanging transaction reports is likely to be comprised between 5.5 to 7.6 million €, annual costs for running the systems have been estimated between 2.5 to 3.8 million €).

MiFID Consumer Day

On 22 March 2005, CESR hosted a consumer day, where 12 representatives of national and European consumer associations met with the MiFID expert groups.

The discussion on the ‘Intermediaries’ section was facilitated by Callum McCarthy, the Chairman of CESR’s Expert Group on Intermediaries and on the Markets section the discussion was facilitated by Karl-Burkhard Caspari, the Chairman of CESR’s Expert Group on Markets.

The importance CESR attaches to receiving comments on its advice from representatives of retail clients and consumers was stressed and CESR expressed its concern that the responses received to previous consultations carried out on MiFID, had not reflected sufficiently this set of stakeholders. CESR made it known that it intended to organise similar meetings in the



future to continue and develop a wider dialogue with consumers on CESR's work.

As the discussion focused on MiFID in relation to CESR's advice on markets and intermediaries, a large number of important points were made, and these are reflected fully in the statement (Ref. CESR/05-350) published on 16 May 2005. This statement is available on the website under Expert Groups/MiFID.

General issues

Consumers' representatives raised some general issues which might help to increase responses from consumers' representatives to CESR consultations. They stated that consumer associations do not necessarily have either the financial knowledge or staff to be in a position to prepare considered responses. In addition, financial services were not always a high priority for consumers.

However, on a practical level, the need for translations from English to national languages was mentioned as a factor which represents an obstacle to their active participation. They also stated that CESR's consultation papers are not always reader friendly. In particular, they would welcome having executive summaries and explanations of the proposals and the reasons why they are especially important from consumers' point of view.

CESR representatives noted the proposals with interest. Regarding the translations or other help, it was pointed out that the national CESR members are most likely to be the natural contact point in this respect.

Finally, the representatives highlighted the importance of investor education and the importance of ensuring it is high on the political agenda.

Next steps

In light of the importance of this work, CESR intends to continue interaction with consumers, through similar events in the future. To this end we will hold a Consumer Day in the autumn, to establish how CESR can improve consumer participation in consultations, and to establish how CESR might best add value to the existing work on consumer education by national authorities.

The European Commission has presented a number of working documents to inform discussion at the European Securities Committee. The discussions which flow from these working documents will assist the Commission in developing a formal proposal which we expect will be published in the early Autumn, possibly by October 2005 with a view to final adoption by the ESC and the Commission by early 2006.

4.2 Transparency

Mandate of the Transparency Expert Group

CESR received a mandate from the European Commission, requesting advice by 30 June 2005, on a number of different technical issues that can be grouped into three areas:

- Technical issues related to notifications of major holdings of voting rights;
- Minimum standards for the dissemination of regulated information;
- Technical questions related to half-yearly financial reports and to equivalence of transparency requirements for third countries issuers.

The European Commission also invited CESR to present a progress report on the conditions for officially appointed mechanisms for storage of information and on possible electronic networks of information about issuers by 30 March 2005.

CESR's advice was prepared by an expert group chaired by Andres Trink, Chairman of the Estonian Financial Supervision Authority and supported by a permanent member of the secretariat, Michel Colinet.

On 30 March 2005, CESR submitted a progress report exploring the various options of how an officially appointed mechanism for storage of corporate information might function (Ref. CESR/05-150b). The report sets out the options of how such an electronic network of information about issuers could be established in the EU, and how issuers might be able to file electronically regulated information with the EU competent authorities.

This report was prepared at the request of the European Commission and formed part of the work conducted by CESR for the Transparency Directive.



On 30 June 2005, CESR submitted its final advice on possible implementing measures covering five aspects of the Transparency Directive (Ref. CESR/05-407), in response to a mandate received from the European Commission on 29 June 2004. The five aspects covered in the advice were issues in relation to:

- dissemination of regulated information;
- notification of major holdings of voting rights;
- half yearly financial reports;
- equivalence of transparency requirements for third countries issuers;
- the procedural arrangements whereby an issuer may elect its 'home Member State' competent authority for the purposes of the Directive.

The content of this final advice reflects comments received during two rounds of consultations on CESR's draft technical advice. The first round of consultation consisted of two consultation papers: a first one on dissemination and storage of regulated information published in October 2004 (Ref. CESR/04-511), and a second one regarding notification of major holdings of voting rights, half yearly reports, equivalence and procedural arrangements, which was published in December 2004 (Ref. CESR/04-512c).. The consultation showed clear preferences in a number of areas. However, in other areas, a clear orientation was not yet visible and therefore in these areas, CESR retained a more open approach as it did in the initial consultation paper. CESR revised its draft advice on the basis of the responses received to this first round of consultation, and released on 27 April 2005 for additional consultation a revised draft Technical Advice on Possible Implementing Measures of the Transparency Directive (Ref. CESR/05-267), addressing all of the issues covered by the mandate of the Commission. The responses to this second consultation have been largely supportive of CESR approach, but on some specific aspects, led CESR to modify its advice in response to significant issues raised by respondents. These issues are set out in the Feedback Statement (Ref. CESR/05-408) covering all of the consultations.

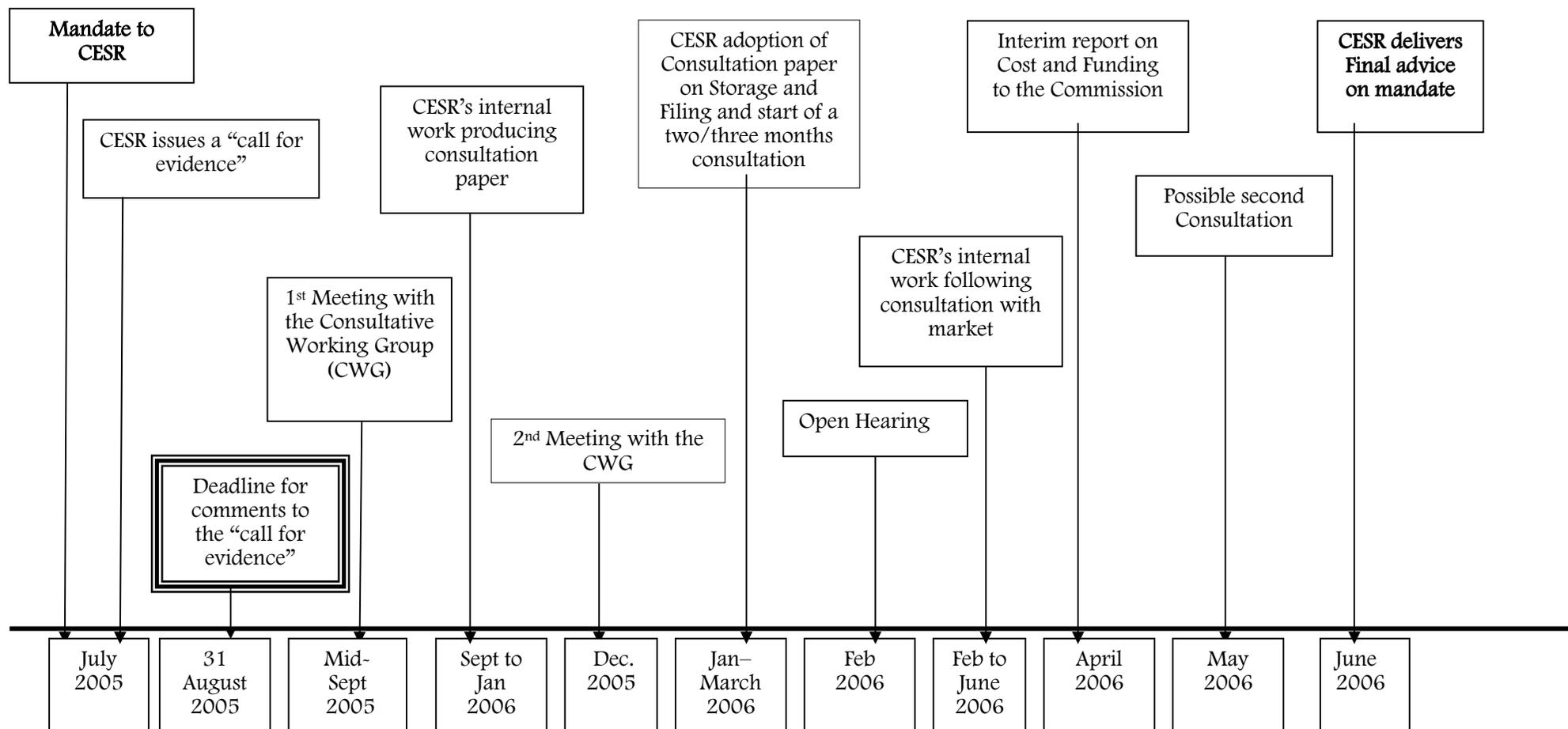
Next steps

CESR has received a new mandate from the European Commission to deliver a technical advice on implementing measures in relation to storage and filing of financial information under the Transparency Directive by 30 June 2006. Following this mandate, CESR launched a call for evidence on 28 July, with a deadline of 31 August 2005. The responses received can be seen on the CESR website, in the section Consultations.

CESR will consult with a new Consultative Working Group on Transparency issues, and launch a consultation period, including an open hearing, in the first quarter of 2006.



