

The Committee of European Securities Regulators



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CESR Half-Yearly Report 2008

FROM JANUARY TO JUNE 2008



1. Introduction

The present interim report for 2008 complements CESR's Annual Report for 2007, published in August 2008, and provides a half-yearly update on the activities of the Committee of European Securities Regulators (CESR) to the European Commission, Parliament and the European Securities Committee. This Report covers the period from January to June 2008.

In the first half of 2008, a lot of CESR's work streams remained linked to one topic: the market turmoil and the implications it possibly could have on both securities market's supervision and legislation. Through its different working groups CESR discussed the implications, lessons to be learnt and future steps to be taken with CESR Members, policy makers and market participants. In that respect, CESR also published its second report on the compliance of Credit Rating Agencies with the IOSCO Code in May 2008 in which CESR formulated its policy proposals for the rating process.

Even though focusing on the market turmoil, meetings like the first 2008 Market Participants Panel that took place in April, also considered other major work streams of CESR, such as the post ECOFIN roadmap, CESR's Work Programme and the third country dialogue – all issues that will consider comprehensive additional work in the second half of 2008 and beyond.



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3. The Market Participants Consultative Panel

The Panel's first 2008 Meeting

On 9 April 2008, CESR's Market Participants Consultative Panel (MPCP) held its 2008 meeting in Paris. This marks the 16th meeting since the MPCP was established. The discussion was facilitated by CESR Chairman Eddy Wymeersch, and was dedicated to the effects of the recent market turmoil, including lessons to be learnt. The role of rating agencies was also considered, taking into account the public consultations by CESR and the International Organization of Securities Commissions (IOSCO) in this area. Furthermore, Members discussed the post-ECOFIN roadmap and the CESR Work Programme for 2008.

Discussion on market turmoil

The discussion about this topic was introduced on the basis of two presentations, given by MPCP members. The first presentation started from the point that the past years proved to be an excellent climate for financial innovation, illustrated by examples such as: segmentation of risks, securitization and risk transformation. Innovations were perceived as being beneficial for the industry and society at large. Parts of innovation might have been risky, but industry should make an effort to improve the handling of risks. Taking risks and to manage these accordingly is inherent to the financial industry.

According to this view, the main trigger for the turmoil lies in the dramatic shift in US monetary policy in earlier years when interest rates were lowered to a very low level. When the turmoil emerged, partly due to a lack of understanding of the innovations, liquidity in the market froze and banks started to hoard liquidity, among others by liquidating assets which in turn led to a fall in asset prices. The addition of liquidity to the market by central banks was helpful, but did not work out due to additional corporate incidents in the market.

At the current stage of the turmoil, fears in the market might be exaggerated according to this view, in particular for the EU which is more diversified and where companies have in

general solid balance sheets. It was stated however that 80% of 'toxic assets' are held by European banks. Lower visibility of the turmoil in the EU might have to do with better management of corporate communications. In comparison to the EU and based on past experience with other financial crises, it was noted that US banks mainly rely on solving the impact of the turmoil on an individual basis, ignoring the impact of individual behavior of firms on the financial system as a whole, without any collective efforts on how to address the impact of the turmoil.

Potential lessons to be learnt included

- The need to avoid of an overreaction in regulatory response;
- A need for regulators to learn more about asset price bubbles;
- A possible review of accounting rules; and
- A stronger focus on stress testing.

The second presentation underlined the fact that the roots of the turmoil were already visible in late 2005, when housing prices peaked. This was largely ignored in 2006 due to prices rising even further. In 2007 however, the quality of mortgage loans deteriorated, the number of foreclosures rose, leading to growing reluctance of banks to provide credit and a general decrease in risk appetite. The need to assess all loans on the books of a financial firm in every aspect on a continued basis was qualified as a daunting task.

On the economic outlook, it was noted that central bank liquidity had indeed reduced existing pressures in the market, but it was estimated that it will nevertheless take quite some time for the economy to recover from the turmoil. In this view, the lessons to be learnt are in the area of establishing regulation in the area of mortgages and adaptation of the originate/distribute model for securitization.

The role of credit rating agencies

With regard to the role of Credit Rating Agencies (CRA), it was noted that the transfer from Basle I to Basle II provided banks with incentives to invest in AAA instruments. In general, more awareness and understanding is needed that AAA ratings for different products do not have the same meaning. In the



subsequent discussion, one MPCP member pointed out that US law will most likely not explore collective efforts to address turmoil issues. This position was illustrated by regulatory trends which would go against the idea to explore collective efforts to address turmoil issues. As an alternative option, it was suggested to learn from the fall-out of the Japanese asset price bubble in the nineties.

Furthermore, in the context of valuation of financial instruments, the lack of detailed understanding of the composition of financial instruments and the importance of what is evaluated was emphasized.

Furthermore, it was suggested: to establish among regulators a think tank to better understand developments in the market and to communicate output with the public, to enhance product understanding of regulators by training and to fit this into the regulatory process, to engage with business schools and to think of a mechanism to facilitate the market in case of impaired price formation.

Based on experience with previous major corporate incidents, one member noted that a common denominator in those incidents had been that a lot of business was kept outside the balance sheet. When regulatory attention shifted to investment vehicles like to SPV's, firms moved to SIV's and subsequently to SICAV's in order to organise activities outside the scope of regulatory attention. Wymeersch responded that the suggestion for an enhanced role of the supervisory board is rightly mentioned and is an issue of corporate governance. Based on personal corporate responsibilities, this member underlined the need for firms to monitor in-depth where counterparties derive their profits from.

Wymeersch concluded this agenda point by emphasizing CESR activities on CRAs and CESR's call for more transparency. In the area of accountancy, CESR does not have regulatory responsibility. With regard to a suggestion for a single EU supervisor, the chairman noted that the trend at the political level seems to move into a direction of colleges of supervisors.

The rating process

The subject was introduced by one member stating that some EU-regulators seem to

oversimplify the problem of understanding financial products by using 'traffic lights'. According to this member, regulators should explain to a wider audience what AAA means in terms of risk probabilities.

Furthermore, concerns were expressed about cliff-effects of (changes in) ratings and the selling process.

Caution existed among Panel members about authorisation of CRA's with all liability issues attached to it for regulators. No evidence had been found to date for improper handling of conflicts of interests by CRA's, despite extensive regulatory attention. Risk of reputation might serve here as a countervailing power. There might be market dissatisfaction, but no market failure. The Panel took the position that cooperation between CRA's and regulators on the basis of self-regulation is the way forward. Hard regulation on the other hand, might slow down the speed of innovation and could have unintended consequences for regulators.

Another member confirmed that CRAs are providing a useful service and regulation is not necessary. In the early years of this century, the approach of comply/explain, annual meetings with CESR and further explanations to individual CESR Members, if needed, sufficed. At present however, CRAs did a poor job in product ratings, in particular with regard to the speed of adjustment of ratings. Additionally, improvements in the management of conflicts of interests by CRA's were suggested. For the wider audience, the limitations of a rating should be communicated in a more effective way.

Other bottlenecks identified in the area of rating agencies included:

- the current market structure of rating agencies with high entrance barriers (amplified by the market practice to require two ratings for a single product);
- the existing prudential leverage of CRA's due to Basle II;
- a mismatch between first ratings and monitoring of current ratings, fostered by existing fee structures;
- a lack of macroeconomic views to be taken into account in the rating process; and



- training and turnover of staff and the length of the process to review and/or to change a rating.

In response to the on-going IOSCO consultation, the need for a clear definition of a structured product was underlined.

EU/ US dialogue

Recent developments in the US regulatory framework led to a more open position vis-à-vis foreign broker/dealers and the intention of US authorities to work closely with Canadian and EU authorities in this respect. The recently announced 'US Treasury Blueprint' for US financial supervision confirmed the responsibility of US authorities for regulation of the financial sector and the need for a comprehensible supervisory structure. The recommendations deriving from this blueprint can be divided into short-term, mid-term and longer-term recommendations. In the short-term, the expansion of the Presidential Working Group (US Treasury, FED, SEC and CFTC) with a number of agencies with responsibilities in the financial sector is on the table. For the mid-term, a merger of the US Securities and Exchange Commission (SEC) and the US Commodity Futures Trading Commission (CFTC) is proposed. For the longer term, a more functional approach of the US supervisory structure was put forward. The Presidential Working Group, the FED and the OCC are considered to be among the winners of this plan. The plan however raises issues of balance of powers with the states and underestimates the benefits provided by securities laws in the seventies, such as competitive markets and a big bang in the clearing of transactions. It remains to be seen whether this plan will result in a more streamlined or a more complex type of supervisory structure.

In response to a question on the likelihood of a swift execution of this plan, it was estimated that not much will happen in the short term. The impact of the plan on the EU/US dialogue was also considered to be limited, although there is always a risk of overreaction, where each reform creates the seeds for the next crisis.

The SEC commenced in March discussions on mutual recognition arrangements with the

Australian Securities and Investment Commission. The SEC has on the 27th of June issues a proposal for a change to rule 15a 6 which would make direct interaction with US investors possible under more circumstances if realised.