Indicative CESR Work Plan for the mandate on Storage and Filing under the Transparency Directive





4.3 Credit Rating Agencies

Mandate of the Credit Rating Agencies Task Force

The European Commission published on 27 July 2004 a call to CESR for technical advice possible measures concerning credit rating agencies that should be submitted by 1 April 2005.

The work in this area was carried forward by a task force led by Ingrid Bonde, Director General of Finansinspektionen, Sweden, and assisted by a member of the Secretariat, Javier Ruiz del Pozo.

In developing the final advice, CESR has co-ordinated closely with CESR's fellow regulatory banking committee (CEBS), who participated in the working group as an observer.

CESR submitted its advice (Ref. CESR/05-139b) for the European Commission on possible measures concerning credit rating agencies and a feedback statement (Ref. CESR/05-140), reflecting comments received to its consultations, on 30 March 2005. This paper discusses the issue of how to deal with credit rating agencies in a regulatory context within Europe. In particular, the report identifies whether there is a need for the introduction of some sort of recognition and/or regulation of rating agencies as these are generally not regulated in Europe today.

In its main conclusions, regarding the development of appropriate rules of conduct, CESR advises the European Commission that the IOSCO Code, published in December 2004, will improve the quality and integrity of the rating process and the transparency of credit rating agencies' operations and reflects the message received from the responses to the consultation. As such, it provides the right answer to the issues raised by the Commission's mandate and analysed throughout the paper.

In relation to the aspect of the enforcement of the IOSCO Code and more specifically, in respect to the final question asked by the Commission's mandate: *'does CESR consider it appropriate that credit rating agencies should be registered in the EU?'*, CESR proposed two possible ways of handling this issue, narrowing down the four alternatives originally considered in its first consultation in

November 2004. A clear majority of CESR members supports a 'wait and see' approach, where no recognition system is set up at present, and the effects of the IOSCO Code are given time to work, as IOSCO and its members have committed to monitoring the implementation of the code. Should self regulation fail to deliver, there might be a need for statutory regulation. Overall, this approach was shared by respondents to the consultation. A distinct minority of CESR members advocated an EU voluntary recognition system, along with a subsequent reporting on the compliance with the IOSCO code.

The paper itself, also analysed a potential set of rules of conduct that might apply to rating agencies and the provisions of the IOSCO code in relation to the aspects studied. In particular, the paper considers the various potential conflicts of interests that might arise as well as the fair presentation and methodologies of rating agencies, staff requirements and the relationship between issuers and credit rating agencies. In addition, an analysis of the use of ratings in private contracts and in European legislation was also provided.

Finally, as regards the competitive direction of Credit Rating Agency activity in the EU, CESR was of the opinion that the impact of regulatory requirements was inconclusive. In particular there was no clear evidence either way that any regulatory requirement would either increase or decrease the entry barriers to the rating industry. Thus, CESR did not recommend the use of regulatory requirements as a measure to reduce or remove entry barriers to the market for credit rating.

Next steps

For the time being, CESR will monitor developments related to credit rating agencies, investors and issuers, particularly by considering the impact of the adoption of the IOSCO Code and of the new rules provided by the Capital Requirements Directive on the behaviour of the credit rating agencies and then making a judgement about whether these measures are effective enough.



4.4 Prospectus

Level 2

Mandate of the Prospectus Expert Group

On 2 June 2005 the Commission issued CESR with a mandate regarding a possible amendment to the requirements in Commission regulation (EC) 809/2004 concerning the treatment of historical financial information which must be included in a prospectus. This has come following market participants' requests to CESR for clarification as to how this will be implemented on a day-to-day basis and follow up work by CESR itself to ensure supervisory convergence in implementation. The initial findings of CESR's work and following discussion with the European Commission indicated that it might be appropriate to tackle potential differences in implementation by amending the Regulation itself.

The expert group is chaired by Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Market Commission (CMVM), and supported by a member of the secretariat, Javier Ruiz del Pozo.

On 6 July 2005, CESR published a consultation paper (Ref. CESR/05-428) setting out proposals for a possible amendment of the Commission's Regulation on Prospectus regarding historical financial information which must be included in a prospectus. The decision to amend the Regulation in this area follows market participants' requests to CESR for clarification as to how this will be implemented on a day-to-day basis and follow up work by CESR itself to ensure supervisory convergence in implementation. The initial findings of CESR's work and discussion with the European Commission indicated that it might be appropriate to tackle potential differences in implementation by amending the Regulation itself. The European Commission has therefore issued CESR with a mandate to set out its advice as to how this may best be done. The deadline set by the European Commission for the submission of CESR's advice is 31 October 2005.

Background

The Prospectus Regulation which came into effect on 1 July 2005, contains requirements

relating to historical financial information which are set out in the annexes adapted to the different types of securities. For example, Annex I to the Regulation, which contains a schedule of disclosure requirements in relation to shares. This requires the inclusion in a prospectus of "audited historical information covering the last three financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year" (Item 20.1).

The primary purpose of including financial information in a prospectus is to enable investors to understand the financial position of the issuer. The historical financial information should therefore provide a record of the issuers' business, as operated and accounted for by the issuer during the period for which historical financial information is required at the date of the prospectus.

Normally, the historical financial information of the issuer reflects the business of the issuer as a whole throughout the required period, including significant acquisitions or disposals. However, there are certain circumstances that arise in relation to public offers or admission to trading of shares, in which the issuer has not prepared its historical financial information as a single business during the whole of the period for which the historical financial information is required under the Regulation (these types of issuers are therefore considered to have a "complex financial history").

Market participants, especially representatives of the accountancy profession, encouraged CESR to provide recommendations in order to provide clarity and convergence as to what is required when issuers have a complex financial history.

With a view to determining whether there was a consensus between its members on the need, in case of an issuer with a "complex financial history", for a prospectus to contain financial information which goes beyond that directly relating to the issuer, CESR undertook a fact finding exercise. Examples of issuers with a "complex financial history" covered by that exercise were cases where:



- the issuer is a newly incorporated holding company inserted over an established business;
- the issuer seeking admission to trading or making an offer consists of companies that were under common control or ownership but which never formed a legal group;
- the issuer has made a significant acquisition (representing more than 25% of the group) during the three year historical record or subsequent to the last audited consolidated financial information on the issuer, including specific reference to cases where the acquired target has different accounting policies;
- the issuer has disposed of a significant part of its business since the last audited accounts;
- the issuer has changed its accounting reference date during the last three year period.

From the work that CESR carried out, it emerged that some CESR members required, as a current practice on a case by case basis, historical financial information not only of the legal entity which issues or proposes to issue securities (which would be the issuer for the purpose of the Regulation), but also in relation to the companies or businesses the issuer has acquired during the period for which historical financial information is required on the issuer.

The European Commission noted that there is some uncertainty about the extent to which the provisions of the Prospectus Regulation relating to historical financial information will enable some competent authorities to continue with their current practice. Therefore, the European Commission has considered it desirable to eliminate this uncertainty and, to this end, has published on 2 June 2005 a mandate to CESR for technical advice.

Level 3

In order to facilitate the work of the competent authorities under the Prospectus Directive, CESR has elaborated a common certificate of approval attesting that the prospectus has been drawn up in accordance with the Directive and with a copy of the said prospectus. In addition, CESR has also established a contact list for use by its members to facilitate contact. This list sets out the contact details of the person(s) responsible for notification in each authority.

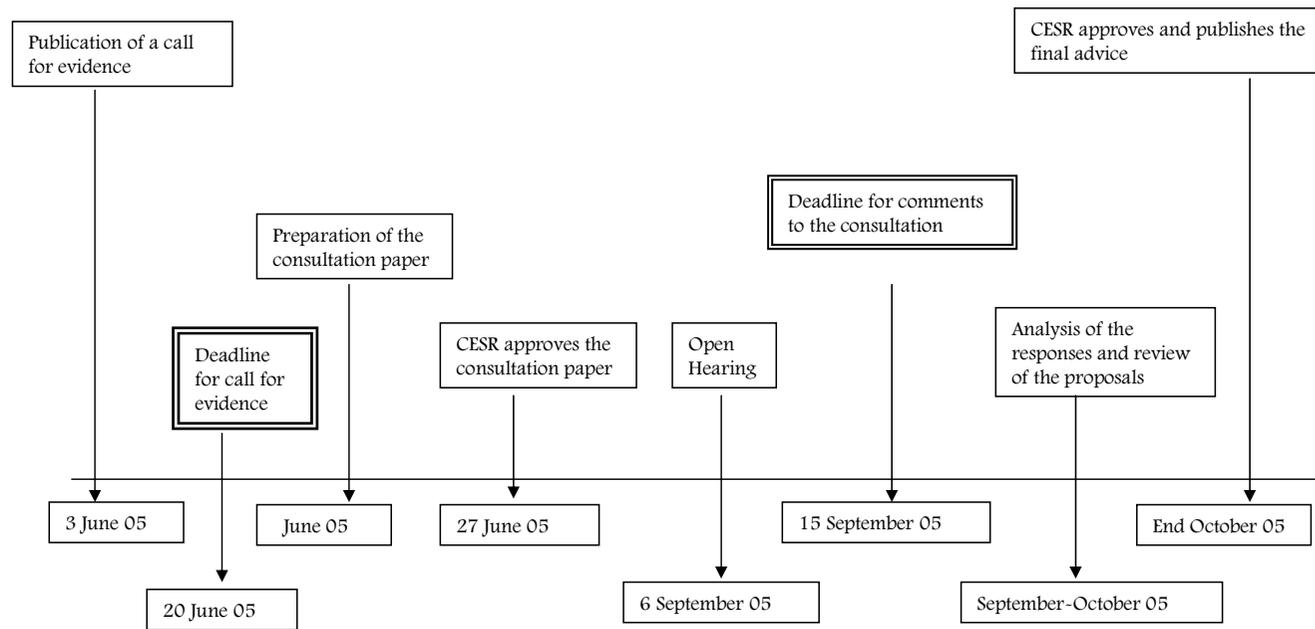
Next steps

CESR has convened a meeting on 16 September where prospectus experts will discuss practical issues on the application of the Prospectus Directive and the Commission Regulation that have arisen after 1 July when the new regime became effective.