Post ECOFIN Roadmap

Chairman Wymeersch highlighted some of the areas derived from the ECOFIN conclusions on how to improve the role of the 3L3 Committees (CESR, CEBS and CEIOPS) in the Lamfalussy approach, such as qualified majority voting and the proposed introduction of an EU mandate in the national mandates of regulators. Recent political discussions indicate that no legislative action will be taken at EU level with regard to the introduction of an EU mandate, but this may require adaptation of national legislation in some jurisdictions. The Chairman added that introduction of rule making powers would seriously strengthen the position of the 3L3 committees, but this would infringe upon the position of Member States and the Commission. Furthermore, delegation of tasks and colleges of supervisors are more likely ways forward to strengthen the role of EU supervision.

CESR Work Programme 2008

Members of the Panel were invited to submit ideas for a strategic CESR-only Work Programme for the next years. Chairman Wymeersch called upon Members of the Panel to indicate areas where CESR is inefficient. In response to a question about the cooperation on MiFID issues, it was clarified that the assessment of the implementation of MiFID will be conducted by the Review Panel and the outcome might facilitate the regulatory dialogue with US authorities. From an operational point of view, the establishment of a Q&A database, discussion of hot topics such as Best Execution among supervisors active in operational supervision and a future assessment of market consequences were mentioned. In the context of the dialogue with the US, one member noted the wish of US compliance officers to check authorisation of EU counterparties and suggested that CESR might play a facilitating role in posting hyperlinks to local websites of individual CESR Members and to lists of authorised brokers and other intermediaries.



Other business

In view of the expiring MPCP membership of Donald Brydon, Chairman Wymeersch expressed his gratitude to this member for his valuable contributions as a member of the Panel.

Next steps

The next meeting of the Market Participants Consultative Panel is scheduled for 29 September 2008 in Paris.

The subsequent meeting is scheduled also for Paris, in December 2008, jointly with CESR Members.

A list of members of the Market Participants Consultative Panel is set out on CESR's website, in the section Market Participants Consultative Panel.

4. Regulatory harmonisation

4.1 Credit Rating Agencies

CESR consults on the Role of CRAs in Structured Finance

On 13 February 2008, CESR published a consultation paper on the role of CRAs in structured finance (Ref. CESR/08-36) to seek market participants' views before the end of March 2008 on the main issues arising from the activity of the CRAs in the structured finance market and, in particular, on their views on possible policy options. CESR received 26 responses to its consultation before the closing date. Those that are public can be viewed at CESR's website.

Besides the consultation, CESR organised an open hearing for interested market participants on 26 March 2008 at CESR's premises in Paris.

Second Report on Compliance of CRAs with the IOSCO Code

On 19 May 2008, CESR published its second report to the Commission on the compliance of CRAs with the IOSCO Code of Conduct and

their role in structured finance (Ref. ESR/08-277). The report followed the Commission's additional request for CESR to review several aspects of the rating process regarding structured finance instruments (Ref. CESR/07-608), also taking into account the responses received from market participants to CESR's consultation paper (Ref. CESR/08-036).

While preparing the report, CESR worked in close co-operation with CEBS, the US SEC and with IOSCO. In the report CESR advises the Commission to take steps and offers its proposal to enhance the integrity and quality of the rating process.

CESR's policy proposals

CESR's policy proposals to enhance the integrity and quality of the rating process can be summarized as follows:

- CESR urges the European Commission, as an immediate step, to form an international CRAs standard setting and monitoring body to develop and monitor compliance with international standards in line with the steps taken by IOSCO, using full public transparency and acting in a 'name and shame' capacity to enforce compliance with these standards via market discipline. This body should be formed of senior representatives of the investor, issuer and investment firms' communities and have an international nature. CRAs should also be part of the body when acting in its standard setting capacity but not when performing its monitoring activity. The members of the body would be appointed in the majority by the international regulatory community and would be accountable to those that appoint them.
- If international regulatory involvement cannot be achieved in the short term, CESR recommends that this body is formed at an EU level. CESR sees itself in a good position to play a key role in the process of regularly assessing whether the body is fulfilling its objectives. To this effect, the body should report periodically.
- In the absence of support from market participants or failure of the body to meet the objectives of ensuring the integrity and



transparency of ratings, CESR considers that this initiative would not add value and that the supervisory authorities should step in to ensure, probably through regulation, the integrity and quality of the rating process.

- The report emphasizes that these proposal should be implemented within a short time period. To that end, CESR encourages the Commission to prepare a calendar setting deadlines for the different steps to be followed and considers that unjustifiable lack of progress according to the timetable should lead the Commission to shift to the consideration of supervisory oversight structures.

CESR's recommendations

Besides the policy proposal, and to enhance the integrity and quality of CRA ratings, the report includes recommendations in relation to the main areas analysed by CESR:

Transparency: CESR highlights the need for CRAs to take appropriate action on an ongoing basis to ensure that they communicate clearly regarding the characteristics and limitation of the ratings of structured finance products. CESR also believes further information should be provided on critical model assumptions to facilitate a greater understanding by market participants and that ratings should clearly label which methodology and version has been used. Where possible, CESR advocates that this information and information on rating performance should be provided in a standardised, publicly available format to support market participants in reaching their investment decisions.

Human Resources: CESR urges CRAs to effectively resource themselves to ensure their ratings are, and remain, of a sufficient quality. CESR expects that CRAs improve the disclosure of selective human resources indicators to promote confidence that they are appropriately resourced and to ensure that remuneration structures are appropriate to promote independence and avoid conflicts of interest in the rating process.

Monitoring of Ratings: CESR stresses the need for CRAs to effectively resource themselves to ensure that their monitoring remains effective

and that rating action is taken in a timely manner.

Conflicts of Interest: CESR acknowledges that a clearer international consensus over acceptable interaction between CRAs and issuers, what constitutes advisory practice and a definition of what constitutes ancillary business would be of benefit to the market. CESR also stresses the need for CRAs to be transparent in the disclosure of the fees they receive from issuers.

Provisions of the CRAs' codes

The report also provides an analysis of the changes in the CRA's codes of conduct. It builds on the work included in CESR's first report to the Commission and contains, in a column format, an analysis of the changes on those provisions of the CRAs' codes that CESR identified last year as areas of non-compliance with the IOSCO Code. The conclusion of this analysis has been that the four CRAs' codes comply to a large extent with the IOSCO Code. Some CRAs have implemented a couple of improvements in their respective code of conduct, but there are still areas or provisions where the CRAs' codes could be improved.

Although there have been some changes introduced, CESR expected to see a more rigorous approach from CRAs in response to last year's report and, thus, CESR's expectations for improvement have been only partially met by the CRAs.

The source of information that CESR has used for this analysis is the input received from the CRAs in meetings and responses to questionnaires and from market participants through the consultation processes undertaken.

Next steps

CESR will follow up the European Commission's decision on possible legislation for Credit Rating Agencies.



4.2 Investment Management

CESR to improve Retail Investor Information for UCITS Products

On 15 February 2008, CESR published an advice to the Commission on 'The content and form of Key Information Document disclosures for UCITS' (Ref. CESR/08-087). The new disclosure document, known as the KID, is intended to simplify and highlight the crucial elements that a retail investor should consider when investing in Undertakings for Collective Investment in Transferable Securities (UCITS).

KID to replace simplified prospectus

The purpose of the KID is ultimately to replace the Simplified Prospectus for Retail Investors, following further market testing to be undertaken by the Commission in 2008. This work was launched at the request of the Commission in April 2007, as part of its wider work to revise the UCITS Directive.

CESR's proposal was subject to significant consultation with market participants and EU retail consumer associations; the results of this are presented in the Feedback Statement (Ref. CESR/08-035) published on 15 February 2008. In addition, a preliminary impact assessment was undertaken and was included in the advice (Ref. CESR/08-087). This marks the first application of the Impact Assessment Guidelines adopted for testing by the 3L3 Committees last year (Ref. CESR/07-089). CESR has considered the factors that are likely to make disclosures of product information useful to retail investors and, in particular, the need for such information to be short, focused, expressed in plain language and presented in a way that enables comparisons to be easily made between different offerings.

CESR's recommendations

A general recommendation that should be noted at the outset is to rename the disclosure the 'Key Information Document' or 'KID'. This is in line with feedback to the consultation and reflects CESR's preference for a single, standardised disclosure document.

Objectives and scope of the KID

CESR recommends that the KID should contain only the essential elements for making and carrying out investment decisions, which excludes information serving only legal or regulatory requirements.

Format and general content

CESR is of the view that the KID should be a single document covering a maximum of two sides of A4. There should be a standardised list of permitted contents in fixed order and hierarchy. Specific recommendations are made for funds of funds, umbrella funds and multiple share classes.

Risk-reward

CESR outlines two broad recommendations for the Commission's testing phase:

- the inclusion of a synthetic risk-reward indicator (SRRI) alongside an explanatory text; or
- improved narrative disclosure.

Consultation responses were mixed in this area; there was support from retail investors' representatives for the concept of an SRRI, while the majority of industry representatives expressed a preference for a narrative approach. CESR noted the need for further technical work on development of a methodology underlying the SRRI. With a view to improving the narrative disclosure, CESR recommends a set of general principles designed to increase the focus on material issues.

Past performance

CESR's recommendations for presentation of past performance information include that the information be presented using bar charts; percentages be used rather than cash figures; and that average yearly performance be shown rather than cumulative. CESR further recommends that the performance of the benchmark should be shown if the fund is managed against one; and that simulated performance be allowed only in specific cases.



Charges

CESR recommends two options for consumer testing – the first an improved version of the existing Simplified Prospectus disclosure, the second supplementing this information with a single ‘summary’ figure.

Further technical work

CESR has identified a number of areas covered by the recommendations on which further technical work will be required; in particular, aspects of risk-reward disclosure, past performance information and charges.

Consultation in 2007

The development of CESR’s investor disclosure document follows a public consultation and increased dialogue with retail investor associations carried out towards the end of 2007, as well as two calls for evidence and a questionnaire on related subjects published earlier that year. It is part of CESR’s ongoing work in response to a request for assistance from the Commission, and should be seen in the context of the Commission’s wider work to revise the UCITS Directive by replacing the Simplified Prospectus with a document which will be more meaningful for retail investors.

Preparation of CESR’s advice has been undertaken by the CESR Expert Group on Investment Management (IMEG), which is chaired by Mr Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione Nazionale per le Società e la Borsa (CONSOB). The Expert Group established a sub-group to develop a recommendation to IMEG on the content of the advice. The sub-group is jointly chaired by the UK FSA and the French AMF and is composed of representatives from eight other Member States.

In developing its proposals, CESR has paid close attention to all the available evidence relating to the failure of the simplified prospectus and, in line with the 3L3 Impact Assessment Guidelines developed jointly by CESR, CEBS and CEIOPS, has placed strong emphasis on systematically analysing the pros and cons of the options it has considered. The joint Impact Assessment Guidelines were

published for consultation in May 2007 (Ref. CESR/07-089).

Next steps

The Commission will carry out market testing throughout 2008 on the basis of the CESR submission.

CESR will then finalise its advice taking into account the results of the testing exercise and further consultation with market participants in summer 2009.

5. Supervisory Convergence

5.1 Monitoring

5.1.1 Review Panel

CESR publishes Methodology for Mapping Exercises

In order to be able to appropriately describe supervisory powers, practices and respective divergences, the Review Panel of CESR identified the issue of enhancement of the quality of the responses provided by CESR Members as a key element in the conduct of future mapping exercise. This is relevant to both surveys undertaken: a mapping exercise, as well as peer reviews. On 5 May 2008, CESR published a methodology for mapping exercises.

In order to achieve its objectives, the Review Panel can use a number of different tools, including mapping exercises, as set out in CESR’s Protocol on the Review Panel. A mapping exercise of powers can have a broader character than a self-assessment or a peer review. A self-assessment or a peer review may not be considered as the appropriate tools, especially in the case of Level 1 and 2 provisions, where it is the Commission’s competence at Level 4 to make assessments on the transposition of EU legislation by Member States, or for example, where the instrument of peer pressure is not appropriate.

In addition, a mapping exercise may assist in cases where Level 3 measures are not yet in



place and where the mapping exercise is intended as a means to promote supervisory convergence.

Self-Assessment of CESR's old UCITS Standards and Guidelines

CESR published on 1 April 2008 the results of a self-assessment of the implementation of the CESR Guidelines to simplify the notification procedure of UCITS by CESR Members (Ref. CESR/08-113), and the results of CESR's revision of its FESCO/CESR Standards, Guidelines and Recommendations which are currently being superseded by the Lamfalussy Directives.

Self-assessment of CESR Members' implementation of the UCITS Guidelines

In June 2006, when adopting guidelines to simplify the notification procedure of UCITS (Ref. CESR/06-120b), CESR committed to monitoring the implementation of the guidelines by reviewing them within two years. The results published represent the first step in fulfilling this commitment.

Next steps

The self-assessment will be followed by the peer review stage which involves each Member's assessment being assessed by their peers.

The results of this exercise will be published in the second half of 2008.

Overall the Members are making headway in their implementation of these guidelines; however, there is still room for improvement with 17 Members assessing themselves as applying over 90 % of the 13 Guidelines.

CESR'S revision of its FESCO/CESR Standards, Guidelines and Recommendations

CESR's Review Panel has examined whether, and to what extent, CESR Guidelines, Standards and Recommendations or respective provisions of its predecessor FESCO issued in the past, have been superseded by subsequently issued European Law. This exercise should ensure the

alignment of CESR measures with existing legislation and market needs.

Even though Level 3 measures are not legally binding, CESR Members have committed themselves to adopting the respective provisions in their supervisory practice, and they play an important role in the creation of supervisory convergence and in giving guidance on regulatory issues. As such, identifying which Level 3 measures still need to be retained following the implementation of new EU legislation is important both for CESR Members and market participants.

Following the conclusion of this work, CESR has decided to update its Level 3 measures by removing six sets of measures which are now superseded in light of the new framework of European Directives. Most of these measures have been incorporated into the new EU rules, mainly into MiFID and its respective Level 2 provisions, and also into specific provisions of the Market Abuse Directive (MAD), the Prospectus Directive and other European Law.

Measures being removed:

1. A European Regime for Investors Protection, the Harmonization of Conduct of Business Rules (Ref. CESR/ 01-014d/ April 2002);
2. A European Regime for Investor Protection, the professional and counterparty regimes (Ref. CESR/02-098b/ July 2002) and Implementation of Article 11 of the ISD: Categorisation of investors for the purpose of Conduct of Business rules (Ref. 2000-FESCO-A/ March 2000);
3. Standards for Alternative Trading Systems (Ref. CESR/02-086b-July 2002);
4. Standards for Regulated Markets under the ISD (Ref. 99-FESCO-C/December 1999);
5. European Standards on Fitness and Propriety to Provide Investment Services (Ref. 99- FESCO-A/ February 1999); and
6. Market Conduct Standards for Participants in an Offering (Ref. 99-FESCO-B December 2000).

As regards the measures above, CESR decided that the removal should take effect



immediately for all Members except for those Members that have not yet transposed the provisions of the MiFID. In the latter case the measures remain valid until transposition has been completed in so far as they do not contradict the provisions of MiFID and its respective Level 2 measures.

CESR's peer pressure group, the Review Panel, is a key group in facilitating supervisory convergence and is chaired by CESR Vice-Chair Mr Carlos Tavares, Chairman of the Portuguese Securities Commission (CMVM).

Peer Review on Guidelines of Notification Procedure of UCITS

On 1 April 2008, the Review Panel started a peer review exercise on CESR's Guidelines to simplify the notification procedure for UCITS. Following the publication in June last year of the CESR Guidelines (Ref. CESR/06-12Ob), the Review Panel is conducting a peer review of the implementation of the Guidelines by CESR Members, a year after they were agreed.

All 13 Guidelines are being assessed, and this exercise is being conducted in accordance with the Methodology (Ref. CESR/07-071b) and the Review Panel Protocol (Ref. CESR/07-070b) agreed in January 2008.

The exercise deals only with the assessment of the Guidelines in relation to those investment funds that are harmonised by the UCITS Directive (85/611/EEC).

A Self-assessment questionnaire has been developed in accordance with the Methodology by:

- a) establishing the objective assessment criteria which focused on the key issues addressed by each of the Guidelines and its corresponding explanatory text;
- b) establishing the benchmarks, which allowed for one of the following benchmark categories to be assigned to each of the Guidelines:
 - Fully applied;
 - Not applied; or
 - Not contributing (for incomplete or no answers).

- c) In addition, for many of the questions, the benchmark of "partially applied" may also be assigned to the Guideline. The benchmarks for each Guideline is referred to as "benchmark" below, and is assessed by giving either a positive or negative answer to a number of questions, referred to below as "questions".

The key issues and the benchmarks aimed at enabling the Review Panel to assess CESR Members' day-to-day application of the Guidelines, taking into account the fact that the Guidelines were established to simplify as a matter of practice, UCITS notification procedures.

Taking into account the practical nature of the Guidelines, the questions asked in order to establish the implementation of the Guideline against the relevant benchmark reflected what should be happening on a day-to-day basis when applying the Guideline in practice, for example. This may be in the form of how notifications can be made to the relevant host or home authority, or the nature of documents that have to be submitted with an application, or a time period and method for communicating decisions to the UCIT in question.

The distinction between those questions where a negative was opposed to a positive answer is required, in order to be considered as being in line with the benchmark reflects those practices which go against the rational and practical application of the Guideline itself. Those questions, where a positive answer is required, reflect those practices that are in line with the practical application of the Guideline. It is important to point out at the outset that in view of the practical nature of the Guidelines and their intended use, the difference between Partial and Non-application of a Guideline in terms of gravity is very narrow.

In addition, this self-assessment questionnaire does not set out the basis for an overall assessment of a CESR Member's implementation of the guidelines – so, a CESR Member who has not fully applied some as opposed to other guidelines is not considered as being "better" or worse in terms of their overall implementation of the guidelines.



5.2 Operational Groups

5.2.1 CESR-Fin

Fair Value of Financial Instruments in Illiquid Markets

The conclusions of the ECOFIN meeting on October 2007 in relation to the financial turmoil identified the need to have improved valuation standards, including of illiquid assets, as one key objective.

The ECOFIN stated again in February 2008 on Financial Market Stability that supervisory authorities should stand ready to take regulatory and supervisory action where necessary and that one of the main policy responses was to improve the valuation standards in particular for illiquid assets. This was also confirmed at the European Council confirmed this in their March 2008 meeting.

Further the updated roadmap of 15 May 2008 stated in relation to CESR the need to assess the deployment of sound asset valuation standards in non-bank investors, particularly in relation to illiquid assets.