CESR expects that these meetings will take place regularly in order to promote convergence on the application of the EU legislation on prospectuses.



Indicative timetable for CESR's advice on Complex Financial Histories





4.5 Investment Management

Mandate of the Investment Management Expert Group

CESR began working on investment management issues in April 2004 following the transfer of these responsibilities from the UCITS Contact Committee. This work is carried forward by an Expert group chaired by Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione nazionale per le società e la Borsa (CONSOB). A permanent member of the CESR Secretariat, Jarkko Syyrälä, assists the Chairman and acts as rapporteur of the Expert Group.

The mandate (Ref. CESR/04-160) and work programme for the Group was approved by CESR in June 2004. Drawing heavily on the responses from a consultation on “The role of CESR in the regulation and supervision of UCITS and asset management in the EU”, and the needs expressed by market stakeholders, it was decided that the short-term priority of the group would be to focus on ensuring that the single market on investment funds is fully functional. The Expert Group would therefore concentrate initially on two aspects related to the harmonised implementation of the UCITS Directives, namely the application of the transitional provisions of the amending UCITS Directives and clarification of some key definitions in the Directives.

Advice on eligible assets for UCITS

On 18 March 2005, CESR launched a consultation on its draft advice regarding the eligible assets of UCITS. CESR’s draft advice includes proposals on:

- The eligibility of “structured financial instruments”
- The eligibility of closed end funds
- The eligibility of money market instruments (MMI) not dealt in on a regulated market
- The efficient portfolio management as regulated by Art. 21 (2) of the UCITS Directive
- The eligibility of credit derivatives
- Index replicating UCITS

The original UCITS Directive (85/611/EEC, often referred to as the UCITS I Directive) was amended, and the two amending Directives (2001/107/EC and 2001/108/EC, the so-called UCITS III) were published in the Official Journal on 13 February 2002.

The amending UCITS Directive 2001/108/EC focused essentially on the “product” (the investment fund). It extended the range of financial assets in which UCITS may invest. As a result, UCITS are now permitted to invest not only in listed shares and bonds as before, but also in bank deposits, money market instruments, financial derivatives (i.e. standardised option and futures contracts dealt on regulated exchanges and over-the-counter derivatives) and in units of other collective investment undertakings. The new rules also recognise investment management techniques widely employed such as “tracking” an index (i.e. investment in securities of different issuers provided for in a given index).

Modern financial markets have generated a huge variety of complex financial instruments which are in constant evolution. In the context of the implementation of the UCITS III Directive, the issue has arisen of whether, or to what extent, some instruments could be considered eligible investments (i.e. “eligible assets”) for a UCITS in compliance with the relevant provisions of the UCITS Directive, in particular the definitions of “transferable securities” under Art. 1 (8), of “money market instruments” under Art. 1 (9) and the list of authorised investments under Art. 19.

The consistent implementation and interpretation of EU legislation is a crucial dimension of the building up of the single market in financial services. In view of this, the Commission intends to make use of the delegated powers conferred by Art. 53a of the UCITS Directive to the Commission, to clarify some of the definitions pertaining to eligible assets which are contained in the UCITS Directive. In its preparation of possible draft comitology instruments, the Commission has therefore requested CESR to prepare technical advice for this purpose.

At present, the CESR Expert group on Investment Management is analysing the large number of consultation responses and developing the advice further. Many respondents took the opportunity to ask for a second consultation, and given the importance CESR places on full consultation and the importance of the issues, CESR has responded positively to this request, and will consult for a



second time during autumn,. When completed, CESR's advice will assist the European Commission in developing a legal text which is likely to take the form of either a Regulation or a Directive.

Next steps

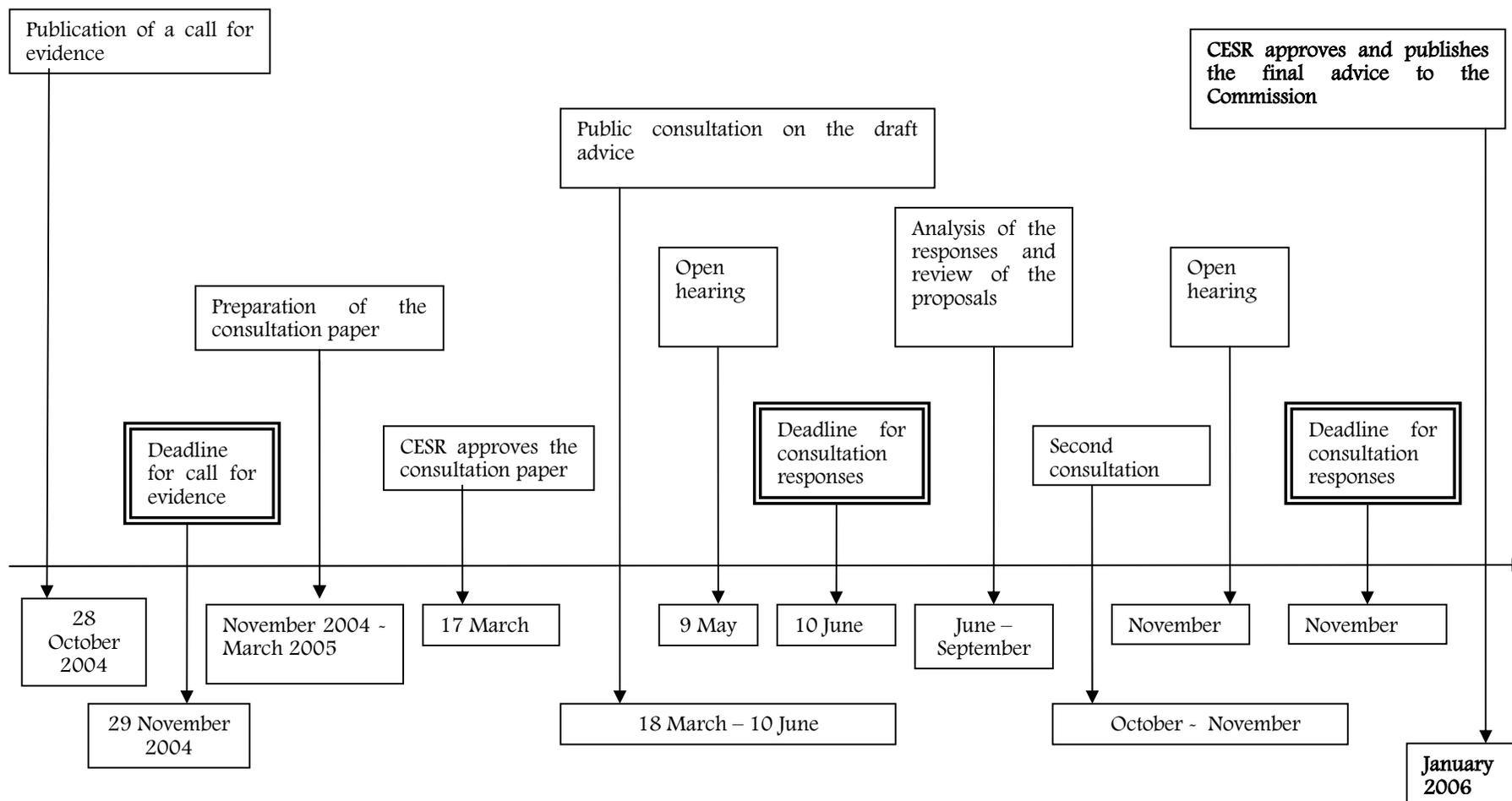
Following a request from CESR, the European Commission has extended the deadline of the mandate for CESR's advice to mid-January 2005. This will enable CESR to re-consult the market for a second consultation, in October-November 2005.

Simplifying the notification process for UCITS

As indicated in the mandate of the Expert Group on Investment Management, following the work done regarding the transitional issues of the amending UCITS Directives, the expert group is currently conducting additional work in this area to develop consistent standards for the notification requirements foreseen by the UCITS Directives to streamline the process. The notification process of cross-border marketing of UCITS has been one of the key areas of concern to the European asset management industry. CESR's aim is to develop guidelines/ a handbook dealing with all the procedures and documentation needed in the notification, including the different forms and model attestations. The expert group aims to provide the first public consultation document on this issue in October 2005.