CESR members considered the type of input they could provide in the abovementioned context. From their viewpoint of securities regulators, they decided that CESR could provide some useful input on the application of the existing IFRS requirements on fair value measurement and related disclosures of financial instruments in illiquid markets. Such input would have the following objectives:

1. Assist preparers and auditors in the current market situation when preparing the next financial statements;
2. Promote disclosures that take the investors perspective into account;
3. Provide input to IASB on fair value measurement and related disclosures of financial instruments in illiquid markets that might assist the IASB in its current work;
4. Form the basis for the requested CESR's contribution to ECOFIN.

Finally, as IFRS are issued by IASB and interpretations of IFRS are the exclusive prerogative of IFRIC, CESR stresses its abovementioned work will not constitute guidance or recommendations on IFRS.

Third Extract of EECS' Database on Enforcement Decisions

During the period covered by this report, the EECS have continued discussing enforcement decisions and emerging issues which are previously submitted to the confidential database of enforcement decisions taken by individual EECS members as a source of information to foster appropriate application of IFRS. The CESR database of enforcement decisions has been running, regularly supplied and visited by members. As of June 2008, a total of 136 decisions were entered onto the database.

On 19 May 2008, CESR published the third extract from the EECS' database of enforcement decisions, containing 14 decisions.

CESR's Contribution to the EU Endorsement Process of IFRS

As a contribution to the endorsement process of IFRS in the European Union, CESR-Fin has provided to the European Financial Reporting Advisory Group (EFRAG) with the following comment letters on IASB projects:

- EFRAG's draft comment letter on IFRIC's Exposure Draft D 24 on Customer Contributions;
- EFRAG's draft comment letter on IASB's Exposure Draft on Amendments to IFRS 1 and IAS 27;
- EFRAG's draft comment letter on IASB's Exposure Draft on Proposed Improvements to IFRS 2007; and
- EFRAG's draft comment letter on IASB's Exposure Draft ED 9 Joint Arrangements;

The comment letters were published at CESR's website.

Next steps

In July 2008, CESR launched a consultation on a public statement “Fair value measurement and related disclosures of financial instruments in illiquid markets” (ref CESR/ 08-437). CESR is going to analyse the comments made by market participants and intends to publish its revised proposals in October 2008.

On equivalence, CESR plans to consult on Indian GAAP in October 2008 and to submit a final advice to the European Commission in early November 2008. In August 2008, CESR also received a new request from the European Commission for a technical advice on 4 other GAAP (Argentinean, Brazilian, Mexican and Taiwanese GAAP). CESR will work on these GAAP in the second semester on 2008.

Through EECs, CESR-Fin will continue its main work of promoting convergence on the application of IFRS by discussing enforcement decisions and emerging issues. It will also provide further updates of its publication of extracts of its database of enforcement decisions.

Finally, CESR-Fin will continue its dialogue with the SEC. Two meetings are scheduled in the second half of 2008.

- Harmonisation of requirements for insiders lists;
- Suspicious Transactions Reporting (STRs);
- Stabilisation Regime as Level 3; and
- The notion of inside information to be analysed as a Level 3 topic.

This set of guidance will be published for European-wide consultation. The consultation paper published in May covers the topics on insider lists and STRs. On the same issues, a survey has been undertaken based on questionnaires sent out to all CESR Members.

The work already conducted by CESR on Level 2 implementing measures for the MAD has been taken into consideration, where appropriate. On the basis of the responses received during the surveys, CESR-Pol has developed the following guidance for the market and CESR Members.

Next steps

A second consultation paper dealing with the topics on stabilization and the notion of inside information shall be published in the second half of 2008.

5.2.2 CESR-Pol

Third set of Guidance and Information on the MAD

CESR is continuing in its efforts to prepare ground for convergent implementation and application of the Market Abuse regime by ensuring that a common approach to the operation of the Directive takes place throughout the EU amongst supervisors. On 20 May 2008, CESR published a first consultation paper on the MAD, called “Third set of CESR guidance and information on the common operation of the Directive to the market” (Ref. CESR/ 08-274).

In its Work Programme (Ref. CESR/07-416), CESR already has informed the market about the **issues to be covered** in this third set of guidance:

Administrative Measures and Criminal Sanctions under MAD

CESR, through its operational group for cooperation and enforcement, CESR-Pol, is seeking to develop a common understanding amongst its Members regarding treatment of aspects of the MAD. On 28 February 2008, CESR published an executive summary to the ‘Report on administrative measures and sanctions as well as the criminal sanctions available in Member States under the MAD’ (Ref. CESR/ 07-693), published in November 2007 upon request by the Commission. The report aims to facilitate greater transparency in the application of the MAD and thus it aims to facilitate effective implementation and application of the MAD

The purpose of CESR’s report is to inform the EU Institutions and market participants about the different approaches to apply sanctions and administrative measures across the EU Member States.



Measures and sanctions under the MAD

According to the provisions in the MAD, Member States have the discretion to decide on the amount of fines and the types of administrative measures applicable in market abuse cases. Furthermore, the Member States may also introduce criminal sanctions in Market Abuse cases.

The exercises undertaken by CESR revealed that there are differences in respect of sanctions applied in cases of market abuse. The report does not seek to analyse these differences or to draw any conclusions on the impact of differences. However, CESR notes that the differences that exist are largely due to the fact that Member States' legal systems differ, and that the division of responsibilities between competent authorities in each Member State, in relation to the investigation of cases and subsequent enforcement also vary. Administrative sanctions and measures available to CESR Members range from a public or private reprimand through to monetary penalties, disqualification from management, or ownership of a regulated entity, withdrawal of licenses.

Internal mappings in 2005 and 2006

In 2005, CESR undertook an internal mapping which sought to identify powers and sanctions in the area of market abuse so as to assist supervisors' understanding of each other's systems. As a result of this initial work CESR recommended that the Commission draw up a list of administrative measures and sanctions available to Member States under the MAD to address calls for greater transparency from market participants and accommodate concerns about the diversity of measures and sanctions applied in Member States. In mid 2006, CESR launched a further mapping exercise, to assess the supervisory powers accorded to CESR Members following the entry into force of the MAD. The purpose of this exercise conducted by CESR's Review Panel, was to ascertain whether competent authorities of Member States had equivalent supervisory powers particularly when dealing with cross border cases. The capacity to act on an equal footing when performing cross-border investigatory/supervisory and sanctioning activities is considered by CESR as a precondition to a credible EU supervisory

system and fundamental to delivering supervisory convergence.

The resulting report was published on 21 June 2007 (Ref. CESR/07-334b). That report not only assessed the attribution of powers to CESR Members but also considered the ability to issue rules, cooperate and exercise their supervisory powers. It also presents how these powers are exercised in practice by the relevant competent authorities. This report and a high level analysis of its findings were submitted to the FSC.

5.3 Level 3 Expert Groups

5.3.1 Transparency

CESR's Call for Evidence on possible Level 3 Work on TD

On 21 February 2008, CESR published a feedback statement on its call for evidence on CESR's possible Level 3 work on the Transparency Directive (TD). The consultation period ran from July to September 2007. CESR received 21 responses from various organisations. The purpose of the feedback statement was to provide a summary of the most significant issues raised during the consultation and CESR's views on how to address them.

Feedback on possible work to promote a consistent application of the TD

Several respondents argued that any assessment on the concrete functioning of the TD seems to be premature. Therefore, they thought CESR should not undertake at this stage any Level 3 work. However, most respondents have identified practical problems that would require CESR's action in order to promote a consistent application of the Directive. In general, this latter group of market participants would like CESR to:

1. Publish information on the transposition of the TD

Several respondents have highlighted the lack of a central information source as a major obstacle to the operation of the Directive in practice, especially for internationally active investors and issuers. CESR should gather and



publish information on how the TD has been implemented across different jurisdictions. For example, this information should include the notification thresholds, the reporting procedure, and how to calculate the holdings.

2. Publish common approaches on the TD to promote a consistent application

Listed are the main issues that market participants consider could be appropriately addressed through Level 3 measures. For the sake of transparency, the issues are quoted as raised by market participants, without CESR passing any judgment on them. Moreover, some of the suggested areas might pertain to Level 1 or 2, and therefore could go beyond what CESR can achieve in its Level 3 capacity.

Regarding major shareholdings notifications, further work would be carried out to:

- Application of the notifications regime to stock lending and derivative products;
- Application of the regime to underwriters;
- Way to calculate the trading book exemption;
- Disclosure of aggregated group holdings;
- Treatment of financial instruments and holdings in UCITS;
- Disclosure deadlines;
- Procedures regarding exemptions and dis-aggregation;
- Several technical details related to the calculation and notification of the holdings;
- Method of communication;
- Standard forms for notification;
- Position of collateral takers;
- Disclosure of holdings that have fallen below disclosure thresholds;

In relations to periodic financial information work on:

- Principles to prepare interim management statements;

Regarding other disclosure obligations, further work on was suggested on:

- Conflicts of competences between authorities as regards dissemination - article 21 of the TD;

- Information requirements pursuant to articles 16-18 of the Directive, including clarification of the requirement to publish information of new loan issues;

In relations to non-EEA issuers and investors the following issues were highlighted:

- Equivalence of periodic financial requirements and major shareholding notification regimes of third countries;
- Treatment of issuers guaranteed by non-EEA states or non-EEA public sector entities;
- Application of the trading book exemption to non-EEA investors.

Regarding dissemination

- CESR should monitor its implementation in the Member States, in particular to avoid what some market participants view as burdensome practices in some Member States; and
- CESR should also monitor national disclosure practices by issuers and or regulatory authorities and stock exchanges in order to ensure a level playing field with news vendors.

Possible format of CESR's Level 3 work to promote a consistent application of the TD

In general there is support for the Q&A format. Some respondents further pointed out that the format should depend on the issue concerned as in some cases recommendations may be a more appropriate way to ensure a consistent approach across Member States. CESR was encouraged by some associations to consult with stakeholders before adopting any Level 3 measures.

The possible establishment of an EU network of national storage mechanisms

There were split views on this issue. Several respondents were against the setting up of an EU network as information posted on their companies' websites is sufficient or because it is still premature.

Other respondents claimed that CESR should not do anything in the absence of a binding legislative measure. Other market participants



requested clarifications on CESR's role and on the involvement of private entities to operate the network. Finally, a number of respondents were in favour of CESR's role in facilitating the establishment of the EU network.

CESR's reaction to the consultation

Taking into account the feedback received from interested parties, CESR Chairmen decided in October 2007 to start working on the TD in its Level 3 capacity. To this end, they set up a Transparency Group of experts and appointed Mr Uldis Cerps, Chairman of the Latvian Financial and Capital Market Commission as Chairman of the group for a two year period. Following the departure of Cerps from the Latvian Authority, Hans Hoogervorst, Chairman of the Netherlands Authority for Financial Markets, was appointed Chairman of the group. The Commission participates in the group as an observer. According to its mandate, the group has started working in parallel with the following 3 streams of work:

A) Mapping exercise to publish information about implementation in Member States

One key concern raised by market participants is the lack of centralised and accurate information about how the Directive has been implemented across the EU. The difficulty in knowing the different requirements in the Member States arises partly because of the Directive's minimum harmonisation status and the implied possibility to prescribe additional transparency measures and the right of the Member States to choose between different options allowed by the Directive. Respondents to the call for evidence would like to be able to access this information about implementation.

This mapping will be closely coordinated with the Commission in order to avoid overlaps with the work the Commission might undertake on more stringent requirements by Member States and other national measures adopted pursuant to different provisions of the TD.

Next steps

CESR's objective is to publish the centralised information about implementation during 2008.

B) Questions asked by market participants and regulators on the Level 1 and 2 Directives

The CESR Transparency Experts group will discuss the issues previously put forward by the competent authorities and also those raised by respondents to the CESR call for evidence.

The aim of the discussions will be to reach common approaches where possible and/or to exchange views about the different practices. This work cannot push for further harmonisation than that agreed to in the level one and two texts. Rather, the group's work will be limited to discussing the way the authorities are interpreting the provisions of the Directives, with the aim of promoting its consistent application.

Next steps

CESR's intention is to publish regularly the outcome of the group's discussions, normally in a Q&A fashion.

C) Establishing an EU network of national mechanisms for the storage of regulated information

The Commission's Recommendation on storage (2007/657/EC) requests CESR to play this role. CESR thereafter would facilitate and provide support to Member States in executing the provisions of article 22.1 (b) of the TD, the Commission's recommendation on storage and the guidelines provided by CESR (Ref. CESR/06-292).

CESR has decided to set up the EU network of national storage mechanisms using the MiFID database on shares admitted to trading on EU regulated markets that it is already running on its website. CESR acknowledges that only share issuers are included in the database and therefore in the network on storage, however the advantage of this solution is that it will allow the implementation in the short term of the CESR consensus about the design of the network, at least for shares.



5.3.2 MiFID

MiFID Suspensions and Removals from Trading

On 21 May 2008, CESR published a protocol on the operation of notifications of Article 41 of the MiFID which deals with suspensions and removals of financial instruments from trading. This protocol has been created to ensure effective co-operation between Competent Authorities with respect to their obligations under Article 41 of MiFID.

The purpose of the notification obligations under Article 41 is to provide investors across all Member States with the same level of protection regardless of where they trade. It was considered valuable to develop a shared understanding of the different circumstances under which trading may be suspended in different Member States according to their national law and the expected course of action under Article 41. An effective communication process is necessary to ensure trading is suspended or an instrument is removed from trading in an effective and timely way. The protocol will be kept under review in light of practical experience.

CESR and CEBS Consult on Commodities

CESR and the Committee of European Banking Supervisors (CEBS) published on 15 May 2008 a consultation paper (Ref. CP 3L3 08 02/CESR/08-370) regarding their joint call for technical advice related to the review under Articles 65(3)(a), (b) and (d) of MiFID and Article 48(2) of the Capital Adequacy Directive (CAD III) issued by the Commission in December 2007. Following up on previous work, CESR and CEBS have been asked to give advice to the Commission on the regulatory treatment of firms that provide investment services in commodity and exotic derivatives.

Market and prudential regulation

In particular, the views of the Committees are sought on whether the MiFID and CAD treatment of this type of firms continues to support the intended aims of market and prudential regulation. The consultation paper

began with an overview over the EU commodity derivatives markets and reviewed the products, trading venues and participants, and included an analysis of possible market and regulatory failures in commodity derivatives markets which provide a framework for the subsequent discussion of policy issues. The market failure analysis focused on potential market failures linked to asymmetric information and negative externalities. As in other financial markets, informational asymmetries can lead to abusive market conduct. In addition, e.g. the low levels of transparency in OTC commodity derivatives markets may give rise to concerns.

Potential regulatory failures may arise where regulation is not sufficiently adapted to the specificities of the commodity derivatives market or due to different regulatory treatment across the EEA.

CESR's and CEBS's consultation paper

The two final sections of the consultation paper examined whether the current regulatory framework as set out in the MiFID and the CRD adequately address the issues raised in the market and regulatory failure analyses or whether there is a need for amendments. A number of possible options were discussed.

The public consultation gathered industry feedback on the conclusions drawn from the market and regulatory failure analyses, and on the options presented for a possible future regime for commodities derivatives markets, in particular, the impact the application of any of these options would have.

Prior to preparing the consultation paper, CESR and CEBS had already published a call for evidence on the call for technical advice on 18 January 2008.

In performing this work, the call for advice suggested that CESR and CEBS analyse whether the present regulatory and market situation for providing investment services in relation to commodity and exotic derivatives gives rise to market failure, in particular by hampering the aims of market and prudential regulation. Furthermore, the call for advice suggested that the Committees analyse whether any different regulatory treatment of these types of firms across Member States gave rise to regulatory



failure by creating significant competitive distortions, significantly impairing the free movement of services and encouraging regulatory arbitrage.

CESR and CEBS were asked to consider if there are shortcomings in relation to commodities in the application of the CAD large exposures and free deliveries treatment, methods for the calculation of capital requirements and the obligation to uphold integrity of markets and conduct of business.

Furthermore, CESR and CEBS should set out, if the analysis of these issues varies in relation to the different types of entities providing investment services or the underlying financial instruments, in particular in relation to energy supply.

Finally, CESR and CEBS were asked to provide advice on an appropriate regime for firms that provide investment services in relation to commodity and exotic derivatives, taking into account the different options presented in the call for advice. The call for advice indicated that CESR and CEBS in their analysis should apply the framework for impact analysis recently drawn up by the 3 L 3 Committees.

Next steps

Following the analyses of the responses received, CESR and CEBS will deliver their final advice to the Commission during autumn 2008.

During the consultation period a public hearing will be organised in July and September 2008 at CEBS' premises in London.

CESR publishes Q&A on MiFID

On 11 April 2008, CESR published the first set of Questions and Answers (Q&A) on the MiFID, including common positions agreed by CESR Members. Looking ahead, CESR is focusing on helping industry adapt to the new legislation and equally, ensuring retail investors are able to get the full benefits from the protections afforded by the MiFID.

This Q&A system follows the model that is currently used by CESR for the Prospectus

Directive. It is intended to provide with responses in a quick and efficient manner, to 'everyday' questions which are commonly posed to CESR by market participants, CESR Members, or the public generally. The MiFID Q&A mechanism has been operated through the two existing sub-groups on markets and intermediaries of the MiFID Level 3 Expert Group.

Regarding the legal status of the answers posted in the MiFID Q&A database, these will not constitute standards, guidelines or recommendations and are not legally binding as any other Level 3 tool.

CESR publishes Retail Investor Guide on MiFID

On 7 March 2008, CESR published a guide for retail investors on the MiFID following its coming into effect on 1 November 2007. The purpose of the guide is to explain, in clear and straightforward language, the new protections retail consumers will experience in buying financial services, following the introduction of this legislation across Europe.

This is the first time CESR has developed a guide destined for consumers and it reflects CESR's strong commitment to increase confidence amongst retail investors. One of the main purposes of the MiFID is to harmonise investor protection throughout Europe and increase consumers' confidence that the products they are being sold, are actually appropriate for their needs.

Next steps

As a next step, the guide will continue to be translated into further languages by CESR's Members, the national securities regulators.

Currently, versions exist in English, Maltese, Finnish, Hungarian, Spanish, French, and Dutch.

One of its core principles is that firms wishing to provide services to retail investors, must act professionally, provide fair information on financial products, and that they take into account the individual circumstances of each consumer.