Indicative CESR work plan on the clarification of definitions of the UCITS Directive





5. Supervisory Convergence (Level 3)

5.1 Policy

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

On 7 April 2005, CESR presented its 2004 Annual Report (Ref. CESR/05-013) and a detailed report on the steps it is taking to improve supervisory convergence in the European Union to the Financial Services Committee (FSC) (Ref. CESR/05-202). The FSC is an EU Council Committee that gathers together high-level representatives of the European Union's Finance Ministries. This marks the first of a more periodic framework of reporting by CESR which will further strengthen CESR's accountability with the EU institutions. Similar reporting to the FSC will take place once a year hereon, and will be particularly focused on CESR's work on supervisory convergence. The Lamfalussy process envisaged a critical role for supervisors to work in a co-ordinated fashion (under what was described as Level 3 of the new four level process). The purpose of this increased supervisory convergence in the day-to-day application of European law and in supervisory practices generally, is to assist the development of the Single Market in Financial Services.

Mr Kees van Dijkhuizen, Chairman of the FSC and Treasurer-General of The Netherlands Ministry of Finance, welcomed this first CESR progress report on supervisory convergence. The Council had on several occasions emphasised the need for supervisory convergence in the EU. He found this first report to be useful input for the FSC's ongoing debate on the development of the EU financial regulatory and supervisory framework. Furthermore, regular reporting by CESR on results achieved would strengthen CESR's accountability links with the Council and the other EU institutions. The report is available on CESR's website www.cesr-eu.org, under Documents/Submissions to EU institutions.

Strategic Task Force

In March 2004, a Strategic Task Force ("Himalaya Group") was established by CESR. Its purpose was to establish an analytical framework to provide answers to the following questions concerning the future regulation of securities markets in Europe:

- 1) What are the reasonable demands in relation to the regulation of securities markets made on CESR at EU level?
- 2) What are the appropriate answers to these demands?
- 3) Are structural changes to CESR necessary?

A first report from this group, the Himalaya report (Ref. CESR/04-527b), was welcomed by the European Parliament in a report (A6-0087/2005) by Ieke van den Burg MEP, as a good starting point for further discussion. A number of its core recommendations, notably on the need for convergence of supervisory powers, responsibilities and practices, subject to parliamentary control, were found to be relevant by the European Parliament. The report recommended a coordinating role for CESR, the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), building on the current supervisory framework, close cooperation between them and, above all, appropriate action by Member States to adapt working methods and increase where necessary the resources of the national supervisory systems.

The European Parliament also noted it was aware that convergence of regulatory powers and sanction systems is more complicated to achieve than supervisory convergence, owing to differing national traditions and legal systems; nevertheless, it asked the Commission, together with the Financial Services Committee and CESR, CEBS and CEIOPS, to clearly identify where this diversity might lead to problems and might undermine the implementation of the FSAP measures.

The Himalaya Task Force discussed the work conducted so far, as well as the report by the European Parliament. A proposal for the future work of the Himalaya Task Force was



established. Three critical areas were identified to be given priority attention: a) streamlining reporting obligations and reducing the burden of compliance costs; b) continue to advocate for similar and equivalent powers; c) the home/host relationship, including the developments of joint operations. The Task Force also identified other issues which are directly or indirectly related to the above mentioned: i) developments of databases; ii) development of a mediation mechanism; iii) an effective peer-review mechanism, and iv) development of a policy vis-à-vis retail investors (better involvement, education).

On the issue of accountability, whilst the advisory activity conducted by CESR at Level 2 does not raise specific concerns in terms of accountability to the EU Institutions (see the last reports of the Inter-Institutional Monitoring Group), it is natural that the growth of visibility of CESR activities at Level 3 raises concerns regarding further enhancing CESR's accountability.

CESR already agreed to be more accountable in its level 3 work towards Member States through the Financial Services Committee (see The Role of CESR at Level 3, An action plan for 2005, Ref. CESR/04-527b and ECOFIN conclusions of October 2004); it was also formally requested to be more accountable to the European Parliament (see both the Reports of Ieke van den Burg MEP, and of Piia-Noora Kauppi MEP on Clearing and Settlement, and the results of the visit of a delegation of the European Parliament to CESR).

It should also be noted that this accountability does not substitute the accountability that continues to apply to CESR members towards their respective national constituencies.

The development of IT Tools

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:

A database of decisions by supervisors

The database used by the Review Panel enables the general public to view the degree of implementation of CESR Standards by the members (both 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 was used for the first time by members as they reviewed, at the European Commission's request, how two Commission' 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. The results of this review were published on 7 July 2005 (Ref. CESR/05/302b). The tool is currently being used to evaluate the level of implementation of Standard no.1 on Financial Information.

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, in order to determine how greater convergence might be achieved.

IT systems for regulated information:

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 (see page 6-7). 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 (see page 9-10). 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, as a result of its work under the new mandate received from the Commission.

5.2 Review Panel:

Mandate

The “Stockholm Resolution” adopted by the European Council on 23 March 2001 stated: ‘The Committee of European Securities Regulators should also contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective cooperation between national supervisory authorities’, carrying out peer reviews and promoting best practice.’

To fulfil this important task, CESR established the Review Panel, in March 2003. The Panel, chaired by Kaarlo Jännäri, Vice Chairman of CESR, is a permanent group comprising the representatives of each CESR Member. The Review Panel is mandated to review the implementation (day-to-day application) by all CESR Members of CESR standards and guidelines into national rules and of EU legislation where requested by the European Commission.

Its recent work includes a survey conducted at the request of the European Commission, regarding Implementation of the European Commission’s Recommendations on UCITS.

On 7 July 2005, CESR published the results of a survey reviewing the implementation of two European Commission Recommendations, which deal with the use of financial derivative instruments for UCITS and some of the key contents requirements for the simplified prospectus of UCITS (Ref. CESR/05-302b).

These two Recommendations, published by the European Commission on 30 April 2004, provide guidance to Member State authorities on the implementation of the most significant sets of changes to the UCITS legislation brought about by the two so-called UCITS III Directives (2001/107/EC and 2001/108/EC). The Recommendations were developed in response to concerns regarding potential inconsistencies in implementation between Member States.

In the autumn of 2004, the European Securities Committee discussions confirmed the continued importance of transparency regarding the steps taken by Member States’

authorities to give effect to the Commission Recommendations, if the UCITS III Directive were to be effectively implemented and its single market benefits fully realized. The European Commission therefore asked CESR to conduct a detailed survey on the implementation of the Recommendations. This survey was conducted by the Expert Group on Investment Management, with the assistance of the Review Panel.

The report concludes that overall implementation of the Recommendations is generally satisfactory across Member States, with a number of Member States having implemented the Recommendations into their national rules almost on a word for word basis. Most of the other Member States have implemented the Recommendations with some adaptation to wording but providing a high degree of consistency. A group of several Member States can be identified which have indicated the implementation of the Recommendations is still underway, either already under public consultation or still under internal consideration by the national authorities. It is therefore to be expected that the implementation situation will improve further by the end of 2005 when these processes are completed.

When analysing the responses, it has to be noted that the Commission’s recommendations fall into two types of categories: those aimed to ensure a high level of investor protection in the investment activity of a UCITS and its disclosure and those aimed at allowing, within the limits of the UCITS Directive, some flexibility in the activity and investments of a UCITS. The level of implementation and therefore the extent to which these two types of objectives are achieved, varies considerably between different sections of the Recommendations. For instance, regarding the Recommendation on the simplified prospectus, the key recommendations on the presentation of the objectives and the investment policy of a UCITS have been implemented by the great majority of Member States. In contrast, the level of implementation on disclosure of costs and fees has not been as effectively achieved, particularly in relation to the indication of the existence of fee-sharing arrangements and soft commissions.



The report has been transmitted to the European Commission and the European Securities Committee, as a basis for further discussion.

The Review Panel is also finalising a report on the implementation of the part of CESR Standards on Investment Protection on Cold Calling, and these results will be published in due course on CESR's website.

Next steps

The Review Panel will review the implementation of CESR's Standard No 1 on Financial Information, which deals with the enforcement of financial information, by the third quarter of 2005, and will also continue its review of transitional guidelines under the UCITS Directive.



5.3. Operational groups

5.3.1 CESR-Fin

Mandate of CESR Fin

CESR-Fin is a permanent Operational Group with the role of co-ordinating the work of CESR members in the area of endorsement and enforcement of financial reporting standards in Europe. CESR-Fin enables CESR to play an effective role in the implementation and enforcement of IAS/IFRS in the European Union (EU) in the context of the EU's new accounting framework that is compulsory for all European listed companies, as of 2005. This allows CESR to participate pro-actively through an engaged dialogue with all the key policy makers involved throughout the European endorsement process, during the formation and implementation of the international accounting standards (IAS/IFRS).

Furthermore, CESR-Fin's role is to assist CESR members in delivering a co-ordinated and effective application of IAS/IFRS by EU listed companies, through the preparation of standards and guidelines on supervision and enforcement of financial reporting in Europe. CESR-Fin has also been tasked with monitoring developments in Europe in the field of auditing.

CESR-Fin is chaired by John Tiner, Chief Executive at the UK FSA, and supported by Michel Colinet, Director of Financial Information at the CESR Secretariat.