Use of Criteria to determine Liquid Shares published

On 21 May 2008, CESR published a table that provides information on the use of the criteria defined in Article 22 of the Commission Regulation (EC) No 1287/2006 to determine liquid shares in the Member States of CESR Members. The table itself does not contain information on whether a particular choice has been made either in the national legislation or by the competent authority itself.

According to Art. 22(1) of the Implementing Regulation, a share admitted to trading on a regulated market shall be considered to have a liquid market if the share is traded daily, with a free float not less than EUR 500 million, and one of the following conditions is satisfied:

- (a) the average daily number of transactions in the share is not less than 500; and
- (b) the average daily turnover for the share is not less than EUR 2 million.

Notification and publication procedure

However, a Member State may, in respect of shares for which it is the most relevant market, specify by notice that both of those conditions are to apply. That notice shall be made public. According to Art. 22(2) of the Implementing Regulation, a Member State may specify the minimum number of liquid shares for that Member State. The minimum number shall be no greater than five. The specification shall be made public. On the basis of Art. 22(3) of the Implementing Regulation, where, pursuant to Art. 22(1) a Member State would be the most relevant market for fewer liquid shares than the minimum number specified in accordance with Art. 22(2), the competent authority for that Member State may designate one or more additional liquid shares, provided that the total number of shares which are considered in consequence to be liquid shares for which that Member State is the most relevant market does not exceed the minimum number specified by that Member State.

Improving the Functioning of the MiFID Database

Under the MiFID, CESR is responsible for publishing certain calculations for shares admitted to trading on a regulated market as well as lists on systematic internalisers, multilateral trading facilities, regulated markets and central counterparties. On 18 February 2008, CESR published a paper that sets out the current structure of the database, and explains the modifications which were to be made in March 2008.

CESR has fulfilled these obligations by publishing a database of shares admitted to trading on regulated markets on 3 July 2007. A further review of the requirements in the MiFID, as well as the needs identified by market participants during the first period of functioning of the database, determined a need for additional functions and modifications to be made. In order to allow for a maximum number of market participants to provide their input, and in order to ensure that the new version of the database meets the needs of regulators and market participants alike, CESR consulted on potential modifications for the database. In December 2007, CESR published a consultation paper (Ref. CESR/07-832) on improving the functioning of the MiFID Database. CESR received 13 responses to the consultation that closed on 21 January 2008.

Following this consultation, a number of changes have been agreed upon, in order to allow for the smooth running of the database, facilitate updates, and ensure a clear presentation of the data for market participants. An updated version of the database was made available in March 2008.

On 21 February 2008, CESR published a feedback statement called "Improving the Functioning of the MiFID Database" (Ref. CESR/08-146). The purpose of the feedback statement was to provide a summary of the most significant issues raised in the consultation, as well as outlining CESR's response to the comments made.



Protocol on the Operation of the MiFID Database

The operation of the MiFID market transparency regime involves making information regarding shares admitted to trading available to market participants. The regime requires CESR Members to make calculations regarding shares admitted to trading. The results of the calculations are being published by CESR.

In order to ensure smooth and harmonised calculation and publication of the relevant data, CESR considered it necessary to agree on a protocol. The protocol which was published on 18 February 2008, describes the tasks and responsibilities of the CESR Members and the CESR Secretariat respectively. Additionally it contains practical guidance on how to conduct the calculations as well as the necessary technical instructions.

CESR's and ERGEG's Call for Evidence on Energy and Gas

On 18 February 2008, CESR and the European Regulators Group for Electricity and Gas (ERGEG) jointly published a call for evidence on record keeping, transparency, supply contracts and derivatives for electricity and gas.

CESR and ERGEG were asked by the Commission to jointly give advice on issues concerning record keeping and transparency of transactions in electricity and gas supply contracts and derivatives. The aim of the call for advice was to find out if additional measures are necessary with respect to transparency in energy trading, as well as provide the Commission with the adequate technical background to adopt the guidelines on record keeping.

Fact-finding exercise

Firstly, CESR and ERGEG were requested to conduct fact-finding on how many undertakings active in 'supply' of electricity and natural gas are within the scope of the MiFID. They were also asked to provide information on what the investment firms' existing record-keeping obligations with respect to transactions in electricity and gas derivatives are, as well as what authorities

oversee trading activities in energy markets in various EU Member States.

Information on transparency

Furthermore, CESR and ERGEG were asked to provide information on the existing pre- and post-trade transparency requirements, deriving from national law that energy traders, brokers and exchanges are subject to. In addition, they were asked to describe the possible nature and reasons for the differences in transparency requirements for spot trading, compared to future and forward trading, and for exchange trading compared to OTC trading. Information was also sought on what information, other than that required by law or thought regulation, is made public by the above entities and information services and whether access to information is equal for all parties active in the market. In case of possible unequal access to or general lack of information, CESR and ERGEG were asked to provide their view on whether this is causing distortion of competition.

The Committees were also requested to consider the possible benefits of greater EU-wide pre- and/or post-trade transparency rules for electricity and gas supply contracts and electricity and gas derivatives. Similarly, they were also asked to assess whether additional transparency in trading could have negative effects on these markets and how these possible risks could be mitigated. Advice was also sought on a possible clarification of the scope of the MAD in relation to trading in commodities and commodity derivatives.

Record keeping

In addition, further advice was requested on record keeping requirements, especially on whether there should be a difference between the record keeping obligations under the proposed amendments to the Electricity and Gas Directives and the existing record-keeping obligations with respect to transactions in electricity and gas derivatives to which investment firms are subject by reason of MiFID. Furthermore, CESR and ERGEG were requested to provide advice on the methods and arrangements for record keeping of transactions in electricity and gas supply (spot) contracts and transactions in electricity and gas derivatives contracts. In addition, advice



was sought on efficient methods to exchange this data between different regulators.

Finally, CESR and ERGEG are asked to provide advice on what timelines or delays should be built into the implementation of any of their recommendations. The call for advice indicates that in their analysis, CESR and ERGEG should apply the framework for impact analysis recently drawn up by the 3L3 Committees (CEBS, CESR and CEIOPS).

Next steps

Following the consultation, CESR and ERGEG will provide their advice on transparency and record keeping by the end of December 2008. The advice on fact-finding questions will be published by the end of July 2008, the advice on the MAD by the end of September 2008.

The call for advice is to run in parallel to the other stream of work where Commission has issued a joint mandate for advice to CESR and CEBS on the possible review of exemptions for some commodity firms from MiFID and Capital Adequacy Directive (CAD). Thus CESR and ERGEG were asked to consider the earlier advice on commodities markets and trading given separately by CESR and CEBS to the Commission as well as the views expressed during the Commission's call for evidence on commodities and the conclusions reached in the subsequent feedback statement.

MiFID Level 3 Work Programme

Following the implementation of the MiFID, CESR published on 5 February 2008 the MiFID Work Programme for future Level 3 work. This Work Programme follows the one adopted by CESR in October 2006 (Ref. CESR/06-550b) which was completed in the course of 2007.

This Work Programme was subject to consultation until 19 November 2007. 17 responses representing 34 organisations were received, some of which were submitted on behalf of several trade bodies.

Respondents raised several points to ensure that the MiFID Q&A network is an effective tool. These included clarifying the legal status

of responses, as well ensuring that answers are consistent with and do not duplicate those published through the Commission's Q&A facility. Respondents also felt that industry consultation should be part of the response process. Several respondents noted that a medium priority had been attached to intermediaries thematic work as a whole and that it might be useful to establish clearer priorities for individual areas of intermediaries thematic work, some of which should be given a higher priority.

Conflicts of interest and best execution were the most frequently mentioned in the feedback as areas of greatest importance, followed by soft commissions and unbundling. Respondents commended CESR's efforts to foster co-operation through its supervisory agenda, and encouraged CESR to give the market time to adjust to the recent regulatory changes before considering further rules and guidelines.

5.3.3 Prospectuses

CESR publishes Fifth Update on Prospectuses Q&A

On 20 May 2008, CESR published the 5th updated version of Q&A regarding Prospectuses, including common positions agreed by CESR Members. After this update the number of questions included in the document amounted to 58.

The Q&As are intended to provide market participants with responses in a quick and efficient manner to 'everyday' questions which are commonly posed to the CESR Secretariat or CESR Members. CESR responses do not contain standards, guidelines or recommendations.

It is CESR's intention to operate in a way that will enable its Members to react quickly and efficiently if any aspect of the common positions published need to be modified or the responses clarified further. In fact, in the fifth update of the Q&A several answers were modified taking into account comments received from market participants. The European Commission Services participate in the discussions of the Group and have provided their position on some of the questions discussed in the paper. However,



these views do not bind the European Commission as an institution.

CESR publishes Data on Prospectuses approved and passported

Following the mandate by the European Commission in July 2007 to collect statistical data in relation to the number of prospectus approved and passported, CESR decided to institutionalise this exercise.

In June 2008, CESR published the compiled table with the data provided by the Members for the period July 2006 to June 2007 (with a quarterly disclosure).

Next steps

The CESR Prospectus Contact Group will continue to meet regularly to provide future updates of the Q & A guide. In particular, the Prospectus Contact Group will analyse the possibility of adopting a light-touch approach under the Prospectus Directive and Regulation in relation to employee share schemes as specifically requested by the European Commission.

In addition the Prospectus Contact Group will continue to publish statistical data on number of prospectus approved and passported.

Another stream of work the Group is going to undertake is the decisions taken by members on the equivalence of third countries' legislation on prospectuses. The objective of this work will be to ensure a harmonized approach.