Over the last six months, CESR-Fin devoted a large part of its activity to two major projects. One of these projects is the implementation of the coordination mechanism as envisaged in CESR Standard No 2 on enforcement of financial information. This included the organisation of the first meetings of enforcers for reviewing practical issues and cases related to financial reporting, and the creation of a CESR database of enforcement decisions in this area. The second important project is the preparation and finalisation of CESR's advice on equivalence of certain third country GAAP with IFRS. Beside these major projects, CESR-Fin continued to monitor the EU process for endorsement of IFRS and prepared a consultation paper on Alternative Performance Measures. In the area of audit, CESR-Fin focused its attention on the developments related to the adoption of the 8th Directive and on practical audit issues raised by the implementation of new EU directives.

A. CESR-Fin activities in the area of enforcement and CESR Recommendation on Alternative Performance Measures.

As an operational group, CESR-Fin views the effective coordination of enforcement activities of CESR members and other EU National Enforcers in the area of financial reporting as an essential mechanism for ensuring proper and consistent application of IFRS in the EU.

To this end, the coordination mechanism set out in CESR Standard No 2 on Enforcement of Financial Information has been further implemented in practice. On the one hand, the European Enforcers Coordination Session (EECS) started its activities in January 2005 and has held so far five meetings fully devoted to discussion of practical and technical issues or cases of financial reporting that emerged from the day to day practice of supervision of financial information in each jurisdiction. These meetings represent an important and efficient mean for high level accounting and financial reporting experts to exchange views and experiences, in particular at this critical moment of first implementation of IFRS in Europe.

In parallel, CESR has completed its IT project for creating a database of enforcement decisions taken by its members and other delegated authorities in relation to financial reporting. The database has been operational since 25 August 2005, and provides a useful source of information for EECS members who are committed to considering the existing decisions of other enforcers before adopting new decisions.

Enforcement practice in the area of financial reporting has also led CESR to publish a draft Recommendation on the use of Alternative Performance Measures (Ref. CESR/05-178). At present, European listed companies use widely differing Alternative Performance Measures, such as EBITDA, cash earnings, restricted earnings ...).

Alternative performance measures can provide investors with appropriate additional information. Properly used and presented, these measures can assist investors in gaining



a better understanding of a company's financial performance.

The objective of this recommendation is to provide guidance on the best way to use and present alternative performance measures appropriately. Therefore, the recommendation establishes some clear principles that companies should consider in the preparation and disclosure of this information. Following consultation, this recommendation will be addressed to CESR members who as securities regulators can, in turn, recommend to nationally listed companies to follow this guidance and to ensure best practice is adopted by companies. As such, this should ensure that the risks of inappropriate use, or misleading use, of alternative performance measures are minimised.

Next steps

Considering their importance in the EU context, the continuation of the EECS meetings and the effective use and development of the database will remain high on the agenda of CESR-Fin over the next months and years. Other aspects, such as establishing appropriate communication flows between the coordination mechanism of CESR and external players (in Europe and outside Europe) in the area of financial information will also receive due attention.

The consultation on CESR's draft recommendation on Alternative Performance Measures closed on 11 July, and the responses received can be seen on the CESR website, in the section Consultations. CESR expects to finalise the recommendation on Alternative Performance Measures by the end of the year.

B CESR-Fin: Equivalence of certain third country GAAP and IFRS

Mandate on equivalence between US, Canadian and Japanese GAAP and IAS, and for a description of enforcement mechanisms in these countries

CESR on 29 June 2004 received a mandate from the European Commission (Ref. CESR/04-305) in which it requested CESR to provide technical advice on the equivalence between Canadian, Japanese and US GAAP (Generally Accepted Accounting Principles) and IFRS. The mandate also asked CESR to describe the enforcement mechanisms in place in Canada, Japan and the USA for enforcement of financial information.

This mandate was related to financial reporting by third

country issuers from Canada, Japan and USA in the framework of the Prospectus and Transparency Directive.

Within CESR, CESR-Fin took charge of this mandate. More specifically, the technical assessment of equivalence of accounting standards has been prepared by the subcommittee on endorsement of CESR-Fin (SISE) which is chaired by Paul Koster, Commissioner at the Dutch AFM. The enforcement aspects have been addressed by the subcommittee on enforcement of CESR-Fin (SCE), which is chaired by Lars Østergaard, Director at the Danish FSA. The two subcommittees were supported by Michel Colinet, Director at the CESR Secretariat.

A Consultative Working Group composed of high quality experts in the area of accounting and financial information had also been set up in the framework of this mandate.

CESR submitted to the European Commission its final technical advice on Equivalence between Canadian, Japanese and US General Accepted Accounting Practices (GAAP) and International Financial Reporting Standards (IFRS) (Ref. CESR/05-230b), and a feedback statement (Ref. CESR/05-395) of the consultations conducted by CESR on this project, on 30 June.

Having received generally supportive comments during the public consultation on CESR's overall assessment of equivalence, CESR has confirmed the premise of its initial technical assessment of equivalence, and the conclusion that considering the needs of investors on EU financial markets, the three third countries GAAP, each taken as a whole, could be considered as equivalent to IFRS subject to a number of remedies (essentially disclosures).

The final advice also provides a number of practical indications in relation to the way in which companies reporting under these GAAP would be expected to provide EU financial markets with additional information (remedies) for a number of technical differences between third country GAAP and IFRS that, as indicated in the advice, can be considered as significant. In order to address particular concerns expressed by respondents, CESR's final advice, following consultation, has been revised to provide several clarifications on these practical indications.



A key element of CESR's conclusion is that companies reporting under Canadian, Japanese and US GAAP are, under no circumstances, expected to do a complete reconciliation of their financial statement into IFRS. Rather, they are primarily expected to apply remedies (in the form of disclosures) in relation to the list of significant differences provided in the advice. Taking account of comments received, the final advice has streamlined the approach to situations where an accounting issue is not included in this list of significant GAAP differences. Now, under the final advice, the scope of application of these situations has been ring fenced. Rather, the situations are expected to be exceptional in occurrence and, when they occur, should be covered by additional disclosures when related to transactions or events that could be material and relevant to investors' decisions.

It should be noted that any exercise of GAAP comparisons is subject to adaptation over time as it represents an assessment of the standards at a given moment. As such, the assessment of equivalence was based on the standards in place in the third countries up to 1 January 2005 (as requested by the European Commission). Throughout the finalisation of this work, CESR has collected evidence that important changes will occur in third countries GAAP, that will solve many of the differences highlighted in the advice. These are largely the result of the convergence projects that are underway between the IASB and the standard setters in the three countries considered. Convergence towards adoption of high quality international reporting is essential for fostering the integration and efficiency of global capital markets and CESR is hopeful that these projects will be taken forward as a matter of priority over the next months and years.

As requested by the European Commission, CESR has also included, within the technical advice, a description of the enforcement mechanisms which are in place in each country. This description is essentially based on the information received from Canada, Japan and the US and is not an assessment of how enforcement works in practice. Effective enforcement mechanisms of financial

information however, are a key element in establishing an appropriate framework within which, investment decisions can be taken in a secure environment, and are therefore critical for investor's confidence.

5.3.2 CESR-Pol

Mandate

CESR-Pol is a permanent operational group within CESR. It is made up of senior officials, from each CESR member, who are responsible for the surveillance of securities activities and the exchange of information. CESR-Pol's purpose is to facilitate effective, efficient and pro-active sharing of information, in order to enhance cooperation upon, and the co-ordination of, surveillance and enforcement activities between CESR members. CESR-Pol's key objective is to make information flow across borders between CESR members as rapidly as it would be internally and, by so doing, to enhance the transparency, the fairness and the integrity of European markets as a whole. The ability of CESR-Pol members to co-operate in the field of enforcement has been established by their signature of the CESR multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (MoU) in January 1999.

Kurt Pribil, Chief Executive Officer of the Austrian Financial Market Authority (FMA) was appointed Chairman of CESR-Pol in September 2003. The group's work is supported by a member of the CESR secretariat, Angie Reeh-Schild.

On 11 May 2005, CESR published guidance destined to facilitate the implementation of the Market Abuse Directive (Ref. CESR/04-505b), accompanied by a feedback statement (Ref. CESR/05-274).

The Market Abuse Directive came into effect on 12 October 2004, and while some delays in the transposition of this legislation into national law has been anticipated, CESR has nevertheless taken steps to prepare the ground for the implementation of the new regime by ensuring a common approach to the operation of the Directive by supervisors throughout the EU.

The provision of a European single market in financial services necessitates the promotion of market integrity, and thus a common



approach to the prevention and enforcement of market abuse.

CESR's operational group, CESR-Pol, which draws together enforcement and cooperation officers from all CESR Member States, has been given responsibility for ensuring the effective implementation of the Directive and has prepared the guidance which covers the following:

- guidance on accepted market practices in relation to market manipulation;
- guidance on what CESR members consider constitutes market manipulation;
- guidance and a common format for reporting suspicious transactions.

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 – these are often referred to as "*Accepted Market Practices*" (AMPs). The guidance re-emphasises that the decision to accept a practice as an AMP applies only to the practice in question in relation to a specific national market. This reflects the fact that the characteristics of each market may differ and as such, it may well be appropriate for one market but inappropriate for another where the conditions (such as the market size etc.) differ. In accordance with the obligations set out in the Directive, CESR published on its website during May, the first Accepted Markets Practices under the MAD regime (concerning practices accepted by the competent authorities of Austria, France and the United Kingdom). The specific AMP's are published including a short description and an explanation of the rationale for the acceptance plus a link to the national legislation or rules where the AMP has been adopted.

In the second part of the paper, CESR identifies 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 Directive.

An innovation of the new European Market Abuse regime is that the Directive places an obligation on market participants to report suspicious transactions. This paper offers guidance as to what might be the indications of suspicious transactions which may involve insider dealing or market manipulation.

Furthermore, the implementing measures of the Market Abuse Directive (2004/72/EC under Article 8) places a duty on firms 'to notify without delay' if they have reasonable doubts regarding a transaction executed or arranged by the firm itself. For this purpose, CESR's guidance sets out a standard reporting format which should be used by market players to report suspicious transactions to the relevant competent authority. The common notification form was generally felt to be useful. Nevertheless, a number of respondents suggested that CESR should ensure that the use of a form does not result in a delay in notification, particularly, in circumstances where the firm lacks information to complete the form in its entirety. In addition, some respondents asked CESR to set a specific timeframe within which they would be considered to have complied with the requirement that they had notified 'without delay'.

CESR agreed that it would be beneficial to report a suspicious transaction even if the reporting form was initially incomplete due to a lack of information and has amended the guidance to reflect this. However, CESR has decided against setting a timeframe within which the firm could be considered to have 'notified without delay'. The reason for this being that situations may differ considerably, making it impossible to be too prescriptive in this regard. For example, a transaction which takes place on 20 June might only become suspicious (without retroactive monitoring) on 20 July. A notification on 20 July therefore, would still, in this case, constitute timely notification.

Finally, at the same time as issuing this guidance, CESR-Pol continues to work on developing the framework on supervisory and enforcement co-operation which will be



equally important in ensuring that the Market Abuse Directive successfully produces its objectives.

In cases of specific investigations, the CESR-Pol network cooperates to facilitate the work of the responsible authority by conducting joint investigations on bilateral and multilateral level, the latter has been carried out specifically by collaborating in ad hoc Urgent Issues Groups which are established when necessary.

Joint investigations are generally conducted according to the paper on Requests to Open an Investigation and Joint Investigations that was agreed amongst CESR members in June 2005. This paper provides flexible guidelines for the procedures to be followed with regard to (a) requests by a competent authority of a Member State to the competent authority of another Member State to open an investigation on the former's behalf, and (b) joint investigations between competent authorities of Member States. In drafting this report, CESR-Pol, has particularly drawn on, and benefited from, the experience developed as a result of the 'Citigroup' case.

Following the approval of the CESR-Pol Urgent Issues Group paper by CESR in January 2005, the first meeting of an Urgent Issues Group was convened in April 2005, to address a specific cross-border issue of an urgent character in collaboration with other CESR-Pol-members concerned. In the meantime, this first Urgent Issues Group has achieved substantial progress in its common investigation. A second Urgent Issues Group was established in August 2005.

Furthermore, CESR has conducted work on **Categorisation on Information** that has to be exchanged in accordance with the Market Abuse Directive. The information to be exchanged among competent authorities falls into three categories (automatic information; information that has to be exchanged in consultation procedures; and information to be exchanged upon request). As a result, CESR-Pol has developed different service levels agreements and different requirements as regards the timing of when the information has to be submitted to the CESR member who

requires information to fulfil its supervisory responsibilities. As the most relevant case for consultation foreseen in the Market Abuse Directive is the process to consult publicly before accepting Market Practices under the MAD regime, the paper lays down the procedure the authorities shall follow if they consider a consultation with some or all CESR members necessary.

Next Steps

CESR-Pol will continue to work on ensuring the effective and consistent implementation of the Market Abuse Directive. Finalisation and further work in these areas will continue in 2005. Moreover, CESR-Pol was recently mandated to conduct work also on the convergent implementation of the MiFID as regards the cooperation among the EU regulators provided therein.

In order to exchange views and experiences as to uncooperative jurisdictions with other bodies that are affected by cooperation difficulties in a similar sense.

Upon the request of the US CFTC, CESR-Pol will also share its experiences regarding the enforcement of combined futures/cash transactions on bond markets.

5.4 Level 3 Expert Groups

5.4.1 Mediation Task Force

Mandate of the Mediation Task Force

CESR has established a Task Force on Mediation, which is chaired by Mr Manuel Conthe, Chairman of the Spanish Securities Commission (Comisión Nacional del Mercado de Valores) and which is mandated to develop a proposal for a general CESR mediation mechanism. The Task Force will be composed of representatives of CESR Members and the European Commission.

The objective of such a mediation mechanism is to facilitate the rapid, effective and balanced solution to disputes between CESR Members in order to facilitate convergence at Level 3 and the fair implementation and application of CESR measures and EU law. The mechanism will have to ensure that the competence of the European Commission is fully respected, and it will not interfere with the respective roles of the European Commission and the European Court of Justice in the interpretation and enforcement of EU law.

CESR published a mandate and call for evidence (Ref. CESR/05-253) on 8 April 2005, announcing its first steps towards the



development of a mediation mechanism to facilitate the rapid and effective solution to disputes between national supervisors. The mediation mechanism will further strengthen efforts to converge supervisory practice at EU level by ensuring fairer implementation and application of CESR measures and EU law.

Following an initial consultation, it has been established that CESR's mediation mechanism will need to conform to some underlying principles. In particular, it should:

- Be a mechanism of peers (i.e. CESR Members) committed to ensuring the success of mediation;
- Ensure safeguards are put in place to ensure an unbiased process;
- Be geared to produce rapid and efficient decisions;
- Avoid any systematic questioning of the 'automaticity' of mutual recognition;
- Incorporate a process to identify suitable cases for mediation (including a system to receive complaints on cross-border cases) and act as a filter for those cases not appropriate for this mediation system;
- Find a way to enable input from market participants;
- Allow enough flexibility to cater for different purposes envisaged by the new FSAP Directives (e.g. Market Abuse Directive, MiFID, Prospectus Directive);
- Publish the outcomes in a manner that protects business confidentiality.

In addition, the mechanism developed will have to ensure that the competences of the European Commission are fully respected, and it will not interfere with the respective roles of the European Commission and the European Court of Justice in the interpretation and enforcement of EU law. Before mediation begins, bilateral efforts between the CESR Members to resolve the dispute should have been fully exhausted.

CESR will also take into consideration work on mediation and other alternative dispute resolution mechanisms undertaken in other

international fora when developing its own mediation mechanism.

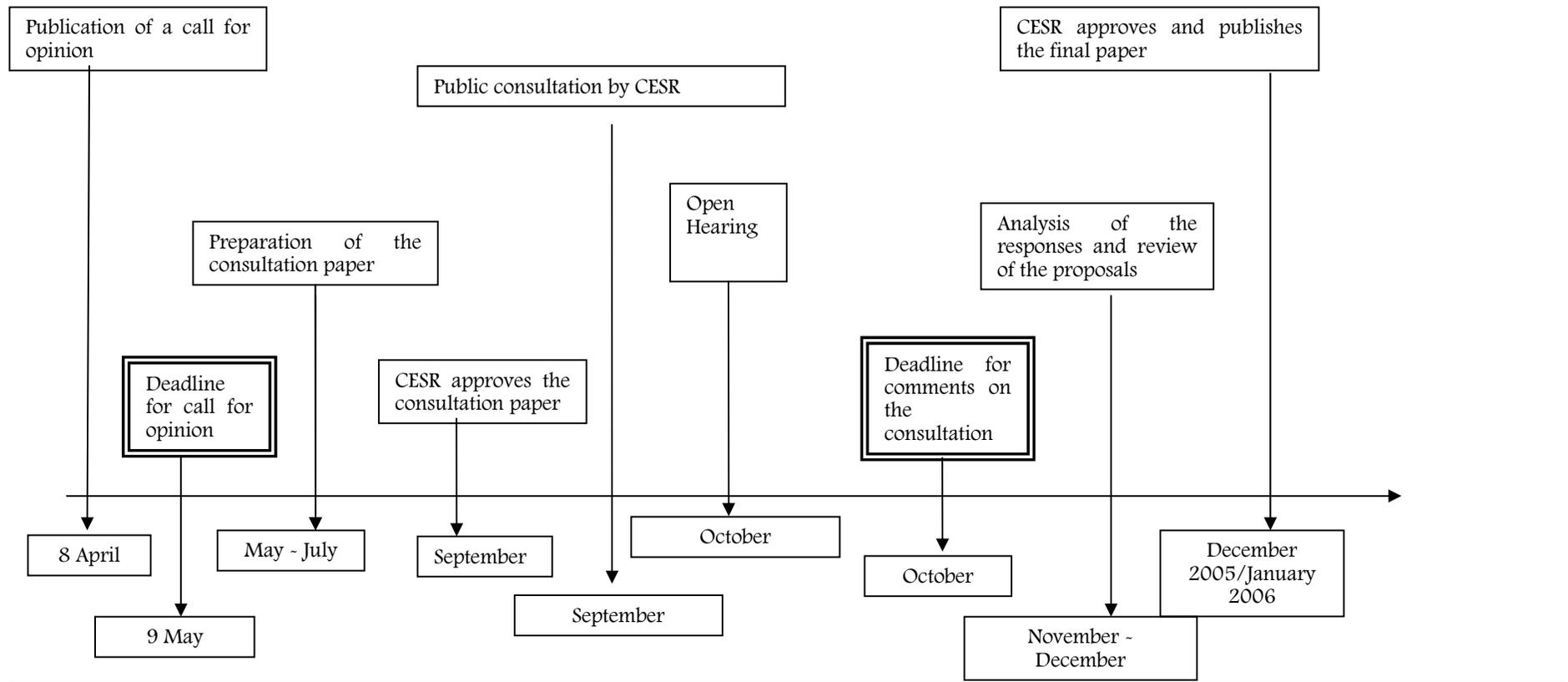
The decision of CESR to develop work in this area follows a report by the Inter-Institutional Monitoring Group (which regularly reviews the functioning of the Lamfalussy process on behalf of the EU institutions) and the views expressed by the Council's European Securities Committee, in which both proposed that CESR should consider establishing a mediation mechanism which goes beyond the Market Abuse Directive. On this basis, CESR consulted on the idea to establish a CESR mediation mechanism on two occasions and received overwhelming support for this initiative.