Takeover Bids Network

Discussions of experiences on the application of the Directive 2004/25 on Takeover bids

CESR has continued organising meetings with representatives from the EU authorities on takeover bids (whether CESR Members or not) to discuss experiences on the application of the Directive 2004/25 on Takeover bids (TOD). Two additional meetings, in January and in June, took place to exchange views on a number of substantive issues such as the equitable price, persons acting in concert,

squeeze-out and sell-out provisions, empty voting techniques or cross-border co-operation between competent authorities.

In addition, during these meeting, besides discussing the substantive questions put forward by the members of the network, presentations of actual cases of relevant takeovers in the UE were made, in order for the members to exchange views and ask questions to the authority that handled the case.

Next steps

The Takeover bid network will continue to meet regularly when the members provide sufficient issues to discuss.

5.3.4 CESR-Tech

Ongoing Operation of the TREM Mechanism

In the first months of 2008, CESR's Transaction Reporting Exchange Mechanism (TREM) exchanged an average of around 50 million transaction reports per months. CESR's working group for information technology, CESR-Tech, expects TREM to carry around one billion transaction reports annually once the system is at full capacity.

In order to ensure that data quality will meet the required expectations, CESR-Tech has set up an ad hoc TREM User Network. The objective of this subgroup of CESR-Tech is to analyse the quality of the data and to propose improvements when necessary. This review will ensure that the system meets its goals regarding market supervision.

As requested by MiFID, TREM was launched on 1 November 2007. It is running successfully since then.

CESR-Tech's 2008 projects

CESR-Tech has launched two IT projects in the first months of 2008:



- a. The Alternative Instrument Identifier (AII) project aiming at adding to TREM the capability to exchange transaction reports on derivative instruments identified by the AII for those instruments that do not have International Securities Identifying Numbers (ISIN) codes;
- b. The Instrument Reference Data (IRD) project aiming at exchanging and storing centrally reference data on all instruments admitted to trading on Regulated Markets in the EEA.

- (i) **home-host co-operation**, with a specific focus on setting up a common framework for the delegation of supervisory tasks;
- (ii) **consistency issues** in the regulatory and supervisory treatment of competing products, such as investment funds and insurance policies;
- (iii) the self-regulatory standards for - and possible coordinated regulatory approaches towards - **Credit Rating Agencies**;
- (iv) **consistency issues on internal governance requirements** stemming from different directives;
- (v) **financial conglomerates**; and
- (vi) issues concerning the **valuation of illiquid financial instruments**, also in light of the weaknesses highlighted during the recent market turmoil.

Both new projects have been launched in early spring 2008. It is planned to go live in November 2008 for the AII project and in June 2009 for the IRD project. With regard to the IRD project, CESR-Tech has launched during spring a procurement procedure to find an IT provider to implement the central database. By the end of June, the specifications of the AII project were written and signed off by CESR Members. The IRD project aims at finalising the specifications by July.

Next steps

Both new projects will now enter an implementation phase.

The AII project will be followed by a test phase prior to a launch in November 2008. Once the system is running, CESR Members will be able to exchange transaction reports on derivative instruments admitted to trading on markets such as Eurex and Liffe.

The implementation of the IRD project will take more time, presumably until 2009.

Next steps

Whilst work has commenced on all these areas, for some there are preliminary deliverables in 2008, although the full visible results on all topics are not envisaged until 2010.

In addition to the identified 3L3 work and irrespective of the differing stages that each of the Committees have attained to date, the Committees will also continue to work, individually, jointly or coordinated, as relevant, on areas identified in the December 2007 Council Conclusions of the Lamfalussy Process.

5.4 Supervisory convergence beyond CESR

5.4.1 Level 3 Committees

Joint Work of the Level 3 Committees

The 3 Level 3 Committees (L3L) have identified and consulted (in November 2007) on a comprehensive list of cross sector areas to work on for the next three years. From these, they have identified **six key areas** to focus their efforts, which are:

3L3 key priorities:

- (i) the implementation and/or further strengthening of self-assessment and peer review mechanisms;
- (ii) the identification of possible obstacles stemming from differences in supervisory powers and objectives;
- (iii) the exploration of tools to further foster convergence and strengthen the national application of Level 3



guidelines, recommendations and standards; and

- (iv) their work on developing convergence in day-to-day supervisory practice and support co-operation within colleges of supervisors.

The Committees will also develop their supervisory culture efforts, including providing individual sector and cross sector training together with developing a 3L3 training platform, and facilitating staff exchanges.

3L3 Committees' revised Impact Assessment Guidelines

CESR, CEBS and CEIOPS published on 30 April 2008, joint Impact Assessment (IA) Guidelines. These Guidelines have been developed as a practical tool to help ensure the effective use of IA within the 3L3 Committees. They are consistent with the Commission's approach to Better Regulation and, specifically, with the EC's own IA Guidelines, though adapted to reflect the more specialised nature of financial services policy and the specific circumstances in which it is developed within the EU.

The effective use of the Guidelines published should enhance credibility and accountability in policy making. Although they describe many practices that are already embedded in the 3L3 Committees' policy making processes, the Guidelines bring additional structure to policy making and reinforce the Committees' commitment to transparent, evidence-based policymaking. One key feature through which this is achieved, is the role given in the Guidelines to market and regulatory failure analysis, as tools for ensuring that the case for regulatory intervention is considered properly.

The Guidelines highlight the important role that the Committees' stakeholders will play, both in terms of the contribution that they can make to the conduct of IAs, and in providing the requisite level of challenge during informal and formal consultation phases. The Committees therefore welcome the very helpful and positive feedback from stakeholders received during the joint 3L3 consultation which closed in August 2007.

Feedback statement

The 3L3 Committees also published a feedback statement summarising the submissions received from stakeholders during the consultation period, and the Committees' response, including the changes made to the guidelines in the light of those submissions.

3L3 conducted pilot studies

Before finalizing the IA Guidelines, the three Committees conducted pilot studies to establish that the Guidelines could work effectively. CESR tested the guidelines in relation to the existing simplified prospectus work stream and CEBS tested the guidelines in relation to the large exposures work stream. CEIOPS is applying the guidelines in its work to deliver advice to the Commission in relation to the Solvency II project.

Scope of impact assessment

The expectation is that IA will apply to the work of the Level 3 Committees where the policy issues under consideration are likely to have significant structural and cost implications to consumers/investors and/or market participants. The scope of the Committees' IA work will take account of IA work to be conducted by the Commission or others. This is so as to avoid unnecessary duplication of effort and to ensure that the exercise adds value.

Procedure

The IA methodology does not represent a complete break with existing L3 Committee practices. Each Committee, in developing its advice and proposals, already considers the consequences of adopting a range of different policy options and consults extensively. Nevertheless, by adopting the IA guidelines we will be putting these procedures on a more structured footing.

Next steps

The Committees have provided joint 3L3 training on the application of the Guidelines and will roll out further training in the second half of 2008.



3L3 Consultation on the Payer accompanying a Funds Transfer

On 26 March 2008, the 3L3 Committees launched a joint public consultation on a common understanding of the information on the payer accompanying a funds transfer.

Accordingly, the Anti Money Laundering Task Force (AMTLF) has proposed a solution to deal with payments that lack the required information in respect of the Regulation 1781/2006 and other provisions covering Anti Money Laundering and Terrorist Financing. The proposed common 3L3 understanding on the information on the payer accompanying funds transfers to payment service providers of payees, has been developed with the assistance of an informal consultation with the industry, which included a workshop held in January 2008.

In accordance with the standard Level 3 Committees' practice, the AMTLF members have agreed to hold a three months public consultation in March. In addition, stakeholders were invited to an open hearing on 6 May 2008 at CEBS' offices in London, to discuss the draft common understanding proposed with the AMTLF experts.

Further, the Committee for the Prevention of Money Laundering and Terrorist Financing (CPMLTF), comprising of representatives from all Member States, asked the AMTLF to work on this topic, interacting with market participants.

The AMTLF was established in the second half of 2006 by CESR, CEBS and CEIOPS, with a view to providing a supervisory contribution in anti-money laundering and Counter Terrorism Finance issues, with a specific focus on the Third Anti-Money Laundering Directive.

5.4.2 CESR Conference

CESR's 2008 Wholesale Day

Following the first meeting that took place in February 2006, CESR organised another "Wholesale Day" that took place in CESR's offices in Paris on 17 March 2008. CESR's Chairman, Mr Eddy Wymeersch, chaired the meeting. A wide range of industry representatives, including EuroMTS,

Bloomberg, DTCC London, Moody's, other market participants identified by the relevant European associations and academics participated in the discussions. Also present was a representative of the Commission.

The aim of this roundtable was to identify current major trends in the non-equity wholesale markets and their regulatory or supervisory implications. The discussions helped CESR to shape its future work programme and to prioritise its future activities. The wholesale day was organised in three sessions:

Session 1: Primary markets;

Session 2: Secondary markets; and

- Trading venues;
- Price formation and evaluation;
- Risk analysis;

Session 3: Conclusions: Impact of public regulation on market choices.

Each session was introduced by a few brief presentations given by invited participants.

Generally, a public regulation is normally a reaction to a market failure. The problem with this approach is that the market mechanism does not work properly during a time of crisis. According to participants, trying to solve the crisis by adding regulation at this point would bring more adverse effects than benefits. Instead, it was suggested that the regulators should focus on improving their early warning and crisis prevention systems as well as their ability to act on the basis of these signals.