Next steps

CESR will publish a consultation paper on the Mediation mechanism on 8 September 2005, which will be open for comments until 30 November 2005.



Indicative timetable for CESR's work on a general mediation mechanism





5.5.2 Clearing and Settlement

Mandate of the CESR/ESCB joint working group

After the publication of the ESCB/CESR “Standards for Securities Clearing and Settlement in the EU” in October 2004, the Joint Working Group received the mandate from CESR/ESCB to work on three strands of follow-up work, as indicated below and as announced in the introduction of the aforementioned Standards. A call for evidence on the follow-up work by CESR and the ESCB was published on 1 August. During the course of this work - given the nature, scope and complexity of this follow-up work - CESR/ESCB will closely link its work with the relevant political and other regulatory stakeholders, in particular the three EU-institutions (Commission, Parliament and Council), CEBS and the BSC. Since the adoption of the Standards, permanent contacts have been kept with the relevant industry associations.

EP Resolution on Clearing and Settlement

On 7 July 2005, the European Parliament adopted a Resolution on clearing and settlement, welcoming the work process established by the European Commission through the CESAME group and supporting the goal of an efficient, integrated and safe market for clearing and settlement. The Parliament also expressed priorities on the way in which future work in this area should be conducted. In particular, the Parliament invites CESR and the ESCB to work in a very open manner, to reconsider the concept of “custodian bank” and to avoid duplicating supervision of institutions already subject to banking supervision. Finally, the Parliament asks that the timing of the implementation of the CESR/ESCB standards should be coordinated with the agenda of the Commission in this area.

CESR will take the upmost account of the opinions expressed by the Parliament in its resolution when finalising the assessment methodology of the standards.

Development of an assessment methodology

The development of an “Assessment methodology” will provide guidance to help assess whether the addressees of the standards have implemented the standards or, where necessary, developed action plans for implementation. This methodology will be comparable to the CPSS-IOSCO assessment

methodology, but specifically adjusted to the needs of the European context.

Analysis of open issues

In the context of developing the assessment methodology, a number of open issues are being further analysed on the basis of a range of interviews and working sessions with targeted market participants in the first half of this year.

Other open issues include:

- the need to harmonise settlement cycles in the EU (Standard 3);
- the effects of CSDs engaged as principals in securities lending (Standard 5);
- the practicability and usefulness of requiring significant custodians to organise DVP settlement in their books (Standard 7);
- the relation between the banking supervisory framework and those standards dealing with credit risks (Standards 5 and 9);
- analysis of the potential risks that significant custodians may trigger in terms of financial stability (Standard 9);
- identification of those cases in which settlement in central bank money is not required (Standard 10); and
- clarification with regard to the measurement of efficiency and cost-effectiveness (Standard 15).

In addition, the practical organisation of the cooperation among regulators (Standard 18) is under further analysis.

Central counter parties (CPSs)

The Joint Working Group’s original mandate identified the need for a clear regime for central counterparties. As a first step, the CPSS-IOSCO recommendation dealing specifically with CCPs has been enhanced, and the scope of a number of the recommendations has been extended to cover explicitly CCPs. CPSS-IOSCO has developed a comprehensive set of global risk management recommendations and a corresponding assessment methodology. The CPSS-IOSCO Recommendations for Central Counterparties were published by the end of 2004. An ESCB-CESR equivalent of the CPSS-IOSCO Recommendations for Central Counterparties is considered with a view to take any European specificities in this area into account.



Next steps

Following the call for evidence, a consultation on a report covering the issues of central counterparties and on the assessment methodology will be early 2006.

5.5. Supervisory convergence beyond CESR

5.5.1 Contacts with other Level 3 Committees

CESR has intensified the coordination with other “Level 3 Committees”: CEIOPS and CEBS. Contacts have taken place, both at the level of Chairs and of Secretary Generals, and a meeting between the secretariats was held in Paris on 31 May 2005.

At this meeting, several issues of importance to the Committees were identified, and they include:

- Mapping exercises for the 3 sectors with the objective of reducing supervisory burdens and streamlining processes: Outsourcing, Internal organisation and controls, reporting obligations, IFRS, credit rating agencies are potential areas for consideration;
- Issues where exchange of experiences can facilitate a supervisor’s ability to cooperate: Home/Host cooperation tools (including points of contact), enforcement practices, exchange of information/confidentiality, mergers and acquisitions;
- Joint work or reports to FSC/EFC: Credit risk transfer, off-shore centres, financial market trends, cross sector risks;
- Issues where two Committees need to share information and where compatible approaches must be developed were reviewed. These include: clearing and settlement (CESR/CEBS), Mutual Funds/Hedge Funds/ Unit linked insurance contracts (CESR/CEIOPS), Mortgages (CEBS/CEIOPS);
- Where necessary, issues for similar functioning of the 3 Committees: consultation practices, accountability, definition of Level 3 measures.

Next steps

The Secretariats of the three Committees will prepare a framework, setting out the structure of the cooperation between the Committees. This will then be published on the respective websites.

- The Chairs and Secretary Generals of the 3L3 Committees will meet two or three times a year, to discuss issues of joint interest.
- To discuss the practical work in progress and to provide information which might be of interest to the other Committees, the Secretariats will continue to meet at least three times per year.

5.5.2 EU/US dialogue

The regulatory and supervisory dialogue with the US CFTC

On 28 June 2005, CESR and the US CFTC published the final Communiqué on a Common Work Programme to Facilitate Trans-Atlantic Derivatives Business, reflecting considerable industry input. The work programme was announced following a meeting in London with the Chairs of the Committee of European Securities Regulators and the Acting Chairman of the CFTC, Sharon Brown-Hruska.

Confirmation of the final Communiqué and work programme follows publication for comment of a proposed plan on 31 March 2005. The proposal in turn followed a Round-Table that was held at the CESR headquarters in Paris, France on 10-11 February 2005.

The work programme incorporates the views of organised derivatives markets, intermediaries and end-users from the European Union and the United States concerning practical operational issues that most affect their conduct of trans-Atlantic business in exchange-traded derivatives and related transactions, and cooperative strategies to further a compatible business and regulatory environment.

Under the terms set forth in the work program, a task force drawn from CESR and the CFTC has been established to review issues relating to enhanced transparency and clarity of regulatory developments, simplified access or recognition procedures, and targeted consultation on cross-border issues, as well as



to consider issues raised by the derivatives industry and end-users.

CESR and the CFTC have committed to ensuring that the regulatory Task Force will ensure, through a variety of means, including targeted consultations, and possible formation of working groups or additional roundtables, that there is meaningful and ongoing involvement of the derivatives industry and end-users in the EU and the US in order to assist in the identification of issues and the development of practical solutions. In order to facilitate specific deliberations of the Task Force, all letters that were received in response to the 31 March 2005 Communiqué will be provided to Task Force members. In addition, the Task Force will seek to involve the derivatives industry and end-users at the earliest possible stage in its deliberations.

Additionally, to the extent that matters are identified that require for resolution the cooperation of other authorities, it is the intention of CESR and the CFTC to explore means to best pursue such cooperation.

Next steps

Over the next nine months, the Joint Task Force will work to ensure enhanced transparency and clarity for market participants. A portal will be established on both the CESR and the CFTC websites, linking to relevant pages on individual Members' websites. A frequently asked questions form will also be developed, to respond to practical questions of general relevancy, as well as to more targeted questions that are of specific interest to Markets, Intermediaries and End-Users.

In order to simplify the access to the markets, the Task Force will also conduct work in order to explore ways of simplifying the application procedures for commencing and operating cross-border businesses.

Regular contacts take place between the staff of CESR and of the US SEC on aspects of regulation.

Visit by John Snow, US Secretary of the Treasury

On 15 June 2005, the Committee of European Securities Regulators (CESR) had the honour of the visit of US Treasury Secretary John Snow. The meeting with Arthur Docters van Leeuwen and Kaarlo Jännäri, respectively Chair and

Vice-Chair of CESR, provided a unique opportunity to explain the evolution of securities markets in the European Union (EU) and the ongoing process of integration and harmonisation, in which CESR plays an operational role. The cooperation with US regulators was discussed, as well as several accounting issues. It came out of the meeting that the constructive cooperation between CESR and the US SEC and the US CFTC should continue in order to properly protect investors and facilitate trans-Atlantic business.

5.5.3 Visit by a delegation from the European Parliament's ECON Committee

On 31 March, CESR was honoured to welcome a delegation of Members of the European Parliament from the Committee on Economic and Monetary Affairs (ECON), chaired by the Chair of the Committee, Pervenche Berès MEP, to discuss the work of CESR.

The visit by Members of the Economic and Monetary Affairs Committee reflects the willingness of the European Parliament to develop regular relations with CESR and to increase their democratic accountability. Similarly, on CESR's behalf, a strong desire to further strengthen its accountability to the EU Institutions and to remain transparent in its working methods was expressed. Discussion focused in particular on the structure and working methods of CESR, such as CESR's consultation practices as well as CESR's wider work programme. Also considered were CESR's advice to the European Commission on the Markets in Financial Instruments Directive (MiFID), as well as CESR's recent work on Credit Rating Agencies. In addition, the efforts undertaken by CESR to improve enforcement of financial information and the initiatives to strengthen enforcement through the CESR network were also covered.

5.5.4 Contribution to the Financial Stability Table of the EFC

In April, CESR submitted its half-yearly advice to the FSC and the EFC on macro-trends and developments in securities markets. This advice presents CESR view on the situation on wholesale markets, primary market activities



and trading of bonds and derivatives, as well as retail markets: investment funds; trading of shares and distribution of products. The advice also identified the main risks for the current economic developments

Next steps

CESR will continue to report to the EFC.



6. Annexes

6.1. The near Future: Indicative CESR Work Programme for Second-half 2005

A) Level 2

<i>Areas of work</i>	Description
MIFID	CESR will follow up its advice to the European Commission, and actively participate in the meetings of the ESC.
Transparency	CESR will spend the last two quarters of 2005 preparing its consultation paper on its draft advice on storage of financial information for release at the end of the year or in early 2006.
Prospectus	The consultation on CESR's draft advice on historical financial information closes on 15 September. Following this, CESR will consider its proposed advice with a view to submitting its advice by end of October 2005. During this period the expert group will continue to review progress on implementation.
Investment Management	CESR will hold a second consultation on its draft advice covering eligible assets. The deadline for the final advice has been extended to the end of January 2006 and therefore CESR will try to consult for a second time in October/November before finalising the advice. Work of a Level 3 nature will also continue in relation to simplifying notification procedures with the publication of a consultation paper expected in October 2005.

B) Level 3

<i>Areas of work</i>	Description
Mediation Task Force	CESR launched a consultation in September 2005 on the establishment of a mediation mechanism. During the consultation period CESR will host an open hearing. The final proposals will be approved and published in early 2006.
MiFID	An evaluation of areas where common approaches and operational tools could be developed (depending on content of Level 2 texts) will begin during the last quarter of 2005.
Clearing and Settlement	Following a mandate from CESR/ESCB, the joint working group on Clearing and Settlement launched a call for evidence with a deadline on 15 September, requesting comments on what it should include in its advice on Assessment methodology. A full consultation will then follow (exact date to be announced)
Review Panel	The Review Panel will work on assessing the level of implementation of Standard 1 on financial information during the third quarter of 2005. In addition, further work will also continue on the review of transitional guidelines under the UCITS Directive.



CESR-Fin - Audit - SISE - SCE	<p>Following the consultation, CESR is likely to publish its recommendations on Alternative Performance Measures in late October/early November.</p> <p>The Group will also devote a large amount of its resources to the effective functioning and further development of its coordination mechanisms of enforcement activities in the area of financial reporting, and thereby contribute to fostering a proper and consistent application of IFRS in the EU. In parallel, CESR-Fin and its subcommittees will continue to monitor the EU endorsement process of IFRS and work on converging methodologies for enforcement of financial information. The group will also analyse possible means for increasing the interactions between CESR and other European and non-European players in the area of financial reporting.</p>
CESR-Pol	<p>CESR-Pol's work to exchange information on specific cases is ongoing. However, in addition to this CESR-Pol will continue to work to ensure convergent application of the Market Abuse Directive.</p> <p>It will also work on the exchange of experiences regarding un-co-operative jurisdictions with the Standing Committee 4 of IOSCO.</p>

c) CESR's ad hoc work

<i>Areas of work</i>	Description
Strategic Task Force	<p>CESR will continue to take forward aspects of the proposals it indicated in the Himalaya paper which were widely supported (the mediation mechanism being one such initiative). Nevertheless, CESR will also stand ready to continue dialogue with all the institutions following further follow up work by the FSC, the report of the European Parliament and the Commission's Green Paper.</p>
Macro-economic conditions	<p>No further reports will be required by the EFC until April 2006. Further ad hoc reports may be requested by the institutions, and the group will then meet to prepare these.</p>
Relations with US Authorities	<p>CESR/CFTC Task force will continue to work on the work programme published in March 2005.</p> <p>Dialogue with US SEC will take place at both working level and at a senior level on an ad hoc basis.</p>
Consumer day	<p>CESR will organise a two day consumer work shop in November 2005 to establish what can be done to further involve consumers in CESR's work, and what CESR can contribute to the various consumer education initiatives underway, both nationally and by other institutions.</p>

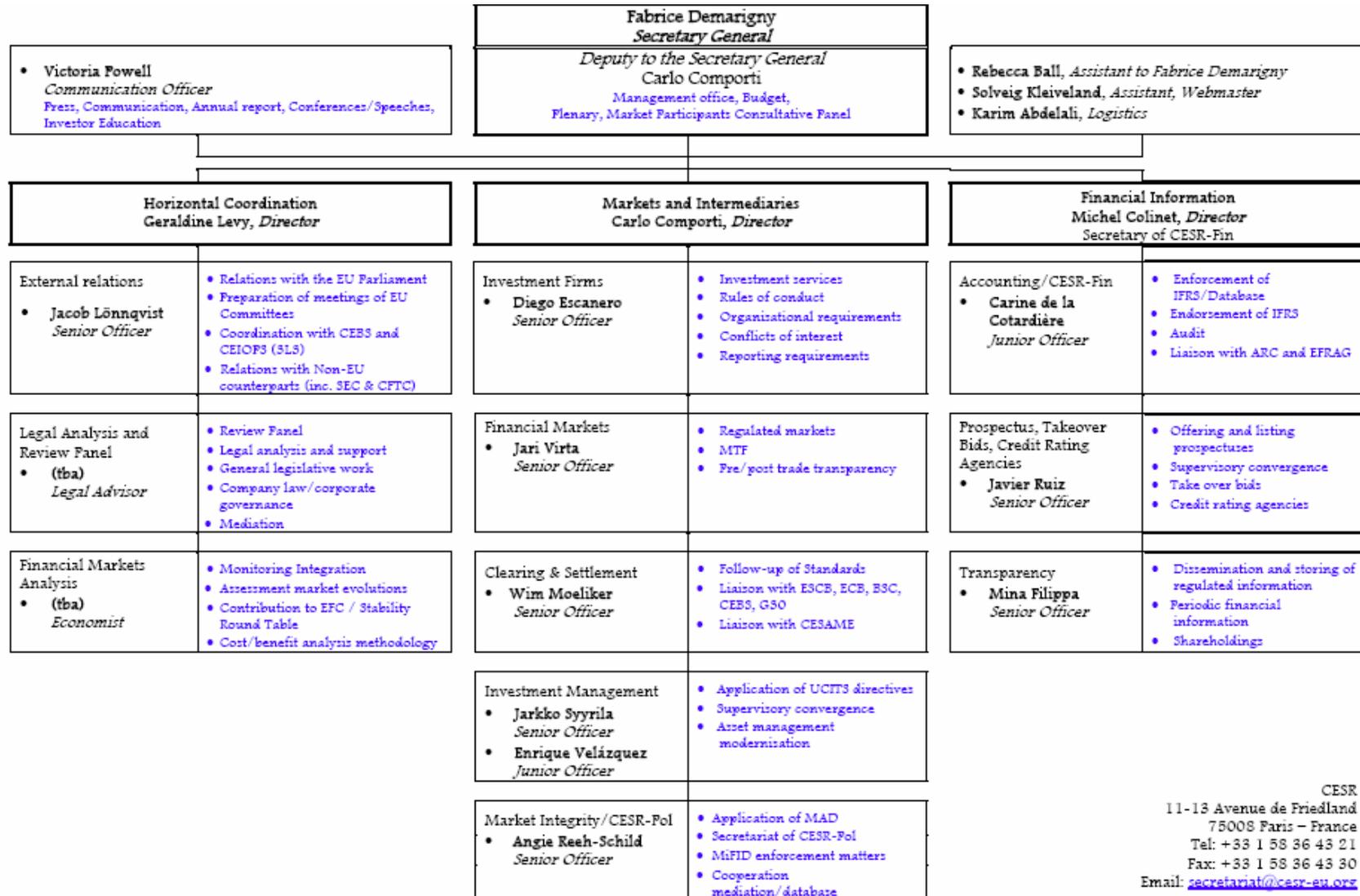


6.2 Secretariat

In order to perform an increasing number of tasks, the CESR Secretariat was strengthened with the recruitment of new permanent staff. CESR recruited 5 additional staff for its secretariat which now numbers 20 people, including the remote members of the secretariat. An organisational chart is set out on the next page.

A programme of internship was renewed, offering 'stage' opportunities for personnel from CESR members. To date, five interns, have joined, or will join shortly, the CESR secretariat. These interns come from the UK, the Netherlands, Spain, Sweden and Malta.

All documents are available on the CESR Website www.cesr-eu.org



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