The following conclusions were drawn from the discussions and the presentations:

Conclusions on primary markets

The weak state of the asset-backed securities (ABS) markets was identified as the biggest problem of the primary markets at that moment. There was a steady increase in the issuance levels in the ABS markets until a fall in Q3 2007 followed by a very low issuance level in Q1 2008. The market is dominated by the high share of the UK and Spanish issues (more than 50 % of collateral) and the generally high ratings with 80 % of the issues having an AAA rating.



The sentiment of the market was characterised by a very low confidence level even though slight improvement was expected. The main concern for the ABS investors was that the mark-to-market volatility which also made it less likely for the investors to participate in the ABS market. Prices in the market differed between credit prices and liquidity prices. The widening of the spreads may not have, per se, represented a significant problem to the market, to the extent that positions did not have to be disclosed or liquidated.

In addition, to the core ABS markets, the related asset-backed commercial paper (ABCP) markets were facing similar contraction. At the same time, the listings of the ABS issues were also declining whereas a similar fall could not necessarily be identified in the standard products.

Conclusions on secondary markets

The impact of MiFID on the secondary market trading of bonds has not been similar to that of equities. This is due to the fact that the traditional trading venues do not have an important role in the bond markets. The trading methodologies are also largely determined by the nature of the market. The new initiatives of some market participants will further increase competition which was welcomed by the market participants. No value was seen in imposing mandatory listing and trading on the exchanges but stimulating trading on the secondary markets was seen as important.

Clearing and settlement

The improvements in technology have addressed some of the liquidity problems due to the fact that the cost of competition in trading services has fallen as a result of this. Significant challenges lie in the post-trading services where OTC trading could also benefit from higher automation and standardisation. This was seen as an area where the public sector could act as a facilitator for increased industry collaboration. In general, the clearing and settlement systems were seen as a source of inefficiency and the removal of the Giovannini barriers was considered to be a priority.

Price formation

As a consequence of MiFID, the issue of price formation has been subject to various initiatives. The participants emphasised the fundamental differences in the nature of the equity and non-equity markets. In the price transparency of bonds, the focus should continue to remain in the retail market. However, for the valuation of bonds both initial and ongoing product disclosure is generally considered to be more important than price transparency. Especially in distressed markets, real-time price transparency might even be harmful. However, further analysis on the benefits of ad hoc post trade price transparency could be useful.

Risk analysis

In risk analysis, the participants emphasised the importance of risks transferring to where there is capacity to manage them. Attendees expressed the view that there needs to be a balance between risk traders and risk absorbers in the market. The capacity of the latter to hold on to the risk should be encouraged especially when the markets are falling.

The importance of the risk shifting role of derivatives was also raised in the discussions. In order to ensure sufficient management of the ensuing counterparty risk, a closer look should be taken at the various laws applicable to netting arrangements at both national and European levels.

5.4.3 Third country dialogue

Equivalence of Third Country GAAP

The European Commission published in December 2007 a “Commission Regulation establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council” (“Commission Regulation on the mechanism”). The Regulation lays down the conditions under which the GAAP of a third country may be considered equivalent to



IFRS pursuant to a definition of equivalence set in article 2. The Regulation also sets in article 4 the conditions for the acceptance of third country accounting standards for a limited period expiring no later than 31 December 2011.

CESR's Advice on Canadian and South Korean GAAPs

On 19 May 2008, CESR published its final advice on the equivalence of Canadian and South Korean GAAPs to the Commission. The Commission "Regulation establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament" published on 18 December 2007, lays down the conditions under which the GAAP of a third country may be considered equivalent to IFRS adopted pursuant to EC Regulation 1606/2002 in accordance with a definition of equivalence set out in Article 2.

The Regulation also sets out in Article 4 the conditions for the acceptance of third country accounting standards that are the subject of an appropriate convergence or adoption programme for a limited period expiring no later than 31st December 2011.

On the basis of this Regulation, CESR received a mandate from the Commission in March 2008 requesting CESR's technical advice on Canadian, Indian and South Korean GAAP. In accordance with this mandate, CESR provides, in this advice, details of its work and conclusions concerning Canadian and South Korean GAAP. CESR did not make any proposals in this advice regarding Indian GAAP as it is still in the process of obtaining information about the situation regarding the use of IFRS in that country.

CESR's advice was subject to consultation with market participants, and the comments raised by respondents are included, within CESR's final technical advice, rather than in a separate feedback statement on this occasion.

CESR recommends to accept Canadian and South Korean GAAPs

CESR recommended the Commission to accept Canadian GAAP according to article 4 of the Commission Regulation on the mechanism for determining equivalence of third country GAAP.

The Canadian Accounting Standards Board (AcSB) has made a public commitment in January 2006 to adopt IFRS by 31 December 2011 and there is publicly available information giving details of both the program and the progress the Canadian Authorities are making to achieve it. Effective measures are being taken to secure a timely and complete transition to IFRS by that date as indicated in the timetable provided in paragraph 31. The Canadian authorities are showing a commitment to the adoption program and all stakeholders are involved in the process.

CESR recommends the Commission accepts South Korean GAAP according to article 4 of the Commission Regulation on the mechanism for determining equivalence of third country GAAP.

The South Korean Financial Supervisory Commission (KFSC) and the Korea Accounting Institute (KAI) have made a public commitment in March 2007 to adopt IFRS by 31 December 2011 and there is publicly available information giving details of both the programme and the progress the South Korean Authorities are making to achieve it.

Equivalence of third country's GAAPs

Third country issuers may be permitted to use financial statements drawn up in accordance with the accounting standards of a third country in order to comply with obligations under Directive 2004/109/EC and, by derogation from Article 35(5) of Regulation (EC) No 809/2004, to provide historical financial information under that Regulation for a period commencing any time after 31 December 2008 and expiring no later than 31 December 2011 in the following cases:



1. the third country authority responsible for the national accounting standards concerned has made a public commitment before 30 June 2008 to converge these standards with International Financial Reporting Standards before 31 December 2011 and both the following conditions are met:
 - a) the third country authority responsible for the national accounting standards concerned has established a convergence programme before 31 December 2008 that is comprehensive and capable of being completed before 31 December 2011;
 - b) the convergence programme is effectively implemented, without delay, and the resources necessary for its completion are allocated to its implementation;
2. The third country authority responsible for the national accounting standards concerned has made a public commitment before 30 June 2008 to adopt IFRS before 31 December 2011 and effective measures are taken in the third country to secure the timely and complete transition to IFRS by that date, or has reached a mutual recognition agreement with the EU before 31 December 2008.

Both the Prospectus Regulation and the Transparency Directive stated that third country issuers (non-EU issuers), who have their securities admitted to trading on an EU regulated market, or who wish to make a public offer of their securities in Europe, are required to prepare and present the financial statements that they publish on the basis of EU endorsed IAS/IFRS, or on the basis of a third country's national accounting standards if they have been declared as equivalent to IAS/IFRS.

At least six months before 1 January 2009, the Commission shall ensure a determination of the equivalence of the GAAP of third countries, pursuant to a definition of equivalence and an equivalence mechanism that it established in December 2007. The mechanism was established on the basis of 2 CESR advices: an advice containing a definition of equivalence (Ref. CESR/07-138) and an advice on a mechanism for determining the equivalence of

the GAAPs of third countries (Ref. CESR/07-289).

CESR's Advice on Chinese, Japanese and US GAAPs

CESR published on 31 March 2008 its "Advice on the equivalence of Chinese, Japanese and US GAAP" (Ref. CESR/08-179) to the Commission. CESR received a mandate from the Commission in December 2007 requesting a technical advice on the equivalence of Chinese, Japanese and US GAAP. In accordance with this mandate, CESR provided details of its work and conclusions concerning the equivalence of these three GAAPs by delivering the advice.

CESR's recommendations

CESR's advice has also been subject to consultation with market participants. CESR has not issued a feedback statement on this consultation but has included comments raised by respondents into the final advice.

CESR's recommendations in the technical advice are the following:

- CESR recommends the Commission find US GAAP equivalent to IFRS for use on EU markets.
- CESR recommends the Commission consider Japanese GAAP equivalent, unless there is no adequate evidence of the Accounting Standards Board of Japan (ASBJ) achieving to timetable the objectives set out in the Tokyo Agreement.
- CESR recommends the Commission postpone a final decision on Chinese GAAP until there is more information on the application of the new Chinese accounting standards by Chinese issuers. CESR points out that the first complete reporting period under the new Chinese standards will only be for 2007 accounting periods. Consequently there is as yet no evidence available concerning the concrete implementation of the standards by companies and auditors. CESR believes that evidence of adequate implementation is important in the context of an outcome-based definition of equivalence. However,



if the Commission were minded to allow Chinese issuers to use Chinese GAAP when accessing EU markets, CESR would recommend the Commission consider accepting Chinese GAAP according to article 4 of the Commission Regulation on the mechanism, until such time as there is adequate evidence to enable a decision to be made under article 2 thereof.

Next steps

In line with some market responses, CESR intends to undertake additional work to assess whether Chinese GAAP has been properly applied by Chinese issuers and will communicate publicly on the outcome of such work at a time when appropriate evidence can be made available to it by the Chinese authorities.